Financing Decision Tree Model for Health Center Capital Projects

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www.caplink.org

About Capital Link

Our Vision: Stronger health centers, actively building healthy communities

Our Mission: Capital Link works to strengthen community health centers—financially and operationally—in a rapidly changing marketplace. We help health centers:

- **Plan for sustainability and growth**
- **Access capital**
- **Improve and optimize health center operations and financial management**
- **Articulate value**

Nearly **30 years** of experience

Worked with **50+** PCAs/HCCNs and regional consortia

ASSISTED **2/3rds** OF HEALTH CENTERS NATIONALLY

LEVERAGED **$1.4 billion**

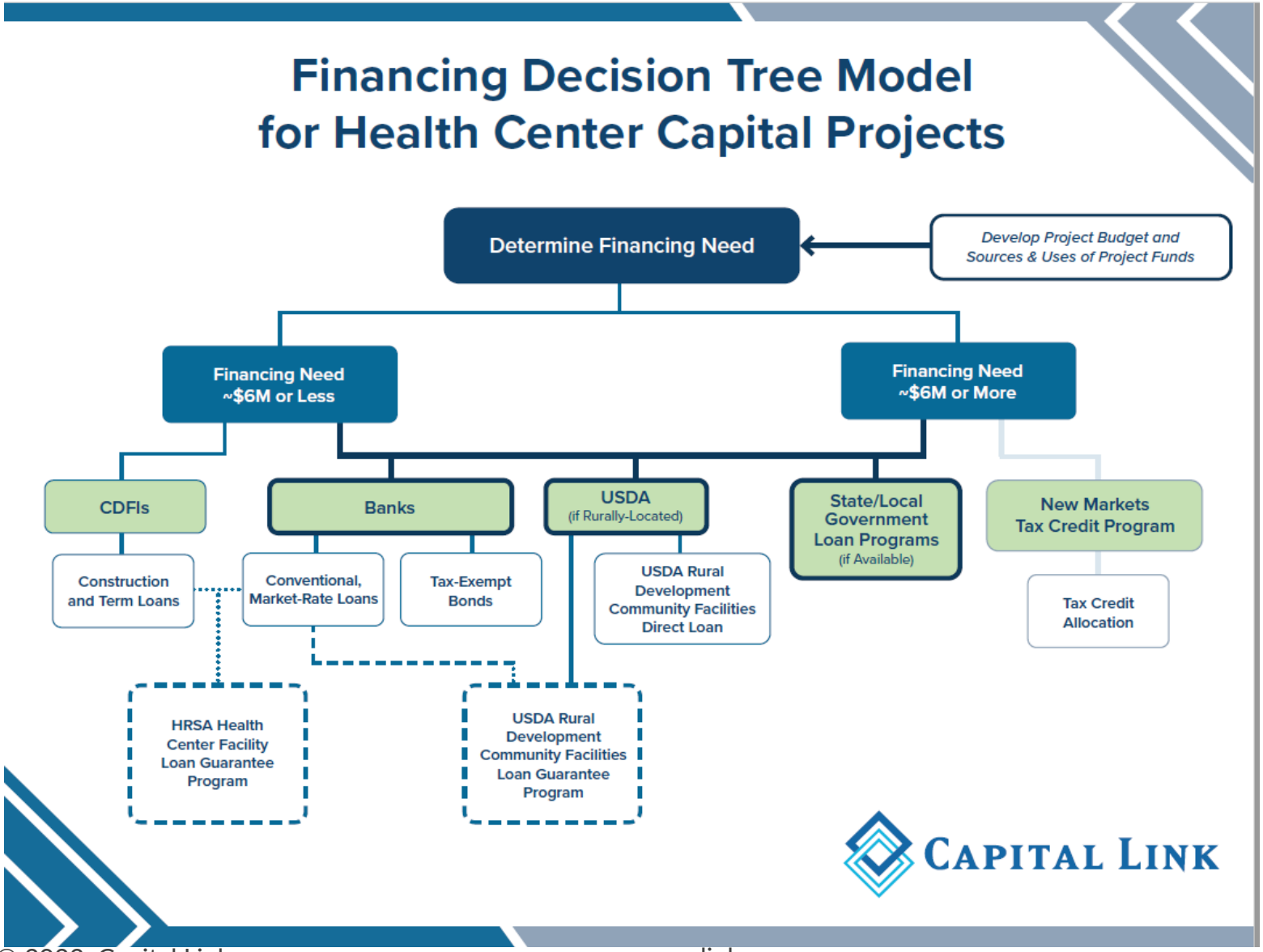
FOR **246+** HEALTH CENTER PROJECTS

TOTALING OVER **$1.7 billion**

Agenda

- Why Use the Decision Tree
- Developing the foundation of all financing decisions: The Sources and Uses Statement
- Understanding Debt Capacity
- Determining the key aspects of the financing need (what sets your loan request apart?)
- Loan size and sources – why does the amount you need to borrow make a difference?

Financing Decision Tree – Why Use This?



Sources and Uses Statement

- It probably goes without saying, but the sources of project cash and the uses of project cash have to balance
- Uses drives Sources
- The earlier the Uses projection, the greater the uncertainty and the higher the contingencies
- Be sure to account for all project-related costs in one place over time
- Prepare for lots of iterations

Start with Uses

Uses of Funds	
Real Estate Related Costs	
Total Building Hard Costs	
Total FFE Costs	
Soft Costs	
NMTC Fees / Costs / Reserves	
Capitalized Interest	
Total Uses of Funds	

Real Estate Related Costs

- **Site Control** which includes owning, leasing, conditional lease, conditional gift, etc.
- If you are leasing and the site is unoccupied, then this helps you keep track of those projected payments you may be making just to hold the property. That should arguably not come from operating cash.

Hard Costs

- It's OK to start at 30,000 feet:
