MA-RI HFMA Capital Finance Conference

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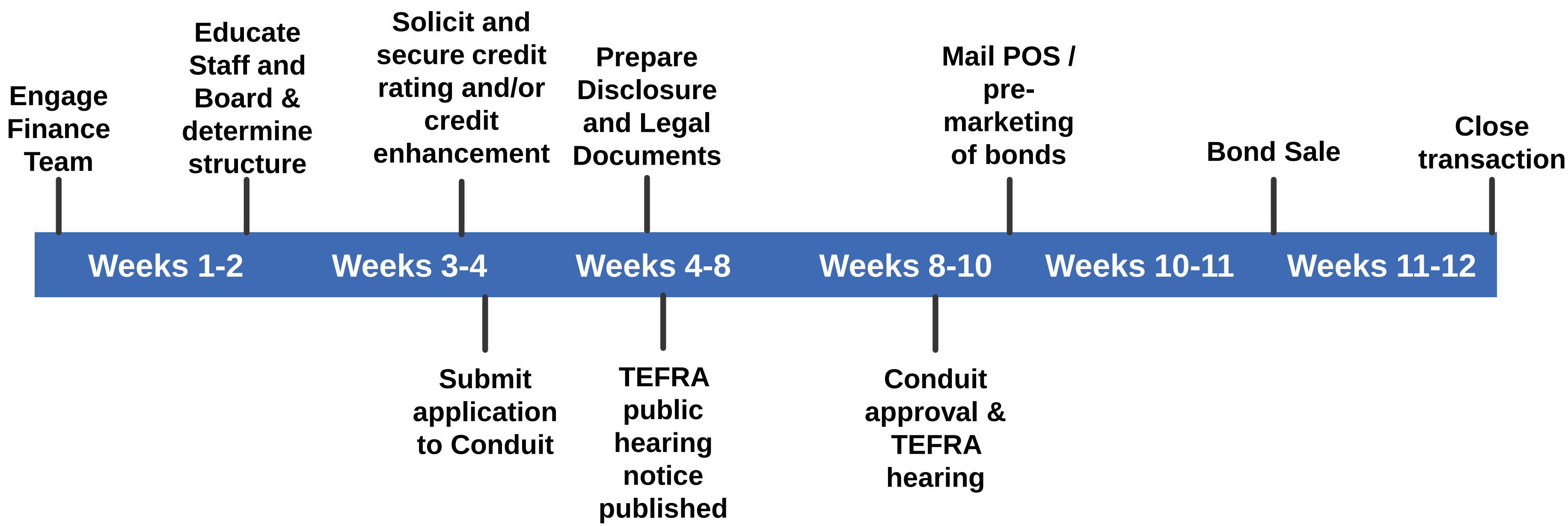
Local Office
100 High St. Suite 2300
Boston, MA 02110
(617) 330-6914

Headquarters
1735 Market St. 42nd Floor
Philadelphia, PA 11970
(215) 567-6100

www.pfm.com

Typical Tax-Exempt Transaction Timeline

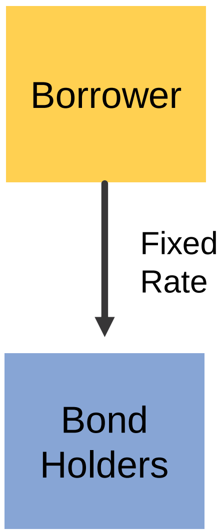
- Issuance process typically takes 10-12 weeks from the date of mandate



- Additional lead time should be given in situations where a “credit renewal” date is approaching

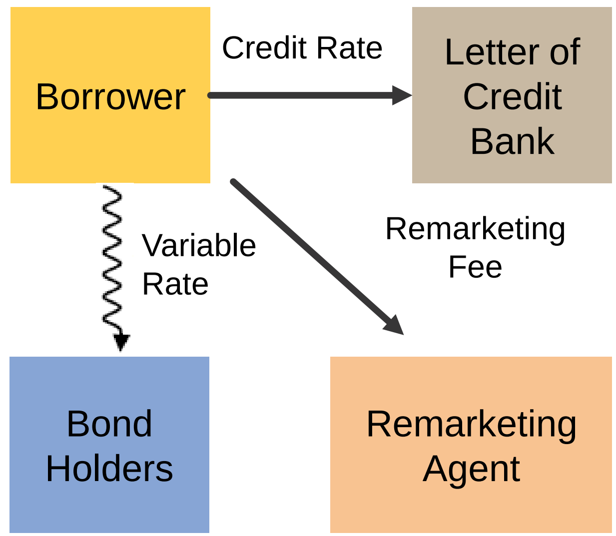
Most Common Public Market Tax-Exempt Bond Structure Mechanics

30-Year Fixed Rate



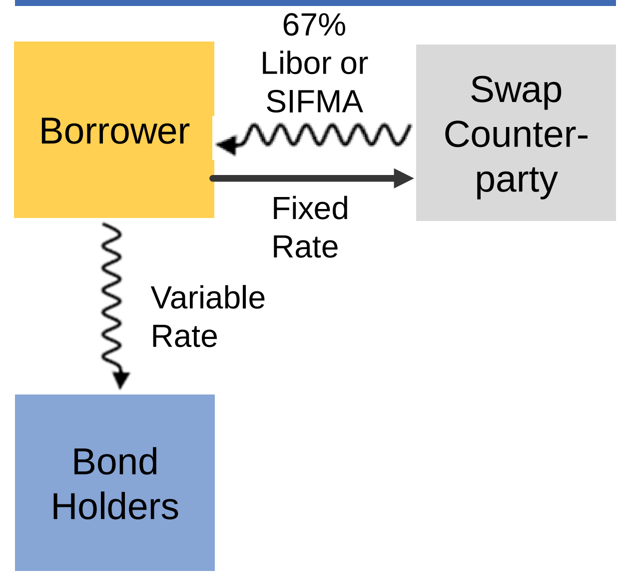
- PROS
  - Lowest <u>risk</u> debt structure
  - 10-yr call
- CONS
  - Higher cost

Variable Rate (with Letter of Credit)



- PROS
  - Low cost
  - Flexible repayment
  - Available to unrated nonprofits
- CONS
  - Risk of increasing rates
  - Requires bank credit support
  - Possibility of failed remarketing

30-Year "Synthetic" Fixed Rate

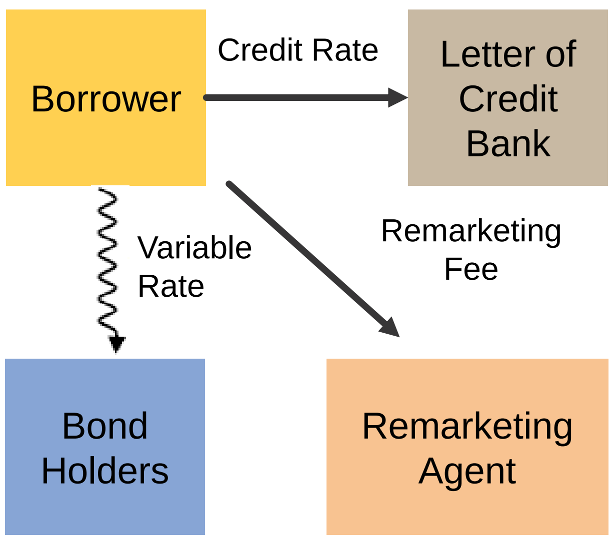


- PROS
  - Lowest cost fixed structure
- CONS
  - Complex structure
  - Swap introduces new risks
  - Requires bank credit support
  - Still requires liquidity facility (LOC) and remarketing

Note: Pros and cons listed above are not comprehensive and reflect a brief summary only.

