I. PURPOSE

The Health Care Facilities Finance Act (the “Act”) was passed by the General Assembly in order to provide an alternative means of financing health care facility construction and modernization. The Act authorizes the North Carolina Medical Care Commission (the “Commission”), upon application by a public or nonprofit agency, to issue tax-exempt revenue bonds and notes and lend the proceeds to the applicant. Bonds are sold through the North Carolina Local Government Commission (the “LGC”) and are retired from loan payments made by the applicant.

II. ELIGIBLE APPLICANTS

Those eligible to apply for financing under the Act include any financially responsible, nonprofit corporation or public agency legally empowered or authorized to acquire, operate, and maintain health care facilities as defined in the Act. Projects eligible for participation in the program include those involved in financing, refinancing, constructing, equipping and otherwise providing health care facilities in the State. In order to establish the eligibility of a project for financing or refinancing, the applicant must demonstrate that:

A. The project is a health care facility within the meaning of the Act;

B. There is a need for the project or the health care facilities of which the project is to be a part in the area in which the health care facilities are located or to be located;

C. The bonds and/or notes to be issued to finance the project are financially feasible and adequate provision has been made for the operation, repair and maintenance of the project and the health care facilities of which it is a part during the period that the bonds and/or notes are outstanding;

D. All public facilities, including utilities, and public services necessary for the health care facilities are or will be made available; and

E. The project and the health care facilities of which it is part will be operated to serve and benefit the general public and there will be no discrimination against any person based on race, creed, color, or national origin.
III. PRELIMINARY APPROVAL

A. Conference

Before undertaking the financing of a project under the Act, the applicant must confer with representatives of the Commission and the Division of Facility Services (“DFS”).

1. Attendees at this conference should include the following:

   a. the Chairman of the Commission or his or her designee, the Secretary or an Assistant Secretary of the Commission, the Chief of the Construction Section of DFS, the Financial Advisor to the Commission, and any other party the Secretary may wish to include;

   b. the Chief Executive Officer and/or Chief Financial Officer of the applicant; it is also recommended that a member of the governing body of the applicant attend the conference;

   c. if requested by the Secretary, the applicant’s legal counsel; and

   d. other participants in the development or financing of the project which the applicant may wish to have present.

2. The purposes of the conference will be to discuss:

   a. the nature and scope of the proposed project, including its estimated cost and the degree to which it will require construction, renovation, and the purchase of equipment;

   b. the preliminary plan of finance, including whether the proposed financing will be a public offering or a private placement and whether the security for such financing will consist of revenues only, revenues plus credit enhancement (usually in the form of bond insurance or a bank letter of credit), or revenues plus a deed of trust on the project and/or health care facilities (typically utilized only in financings undertaken for nursing homes and continuing care retirement communities); and

   c. the preliminary plan of construction, including the proposed management of the construction project.
B. Selection of other participants

1. Architect or Design Engineer

The applicant will need to employ an architect or design engineer to design the project if construction or renovation activities are to be undertaken. The architect or design engineer, as the case may be, should be experienced in designing the type of project contemplated, and the applicant is strongly encouraged to check carefully the architect’s or design engineer’s credentials, examples of its work and its references. In developing a contract, the applicant may use the DFS form, Agreement Between Owner and Architect, or Engineer or the Standard AIA form, Standard Form of Agreement Between Owner and Architect, or any modification of either thereof. Whatever form of contract is used should be carefully reviewed by counsel to the applicant. A copy of the executed agreement must be filed with DFS.

2. Feasibility Consultant

Unless waived by the Executive Committee of the Commission, the need for a feasibility study will be governed by the Commission’s existing policy, as determined pursuant to resolution adopted by the Commission on June 12, 1992 and attached hereto as Exhibit A. In addition, if the LGC, the investor with whom the bonds are to be privately placed, or the insurer or letter or credit provider requires a feasibility study, a consultant must be selected to develop the study. The applicant shall select a feasibility consultant from among nationally recognized management consulting firms and must consult with the Commission’s staff before a final selection is made.

3. Investment Bankers

If the financing involves the public offering of bonds of the Commission, the applicant shall select one or more investment banking firms to manage the development of the financing and market the bonds. The selection of an investment banking firm is a critically important step in the financing process and should be made only after careful study and reflection by the governing body and senior management of the applicant. Among the matters as to which the applicant should be satisfied prior to making a selection are the following: (i) the firm’s ability to assist the applicant in structuring the financing, i.e., the balance, if any, between fixed and variable rate indebtedness, flexibility in prepayment terms and business and financial covenants; credit enhanced or stand alone, etc.; (ii) its ability to produce sophisticated financial analyses and come up with creative solutions to problems; (iii) its ability to listen to the concerns of, and communicate with, the governing body and senior management of the applicant; (iv) its experience in health care financing, both nationally and in North Carolina; (v) its ability to assist the applicant in making presentations to rating agencies, credit enhancers and institutional investors; (vi) its ability to price competitively, and market success-fully, bonds to individual and institutional investors in North
Carolina, in the region and nationally; and (vii) the competitiveness of its proposed fee arrangement.