  - $250 per square foot to $1,000 (!!) – variation due to design, planned services, need to accommodate use during construction, rural/urban location, requirement for prevailing wages, sustainability factors, parking or other reasons to dig, contingencies, general inflation in building materials…
- Your goal as the architect goes through Schematic Design / Renderings to the stages of Design Development is to monitor their work (get them to build the building you want & not necessarily what will win them a design award) and try to get a Schedule of Values at various stages – that represents their estimate of the costs of materials, labor, etc. *It will be wrong, but it will be closer than your guess.* *See next slide..*
- Terms to get familiar with:
  - General Conditions - all items required to support the management staff
  - General Requirements – fencing, portable toilets, site security, etc.
  - Contingencies (Contractor's , Owner's, Design) and Escalation
  - Value Engineering
  - GMP (Guaranteed Maximum Price)

Schedule of Values

General Requirements	
Sitework & Utilities	
Concrete and Masonry	
Structural Steel - Superstructure	
Waterproofing	
Exterior Siding	
Cabinetry and Millwork	
Doors, Windows, Hardware, Entrances & Storefronts	
Painting	
Walls, Ceilings	
Flooring and Tiles	
Roofing	
Elevators	
Mechanical / HVAC	
Plumbing & Sprinklers	
Electrical & Fire Alarm	
Specialties, Site Furnishings, Signage	
Landscaping / Paving / Exterior Improvements	
Contractor's Contingency	
Owner's Contingency	
General Conditions	
General Liability Ins.	
GC Overhead & Profit (incl. pre-construction fee)	

Furniture Fixtures and Equipment

- Depends on uses (medical vs. dental vs. behavioral health vs. other specialty services like lab, x-ray, pharmacy)
- How much of what you already own are you moving from somewhere else?
- Start the easy way - Get general bids from the vendors (i.e. # of exam rooms or operatories x $X/each)
- Or do it the hard way – price shop for every item; You will likely end up doing a mix of both
- Be sure relevant staff is involved in decision-making, but that there is only one point of contact for actual purchase commitments