Variable Rate Demand Bonds

Mechanics (assuming liquidity facility)



<u>Example All-in Cost</u>

SIFMA + Spread + Remarketing Fee + Credit Fee

Advantages

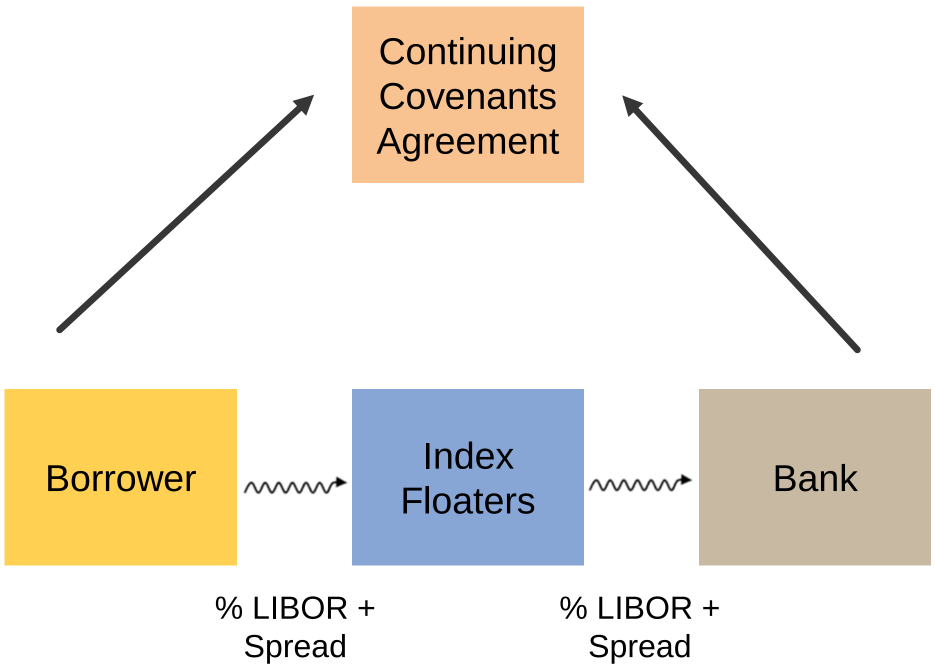
- Historically lowest cost of funds
- Greater optional prepayment flexibility
- Hedge against reduced investment income in low rate markets
- Flexible principal repayment

Disadvantages

- Greater interest rate fluctuation
- Potential upward interest rate risk over time
- Increased budgetary complications
- Remarketing risk
- Letter of credit risk
- Bank downgrade risk
- Initial and continuing disclosure
- Regulatory uncertainties

Directly Purchased Index Floater – An Alternative to VRDBs

Structure Overview



<u>Example All-in Cost</u>
% LIBOR + Spread or SIFMA + Spread

Mechanics

- Index Floater is a standard, multi-modal VRDB with an additional 1 – 5 year initial Index Floater mode
- During the Index Floater mode, the bond pays an interest rate equal to a short term index plus a fixed credit spread equal approximately to what the LOC fee would have been on an LOC backed weekly VRDB
- Bond is subject to a one-time mandatory investor tender at par at the end of the 1- 5 year initial Index Floating period, at which time the bond can be remarketed, at the option of the borrower, to any other mode available under the documents
  - The mandatory tender date corresponds to what the LOC expiration date would have been on an LOC backed VRDB
- In lieu of writing an LOC, the bank simply purchases the bond for its own account on a buy and hold basis
- There is no Reimbursement Agreement. Rather, the bank receives its rights as bondholder and via a Continuing Covenants Agreement that contains all the protections typically found in an RA
- During the term of the Index Floater mode, no LOC, liquidity or remarketing fee is required to be paid by the borrower
  - The LOC fee is effectively built into the bond rate, in the form of the fixed spread

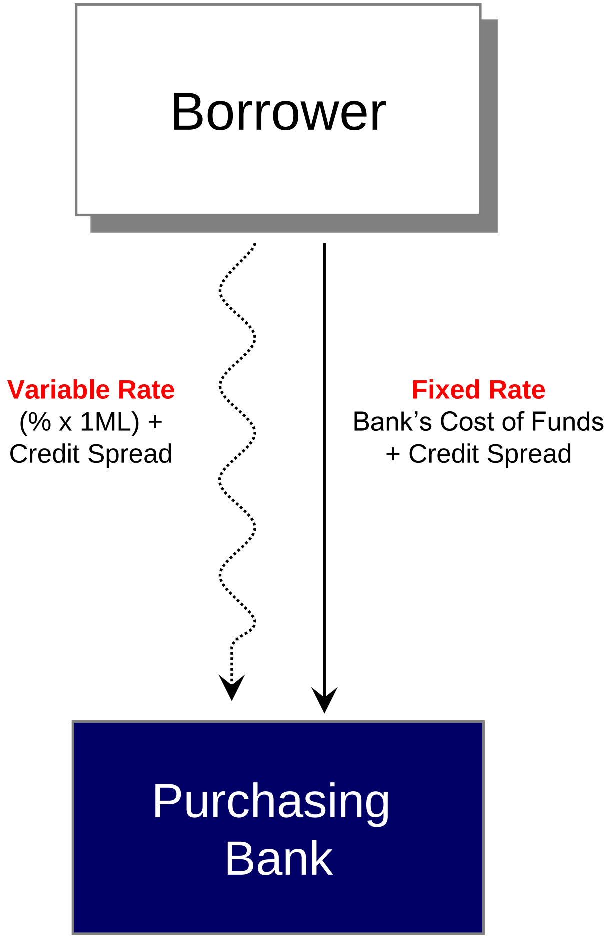
Bank Lending Structure Overview

- **Interest Reset Procedure:**
  - *Fixed* : Bank's Cost of Funds + *Credit Spread*
  - *Variable*: (65-75% x 30-day LIBOR) + *Credit Spread*

