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## **MN HFMA WINTER CONFERENCE**

# **FINANCIAL CONSIDERATIONS IN THE BUILD ENVIRONMENT**

Shawn Deluhery

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**CPAs & BUSINESS ADVISORS**



Shawn Deluhery

Director, Tax Credits, Incentives, & Strategy

[sdeluhery@eidebailly.com](mailto:sdeluhery@eidebailly.com)



Connect with me on [LinkedIn](#)



# OBJECTIVES

- Understand financial tools in the build environment
- How market understanding plays a role in facility planning
- Importance of accurate recording of the construction project
- Inflation Reduction Act / Energy Credits and exploring other available funding sources



# CONSIDERATIONS WHILE PURSUING A BUILDING PROJECT

Ability to demonstrate existing and future financial stability

Over-building / Over-borrowing

Understanding Debt Capacity

Governance and Management

Terms of Loans and Debt Covenants

Lack of Adaptability

Overall project organization, timing, etc.

# FINANCIAL TOOLS AVAILABLE IN THE BUILD ENVIRONMENT

- Financial statement, financial strength
- Debt Capacity Study
- Examined forecast / feasibility studies

History and Current  
State



Internal view of debt  
affordability



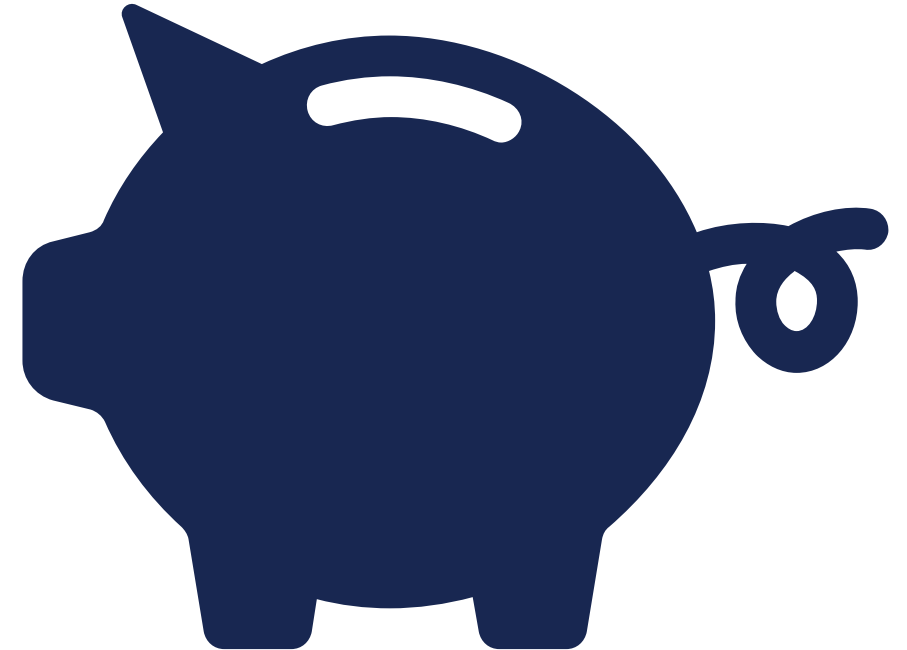
External explanation of  
need and affordability  
to lender / others

# FINANCIAL STATEMENTS, STRENGTH

- The basis of affordability is the financial statements
- Basis of strength:
  - Consistent historical performance which can afford additional debt
  - Available cash on hand for insurance and safety
  - Healthy balance sheet
  - Good environment and market conditions

# DEBT CAPACITY STUDY

- What is Current Debt Structure:
  - Covenants
  - Refinancing
- What is Impact of Future and Pending Legislation
- What is Affordable (Available vs. Feasible)



# DEBT CAPACITY STUDIES

Determines the:

- (1) maximum amount of new debt that could be incurred by the hospital while
- (2) maintaining key financial indicators.