In those cases where the applicant is entering the tax-exempt bond market for the first time, the Commission strongly recommends that the applicant solicit proposals to act as senior manager for the financing from at least three reputable investment banking firms; the applicant may, of course, solicit proposals from as many firms as it wishes.

An applicant that has an established relationship with an investment banking firm from a prior financing is free to use that firm on all future financings. An applicant which desires to change investment banking firms from one issue to the next may select any reputable firm or firms it desires.

Any selection of investment bankers pursuant to this section is subject to the approval of the Commission.

4. Private Placement Investors

If the project is to be financed by the private placement of bonds, the Commission recommends that the selection of private placement investors be based on the solicitation of proposals from at least three institutional or other sophisticated investors. The applicant, subject to the approval of the Commission, may select the proposal that, in its judgment, is most responsive to its financing goals. Interest cost should be a significant factor, though other factors, such as length of maturity, prepayment provisions, required security, and covenant flexibility, are also important and may form a basis for the selection.

5. Bond Insurer, Letter of Credit Provider or Liquidity Facility Provider

As in the case of private placement investors, the Commission recommends that any selection of a bond insurer, letter of credit provider or liquidity facility provider be based upon a request by or on behalf of the applicant for competitive proposals from at least three such insurers or providers. Cost is but one of the factors that should be taken into account in evaluating the proposals.

6. Bond Counsel and Other Counsel

The selection of bond counsel by the applicant is also extremely important. The firm chosen as bond counsel is responsible for the preparation of the legal documents for the financing and the rendering of the opinions concerning the validity of the bonds and legal documents and the tax-exempt status of the interest on the bonds. In light of these responsibilities, the Commission strongly recommends that the firm chosen have extensive experience in tax-exempt financings for health care facilities, the issuance of both fixed and variable rate tax-exempt debt, and the use of creative structures in tax-exempt financings, including those involving derivative products, in order to achieve
interest cost savings. In an era of growing vigilance by the Internal Revenue Service and the Securities and Exchange Commission with respect to tax-exempt financings, particularly those undertaken for health care facilities, the firm chosen should be recognized for its competence in tax and securities law relating to tax-exempt financing.

In those cases where the applicant is entering the tax-exempt bond market for the first time, the Commission strongly recommends that the applicant solicit proposals to act as bond counsel for the financing from at least three firms meeting the criteria set forth above; the applicant may, of course, solicit proposals from as many firms as it wishes.

An applicant that has an established relationship with a law firm from a prior financing is free to use that firm on all future financings. An applicant which desires to change law firms from one issue to the next may select any reputable firm or firms it desires.

Any selection of bond counsel pursuant to this section is subject to the approval of the Commission.

The applicant, the investment banker and any other party to the financing are responsible for the employment of their respective counsel.

C. Application

A formal application for the financing of a project should be submitted by the applicant to the Secretary of the Commission at least thirty (30) days prior to a regularly scheduled meeting of the Commission. The appropriate application will be provided to the applicant at the time of the conference, and it must be completed and submitted with the following additional information:

1. A complete narrative description of the project, including its purpose, scope, etc.

2. If the project involves construction and/or renovation, the basis pursuant to which such construction or renovation will take place (e.g. competitive bidding, negotiated construction contract, or design-build arrangement). See Section IV herein.

3. Cost estimates and estimated construction schedule for the project, including cost estimates and estimated dates of installation for all items of movable equipment costing in excess of $100,000.

4. Schematic plans, including architectural floor plans, a site plan, outline specifications, and a subsoil investigation report.

5. A preliminary feasibility study prepared by a management consultant selected by the applicant after consultation with the staff of the
Commission or an internally-generated financial projection for the first three (3) fiscal years following project completion, and audited financial reports for the three (3) most recent fiscal years for which audited financial statements are available.

D. Commission Action

Following a review of the application and accompanying information, the Commission’s staff will make a recommendation to the Commission regarding preliminary approval of the financing of the project. The Commission may approve the financing of the project subject to compliance with certain contingencies or deny the application.

