

**CALIFORNIA HEALTH FACILITIES FINANCING AUTHORITY  
EXECUTIVE SUMMARY**

<p><b>Applicant:</b> Verdugo Mental Health ("VMH") 1540 East Colorado Street Glendale, CA 91205 Los Angeles County</p> <p><b>Project Site:</b> Same as above <b>Facility Types:</b> Community Mental Health Clinic</p>	<p><b>Amount Requested:</b> \$6,200,000 <b>Loan Term:</b> 30 years <b>Date Requested:</b> August 24, 2006 <b>Resolution Number:</b> F-320</p>																				
<p><b>Uses of Bond Proceeds:</b> Loan proceeds will be used to construct a new replacement facility at the current site to meet the increased demand for patient services.</p>																					
<p><b>Type of Issue:</b> Negotiated public offering, fixed interest rate <b>Existing Borrower:</b> Yes, payments are current <b>Credit Enhancement:</b> Cal-Mortgage Insurance (A) wrapped with FGIC (AAA) <b>Expected Credit Rating:</b> AAA (based on FGIC) <i>(VMH does not have an underlying credit rating)</i> <b>Senior Underwriter:</b> Altura, Nelson &amp; Co., Incorporated <b>Bond Counsel:</b> Quint &amp; Thimmig LLP</p>																					
<p><b>Financial Overview:</b> VMH has reversed its operating losses with continued profitability due to market pricing of its services and cost management initiatives. The balance sheet remains strong with a stable net asset balance.</p>																					
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<p><b>Legal Review:</b> No information was disclosed to question the financial viability or legal integrity of the Applicant.</p>																					
<p><b>Staff Recommendation:</b> Staff recommends the Authority approve a resolution to provide a loan to Verdugo Mental Health in an amount not to exceed \$6,200,000, subject to a final Cal-Mortgage Insurance commitment and a wrap by FGIC.</p>																					

**VERDUGO MENTAL HEALTH (“VMH”)**

**STAFF SUMMARY AND RECOMMENDATION**

August 24, 2006  
Resolution Number: F-320

**I. PURPOSE OF FINANCING:**

The proceeds of the 2006 Bonds will be used to fund the construction of a replacement facility at VMH’s primary campus site at 1540 East Colorado Street in Glendale, California. Over the past three years, VMH has consolidated its operations from three separate physical sites to its Glendale site to reduce the occupancy costs of various facilities. However, with the changing demand for patient services, the consolidated facilities at Glendale site have become inadequate and will need to be replaced with the new and larger facility.

**Construction of New Facility..... \$5,500,000**

VMH is housed in three buildings totaling approximately 15,900 square feet (sq. ft.) located on an acre site at 1540 East Colorado Street in Glendale, California. The first 11,750 sq. ft. building is inadequate for VMH programs because of an inefficient layout, changing service delivery patterns, and the need to bring the structure up to City building code standards. The building will be demolished and replaced with the construction of the new two-story 14,740 sq. ft. building, with underground parking for 28 vehicles. The first floor of the new building will be used for adult services and the second for childrens services. The second two-story 3,900 sq. ft. Glen Roberts clinic building will remain and be attached to the new building. It will be renovated to be used for support services with a pharmacy on the first floor and administrative services on the second. The third modular building will be razed after completion of the new outpatient clinic building and replaced with above ground parking for 57 vehicles. This proposed project will bring the total floor space to 18,640 sq. ft. and will allow VMH to provide more efficient and client-friendly services.

**Debt Service Reserve Fund..... 368,400**

**Financing Costs ..... 751,600**

*Bond insurance* ..... 520,660

*Cost of issuance* ..... 168,640

*Underwriters discount* ..... 62,300

**Total Uses of Funds ..... \$6,620,000**

**FINANCING STRUCTURE:**

- Negotiated public offering with serial and term bond maturities.
- Fixed interest rates.
- 30-year loan with final maturity date of 2036.
- Credit enhancement – Cal-Mortgage Insurance and FGIC.
- Expected Credit Rating: AAA (S&P), based on Cal-Mortgage Insurance and FGIC.
- Debt Service Reserve Fund.
- General obligation and gross revenue pledge.
- Financial covenants acceptable to the Authority.