- **Term/Amortization:**
  - Up to 20-30 year amortization
  - 3-15 year term, usually (bank put)
  - Negotiate extension or refinance at or before end of term

- **Prepayment Provisions:**
  - *Fixed*: "Make Whole", % of outstanding par
  - *Variable*: Anytime at par, usually

- **Liquidity Support:** Because bonds do not have an ongoing put feature, external liquidity is not necessary; but, issuers need to manage the rollover process



Positive Structural Features

- **Longer tenors** than available in the LOC/SBPA market
- **No debt service reserve fund** required, even for “BBB” or non-rated credits
- **No credit ratings** required
- **Fixed or variable rate** structures available
- **“Draw down” structures available**
- **Taxable or tax-exempt**
- **No formal disclosure document** – e.g. Appendix A
- **Lower issuance costs** than a public offering – no credit rating or underwriting
- **Alternative to VRDBs** and other variable rate debt structures → useful for borrowers with **existing underwater swaps** → ability to diversify capital structure

Considerations / Risks	Floating Rate				Fixed Rate			
	Self-Liquidity VRDB	VRDB w/ LOC	Floating Rate Notes (“FRN”)	Direct Purchase Index Floater	Fixed Rate Direct Purchase	Fixed Rate Mandatory Tender Put Bonds	Synthetic Fixed Rate Bonds	Public Market Fixed Rate
Bank Downgrade Risk *Risk that spread over SIFMA increases or bond is tendered due to investor discomfort with bank credit*	–	✓	–	–	–	–	–	–
Remarketing Risk *Risk that one remarketing agent may not be as strong as another, and spread can suffer*	✓	✓	–	–	–	✓	–	–
Interest Rate Risk *Risk that interest rates change unfavorably during the life of the bonds*	✓	✓	✓	✓	–	–	–	–
Systemic Put Risk *Risk that the bonds can be “put back” on short notice*	✓	✓	–	–	–	–	–	–
Renewal / Rollover Risk *Risk that pricing is not renewed at the same rate every time during the life of the bond*	–	✓	✓	✓	✓	✓	–	–
Liquidity Limitations *Liquidity is monitored and restricted by rating agencies / bondholders*	✓	–	–	–	–	–	–	–
Bank Covenants *Subject to bank covenants (generally more strict than public market)*	–	✓	–	✓	✓	–	–	–
Additional Public Disclosure Required *Need for an Official Statement and Appendix A*	✓	✓	✓	–	–	✓	✓	✓
Uses Bank "Dry Powder" *Uses up capacity with bank so that borrowing may be more difficult later in periods of less favorable market conditions*	–	✓	–	✓	✓	–	–	–
Requires Derivatives *Structure requires the use of a new derivative product*	–	–	–	–	–	–	✓	–

Overview: Tax-Exempt vs. Taxable vs. Private Placement Debt

	Tax-Exempt Public Market	Taxable Public Market	Bank Private Placement
Market Depth / Size	•$2.96 TN ($372 B in floating rate modes) •No size restraints •Slight "liquidity" premium for smaller issues (<$20M)	•$473 B in taxable municipals •Optimal size >$300M to be index eligible •<$300M requires premium	• Any size • Subject to bank credit capacity
Eligible Buyers	•Broad distribution, both institutional and retail	•Broadest institutional distribution	• Select number of financial institutions in today's market
Structure	•Bullet or amortizing (amortization much more common in TE market)	•Typically bullets (although amortizing is possible but typically at a cost)	• Customized
Maturities	•Typically Up to 30 years – occasionally 35-40 years	•10 and 30 year bullet maturities •Small number of century bonds (100 years)	• Stated maturity up to 30 year term • Subject to hard put at bank's term limit
Call Flexibility	•10-year par call (can be shorter but will typically cost more)	•Make-whole call •No ability to refund for savings	• Customizable for flexibility
Covenants	•MTI financial covenants	•MTI financial covenants	• MTI financial covenants plus potential bank covenants
Documentation	•Official Statement, underwriting agreement, 10b-5 opinion, agreed upon procedures letter, bond counsel opinion	•Prospectus, supplement, underwriting agreement, 10-b5 opinion, agreed upon procedures letter	• No public disclosure required, supplemental indenture, creditor agreement, bond counsel opinion, 10b-5 opinion
Ratings	•Ratings expected	•Ratings expected	• Document review
Preparation Time	•10-12 weeks	•4-6 weeks	• 4-6 weeks
Use of Proceeds	•Subject to qualification	•Unrestricted	• Unrestricted (if taxable) • Subject to qualification (if tax-exempt)

Taxable Debt

- Many healthcare issuers have decided to issue taxable debt (rather than tax exempt debt) to take advantage of certain benefits that the taxable debt market offers
  - Current narrow spread between tax exempt and taxable rates
  - Unrestricted use of proceeds – “general corporate purposes”
  - Ability to enhance balance sheet liquidity, or secure a cash “war chest” for strategic opportunities
  - Avoids tax-compliance issues and related administrative effort
  - New investor base (diversification) with deeper market of investors
  - Ability to do advance refundings

	Taxable Muni Market (Muni CUSIP)	Taxable Corporate Market (Corporate CUSIP)
Issuer	• Conduit Issuer	• Corporation
Size of Issue	• Below Index Eligible tranches possible (<$300MM)	• Index Eligible tranches (+$300MM) • Index Eligible pricing benefit (10-15 bp estimate) • Ability to “re-open” CUSIPs
Structure	• Serial bonds • Term bonds with sinking funds • Bullets	• Bullets are most common • Serial & term bonds may be possible
Investor Base	• Smaller than Corporate	• Larger than Muni
Use of Proceeds	• General corporate purposes (usually)	• General corporate purposes (usually)
Call Option	• 10-year par call • Make Whole call	• Make Whole call

What Can Be Financed with Tax-Exempt Bonds?

Eligible

- 3 Years of capital spending for projects:
  - Land acquisition
  - Construction & renovation
  - Equipment
  - "Soft Costs"
- Reimbursement of prior capital expenditures (subject to restrictions)
- Refinancing of taxable loans used to finance qualified projects

Not Eligible

- Working capital
- Facilities exclusively used for "Private Use," e.g. restaurants, stores, churches, doctors
- Costs of issuance greater than 2% of the amount borrowed

Tax Considerations Timeline

- Compliance requirements apply to **<u>every</u>** tax-exempt borrowing and certain taxable subsidy obligations
- Compliance begins with pre-issuance planning and continues with post-issuance policies and procedures (does it ever end…)

Pre-Issuance

- Timing, Debt Management
- Project draw schedule, Refunding opportunities
- Evaluate available exceptions and elections
- Identify investment options

Issuance

- Make elections in Tax Certificate
- Establish and document issue price
- Invest bond proceeds, establish FMV
- Revise draw schedule

Post-Issuance

- Arbitrage reporting
- Monitor expenditures
- Monitor investments
- Record retention

Rule 15c2-12 – Additional Post-Issuance Compliance Considerations

- Annual Financial Information
  - Audited financial statement if available
  - Financial information and operating data
- Event Notices[1]
  - Delinquent principal and interest payments
  - Defaults
  - Unscheduled draws on reserves and credit enhancements reflecting financial difficulties
  - Substitution of credit or liquidity providers
  - Rating Changes
  - Defeasances
  - Adverse tax opinions affect tax-exemption
  - Bond Call
  - Bankruptcy
  - Appointment of successor trustee
  - Merger, acquisition or sale of issue assets
  - If material, incurrence of financial obligations or agreement to covenants, events of defaults, remedies, etc.

