Primer on NCMCC Bond Financing Legal Structures

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Robinson Bradshaw

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1. Finance Team – Roles and Responsibilities

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Finance Team – Publicly Offered Bonds

- NCMCC: The NCMCC is often referred to as the "conduit issuer," because the NCMCC lends the proceeds of the bonds to the Borrower and is obligated to repay the bonds only from specified "revenues" (i.e., the loan payments made by the Borrower, which are equal to the principal and interest due on the bonds). For interest on bonds to be federally tax-exempt, the bonds must be issued by a governmental conduit issuer such as the NCMCC.
- LGC: Also must approve, and act as agent of sale for, the bonds.
- Borrower: A 501(c)(3) organization (i.e., a charitable nonprofit) that uses the bond proceeds to finance a capital project (health care facilities) or to refinance existing bonds.
- Financial Advisor: Some NCMCC Borrowers engage a financial advisor to provide advice regarding issuance of the bonds. Financial advisors are now regulated by the SEC/MSRB.
- Underwriter: Offers and sells the bonds.
- Bond Counsel: Represents the NCMCC.
  - Delivers "approving opinion," which must conclude that bonds are validly issued and interest is federally tax-exempt
  - Drafts principal legal documents
  - Coordinates and conducts closing/prepares bond transcripts

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Finance Team – Publicly Offered Bonds (Cont'd)

- Underwriter's Counsel:
  - Drafts offering document ("official statement") and underwriting agreement ("bond purchase agreement")
  - Conducts certain due diligence on behalf of the Underwriter
- Borrower's Counsel:
  - Reviews and negotiates documents on behalf of Borrower
  - Delivers opinions regarding enforceability of documents against Borrower, 501(c)(3) status of Borrower and disclosure about the Borrower in the official statement (referred to as "negative assurance")
- Master Trustee/Bond Trustee: Holds and invests bond proceeds (at Borrower's direction) until disbursed; collects payments from Borrower and makes payments to bondholders; pursues remedies against Borrower upon default.
- Rating Agencies: Provide credit ratings for the bonds.
- Credit/Liquidity Provider: Provides credit enhancement (e.g., bond insurance, letter of credit) or liquidity support (e.g., standby bond purchase agreement) for the bonds.

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2. Master Trust Indentures

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Master Trust Indentures Generally

- Master trust indentures ("Master Indentures" or "MTIs") are the legal superstructures used by nonprofit healthcare entities such as NCMCC Borrowers since the 1980s to facilitate the incurrence of tax-exempt and taxable debt over time on a parity basis.
- Master Indentures were originally intended to serve three specific purposes:
  - Creation of a credit group
  - Creation of a common pool of collateral
  - Establishment of common covenants
- To implement a Master Indenture structure, one or more legal entities in a nonprofit health group enter into a Master Indenture with a corporate trustee (referred to as the "Master Trustee").
- Promissory notes referred to as "Obligations" or "Master Obligations" are issued under the Master Indenture by one or more of the parties thereto to evidence and secure debt they incur.
- A Master Obligation is issued pursuant to a supplement to the Master Indenture, which is referred to as a "Supplemental Master Indenture."
- For example, the Borrower will issue a Master Obligation as further evidence of its obligation to make loan payments equal to the principal and interest on the related series of tax-exempt bonds.
- There are two types of Master Indentures:
  - "Obligated Group" master indentures
  - "Corporate Parent" master indentures

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Obligated Group Master Trust Indentures

- Creates a credit group, referred to as the "Obligated Group," the members of which are jointly and severally liable for all Master Obligations issued under the Master Indenture.
- Creates a common pool of collateral that secures all Master Obligations (and, therefore, all related bond issues) on a parity (i.e., equal) basis.
  - Typically, a "revenue" pledge, which is at least a pledge of accounts receivable
  - Sometimes, a mortgage on the real property of each member of the Obligated Group
- Establishes common covenants for the benefit of the holders of all Master Obligations (and, therefore, the holders of all related bond issues). Master Indentures for NCMCC Borrowers traditionally include the following covenants:
  - Limitations on additional debt
  - Limitations on liens (usually referred to as a "negative pledge")
  - Limitations on transfers of operating assets, cash and investments and accounts receivable
  - Limitations on mergers, consolidations and transfer of all or substantially all of the assets of a member of the Obligated Group
  - Limitations on admission to and withdrawal from the Obligated Group
  - 1.20 debt service coverage ratio (usually referred to as the "rate covenant")
  - In recent years, a days' cash on hand covenant (a "liquidity covenant") also may be included

