

Health Issues Brief

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Economics of a Not-for-Profit Hospital

Did you know that Florida Hospital treats over 900,000 patients per year? This number includes 98,000 inpatients, 234,000 outpatients and 572,000 emergency/urgent care patients— at a cost of \$1.1 billion.¹ Safeguarding the hospital’s financial future is critical to serving our patients, now and in the future.

In order to keep up with our growing Central Florida community and the aging "baby boomer" generation, Florida Hospital plans to invest \$1.2 billion in new facilities and equipment in the next seven years.² To do this, the hospital must generate enough income to meet its current expenses as well as fund this investment.

Hospitals can generate income in two ways: increased revenues and decreased expenses. For-profit hospitals generate profits that return dividends to shareholders. Not-for-profits like Florida Hospital generate margins that are reinvested into new technologies, services, equipment, and physical facilities for the communities they serve.

National healthcare consulting firm urges continued fiscal diligence

Florida Hospital recently commissioned a study to analyze its current financial position and to target the income needed over the next five to 10 years to meet community needs. The study was conducted by the national healthcare consulting firm of Cleverley and Associates.

While Florida Hospital achieved a 6.14% operating margin in 2002, or \$73.8 million on revenues of \$1.1 billion,³ the Cleverley study recommended that Florida Hospital work toward an annual 9.5% margin⁴ to meet the needs of the Central Florida community.

“Think of hospital margins like household margins,” says CFO Brian Paradis. “In most households, money is spent or set aside for home repairs and improvements, vacations, savings, etc.”

“For a household with a \$50,000 annual income, a 7.5% margin equals \$3,750 before taxes.”

Cleverley noted that Florida Hospital is well managed, and that its current financial position is above average compared to other local and most US hospitals. Cleverley also pointed out that much of Florida Hospital's margin is related to efficient operations as opposed to revenues from investments or high patient charges. In fact, Florida Hospital's charge-to-cost ratio -- the ratio of hospital charges vs. actual hospital costs -- is about half that of other hospitals in the state.⁵

Capital Needs are growing

Florida Hospital will need enough cash to finance the replacement and renovation of existing capital assets, invest in new services and meet the area's projected population growth while maintaining its strong financial rating. Both internal and external market forces make this a continuing challenge:

Physical Plant

Currently, the average age of Florida Hospital's facilities is younger than the national average - but this statistic is skewed by the hospital's recent investments. Florida Hospital Celebration Health and the Florida Hospital Cancer Institute were built in the

“It’s pretty simple,” says Brian Paradis, CFO of Florida Hospital. “If your family is growing and you need a bigger house, you’ll need a bigger mortgage – so you’d better have a bigger income.”

last five years. While crucial to meet the needs of a growing population, these new investments came at the expense of upgrades to the hospital's basic infrastructure. Major portions of the hospital need to be upgraded or replaced.

Technology

Providing the highest quality services requires substantial resources. For example, new drug-coated stents⁶ that help keep coronary arteries open cost \$3,300 each, more than twice the cost of regular stents. Medicare -- half of Florida Hospital's business -- reimburses just \$2,000.⁷

Imaging equipment is another example. CT scan machines cost up to \$1 million and PET imaging machines cost well over \$2 million.⁸ This kind of technology is needed to advance the diagnosis and treatment of multiple diseases.

Operating Expenses are rising while reimbursement is falling

Cleverley also suggests that Florida Hospital will need funds to cover increasing operating expenses: keeping up with inflation, increasing salaries, and declining Medicaid and Medicare reimbursements.

Drugs and Supplies

Prescription drug costs have risen substantially over the past few years. In 2000, pharmaceuticals rose 17.3%⁹ and continue to rise:

	<u>2002 Inflation rate</u>	<u>2003 Inflation rate</u> ¹⁰
Blood and blood products	20%	15%
Drugs	15%	13%
Biotech drugs	17%	17%
Biological drugs	4%	16%
Chemotherapy drugs	15%	20%

Salaries and Wages

Florida Hospital is the third-largest employer in Central Florida, with over 14,000 employees. Fifty-one percent of annual hospital costs go to wages and benefits -- mostly for clinical and professional positions.

