Rural hospital closures and financial distress

George H. Pink and Brystana G. Kaufman

ORHP Reverse Site Visit
Bethesda, MD
June 24, 2015

This work is funded by federal Office of Rural Health Policy, Award #U1GRH07633
Agenda

- The rising rate of rural hospital closures
- Predicting financial distress in rural hospitals
- How can SFCs help CAHs in financial distress?
- What happens after a rural hospital closes?
The Rising Rate of Rural Hospital Closures

Brystana G. Kaufman, Sharita R. Thomas, Randy K. Randolph, Julie R. Perry, Kristie W. Thompson, George M. Holmes, and George H. Pink

Forthcoming in the Journal of Rural Health
What is a hospital closure?

- Sometimes difficult to identify because:
  - Open, closed, open, closed
  - No media coverage because it is a community non-event or part of a system reconfiguration
  - Inpatient stays open but ER closes, inpatient closes but ER stays open, and other permutations
  - Hospital is being replaced by a new facility

- For this study, we defined closure as permanent cessation of acute inpatient care.
2010-14 rural hospital closures: Where were they?

Map showing the locations of rural hospital closures from 2010 to 2014. The map is color-coded to represent different regions of the United States: Northeast, South, Midwest, and West. Blue markers indicate the locations of hospital closures. A checkbox option is provided to select Medicaid Expansion States.
2010-14 rural hospital closures: When did they close?
2010-14 rural hospital closures:
What types of hospital were they?

Micro/Metro Designation

- Neither: 58%
- Micro: 20%
- Metro: 22%

Ownership

- Gov’t owned
- Not gov’t owned
2010-14 rural hospital closures: How far away is the next closest hospital?
2010-14 rural hospital closures: Why did they close? (As reported by news media)

**Market Factors**
- Small or declining populations
- High unemployment (as high as 18%)
- High or increasing uninsured patients
- High proportion of Medicare and Medicaid patients
- Competition in close proximity

**Hospital Factors**
- Low daily census, as low as 2.3 patients a day
- Lack of consistent physician coverage
- Deteriorating facility
- Fraud, patient safety concerns, and poor management

**Financial Factors**
- High and increasing charity care and bad debt
- Severely in debt
- Insufficient cash-flow to cover current liabilities
- Negative profit margin
Most closures in South
Annual number of closures increasing
Most are CAHs and PPS hospitals (vs MDH and SCH)
Most are in states that have not expanded Medicaid
Patients in affected communities are probably traveling between 5 and 25 more miles to access inpatient care
Most hospitals closed because of financial problems
Financial performance and condition of hospitals in the year before they closed: Summary

- Financial performance and condition far below benchmark for most hospitals
- Most hospitals were unprofitable, illiquid, and unable to service debt
- Most had less than:
  - 150 FTEs, $10 million in salary expense, and 30% occupancy rate
  - Most had already closed obstetrics
- Date in appendix also shows most had:
  - Negative or close to zero net income and net assets
Predicting financial distress in rural hospitals

Brystana G. Kaufman, George M. Holmes, and George H. Pink

To be submitted to Medical Care Research and Review
Risk of Financial Distress Among Critical Access Hospitals: 
A Proposed Model

Mark Holmes, PhD and George H. Pink, PhD 
North Carolina Rural Health Research and Policy Analysis Center, University of North Carolina

Introduction
During the 1980s and 1990s, hundreds of rural hospitals closed their doors across the United States. In response, the Medicare Rural Hospital Flexibility Program created the Critical Access Hospital (CAH) program to help stabilize the finances of rural hospitals and sustain access to needed healthcare services for rural residents. Characterizing the overall financial performance of a hospital can be difficult because hospitals seldom perform poorly in all dimensions of financial performance. For example, a hospital may be unprofitable but have ample financial reserves. Although researchers have long been interested in measuring the financial distress of businesses, there has been little attention given to hospitals in general and rural hospitals in particular.

The purpose of this brief is to present a model to predict the financial distress of CAHs. A well-functioning prediction model can be used by administrators and state program officers as an early warning system to identify hospitals at increased risk of facing financial distress.

Approach
After reviewing the research literature and conducting focused discussions with multiple lenders and consultants specializing in critical access hospitals, we developed a model of CAH financial distress. Figure 1 shows that today’s characteristics recent financial performance and measures of a market in which a hospital operates are used to assign CAHs to one of four “risk levels” that predict whether a CAH will be in financial distress two years later.

