

Despite recent unprecedented federal investment in health centers, considering a variety of financing options is critical to the success of most capital projects. Many capital projects cannot proceed without obtaining long-term debt financing and/or short-term bridge loans. Debt financing is a tool that allows the health center to pay for the cost of the project over time, ideally tied to the useful life of the assets being financed. Obtaining the lowest cost and most flexible source of debt financing can greatly ease the financial burden that a capital project imposes on a health center's operations.

### Understanding Your Ability to Borrow - Debt Capacity

Debt capacity is the amount of debt a health center can afford to take on, given its historical or projected financial position. When evaluating potential borrowers, lenders look at a health center's historical or projected operating performance in order to determine a range of debt the health center could feasibly service as part of a capital project.

Debt capacity is a cash flow calculation based on "Funds Available for Debt Service," which is defined as Net Income + depreciation + amortization + interest expense. This amount can then be discounted to reflect a standard Debt Coverage Ratio requirement of 1.25, which provides lenders an additional cushion for cash flow variations. This discounted cash flow can then be used to calculate the amount of debt that the health center could support, given a specific interest rate and loan term.

### Types of Lenders for Health Centers

**Conventional Bank Lenders** provide market rate financing for all or a portion of a capital project. Conventional lenders willing to fund community health center capital projects are available both locally and nationally. In some cases, a health center can leverage a local banking relationship for lower rates, more flexible terms, and quicker turnaround. So, a health center should start its search for debt options by first contacting its own depository bank. A health center could potentially borrow more money or borrow at a lower interest rate, if it has a loan guarantee from a hospital partner, HRSA, or the USDA.

- The benefits of conventional loans are that they are less complex and can be relatively easy to structure and close. The shorter time frame could also make this option less expensive than below market options.
- The costs of conventional debt are the market interest rates and the shorter loan terms. Debt service (the interest and principal payments) is usually higher because of these factors.

**Community Development Financial Institutions (CDFIs)** are organizations that were created to expand the availability of credit, investment capital, and financial services in distressed urban and rural communities. CDFIs can be development corporations, community development banks, credit unions, and micro-enterprise loan funds at the local and national level.

- The benefit of working with CDFIs is that they are specialized lenders working in a market niche historically underserved by conventional lenders. They often make loans and investments that are considered too risky by industry standards. They are also usually able to offer flexible terms and structuring.
- A constraint is that CDFIs typically fund projects of a smaller scale, making them less attractive for larger projects. Larger projects could obtain a portion of their funding from this source.

**Tax-exempt Bonds** are bonds issued by municipal, county or state governments, whose interest payments are not subject to federal, and sometimes state or local, income tax. Because the interest income from tax-exempt bonds is exempt from taxation, bond investors can offer lower-interest loans to certain types of eligible borrowers, including community health centers. The bonds can carry either a variable rate or a fixed rate.

- The benefits of tax-exempt bonds are below market interest rates and longer terms, sometimes up to 30 years.
- The constraints are that tax-exempt bonds do have higher transaction and legal costs and are more complex to set up. The complexity could result in a longer time to closing.
- Bond issuances are most economically feasible for larger projects.

With the higher transaction costs, most stand-alone bond issuances are not economically feasible for loan amounts smaller than \$5 million. Some statewide issuers have developed special programs for smaller borrowers, including pooled bond programs, credit enhancement, or simplified programs that reduce the paperwork.

There are two primary types of bond issuances. **Publicly offered bonds** are resold on the secondary market, while **private placement issues** are sold to a pre-identified buyer. Publicly Issued Bonds need to be “credit enhanced” with a letter of credit from a qualified bank or with bond insurance. This credit enhancement creates increased issuance costs associated with establishing the letter of credit or bond insurance as well as an additional annual fee.

**New Markets Tax Credits** (NMTC), passed by Congress in 2000, are investment tax credits designed to stimulate investment in low-income communities. Areas that qualify as Low-Income Communities either have census tracts with a poverty rate of at least 20% or have census tracts where the median family income is below 80% of the area’s median family income.

The benefits to NMTC include:

- The tax credit portion of most transactions adds “near equity” to the project, up to 25% in some cases. If a health center has capital grants for a project, it may be possible to structure these in ways to further leverage the value of the tax credits.
- Loans are typically structured as interest only for the first seven years of the transaction.
- Many structures carry below market interest rates and longer terms.

The costs, however, of NMTC can be significant.

- NMTC loans do have higher transaction and legal costs and are the most complex financing to set up.
- The complexity could result in a longer time to closing.
- NMTC loans cannot be prepaid during the initial seven year period. Capital campaign funds that will be used for debt repayment will need to be invested during this time until repayment is allowed.
- NMTC are most economically feasible for larger projects, usually those that exceed \$5 million.

## Notable Financing Options in California

Options	CPCA Loan Programs	Tax-Exempt Bonds (Private)	Tax-Exempt Bonds (Cal Mortgage)	Help II (CHFFA)	USDA
Loan Size	Up to \$600,000	\$2-5 million	\$5-20+ million	Up to \$750,000	Varies
Maximum Term	5 years	10-20 years	30 years	15 years	40 years
Interest Rate	3.175%	6%+ fixed	5%+ fixed	3%	4.25% est.
Fees	Low	Moderate	High	Low	Low

Visit [www.caplink.org](http://www.caplink.org) for more information on our products, services and resources for health centers.