1 – For a complete list, please refer directly to the statute.

Tax Cuts and Jobs Act

- Passed in December 2017, has had a few impacts on the capital markets that institutions should monitor
  - With the reduction in the corporate tax rate to 21%:
    - 1) **Rate Increases (Margin Rate Factor)** - several commercial banks are increasing the loan rates per formulaic adjustments in the loan documents → In some situations, this has resulted in a ~21% increase in the unadjusted rate
    - 2) **Reduced Value of Tax-exemption** - the theoretical value of tax-exempt has been reduced; as a result, it is possible that more borrowers may consider taxable debt in the future
  - With the **elimination of advance refundings**:
    - There will be fewer advance refundings of tax exempt bonds – although some organizations may decide to do advance refundings on a taxable basis
    - Other strategies have been developed to achieve the economic benefit of advance refundings – taxable advance refundings, forward starting swaps, forward delivery bonds, Cinderella Bonds, and Cash Optimization

The Municipal Advisor Rule

- Effective July 2014, financial advisors and broker-dealers who provide municipal advisory services have to register as municipal advisors.
- Broker-dealers can no longer provide advice to a municipal issuer on any deal unless they meet certain exceptions:
  - They've been engaged as underwriter for specific/future/issuance
  - They're responding to an RFP

Value of an Independent Registered Municipal Advisor (IRMA)

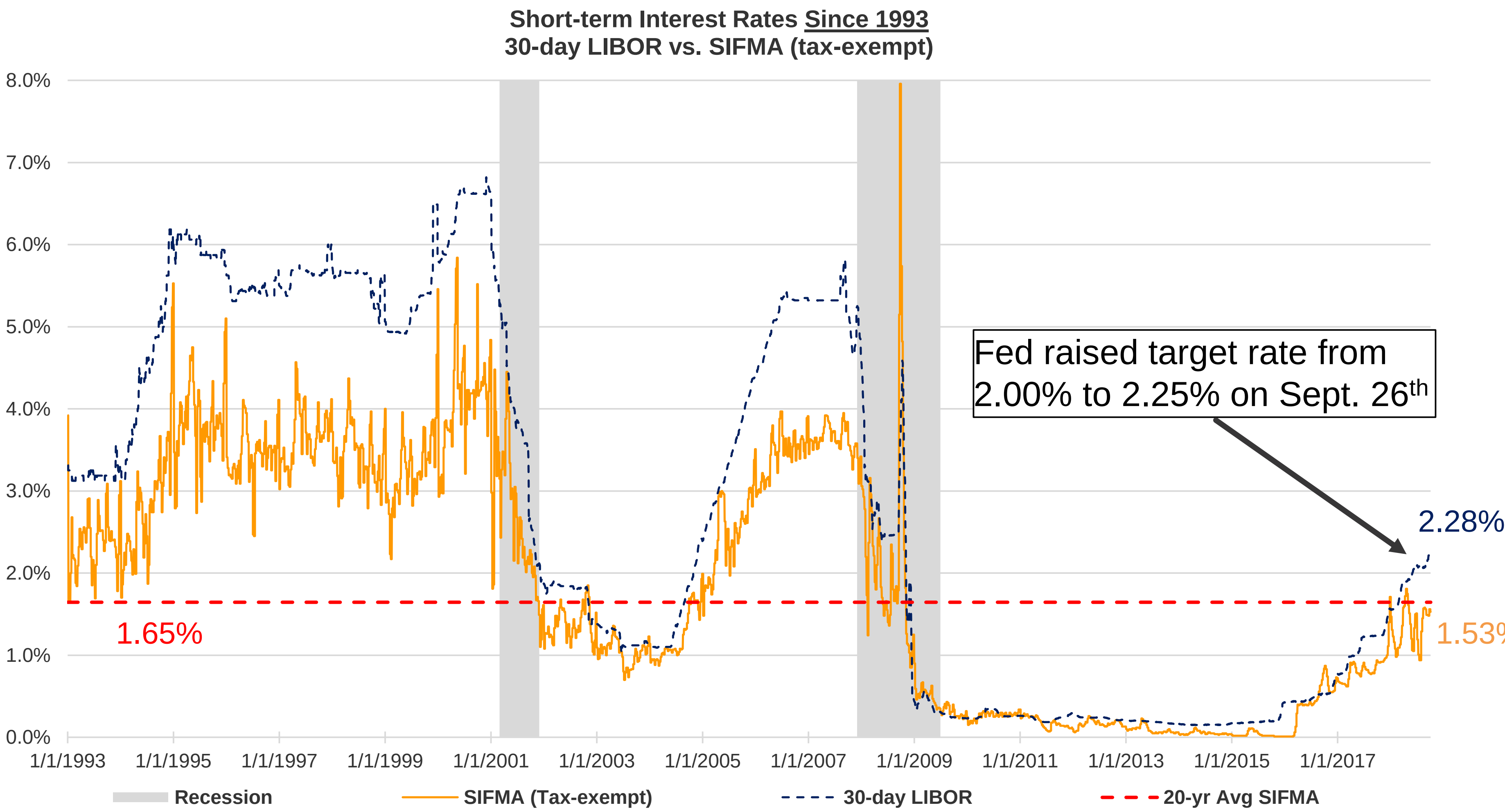
- **No Conflicts of Interest** – an IRMA has a fiduciary duty to their clients to ensure

- **Complete Independence** - Independent advice from an experienced financial advisor can protect both the organization and its management team.

- **Fair Market Pricing** - Independent advice on bond pricing and bank lending can help an organization achieve fair market value for its debt. In addition, an advisor can help an organization pay market-appropriate fees for underwriting services.

