LarsonAllen
Orange City Area Health System

From Vision to Reality:
Finding and Deploying Capital for New CAH Health Care Facilities

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NOTICEABLY DIFFERENT

Session Objectives

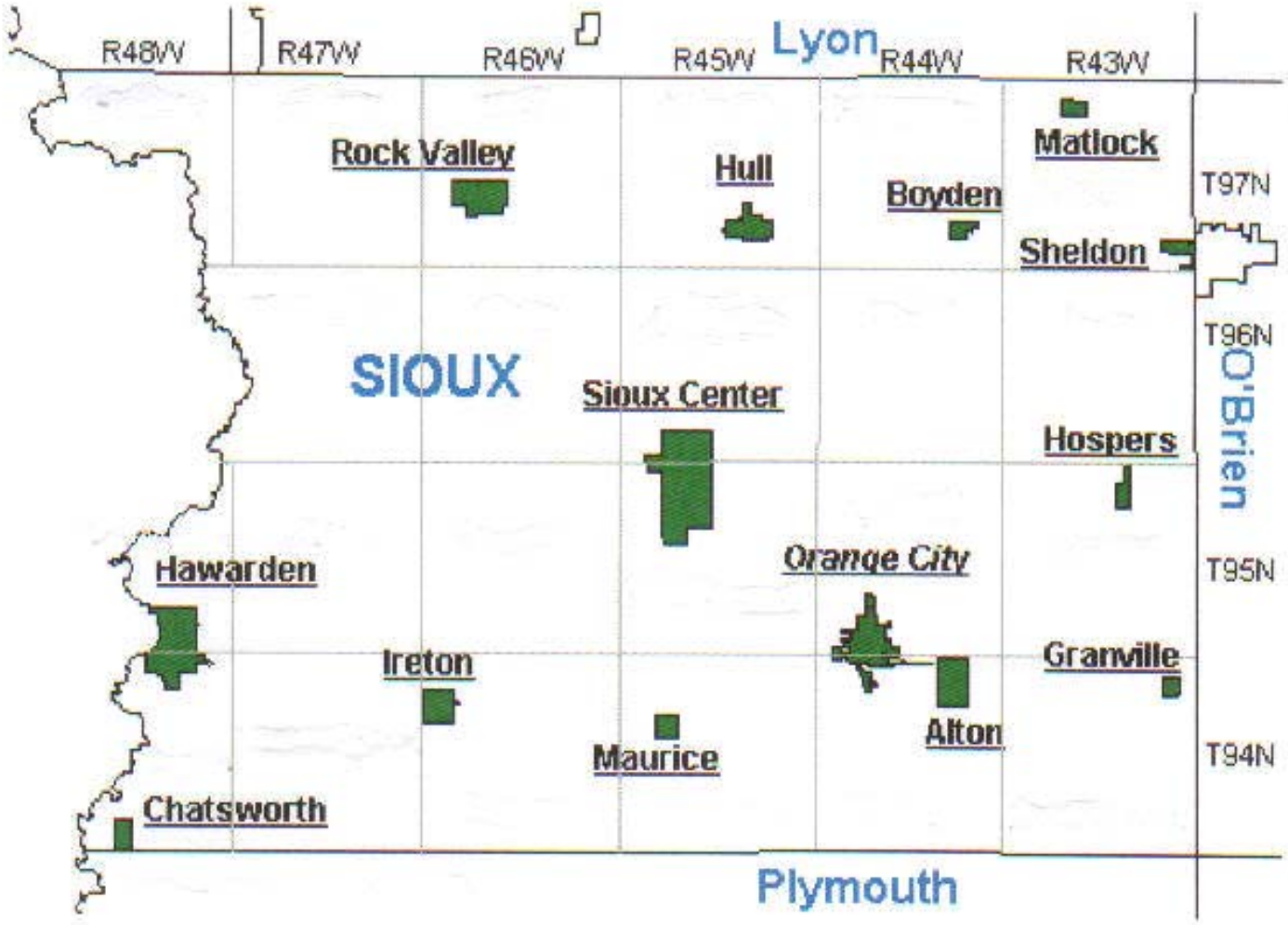
Using Orange City Area Health System's Experience, we will…

