Grace Health, Kentucky

This case study describes the unique capital financing structure utilized by Grace Community Health Center, dba Grace Health, in southeastern Kentucky for the development of a nearly two-acre community health center medical campus project. The project was financed using both New Market Tax Credits and a HRSA Loan Guarantee—adding complexity to the structure—but enabling the financing to proceed as planned.

About Grace Health

Grace Health was founded in 2008 and is a 501(c)3 non-profit Federally Qualified Health Center (FQHC) serving the southeastern Kentucky counties of Bell, Clay, Knox, Laurel, Leslie, and Northern Whitley. The center offers compassionate and integrated care that is coordinated by primary care practitioners to provide medical, dental, and behavioral health care as well as substance use disorder services and 340B discounted pharmacy for all patients regardless of their ability to pay. Grace Health received initial funding from HRSA in 2008 to support two community-based clinics. Since that time, Grace Health has expanded operations to include 11 satellite clinics consisting of seven primary care clinics, a women's care facility, and a pediatric clinic. In addition, Grace Health operates 32 school-based health centers in Leslie, Bell, Knox, and northern Whitley counties to provide medical and dental services. In 2019, as the largest provider of women's care services in the region, Grace Health achieved a major milestone by delivering more than 1,000 babies during the year. In 2021, the center served almost 32,000 patients with 300+ community-based staff members. The Grace Health patient care delivery model emphasizes comprehensive services for patients with a focus on managing health conditions accompanied by supportive services to reduce barriers to patient care.

The poverty rate in this region of Kentucky—at 33.7%—is double the state and national average, as is the child-poverty rate at 44.6%. Additionally, over 50% of the population in southeastern Kentucky is unemployed or no longer seeking employment. The region has suffered severe economic hardship as coal mining, once a significant industry, has decreased due to a national shift to renewable energy sources.

Substance use disorder also affects employability in the service area. According to a 2019 Kentucky Health Issues Poll (KHIP), three in 10 Kentucky adults (30%) reported that a family member or friend experienced problems related to the abuse of prescription pain relievers such as OxyContin, Percocet, Vicodin, and Codeine. Two in 10 Kentucky adults (20%) reported that a family member or friend had experienced problems as a result of heroin use. In 2014, Grace Health began integrating behavioral health services and substance use disorder services into its primary care practice, including providing Medication Assisted Treatment (MAT). The MAT program incorporated into the Women's Care program to address the critical need for this service among pregnant and parenting mothers in the service area.

The capital project will provide space to allow the center to greatly increase its capacity to provide critically needed integrated care services, including behavioral health and substance use disorder services, thereby improving the health of the community.

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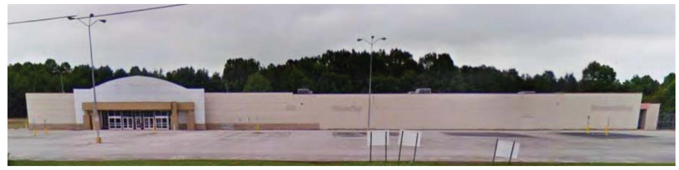
Capital Project Description



The planned Grace Health building before construction.

Grace Health plans to renovate and transform an existing 88,000-square-foot former K-Mart building into a state-of-the-art medical campus in rural southeastern Kentucky. The center is responding to unmet medical, dental, mental health, and substance use treatment needs in Knox and Whitley Counties by consolidating four smaller satellite sites into this larger facility. The resulting medical campus will allow for the expansion of services and support an integrated "whole-person" model of care for the large number of medically underserved rural residents. Pre-construction activities began November 2019 and construction began in Summer 2021, with an expected completion date in late 2022.

Artist rendering of the proposed final Grace Health building.

The facility will almost double the space available for services, from 46,000 square feet and 53 exam rooms currently, to 88,000 square feet with 85 exam rooms and 11 dental operatories once the project is completed. As illustrated below, the space will allow for significant growth in patients, visits, and FTEs.