Soft Costs

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The actual list may be longer – here is a sample with some ranges:

Architectural Fees: Depends on what they are designing (new construction vs renovation, programs/services, square footage, sustainability factors $20 - $45 sq. ft. (but it may not be quoted this way)	**Consultants:** Cost Estimator Expediter Capital Campaign Support Financial Feasibility Legal
Engineering / Geotechnical: Depends on site details and plans (underground parking?)	**Insurance & Bonding** Builder's Risk, Payment & Performance Bonds Varies – estimate at 2% of hard costs)
Space & Programing Planning: Depends on space sizes, programs – could be $0 if you are doing it	**Permits and Fees** (very local!) Building Permit Roofing permit Utility hook-up fees
Environmental Assessment: (Phase 1: $5K-$10K); Phase 2: – more! Depends on scope	**Appraisal** (as-is, as-built) $10K – $25K (lender should order, you pay)
Surveys: $5K - $15K	**Title Reports** (often free!) and **Title Insurance** (Never Free☹); varies tremendously by state; $25K - $75K
Owner's Rep. Almost mandatory if this is your 1st project. $50K – $200K	**Soft Cost Contingency** – use 5%

Closing Costs

No NMTC? – expect .5%-1% loan fee + documentation costs + legal from a bank; 2% loan fee + costs from a CDFI;

With NMTC – whole different game

On the plus side: the high NMTC costs/reserves don't come out of your pocket – but they do reduce the gross NMTC benefits from ~29% to ~18-20% of total project costs ☹…BUT, those costs also increase the project size and so can increase the NMTC's you are eligible for ☺

Capitalized Interest

You don't want to be making loan payments from operating cash flow during construction – so you want to calculate and capitalize them

Worth understanding that a classic bank construction loan goes from $0

While an NMTC loan disbursement starts with all the funds at closing and goes

Sources of Project Cash

Sources of Project Cash		
	Bank/CDFI Loan*	
	City Grants	
	State Grants	
	Foundation Grants	
	HRSA Capital Grants	
	Federal Earmark	
	Other Philanthropy and Fundraising	
	Pre-incurred Costs (only in NMTC)	
	Health Center Cash	
	New Markets Tax Credit Equity (Federal/State?)	
	Total Sources of Project Cash	

* The formula here is **Total Uses – all non-loan sources = amount to borrow (Bank/CDFI Loan)**