Focuses primarily on your income statement and considers:

- Existing debt structures,
- Normalized operations,
- Project related adjustments,
- Reimbursement implications from project



# DEBT CAPACITY STUDY – PRO FORMA

Income Statement	Final 2022	Unaudited 2023	Normalize Operations	Project Adjustments	Post-Construction Scenarios		
					3.50%	3.75%	4.25%
Unrestricted Revenues, Gains, and Other Support							
Net patient service revenue	\$ 25,677,000	\$ 27,449,000		\$ 1,102,000	\$ 28,551,000	\$ 28,578,000	\$ 28,633,000
Other revenue	1,943,000	2,162,000	(584,000)		1,578,000	1,578,000	1,578,000
<b>Total revenues, gains, and other support</b>	<b>27,620,000</b>	<b>29,611,000</b>	<b>(584,000)</b>	<b>1,102,000</b>	<b>30,129,000</b>	<b>30,156,000</b>	<b>30,211,000</b>
Operating Expenses							
Salaries and wages	13,719,000	14,618,000			14,618,000	14,618,000	14,618,000
Employee benefits	3,046,000	3,318,000			3,318,000	3,318,000	3,318,000
Professional fees	3,290,000	3,476,000			3,476,000	3,476,000	3,476,000
Supplies	2,733,000	2,862,000			2,862,000	2,862,000	2,862,000
Other	3,183,000	3,724,000			3,724,000	3,724,000	3,724,000
Depreciation and amortization	1,504,000	1,390,000		1,655,000	3,045,000	3,045,000	3,045,000
Interest and amortization	16,000	6,000		863,000	869,000	931,000	1,056,000
<b>Total operating expenses</b>	<b>27,491,000</b>	<b>29,394,000</b>	<b>-</b>	<b>2,518,000</b>	<b>31,912,000</b>	<b>31,990,000</b>	<b>32,115,000</b>
<b>Operating Income (Loss)</b>	<b>129,000</b>	<b>217,000</b>	<b>(584,000)</b>	<b>(1,416,000)</b>	<b>(1,783,000)</b>	<b>(1,834,000)</b>	<b>(1,904,000)</b>
Other income (loss), net	118,000	242,000	-	-	242,000	242,000	242,000
<b>Revenue in Excess of (Less Than) Expenses</b>	<b>\$ 247,000</b>	<b>\$ 459,000</b>	<b>\$ (584,000)</b>	<b>\$ (1,416,000)</b>	<b>\$ (1,541,000)</b>	<b>\$ (1,592,000)</b>	<b>\$ (1,662,000)</b>
Add Back:							
Depreciation and amortization	1,504,000	1,390,000	-	1,655,000	3,045,000	3,045,000	3,045,000
Interest expense	16,000	6,000	-	863,000	869,000	931,000	1,056,000
<b>Income Available for Debt Service</b>	<b>\$ 1,767,000</b>	<b>\$ 1,855,000</b>	<b>\$ (584,000)</b>	<b>\$ 1,102,000</b>	<b>\$ 2,373,000</b>	<b>\$ 2,384,000</b>	<b>\$ 2,439,000</b>

# DEBT CAPACITY STUDY – MAXIMUM DEBT

<b>Debt Service Coverage Ratio</b>	3.50%	3.75%	4.25%
Income Available for Debt Service	\$ 2,373,000	\$ 2,384,000	\$ 2,439,000
Principal Payments	371,000	352,000	317,000
Interest Payments	869,000	931,000	1,056,000
Total Debt Service	\$ 1,240,000	\$ 1,283,000	\$ 1,373,000
Debt Service Coverage Ratio (Times)	1.91	1.86	1.78
<b>Maximum Debt Capacity</b>	3.50%	3.75%	4.25%
Expenses in Excess of Revenues	\$ (1,541,000)	\$ (1,592,000)	\$ (1,662,000)
Add back:			
Depreciation and amortization	3,045,000	3,045,000	3,045,000
Interest expense	869,000	931,000	1,056,000
Total Income Available for Debt Service	2,373,000	2,384,000	2,439,000
Annual Principal & Interest payments	\$ 1,582,000	\$ 1,589,000	\$ 1,626,000
Internal Benchmark	1.50	1.50	1.50
	3.50%	3.75%	4.25%
Maturity (Years)	35	35	35
Interest Rate	3.50%	3.75%	4.25%
Maximum Debt Capacity	31,641,046	30,741,556	29,344,890
Project Debt	(25,000,000)	(25,000,000)	(25,000,000)
Surplus (Shortfall)	6,641,046	5,741,556	4,344,890

