

Economic Recession Hits Healthcare

Dear Colleagues:

The failure of the US housing market and the subsequent tumultuous events in the capital markets over the past twelve months have challenged all sectors of the US economy, including healthcare – a field that some once thought was *recession-proof*. In my 25 years in the healthcare field, I cannot recall a time when our industry faced as many challenges as it does today. Currently, unemployment is over seven percent (7%); hospitals and providers have experienced a decrease in procedural volume and previously unencountered barriers to access for capital; insurance coverage is shifting from a defined benefits to a defined contributions basis (thereby shifting a higher percentage of costs onto patients); and, healthcare expenditures are continuing to soar.

An August 2008 survey conducted by the National Association of Insurance Commissioners suggests that the effect of the current recession and “*economy-related woes*” were reason enough for 22% of respondents to reduce physician office visits. The fact that the number of healthcare office visits fell 1.2% between July 2007 and July 2008 substantiate these claims.² Non-emergent procedures have also dropped, a reduction blamed by many on the economy. For example, from March 2007 to March 2008, knee replacements and hip procedures fell 18.6% and 45%, respectively.²

The effect of the ongoing economic woes is also evident by a reduction in pharmaceutical spending in 2008. Eleven percent of survey respondents indicated that they scaled back on prescription drugs – claims evidenced by a 0.5% and 1.97% reduction in the number of prescriptions filled in the first and second quarters of 2008, respectively.³ It is expected that overall individual healthcare spending for 2008 will have fallen to a 15 year low.⁴ However, while the past year has been characterized by a decline in the growth of healthcare expenditures, overall spending on healthcare expenditures (\$2.4 trillion in 2008) will outpace the limping economy.⁵ As healthcare expenditures rise and the economy wanes, healthcare expenditures will engross a larger percentage share of the Gross Domestic product (GDP) and are predicted to account for over 20% of the GDP in 2018.⁶

The struggling economy has also affected hospitals’ operating margins as patients are seeking care less frequently and hospitals must share a greater portion of bad debt and charity care expenditures.⁷ As the number

of Americans without insurance rose from 2001 to 2007, hospitals experienced a \$12.5 billion increase in uncompensated care.⁸ Also hindering hospitals’ abilities to meet daily operational costs, the days-cash-on-hand ratio, (which measures liquidity), decreased significantly in 2008 and reached a historic low in the third quarter of 2008.⁹ A recent survey of hospitals conducted by Thomson Reuters also found that operating margins were down in 2008 for every hospital in the sample, with over 50% of the hospitals sampled operating in the red as non-operating incomes plummeted. This is a significant increase from the 25% of hospitals operating with negative margins in the second quarter of 2008.¹⁰ Further, overall hospital spending is expected to slow from 7.2% in 2008 to a 5.7% in 2009,¹¹ resulting in approximately 47% percent of hospitals expecting to have layoffs in the coming year.¹²

According to the American Hospital Association’s recent survey of over 600 hospitals, nine out of ten hospitals reported difficulty in accessing tax-exempt bonds or securing debt from banks and other financing institutions, thereby forcing a reduction in capital expenditures. Hospitals, which rely on philanthropy, borrowed money, and their organization’s own reserves to finance capital expenditures, have experienced a decline in each of these areas.¹³ In fact, “*eighty-two percent [82%] of respondents have put facilities projects on hold, sixty-five percent [65%] have put clinical technology projects on hold and sixty-two percent [62%] have put information technology projects on hold.*” Additionally, forty-five percent [45%] of respondents have postponed capital projects that were originally expected to begin within the next six months. When respondents were asked to provide reasoning for postponing projects, 83% cited “*uncertainty about future economic conditions*” as “*very*” or “*somewhat important*,” and 53% stated their decision was based on the fact that the “*usual sources of capital were unavailable.*”¹⁴

As hospitals restrict future growth, they restrict their ability to meet the needs of the growing and aging population. This decline coupled with the reduction of healthcare spending in the private market is met with an expected massive increase in spending in the national or public sector. According to the Center for Medicare and Medicaid Services (CMS), the growth in public funding for healthcare expenditures (i.e., 7.2%) will exceed expenditures by private payors (5.3%), thereby

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resulting in the public share of healthcare funding to rise to over 50% by 2016, and reaching 51.3% in 2018. The rising unemployment rate will further the increase in public spending as approximately 61% individuals receive healthcare through employer sponsored insurance (ESI) plans.¹⁵ According to the Kaiser Family Foundation, if unemployment is seven percent, the number of individuals with ESI will decline by 5.6 million. Consequently, the number of individuals seeking enrollment in public funding programs such as Medicaid and SCHIP will increase by 2.4 million, with the number of uninsured increasing another 2.6 million.. At seven percent unemployment rate the federal share of funding for Medicaid and SCHIP programs would need to increase \$4.7 billion, with state funding increases of \$3.6 billion to meet the mounting enrollment.

