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HFMA's Healthcare Financial Pulse The Financial Health of U.S. Hospitals and Healthcare Systems

January 2009

HFMA's Healthcare Financial Pulse is sponsored by:

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Key survey findings

- Access to capital is constrained
 - Both “have” and “have-not” hospitals are struggling to access capital
- Hospital margins are weakening
 - Patient volumes are declining
 - Bad debt and charity care is increasing
 - Nonoperating margins, including revenue from investments, have declined
- Hospitals are cutting spending
 - Significant cuts in capital spending are likely
 - Cuts may harm services to patients



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Key actions needed

- Create a shared sense of urgency, understanding, and leadership
- Be a low-cost provider
- Preserve cash



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Both “have” and “have-not” hospitals are struggling with capital access

Percentage of respondents indicating access challenges over the last three to six months

	All respondents	Hospitals with limited access to capital*	Hospitals with broad access to capital*
Substantial increase in cost of debt	38%	43%	29%
Failure of debt offering	17%	17%	15%
Denied bank loan	2%	7%	1%
Denied commercial lending	5%	10%	2%
Difficulty securing liquidity facility	18%	31%	18%
Line of credit drawn to maximum	4%	10%	2%
Withdrawn/delayed bond issue	17%	17%	24%
Delayed public offering	6%	7%	6%
Capital needed, but did not attempt to access sources	19%	31%	17%

Source: Healthcare Financial Management Association, www.hfma.org

Key findings:

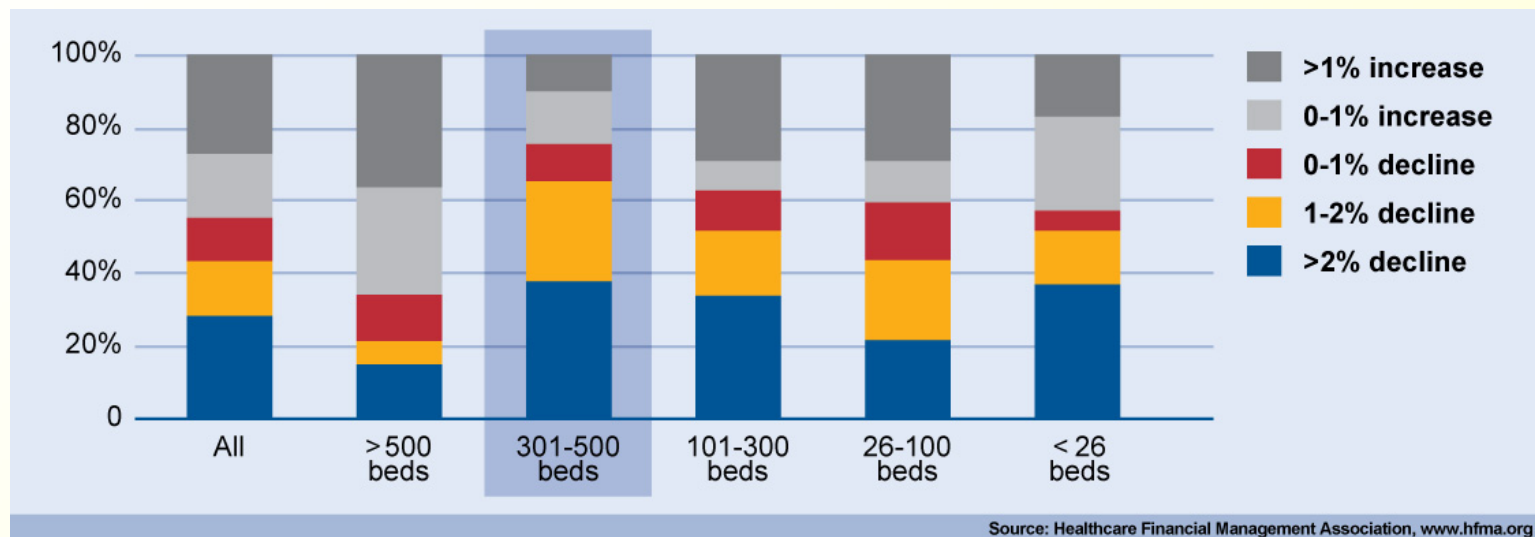
- 29% of “have” hospitals indicate substantial increase in cost of debt
- 43% of “have-not” hospitals indicate substantial increase in cost of debt