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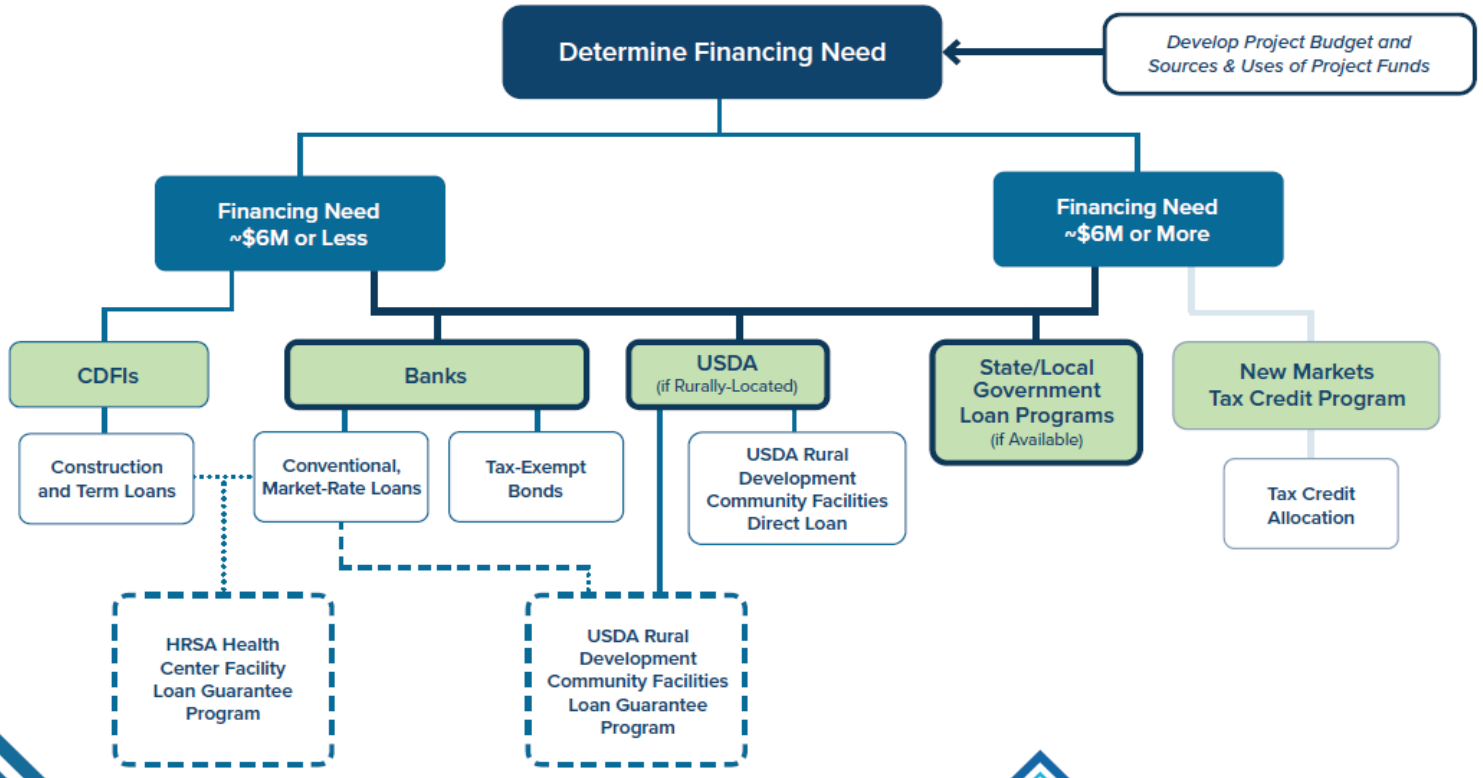

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So now you have some idea of the net loan required to equalize the projected Uses of Cash and Sources of Cash.

OK, now what?

Let's assume that the calculated total loan amount is above what you project as the center's **Debt Capacity***.

***You can find a useful Debt Capacity calculator on our website:**
https://www.caplink.org/data-products/debt-capacity-calculator

When doing this calculation be sure to do it over a range of interest rates. Right now, 5%, 6%,and 7% are probably reasonable – if using USDA Community Facility funding, a lower fixed rate may be available as well as a longer amortization period.

What if my Debt Capacity is below the calculated Loan Amount? (Panic!!)

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No, don't panic!

- First go back and sharpen your pencil: perhaps reduce overly-conservative cost estimates or REALLY high contingencies (though that could be dangerous in the current inflationary environment),
- Decrease the size of the project, or stage it if possible
- Increase health center cash invested in the project (if possible);
- Identify other sources of funding (earmarks are back!!)
- Identify other lenders with subsidized interest rates (local hospital systems??, Conversion Foundations, Foundation Program-Related Investments

Total Project Costs < **$6M**

The $6M total project cost threshold is largely driven by NMTC program net benefit (conventional wisdom).

Helpful hint; if all your project costs =~ $5M, it could cost you $1M in NMTC fees and reserves which are eligible project costs – so you still might get there.

NMTC Program eligibility is also geographically determined, so just having a total project cost above $6M is generally "necessary, but not sufficient".

Your bank/lender options for 'smaller' loans depend on your creditworthiness =

- financial history,
- debt service capacity,
- **financial projections,**
- Availability of Loan Guarantees (?) – HRSA or USDA

Banks

Banks are the logical first option for health centers seeking financing to support their capital expansion projects.