Due to the increasing nursing shortage, full-time nurses' salaries jumped 10 percent last year.¹¹ Growing shortages in other allied health professions like imaging technicians and respiratory therapists mean that other salaries will also be subject to increases above the general rate of inflation.

Florida Hospital generated \$2.05 billion in economic activity in 2002, comprising 7.2% of the Central Florida economy.
UCF Community Impact Assessment, 2003.

Uncompensated Care continues to be a challenge

Hospitals are unique in that they provide the services, but are not able to negotiate with government payers -- over half of Florida Hospital's business. And, people must be seen and treated in hospital emergency rooms regardless of ability to pay.

Charity and Bad Debt

Over 175,000 Orange County residents are uninsured or underinsured. Hospital emergency rooms remain the "safety net" for people unable or unwilling to pay. In 2002, Florida Hospital incurred real costs of over \$67 million in charity care and bad debt.¹²

Medicare

In 2002, Florida Hospital absorbed \$48 million in Medicare payment reductions.¹³ Over 40% of Florida Hospital's patients are covered by Medicare, and a 9.4% increase in Medicare admissions is projected (nationwide) over the next five years. During the same five years, additional reductions will lower payments to hospitals by \$645.7 million.¹⁴

Medicaid

Unreimbursed Medicaid costs at Florida Hospital totaled \$10 million in 2002.¹⁵ Medicaid is the financial provider for one of every four children in Florida and 44% of all pregnant women.¹⁶ Florida's Medicaid program pays less than the Medicaid programs in the rest of the nation: the state's hospitals are reimbursed 83% of the costs of caring for Medicaid patients, compared to a national Medicaid average of 94% of costs.¹⁷

Preparing for the future

"Our primary mission is clear: to provide quality healthcare to Central Florida residents," said Florida Hospital President Don Jernigan, "and we must remain a fiscally viable enterprise to carry out our mission.

"Hospitals are unique in that we provide the services, but are not able to negotiate over half of our payments," he continued. "Reductions in government payments, rising pharmacy costs, rising numbers of uninsured, and the medical liability crisis all remain challenges.

"As we look to the future, we know we will continue to be subject to pressures from outside of the hospital," he concluded. "The Cleverley study reminds us how important it is to work hard today to ensure our tomorrow, and that of our community."

In 2002, Standard & Poor (S&P) upgraded Adventist Health System's bond rating to a "stable A."

"An S&P rating is crucial as it impacts the interest rate for borrowing money and more importantly, our access to capital," says CFO Brian Paradis. "Our goal is to get to A+ and stay there."

S&P ratings range from AAA to D. Adventist Health System has steadily increased its rating from a "Negative A-" in 1999, a hard year for all area hospitals.

¹ Florida Hospital Financial Planning

² Florida Hospital projections

³ Florida Hospital Financial Planning

⁴ Financial Performance Review, Cleverley & Associates, 2/4/03

⁵ The charge-to-cost ratio of Adventist Health System is 160% compared to other Florida hospital rates that run as high as 304%, according to *"The Nation's Most and Least Expensive Hospitals"* by the Institute for Health & Socio-Economic Policy.

⁶ Stents are tiny, hollow mesh "tubes" inserted into the coronary arteries after the artery-blocking plaque is flattened against the artery walls. These new stents are coated with a special drug that prevents arteries from re-clogging.

⁷ Orlando Business Journal, 1/10/2003

⁸ American Hospital Association, The State of Hospitals Financial Health

⁹ American Hospital Association, The State of Hospitals Financial Health

¹⁰ Hospital Purchasing Group

¹¹ American Hospital Association

¹² Florida Hospital Accounting Department

¹³ Florida Hospital Accounting Department

¹⁴ Florida Hospital Association

¹⁵ Florida Hospital Accounting Department

¹⁶ Florida Hospital Association

¹⁷ Florida Hospital Association