IV. PROJECT DEVELOPMENT AND CONSTRUCTION

A. Project Cost and Timing

The determination of the cost of a project and its schedule for commencement and completion are essential elements in sizing the proposed bond issue. Rating agencies, feasibility consultants, bond insurers, investors, the LGC and the Commission require reasonable assurance that the bond issue, together with other funds available or to be made available during the construction period, is sufficient to complete the project. While some projects can be financed solely on the basis of cost estimates, those financings generally require larger construction contingencies and, in many cases, the health care institution must maintain substantial liquid reserves to provide for cost overruns. The cost of the project must, of course, be within applicable certificate of need limitations.

B. Construction Approach - Alternatives

In arriving at a project cost, the applicant may follow any of several different approaches or variations thereon. It is essential that the applicant analyze the pros and cons of the various approaches to construction and, after careful consideration and consultation with its advisors, choose the approach that it believes will best serve its interests. The decision will drive the expenditure of significant funds, the timetable for planning and completion of the project and the timing of the financing and should be made only after careful reflection. While the decision is the applicant’s to make, the staffs of the Commission and the Construction Section of DFS are available to consult with and advise the applicant. The goals of the Commission relative to the construction process remain what they have been from the program’s inception: (i) the construction of modern and efficient health care facilities; (ii) the improvement of health care and services to the fullest extent practicable; (iii) the assurance of the highest quality construction at competitive costs; and (iv) the protection of the Commission’s bondholders.

Among the construction options available to an applicant are the following:
1. Competitive Bidding - This approach involves the receipt of competitive bids, based on final working drawings, from owner-qualified contractors and the selection of the low bidder. It may be accomplished in several ways: (a) through a single prime contractor, i.e., a single general contractor bids a project that includes all subcontracted work; (b) through a managing contractor - usually a two-step process whereby a managing contractor submits a competitive bid to manage the project based on a defined budget and project scope and then obtains competitive bids for all subcontract work, the total of the managing contractor’s bid price and the subcontract bid prices being combined to arrive at the total cost of construction; or (c) through multi-prime contractors where separate bids are taken for the following categories of the work to be performed: (i) heating, ventilating and air-conditioning; (ii) plumbing; (iii) electrical; and (iv) general trades work, and each prime contractor enters into an agreement with the applicant to perform the work.

The process of competitive bidding tends to result in the lowest project cost since the bids are based on final working drawings and plan and specifications (which minimizes the likelihood of later surprises and change orders) and the process encourages competition. Under this system construction contingencies have usually been limited to 1%. A countervailing factor is that the preparation of final working drawings and the completion of the bidding process extend the time line for completing the financing and commencing the construction of the project. During a protracted period of deterioration in the tax-exempt bond market this could result in increased interest costs to the applicant which might equal or exceed the savings realized on project costs.

2. Negotiated Contract

In a negotiated contract the applicant would select an experienced contractor or construction manager to construct the project, and the cost of the project would be negotiated rather than competitively bid. Often the contractor will agree to a guaranteed maximum price (“GMP”) for the project. This is somewhat of a misnomer since “changes in the work” will increase the GMP. Under this approach considerable time may be saved as compared to the competitive bidding process, and time may possibly be saved in the construction process. On the negative side of the ledger, costs may be higher than in a competitively bid project because of (a) the absence of competition and (b) the fact that the contractor is pricing based on preliminary drawings and will build a protective factor into its GMP. A larger construction contingency (10% is not uncommon) may also be required. The more final the drawings, the more valid the GMP is likely to be. In addition, the potential for favoritism exists in any arrangement of this type, and the absence of competition could adversely affect performance and quality of the work.

3. Design-Build
While there may be variations, the design-build approach generally follows a three-step process: (a) applicant selects architect/engineer to perform project programming, including project size, budget, function, features and operational needs (up to approximately 35% of the project’s design), and solicitation is issued for design-build team to provide final design and construction services; (b) design-build team, consisting of engineers, architects, cost estimators, specialty engineers, construction manager, and contractors, is selected based on qualifications and price and is responsible for engineering, design and construction of the project; and (c) design is completed and constructed by design-build team (from 35% design level to final construction).

The theory of the design-build approach is that the applicant gains a single source of responsibility for, and a guarantee of overall cost of, the project. Under this approach the applicant has an active role in the process; the design and construction schedules are critical. Parallel, rather than sequential, tasking in the design and construction schedules are the norm, and there is a promise of guaranteed price and schedule. Weighed against the foregoing are the opportunities for favoritism and the absence of competition that could increase costs, a “fast track” process that may militate against proper weighing of design options and functional planning, the possible absence of clearly defined roles for all team members, and the necessity that management of the applicant be more knowledgeable about the construction process.