- Demonstrate how Financial Modeling can ensure access to resources via critical success factors
- Discuss preserving CAH status following relocation
- Provide an overview of potential financing options related to facility replacement

Case Study Scenario

- Orange City Area Health System
  Orange City, Iowa
- 1st Replacement CAH in State of Iowa
- Seven Year Journey Culminating in a 128,000 sf, $30M New Medical Campus

Sioux County, Iowa



Economic Impact of Health Sector

	Impact		
Hospitals	**Employment**	**Payroll (millions)**	**Retail (millions)**
Orange City	769	$22,282	$5.6
Sioux Center	670	13,620	3.4
Rock Valley	458	7,914	2.0
Hawarden	94	2,784	.7
Total Hospitals	1,991	46,600	11.7
Other Medical/Health	937	27,555	7.0
Totals	$2,928	$74,155	$18.7

Source: 2006 Iowa Hospital Association utilizing 2004 Data

OCAHS ... At a Glance

- 25 Bed CAH
- 50 & 33 Bed Nursing Homes
- 48 Unit Congregate Housing
- 3 Primary Care Clinics/Employed Physicians
- Home Health/Hospice
- 475 Employees
- Annual Budget 2007: $40 Million

Using Financial Modeling to Identify Critical Success Factors

Situation Assessment: Facilities

- Facility at full capacity in key areas
  - Clinics
  - Operating Rooms
  - Emergency Room
  - Imaging
- Current site land locked – expansion at current site expensive and impractical
- Preferred Solution: Replacement Hospital at New Site

Situation Assessment:

Overview of Models Analyzed

Model	Assessment	Capital Investment Required
Limited Investment in Current Facilities	*Not Sufficient for Future Growth*	Less than $2M
Major Investment in Current Facilities	*Too Expensive Relative to Capacity Gained*	$3 to $15M
Regional Provider in New Facility	*Preferred Facility Option*	$29M+

Situation Assessment:

Historical Financial Performance

FINANCIAL ASSESSMENT

- Insufficient debt capacity to fund preferred option
- Need for performance improvement

($ in Millions)	Actual 2000	Annual Growth Rate
Net Patient Revenue	$14.6	8.5%
Operating Income	$0.2	-29.8%
Excess Income	$0.4	-18.4%
EBITDA	$1.8	10.8%
Unrestricted Cash	$1.6	-3.1%
Long-Term Debt	$6.0	-3.5%
Net Assets	$9.8	3.0%

The Dilemma

How to fund $29M of Capital Investments with Less Than $2M of Current Debt Capacity?