Short-term (variable) Interest Rates

Taxable & Tax Exempt rates as of 10/05/2018

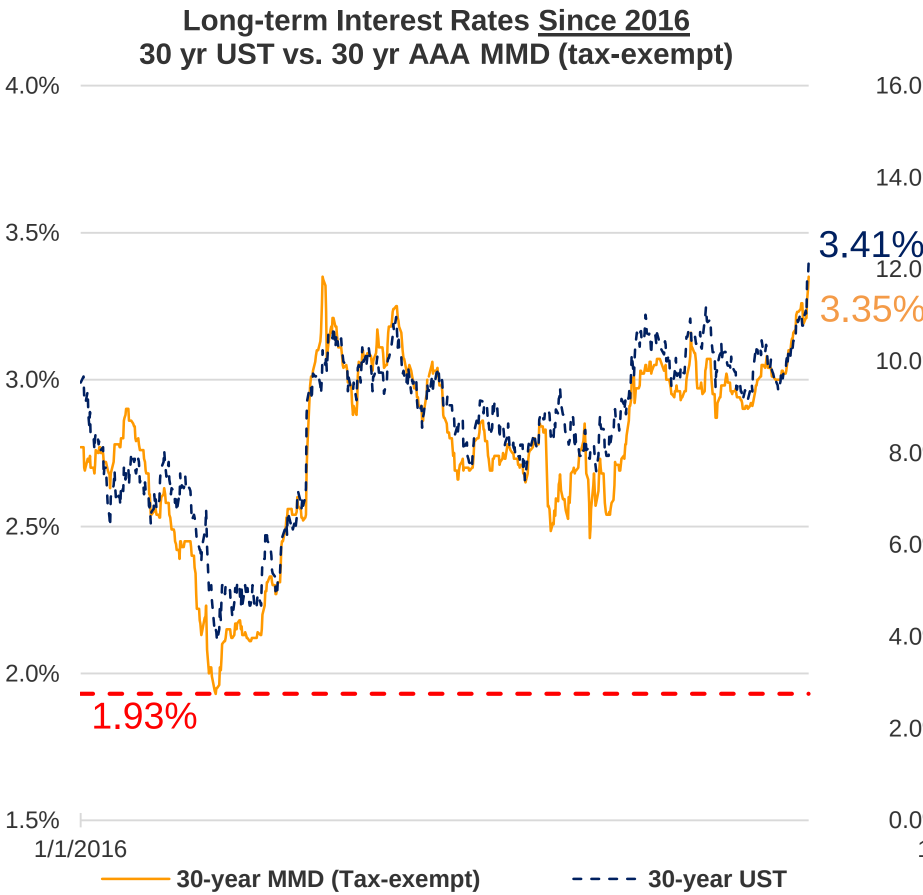


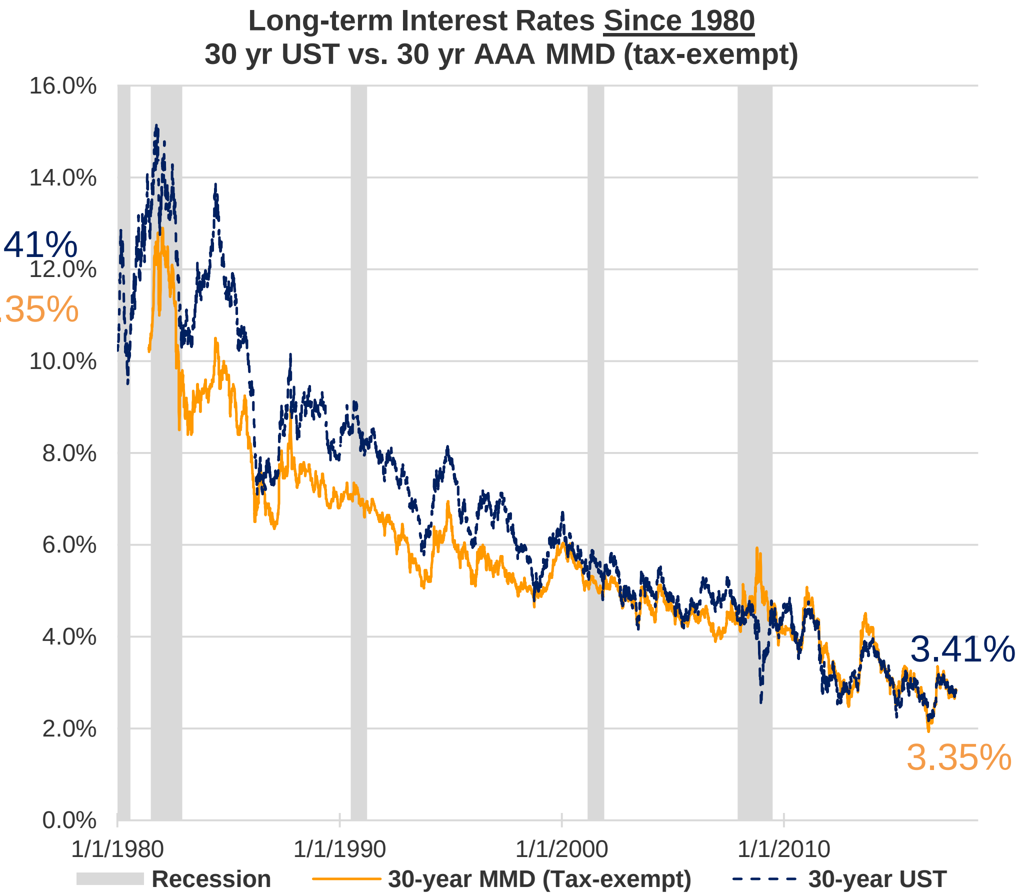
Source: TM3 & National Bureau of Economic Research.

