Commission on Health Care Facilities in the 21st Century

Healthcare Restructuring and Debt

August 24, 2006
Topics to be covered

- Typical healthcare provider debt and non-debt liabilities
- Restructuring and participants in capital debt financing process
- Examples of closures and restructurings involving DASNY clients
- Considerations for Commission deliberation
Some Common Types of Obligations
Liabilities of a typical hospital or nursing home include some or all of the following:

- **Vendor / Trade Debt**
- **Commercial Lease Financing**
- **Corporate Debt** (including bank loans, letters of credit, receivable financings)
  - Capital and working capital
- **Tax Exempt Bonds/Leases**
  - Capital
  - Dormitory Authority
  - Industrial Development Agencies (IDA)
- **Third Party Payers** (Medicaid, Medicare, insurance plans)
- **Wages**
- **Pension / Benefits**
- **Malpractice and other insurance**
- **Taxes**
  - Federal
  - State
  - Local (e.g. water / sewer)
- **Inter-company / Affiliate**
- **Leases/other long term contractual commitments**
Security for Healthcare Obligations

Debt obligations of the hospital or nursing home may be a general unsecured obligation of the institution or maybe secured by any of the following:

- Mortgage on Institution’s Real Estate
- Gross Receipts of the Institution
- Right to receive specific funds (e.g. DoH pools)
- Specified Collateral (e.g. bank accounts)
- Equipment Financed
- Guarantee of another (usually a stronger hospital or system will “guarantee” the debt of another)
Capital Tax-Exempt Healthcare Financing

Issuer

Credit Enhancer

Provider

Trustee

Bond Holders
Categories of Healthcare Restructuring

- Closure of Facility
- Reconfiguration of facility and/or business lines
- Sale of facility and/or business lines
- Financial Restructuring

An Institution’s Board may determine that bankruptcy protection may be advantageous or essential to achieve some of the above objectives.
DASNY Restructuring Experiences

Hospital A
Small, stand alone community hospital; downstate region; State secured debt; underperforming financially

Institutional Action Taken
- Board determined that it would no longer operate a hospital
- Hospital Closure (DoH approval of plan)
- No filing under Bankruptcy Law or assignment for benefit of creditors

DASNY Action Taken
- Settlement Agreement with Hospital
- Foreclosure/Receiver

Results
- Hospital property sold in foreclosure sale
- Bondholders paid in full from sale proceeds and statutory fund established for Secured Hospital Program
- Limited resources available to pay unsecured creditors

Timeframe
Approximately 2 years

Dormitory Authority
Hospital B
Small, community hospital; downstate region; member of larger healthcare system; FHA mortgage insurance; under-performing financially

Institutional Action Taken
- Hospital Closure
- “Liquidating Chapter 11”

DASNY/DoH Action Taken
- Secured loan to assist with costs of closure and liquidation
- Loan made to Debtor in Possession (DiP Financing)

Results
- Third Party lender provided DiP Financing
  - Included prepayment of DASNY’s mortgage loan
- DASNY Bondholders paid in full (without recourse to FHA mortgage insurance benefits)
- Hospital property sold
- DASNY secured loan repaid from sale proceeds
- Claims of other secured/unsecured creditors to be addressed through Debtors Plan of Reorganization

Timeframe
- Approximately 2 years and ongoing

Dormitory Authority
DASNY Restructuring Experiences

**Hospital C**
Large multi-hospital/nursing home system (recent merger); serving 3 different healthcare markets in New York City; multiple DASNY bond issues secured by LOC or FHA and commercial loans; financially under-performing for years; significant cash losses

**Institutional Action Taken**
- Restructuring Consultant
- Bankruptcy filing (Chapter 11: Reorganization)

**DASNY/DoH/HUD Action Taken**
- DIP Loan to assist with restructuring
- DASNY/HUD subordination of mortgage interest on “non-core” property to facilitate third-party working capital borrowing

**Results**
- Third Party lender provided DiP financing
  - Included prepayment of DASNY’s mortgage loans
- Bondholders paid in full (without recourse to FHA mortgage insurance benefits)
- Business Restructuring underway, includes closure and divestiture of some acute care facilities
- Debtor has not yet filed a Plan of Reorganization

**Timeframe**
- Approximately 2 years and on going

Dormitory Authority
DASNY Restructuring Experiences

Hospital D
Small multi-hospital system with nursing homes; downstate region; multiple loans FHA mortgage insurance; underperforming financially

Institutional Action Taken
- Bankruptcy filing (Chapter 11-Reorganization)