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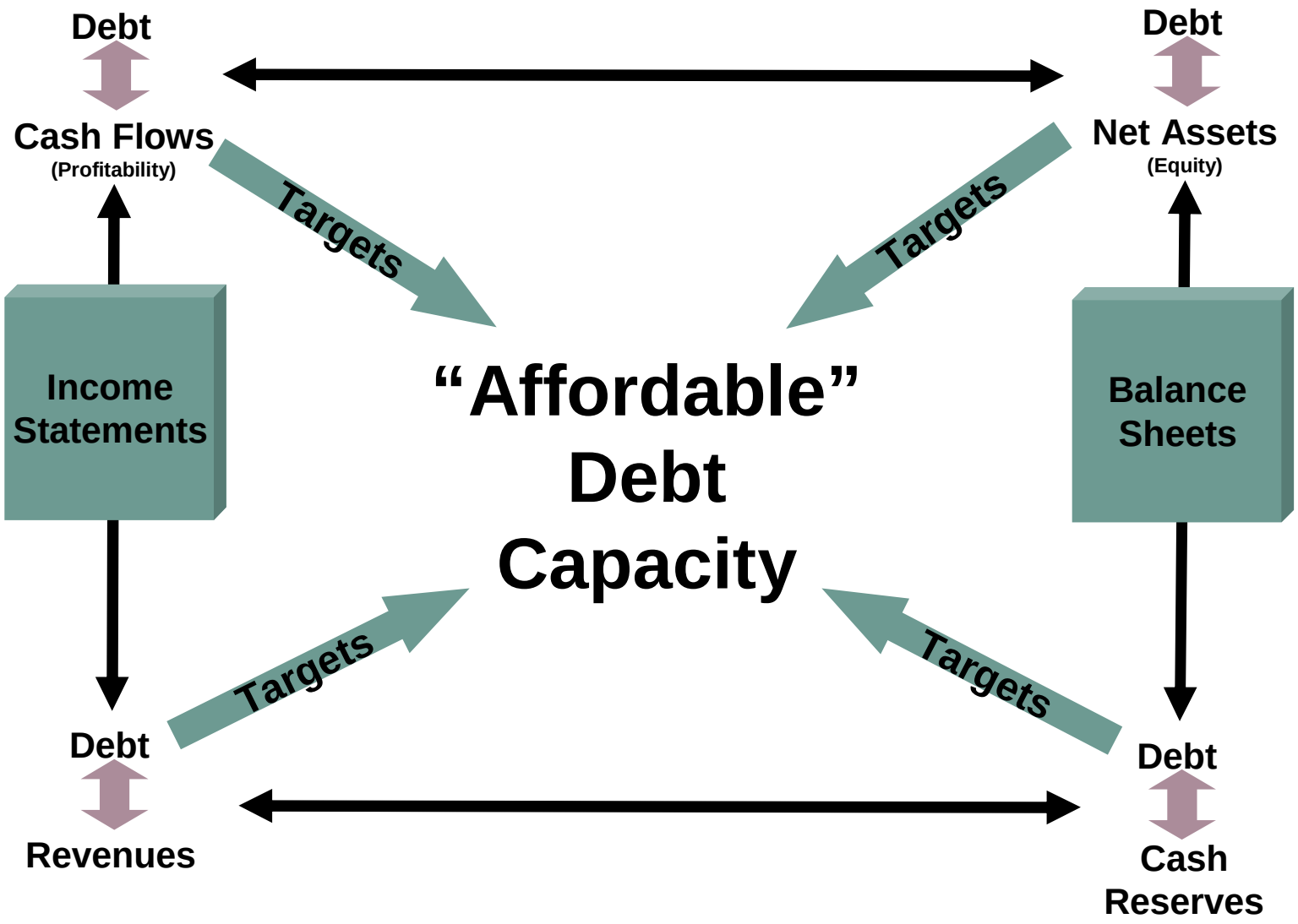
Fundamentals of Debt Capacity



Capital Capacity Defined

Capital Capacity

=

"Affordable" Debt Capacity

+/-

Excess (Deficit) Cash Flows

+

Philanthropy

Example "Affordability" What If Assessment:
Growth & Equity/GO Support

Capital Need: $29M

Projected Maximum "Affordable" Project Costs

Project Philanthropy & GO Debt	*Annual Growth Rate (Volumes)*					
	None	**2.0%**	**3.0%**	**4.0%**	**5.0%**	**6.0%**
None	($0.6M)	$3.5 M	$9.2 M	$15.3 M	$21.4 M	$25.8 M
$1,000	$0.6 M	$4.7 M	$10.4 M	$16.5 M	$22.7 M	$26.9 M
$2,000	$1.8 M	$6.0 M	$11.6 M	$17.8 M	$23.9 M	$28.0 M
$3,000	$3.1 M	$7.2 M	$12.9 M	$19.0 M	$25.1 M	**$29.1 M**
$4,000	$4.3 M	$8.4 M	$14.1 M	$20.2 M	$26.4 M	**$30.2 M**
$5,000	$5.5 M	$9.7 M	$15.3 M	$21.5 M	$27.5 M	**$31.3 M**
$7,500	$8.6 M	$12.7 M	$18.4 M	$24.6 M	**$30.2 M**	**$34.1 M**
$10,000	$11.7 M	$15.8 M	$21.5 M	$27.6 M	**$33.0 M**	**$36.9 M**