Grace CHC	FY2021	Projected 2028 (Year End)	Growth
Number of Patients	30,575	46,000	50%
Number of Visits	126,137	180,000	43%
Permanent FTEs	301	372	24%

Project Financing

The $30 million expansion project was financed with a significant cash contribution from the health center and with New Markets Tax Credit (NMTC) financing. The tax credit allocation was provided by three Community Development Entities (CDEs); an investor purchased the tax credits, and two lenders made loans for the project—one from a bank, which was guaranteed by HRSA through its Loan Guarantee Program (LGP), and one from a Community Development Financial Institution (CDFI), without a guarantee. Details of the financing structure are included later in this document. First, we will describe the two federal financing programs that were utilized for the transaction.

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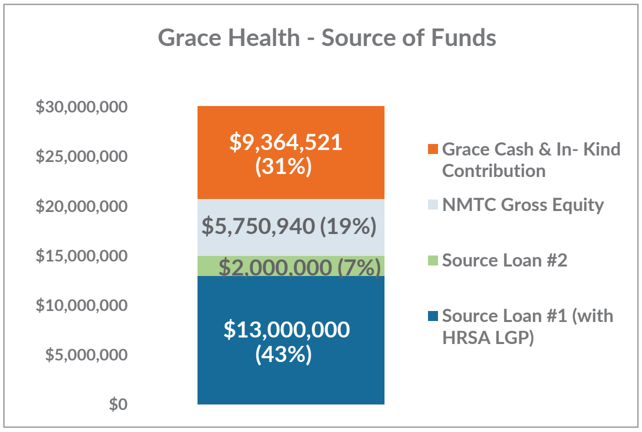
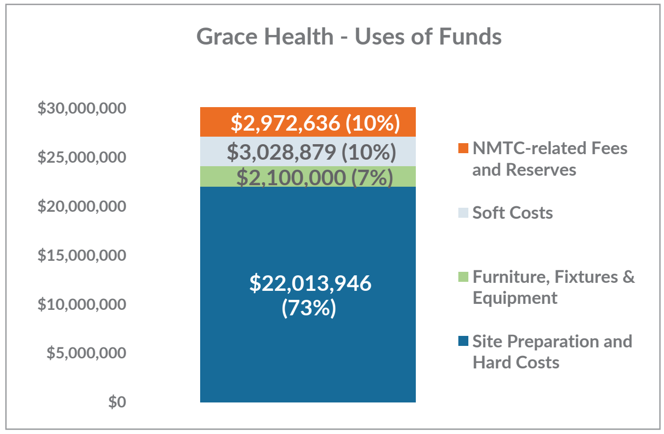




Two Federal Financing Programs Combined to Finance Grace Health Project

Helpful link for understanding NMTC program:

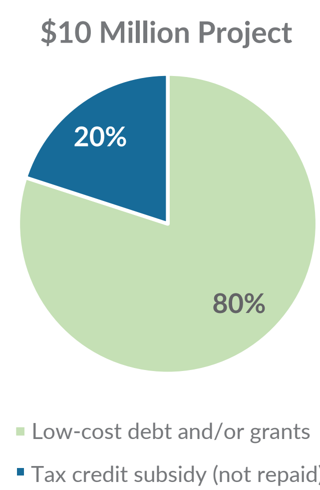
New Markets Tax Credits

In order to develop the most advantageous financing structure for the health center, Capital Link worked with Grace Health to bring together two important federal financing tools to benefit the project, as described below.

New Markets Tax Credit (NMTC) Program Highlights

Authorized by Congress in 2000 and administered by the Community Development Financial Institutions (CDFI) Fund within the US Treasury Department, the NMTC program provides tax credits to investors in exchange for making investments in certain low-income census tracts throughout the United States and its territories.

