

Chapter 13: Supporting Essential, Financially Distressed Hospitals

Key Points

- **Essential hospitals experiencing financial distress should receive financial support from the State. However, this support should not be unconditional.**
- **Essential hospitals receiving support should comply with conditions related to management and governance and undergo close monitoring of efficiency, quality and overall financial health.**
- **The Commission recommends adding supplemental payments to the Medicaid hospital payment rates to essential, financially distressed hospitals to take advantage of federal matching funds while better targeting public resources.**
- **The Commission proposes the creation of a Distressed Hospital Program to provide additional funding to essential, financially troubled hospitals. This program would include time-limited grants focused on improving operations as well as capital funds.**

One of the goals of the Commission's work is to strengthen the acute care hospital system in New Jersey. As discussed in previous chapters, the premise that underlies the Commission's framework for evaluating the hospitals' essentiality and financial viability is responsible allocation of the State's scarce resources for health care services. The State decision-making and action that the framework implies – directing State resources for helping financially troubled hospitals to those hospitals that provide essential services to their regions – is prudent and responsible State policy.

The converse implication of this policy is that the State will not provide support for non-essential hospitals that are not financially viable, and as a result, some of them will close. The State's policy of allowing some non-essential hospitals to close should help strengthen the remaining hospitals by consolidating patient volume and revenue in fewer hospitals and reducing excess capacity. As discussed in Chapter 4, analysis of supply and

demand for hospital services suggests that there is a surplus of hospital beds, and that the surplus is greatest in the areas of the State with the most financially distressed hospitals. Closure of some hospitals will consolidate existing patient volume in fewer hospitals, thus reducing the excess capacity. Moreover, the marginal cost of caring for closed hospitals' former patients is lower than the increased revenue remaining hospitals will receive for caring for them, thus providing a favorable margin.

To provide direct support to help essential, financially troubled hospitals improve their financial performance will require an increase in state funding combined with a reallocation of existing funding. This chapter provides the Commission's recommendations on how the State should provide this financial support. It also includes recommendations for conditions the State should impose on hospitals receiving such support.

I. Medicaid and Charity Care Payments

The first priority for states in providing financial support for hospitals and reducing their uncompensated care burden is to maximize the impact of their state expenditures by leveraging federal matching funds. States generally do this through:

- Medicaid hospital payment systems and
- Medicaid coverage expansion programs.

New Jersey has been very successful at leveraging federal funding in the past. However, it is increasingly difficult to access federal funds. Thus, it is important that the existing funding programs, to the extent possible, be aligned with the Commission's goal of supporting essential, financially troubled hospitals. Since there is no opportunity to claim federal match by increasing charity care subsidy payments to hospitals because, as discussed above, New Jersey has exceeded its federal DSH allotment for 2008, one way for the State to support essential, financially troubled hospitals is to revamp the way charity care subsidy payment are distributed. In addition, there is some opportunity, although limited, to leverage additional federal funding to increase Medicaid payments to provide increased payments to essential, financially troubled hospitals.

Recommendation:

The State should consider a supplemental add-on payment to the Medicaid fee-for-service base DRG rate for essential hospitals in financial distress.

In spite of the increasing difficulty in accessing federal funding, there is an opportunity for New Jersey to increase Medicaid fee-for-service funding targeted to essential hospitals through a new supplemental payment. For example, the Division of Medical Assistance and Health Service (DMAHS) could design an add-on payment for hospitals that are essential based on the Commission's criteria, plus other factors, as appropriate, and that have financial performance "scores" less than the statewide average in the prior year. The new add-on payments would require an increase in

state expenditures, but would be eligible for federal matching funds as long as they comply with the federally-defined upper payment limit (UPL) that governs Medicaid payments. Information provided to the Commission indicates that there is room under the private hospital UPL to increase Medicaid payments.¹³⁸

II. Distressed Hospital Program

Even with the benefit from closure of some hospitals and increased Medicaid and charity care funding as recommended in the previous section, state funding support will likely be necessary to help some or all essential, financially troubled hospitals improve their financial conditions.

Recommendation:

The Commission recommends that the State create a Distressed Hospital Program focused on providing financial support to financially distressed, essential hospitals. The program would be financed through an increase in the Ambulatory Assessment (which would be used to service debt financed by NJHCFFA backed bonds).

Increasing the Ambulatory Assessment to fund the Distressed Hospital Program is an effective way to generate necessary funds. In doing so, it also helps address issues raised earlier in the report regarding the competitive disadvantage of hospitals relative to free-standing ambulatory care facilities due to uneven regulatory requirements.

The Distressed Hospital Program would only distribute funds to eligible hospitals. Eligibility would be limited to those hospitals caring for a high percentage of patients from vulnerable populations, those experiencing substantial financial difficulties, and those located in an underserved area or providing an essential service that is otherwise unavailable within reasonable proximity.

¹³⁸In addition, a financially troubled, essential hospital could receive the DRG add-on payment only if it is not already being paid at its hospital-specific DSH limit, i.e., the hospital's Medicaid and charity care subsidy payments equal its cost of caring for Medicaid and uninsured patients. According to DMAHS, most hospitals' Medicaid and charity care subsidy payments are less than their hospital-specific DSH limits.