Red = Potential Financial Success

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Critical Success Factors

- Performance Improvement *($800,000 to $1M)*
  - Improve the operating margin of the system
- Growth *(5%-6% Annual Growth)*
  - Physician recruitment, including specialists
- External Support *($8M to $9M)*
  - Achieve community philanthropic support
  - Achieve public (city) annual tax support and/or support for a portion of the initial financing (G.O. Bonds)
- ***Need to demonstrate significant progress on each initiative prior to financing!***

Example: Demonstrated Early Success

($ in Millions)	Actual 2000 (Base Year)	NEAR TERM SUCCESS	Actual 2003	Projected 2004	Annual Growth Rate (2000-2004)
Net Patient Revenue	$14.6	Growth	$21.4	$23.4	**13%**
Operating Income	$0.2		$0.8	$1.3	**60%**
Excess Income	$0.4	Improved Profitability	$0.8	$1.5	**39%**
EBITDA	$1.8		$2.2	$2.8	**11%**
Unrestricted Cash	$1.6	Improved Reserves	$3.2	$4.3	**29%**
Long-Term Debt	$6.0		$4.5	$4.0	**-10%**
Net Assets	$9.8		$11.3	$12.8	**7%**
Pro Forma Indicators *					
Debt Service Coverage	***1.00 x***		***1.22 x***	***1.56 x***	
Debt Service % of Revenues	*16.4%*		*11.2%*	*10.3%*	
Cushion Ratio	*0.88 x*		*1.78 x*	*2.39 x*	
Debt to Capitalization	*58%*		*55%*	*52%*	

*** - Based on Maximum Annual Debt Service including $20.0M of new debt (MADS=$1.8M)**

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Estimating the Value of Physician Development

EXAMPLE:
TOTAL "LEVERAGE" PER PHYSICIAN SPECIALTY

	NET SYSTEM LEVERAGE per FTE Provider					
Physician Specialty	**Prof WRVUs**	**Prof Revenues**	**IP Admits per FTE**	**Net IP Revenue per FTE**	**Net OP Ancillary per FTE**	**System Revenues per FTE**
Incremental New Physicians						
Primary Care	3,415	$369,000	50	$230,000	$190,000	$789,000
General Surgery	4,773	$516,000	75	$667,500	$396,000	$1,580,000
Orthopedics	7,063	$763,000	50	$575,000	$715,000	$2,053,000
OB/GYN	5,448	$588,000	75	$300,000	$422,000	$1,310,000
ENT	6,307	$681,000			$350,000	$1,031,000

Remember to Rationalize Assumptions Against Market Share Impact

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A Different Look at Understanding Projections?

TRADITIONAL VIEW

($000s)	Base Year Actual		Stabilized Yr Projected
	2000		2007
Op Revenues	$14,778		$31,901
Non Capital Expenses	$13,142		$27,024
Operating EBIDA	**$1,636**	?	**$4,877**
Capital Expenses	$1,439		$3,434
Total Expenses	$14,581	***What's***	$30,458
Operating Income	$197	***Driving***	$1,443
Non-Operating	$203	***This?***	$190
Total Margin	$400		$1,633

Question
How are we going to triple operating EBIDA in the next 7 years?

A Different Look at Understanding Projections?

STRATEGIC VIEW

Base Year Operating EBIDA (2000)	**$1,636**	Where we are
Impact of Key Assumptions		
Revenue vs. Expense Inflation (Spread)	($784)	Baseline Environment
Baseline Growth	$536	Constant Share
Impact of Key Management Actions		
Physician Development	$2,873	Critical Success Factors
Margin Improvement Initiatives	$900	
Impact of New Facility: Add'tl Space Costs	($284)	
Projected Stabilized Operating EBIDA (2007)	**$4,877**	Where we're going to be