To date over, $60 billion of NMTCs have been awarded to community development entities (CDEs) in all 50 states. After receiving tax credit allocation awards, the CDEs choose among competing eligible projects to determine which will receive investments. CDEs prioritize projects based on their location in low-income communities with high levels of poverty, lower levels of median family income, and higher levels of unemployment. CDEs also prioritize projects that provide high levels of benefits for low-income communities and populations, particularly jobs (especially those that are accessible to low-income community residents) and services that benefit low-income communities.



Federally Qualified Health Center (FQHC) projects are often among the prioritized projects that receive investments from CDEs because they are generally located in census tracts that experience high levels of economic distress and they provide high levels of benefits to low-income community residents—both in terms of jobs and services.

The benefits of the NMTC program are significant for FQHCs. Not only does the program provide low-cost financing for eligible projects, the tax credits provide a subsidy that equals approximately 20-25% of eligible project costs, making projects much more affordable for health centers.

NMTC transactions are highly complex and generally require a health center to engage a range of third-party NMTC facilitators/advisors to assist with structuring and closing the transaction. Despite the complexity, this program is among the most sought-after and beneficial capital financing mechanisms for eligible health center projects. To date, FQHCs have benefited from approximately $4 billion in capital financing through the program.

HRSA Loan Guarantee Program Highlights

Originally authorized in the late 1990s, Congress renewed and expanded HRSA's Loan Guarantee Program (LGP) budget authority in 2018, allowing HRSA to guarantee almost $900 million in loans to Section 330 FQHCs. The HRSA Loan Guarantee Program facilitates access to capital funding and may reduce financing costs for health centers by guaranteeing up to 80 percent of the principal and interest on loans made by non-Federal lenders to health centers to finance capital infrastructure projects.

A loan guarantee is made for the benefit of a lender, to reduce the lender's risk. In turn, the guarantee allows a lender to make a loan to a health center that it might not otherwise make, or allow it to offer the loan with better terms and conditions. Health centers may need a loan guarantee due to relative financial weakness, inconsistent financial results, inexperience with capital project management, challenging collateral situations, and/or lack of debt history. Even financially strong health centers with a strong past capital project management track record may benefit from obtaining a loan guarantee because it may result in lenders offering more attractive terms.

APPLICANT ELIGIBILITY - Eligible applicants must be current Health Center Program awardees receiving operational funding, as defined under Section 330; Look-Alikes are not eligible.

LENDER ELIGIBILITY - Eligible lenders are non-Federal lending institutions, including most banks and CDFIs. Lenders must agree to service the loan, hold at least the unguaranteed portion (20%) of the loan, and participate in monitoring and reporting activities.

Eligible Project Costs - Capital Projects

- Renovation and new construction costs
- Equipment purchases related to alteration/renovation or construction/expansion activities
- Land and building purchases related to the capital project
- Financing and consultant fees
- Architectural and engineering fees