As unemployment and Medicaid and SCHIP enrollment rise together, states are simultaneously experiencing a decrease in revenues from a reduced workforce. It is estimated that a one percent increase in unemployment will result in a three to four percent decrease in state revenues, thereby further hindering the states' ability to meet the growing costs of their Medicaid and SCHIP budgets. Currently, 41 states and the District of Columbia are reporting budget shortfalls for 2009. Given that Medicaid expenditures account for almost one-fifth of most states' budgets, many states will need to make cuts to both Medicaid and SCHIP, which could create a funding gap of \$21 billion if the federal government does not intervene.¹⁶ Medicaid enrollment was four percent [4%] in 2008, compared to 0.2% in 2007.¹⁷ Additionally, Medicaid expenditures are expected to increase over seven percent each year for the next ten years, far outpacing the projected growth rate of the economy. By 2017, Medicaid spending will reach \$674 billion and is expected to account for 3% of the Gross Domestic Product (GDP).¹⁸

As the population continues to age, growth in spending on Medicare is expected to increase from five percent in 2010 to 8.2% in 2018.¹⁹ Last spring, government analysts predicted that the Medicare Part A Hospital Insurance Trust fund would go bankrupt by 2016. Yet, due to the weakening economy and increased reliance on public funds to cover healthcare expenditures, the Medicare chief actuary predicted that the bankruptcy would occur in 2013, three years earlier than originally expected. Medicare has issued several cost-saving measures including a transition from fee for service (FFS) reimbursement to value-based purchasing reimbursement models.²⁰ Given that hospitals receive about fifty percent [50%] of operating revenues Medicare and Medicaid patients, reductions in reimbursement funding to these programs will critically affect the ability of hospitals to obtain a break even or positive operating margin.²¹

While spending in the private sector has declined and spending in the public sector is expected to rapidly increase, there may be light at the end of the tunnel. Congress has recognized the impending healthcare crisis in its American Recovery and Reinvestment Act

(ARRA), signed by President Obama on February 17, 2009. The \$787 billion economic stimulus bill is intended to jumpstart the economy by providing funding to small businesses as well as creating jobs. One major focus of the ARRA is healthcare.²²

The ARRA has allotted \$19.2 billion to ensure that each American has a complete, interoperable electronic health record (EHR) by 2014. The net effect of this investment will be a long-term cost savings, improved outcomes, and increased communication between physicians. Beginning in 2011, the funding will increase reimbursement for Medicare and Medicaid providers (up to \$60,000 per physician and \$11 million per hospital) who use EHRs,²³ and will begin penalizing physicians who are not using EHRs through reduced reimbursement beginning in 2015.²⁴

In response to the potential increase in the number of uninsured and the resulting increased enrollment in public insurance programs, the ARRA will provide over \$24 billion to subsidize individuals who seek to purchase an extension of ESI through the Consolidated Omnibus Budget Reconciliation Act of 1985 (COBRA).²⁵ The funding will subsidize up to 65% of the premium for individuals who lost their jobs between September 1, 2008 and December 31, 2009, and whose gross income was less than \$165,000 per year (\$290,000 for couples). The subsidy will not count as personal income and will be available for a maximum of nine months.²⁶ Additionally, Congress has recognized the expanding Medicaid enrollment (and the negative impact on state budgets) by providing \$87 billion (over 11% of all ARRA spending) in matching federal funds.²⁷

President Obama has also earmarked \$76.8 billion in his 2010 budget in support of expanding access and quality of healthcare. Perhaps one of the largest aspects of the health portion of the budget is the establishment of a \$630 billion reserve, to be set aside over ten years, to help reform the healthcare system and reach the ultimate goal of providing health insurance coverage for all Americans. The reserve will be financed equally by both new revenue and *"savings proposals that promote efficiency and accountability, align incentives toward quality, and encourage shared responsibility."*²⁸ President Obama also seeks to double the amount of federal money spent on cancer research. Other health-related initiatives include allowing the FDA to regulate/provide a regulatory pathway for consumer purchases of drugs from overseas, improving the oversight of CMS, ensuring the long-term viability of Medicare, and providing more health insurance coverage for low-income Americans. Additionally, the budget provides \$73 million to improve access to care in rural areas and provides another \$1 billion for comparative information on effective treatment protocols for certain conditions.²⁹

The recent months have made it evident that healthcare is not recession-proof. As Americans are faced with shrinking incomes, fear of job loss, and rapidly changing capital markets, they often must consider cost when

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making healthcare decisions. As the healthcare market becomes more elastic (i.e., sensitive to price), and Americans share a greater proportion of healthcare expenditures, hospitals and healthcare providers will have to find ways to not only promote quality but also cost efficiency for patients seeking medical care.

