



# CHA Special



# REPORT

July 2009

ANALYSIS OF CRITICAL ISSUES FACING CALIFORNIA HEALTH CARE LEADERS

## California Hospitals and the Economy – Ongoing Credit Crisis Jeopardizes Seismic Compliance Mandate

The following report is based on the results of a CHA survey of hospital chief financial officers conducted in the second quarter of 2009.

The ongoing credit crisis and the nation’s faltering economy continue to cause unprecedented financial and operational challenges for California hospitals. More than a quarter of hospitals statewide (28 percent) have seen interest expenses increase in the first quarter of 2009, while many others have been frozen out of the credit market entirely. As a result, hospitals across the Golden State are faced with limited access to capital and increased cost of borrowing at a time when these facilities also are confronting the additional burden of complying with an unfunded seismic mandate that has an estimated price tag of \$110 billion.

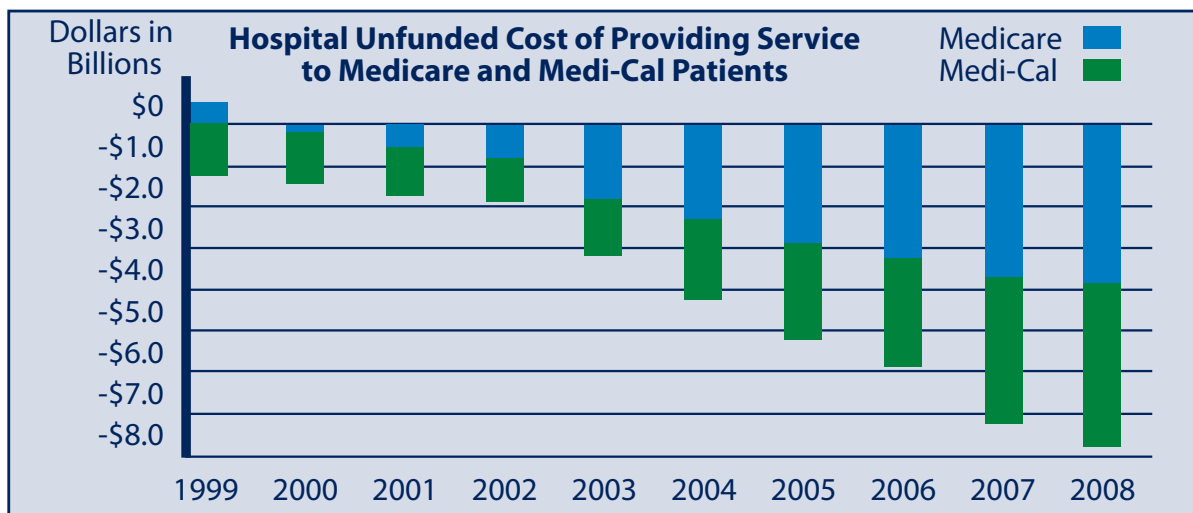
These findings come from an April 2009 survey of hospital chief financial officers conducted by the California Hospital Association (CHA). The study was a follow-up to an initial CHA survey conducted in late 2008 that examined how the economic downturn was impacting California hospitals.

The newest survey results reveal that hospitals are experiencing

concurrent financial hardships stemming from a range of economic forces. These new pressures have intensified the existing financial burdens already faced by California hospitals, among which is the fact that most hospital services are provided to patients covered by governmental programs (e.g., Medicare and Medi-Cal) that fail to cover the cost of care. Additional financial impacts resulting from the economic recession include:

- Limited access to capital.
- Increased cost of borrowing, which prices hospitals out of the market.
- Increasing numbers of uninsured patients as a result of rising unemployment and the loss of job-based health coverage.
- Devaluation of investment holdings.
- Increases in bad debt and charity care.
- Erosion of revenue and elective procedures.

### Government Health Care Programs Fail to Cover Costs



The combination of these factors, according to the CHA survey, indicates that nearly two-thirds of California hospitals (64 percent) will not be able to secure the capital necessary to comply with the existing seismic deadlines.

**64%**  
cannot secure capital  
to fund seismic mandate

**Accessing Affordable Capital**

Accessing affordable capital requires hospitals to demonstrate financial capability and stability. Financial capability is determined by the amount of cash in excess of reserves and investment balances available for project investment. Hospitals can increase their financial capability by generating cash from:

- Operations
- Philanthropy and fundraising
- Investment balances

Based on the results of the most recent CHA survey, 45 percent of hospitals indicate decreases in their operating margins in 2009; more than half report decreases in cash on hand (with almost one-third reporting a significant decrease); and 34 percent of hospitals report decreases in charitable contributions. This means that many hospitals are unable to maintain financial strength and, therefore, face barriers in accessing capital. More than 60 percent of hospitals report a continued deterioration in the ability to access capital for all hospital financing needs.