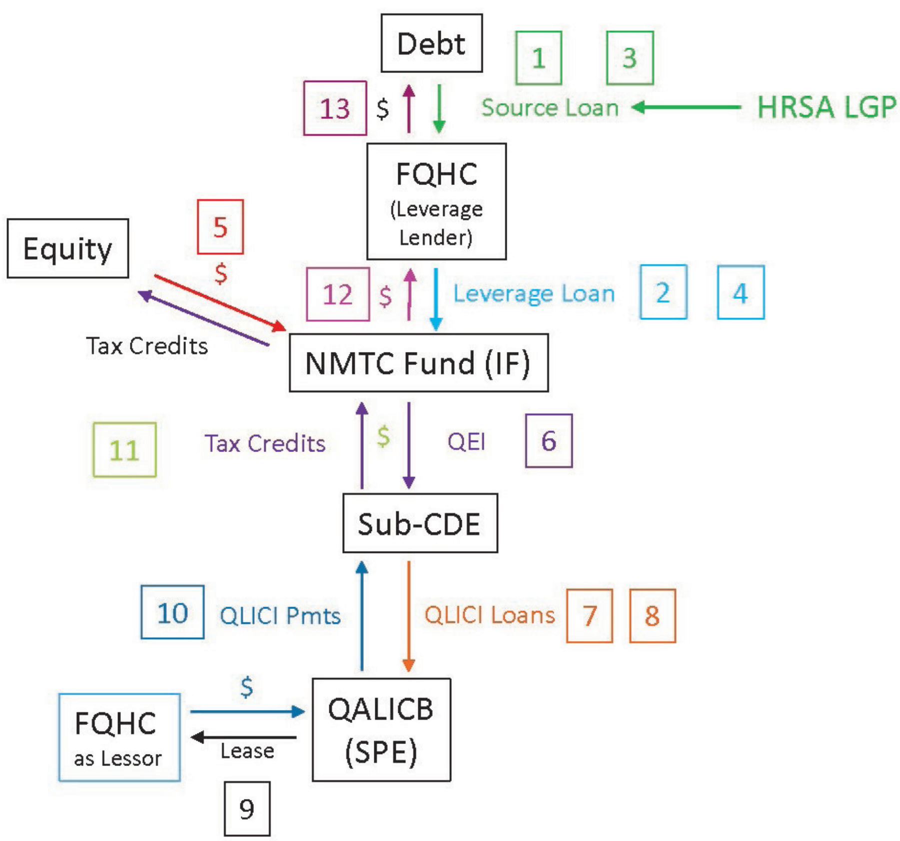
For more information on the HRSA Loan Guarantee Program, access Capital Link resources here.

Combining the HRSA LGP with NMTCs

NMTC financings usually require one or more loans from third-party lenders such as commercial banks or CDFIs. Because of the NMTC structure, lenders often do not have direct or immediate access to the collateral for the loan, which creates risks that are sometimes challenging to mitigate. To the extent that a lender in an NMTC transaction is uncomfortable with the health center's credit or collateral—or is just concerned that the size of the transaction is large as compared to the center's previous experience—the HRSA Loan Guarantee is a valuable resource.

In the Grace Health transaction, the lender was concerned with the size of the transaction relative to the health center's track record and was concerned about the adequacy of the collateral for the leased site. Enter the HRSA Loan Guarantee Program. By obtaining a HRSA guarantee for the loan provided by the lead lender, the center was able to satisfy the lender's concerns, enabling the lender to provide the loan with terms that were advantageous to the health center.

The Grace Health detailed transaction diagram is included as Appendix A. The following transaction diagram is a simplified version of the financing structure, highlighting the key features that enable the NMTCs and the LGP to be used together for the benefit of the health center. The following page accompanies the numbered portions of the diagram, explaining key features of the structure.



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Key Features of the NMTC/LGP Structure

1. **THE SOURCE LOAN:** The health center obtains a loan from an eligible lender (bank or CDFI). This loan, called a "Source Loan," carries an 80% Guarantee from HRSA, mitigating the lender's risk. The lender utilizes its own loan documents for the loan and HRSA provides a Loan Guarantee Agreement.
2. **THE LEVERAGE LOAN:** The health center combines funds from the Source Loan with grants or other cash and makes a Leverage Loan to a single-purpose NMTC Investment Fund (IF). The IF is structured as a for-profit LLC or other corporate entity that is controlled by the NMTC Investor.
3. **COLLATERAL FOR THE SOURCE LOAN:** Typical collateral for the Source Loan includes:
    a. Assignment of the Leverage Loan
    b. A pledge of the IF's membership interests in sub-CDE in connection with the Leverage Loan
    c. Mortgage on other properties (if needed)
    d. Furniture, Fixtures, and Equipment (FFE) owned by FQHC
    e. UCC all-asset lien
    f. HRSA guarantee
4. **COLLATERAL FOR THE LEVERAGE LOAN**: The Leverage Loan is collateralized by the IF's ownership interest in the Sub-CDE; it does not receive a mortgage on the underlying project.
5. **THE NMTC INVESTMENT**: An investor (generally a bank or other entity with federal tax liability) contributes equity to the IF in exchange for receiving tax credits over seven years. Depending on the market for tax credits, the equity amount may constitute 25% to 35% of the capital contributed to the IF.
6. **THE QUALIFIED EQUITY INVESTMENT (QEI):** The IF aggregates the debt and equity contributed by the health center and the investor and makes a Qualified Equity Investment (QEI) into a "Sub-CDE," a for-profit LLC set up by the CDE for the transaction. The Sub-CDE is effectively owned by the IF. In exchange for the investment, the Sub-CDE provides tax credits to the IF. Since the IF is owned by the investor, the investor receives the benefit of the tax credits.