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Corporate Parent Master Trust Indentures

- In the mid-1990s, some large, highly rated health systems began replacing their traditional Obligated Group Master Indentures with so-called "Corporate Parent" Master Indentures, similar to those used by highly rated, for-profit holding companies. In 1996 the NCMCC and LGC approved the first corporate parent master indenture (for Carolina Medicorp, now Novant).
- Two types of corporate parent master indentures:
  - "Pure" Corporate Parent Master Indenture: Only the corporate parent is a party to the Master Indenture and issues Master Obligations; however, the corporate parent can designate certain affiliates (originally referred to as "Restricted Affiliates") that will be obligated to upstream moneys to the corporate parent to pay Master Obligations.
  - "Hybrid" Corporate Parent Master Indenture: Creates an Obligated Group like traditional Master Indentures, but also permits members of the Obligated Group to designate Restricted Affiliates like "Pure" Corporate Parent Master Indentures.
- Under Corporate Parent Master Indentures, Master Obligations were initially, and in some cases are still today, general unsecured obligations of the corporate parent or the members of the Obligated Group.
- Initially, the only two significant covenants in Corporate Parent Master Indentures were the rate covenant and the negative pledge. Covenants (or financial tests) limiting additional debt, transfers of assets, mergers and admission to or withdrawal from the credit group were eliminated. Over time, however, some or all of these covenants may have been added back.

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3. Overview of Bond Legal Documents

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Summary of Principal Bond Documents

- Bond Indenture: NCMCC issues the bonds pursuant to a "Trust Agreement."
- Loan Agreement: NCMCC lends the proceeds from the sale of the bonds to the Borrower pursuant to a Loan Agreement. The Borrower promises to make loan payments equal to the principal and interest due on the bonds.
- Supplemental Master Indenture: The Borrower issues a Master Obligation pursuant to a Supplemental Master Indenture as further evidence of its obligations under the Loan Agreement to make payments equal to the principal and interest due on the bonds.
- Official Statement: The bonds are offered and sold pursuant to an offering document which is usually referred to as an "Official Statement."
- Appendix A: The disclosure about the Borrower is typically set forth in Appendix A to the Official Statement.
- Bond Purchase Agreement: The Underwriter agrees to purchase the bonds on the terms and conditions set forth in the underwriting agreement, which is usually called a "Bond Purchase Agreement."
- Continuing Disclosure Undertaking: The Borrower agrees to file certain financial information and operating data annually and notice of certain material events with the Municipal Securities Rulemaking Board (the "MSRB") for posting on its Electronic Municipal Market Access ("EMMA") website.

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Bond Indenture/Trust Agreement

- The parties to the Bond Indenture/Trust Agreement are the NCMCC and a corporate trustee (referred to as the "Bond Trustee").
- Bond Counsel is responsible for drafting the Bond Indenture/Trust Agreement.
- The NCMCC issues the bonds pursuant to the Bond Indenture/Trust Agreement.
- The Bond Indenture/Trust Agreement sets forth all the terms of the bonds, including final maturity, required principal amortization (i.e., mandatory sinking fund redemption), optional and extraordinary redemption provisions, interest rates and interest payment dates.
- Because the bonds will be limited obligations of the NCMCC payable solely from certain revenues, the NCMCC pledges certain revenues (i.e., the loan repayments that the Borrower will make pursuant to the Loan Agreement and the related Master Obligation) to the Bond Trustee as the source of payment and security for the bonds.
- Other key terms and provisions of the Bond Indenture/Trust Agreement:
  - Definitions
  - Establishment of and disbursements from the Construction Fund
  - Establishment of other funds and accounts (e.g., Bond Fund, Debt Service Reserve Fund)
  - Investments of amounts on deposit in funds and accounts
  - Covenants of the NCMCC
  - Events of Default and Remedies

