JOINT HEARING ON PROPOSITION 3:
CHILDREN'S HOSPITAL BOND ACT OF 2008

Senate Health Committee
and
Assembly Health Committee

July 9, 2008
1:30 p.m. – 3:30 p.m.
State Capitol
Room 112

Background Paper

On November 4, 2008, the voters of California will consider Proposition 3, the Children's Hospital Bond Act, an initiative statute that has qualified for the statewide ballot. Proposition 3 would authorize the state to sell general obligation bonds to provide funding to eligible children's hospitals for capital improvement projects. This joint informational hearing has been scheduled pursuant to Elections Code Section 9034, which requires the appropriate policy committees of the Legislature to hold public hearings on each initiative measure that qualifies for the ballot.

This background paper summarizes the relevant existing law pertaining to children's hospitals, the major provisions of the proposed initiative, the Legislative Analyst's Office review of the initiative's fiscal effects, the proponent's arguments in support of the initiative, and related background information.

Existing law
Existing state law designates specific hospitals as children's hospitals for the purposes of payment of disproportionate share hospital funds and for participation in other health programs, including the child health and disability prevention program. Existing law names thirteen children's hospitals, including five University of California children's hospitals and eight private nonprofit hospitals, all of which would be eligible for funding under this initiative. The eight private, non-profit children's hospitals are located in Palo Alto, Oakland, Madera, Los Angeles, Long Beach, Loma Linda, Orange, and San Diego. The University of California children's hospitals are located at the University of California's five academic medical centers in San Francisco, Davis, Los Angeles, Irvine, and San Diego

Proposition 61, the Children's Hospital Bond Act of 2004, was an initiative statute which voters approved in the November 2004 statewide general election, and which authorized the sale of $750 million in general obligation bonds to provide funding for children's hospitals. The hospitals eligible to receive funds under Proposition 61 are the same 13 children's hospitals that would be eligible for funding under Proposition 3. Under the terms of Proposition 61, each of the 13 children's hospitals is entitled to its authorized share so long as it meets the requirements specified in the act and the California Health Facilities Financing Authority (CHFFA) deems the project to be feasible. Proposition 61 provides that, if a hospital does not spend its allocation by June 30, 2014, its remaining funds shall become available for other similarly situated children's hospitals, i.e., U.C. children's hospital funds must only be available to other U.C. children's hospitals and likewise for private children's hospitals.

Proposition 3 – Children's Hospital Bond Act of 2008

Proposition 3, on the November ballot, would authorize the state to sell $980 million in general obligation bonds for capital improvement projects. The funds raised from the sale of the bonds could only be used for eligible projects, which are defined by the initiative to include constructing, expanding, remodeling, renovating, furnishing, equipping, financing, or refinancing children's hospitals.

The initiative would require 20 percent of the bond proceeds to be awarded to the five University of California children's hospitals, all of which are designated in the initiative, which in essence, makes each of these hospitals eligible for $39.2 million.

The initiative would also require 80 percent of the bond proceeds to be awarded to nonprofit hospitals that meet specific eligibility criteria. These criteria include that between June 30, 2001, and June 29, 2002, as reported to the Office of Statewide Health Planning and Development (OSHPD) before July 1, 2003, the hospital provided the following services:

- at least 160 licensed beds for infants and children.
- over 30,000 total pediatric patient days, excluding nursery acute days.
- medical education to at least eight full time pediatric or pediatric subspecialty residents.

According to the initiative sponsors, the following children's hospitals meet these criteria:

- Rady Children's Hospital, San Diego (formerly Children's Hospital and Health Center, San Diego)
- Children's Hospital Los Angeles
- Children's Hospital and Research Center at Oakland
- Children's Hospital of Orange County
- Loma Linda University Children's Hospital
- Lucile Salter Packard Children's Hospital at Stanford
- Miller's Children's Hospital, Long Beach
- Children's Hospital Central California

Given the initiative provisions, each of these hospitals would be eligible for $98 million.

Proposition 3 would authorize children's hospitals to apply for grants and require the California Health Facilities Financing Authority (CHFFA), within the Treasurer's Office, to develop, process, and award the grants within 60 days. The initiative would direct CHFFA, in awarding grants, to consider whether the proposal addresses the following factors:

- Expansion or improvement of health care access by children eligible for governmental health insurance programs, and indigent, underserved, and uninsured children;

- Improvement of child health care or pediatric patient outcomes;
- Provision of uncompensated or undercompensated care to indigent or public pediatric patients;
- Provision of services to vulnerable pediatric populations;
- Promotion of pediatric teaching or research programs; and,
- Demonstration of project readiness and project feasibility.