* See slide 25 for how “broad access” and “limited access” to capital are defined



Patient volumes are trending lower

Percentage change in inpatient volume that hospitals have experienced in last six months



Key findings:

- Inpatient volumes are down in 55% of hospitals; in 27% of these hospitals, volumes are down 2% or more
- Mid-sized hospitals note the most substantial drop: More than three quarters of respondents from hospitals with 300 to 500 beds note a decrease in inpatient volumes; 38% of these respondents indicate >2% decline
- 46% of hospitals that note a decline in *inpatient* volume also note a drop in *outpatient* volume (not illustrated in this chart)

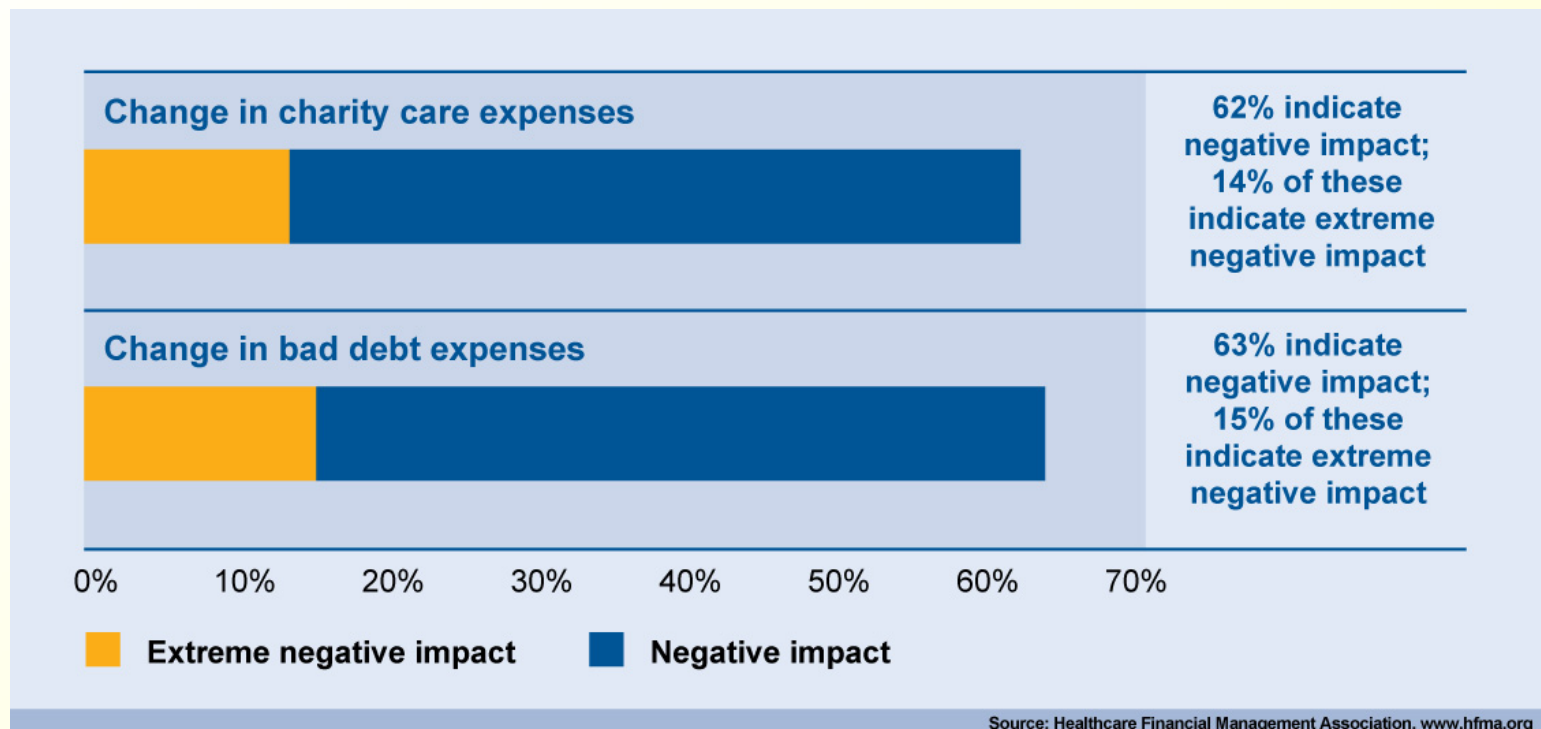


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Bad debt and charity care expenses are negatively impacting performance

To what extent have changes in charity care and bed debt expenses affected financial performance?



