Rural Healthcare Financing Basics

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PROJECT TYPES

- **Critical access hospitals**
- **General acute hospitals**
- **Surgical hospitals**
- **Medical office buildings**
- **Senior housing / long term care**

HOSPITALS

Initial Qualification Review

- **Historical profitability**
- **Stability of operations**
- **Balance sheet support**
- **Evidence of quality management**
- **Secondary sources of support**

HOSPITALS

Operations Review

- **Adding new service lines?**
- **Is the hospital adapting to industry changes in healthcare delivery?**
- **Ability to handle projected debt load?**

HOSPITALS

Examples

- **Hospital expansion and clinic renovation**
- **Hospital replacement construction with more outpatient focus**
- **Hospital replacement construction to add new service lines**

HOSPITALS

Management Coordinates With:

- **Hospital Board**
- **Community leaders**
- **Other financial institutions involved**
- **USDA**
- **Feasibility firm**
- **Design and construction team**

BORROWER

What is the Borrower's primary service area ("PSA")?

- **County? Certain ZIP codes?**
- **Where do 80% of the patients live?**
- **How much patient "out-migration" is on-going, and to where?**
  - How much is inevitable (specialized care, extremely ill)?
  - How much can be regained by the Borrower?
- **Largest employers in the PSA? Their outlook?**
- **Historical <u>and</u> projected demographic trends?**

BORROWER

Business Overview

- **Inpatient vs. outpatient revenue mix**
  - *Outpatient is the future of healthcare*
  - *Outpatient is greater need in rural communities*
- **Inpatient / swing volume**
  - Inpatient Average Daily Census
  - Inpatient Occupancy
  - Swing Average Daily Census
    - *Does the hospital make use of Swing beds to keep eligible inpatients after 4-days?*
  - Is there a nursing home in town? How's that relationship?

BORROWER

Business Overview, cont'd

- **What is the trend in Borrower's clinic visits over time?**
- **How many clinics in how many surrounding communities?**
- **What are the trends in radiology, therapy and other ancillary business lines?**

BORROWER

Affiliations & Support

- **Sales & Property Taxes**
- **Foundation**
- **Affiliations with health systems**
  - Patient transfer agreement
  - Regain patients post-op / post-acute
  - Possible donations
  - Give up a board seat
  - Possibly leverage IT, lab and other services

BORROWER

Board

- **Member profiles** (careers, areas of expertise)
- **Any financial or medical experts?**
- **Do they seem proactive? Quick to grasp information and make decisions?**

Management

- **CEO, CFO, CNO/COO**
- **Confidence and Competence**
- **Background with other health systems?**
- **Prior construction / expansion / turn-around experience?**
- **Initiatives / new business lines they've implemented**
- **What does management believe are the biggest challenges?**

BORROWER

Doctors

- **Leading referrers?**
- **How many?**
- **Age range? Any near retirement?**
- **Tenure in town?**
- **Any OB? Pediatrics? Surgeons?**
- **Visiting specialists?**

Mid-Level

- **PAs and NPs are cost-effective**

Nurses / Techs / Therapists

- **Employees or contract?**

BORROWER

Recruiting

- **Has Borrower demonstrated ability to recruit recently?**

How is ER covered?

- **Employee?**
- **Local physician?**
- **Contracted group?**

Hospitalist program?

- **Staff? Contracted?**
- **Non-existent?**

PROJECT

Scope

- **Emphasize inpatient or outpatient?**
- **Adding new services?**
- **Is the existing facility at capacity?**

Size

- **Compare to status quo**
- **Private vs. semi-private rooms**
- **Adding expenses?**

PROJECT

Growth Projected

- **Has there been inpatient or outpatient growth recently?**
- **Is projected growth aggressive?**
- **Replacement facilities can achieve more growth**
  - Initial bump the first few years
  - Levels off / small decline thereafter
  - *More recent replacements are seeing lesser bumps*

PROJECT

Construction Team

- **Architect, Engineer, Contractor**
  - Hospital experience
  - Size and footprint
- **Contract type – guaranteed max price?**
- **Bonding**
- **Up front plan & cost review**
  - Monthly pay app inspector (same firm as up front)
- **Construction lender**
  - Have a strong construction monitoring and funding department, or is the account officer handling this?
  - Is the account officer experienced with complicated construction?

FINANCIALS

Financial Reporting

- **Auditor size, reputation and healthcare expertise**
- **Feasibility firm size, reputation, healthcare expertise**
  - Same as auditor?
- **Do internal statements resemble / reconcile to the audit?**
- **<u>Other entities consolidated?</u> (i.e., fundraising arm)**
  - Is this entity a guarantor or co-borrower?
  - If not, analysis should not include their financials

FINANCIALS

High Level

- **Is the borrower cost-reimbursed by Medicare?**
- **What is Medicaid's reimbursement methodology in this state?**
- **Does current cash flow cover the request?**
  - With an estimate of additional cost reimbursement?
- **Payor mix by gross charges**
  - Some payors more profitable
- **Revenue by department (inpatient, swing, clinic, etc.)**
- **Referred volume by physician**

FINANCIALS

Healthcare Oddities

- **Seasonality**
  - Beware annualizing partial periods
  - Elective healthcare is slow during summer
  - Injuries higher in summer activity and icy winters
  - Flu season (severe or mild?)
- **Revenue Adjustments**
  - Contractual allowance (MSRP vs. purchase price)
    - Varies by payor
  - Prior year adjustments
  - Cost report settlements
  - One-time bad debt write-offs
    - Warrant underwriting adjustment?