# KEY FINANCIAL INDICATORS

## Liquidity

- Current Ratio, Days Cash on Hand, Days in Accounts Receivable

## Cost

- Salaries to Net Revenue, Average Age of Plant, FTEs per Adjusted Occupied Bed

## Capital Structure

- Equity Financing, Debt Service Coverage Ratio, Long-Term Debt to Capitalization

## Profitability

- Operating Margin, Total Margin, Cash Flow Margin, Return on Equity

# RELEVANT FINANCIAL INDICATORS

## Debt Service Coverage Ratio

- Calculates the amount of cash available for servicing debt interest and principal payments from operations annually.
- Covenant minimum, 1.25.

## Days Cash on Hand

- Measures the liquidity of the hospital and indicates the number of days the hospital could meet its average cash payments without collecting any revenue.
- Consider covenant requirements, 90 days

## Current Ratio

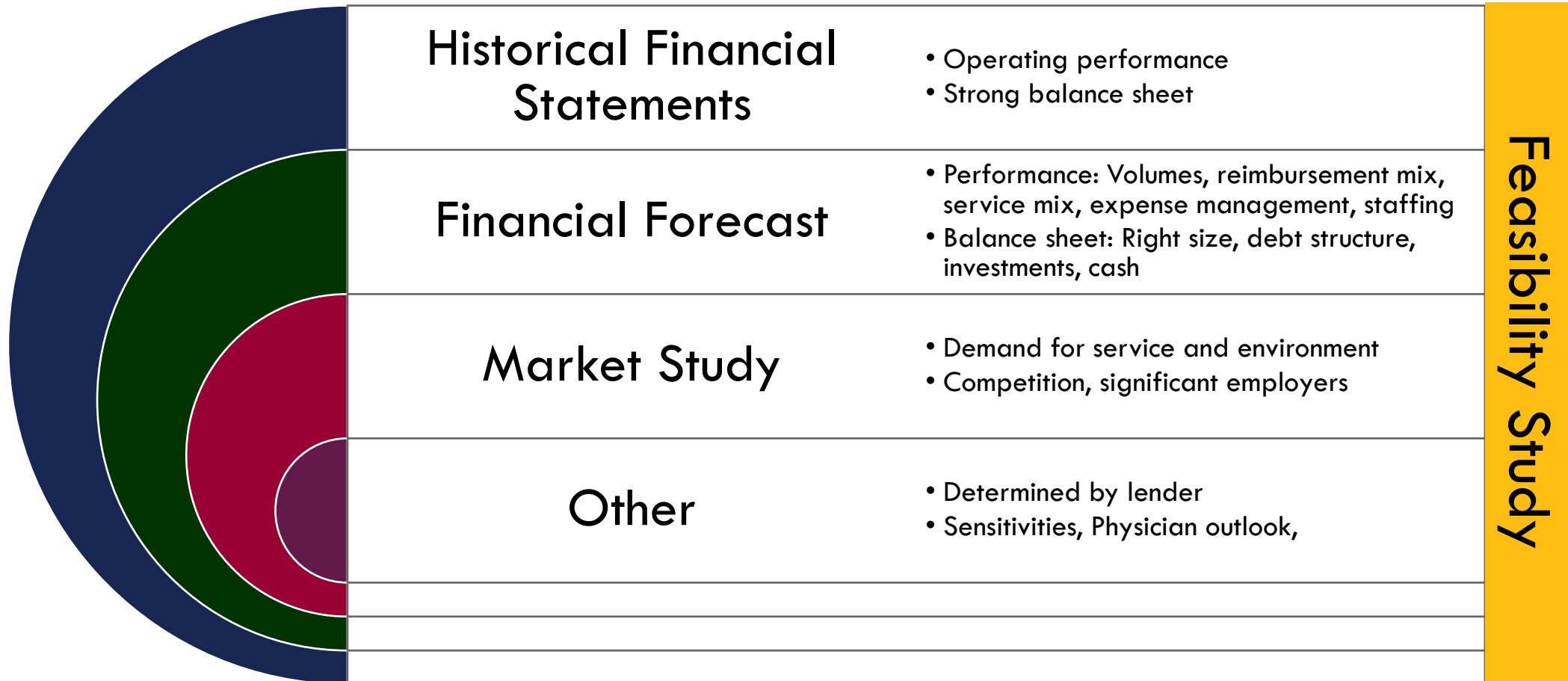
- The measure of dollars held in current assets in comparison to current liabilities.
- Serves as an indicator used to show the hospital's ability to pay short-term obligations.
- Above 2.00, considered healthy.