Future outlook:

- Bad debt and charity care expenses will likely increase as unemployment continues to rise

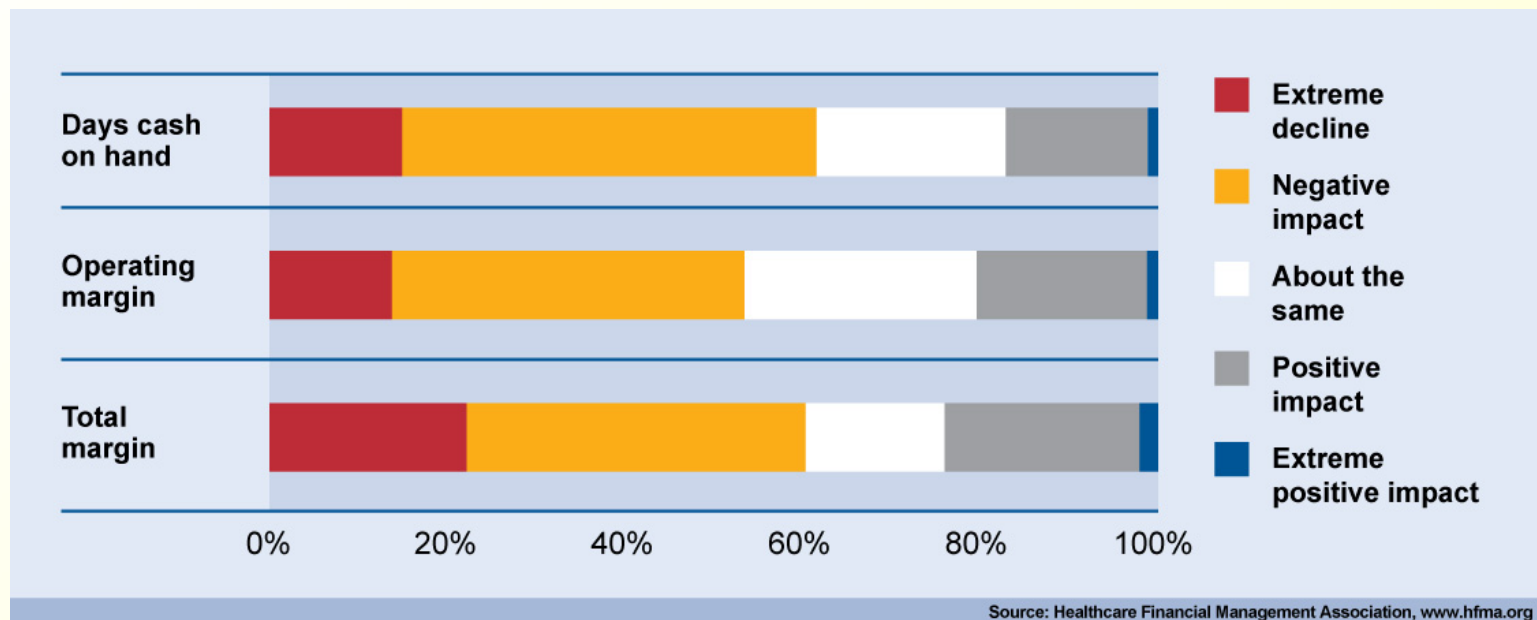


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Hospitals expect continued declines in financial performance

What changes in your financial performance do you expect over the next three to six months?



Key findings:

- 61% anticipate negative shift in days cash on hand
- 60% anticipate a decline in total margin
- 54% anticipate a decline in operating margin



Larger organizations are the most pessimistic about margins

Percentage of respondents expecting “extreme decline” in the following financial performance indicators over the next three to six months

	Total Margin	Operating Margin	Days Cash on Hand
All	22%	14%	15%
Health system	35%	9%	35%
>500 beds	29%	5%	21%
300-500 beds	43%	31%	22%
100-300 beds	18%	19%	21%
26-100 beds	13%	18%	5%
<26 beds	17%	6%	5%