Historical Long term and Short Term MMD vs. Treasury

Taxable & Tax Exempt rates as of 10/05/2018

- AAA MMD remains at low levels - current AAA MMD = 3.35%

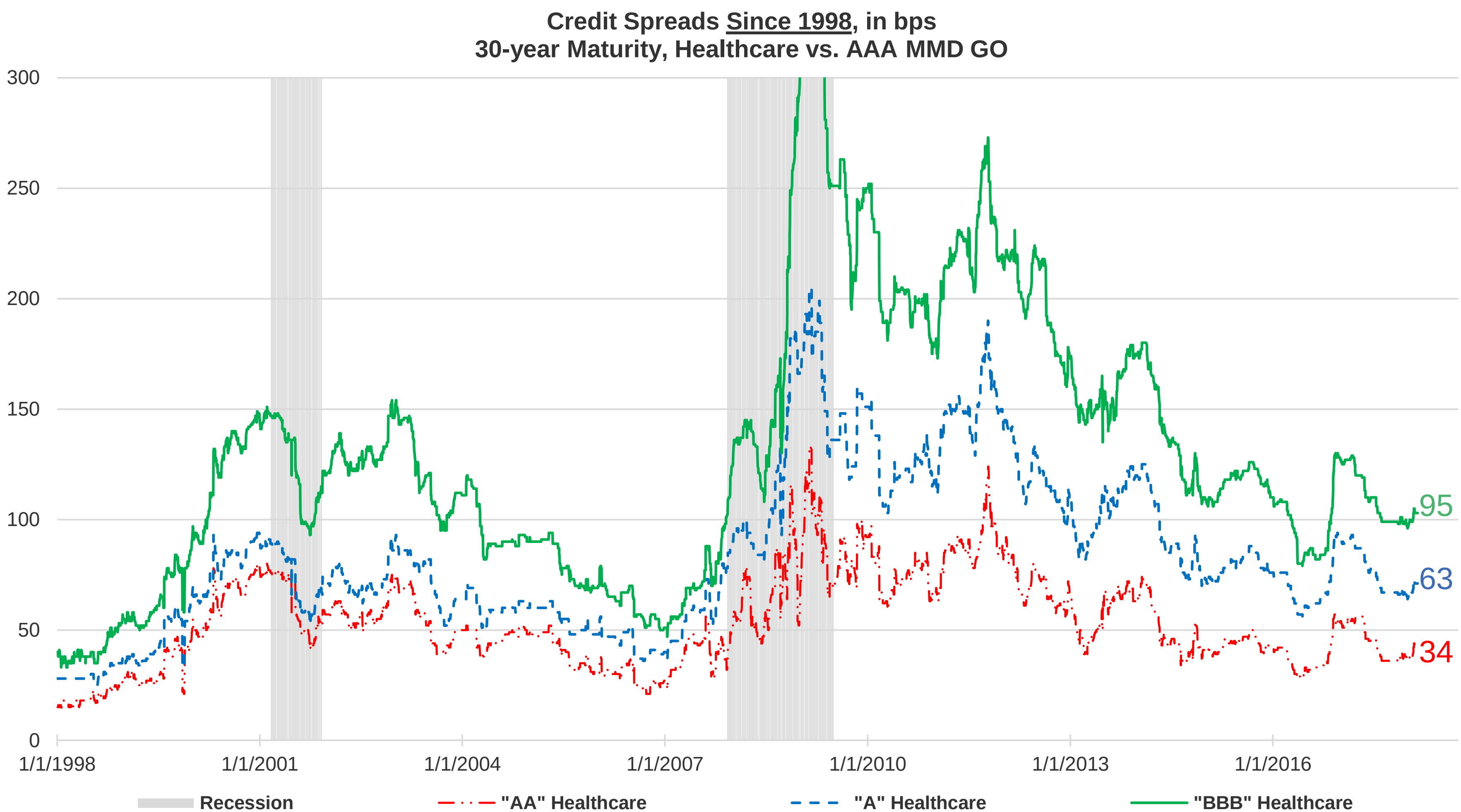




Source: TM3 & National Bureau of Economic Research.

Healthcare Credit Spreads

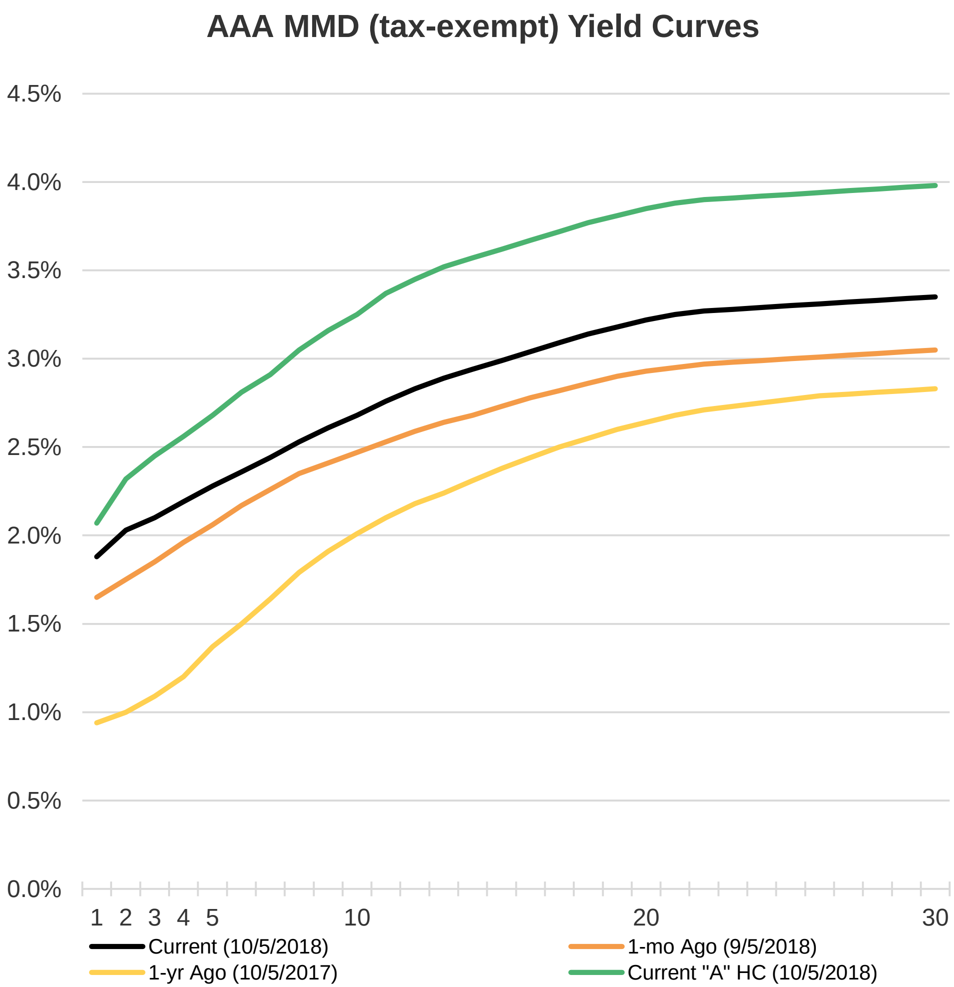
Tax Exempt as of 10/05/2018



Source: TM3 & National Bureau of Economic Research.