While the sea change of healthcare is rapidly affecting individuals across America, challenges such as those described above also present considerable opportunities for leaders in the healthcare field to pursue innovative solutions to these challenges. I look forward to continuing to work with the best and the brightest in the field to find and implement those solutions which provide the greatest benefit for all stakeholders: i.e., investors, managers, medical professionals, staff, and, most importantly, the patient community we all serve.

Regards,



Robert James Cimasi, MHA, ASA, CBA, AVA, CM&AA
President

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Robert James Cimasi, MHA ASA, CBA, AVA, CM&AA, President. Mr. Cimasi is a nationally recognized healthcare industry expert, with over 25 years experience in serving clients, in over 49 states, with a professional focus on the financial and economic aspects of healthcare industry including: valuation consulting; litigation support & expert testimony; business intermediary and capital formation services; certificate-of-need and other regulatory and policy planning; and, healthcare industry transactions, joint ventures, mergers and divestitures.

Mr. Cimasi holds a Masters in Health Administration from the University of Maryland, and several professional certifications. He has been certified and has served as an expert witness on cases in numerous states, and has provided testimony before federal and state legislative committees.

Mr. Cimasi is a nationally known speaker on healthcare industry topics, is the author of several nationally published books, chapters, published articles, research papers and case studies, and is often quoted by healthcare industry press. Mr. Cimasi's latest book, *"The U.S. Healthcare Certificate of Need Sourcebook"*, was published in 2005 by Beard Books. In 2006, Mr. Cimasi was honored with the prestigious *"Shannon Pratt Award in Business Valuation"* conferred by the Institute of Business Appraisers and was elevated to the Institute's College of Fellows in 2007.



Todd A. Zigrang, MHA, MBA, CHE, Senior Vice-President. Mr. Zigrang has over twelve years experience in providing valuation, financial analysis, and provider integration services to HCC's clients nationwide. He has developed and implemented hospital and physician driven MSOs and networks involving a wide range of specialties; developed a physician-owned ambulatory surgery center; participated in the evaluation and negotiation of managed care contracts, performed valuations of a wide array of healthcare entities; participated in numerous litigation support engagements; created pro-forma financials; written

business plans and feasibility analyses; conducted comprehensive industry research; completed due diligence analysis; overseen the selection process for vendors, contractors, and architects; and, developed project financing.

Mr. Zigrang holds a Masters in Business Administration and a Master of Science in Health Administration from the University of Missouri at Columbia. He holds the Certified Healthcare Executive (CHE) designation from, and is a Diplomat of, the American College of Healthcare Executives and a member of the Healthcare Financial Management Association.



Lance A. Haynes, MSF, Vice President. Mr. Haynes focuses on the area of financial and economic analysis and consulting. His main responsibilities are comprised of business, tangible asset and intangible asset valuations, as well as financial analysis and forecasting for healthcare services related enterprises. Mr. Haynes has performed valuations for many types of ancillary services providers including Surgical/Specialty Hospitals and Ambulatory Surgery Centers, Cardiac Catheterization Labs, Diagnostic Imaging Centers and Kidney Dialysis Centers, and has also performed valuations and financial analyses for Home Healthcare

Providers, Long-term Care Facilities and Physician Medical Practices across various specialties. In addition, Mr. Haynes has performed joint venture service line and lease arrangement valuations for hospitals and physician groups, and has assisted with numerous litigation support engagements. Prior to joining HCC, Mr. Haynes was a Research Associate with Flagstone Securities, a specialty investment bank, located in St. Louis, Missouri, where his main responsibilities included the development and maintenance of company earnings models and proprietary stock indices for publicly traded companies.

Mr. Haynes received his Bachelor of Arts in Finance from the University of Northern Iowa and his Master of Science in Finance from St. Louis University. Mr. Haynes is a Level III candidate in the Chartered Financial Analyst (CFA) Program, and is a member of both the CFA Institute and CFA Society of St. Louis.



Anne P. Sharamitaro, Esq., Vice President. Ms. Sharamitaro focuses on the areas of Certificate of Need (CON); regulatory compliance, managed care, and antitrust consulting. Ms. Sharamitaro was admitted to the Missouri Bar in 2005 after graduating with J.D. and Health Law Certificate from St. Louis University School of Law. At St. Louis University, served as an editor and staff member of the Journal of Health Law, published by the American Health Lawyers Association. She has presented healthcare industry related research papers before Physician Hospitals of America (f/k/a American Surgical Hospital Association) and the National Association of Certified Valuation Analysts.



Kelly Gordon is a Research Associate at Health Capital Consultants (HCC). Ms. Gordon is in her second year of the Master of Health Administration program at Saint Louis University and will graduate in May 2009. Ms. Gordon also has a Master of Social Work from Washington University in Saint Louis. At HCC, Ms. Gordon provides research support in the areas of medical specialty trends related to a wide and diverse array of healthcare industry enterprises.