FINANCIALS

Non-Operating Income, cont'd

- **Donations**
  - Unrestricted
  - Restricted
    - By whom?
    - What are the restrictions?
    - What is the purpose of the donation?
  - Capital Campaign
  - Not usually leaning on donations as repayment source

FINANCIALS

Non-Operating Income, cont'd

- **Sales / property tax revenue**
  - How long have these been in place?
  - How many renewals so far?
  - When are they next up for vote?
  - What does tax base look like going forward?
  - ***What does Borrower look like without them?***
- **Investment income**
  - Unrealized gain / (loss)
  - Susceptible to market volatility
  - Not leaned upon for repayment

FINANCIALS

Expenses

- **Staffing cost trends**
  - Physicians coming and going
  - Contract labor
  - Opening new clinic / line of business that hasn't ramped up yet
- **Supply cost trends**
- **Expensing project costs that should be capitalized?**
- **IT costs**
  - These and other support costs can be leveraged with an affiliation ("purchased services")

FINANCIALS

Expenses, cont'd

- **Bad Debt Provision**
  - Not an expense per GAAP
  - Revenue deduction
  - Used to bridge A/R and Allowance for Bad Debts from one balance sheet period to another
  - Can swing with shifts in payor mix and local economy
- **Charity Care**
  - Not an expense per GAAP
  - Does not get booked as revenue to begin with
  - Audit notes show cost

UNDERWRITING RATIOS

Cash Flow Coverage

- **Including the right entities / obligors?**
- **Adjustments required for one-time events?**
  - Bad debt write-off
  - Contractual allowance adjustment
  - Expensing project costs vs. capitalizing
  - Gain (loss) on sale
  - (Loss) on extinguishment of debt
  - Unrealized investment gain / (loss)
- **In-Place DSCR:**
  - Historical EBITDA / [Pro Forma Debt Svc. & Capital Leases]
    - Can add estimate of Medicare cost reimbursement if applicable
    - Is this ratio at least break-even for replacement / expansion?

UNDERWRITING RATIOS

Cash Flow Coverage, cont'd

- **Pro Forma DSCR**
  - Pro Forma EBITDA / [Pro Forma DS & Capital Leases]
- **Stress Testing**
  - Feasibility Study
  - Cost-reimbursed facilities *could* be more insulated
  - Stress testing is more important the more bullish projected growth is
- **"Right-sized" DSCRs**
  - Historical EBITDA / [Right-sized DS]
  - Pro Forma EBITDA / [Right-sized DS]
    - Lower proposed loan amount hypothetically using excess cash
    - Rural hospitals usually prefer to retain cash and maximize borrowing

BENCHMARKING

Liquidity / Operating Cycle

- **A/R Days**
- **A/P Days**
- **Current Ratio**
- **Days Cash on Hand – Unrestricted**
- **Days Cash on Hand – Total Sources**
  - Cash and marketable securities (liquidity)

Leverage

- **D/TNW** (now and including new debt)
- **FD / EBITDA** (new debt, historical and pro forma EBITDA)
  - What does hypothetical lower loan amount using excess cash do to these?

COLLATERAL

- **Which entities' assets?**
- **Cash collateral during construction?** No USDA guaranty yet
- **Mortgage / deed of trust perfection** (public bodies)
  - Revenue pledge?
  - Going concern appraisal policy?
- **Existing and future capital leases**
- **Inter-creditor agreement among USDA and other lenders**
- **What will they do with old facility?**
  - Tear down?
  - Convert?

COVENANTS

Financial Covenant Suggestions (pick relevant ones)

- **DSCR**
- **Tangible Net Worth**
- **Leverage** (FD / EBITDA, D/TNW)
- **Days Cash** (unrestricted, total)

Boiler Plate Covenant Suggestions

- **Annual Additional Debt Limit** (capital leases)
- **Annual Unfinanced CapEx Limit**
- **Pre-close: CMS confirm the facility will remain CAH post-replacement** (if applicable)
- **ALOS / Maintain CAH status continually** (if applicable)

PUBLIC / PRIVATE PARTNERSHIP

Brining private market expertise together with public funding.

- **Private lenders working with USDA to provide safe and sound credit structures for the clients.**
- **Expertise from private sector can be used to monitor construction, ramp up and long term portfolio management.**
- **Private sector lenders will monitor the entire loan amount, not just their “share.”**

PUBLIC / PRIVATE PARTNERSHIP

Traditional Structure Example:

- **Expansion project in South Central Colorado**
  - $21,400,000 total project, including
  - $10,000,000 refinancing
  - $11,400,000 renovation / expansion
- **Construction split into 2 separate notes:**
  - $7,000,000 note with a loan note guaranty, fixed at origination for 30 years at 5.25%.
  - $14,400,000 construction note to be taken out by USDA Direct loan at C/O.

PUBLIC / PRIVATE PARTNERSHIP

- **Benefits for USDA**
  - Private sector credit partner to help structure debt, monitor both construction and ramp up, and provide “second set of eyes” for long term portfolio monitoring.
- **Benefit for Borrower**
  - Long term low rate. Blended rate on transaction was less than 4.00%, fixed for 30 years (Gty Loan @ 5.25% and Direct Loan at 3.25%).
  - Low Fee Structure with utilization of bank financing versus bond financing for construction
- **Benefit for Bank**
  - Long term relationship with borrower with minimal refinancing risks.

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