Borrowing Rates Have Been Increasing as Yields Flatten

Tax Exempt as of 10/05/2018



Estimated Borrowing Rates *

Maturity	AAA MMD (Tax-exempt)	Spread	TM3 "A" Healthcare	YTM
2 yr	2.03%	**0.29%**	2.32%	--
5 yr	2.28%	**0.40%**	2.68%	--
10 yr	2.68%	**0.57%**	3.25%	--
20 yr	3.22%	**0.63%**	3.85%	4.30%
30 yr	3.35%	**0.63%**	3.98%	4.50%

Benchmark Rates

Maturity	AAA MMD (Tax-exempt)	US Treasury	LIBOR	SIFMA (Tax-exempt)
Weekly	--	--	--	1.53%
30-day	--	--	2.28%	--
2 yr	2.03%	2.89%	3.06%	2.03%
5 yr	2.28%	3.07%	3.19%	2.23%
10 yr	2.68%	3.23%	3.27%	2.43%
20 yr	3.22%	3.36%	3.32%	2.63%
30 yr	3.35%	3.40%	3.29%	2.71%

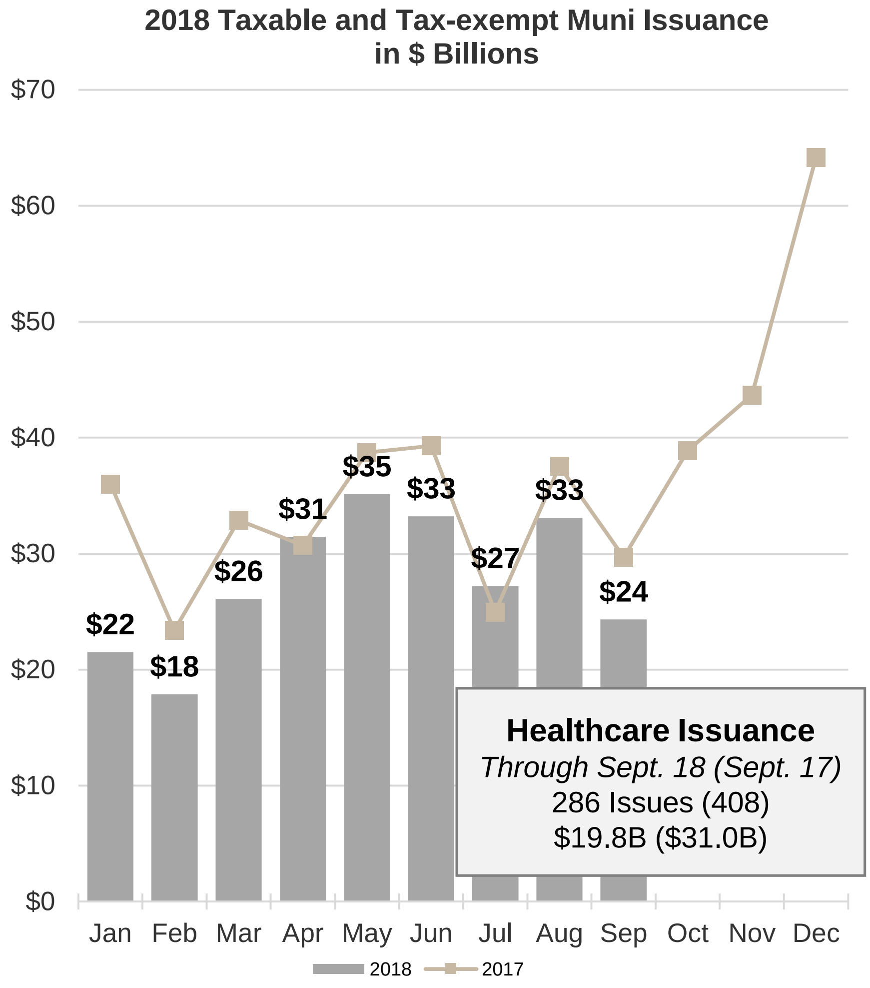
**TM3's "A" Healthcare Yield curve; 5.0% coupon scale.*

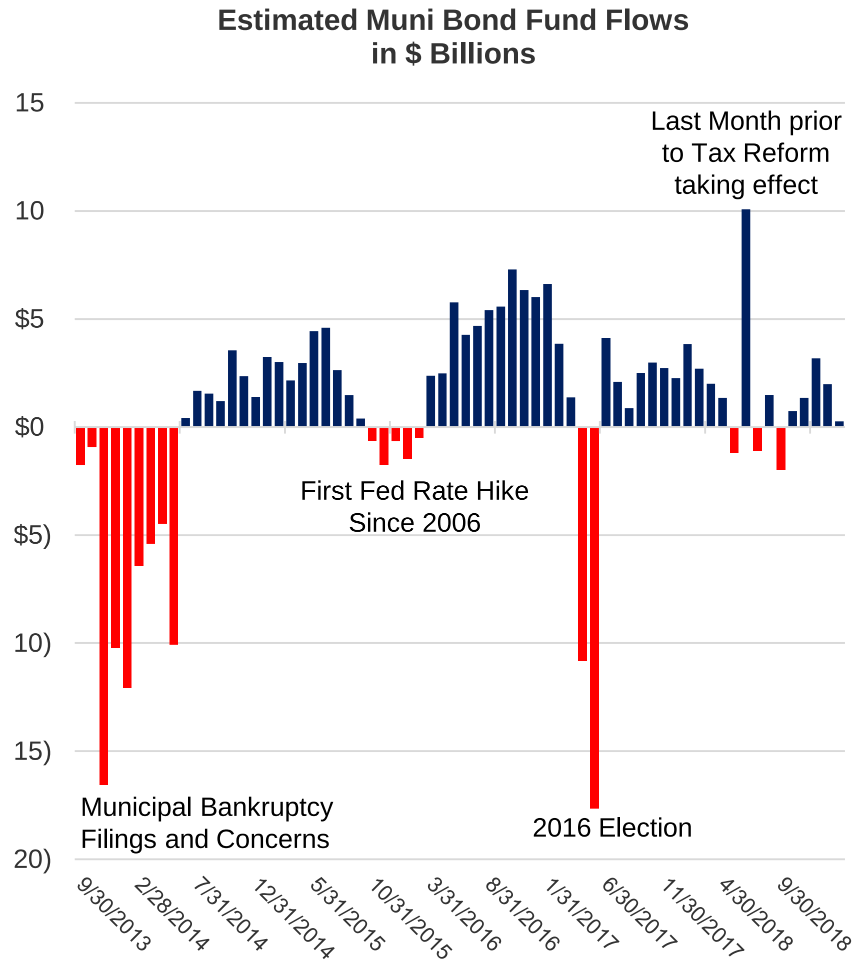
Source: TM3

YTM – Yield to Maturity

Municipal Funds – Periodic, Event-driven Severe Outflows

Tax Exempt as of 9/30/2018





Source: TM3 and ICI.

Security/Covenants of Recent Transactions

- In recent years, security and covenant packages have trended to be less restrictive with most investment grade deals being secured by Gross Revenues without a Mortgage.