DASNY/DoH Action Taken
- DIP Loan to assist Debtor in developing viable plan of reorganization acceptable to other creditors

Results
- Sale of one hospital by system
- DASNY bonds issued to refinance taxable debt incurred by acquirer of Debtor’s hospital
- Bondholders being paid from ongoing mortgage payments
- Business Restructured / Emerged from Bankruptcy
- DASNY/DoH loan repaid (as provided in Plan of Reorganization)

Timeframe
- Approximately 5 years

Dormitory Authority
Hospital E
Large community hospital (two sites in New York City); FHA mortgage insurance, high need community, under performing financially

**Institutional Action Taken**
- Convert one hospital site to diagnostic and treatment center

**DASNY/DoH Action Taken**
- Assess implications of conversion on both DASNY Bonds and Borrower's obligations under Loan Documents

**Results**
- Bondholders being paid from ongoing mortgage payments
- Business Restructuring underway
DASNY Restructuring Experiences

Same system, a few years later….

Institutional Action Taken
- Bankruptcy filing (Chapter 11: Reorganization)
- Non-debt obligations soon to become secured claims through statutory liens (e.g., judgments against the Institution)
- Restructured balance sheet

DASNY/DoH/HUD Action Taken
- Secured DIP loan to provide working capital during the restructuring

Results
- Third Party lender provided financing
  - DASNY’s mortgage loan not prepaid
- Bondholders being paid from ongoing mortgage payments
- Business Restructuring underway

Timeframe
- Approximately 2 year process, including 1 year in Chapter 11
- On going

Dormitory Authority
DASNY Restructuring Experiences

Hospital F
Medium sized, multi-hospital system in urban, upstate New York, underperforming financially

Institutional Action Taken
- Parent determined to close a hospital in system (DoH approval of plan)
- System was passive parent of DASNY and IDA Borrowers (no joint liability)

DASNY Action Taken
- Assessed financial and legal implications of closure on DASNY Borrower

Results
- Hospital closed/dissolution
- Bondholders received negotiated payments that were funded by purchase of IDA mortgage by DASNY’s Borrower
- Court receiver appointed
- Hospital property sold

Timeframe
- Approximately 5 years

Dormitory Authority
DASNY Restructuring Experiences

Hospital G
Small community hospital – upstate NY, 2 hospital town, FHA mortgage insurance; under performing financially

Institutional Action Taken
- Close emergency room
- Convert most acute-care beds to rehabilitation

DASNY/DoH/HUD Action Taken
- Loan to assist with restructuring
- Reviewed plans and worked with FHA to determine compliance with financing documents

Results
- Bondholders being paid from ongoing mortgage payments
- Business Restructuring complete – assessment underway

Timeframe
- Approximately 1 year
Healthcare restructuring is both time and resource intensive; although clearly defined goals can save both;

Cannot underestimate the amount of capital necessary to effectuate;

It is not a predictable process and is highly dependent on the unique set of circumstances;

Restructuring necessarily has to address all types of debt, including capital debt;

Boards of Directors may elect to pursue bankruptcy protection to implement restructuring;

To date, DASNY has not had to call upon credit enhancers as restructurings have occurred, nor have bondholders been harmed;

Responsible treatment of capital debt (i.e. avoid bond defaults and calls on credit enhancement) will allow for future access to capital markets to assist reinvestment.
Suggested Items for Checklist
(Non-Patient Access Considerations)

- Governance / Board strength / changes
- Clarity of Goals: Mission vs. Business
- Management strength/changes
- Advisors/Consultant/Legal assistance
- Affiliations
  - Financial and management / personnel resources to assist
  - Financial effects
- Restructuring costs
  - Employee severance, closure expenses, working capital
- Unfunded tax and pension/benefit obligations
- Trade obligations
  - How much and to whom

Dormitory Authority
Suggested Items for Checklist (Non-Patient-Access Considerations)

- Accumulated malpractice liability
  - Fully insured
  - Adequacy of coverage
  - Self Insured (or large deductible / retention)
    - Adequacy of funding
- Existing Short- and Long-Term debt
  - Amount(s)
  - Lender
  - Security – What is it and how much is it worth?
  - Guarantees – What would be the effect of payment on the guarantor?
  - Credit enhancement – How critical is the enhancer in the future?
- Business Disruption - Community and Physician relations
- Timeframes
- Need for additional Capital (Liquid and Non-Liquid Assets)
  - Working capital
  - Reinvestment capital
  - Must be sufficient to cover continued operations or closure costs

Dormitory Authority