Source: Healthcare Financial Management Association, www.hfma.org

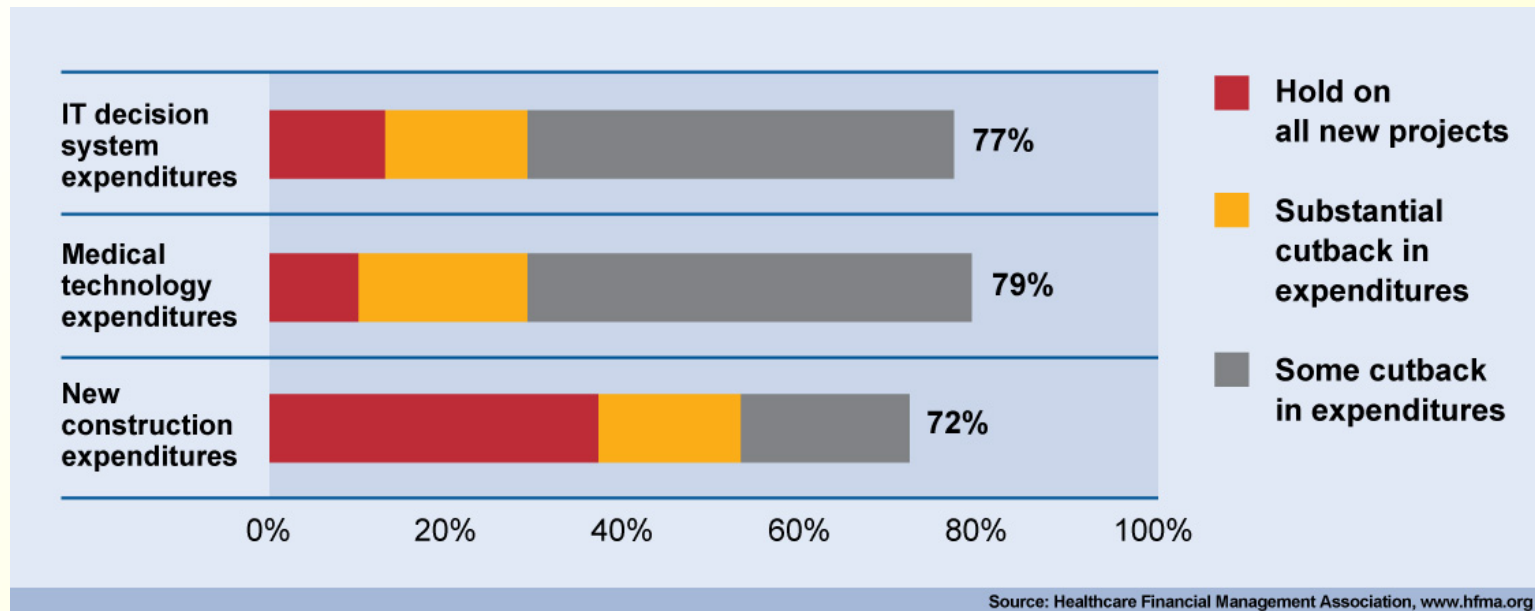
Key findings:

- 35% of respondents in system headquarters expect an extreme decline in total margins and cash on hand
- 43% of hospitals with 300 to 500 beds anticipate an extreme decline in total margin, fueled in part by anticipated decline in operating margin



Substantial capital spending cuts are likely

Percentage of respondents indicating expected changes in capital spending over the next three to six months if credit continues to be constrained



Key findings:

- 37% indicate hold on all new construction projects
- 53% indicate cutbacks in operating expenditures (*not shown on chart*)
- 78% indicate reduction in capital expenditures (*not shown on chart*)



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Capital constraints could lead to cutting back service lines

“To cash flow the needed replacement facility, we may have to find ways to scale back the project cost even further than what we already have. One example might be to build less acute care patient rooms, below the 25 we are licensed for as a critical access hospital. Even though this would still satisfy our average census needs, it would hamper our ability to assume more patients during flu season and other peak census times.”

— *Survey respondent*

“Planned ED expansion will be put on hold. With closing of two local hospitals, access to care may be reduced.”

— *Survey respondent*



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Capital constraints could delay investment in important capital projects

“We anticipate difficulty replacing aging equipment and facility. This, in turn, affects the ability to recruit physicians to our organization. It could easily shut us down.”

— *Survey respondent*

“Because we maintain a strong balance sheet, we will be able to continue to fulfill our mission. We will, however, delay and/or cancel capital projects and focus on operations and improvements in performance to preserve cash flow.”