## Equity Financing

- The proportion of total assets that have been financed with equity.
- Less than 20% considered to be an indicator of financial stress

# FEASIBILITY STUDY

- External document explaining financially the organization will continue to be a going concern into the near-term future:



# MARKET ASSESSMENTS



Reviewing results

Determining your  
service area

Patient admission  
information

## Results


- Definition of service area
- In-migration and out-migration
- Population trends (overall and aging class)
- Competitors
- Market share of service area

# MARKET PROJECTIONS: INPATIENT VOLUME

## Data and Analytics | Market Scenario Planner - Inpatient

Service Line	2022 Volume Estimate	2027 Volume Forecast	2032 Volume Forecast	5 Yr Growth	10 Yr Growth
Cardiac Services	344	327	313	-5.1%	-8.9%
ENT	24	19	17	-19.3%	-28.1%
General Medicine	1,115	1,065	1,033	-4.5%	-7.4%
General Surgery	219	203	192	-7.2%	-12.2%
Gynecology	24	18	14	-26.1%	-42.7%
Invalid	3	3	3	5.0%	9.0%
Neonatology	222	262	335	17.9%	50.6%
Neurology	144	137	132	-4.6%	-8.0%
Neurosurgery	23	24	24	4.3%	4.6%
Obstetrics	210	200	207	-5.0%	-1.4%
Oncology/Hematology (Medical)	89	82	77	-7.1%	-13.3%
Ophthalmology	3	3	3	-5.0%	-6.5%
Orthopedics	164	148	140	-9.6%	-14.6%
Other Trauma	27	26	27	-0.2%	0.3%
Rehabilitation (Acute Care)	3	3	3	7.1%	11.4%
Spine	64	55	47	-13.9%	-25.8%
Thoracic Surgery	18	15	14	-14.1%	-21.4%
Urology	45	41	39	-7.8%	-13.0%
Vascular Services	53	48	43	-9.7%	-19.5%
<b>Total</b>	<b>2,794</b>	<b>2,681</b>	<b>2,664</b>	<b>-4.0%</b>	<b>-4.6%</b>

# MARKET PLANNING: OUTPATIENT VOLUME PROJECTIONS

 **Data and Analytics | Market Scenario Planner - Outpatient**

Service Line	2022 Volume	2027 Volume	2032 Volume	5 Yr Growth	10 Yr Growth
Cardiology	8,986	9,330	9,313	3.8%	3.6%
Cosmetic Procedures	565	544	525	-3.7%	-7.1%
Dermatology	3,635	3,595	3,558	-1.1%	-2.1%
Endocrinology	165	187	199	13.9%	21.0%
ENT	2,408	2,637	3,054	9.5%	26.8%
Evaluation and Management	80,663	83,033	88,262	2.9%	9.4%
Gastroenterology	2,170	2,077	1,953	-4.3%	-10.0%
General Surgery	497	483	466	-2.9%	-6.2%
Gynecology	611	585	580	-4.2%	-5.0%
Lab	36,395	38,323	39,371	5.3%	8.2%
Miscellaneous Services	17,208	18,379	19,931	6.8%	15.8%
Nephrology	476	469	454	-1.4%	-4.8%
Neurology	1,279	1,344	1,450	5.1%	13.3%
Neurosurgery	70	69	70	-1.5%	0.9%
Obstetrics	215	195	183	-9.2%	-14.9%
Oncology	1,399	1,334	1,265	-4.7%	-9.6%
Ophthalmology	8,310	8,704	8,915	4.7%	7.3%
Orthopedics	2,559	2,689	2,760	5.1%	7.9%
Pain Management	1,011	1,044	1,039	3.3%	2.8%
Physical Therapy/Rehabilitation	19,317	20,786	22,411	7.6%	16.0%
Podiatry	1,603	1,684	1,704	5.1%	6.3%
Psychiatry	8,999	9,989	10,100	11.0%	12.2%
Pulmonology	1,127	1,037	976	-8.0%	-13.4%
Radiology	24,755	24,593	24,684	-0.7%	-0.3%
Spine	171	185	189	7.8%	10.1%
Thoracic Surgery	48	48	46	-1.3%	-5.9%
Trauma	652	651	653	-0.2%	0.2%
Urology	928	887	841	-4.3%	-9.4%
Vascular	1,537	1,613	1,653	4.9%	7.6%
<b>Total</b>	<b>227,757</b>	<b>236,496</b>	<b>246,603</b>	<b>3.8%</b>	<b>8.3%</b>