What's the relationship between the FQHC and QALICB?

In order to facilitate the NMTC financing, the FQHC Sponsor establishes a nonprofit or for-profit affiliated LLC to serve as the "Qualified Active Low-Income Community Business" (QALICB), which will own and complete the project. The health center transfers its title to the property or its rights in a long-term lease agreement to the QALICB. The FQHC enters into a lease with the QALICB for the seven-year NMTC compliance period, during which it operates and provides services at the property. At the end of the compliance period, the transaction "unwinds" and the property or the long-term lease is transferred back to the FQHC.

7. **THE QUALIFIED LOW-INCOME COMMUNITY INVESTMENT (QLICI) LOANS**: The Sub-CDE makes a series of loans to a "Qualified Active Low-Income Community Business" (QALICB), a special purpose LLC set up by the health center for the project. The QLICI loans mirror the capital contributed to the IF, with one or several loans (Loan A) matching amounts provided by the FQHC Sponsor, and one loan (Loan B) representing the equity from the investor, net of fees required for the transaction. Loan B covers approximately 20 to 25% of project costs and is generally put back to the health center after the expiration of the seven-year tax credit compliance period—at that time becoming equity for the health center.
8. **COLLATERAL FOR QLICI LOANS**:
   Typical collateral for QLICI Loans includes:
   a. Mortgage on financed property
   b. Pledge of leasehold mortgage
   c. Assignment of rents, leases, and rights under leases
   d. Blanket lien on any cash or other assets contributed to or held by QALICB SPE
   e. Note: HRSA requires an appraisal although no direct interest in the property at this level
9. **LEASEBACK TO THE SPONSOR FQHC**: For the purposes of the financing, the QALICB SPE holds the real estate (or the lease, in the case of leased property) and leases the facility back to the FQHC. The FQHC lease payments are structured to cover the Sub-CDEs costs and to push cash through the structure to make interest-only payments on the Leverage Loan. At the end of the seven-year tax credit compliance period, the transaction "unwinds" and the real estate or lease is generally transferred back to the Sponsor FQHC.
10. **QLICI PAYMENTS:** During the seven-year tax credit compliance period, the QALICB makes monthly or quarterly payments to the Sub-CDE, paid from the cash generated by lease payments from the FQHC Lessor.
11. **PAYMENTS TO THE NMTC FUND:** In addition to providing tax credits to the IF/Investor in exchange for the QEI, the Sub-CDE makes payments to the IF from a portion of the cash received from the QALICB, after retaining some of the cash to cover its costs.
12. **PAYMENTS ON THE LEVERAGE LOAN:** The IF makes regular payments to the FQHC for interest-only payments on the Leverage Loan.
13. **PAYMENTS ON THE SOURCE LOAN:** The FQHC makes monthly payments to the Source Loan Lender. These payments are negotiated between the Lender and the FQHC, but may include an interest-only period and an amortizing period, with payments of principal and interest. These payments may (but generally do not) match the payments made from the IF to the FQHC on the Leverage Loan.

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Summary Recommendation

While every transaction is likely to have its own unique nuances, and HRSA may accept other structures for LGP/NMTC combination transactions, this basic structure has been utilized successfully to "marry" the NMTC requirements with HRSA's LGP requirements. To the extent that that health centers and their financing partners can replicate this structure, HRSA approval and documentation processes should be streamlined.