— *Survey respondent*



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Capital constraints could mean staff and operational cutbacks

“Increasing debt service interest costs and declining investments mean we have to cut operating costs/FTEs.”

— *Survey respondent*

“We will have to materially reduce our staffing to offset the uncompensated care increases we are seeing—also we will be eliminating programs, [and] we will reduce capital investment into new technology.”

— *Survey respondent*



Reduced nonoperating income is a challenge for some hospitals

“Investment markets have reduced days cash significantly—to approximately 24 days.”

— *Survey respondent*

“We are concerned about investment losses and required contributions to defined pension.”

— *Survey respondent*

“Fortunately, our earnings are covering our investment losses; however, this cannot be sustained much longer. [We] may need to make some difficult decisions.”

— *Survey respondent*

“Although donors made \$8.35 billion in charitable contributions in 2007, the 5.5 percent increase in the U.S. rate of giving was less than half the 11.5 percent increase in 2006 when donations totaled \$7.9 billion.”

— *Association for Healthcare Philanthropy’s
Annual Report on Giving, October 2008*



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Debt management will become increasingly important

“...the swap market changes in the last 30 days have exacerbated the liquidity problem. Most of us who have floating to fixed rate swaps have booked a big unrealized loss on these in November. In turn, because the losses exceed the collateral threshold, we are having to post collateral. We can do it one of two ways. One, we can take cash and move it into the ‘funds limited as to use—collateral’ category or we can borrow on our line of credit and do the same thing. In the first case, days cash will drop because the cash is moved to a ‘limited as to use’ category that is, in effect, restricted. In the second case, days cash will stay the same but the collateral will be funded by creating more LT debt. In either case, we’re going to suffer.”

— *Health system CFO*



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Factors that will most affect long-term financial position and ability to fulfill mission

- Patient volume
- Uninsured/underinsured
- Nonoperating income
 - Investment income
 - Philanthropic giving
- Capital access and cost of debt
- Regulatory and payment “wild cards”



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Hospitals need to act immediately to control their financial position

- Provide a sense of urgency, understanding, and leadership
- Strive to be a low-cost provider
- Preserve cash



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Provide a sense of urgency, understanding, and leadership

- Communicate to the board, executive leaders, and all staff the dimension of the economic situation
- Create leadership consensus about the needed changes
- Provide workable solution sets
- Communicate proactively and continually with your communities about shared challenges and goals
- Communicate your action plan to the capital markets



Be a low-cost provider

- Develop a strategic approach to cost management
- Focus on improving efficiency and quality
- Understand the true costs of providing care and service, as well as the true effect on cost of any changes
- Invest in staff's ability to work smarter
- Embrace and champion the evolution of traditional staff and professional roles in health care to reflect the realities of the labor market, as well as 21st century technology and care processes



Preserve cash

- Closely manage financial budgeting and spending processes
- Take a “zero-based” look at all service lines, using a broad range of future environmental assumptions to assess importance to mission and viability
- Reassess financial risk tolerance
- Reassess capital initiatives, including effects on patient care and return on investment
- Seek alternative forms of capital
- Focus efforts to enhance the efficiency and effectiveness of revenue cycle operations



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The long-term outlook: Health care is a resilient industry

“The market challenges of today could lead to efficiencies and investments that enable hospitals to provide more value to their communities in the future.”

— *Bob Broadway, FHFMA, 2008-2009 Chairman, HFMA*

“Few sectors of the economy have faced—and weathered—as much continuous financial tension as the hospital sector, which must regularly adjust to payment and regulatory changes. Hospital financial leaders must, once again, marshal all of their assets to face current realities and use their considerable expertise to provide what is best for their communities.”

— *Richard L. Clarke, DHA, FHFMA, President and CEO, HFMA*



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HFMA is committed to advancing
the industry

Find solutions, tools, and updated
data at www.hfma.org



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About the survey:

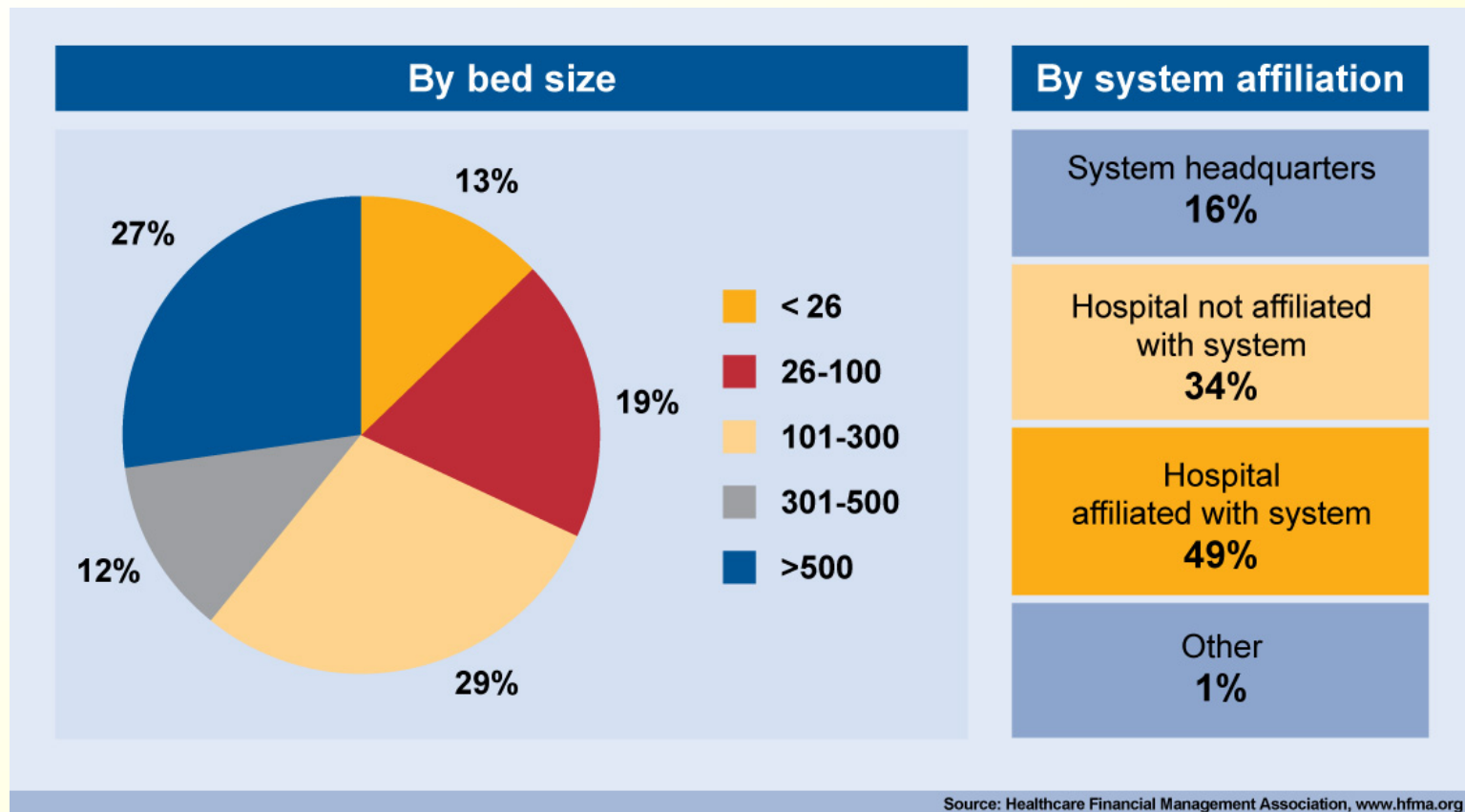
Study methodology

Response rate	19%
Response count	309

E-mail survey sent to financial executives in hospitals and health systems. Survey responses represent diverse hospital and health system segments.



About the survey: Respondent demographics





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About the survey:

Respondent demographics

Control

Not-for-profit	70%
Investor-owned, corporation	10%
Government	14%
District	6%



About the analysis:

Access to capital is measured in three dimensions

Profitability, liquidity, and capital structure indicate creditworthiness. Hospitals that perform better in these areas are deemed to have broad access to capital; hospitals with weaker performance in these areas are deemed to have limited access to capital.

Financial performance criteria	Performance associated with broad access to capital	Performance associated with limited access to capital
Operating margin	> 2%	< 0.0%
Debt service coverage ratio	> 3.50	< 1.25
Days cash on hand, short term	N/A	< 5
Current ratio	> 2.0	< 1
Debt to capitalization	0%-35%	< 0% or > 70%
Hospitals/systems meeting criteria	32%	19%

Source: Healthcare Financial Management Association, www.hfma.org



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