BENEFIT: Linkage of "Value" of Key Assumptions and Critical Success Factors

Economic Impact of CAH Status

($000s)	PPS Model	CAH Model	
Base Year Operating EBIDA (2000)	$1,636	**$1,636**	Where we are
Impact of Key Assumptions			
Revenue vs. Expense Inflation (Spread)	($784)	($784)	Baseline Environment
Baseline Growth	$536	$536	Constant Share
Impact of CAH Status			
Baseline Impact (CAH vs. PPS)	$0	$587	Value of CAH Status
Incremental New Facility Related	$0	$920	
Impact of Key Management Actions			
Physician Development	$2,873	$2,873	Critical Success Factors
Margin Improvement Initiatives	$900	$900	
Impact of New Facility: Add'tl Space Costs	($284)	($284)	
Projected Stabilized Operating EBIDA (2007)	$4,877	**$6,384**	Where we're going to be

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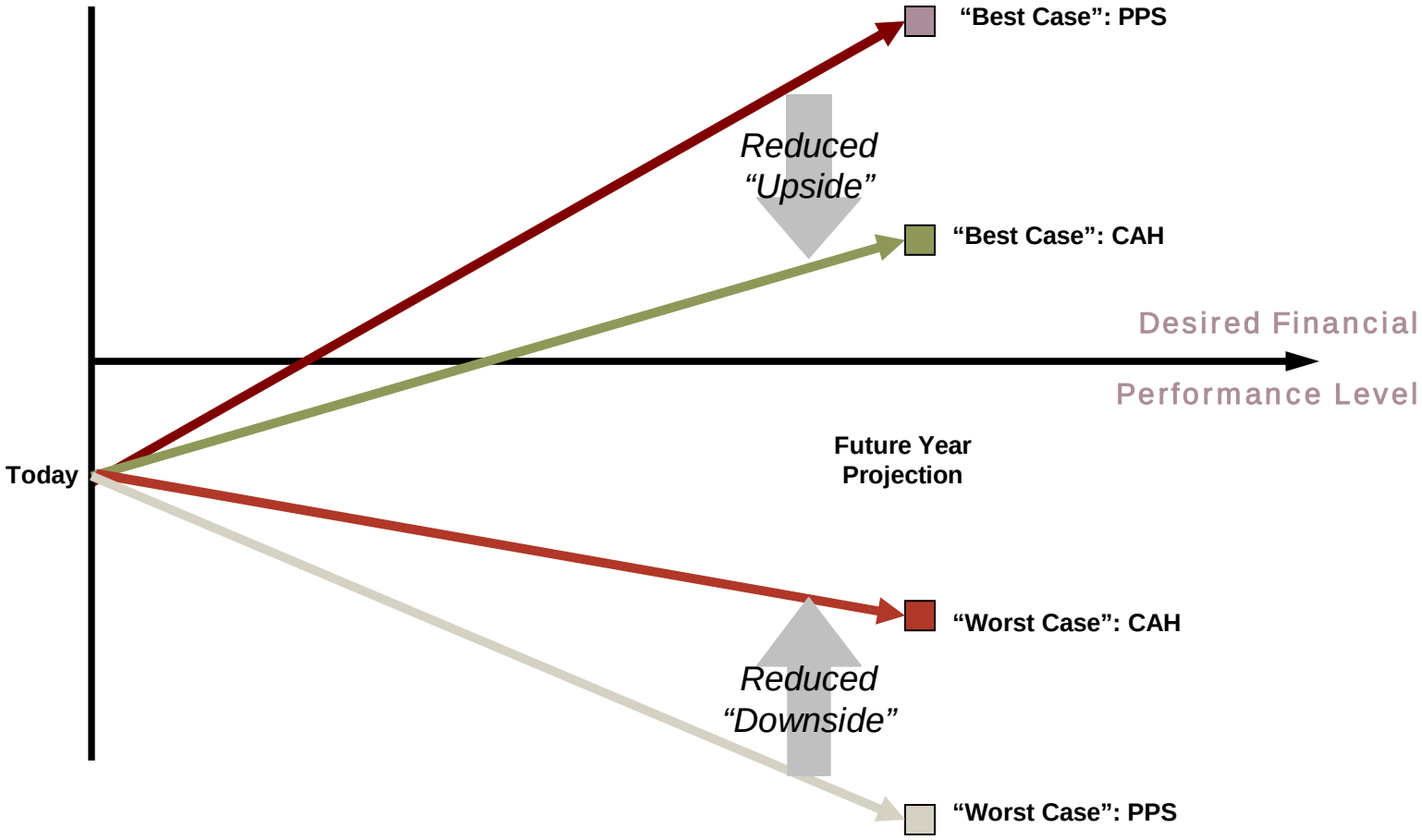
Planning Considerations: CAH Status