Proposition 3 would limit the amount of grants that may be awarded to each children's hospital and would require that funded grants be completed within a reasonable period of time. The initiative would require that a certification of project completion must be submitted to CHFFA. The initiative would also require that each hospital must exhaust its allocation of funds by June 30, 2018, or its unused funds would become available for other children's hospitals within its category (UC or private). The initiative would allow CHFFA to take specific remedial actions, including requesting the return of all or a portion of a grant, if it determines that a children's hospital failed to complete a project, as specified

The initiative would limit administrative expenditures by CHFFA to actual costs or one percent of the total bond, whichever is less.

The initiative does not provide a means for being amended, and, therefore, it could not be amended by the Legislature after it is enacted. Subsequent voter approval would be required for any amendment.

LAO Fiscal Analysis
According to the Legislative Analyst's Office (LAO), the cost to the state of the bonds issued under Proposition 3 would depend on the interest rates obtained when they were sold, and the time period over which the debt would be repaid. The LAO estimates that, if the $980 million in bonds authorized by this measure were sold at an interest rate of 5 percent and repaid over 30 years, the cost to the state General Fund would be about $2 billion to pay off both the principal ($980 million) and the interest ($1 billion). The actual annual payments for principal and interest may vary significantly year to year, depending on how the issuance is structured. However, the LAO estimates that average principal and interest payments would be about $64 million annually. The LAO also points out that the initiative would result in minor costs (limited to actual costs or one percent of the bond funds) to CHFFA, paid for with bond proceeds, for development of a written grant application, the processing of applications and the awarding of grants to eligible children's hospitals.

Background

There are currently thirteen children's hospitals in California, five of which are operated by the University of California as part of the UC medical centers. These 13 hospitals are named in existing statutes as children's hospitals and are the only institutions that would be subject to the provisions of Proposition 3.

According to CCHA, the proponents of the initiative, children's hospitals provide specialized care, and traditionally treat the most serious and life threatening diseases such as childhood leukemia, cancer, heart defects, sickle cell anemia, diabetes and cystic fibrosis. CCHA points out that, because it is the mission of these hospitals to treat very sick children, the "acuity," or measure of care requirements, of patients treated at these hospitals, is more than 25 percent higher than that of other hospitals that treat children.

Children's hospitals have a different mix of payors than other acute care hospitals in California. A much greater number of their patients are covered by Medi-Cal and a much smaller number are uninsured or medically indigent patients, for whom the county reimburses facilities for their care. The large proportion of Medi-Cal patients results in large uncompensated care costs for these hospitals, because Medi-Cal reimbursements are significantly less than the cost of providing the health care services.

Of the seven private children's hospitals for which data from OSHPD are available (data for the U.C. hospitals and Loma Linda University Children's Hospital are not available because these hospitals are part of a larger hospital campus and not separately licensed as children's hospitals); five of the children's hospitals receive a greater proportion of disproportionate share hospital payments, which are additional funds provided to certain hospitals that serve Medi-Cal or other low-income patients, than the statewide average. All seven hospitals receive a greater percentage of Medi-Cal revenue than the statewide average, and three of the hospitals had a negative operating margin at the end of fiscal year 2006-07.

Proposition 61 implementation

At the end of 2007, $234 million of Proposition 61 funds had been disbursed for 17 projects. These projects included the upgrade of MRI equipment and the purchase of replacement ultrasound machines, monitors, and ventilators, remodeled oncology clinics, and new construction. Several hospitals are using Proposition 61 funds as part of the funding for larger construction and expansion projects. For example, Children's Hospital Los Angeles and Mattel Children's Hospital at UCLA used Proposition 61 funds as part of their funding to build new hospital bed towers. Children's Hospital Central California expanded its neonatal intensive care unit, Children's Hospital of Orange County is expanding its ambulatory care capabilities, and Lucille Salter Packard Children's Hospital at Stanford is building a surgical suite and a cancer center.