Sale Date	State	Par Amount	Federal Tax Status	Obligor	M	SP	F	Primary Underwriter	DSRF	Mortg.	Rate Covenant	Financial Covenants
10/17/2018	IL	123,505	Tax-Exempt	Edward Elmhurst	NR	A	A	BAML	No	No	DSC - 1.10x, annual	DSC - 1.10x, semi-annual; 75 DCOH, semi-annual
10/17/2018	IL	51,425	Tax-Exempt	Edward Elmhurst	NR	A	A	BAML	No	No	DSC - 1.10x, annual	DSC - 1.10x, semi-annual; 75 DCOH, semi-annual
10/17/2018	FL	101,575	Tax-Exempt	South Broward Hospital	Aa3	AA	NR	BAML	No	No	1.10x MADS + P&I on other debt paid from Gross Revenues	
10/16/2018	PA	83,005	Tax-Exempt	St Clair Memorial	NR	AA-	AA-	MS	No	No	1.10x MADS, consultant; <1.00x for 2 years, default	
10/16/2018	MN	682,285	Tax-Exempt	Essentia Health	NR	A-	A-	BAML	No	No	DSC - 1.10x, consultant; <1.00x default	65 DCOH, annual; Debt-to-Cap <65%, annual
10/16/2018	ND	41,200	Tax-Exempt	Essentia Health	NR	A-	A-	BAML	No	No	DSC - 1.10x, consultant; <1.00x default	
10/10/2018	OH	127,295	Tax-Exempt	Ohio Health Corporation	Aa2	AA+	AA+	BARC	No	No	DSC - 1.00x, annual	
10/10/2018	OH	50,000	Tax-Exempt	Ohio Health Corporation	Aa2	AA+	AA+	BARC	No	No	DSC - 1.00x, annual	
10/3/2018	IL	341,640	Tax-Exempt	OSF Healthcare System	A2	A	NR	JPM	No	No	DSC - 1.10x, consultant; <1.00x for 2 years, default	
10/2/2018	IN	82,015	Tax-Exempt	Parkview Health	Aa3	AA-	NR	JPM	No	No	DSC - 1.00x, annual	
10/2/2018	IN	33,035	Taxable	Parkview Health	Aa3	AA-	NR	JPM	No	No	DSC - 1.00x, annual	
10/2/2018	GA	80,945	Tax-Exempt	Augusta University Health	Baa1	BBB	NR	JPM	No	Yes	DSC - 1.10x, annual	

2018 Q3 Health Care Transactions

Sale Date	State	Par Amount	Federal Tax Status	Obligor	Series	Moody's	S&P	Fitch	Primary Underwriter
9/25/2018	MT	88,360	Tax-Exempt	Kalispell Regional Medical	2018B	NR	BBB	NR	DA Davidson
9/18/2018	MN	200,000	Tax-Exempt	Mayo Clinic	2018A	Aa2	AA	NR	BAML
9/13/2018	LA	72,620	Tax-Exempt	St Tammany Parish Hospital	2018A	NR	NR	A+	Citi
9/12/2018	FL	350,000	Tax-Exempt	Sarasota Memorial Hospital	2018	A1	NR	AA-	JPMorgan
9/12/2018	MD	91,985	Tax-Exempt	University of Maryland Capital Region Medical Center	2018	Aa1	AA+	NR	Barclays
8/29/2018	CO	37,815	Tax-Exempt	Denver Health	2018	NR	BBB	BBB	Piper Jaffray
8/28/2018	WV	240,300	Tax-Exempt	Cabell Huntington Hospital	2018A	Baa1	BBB+	NR	Morgan Stanley
8/22/2018	CA	245,660	Tax-Exempt	Adventist Health System West	2018A	NR	A	A+	Ziegler
8/16/2018	CA	49,835	Tax-Exempt	Los Angeles Biomedical Research Institute	2018	Baa2	NR	NR	Wells Fargo
8/15/2018	PA	943,365	Tax-Exempt	Allegheny Health Network	2018A	NR	A	NR	Citi
8/7/2018	WI	97,500	Tax-Exempt	Advocate Aurora Health	2018A	Aa3	AA	AA	JPMorgan
7/31/2018	WV	57,910	Tax-Exempt	West Virginia United Health System	2018E	A2	A	NR	BAML
7/26/2018	CO	45,915	Tax-Exempt	UC Health	2018A	Aa3	AA-	AA	Citi
7/26/2018	CO	76,170	Tax-Exempt	UC Health	2018B	Aa3	AA-	AA	Citi
7/26/2018	CO	75,265	Tax-Exempt	UC Health	2018C	Aa3	AA-	AA	Citi
7/26/2018	NY	309,045	Tax-Exempt	Montefiore	2018A	Baa2	BBB	NR	BAML
7/25/2018	ID	73,760	Tax-Exempt	Saint Luke Health System	2018C	A3	A-	NR	JPMorgan
7/25/2018	ID	165,506	Tax-Exempt	St. Luke Health System	2018A	A3	A-	NR	JPMorgan
7/18/2018	VA	206,860	Tax-Exempt	Inova Health System	2018A	Aa2	AA+	NR	Morgan Stanley
7/17/2018	VA	54,365	Tax-Exempt	Valley Health System	2018	A1	A+	NR	ZS
7/17/2018	UT	50,000	Tax-Exempt	Intermountain Healthcare.	2018C	Aa1	AA+	NR	Wells Fargo
7/11/2018	ME	164,330	Tax-Exempt	Maine Medical Center	2018A	A1	A+	NR	Morgan Stanley
9/26/2018	MT	11,640	Taxable	Kalispell Regional Medical	2018A	NR	BBB	NR	DA Davidson
7/25/2018	PA	60,880	Taxable	St. Luke's University Hospital Bethlehem	2018C	A3	A-	NR	BAML
9/13/2018	LA	12,285	Taxable	St. Tammany Parish Hospital	2018B	NR	NR	A+	Citi
9/11/2018	MT	42,210	Taxable	Billings Clinic OG	2018B	NR	AA-	AA-	Wells Fargo
8/28/2018	CO	200,000	Taxable	Catholic Health Initiatives	2018B	NR	BBB+	NR	Morgan Stanley
8/9/2018	KY	128,980	Taxable	Baptist Healthcare System	2018A	Baa1	NR	A	BAML
7/30/2018	WV	210,850	Taxable	West Virginia University Health System	2018B	A2	A	NR	BAML
7/26/2018	NY	376,105	Taxable	Montefiore	2018C	Baa2	BBB	NR	BAML
7/25/2018	ID	149,910	Taxable	Saint Luke's Health System	2018B	A3	A-	NR	JPMorgan
7/24/2018	VA	101,455	Taxable	Centra Health	2018	A2	A	NR	Barclays
7/18/2018	MI	300,000	Taxable	McLaren Health Care	2018A	Aa3	NR	AA-	JPMorgan
7/17/2018	CA	202,272	Taxable	Valley Children's Hospital	2018A	A1	AA-	NR	JPMorgan
7/11/2018	ME	175,260	Taxable	Maine Medical Center	2018B	A1	A+	NR	Morgan Stanley

Transactions below the line in green are taxable.

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