- Conventional banks are generally considered to represent the "market rate" financing option, though banks may compete with each other with lower rates, more flexible terms, and/or a more efficient application process.

- Start with your bank but don't hesitate to shop around. Yes, a new bank is likely to ask for your account relationship but that might be an acceptable price to pay for a much better deal.

A health center that has challenges qualifying for bank financing may potentially benefit from a loan guarantee from HRSA or the USDA (for rural projects – more info later).

- **When comparing banks, don't focus exclusively on interest rates. Be aware of:**
  - **Term/amortization**
  - **Ratios/covenants**
  - **Pre-payment penalties**
  - **Default provisions**
  - **Community relationships**

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Tax-exempt (TE) bonds

- Think of them as lower-interest, long-term, often fixed-rate debt. They make much more sense in our current rising interest rate environment than in the last 10+ years.
- Yes you are eligible for TE debt even though you are a TE organization
- TE bonds can carry either a variable or fixed rate, but often have lower interest rates than conventional bank loans because the interest income to the bond buyer is exempt from taxation.
- They are issued by municipal, county, or state government authorities (but that word might make you think the money comes from those entities – it doesn't).
- The issuer just provides the tax-exemption for the buyer. Smaller bonds (less than $5 million) are typically purchased by a single buyer (often a bank) and are referred to as "private placements". The cost of closing these bonds is usually much less (less, not low) and the closing process is much less complicated than for very large bonds, which may be offered to the general public.
- However, few health centers will have the size or credit rating to participate in the public bond market. Tax-exempt financings are often structured with longer terms than conventional bank loans—maybe as high as 20-30 years.

Consider a Community Development Financial Institution (CDFI)

- CDFIs are primarily small (by bank standards), non-profit lenders whose primary mission is community development.
- CDFIs can be development corporations, community development banks, credit unions, and community loan funds, and their focus may be at the local, state, or national level (consult the CDFI Fund website for entities serving your area: https://www.cdfifund. gov/tools-resources).
- Compared to commercial banks, CDFIs have more underwriting flexibility (they can take on more risk) than regulated bank lenders, but are often limited in the size of loans they can make (typically less than $6 million).
- CDFIs are a good option for health centers that do not qualify for bank financing projects, or those that are seeking an additional lender to participate in a subordinated position because a bank is only willing to provide a portion of the required loan. So don't necessarily think 'either/or' – consider using both.
- Be sure to clearly understand why your bank won't lend to you before looking around. 1 bad year in the last 3?, low R/E collateral value in low-income community? Too grant–dependent? Each of these suggests a different response.

HRSA Health Center Facility Loan Guarantee Program (LGP)

- The LGP offers loan guarantees for the construction, renovation, and modernization of medical facilities operated by health centers.
- The guarantee can cover up to 80% of the principal amount of loans made by non-federal lenders. Lenders should be aware that this is a principal, and not a payment, guarantee.
- The HRSA LGP was designed to improve a health center's ability to obtain a loan that it may not otherwise be able to secure due to commercial underwriting requirements. The HRSA LGP application can be somewhat lengthy, so centers should apply early in their facility planning process if they believe they will require a guarantee to secure a bank/CDFI loan.

https://bphc.hrsa.gov/initiatives/health-center-loan-guarantee-program

United States Department of Agriculture (USDA) Rural Development Community Facilities Program

Community Facilities is a division of the USDA Rural Development. It administers both direct loans and loan guarantees for projects located in rural areas and towns with populations of up to 20,000. Smaller communities may be eligible for capital grants from USDA as well.

- Health centers are eligible for direct loans that have a subsidized government rate typically well below that of "market rate" loans offered by banks. (However, somewhat counter-intuitively, the health center applicant may need to provide a loan application rejection letter from a bank in order to qualify.)

- The USDA application process is quite thorough and will often take several months to complete. The USDA Rural Development Community Facilities program also offers loan guarantees to banks that are unwilling to make a loan to a health center without it.