According to CHFFA, several hospitals, including Loma Linda University Children's Hospital, Children's Hospital and Research Center Oakland, UC San Diego Children's Hospital, UC Irvine Children's Hospital, and UC San Francisco's Children Hospital have received none, or very little, of their allocations of Proposition 61 funds. There are indications that some of these hospitals may be planning to combine this allocation with their future bond allocation (if Proposition 3 passes) to build new hospitals. The projected estimated cost for each new hospital is in the hundreds of millions of dollars. The table below summarizes the CHFFA allocation of Proposition 61 funds for each eligible hospital as of December 31, 2007.

Summary of Proposition 61 Allocations and Disbursement by Eligible Hospital (as of December 31, 2007)*:

Children's Hospital	Authorized	Disbursed	Remaining
Children's Hospital and Research Center Oakland	$ 74,000,000	1,695,274	$72,304,726
Children's Hospital Central California	74,000,000	8,821,232	65,178,768
Children's Hospital Los Angeles	74,000,000	72,188,287	1,811,273
Children's Hospital Orange County	74,000,000	19,327,979	54,672,021
Loma Linda University Children's Hospital	74,000,000	0	74,000,000
Long Beach Memorial Medical Center [Miller Children's Hospital, Long Beach]	74,000,000	31,495,693	42,504,307
Lucile Salter Packard Children's Hospital at Stanford	74,000,000	51,375,519	22,624,481
Mattel Children's Hospital at the University of California Los Angeles (UCLA)	30,000,000	29,827,500	172,500
Rady Children's Hospital [formerly Children's Hospital and Health Center (San Diego)]	74,000,000	11,258,181	62,741,819
University of California, Davis Children's Hospital	30,000,000	8,245,823	21,754,177
University Children's Hospital at University of California, Irvine	30,000,000	0	30,000,000
University of California, San Diego Children's Hospital	30,000,000	0	30,000,000
University of California, San Francisco Children's Hospital	30,000,000	0	30,000,000
Totals	**$742,000,000**	**$234,235,488**	**$507,764,512**

Bond Financing

Bond financing is a type of long-term borrowing used by the state to raise money for various purposes. The state obtains this money by selling bonds to investors and, in exchange, agrees to repay this money, with interest, according to a specified schedule. The state constitution provides that general obligation debt can only be issued upon the vote of the people and it pledges the full faith and credit of the state to repay the debt before all obligations, except for K-14 education. The amount needed to pay principal and interest is continuously appropriated from the state's general fund.

The state currently has about $53 billion of infrastructure-related general fund bond debt outstanding on which it is making principal and interest payments. This total includes $45 billion of authorized general obligation bonds and $8 billion of lease-revenue bonds. When examining the total indebtedness of a state, entities that rate the state's credit take into consideration general obligation and lease-revenue bonds because both are paid from the state's general fund and the proceeds are used for state capital outlay. The LAO estimates that debt payments for infrastructure-related general obligation and lease-revenue bonds were about $5.2 billion for 2008-09, and payments are expected to rise to $5.7 billion in 2010-11, then slowly decline, based on the bonds currently authorized. The LAO notes that the debt service ratio has risen sharply since the early 1990s, but also acknowledges that states do not have an optimal or maximum debt service ratio.

Hospital Seismic Safety Act
This initiative allows eligible hospitals to use bond proceeds for capital projects which could include hospital seismic safety improvements. The Act establishes timelines for hospital compliance with seismic safety standards. By January 1, 2008, buildings posing a significant risk of collapse and a danger to the public must be rebuilt or retrofitted to be capable of withstanding an earthquake, or be removed from acute care service. By January 1, 2030, hospital buildings must be not only capable of remaining intact after an earthquake, but also capable of continued operation and provision of acute care medical services, or changed to non-acute care use. Existing law also allows OSHPD to grant delays of up to five years from the 2008 deadline, under certain circumstances, including upon a demonstration that compliance will result in a loss of health care capacity that may not be provided by other general acute care hospitals within a reasonable proximity, and allows OSHPD to extend the 2013 deadline further, to 2015 or 2020, when certain circumstances apply. Several children's hospital projects involve new construction or expansion of capacity and are part of a hospital's overall plans for meeting the state's seismic standards. For example, the Children's Hospital and Research Center Oakland is facing a 2013 deadline under the state's hospital seismic safety standards and plans to use its Proposition 3 and remaining Proposition 61 funds to build a new hospital that would meet those requirements

Related Legislation
AB 10 (De La Torre) of 2008 would have enacted the Children's Hospital Bond Act of 2008, which would have authorized the issuance of $980 million in general obligation bonds to fund capital expenditure projects for children's hospitals. *This bill was subsequently amended to a different subject.*

SB 953 (Dunn) of 2003 would have enacted the Children's Hospital Bond Act of 2004, which would have authorized a program to fund capital expenditure projects for children's hospitals through general obligation bonds (of an unspecified amount). *This bill was held in the Senate Appropriations Committee in 2003*.