**45%**  
indicate decreases in  
operating margins in 2009

**Hospital Operating Income and Revenues**

For capital-improvement projects, such as those related to the seismic mandate, creditors and rating agencies evaluate hospital balance sheets and demonstrated stability looking both backward and projecting forward. Creditors also are looking for sustained operating results, specifically operating income of greater than 3 percent. In aggregate, California hospitals reported operating margins of less than 1 percent for each of the last three years, with 2007 and 2008 in the negative. More than one-third of all California hospitals report negative operating margins.

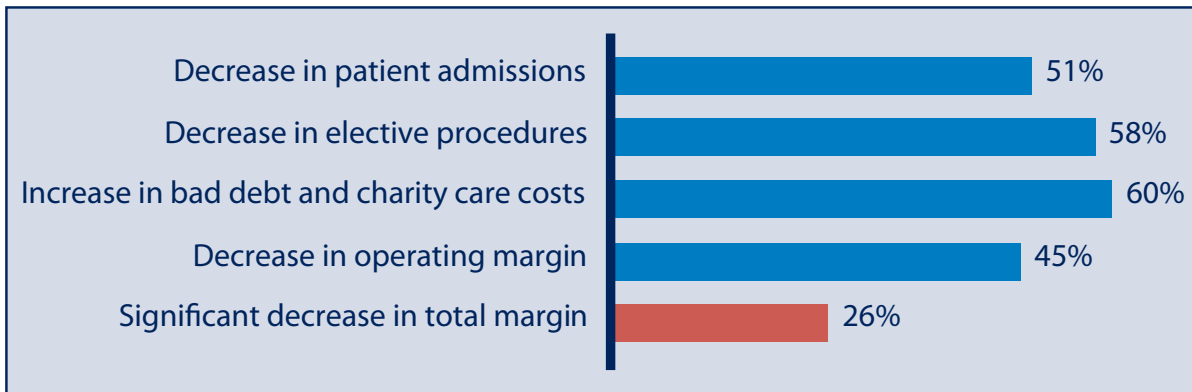
Among the factors impacting operating revenues, according to the CHA survey, is a significant increase in the number of uninsured patients seeking care in hospital emergency rooms. More than 57 percent of hospitals have seen a rise in the number of uninsured patients, most likely as a result of rising unemployment and the loss of job-based health coverage. This is a 22 percent increase since CHA's previous survey. Additionally, more than half of California hospitals report a decrease in inpatient admissions and elective procedures since CHA's earlier report.

**57%**  
have seen rise in  
uninsured patients

At the same time, 60 percent of hospitals report an increase in the amount of bad debt and charity care provided. As a result, 50 percent of hospitals report that their total margins have

**60%**  
report increase in bad debt  
and charity care provided

**Percent of Hospitals Reporting Impact of Economic Crisis**



decreased this year. Of those, 26 percent indicate that the decrease is significant.

In 2008, the costs of uncompensated care provided by California hospitals totaled \$11.3 billion. Of that amount, Medicare shortfalls accounted for nearly \$3.7 billion, while Medi-Cal underfunded hospitals by \$4.1 billion.

As the current debate over national health care reform intensifies, it should be remembered that the ability of hospitals to continue providing patient care is dependent on adequate reimbursements from all payers. Any reform proposals that perpetuate these underpayments through a public plan will further penalize California hospitals.

### Compliance With Seismic Mandate

California's hospital seismic law — SB 1953 — was passed by the Legislature a few months after the Northridge earthquake in 1994. Although 23 hospitals were damaged in the Northridge earthquake, it should be noted that no hospital buildings collapsed as a result of a hospital building failure in the Northridge earthquake.

In fact, it has been nearly 40 years since an earthquake caused a structural failure of a hospital building in California. There was a death due to the collapse of a hospital building in 1971, in the aftermath of the Sylmar earthquake in Los Angeles. The tragedy of that earthquake resulted in the passage of the first seismic law pertaining to hospital buildings, which took effect in 1973. Any hospital building constructed in 1973 or after already complies with specialized hospital seismic requirements. As a result, most

hospital buildings in California are already safer than other buildings in local communities.

