

## Evaluating Financing Options

By Kelly Arduino, Director of Financial Advisory Services  
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Health care organizations are receiving financing, even in today's more expensive and more onerous lending environment. That said, lenders aren't the only ones proceeding with caution. As a financial advisor that assists management and boards in evaluating financing options, I see increased diligence on the part of borrowers too. Even where there is a long term banking relationship, many organizations are conducting a competitive RFP process and asking detailed questions about terms and risks associated with the debt. The goal of this article is to review a few common beliefs on how best to evaluate debt options and conduct effective diligence.

***We should decide on a financier/lender as soon as possible in the capital planning process.***

FALSE: It is common for the size and scope of a project to change in the course of planning a renovation/expansion and the amount of borrowing can influence the best type of lender for the project. For example, a hospital that started out with the intention of building a replacement facility at an estimated cost of \$40 million, realized that their debt capacity would not support that amount of debt. Instead, the hospital decided to build an outpatient surgery center for \$5 million. In the case of the replacement facility a HUD 242 loan would be an appropriate choice, but in the final decision, the local bank provided a cost-effective option. If the hospital would have chosen a HUD lender from the onset they would likely be tied to that lender. That lender may not offer the full array of financing products and/or not be as competitive on a smaller financing and it would not be unusual for the hospital to have to pay some type of termination fee.

***The Costs of Issuance (COI) should be compared and can differentiate one firm from another.***

FALSE: COI includes a number of items that have nothing to do with the financing firm. Examples include, title recording, appraisal, legal counsel, etc. However, COI vary significantly between the types of financing vehicles with HUD generally having the most costs and bank loans having the least. That said, commercial bank loans often bury COI in the interest rate, so the best comparison of the costs of financing options is the All-In-Cost which is the equivalent calculation of an APR for a mortgage. Some lenders will also specify the True-Interest Cost (TIC) calculation, which includes only the underwriting/origination fees + the interest rate and is a better comparison of the costs of using a particular lender that the overall cost of the financing.

**The most important determinant of choosing a financing proposal is the interest rate.**

There are a number of considerations that should be taken into account when evaluating options, especially in today's market where

we have since a significant change in covenants and reporting requirements. In general, lenders are less lenient about allowing organizations to borrow more debt as evidenced by limits on and/or approval for additional borrowing. Other covenants such as the Debt Service Coverage Ratio (DCOR), which measures your ability to cover your current year interest and principal payment, and days cash on hand (DCOH), which gauges liquidity by measuring the number of days of cash operating expenses you could support if your revenue stream were to be reduced or eliminated, are used by lenders to monitor financial performance and evaluate the likelihood that the debt will be repaid. If an organization falls below this number, then the lender often has the right to call in a consultant or in extreme cases can declare a default. Lenders have higher standards for maintaining minimum DCOR and DCOH so that if there is financial trouble they can intervene earlier. From the perspective of the organization, this can mean less money to spend on working capital or other special projects; rather it must be set aside to meet the debt covenants. More frequent reporting, specifically quarterly and in some cases monthly financials and utilization are required to be submitted to the lender. This can be time consuming for the organization. In short, the flexibility of operating your business and the amount of time spent satisfying lender reporting requirements should be an important consideration in addition to the interest rate.

### About the Author

Kelly Arduino has over 15 years of experience in health care with an emphasis in health care finance and strategy. As an unbiased financial advisor for clients which include critical access hospitals, independent community hospitals, and senior living facilities, her work centers on planning for and secure capital to finance large renovation/replacement projects. She also works with clients on an "as needed" basis to evaluate financing proposals and to provide advice on debt related decisions. To learn more, please contact Kelly at [karduino@wipfli.com](mailto:karduino@wipfli.com) or visit [www.wipfli.com/arduino](http://www.wipfli.com/arduino).

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