A. Eligibility

For a hospital to qualify for the state support to continue operations it must meet all of the following conditions:

Care for Vulnerable Populations (minimum thresholds)

- 10% Medicaid Discharges
- 10% Uninsured Discharges
- 10% Medicaid ED visits
- 20% Uninsured ED visits
- 25% Medicare DSH patient percentage

Financial

- Negative profit margin for the system for 2 consecutive years.
- Days Cash-on-Hand less than 50
- Current Ratio less than 1.5
- Long-term debt to capitalization greater than 75%
- Inpatient Occupancy rate greater than 50%

Geography and Services

- Located in a medically underserved area
- Travel time to nearest hospital must be greater than 15 minutes
- Designated Trauma Center
- Mental Health Services

B. Conditions of Participation in the Distressed Hospital Program

Following a hospital's approval to participate in the Distressed Hospital Program, the State would impose a number of requirements on the facility.

Immediately

- Arrange for a financial and operational audit – including a review of hospital management
- Provide a seat on the Hospital board
- Assess surrounding markets for strategic partnerships

Within 6 Months

- Reduce case mix adjusted length of stay by 10%
- Initiate program reductions based on results of audits
- Prepare a plan for sale of assets
- Implement staffing reductions as necessary

Within 1 year

- Reduce accounts receivable balances by 20%
- Reduce managed care denials by 25%
- Ensure charge master is updated

C. Types of Financial Support for Essential Hospitals from the Distressed Hospital Program

Recommendation:

The States should provide time-limited grants and/or zero-interest loans for operating and financial performance improvements to essential, financially distressed hospitals.

State-funded grants and zero-interest loans to essential, financially troubled hospitals could help address chronic barriers to financial viability. For example, hospitals could use the funds to retain consultants to help them develop and implement operations improvements and capital investment plans. As discussed in Chapter 15, a condition of the grants would be significant State oversight and involvement with the hospital's board and periodic reporting of progress and attainment of benchmark performance levels. Hospitals receiving grants should have to demonstrate improved and sustainable financial performance; for example, hospitals would have to attain financial performance levels necessary to qualify for FHA-insured loans for capital investment in physical plant and technology.

Recommendation:

The State should establish a capital grant program for hospital facility renovation and information technology investment to essential, financially distressed hospitals.

Some of New Jersey's essential, financially troubled hospitals do not currently meet the financial performance requirements for FHA-insured loans, which are generally below the levels for the lowest investment grade credit ratings. State-funded capital grants, similar to those the HEAL NY program provides, may be the only means for some of these hospitals to access capital financing to renovate their old physical plants and invest in information and medical technology.

III. Help in Accessing Low-Cost Financing

Many states assist financially distressed hospitals by facilitating the process of securing loans or capital from the sale of non-core assets and helping to obtain revolving lines of credit secured by accounts receivables to address working capital and temporary liquidity needs. In addition, many states offer hospitals financing and refinancing of capital projects through publicly offered and private placement tax-exempt bonds. The New Jersey Health Care Facilities Financing Authority (NJHCFFA) issues municipal bonds to provide not-for-profit hospitals and other health care organizations with access to low-cost capital. NJHCFFA can issue both federally tax-exempt and taxable bonds, and interest on all bonds issued by the Authority is exempt from New Jersey taxation.

Another way states can assist hospitals to access low cost financing is by helping them obtain U.S. Department of Housing and Urban Development Federal Housing Administration (FHA) Section 242 mortgage insurance. FHA-insurance enhances the creditworthiness of borrower hospitals, thereby enabling them to finance their debt at more affordable rates than they would otherwise be able to attain. To qualify for FHA insured loans, hospitals must have an average operating margin of zero or greater for the last three years, and an average debt service coverage ratio of at least 1.25 percent. In addition, eligible hospitals must be willing and able to grant an FHA insured lender a first lien on the property, plant and equipment that secure the mortgage.¹³⁹

The majority of the FHA 242 loans have been to hospitals in New York, but FHA has made efforts to broaden its mortgage insurance portfolio to hospitals in other states. In 2000, New York hospital mortgage balances comprised 89 percent of the FHA's total mortgage portfolio, but as March 2007, hospitals in other states comprised 45 percent of FHA's \$5.7 billion outstanding principal balance. Over 20 New Jersey hospitals have obtained FHA-insured loans since the program's inception.¹⁴⁰

IV. Conclusion

This chapter provided the Commission's recommendations for the type of support that should be made available to financially distressed, essential hospitals. However, the Commission notes again that funds distributed to support failing hospitals must be attached to conditions. Some of these conditions are outlined in this chapter and include a variety of management and governance issues along with efficiency goals.

The type of support the Commission recommends making available to failing, essential hospitals is supplemental Medicaid payments, charity care payments refocused on "needy" hospitals, and a newly created Distressed Hospital Program. Clinical quality and efficiency benchmarks that should be monitored and met as part of receiving support are presented in Chapter 15.

The Commission recognizes that one of the outcomes of our effort to ensure that the State has a rational distribution of financially viable acute care hospitals and services sufficient to meet the needs of its residents, is that some non-essential, financially distressed hospitals may close. In the next chapter, we discuss policies and procedures to minimize the impact of hospital closures and to ensure that the closure of financially distressed hospitals that are not essential is as orderly as possible.

¹³⁹U.S. Department of Housing and Urban Development.

¹⁴⁰U.S. Department of Housing and Urban Development. FHA Mortgage Insurance for Hospitals – Portfolio Data. (<http://www.hud.gov/offices/hsg/hosp/portdata.xls>)