Key Financial Indicator: Example = Debt Service Coverage



Historical Perspective: Cost Based Reimbursement

History of Cost Based Reimbursement

100% Cost Based Reimbursement

Inpatient Routine Cost Limits

Inpatient PPS (5 Year Phase In)

OP Operating & Capital Cost Reductions

Capital PPS (10 Year Phase In)

Outpatient PPS (3 Year Phase In)

History of CAH Reimbursement

Cost Based excluding Lab & Swing Bed

Lab & Swing Bed Cost Based

Co-Insurance "Loophole" Ended

Cost Based + 1%

***Assumption**: Next Five Years*

- *Similar to Prior History?*
- *Introduction of IP Routine Cost Limits*
- *OP Lab reduced to fee schedule levels*

Most "At Risk" in Current Payment System

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Using Financial Modeling to Gain Insight on the Solution

Lessons Learned Regarding Financial Modeling

- Convert future financial performance to single point estimate of **Affordability**
- Focus on key assumptions that **Management can impact**
- Understand the incremental **Value** of strategic options and opportunities
- Analyze multiple scenarios with focus on **Affordability** of variable combinations

Financing Options and CAH Relocation

Project Budget/Funding

SOURCES OF FUNDS	($ Millions)	
Bank Loan (90% USDA Guaranteed)	$20.0	
GO Bond Proceeds	$4.0	
Philanthropy	$4.9	
REDLG Loan	$0.4	
Hospital Cash	$0.3	
Total Sources of Funds	**$29.6**	
USES OF FUNDS		
Construction, Architect, CM Fees, Fixed Equip	$24.5	*$191/Sq Ft*
Capitalized Interest	$1.1	*(construction loan)*
Land	$0.4	
FF&E	$3.4	
Financing & Issuance Costs	$0.2	*(1% of Loan Guarantee)*
Total Uses of Funds	**$29.6**	

Critical Success Factors

- Improve Operating Margin
- Recruit Additional Physicians
- Obtain Philanthropic Support
- General Obligation Bond Passage

- Access Capital Financing
- Plan/Design/Build New Facility within Budget

Financing Options Considered

1. Tax-Exempt Revenue Bonds
2. HUD 242
3. USDA Rural Development Guarantee

Why not Revenue Bonds?

- Existing covenants on a congregate housing project combined with inability to defease, yielded insufficient capacity.

Why not HUD 242?

- Time, cost of application and uncertainty of outcome led to exploring other options.

Another Option?

What is USDA Rural Development Community Facility Loan Guarantee and how does it work?

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USDA Rural Development Loan Guarantee

- 90% Federal guarantee in event of default
- Maximum guarantee – project feasibility
- Tax-exempt financings not eligible
- 10% of loan applies to lenders lending limits
- Security, financial reporting, terms – Lender determined

Benefits

- Opportunity to involve multiple local lenders
- Keeps dollars local
- Enhances philanthropic efforts
- Once in place, relatively simple administratively
- Low cost (1% of Guarantee)

USDA Rural Development Loan

Due to its relative unfamiliarity, particularly in a health care setting, the onus is often on the hospital to explain to local lenders.

USDA RD Process/Timeline

- Preapplication submitted – Nov ’03
- Initial bank coalition meeting – Nov ’03
- Preapplication approved – Jan ’04
- Application submitted – Mar ’04
- Conditional Commitment – June ’04
- Construction Start – July ’04
- Construction Loan – Nov ’04
- Permanent Loan/Guarantee – May ‘06

Preserving CAH Status

"Wash the tires with soap and water!"

Working with CMS in Relocating

- Engage early
- Establish a relationship
- Communicate regularly
- Respond timely
- Document conversations to summarize understanding

CMS Criteria

75% of...

- Same service area
- Same services
- Same staff

Summary

Questions