USDA CF Direct Loans

- Loan repayment terms may not be longer than the useful life of the facility, state statutes, the applicants authority, or a maximum of 40 years, whichever is less

- Interest rates are set by Rural Development, contact the state office for details and current rates;

- Once the loan is approved, the interest rate is fixed for the entire term of the loan, and is determined by the median household income of the service area and population of the community

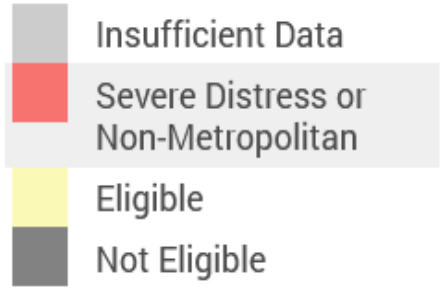
- There are no pre-payment penalties

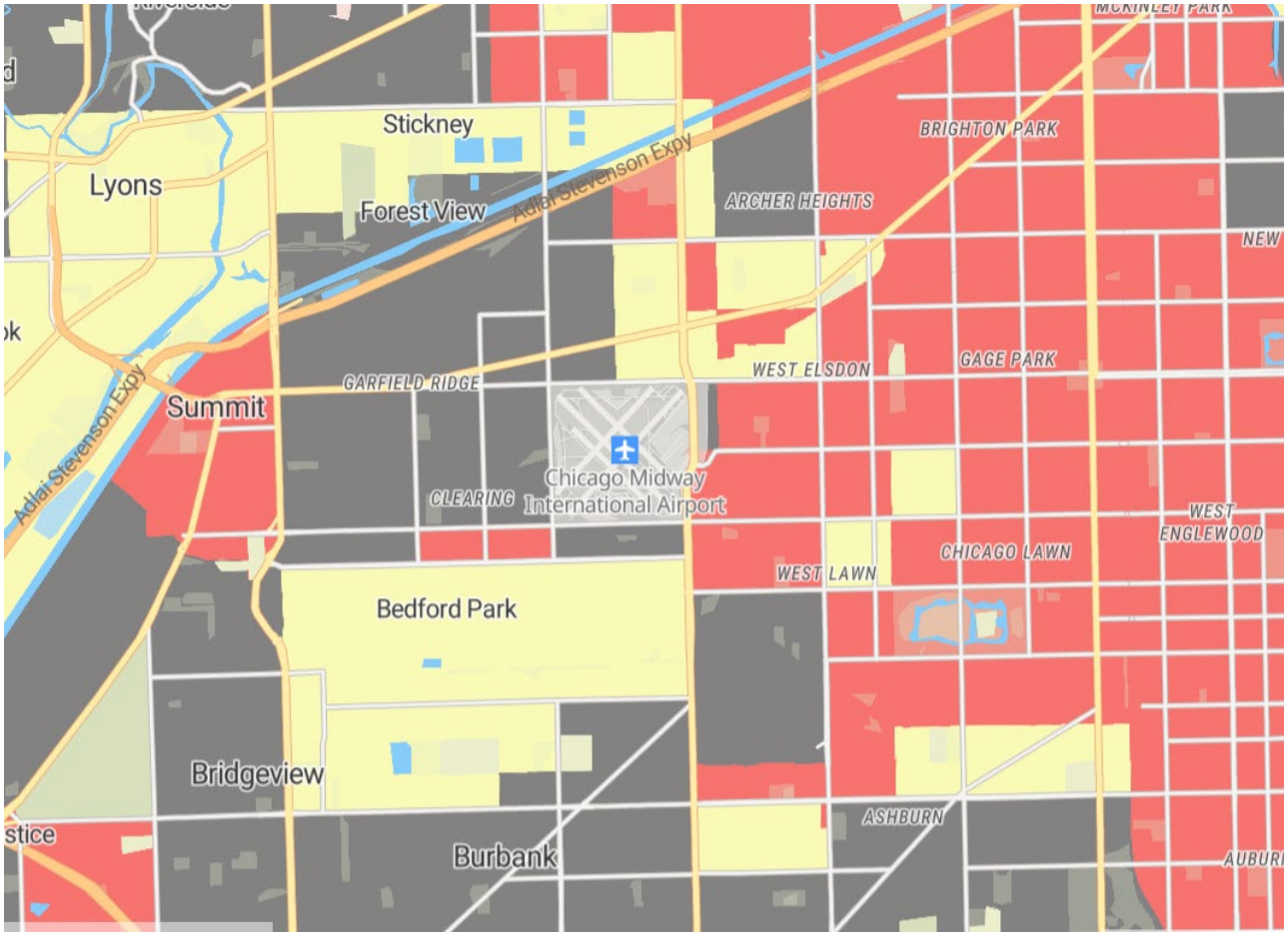
https://www.rd.usda.gov/programs-services/community-facilities/community-facilities-direct-loan-grant-program