As can be seen from the foregoing, there are pluses and minuses to each of the foregoing approaches. Each, however, is permissible under the Act. The applicant should weigh each of the options carefully and select the one that best meets its needs. In negotiating any contract, the applicant should be represented by counsel with experience and expertise in construction law and contracts. The staffs of the Commission and the Construction Section of DFS are available to consult with the applicant concerning these matters.

C. Execution of Construction Contracts

Contracts may be executed by the applicant prior to the sale of bonds. However, the applicant should be aware that it assumes all risk of the financing not being completed and may have substantial financial exposure.

An executed copy of the construction contract must be filed with DFS.

D. Equipment

As soon as possible after the execution of construction contracts, the applicant should compile and submit to the Secretary of the Commission a list of equipment to constitute a part of the project. This list may be amended by the applicant from time to time. The list should be broken down into (i) fixed equipment to be purchased outside the construction contract and (ii) movable equipment, i.e. depreciable equipment not normally purchased through construction contracts,
and must include the estimated cost of the equipment by type. Equipment may be purchased by competitive bid or negotiation.
E. Construction Activities

The Commission has established the following procedures intended to aid the applicant in supervising its project. The Commission will, through the staff of the Construction Section of DFS, offer engineering and architectural assistance to the applicant if requested.

1. Prior to the beginning of construction, the applicant must arrange a conference to be attended by the designers, prime contractors, and the staff of the Construction Section of DFS.

2. The applicant must deliver to the staff of the Construction Section of DFS a monthly report in writing setting forth the status of the project, including, but not limited to, whether it is on schedule and within budget, any major change orders and the cost and source of funds to pay the same, and the status of any current disputes with contractors or subcontractors.

3. If requested by the Construction Section of the DFS, meetings will be held from time to time and attended by the architect and prime contractors and by the applicant and staff of the Construction Section of DFS when necessary to coordinate orderly job completion.

4. Construction work must be accessible during normal business hours to staff of the Construction Section of DFS who may make periodic inspections to insure compliance with contracts, regulations, codes, and licensure requirements.

5. Each contractor must develop, maintain and promote a safety program for all employees in accordance with N.C. Department of Labor standards.

6. The architect or design engineer will submit to the applicant the following documents to substantiate final payment to the contractors:

   a. a certificate of release on an approved form from each prime contractor that saves harmless the applicant from any liens or claim arising from his contract; and
   
   b. guaranties, test reports, maintenance data, etc. from each prime contractor as required by the contract documents.

V. PREPARATION OF BOND DOCUMENTS

A working group consisting of the Commission’s staff; LGC staff; Bond Counsel; staff of the applicant; the applicant’s counsel; investment bankers and their counsel or representatives of a private placement investor; representatives of insurers, letter of credit providers or liquidity facilities, if any; the feasibility consultant, if any; and such other
parties as may be appropriate to a successful financing will be formed to prepare and review bond documents and structure the plan of finance. A representative list of the documents to be developed is as follows:

A. Loan Agreement
B. Trust Agreement
C. Master Trust Indenture
D. Feasibility Study (where required)
E. Deed of Trust (typically utilized only in financings for nursing homes and continuing care retirement communities)
F. Official Statement

VI. SALE OF BONDS

A. The Commission will request the sale of bonds by the LGC only after all of the required bond documents are in substantially final form.
B. Final terms of the sale will be negotiated with the investment bankers or private placement investor through the LGC by the Commission staff and the applicant.
C. Prior to the award of the bonds, the terms of the sale must be approved by the Commission or its Executive Committee, by the LGC or its Executive Committee, and by the governing board of the applicant or its designee.

VII. FINANCIAL AND STATISTICAL REPORTING

A. The applicant will provide quarterly unaudited financial statements, together with relevant operating statistics, to the Commission and to other agreed upon parties. No later than 120 days after the end of the fiscal year (or such other time as is prescribed by the bond documents), the applicant will furnish to the Commission a copy of its annual audit prepared by an independent certified public accountant or a firm of independent certified public accountants. Other reports and verifications may be required depending upon the nature of the transaction.

VIII. ANNUAL REPORT

An annual report on the Commission’s activities will be prepared in accordance with the requirements of N.C.G.S. §131A-19.
Extract from minutes of September 10, 1999 Medical Care Commission meeting related to Guidelines for Feasibility Studies

**REPORT:** Commission Guidelines on Feasibility of Finance Projects as Proposed by the Ad Hoc Current Guidelines – Joseph D. Crocker

**RECOMMENDED:** The Commission rescind its Guidelines for the Requirement for a Financial Feasibility Study dated June 12, 1992 and adopt the following. The requirements for financial feasibility are deemed to have been met if:

1) The bonds are insured by a bond insurer with ratings in the AAA, AA, or A categories of Standard and Poor’s, Fitch ICBA, or Moody’s and no ratings below the A category from any of the above named agencies.