# THE UTILIZATION SHIFTS AHEAD

## Comparison of major volume segments, 2023 to 2033



AGE 0-64

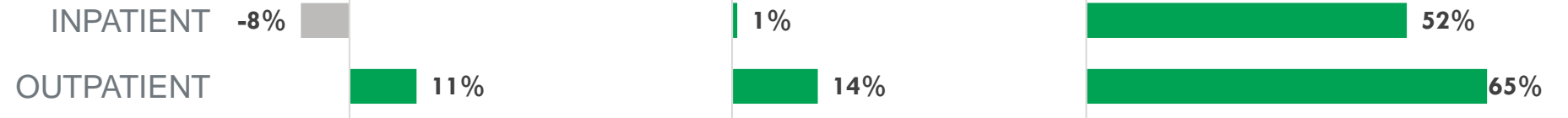


AGE 65-74



AGE 75+

Projected volume<sup>2</sup> growth



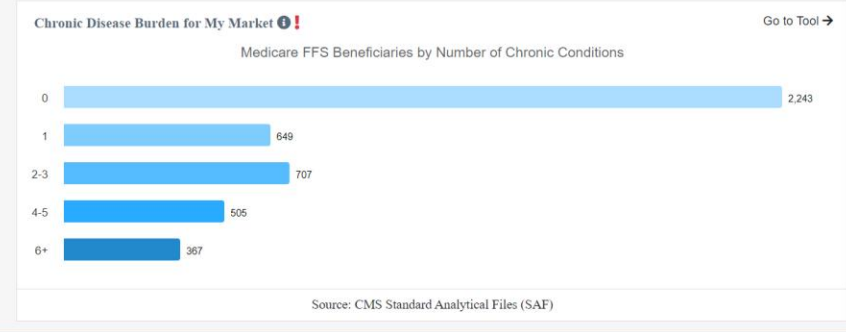
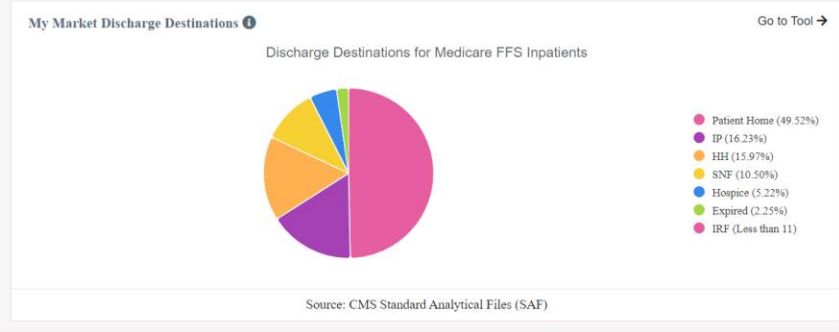
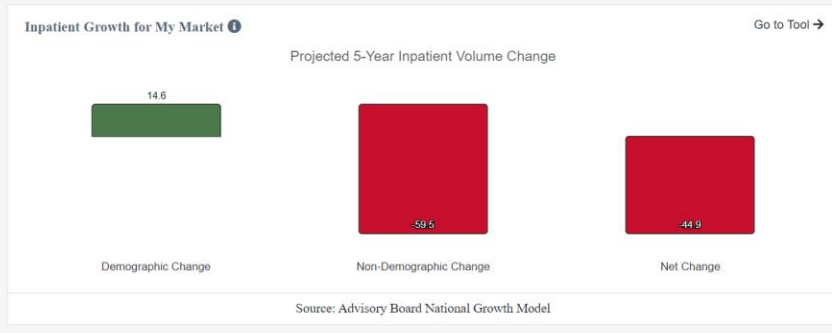
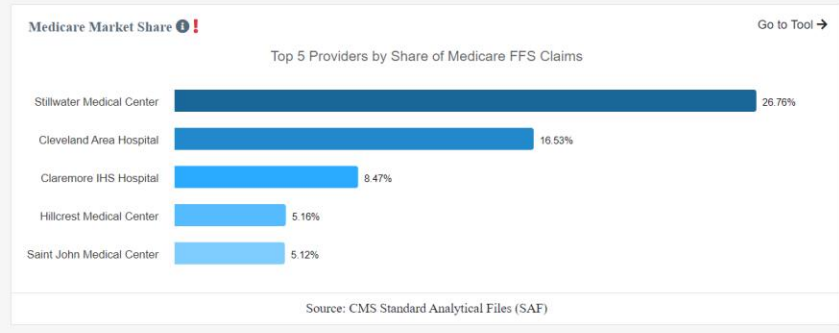
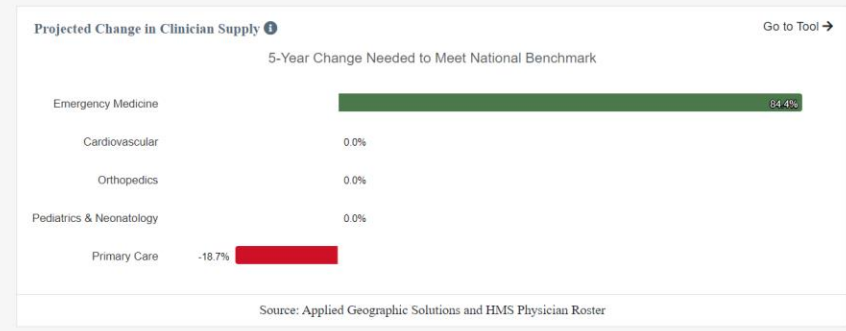
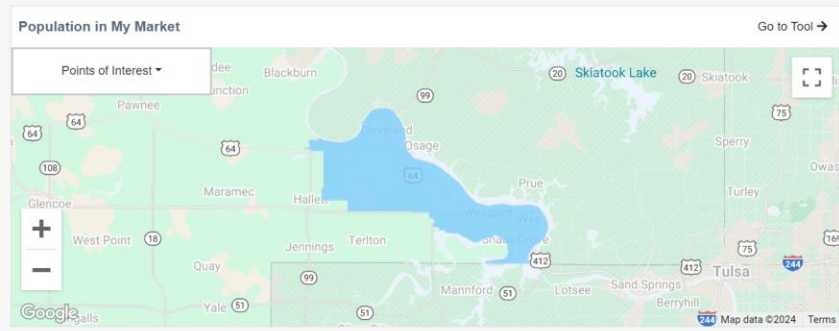
1. Major complications or comorbidities (MCC) or complications and comorbidities (CC).

2. Excludes lab, evaluation & management, radiology, physical therapy & rehabilitation, and miscellaneous services.

# MARKET SCENARIO PLANNER – MARKET HUB

Selected Market: [City Cleveland OK](#) [Compare Markets](#)

[My Market](#) [My Facility](#)



# FIXED ASSET PLANNING - ACCOUNTING

- Accurate recording of construction projects
  1. Disposal of existing, depreciation
  2. Recording CIP in appropriate buckets
  3. Capitalized vs. expense
  4. Software

# FIXED ASSET PLANNING – COST SEGREGATION

- Software to understand the componentization and interdependency of construction costs
- Documents, blueprints, site visit, operations to determine the operational useful life of the composition of assets (i.e. hospital)
- Result is a useful life of the hospital more accurately reflecting the useful lives which can result in more depreciation in the near term
- Critical Access Hospital:
  - 25-year composite average before
  - 20-year composite average after
  - \$1,000,000 benefit