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Loan Agreement

- The parties to the Loan Agreement are the NCMCC and the Borrower.
- Bond Counsel is responsible for drafting the Loan Agreement.
- The NCMCC lends the proceeds from the sale of the bonds to the Borrower, and the Borrower agrees to make loan repayments at the times and in the amounts that principal, premium, if any, and interest on the bonds are due, pursuant to the Loan Agreement.
- Other key terms and provisions of the Loan Agreement include:
  - Definitions
  - Representations and Warranties of the NCMCC and the Borrower
  - Loan Repayment Terms
  - Acquisition/Construction of the Project
  - Covenants of the Borrower, including NCMCC reporting requirements and Continuing Disclosure Undertaking
  - Events of Default and Remedies

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Official Statement

The Official Statement consists of a front part principally drafted by Underwriter's Counsel and several appendices, which include disclosure about the Borrower (usually Appendix A), the Borrower's audited financial statements, a summary of the Master Indenture, Trust Agreement and Loan Agreement prepared by Bond Counsel and the form of Bond Counsel's approving opinion.

The front part of the Official Statement includes:

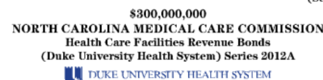
- Description of the terms of the bonds
- Description of the security and sources of payment for the bonds
- Bondholder's risks
- Plan of finance or refunding
- Summary of continuing disclosure obligations
- Tax treatment of the bonds
- Ratings

In NCMCC publicly offered bond issues rated lower than "A" (e.g., most CCRC financings), a feasibility study also is included as an appendix.

New Issue /DTC Book-Entry Only

Ratings: Moody's: Aa2
S&P: AA
Fitch: AA
(See "Ratings" herein)

$300,000,000
NORTH CAROLINA MEDICAL CARE COMMISSION
Health Care Facilities Revenue Bonds
(Duke University Health System) Series 2012A



Issuer:	We are a state agency incorporated into the Department of Health and Human Services of the State of North Carolina.
Borrower:	We will lend the proceeds of the 2012A Bonds to Duke University Health System, Inc., a North Carolina nonprofit corporation, which we refer to as "DUHS." DUHS operates a leading academic healthcare delivery system that includes Duke University Hospital, which draws patients from around the nation and the world. See Appendix A.
Use of Proceeds:	DUHS will use the proceeds of the 2012A Bonds to (1) finance the cost of additional health care facilities and (2) pay certain expenses of issuing the 2012A Bonds. See "Plan of Financing" on page 28.
Limited Obligation:	We will be obligated to pay principal of and interest on the 2012A Bonds only from the revenues and other funds we pledge for the payment thereof, including the payments under the Loan Agreement and Obligation No. 35 made or funded by DUHS, certain Designated Members and any future members of the Combined Group under the Master Indenture (as each such capitalized term is defined in this official statement). See "Security and Sources of Payment" on page 8.
Tax Exemption:	In the opinion of bond counsel, interest on the 2012A Bonds is (1) excludable from the gross income of the owners thereof for federal income tax purposes, (2) not an item of tax preference for purposes of the federal alternative minimum tax and (3) exempt from State of North Carolina income taxes. See "Tax Treatment" on page 34.
Dated:	Date of delivery.
Delivery Date:	On or about June 28, 2012.
Denominations:	$5,000 or any multiple thereof.
Interest Payment Dates:	June 1 and December 1 of each year, commencing December 1, 2012.
Due:	June 1, as shown on the inside cover page.
Redemption:	The 2012A Bonds are subject to optional, mandatory and extraordinary redemption prior to maturity. See "Description of the 2012A Bonds—Redemption" on page 25.
Bond Counsel:	Robinson, Bradshaw & Hinson, P.A., Charlotte, North Carolina.
Underwriters' Counsel:	Parker Poe Adams & Bernstein LLP, Raleigh, North Carolina.
DUHS's Counsel:	Christy M. Gudaitis, Associate University Counsel, Durham, North Carolina and Sutherland Asbill & Brennan LLP, Atlanta, Georgia.
Limited Information:	Only selected information is presented on this cover. You should read this official statement in its entirety to make an informed decision regarding the 2012A Bonds.