2) The bonds are supported by a letter of credit from a bank with long term ratings in the AAA, AA, or A categories of Standard and Poor’s, Fitch ICBA, or Moody’s, and no ratings below the A category from any of the above named agencies.

3) The bonds are guaranteed by an entity with long term ratings in the AAA, AA, or A categories of Standard and Poor’s, Fitch ICBA, or Moody’s and no ratings below the A category from any of the above named agencies.

4) The borrower has a rating which takes into account the issuance of the new debt from at least one of the rating agencies mentioned above that is in the AAA, AA, or A categories of Standard and Poor’s, Fitch ICBA, or Moody’s, and no ratings below the A category from any of the above named agencies.

5) A financial feasibility study conducted by a recognized management consulting firm acceptable to the Commission, which projects the borrower as being able to meet its obligations to the satisfaction of the Commission.

6) The borrower requests and receives from the Commission a waiver from the requirement of obtaining a feasibility study and provides the Commission with an “Agreed Upon Procedures” forecast demonstrating its ability to meet its obligations to the satisfaction of the Commission.

**HOWEVER:** The Commission reserves the right to require the delivery of a financial feasibility study if in its discretion it concludes that such a study is warranted, irrespective of the exceptions cited in items one through four above.

**COMMISSION ACTION:** Motion made by David Jones, seconded by Dr. Unger and unanimously approved as amended.
I. Policy on Selection of Bond Counsel – Lucy Bode

Resolved: Whereas it is the desire of the North Carolina Medical Care Commission to encourage the use of North Carolina licensed attorneys in the issuance of bonds under the Health Care Facilities Finance Act, G.S. 131A, it hereby adopts the following policy as to the selection of bond counsel. The Commission encourages the selection by the prospective borrower of firms domiciled within the State of North Carolina to serve as bond counsel on Commission bond issues. A prospective borrower wishing to use an out of state firm as bond counsel shall provide a written justification to the Commission of the borrower’s reasons for choosing an out of state firm. Borrowers are to select a firm from the list of firms set forth in the North Carolina section of the “Red Book.” All bond counsel will be required to provide the Commission an engagement letter satisfactory in form and substance to the Commission. All bond counsel selections remain subject to the approval of the Commission.

NOTE: Set forth below is the list of municipal bond attorneys contained in the North Carolina Section of the Fall 2003 issue of the “Red Book.”

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<td>Charlotte, Raleigh &amp; Winston-Salem</td>
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Commission Action: Motion made by Mr. David Jones, seconded by Mr. Lockamy and approved by a vote of eleven to one. At the February 2005 meeting, staff is to report a list of who has served as bond counsel during the previous year.
Resolution Regarding Use of SWAPs in connection with Medical Care Commission Debt Issues

Resolved:

Whereas Healthcare Facilities are continually trying to manage and reduce expenses in order to provide services to the populations they serve at reasonable costs; and

Whereas a SWAP which is a contract between two parties to exchange interest rate payments based on specific negotiated terms and is a type of financial instrument that may be used to reduce the cost of debt; and

Whereas a number of healthcare facilities have utilized SWAPS in connection with Medical Care Commission debt issues; and

Whereas it is anticipated that the use of SWAPS will increase; and

Whereas SWAPS inherently carry a certain amount of risk.

The Medical Care Commission does hereby adopt the following policy for the use of SWAPS in connection with debt issues done through the Medical Care Commission.

In situations where a healthcare entity proposes to enter into a SWAP in order to manage debt service on a Medical Care Commission debt issue, the healthcare entity will provide to the Medical Care Commission, prior to entering into the SWAP, evidence that it has employed an independent firm experienced in the structuring and pricing of SWAPs to advise it during the process of implementing the SWAP. The SWAP advisor will provide the Medical Care Commission a certification that it has informed both the management and the governing board of the entity as to the structure, benefits and risks associated with SWAPs prior to entering into the SWAP. The Medical Care Commission will also be furnished with a certificate signed by both the chairman of the governing board and the chief executive officer that they understand the structure, benefits and risks of SWAPS. In addition the SWAP advisor will provide to the Medical Care Commission and the healthcare entity a fairness opinion as to the terms and pricing of the SWAP.

This resolution is effective as of May 16, 2003.