What are New Markets Tax Credits?

- Federal economic development program administered by the US Treasury and authorized since 2000 (however, not permanently appropriated). Designed to drive private investment into low income areas.
- Utilized in over $3 billion of FQHC capital projects (you will not be the first!)
- Annually the US Treasury awards a limited amount of tax credit authority to winning applicants, who are all approved "Community Development Entities" (CDEs) (you do not need to become a CDE – you just need to find one who likes your project, and CL can help with that)
- Health center capital projects are ideal NMTC investments because they are usually located in "Highly Distressed" low-income census tracts (to be discussed) and provide multiple positive community benefits

Does My Project Qualify?





https://www.novoco.com/resource-centers/new-markets-tax-credits/data-tools/nmtc-mapping-tool

Why Use NMTC ?

- Tax credits provide net "equity" = ~18%-20% of total project cost (Back of the envelope: Total Qualifying Project Costs x 39% x credit price@ ~$.75 *less* associated closing costs/fees/reserves)
- An "Investment" is converted into a loan that isn't repaid (Got that?? I know, it doesn't make much intuitive sense, but the investor receives federal tax credits over seven years and "puts" the investment back to the FQHC at the end of the tax credit period)
- Loans are structured with interest-only payments for 7 years, which conserves operating cash
- Structure allows leveraging of other financing sources: grants, loans, cash and project expenses that you have already paid up to 24 months prior to closing

Tune into our webinar on January 10 for more....much more ☺

- **Estimating Health Center Project Costs**
  https://www.caplink.org/project-costs
- **HRSA Health Center Facility Loan Guarantee Program Toolkit for Health Centers**
  https://www.caplink.org/hrsa-loan-guarantee-program-toolkit-for-health-centers
- **HRSA Health Center Facility Loan Guarantee Program Instructions**
  https://bphc.hrsa.gov/sites/default/files/bphc/initiatives/hcf-lgp-instructions.pdf
- **New Markets Tax Credits**
  https://www.caplink.org/NMTC
- **Spotlight on Capital Resources: Community Development Financial Institutions**
  https://www.caplink.org/images/stories/Resources/publications/pub-spotlight-on-capital-resources-cdfls.pdf
- **Spotlight on Capital Resources: Tax-Exempt Bonds**
  https://www.caplink.org/images/stories/Resources/publications/pub-spotlight-on-capital-resources-tax-exempt-bonds.pdf
- **Working with the USDA: Opportunities for Rural Federally Qualified Health Centers**
  https://www.caplink.org/images/stories/Resources/publications/pub-working-with-the-usda-guide-for-health-centers.pdf
- **Capital Link Client Case Studies**
  https://www.caplink.org/resources/client-stories

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Webinar Recordings: https://caplink.org/resources/webinar-recordings

Health Center Resources Clearinghouse: https://www.healthcenterinfo.org/

COVID-19 Resources: https://caplink.org/covid-19

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