

## Office of the President

### TO MEMBERS OF THE COMMITTEE ON FINANCE

#### ACTION ITEM

*For Meeting of March 23, 2016*

### **APPROVAL OF EXTERNAL FINANCING, SANTA MONICA ORTHOPEDIC HOSPITAL LEGAL SETTLEMENT, LOS ANGELES CAMPUS**

#### **EXECUTIVE SUMMARY**

The Santa Monica Orthopedic Hospital was completed and occupied in January 2012. The project was part of the multi-phase seismic reconstruction plan for health sciences facilities at the Los Angeles campus. The 172-bed, 167,515 assignable square foot (ASF) (321,921 gross square foot (GSF)) hospital replaced the 197-bed, 155,323 ASF West Tower and the 14,726 ASF Nethercutt Emergency Center. These 1960s-era facilities suffered significant structural damage during the 1994 Northridge earthquake and did not meet contemporary seismic safety standards. The 94-bed, 83,980 ASF Merle Norman Pavilion (187,000 GSF), built in the mid-1980s, was retained and underwent partial renovation and refurbishment, with a 9,413 GSF portion demolished to accommodate the new construction. Construction of a replacement central plant (22,053 GSF) and a 620-car parking structure on an adjacent site were also included in the project. This action solely requests approval of external financing to fund a \$44 million construction-related legal settlement previously approved by the Regents in January 2015 (*Tutor Saliba Perini v. Regents – Authorization to Settle Construction Dispute – UCLA Santa Monica*) and paid for via hospital reserves in February 2015.

#### **RECOMMENDATION**

The President of the University recommends that the Committee on Finance recommend to the Regents that:

- A. The President be authorized to obtain external financing in an amount not to exceed \$44 million for the Santa Monica Orthopedic Hospital legal settlement, where said settlement was both previously approved by the Regents and paid in full via hospital reserves. The President shall require that:
  - (1) As long as the debt is outstanding, the gross revenues of UCLA Medical Center shall be maintained in amounts sufficient to pay the debt service and to meet the requirements of the authorized financing.
  - (2) The general credit of the Regents shall not be pledged.

- B. The President be authorized to execute all documents necessary in connection with the above.

### **BACKGROUND**

The Santa Monica Orthopedic Hospital was part of the multi-phase seismic reconstruction plan for health sciences facilities at the Los Angeles campus. The 172-bed, 167,515 ASF hospital (321,921 GSF) replaced the 197-bed, 155,323 ASF West Tower and the 14,726 ASF Nethercutt Emergency Center. These 1960s-era facilities suffered significant structural damage during the 1994 Northridge earthquake and did not meet contemporary seismic safety standards. The 94-bed, 83,980 ASF Merle Norman Pavilion (187,000 GSF), built in the mid-1980s, was retained and underwent partial renovation and refurbishment, with a 9,413 GSF portion that was demolished to accommodate the new construction. Construction of a replacement central plant (22,053 GSF) and a 620-car parking structure on an adjacent site were also included in the project.

The project began construction in February 2002 and was completed in January 2012. The project was completed behind schedule, within the augmented budget approved by the Regents of \$572.9 million, funded from \$390.7 million in external financing, \$72.2 million in federal funds, \$55 million in State lease revenue bonds, \$30 million in hospital reserves, and \$25 million in State Children's Hospital Bond program funds.

The legal settlement as described above resulted from claims of \$128.8 million by contractor Tutor Saliba Perini (Tutor) asserted against the University in connection with the construction of the Santa Monica Orthopedic Hospital. Tutor's claims included lost productivity, delay, extra work, escalation, and retention. The University, in turn, claimed \$25.2 million against Tutor for delays, defective work, mismanagement, and improper billings. The Tutor claims related to the Santa Monica Orthopedic Hospital were settled in exchange for payment of \$43.5 million and the execution of mutual releases by the parties, as approved by the Regents in January 2015 and subsequently paid via hospital reserves in February 2015.

### ***Financial Feasibility***

This item solely requests external financing to fund the \$44 million legal settlement. The external financing will be supported by the gross revenues of UCLA Medical Center. Based on a six percent financing rate and 30-year term, the estimated average annual debt service is \$3,197,000. Throughout the projection period, UCLA Medical Center's debt service coverage remains above industry averages, and days' cash on hand remains above the recommended floor of 60 days established by the Office of the President. Actual days' cash on hand in FY 2015 was 191.72 days, and is projected to be 176.22 days in FY 2016. Financial Projections for the UCLA Medical Center are provided in Attachment 1.