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## II. FINANCIAL STATEMENTS AND ANALYSIS:

### Verdugo Mental Health Statement of Activities (Unrestricted)

	For ten months ended April 30	For the year ended June 30		
	2006 (Unaudited)	2005	2004	2003
<b>REVENUE</b>				
Patient revenue	\$ 4,102,348	\$ 5,113,396	\$ 4,453,807	\$ 4,357,771
Grant revenue	597,324	721,336	948,921	1,130,788
Other revenue	79,215	210,255	338,721	157,647
Net assets released from restrictions	-	-	-	-
Total revenues	<u>4,778,887</u>	<u>6,044,987</u>	<u>5,741,449</u>	<u>5,646,206</u>
<b>EXPENSES</b>				
Salaries and related expenses	3,598,575	4,583,359	4,357,966	4,433,896
Advertising	15,307	11,040	5,836	12,289
Automobile and mileage	11,586	14,773	11,468	8,926
Bad debts	-	-	-	3,009
Building maintenance	49,895	72,938	85,836	62,947
Business meetings	17,526	24,147	14,560	13,875
Computer supplies and expenses	25,435	16,152	1,953	3,321
Consulting and professional fees	164,932	208,154	148,541	126,772
Data processing services	7,174	11,042	10,382	9,794
Dues and subscriptions	25,114	32,648	28,179	29,700
Equipment maintenance and rental	94,336	107,691	55,347	52,996
Facility leases	47,421	49,007	45,564	125,531
Insurance	120,711	144,447	144,306	129,894
Interest	77,335	100,232	108,785	104,174
Legal and accounting	22,210	29,291	29,556	40,624
Fundraising expenses	10,308	8,370	11,675	1,509
Office and program supplies	97,103	122,724	116,939	122,594
Other expenses	4,332	5,053	5,742	10,932
Pharmacy and laboratory expenses	3,986	7,117	11,792	25,295
Printing and duplication	10,967	19,144	24,181	20,215
Purchased services	107,759	100,252	135,919	90,945
Staff development and training	2,903	14,305	4,484	3,607
Taxes and licenses	1,972	2,247	2,352	2,552
Telephone and answering service	60,968	74,385	71,347	81,692
Utilities	29,818	40,005	39,851	49,222
Depreciation	61,539	83,160	87,153	92,908
Total expenses	<u>4,669,212</u>	<u>5,881,683</u>	<u>5,559,714</u>	<u>5,659,219</u>
<b>Change in unrestricted net assets</b>	<b>109,675</b>	<b>163,304</b>	<b>181,735</b>	<b>(13,013)</b>
Unrestricted net assets at beginning of year	688,276	524,972	343,237	356,250
Unrestricted net assets end of year	<u>\$ 797,951</u>	<u>\$ 688,276</u>	<u>\$ 524,972</u>	<u>\$ 343,237</u>

**Verdugo Mental Health  
Statement of Financial Position**

	<u>As of April 30</u>	<u>As of June 30</u>		
	<u>2006</u>	<u>2005</u>	<u>2004</u>	<u>2003</u>
<b><u>Assets</u></b>	<b>(Unaudited)</b>			
Cash	\$ 3,523	\$ 323,220	\$ 35,540	\$ 224,639
Investments	681,787	364,863	362,890	340,735
Accounts receivable	728,957	414,923	414,953	459,182
Other receivables	-	4,207	6,270	2,847
Prepaid expenses	88,148	66,737	73,697	71,514
Bond reserve fund/deferred loan costs	183,342	187,912	-	-
Deposits	3,044	6,355	3,310	2,163
Property and equipment, net	2,878,502	2,718,828	2,713,414	2,776,916
<b>Total Assets</b>	<b>\$ 4,567,303</b>	<b>\$ 4,087,045</b>	<b>\$ 3,610,074</b>	<b>\$ 3,877,996</b>
<b><u>Liabilities</u></b>				
Accounts payable	\$ 423,462	\$ 102,830	\$ 91,249	\$ 321,848
Accrued expenses	801,045	902,180	597,057	734,879
Credit line	560,000	440,000	380,000	246,000
Notes payable	1,031,826	1,000,741	828,750	1,085,424
Unfunded accrued pension costs	264,087	264,087	536,241	536,241
<b>Total Liabilities</b>	<b>3,080,420</b>	<b>2,709,838</b>	<b>2,433,297</b>	<b>2,924,392</b>
<b><u>Net Assets</u></b>				
Unrestricted net assets				
Undesignated	1,486,883	1,209,340	1,318,190	1,136,455
Unfunded pension losses	(688,932)	(521,064)	(793,218)	(793,218)
<b>Total unrestricted net assets</b>	<b>797,951</b>	<b>688,276</b>	<b>524,972</b>	<b>343,237</b>
Temporarily restricted net assets	46,952	46,952	43,902	41,417
Permanently restricted net assets	641,980	641,979	607,903	568,950
<b>Total Net Assets</b>	<b>1,486,883</b>	<b>1,377,207</b>	<b>1,176,777</b>	<b>953,604</b>
<b>Total Liabilities &amp; Net Assets</b>	<b>\$ 4,567,303</b>	<b>\$ 4,087,045</b>	<b>\$ 3,610,074</b>	<b>\$ 3,877,996</b>