J.P. Morgan

BofA Merrill Lynch **SunTrust Robinson Humphrey** **TD Securities (USA) LLC**

June 14, 2012

Appendix A

- Appendix A contains detailed disclosure about the Borrower.
- The principal drafters of Appendix A are the Borrower, Borrower's Counsel and Underwriter's Counsel.
- The antifraud provisions of the federal securities laws, particularly Rule 10b-5, apply to all of the Official Statement, including Appendix A.
  - Rule 10b-5 imposes liability for material misstatements or omissions.
- In determining whether stub period financial information should be included in Appendix A or is stale, a 135-day rule is applied by analogy from corporate securities offerings.
- The financial statement and operating statistic disclosure in Appendix A is accompanied by MD&A, which explains financial and operating results to investors.

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Bond Purchase Agreement

- The parties to the Bond Purchase Agreement are the Underwriter, the LGC, the NCMCC and the Borrower. Underwriter's Counsel is responsible for drafting the Bond Purchase Agreement.
- The Underwriter agrees to purchase the bonds on the terms and conditions set forth in the Bond Purchase Agreement.
- The Bond Purchase Agreement sets forth the Underwriter's "outs", i.e., certain events which, if they occur before closing, will give the Underwriter the right not to purchase the bonds.
- The Borrower will be required to indemnify the NCMCC, the LGC and the Underwriter for liability resulting from a material misstatement or omission in the Official Statement.
- The Bond Purchase Agreement is signed and released immediately after the final approval of the bonds by the NCMCC Executive Committee:
  - For fixed rate bonds, this almost always occurs on the day after pricing (which is usually 2-3 weeks before closing). This timing is very important to the Underwriter, who needs to write the "tickets" filling the orders placed by investors as soon as possible after pricing.
  - For variable rate bonds, this occurs the day of pricing (which is the day before closing) or earlier.

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Continuing Disclosure Undertaking

- The Continuing Disclosure Undertaking, which may be a separate agreement or a covenant included in another agreement (e.g., the Loan Agreement), is an obligation of the Borrower. In NCMCC bond financings, the Continuing Disclosure Undertaking is a covenant in the Loan Agreement.
- The Borrower must agree to provide continuing disclosure in order to enable the Underwriter to comply with Rule 15c2-12 under the Securities Exchange Act of 1934.
- The Borrower must agree to file its audited annual financial statements and updates of operating data in Appendix A annually.
- The Borrower also must agree to file notices of the occurrence of the fourteen material events specified in Rule 15c2-12.
- In NCMCC publicly offered deals, in response to expectations of institutional investors, Borrowers also agree to disclose additional information, such as quarterly financial and operating data, to the secondary market by filing such information on EMMA.

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Variable Rate Bonds/Multi-Modal Indentures

- Variable rate bonds are traditionally issued pursuant to “multi-modal indentures” that provide the Borrower with the option to choose from a number of interest rate options (“modes”) over time.
- Variable rate demand bonds (“VRDBs”) were introduced in response to the record high interest rates in the early 1980s. Traditional VRDBs are issued in two principal modes: Weekly and Daily. The interest rate is reset on traditional VRDBs weekly or daily by underwriters/remarketing agents at the lowest rate necessary to cause the bonds to trade at par. The target interest rate for VRDBs is the SIFMA Municipal Swap Index (the “SIFMA Index”). Because the holders of Weekly and Daily VRDBs have the option to tender their bonds at par plus accrued interest on a weekly or daily basis, liquidity support for VRDBs must be provided by a bank (“third-party liquidity”) or by the Borrower (“self-liquidity”).
- In 2008, a new self-liquidity VRDB product for highly rated Borrowers known as “Window VRDBs” was developed, with a much longer tender period. Because the Borrower is not obligated to purchase Window VRDBs tendered by holders for 7-13 months, the self-liquidity requirements are less stringent than those for traditional Weekly or Daily VRDBs.
- Since the fall of 2009, all but one of the NCMCC variable rate bond issues have been bank direct purchases. Bank direct purchase modes are medium-term or long-term modes during which the bonds bear interest at a variable (or fixed) rate, subject to additional covenants and events of default required by the bank holder. These additional covenants and events of default are essentially the same as the ones the bank would have required to provide liquidity support for VRDBs.

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Questions?

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