Issues and comments

This is an informational hearing required by the Elections Code. The committees do not have the ability to amend the initiative, but may wish to consider the following issues as part of the hearing.

1. Impact on General Fund. This initiative would commit the state to annual payments of $64 million from the general fund for principal and interest, at a time when the state is facing significant projected shortfalls. Additionally, since over $500 million of Proposition 61 funding has not yet been dispersed, the committee may wish to consider whether this is an appropriate time to authorize an additional $980 million in general obligation bonds.

2. Is the issuance of general obligation debt for a grant program for children's hospitals a priority for issuing general obligation debt? The state has limited resources and bonding capacity. The committee may wish to explore whether other purposes may be denied funding or be forced to use alternative means of financing.

3. Other hospitals are struggling. The funding that would be provided by Proposition 3, as with Proposition 61, is limited to 13 hospitals. Other hospitals in the state are struggling to finance their own capital needs. Other hospitals in California treat children, some of them exclusively, but are not eligible for funding under the initiative.

4. Funding of equipment. The initiative does not limit bonds to costs of acquisition and development of real property, but also allows funds to be used for the purchase of equipment. The children's hospitals have spent some of their Proposition 61 funds for equipment. It is unclear as to the economic life of the equipment, but it may be shorter than the life of the issued bonds. Equipment depreciates and may become outdated or obsolete on a shorter timeline than the life of general obligation bonds.

Arguments in support

According to the California Children's Hospital Association (CCHA), the sponsor of Proposition 3, California's children's hospitals treat over 1.5 million children's injuries and illnesses each year without regard to a family's income or ability to pay. CCHA notes that these facilities handle 72 percent of all inpatient care for children who need heart surgery, more than 55 percent of care for children with cancer, and 60 percent of care for those who undergo organ transplants. CCHA also notes that more than 55 percent of inpatients are children with serious illnesses, who are eligible for the California Children Services program, which provides medical care and medical therapy for children with certain physical limitations and chronic health conditions or diseases. Children's hospitals provide graduate medical training for nearly 700 full-time residents, over 300 of whom are in pediatric subspecialties.

CCHA points out that Medi-Cal, California's Medicaid program, covers more than half of the children treated at children's hospitals. However, Medi-Cal reimbursements are often lower than the actual cost of care. CCHA also states that advances in technology and research are bringing hope to children and their families where there was none before. Medical technology improvements occur rapidly, especially with regard to the most serious childhood illnesses. CCHA contends that children's hospitals must have access to the latest technology in order to effectively treat seriously ill children. CCHA specifies that the bond money would be used to purchase new medical technologies and ensure access for seriously ill and injured children.

CCHA argues that most of the hospitals that are eligible for 2004 Proposition 61 bond funds have used all their available funds or have building and equipment needs that far exceed the funds available. By the end of 2008, it projects that 68 percent of the Proposition 61 funds are planned to have been awarded. They also point out that the hospitals which have used none of the 2004 funds have very large expansion and/or reconstruction projects that will depend on the combined funds from the 2004 and 2008 initiatives. They point to the example of Loma Linda University Children's Hospital, which has plans to build a new children's hospital and ambulatory care facility to meet the needs of the growing population in the inland empire. The estimated costs for hospital construction exceed $700 million. The hospital is at or near capacity on a daily basis, and the size of the current facility will not meet the needs of the children in its region.

CCHA argues that the need for these bond funds is not due primarily to the state's seismic requirements. They note that seismic requirements have placed upward pressure on construction costs, but argue that the primary pressure on the children's hospitals is creating sufficient capacity to meet the growth in the pediatric population, and the shortage of providers of specialized pediatric care.

CCHA states that it is impossible for them to make the capital investment necessary without supplemental public support.