**Financial Ratios:**

**Proforma (a)  
6/30/2005**

Debt Service Coverage (x)	<b>1.28</b>	<b>2.96</b>	<b>1.03 (b)</b>	<b>1.27</b>
Debt/Unrestricted Net Assets (x)	<b>10.01</b>	<b>1.45</b>	<b>1.58</b>	<b>3.16</b>
Margin (%)		<b>2.70</b>	<b>3.17</b>	<b>(0.23)</b>
Current Ratio (x)		<b>0.95</b>	<b>0.82</b>	<b>0.71</b>

(a) Recalculates June 2005 audited results to include the impact of this proposed financing and consultant's feasibility report as required by Cal-Mortgage.

(b) Debt service coverage for 2004 would have been 2.53x if large loan payment of \$256,674 was not made.

Notes:

Current assets represent total assets less property and equipment, net.

Current liabilities represent total liabilities less non-current portion of notes payable and unfunded accrued pension costs.

**Financial Discussion:**

**VMH has reversed its operating losses with continued profitability due to market pricing of its services and cost management initiatives.**

VMH, as a community mental health clinic, provides outpatient mental healthcare to the low to moderate-income population. VMH receives over 85% of its revenues from patient revenue, mostly from Medi-Cal programs for adult and children outpatient services through Los Angeles County Department of Mental Health (LCDMH). Additional revenue comes from grants from Federal, State, County and private sources.

Total revenues had a minor increase of 7% over our review period from 2003 to 2005 (review period). The patient revenue contributed to the overall increase in total revenue due to market pricing of its services. Operating expenses for the review period increased only 3% due to cost containment measures implemented by management. Salaries and related expenses, 78% of the total expenses, largely contributed to the overall increase in total expenses. As a result of the consolidation in 2004, the facility expenses decreased 64%.

VMH experienced a minor operating loss in the 2003, but reversed this trend in 2004 with a continuous demand for its services and control of its costs, resulting in profit margins exceeding 2% for the review period. Unrestricted net assets increased 100% for the review period. The interim period may not indicate an increase in revenue for 2006 due to a drop in children services and the loss of Cal-Works funding (over the review period). The 2006 revenue is estimated to be approximately \$5.8 million, and with a positive trend in controlling expenses, it could result in an increase of approximately \$100,000 in unrestricted net assets. In 2007, VMH expects to meet its pension fund obligation, and anticipates a reduction in benefit-related expenses.

**The balance sheet remains strong with a stable net asset balance.**

With the surge in business activities over the review period, cash has increased, the accounts receivable were under control, and accounts payable and accrued expenses remained manageable. VMH intends to improve its cash position through effective cash flow management and continued profitability. VMH is highly leveraged, with a proforma debt-to-unrestricted net assets ratio of 10.01x, however with this proposed financing, VMH will have a proforma debt service coverage ratio of 1.28x, indicating an ability to repay the debt.

**III. UTILIZATION STATISTICS:**

	<b>2006</b>	<b>2005</b>	<b>2004</b>	<b>2003</b>
<b>Total Clients Units</b>	<b>2,907</b>	<b>2,822</b>	<b>2,586</b>	<b>2,958</b>
<b>Total Encounter Units</b>	<b>54,646</b>	<b>53,053</b>	<b>55,928</b>	<b>59,108</b>

VMH records key utilization statistics by program category for meeting the LCDMH contract revenue target. The utilization statistics had a downward trend as a result of VMH’s policy to

price services closer to the LCDMH units of service rates. Previously, the pricing was below LCDMH units of service rates, and as a result, more units of service were produced to meet LCDMH contract revenue target. In the past three years, VMH has gradually increased pricing close to LCDMH units of service rates, and as a result low units of service were produced to meet LCDMH contract revenue target.