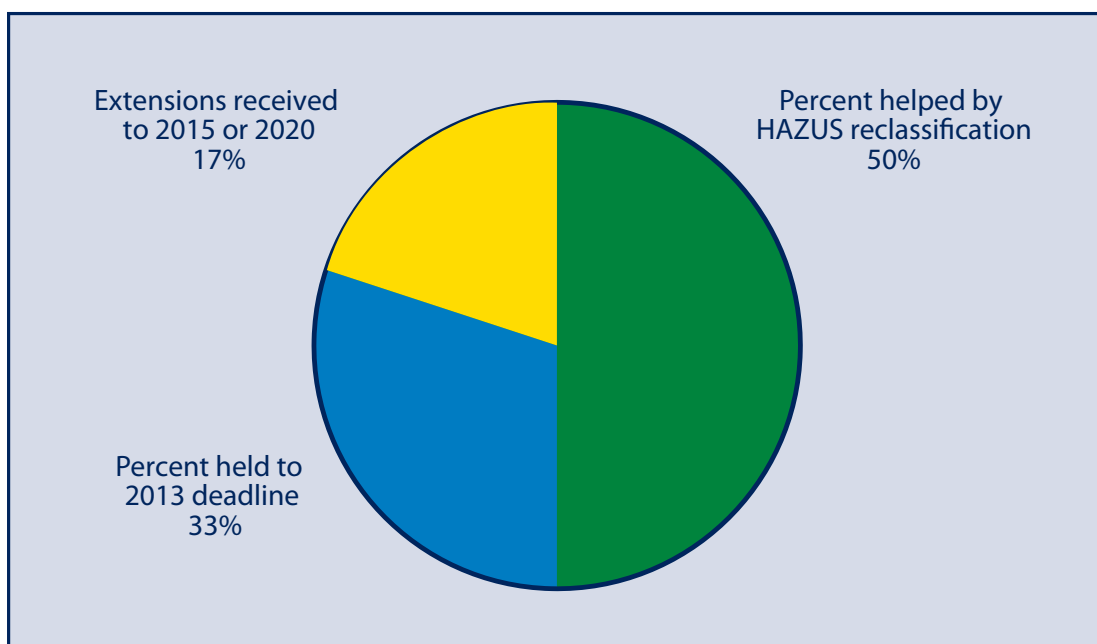
Because the goal of having earthquake-compliant hospital buildings is a worthy public policy objective, California hospitals have long supported the objectives set forth in SB 1953. Under this mandate, every hospital building in California must comply with seismic standards that will not only ensure structural integrity when an earthquake occurs, but also enable hospitals to remain operational and continue caring for patients after the quake strikes.

The current mandate requires hospitals to comply by deadlines as soon as 2013 or 2015. Many hospitals have made progress toward meeting the 2013/2015 timelines, but the costs are enormous. The RAND Corporation estimates the cost of this unfunded mandated at \$110 billion, without financing costs. This law currently impacts approximately 900 acute-care inpatient hospital buildings. The state could force these buildings to close their doors to patient care if they cannot meet the compliance deadlines.

According to the CHA survey, the top two barriers impeding hospitals' ability to comply with the seismic mandate are the inability to secure capital to fund retrofitting and/or replacement (64 percent) and deteriorating revenue caused in large part by government program underfunding (62 percent).

The Office of Statewide Health Planning and Development (OSHPD) estimates that about 50 percent of California hospital buildings will benefit from a reclassification under the HAZUS program, and will not be subject to the seismic retrofitting requirements until 2030. CHA's survey indicates

## Hospital Buildings At Risk



that at least one-third of hospital buildings will not benefit from a HAZUS reclassification and are being held to the 2013 deadline. Some hospitals not benefiting from HAZUS have received an extension to 2015 or 2020, depending on certain circumstances. Access to affordable capital is a barrier for almost all hospitals.

The requirements of the unfunded seismic mandates place a tremendous increased burden on hospitals. Considering it typically takes up to 10 years in California to obtain financing, and to design and construct a new hospital, it is clear that the current seismic deadlines are impossible for many hospitals to meet in this economic environment. Further, the cost of hospital construction in California far exceeds the cost in other states.

### **Faltering Economy Forces Difficult Decisions**

California hospitals are not unique to the negative impacts of the faltering economy. Hospitals across the United States

are being impacted by the nation's economic crisis, forcing many facilities to reconsider or postpone capital improvements, reduce staff, make cutbacks in patient care services or downsize or close facilities. While many California hospitals are making similar decisions, their ability to respond to the economic downturn in a way that protects access to patient care is constrained by the fast-approaching seismic compliance deadlines.

During economic downturns, hospitals often shoulder an increased burden of caring for patients who have no other source of health care, as well as having to cope with reduced governmental reimbursement. While CHA recognizes that the financial crisis affecting both the state and the nation limits the ability of government to provide financial assistance, other forms of relief for hospitals must be considered to ensure current access to health care services will not further erode.

Revisiting the seismic mandate must be an essential part of the state's economic recovery plan.

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