Key Success Factors for Grantees Applying to the LGP and Utilizing NMTC

Carefully review the HRSA Loan Guarantee Application here. In particular, to ensure a timely process, pay special attention to the following:

- Research/review HRSA LGP pre-application tips/guidelines
- Address the EID Checklist and all environmental requirements early in the application process

During the Feasibility Review part of application process, be prepared to discuss the following:

- Senior management changes (past, present, and future)
- Projections and projection assumptions in detail
- Existing debt service coverage and how it is expected to change if new/additional project debt is being added
- Provider recruitment (past, present, and future)
- Employee recruitment/retention (past, present, and future)
- COVID-19 response and federal funding awarded
- Paycheck Protection Program (PPP) loan status, if applicable
- 340B Program, if applicable
- Project rationale; space usage; projected impacts
- Experience of owner representatives, architect, contractor
- Project budget/plan and cost review
- Permitting status
- FF&E
- Representatives from the Board of Directors should be prepared to discuss the project in terms of both expectations and possible concerns/risks

Before submitting an LGP Application:

- Contact the HRSA LGP to schedule a Pre-Application Consultation
- Prepare to discuss the scope of your project, type of project, financing needs, potential lender(s), project timeline, and status of project planning.

- An Environmental Information Documentation (EID) checklist must be included in your application package. This checklist, which provides HRSA with preliminary information for its environmental and historic preservation assessment, is often completed by the architect or engineer. Completing this checklist early in the process can help uncover any environmental or other issues that may affect the project schedule.

Loan Guarantee Approval Time

Once a complete application is submitted, it takes **approximately 60 days** from when the application is deemed complete to review and process an LGP application and issue a Guarantee Commitment Letter. Includes programmatic, environmental, architectural/engineering (A/E) reasonableness, and financial sustainability and viability reviews conducted by HRSA and its Lender Coordinator.

Other Helpful Links for the HRSA LGP:

HRSA LGP Handbook:

Developed by Capital Link with support from HRSA, the Loan Guarantee Program Handbook for Lenders has been developed as a resource for lenders as they seek to utilize the program in connection with loans to eligible health centers. (Released in 2021)

HRSA LGP Toolkit:

Developed by Capital Link with support from HRSA, the Health Center Facility Loan Guarantee Program Toolkit provides health centers with a detailed outline for preparing a capital project, collecting the materials needed to submit an LGP application, and tips to help navigate the application process efficiently. (Released in 2020)