Attachment 1: Summary of Financial Feasibility

**SUMMARY OF FINANCIAL FEASIBILITY**

Project:	UCLA Health System, Santa Monica Orthopedic Hospital Legal Settlement
Total Estimated Cost	\$44,000,000
Proposed Sources of Funding:	
External Financing	\$44,000,000
Total	\$44,000,000
Projected Financing Terms:	
Interest Rate	6%
Term	30 years
Average Annual Debt Service	\$3,197,000
Existing UCLA Health Long-Term Debt as of December 31, 2015	\$810,389,000
Projected Total Debt Service in FY 2016-17	\$58,818,000

## **PROJECTED FINANCIAL PERFORMANCE**

### **KEY ASSUMPTIONS**

#### **Utilization**

- Average daily census (ADC) is expected to increase from 738 in 2016 to 758 in 2020. The growth is projected to occur at both Ronald Reagan UCLA Medical Center (Ronald Reagan) and Santa Monica-UCLA Medical Center and Orthopedic Hospital (Santa Monica). The increase in ADC is a result of (1) an increase in bed capacity (2) growth in primary care clinics and (3) continued development of leading edge clinical services and technologies.
- Ambulatory clinic and emergency room visits are expected to increase from 808,377 in 2016 to over 979,055 by 2020 as a result of (1) growth in the insured population under the Affordable Care Act (ACA) and (2) technological advancements and reimbursement incentives that continue to drive appropriate clinical treatment from the inpatient setting to outpatient venues.

#### **Revenue**

- Net patient service revenue reflects projected patient volume growth. In addition, it reflects ongoing strategies to optimize reimbursement through improved revenue capture and contracting efforts.
- The projection assumes modest increases for governmental payors and an annual increase of three percent for commercial payors.

#### **Operating Expenses**

- Total labor (salary and benefits excluding Pension and Other post-employment benefits (OPEB)) inflation is five percent per year from FY 2016 to FY 2020. FTE's are projected at clinically appropriate levels.
- Pension expense is based on actuarial estimates. Pension funding is based on a percentage of payroll approved by the Regents: 14.8 percent, 14.9 percent, 15 percent, 15.1 percent and 15.1 percent for FYs 2016-20, respectively.
- Other post-employment benefits expense based on actuarial estimate assuming GASB 75 is adopted in fiscal year 2017.
- Total annual supply inflation of five percent percent is used during the projection periods.
- All other expenses are projected to increase at three percent percent annually.

#### **Financing**

- A new long-term revenue bond in the amount of \$44 million would be issued in FY 2016 at an interest rate of six percent for 30 years.
- Throughout the projection period, UCLA Health System's debt service coverage remains above industry averages, and days cash on hand remains above the recommended floor of 60 days established by the Office of the President. Days' cash

on hand was 191.72 days in FY 2015, and is projected to be 176.22 days in FY 2016.

### **Capital Investments**

- Capital expenditures are projected to be: \$219 million in FY 2016, \$209 million in FY 2017, \$145 million in FY 2018, \$100 million in FY 2019 and \$100 million in FY 2020.

### **Sensitivity Analysis**

- Sensitivity analyses were performed to evaluate the impact on income and other key financial indicators of selected changes on revenue and expenses.
- The ability to achieve forecasted results is highly dependent upon achieving forecasted assumptions pertaining to commercial contract increases and the continuation of third-party governmental reimbursement programs.
- The volatility surrounding the pension and post-employment benefit expense assumptions may materially affect forecasted financial results.

## Patient and Financial Data

### UCLA Medical Center Projected Debt Service Coverage Ratio (Dollars in Thousands)

	<b>FY2015 Actual</b>	<b>FY2016 Projection</b>	<b>FY2017 Projection</b>	<b>FY2018 Projection</b>	<b>FY2019 Projection</b>	<b>FY2020 Projection</b>
Net Income/(Loss)	223,408	79,993	53,876	74,772	(28,894)	(22,304)
Depreciation	130,946	137,856	153,689	164,629	170,209	173,779
Interest Expense	38,620	41,042	48,122	47,522	46,859	46,120
Non-cash OPEB Expense <sup>(1)</sup>	0	0	73,000	73,000	73,000	80,300
Non-cash Pension Expense <sup>(2)</sup>	27,996	31,795	(14,639)	(41,960)	34,036	(7,373)
Net Rev Available for Debt Service	420,970	290,686	314,048	317,963	295,210	270,522
Total Debt Service	51,276	51,480	58,818	58,756	58,771	59,616
<b>Modified Debt Service Coverage Ratio</b>	8.21	5.65	5.34	5.41	5.02	4.54

(1) Represents the difference between OPEB expense and OPEB funding.

(2) Represents the difference between pension expense and pension funding. Negative amounts reflect that the estimated expenses are less than the estimated cash contribution.