# THE CLIMATE ECONOMY

\$560 billion of energy incentives according to the Congressional Budget Office

\$1.7 trillion of energy incentives according to private reports



# ENERGY INCENTIVE PROGRAM

## Clean Energy Investment Tax Credit (Section 48)

Investment in equipment that produces energy from alternative sources:

- Solar
- Wind
- Geothermal
- Fuel Cells
- Microturbines
- Combined heat and power systems
- Equipment that recovers waste energy
- Energy storage (batteries, ice)
- Biogas
- Microgrid controllers
- Electrochromic Glass

### WHAT DO I GET?

- Basic credit = 6% of cost
- If wage rules met = 30% of cost
- If domestic content = + 10%
- If in a “energy community” + 10%
- Additional bonuses for solar and wind with an environmental justice allocation.

# CLEAN ENERGY PROPERTY TAX CREDIT

## The Formula

### Credit Percentage

- Basic credit = 6%
- If wage rules met = 30%
- If domestic content = + 10%
- In energy community = + 10%
- Additional bonuses for solar and wind with an environmental justice allocation.



### Basis Considerations

- Cost Segregation Needed
- Section 263A (UNICAP)
- Interconnected property
- Dual use property (TR 1.48-9)
- Basis reduction 50% of credit
- Tax-exempt bonds reductions
- Federal grant funding

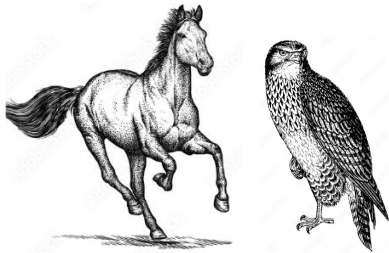
# COME TOGETHER



# BASIS X PERCENTAGE EXAMPLE



$$\$800,000 \times 6\% = \$48,000$$



$$\$5,000,000 \times 40\% = \$2,000,000$$

- Functional Interdependence Test
- Soft cost indirect spread (263A)
- Eligible bonus percentages
- Registration process



# 1

# THE CHALLENGE

- Bidding process
- New behavioral health hospital
- 250,000 square feet
- \$20M for the Heating, Ventilation and Air Conditioning System base bid
- HVAC choices were a natural gas-powered system or a geothermal one



The hospital wanted to be energy efficient and sustainable but did not have the funds to cover the **\$6,000,000** for the upgrade to a geothermal-powered system.

1

# THE RESOLUTION



The moral of the story is to run an energy incentive assessment to help you, your board and your bank make decisions.



## Leadership

- \$7.8M incentive direct pay
- Covers \$6M upgrade to geothermal
- \$1.8M extra in direct pay
- Sustainable and Green
- Utility bill 10-year payback



## Designer

- \$1.25M deduction
- \$600K more in designer fees from increased scope
- Goodwill from a happy client
- Right down main street for the Research & Development Credit (R&D)

## 2

# THE CHALLENGE

- During construction
- \$30M child crisis center
- \$4M of electrical costs
- Solar panels were quoted at \$1M



The non-profit had put this out to bid and started construction before the renewable legislation under the Inflation Reduction Act came out. They wanted to introduce a renewable(s) building. Solar panels were quoted at \$1M.

# 2

# THE RESOLUTION



The moral of the story is that it is not too late to have conversations with your design team about introducing a renewable.



## Leadership

- \$1.5M direct pay “rebate”
- Covers the solar panels
- \$500K extra
- Sustainable and Green
- Utility bill 7-year payback



## Designer

- \$5/SF 179D deduction
- \$1M solar scope increase
- Goodwill from a happy client
- Right down main street for the Research & Development Credit (R&D)

# ENERGY CREDIT FINANCIAL CONSIDERATIONS

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- Not all cost basis amounts are the same
- Extent of usage / productivity
- Cost investment now, credit and utility efficiency come later
- Grants
- Bonds / loans impact to energy credit
- Tax credit and the IRS

# COMMUNITY





**QUESTIONS?**

# THANK YOU!

Shawn Deluhery

Director

[sdeluhery@eidebailly.com](mailto:sdeluhery@eidebailly.com)

612.253.6577



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