Acknowledgment

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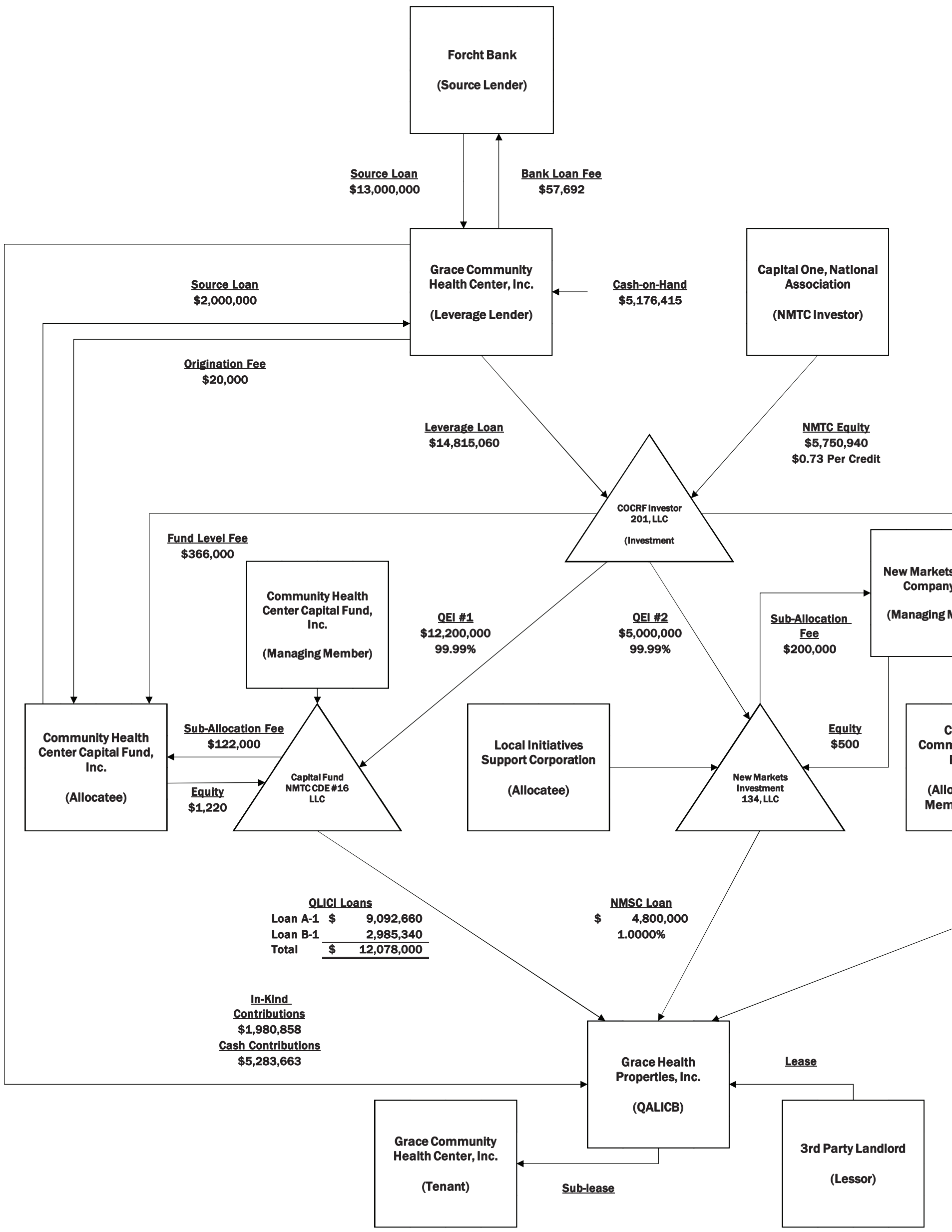
Appendix A - Grace Health Detailed Transaction Diagram

GRACE COMMUNITY HEALTH CENTER, INC.
FINANCIAL FORECAST
SUPPLEMENTAL SCHEDULE – FLOWCHART – OVERALL

Development Costs		
Site Preparation	$	455,624
Construction of Leased Space		1,398,200
Rehab of Existing Building		19,230,122
Construction Contingency		930,000
Architectural Fees		663,400
Engineering Fees		589,907
Environmental Assessment (Phase I)		1,500
Surveys		14,459
Title Reports & Title Insurance		73,812
Appraisal		4,250
Other Fees		31,981
Consulting		1,446,570
Permits & Fees		25,000
Moving & Administrative Costs		50,000
Development Fee		28,000
Legal, Accounting & Other Consulting		656,133
Financing Assistance Fee		12,500
Miscellaneous Administrative Costs		25,000
Soft Costs Contingency		100,000
Asset Management Fee Reserve - Capital Fund NMTC CDE #16 LLC		427,000
Audit & Tax Fee Reserve - Capital Fund NMTC CDE #16 LLC		96,000
Asset Management Fee Reserve - New Markets Investment 134, LLC		175,000
Audit & Tax Fee Reserve - New Markets Investment 134, LLC		38,000
Interest During Construction		347,313
Lease Payments During Construction		302,500
Audit & Tax Fees During Construction		20,250
Total Development Costs	**$**	**27,142,521**



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