### UCLA Medical Center Projected Patient Volumes

	<b>FY2015 Actual</b>	<b>FY2016 Projection</b>	<b>FY2017 Projection</b>	<b>FY2018 Projection</b>	<b>FY2019 Projection</b>	<b>FY2020 Projection</b>
Discharges	42,303	41,789	41,888	43,082	43,082	43,082
Average Length of Stay	6.37	6.45	6.46	6.42	6.42	6.42
ADC	738	738	742	758	758	758
Available Beds	805	805	815	831	831	831
Percent Occupancy	92%	92%	91%	91%	91%	91%
<u>Discharge Mix - Inpatient Only</u>						
Medicare	29.11%	27.55%	27.55%	27.55%	27.55%	27.55%
Medical	17.21%	12.09%	12.09%	12.09%	12.09%	12.09%
Contract	49.30%	55.88%	55.88%	55.88%	55.88%	55.88%
Capitation	3.74%	3.61%	3.61%	3.61%	3.61%	3.61%
Non-Sponsored	0.63%	0.86%	0.86%	0.86%	0.86%	0.86%
Total	100.00%	100.00%	100.00%	100.00%	100.00%	100.00%
<u>Ambulatory Visits</u>						
Hospital Outpatient Visits	693,355	735,269	763,178	800,600	839,892	881,149
Emergency Visits	73,285	73,108	84,798	88,956	93,321	97,905
Total Visits	766,640	808,377	847,976	889,555	933,214	979,055

**UCLA Medical Center**

**Projected Financial Performance**  
**Statement of Revenues and Expenses**  
(Dollars in Thousands)

	<b>FY2015 Actual</b>	<b>FY2016 Projection</b>	<b>FY2017 Projection</b>	<b>FY2018 Projection</b>	<b>FY2019 Projection</b>	<b>FY2020 Projection</b>
<b>Operating Revenue</b>						
Net Patient Revenue	2,167,145	2,231,908	2,375,665	2,504,175	2,606,252	2,713,837
Other Operating Revenue	86,718	70,997	71,597	71,597	71,597	71,597
Net Operating Revenue	2,253,863	2,302,905	2,447,262	2,575,772	2,677,849	2,785,434
<b>Operating Expenses</b>						
Operating Expenses	1,887,676	2,062,749	2,215,137	2,317,247	2,515,420	2,610,950
Depreciation	130,946	137,856	153,689	164,629	170,209	173,779
Total Operating Expense	2,018,622	2,200,605	2,368,826	2,481,876	2,685,629	2,784,729
Net Operating Gain/(Loss)	235,241	102,300	78,436	93,896	(7,780)	705
Non-Operating Income/(Expense)	(11,833)	(22,307)	(24,560)	(19,124)	(21,114)	(23,009)
Net Income/(Loss)	223,408	79,993	53,876	74,772	(28,894)	(22,304)

**UCLA Medical Center**  
**Projected Financial Performance**  
**Statement of Net Assets**  
**(Dollars in Thousands)**

	<b>FY2015 Actual</b>	<b>FY2016 Projection</b>	<b>FY2017 Projection</b>	<b>FY2018 Projection</b>	<b>FY2019 Projection</b>	<b>FY2020 Projection</b>
<b>Current Assets</b>						
Cash	734,777	733,930	609,751	567,397	551,996	510,487
Accounts Receivable (Net)	340,213	348,106	369,888	388,198	403,278	419,170
Other Current Assets	53,859	58,733	63,339	67,193	72,110	75,766
Total Current Assets	1,128,849	1,140,769	1,042,978	1,022,788	1,027,384	1,005,423
<b>Other Assets</b>						
Investments	256,750	259,230	259,230	259,230	259,230	259,230
Cash held by trustee	2,792	2,517	2,293	2,122	2,011	1,958
Donor restricted	12,213	12,213	12,213	12,213	12,213	12,213
Other Assets	463,759	462,623	461,667	460,621	459,575	458,529
Total Other Assets	735,514	736,583	735,403	734,186	733,029	731,930
<b>Property, Plant and Equipment</b>						
Total PP&E	1,845,365	1,926,509	1,981,420	1,961,791	1,891,583	1,817,804
<b>TOTAL ASSETS</b>	<b>3,709,728</b>	<b>3,803,861</b>	<b>3,759,801</b>	<b>3,718,765</b>	<b>3,651,996</b>	<b>3,555,157</b>
<b>LIABILITIES AND NET ASSETS</b>						
<b>Current Liabilities</b>						
Current Portion Long Term Debt	10,438	10,696	11,234	11,912	13,496	16,863
Third Party Settlements	9,503	9,121	9,508	9,832	10,131	10,444
Other Current Liabilities	306,108	318,573	337,585	349,439	361,957	371,260
Total Current Liabilities	326,049	338,390	358,327	371,183	385,584	398,567
<b>Total Long Term Debt and Capital Lease, net of current</b>	<b>1,139,503</b>	<b>1,265,807</b>	<b>1,254,573</b>	<b>1,242,661</b>	<b>1,229,165</b>	<b>1,212,302</b>
<b>Total Pension &amp; OPEB Liability</b>	<b>1,041,200</b>	<b>1,072,995</b>	<b>2,292,056</b>	<b>2,323,096</b>	<b>2,430,132</b>	<b>2,503,059</b>
<b>TOTAL LIABILITIES</b>	<b>2,506,752</b>	<b>2,677,192</b>	<b>3,904,956</b>	<b>3,936,940</b>	<b>4,044,881</b>	<b>4,113,928</b>
<b>NET ASSETS</b>	<b>1,202,976</b>	<b>1,126,669</b>	<b>(145,155)</b>	<b>(218,175)</b>	<b>(392,885)</b>	<b>(558,771)</b>