#### **IV. ORGANIZATION**

##### **Background:**

In 1957, Glendale Mental Health Services, the predecessor to Verdugo Mental Health Center (VMH), was formed as a nonprofit corporation to provide outpatient psychiatric services for children and adults as a result of the survey conducted by the Glendale Welfare Planning Council assessing the community needs for local mental health services. In 1962, Glendale was one of the first private agencies to establish a contract with the LCDMH. After 1963, VMH moved several times as contract monies and client caseload increased. In 1973, VMH opened Burbank Child Guidance Clinic to work specifically with child-related problems. In 1981, the name was changed to Verdugo Mental Health Center.

In 1985, VMH developed self-pay program to provide low cost therapy to individuals who did not qualify for government funds due to low clinical priority. In 1986, VMH opened its Positive Direction Center as a drop-in center for persons in mental health recovery. Utilizing funds received through a Community Development Block Grant, VMH constructed the Glen Roberts Child Study Center in 1987 to provide space for child treatment and research. In late 1993, Verdugo acquired property adjacent to the Glen Roberts Child Study Center at 1540 East Colorado Street in Glendale, and relocated the adult outpatient program and administrative services to the new site during 1994. Also in 1994, VMH transitioned from a traditional clinical model of mental health service delivery to a rehabilitation model for State of California, Department of Mental Health contract programs. In 2001, VMH changed its name to Verdugo Mental Health and operates under that name currently.

##### **Competition:**

VMH is the only outpatient clinic under contract with the LCDMH to treat the severe and persistently indigent and low-income residents in the City of Glendale. VMH has no competition within the service area for those patients served.

##### **Licenses and Contracts:**

The VMH was licensed as community mental health clinic. Currently VMH is certified by the State's Medi-Cal program as a community mental health clinic. VMH also has contract with the Los Angeles County Department of Health Services.

**V. OUTSTANDING DEBT:**

Description	Original Amount	Amount Outstanding As of 6/30/05	Estimated Amount Outstanding After Proposed Financing
<b>Existing:</b>			
CHFFA 2005 Series A Bond	\$1,100,000	\$1,000,741	\$1,000,741
<b>Proposed:</b>			
CHFFA 2006 Series A Bond	5,870,000	-0-	6,200,000
<b>TOTAL DEBT</b>		<b>\$1,000,741</b>	<b>\$7,200,741</b>

**VI. SECTION 15438.5 OF THE ACT (Savings Pass Through):**

It is the intent of the Legislature in enacting this part to provide financing only to health facilities that can demonstrate the financial feasibility of their projects. It is further the intent of the Legislature that all or part of any savings experienced by a participating health institution, as a result of that tax-exempt revenue bond funding, be passed on to the consuming public through lower charges or containment of the rate of increase in hospital rates.

VMH has provided a description of its savings pass through in **Exhibit A**.

**VII. SECTION 15459.1 OF THE ACT (Community Service Requirement):**

As a condition of the issuance of revenue bonds, whether by the Authority or any local agency, each borrower shall give reasonable assurance to the Authority that the services of the health facility will be made available to all persons residing or employed in the area served by the facility. As part of this assurance, borrowers shall agree to a number of actions, including (1) to advise each person seeking services at the borrower’s facility as to the person’s potential eligibility for Medi-Cal and Medicare benefits or benefits from other governmental third-party payers, and (2) to post notices in appropriate areas within the facility regarding services being available to all in the service area. This agreement is a standard “Certification and Agreement Regarding Community Service Obligation”.

VMH has executed this certification indicating whether Medi-Cal and Medicare patients are accepted. A copy of the certification is provided as **Exhibit B**.

**VIII. RELIGIOUS AFFILIATION DUE DILIGENCE:**

Staff has reviewed the Applicant’s responses to the questions contained in the Religious Affiliation portion of the application. No information was disclosed in the questionnaire or discovered by staff to question the Applicant’s compliance with the provisions of the Authority’s Act relating to religious affiliation.



**IX. LEGAL REVIEW:**

Staff has reviewed the Applicant's responses to the questions contained in the Legal Status portion of the Application. No information was disclosed to question the financial viability or legal integrity of this applicant.

**X. STAFF RECOMMENDATION:**

Staff recommends the Authority approve a resolution to provide a loan to Verdugo Mental Health in an amount not to exceed \$6,200,000, subject to a final Cal-Mortgage Insurance commitment and a wrap by FGIC.