**UCLA Medical Center**  
**Projected Financial Performance**  
**Statement of Cash Flow**  
**(Dollars in Thousands)**

	<b>FY2015 Actual</b>	<b>FY2016 Projection</b>	<b>FY2017 Projection</b>	<b>FY2018 Projection</b>	<b>FY2019 Projection</b>	<b>FY2020 Projection</b>
<b>Sources</b>						
Net Income	223,408	79,993	53,876	74,772	(28,894)	(22,304)
Add: Depreciation	130,946	137,856	153,689	164,629	170,209	173,779
Add: Interest Expense	38,620	41,042	48,122	47,522	46,859	46,120
<b>EBITDA</b>	<b>392,974</b>	<b>258,891</b>	<b>255,687</b>	<b>286,923</b>	<b>188,174</b>	<b>197,595</b>
Add: Non-cash OPEB Expense	19,897	23,253	97,242	99,573	102,277	112,487
Add: Non-cash Pension Expense	126,325	145,361	110,810	92,857	176,101	142,365
<b>Modified EBITDA</b>	<b>539,196</b>	<b>427,505</b>	<b>463,739</b>	<b>479,353</b>	<b>466,552</b>	<b>452,447</b>
Debt Proceeds	0	137,000	0	0	0	0
<b>Total Sources</b>	<b>539,196</b>	<b>564,505</b>	<b>463,739</b>	<b>479,353</b>	<b>466,552</b>	<b>452,447</b>
<b>Uses</b>						
Property, Plant and Equipment	99,929	219,000	208,600	145,000	100,001	100,000
Debt Payments (principal + interest)	51,276	51,480	58,818	58,756	58,771	59,616
Health System Support	130,170	156,300	165,000	150,000	150,000	150,000
Working Capital/Other	(30,834)	(727)	5,809	6,561	1,839	2,415
Pension Funding	98,329	113,566	125,449	134,817	142,065	149,738
OPEB Funding	19,897	23,253	24,242	26,573	29,277	32,187
<b>Total Uses</b>	<b>368,767</b>	<b>562,872</b>	<b>587,918</b>	<b>521,707</b>	<b>481,953</b>	<b>493,956</b>
<b>Beginning Cash</b>	<b>821,098</b>	<b>991,527</b>	<b>993,160</b>	<b>868,981</b>	<b>826,627</b>	<b>811,226</b>
Net Change in Cash	170,429	1,633	(124,179)	(42,354)	(15,401)	(41,509)
<b>Ending Cash</b>	<b>991,527</b>	<b>993,160</b>	<b>868,981</b>	<b>826,627</b>	<b>811,226</b>	<b>769,717</b>

**UCLA Medical Center**  
**Projected Financial Performance**  
**Key Financial Ratios**  
(Dollars in Thousands)

	<b>FY2015 Actual</b>	<b>FY2016 Projection</b>	<b>FY2017 Projection</b>	<b>FY2018 Projection</b>	<b>FY2019 Projection</b>	<b>FY2020 Projection</b>
Total Margin	9.91%	3.47%	2.20%	2.90%	-1.08%	-0.80%
EBITDA (\$000's)	392,974	258,891	255,687	286,923	188,174	197,595
Modified EBITDA (\$000's)	539,196	427,505	463,739	479,353	466,552	452,447
Days Cash on Hand	191.72	176.22	143.19	130.21	117.71	107.60
Modified Debt Service Coverage	8.21	5.65	5.34	5.41	5.02	4.54
Debt-to-Capitalization	48.6%	52.9%	113.1%	121.3%	147.0%	185.5%

(1) Modified EBITDA is EBITDA excluding (adding back) OPEB and pension expenses.

(2) Modified Debt Service Coverage excludes (adds back) non-cash OPEB and pension expenses.