Key Findings
• A model that uses current financial performance and market characteristics can be used to predict financial distress of Critical Access Hospitals (CAHs).
• The model separates hospitals into risk of financial distress categories: hospitals in the highest risk category had up to 11 times the rate of financial distress events as hospitals in the lowest category.
• Risk of financial distress categories can provide an effective early warning system for CAH boards and administrators as well as enable state program directors to prioritize resources more effectively.
• The model will be further refined based on input from researchers, practitioners, and CAH administrators.
Model of financial distress principles

- Developed specifically for rural hospitals
- Used scientific approach – can we predict “bad outcomes”?
- Model should have high face validity
- Used data publicly available for all rural hospitals
- Focused on identifying hospitals at risk for distress
- Model should be parsimonious and easy to understand
Accounting basis of financial distress

- Balance sheet equation (duality):
  - Total assets - Total liabilities = Net assets

- Income statement equation:
  - Total revenue – Total expenses = Net income

- And for a NFP:
  - Net assets (t+1) = Net assets (t) + Net income (t+1)

- Therefore:
  - Profitability ➔ Growth in net assets
  - Unprofitability ➔ Decline in net assets
A general process of financial distress

Unprofitability

Net assets decline

Insolvency

Bankruptcy

Closure

Unprofitability, net assets decline, and closure data are readily available. Insolvency and bankruptcy data are not.
Financial distress is defined as:

- **Unprofitability:**
  - 2 years negative operating margin
  - Negative cash flow margin

- **Net assets decline:**
  - >20% decline in net assets
  - Negative net assets

- **Closure**
  - No longer provides inpatient care

In some circumstances, there may not be financial distress even though the markers suggest otherwise.
## 2013 Rural hospitals in US with financial distress signals

<table>
<thead>
<tr>
<th>Financial distress signal</th>
<th>Number</th>
<th>Percent</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Unprofitability:</strong></td>
<td></td>
<td></td>
</tr>
<tr>
<td>2 years negative operating margin</td>
<td>659</td>
<td>30%</td>
</tr>
<tr>
<td>Negative cash flow margin</td>
<td>537</td>
<td>24%</td>
</tr>
<tr>
<td><strong>Net assets decline:</strong></td>
<td></td>
<td></td>
</tr>
<tr>
<td>&gt;20% decline in net assets</td>
<td>355</td>
<td>16%</td>
</tr>
<tr>
<td>Negative net assets</td>
<td>237</td>
<td>11%</td>
</tr>
<tr>
<td><strong>Closed:</strong></td>
<td></td>
<td></td>
</tr>
<tr>
<td>No longer provides inpatient care</td>
<td>14</td>
<td>1%</td>
</tr>
</tbody>
</table>
Two years ago, could we have predicted hospitals that are under financial distress today?

<table>
<thead>
<tr>
<th>Financial distress signals</th>
<th>Number</th>
<th>Percent</th>
</tr>
</thead>
<tbody>
<tr>
<td>0 signals</td>
<td>1,326</td>
<td>58%</td>
</tr>
<tr>
<td>1 signal</td>
<td>386</td>
<td>17%</td>
</tr>
<tr>
<td>2 signals</td>
<td>313</td>
<td>14%</td>
</tr>
<tr>
<td>3 signals</td>
<td>148</td>
<td>7%</td>
</tr>
<tr>
<td>4 signals</td>
<td>82</td>
<td>4%</td>
</tr>
<tr>
<td>5 signals</td>
<td>2</td>
<td>.1%</td>
</tr>
<tr>
<td>Total</td>
<td>2257</td>
<td>100%</td>
</tr>
</tbody>
</table>
Model of rural hospital financial distress

Current Characteristics of Hospital

Financial Performance:
- Profitability
- Reinvestment
- Hospital size
- Benchmark performance

Market Characteristics:
- Competition
- Economic condition
- Market size

Government Reimbursement:
- Medicare
- Medicaid

Risk of Financial Distress in 2 Years

- High
- Mid-high
- Mid-low
- Low
Predictors of financial distress

- **Financial performance**
  - Profitability: total margin, two year change in total margin
  - Reinvestment: Retained earnings / total assets
  - Hospital size: Net patient revenue (millions)
  - Benchmark performance: Percent of benchmarks met over two years

- **Market characteristics**
  - Competition: Log of miles to nearest hospital with > 100 beds and market share (if <25%)
  - Economic condition: Log of poverty rate in the market area
  - Market size: Log of population in the market area

- **Government reimbursement**
  - Medicare: CAH status
  - Medicaid: Medicaid to Medicare fee index (KFF)
CAH-specific benchmarks

- Decided to create CAH-specific benchmarks of “high but attainable financial performance”
- Established by a large sample of informed practitioners versus academic black box or arbitrary rankings
- Focus on absolute vs. relative performance
- Robust enough to apply to all rural hospitals
Benchmarks in the model

Profitability indicators:
- Total margin >3%
- Cash flow margin >5%
- Return on equity >4.5%
- Operating margin >2%

Liquidity indicators:
- Current ratio >2.3 times
- Days cash on hand >60 days
- Days revenue in accounts receivable <53 days
Benchmarks in the model

Capital structure indicators:
- Equity financing >60%
- Debt service coverage >3 times
- Long-term debt to capitalization <25%

Cost indicator:
- Average age of plant <10 years
2012-13 Rural hospitals in US benchmark performance

<table>
<thead>
<tr>
<th>Average percentage of benchmarks met in 2012 and 2013</th>
<th>Number</th>
<th>Percent</th>
</tr>
</thead>
<tbody>
<tr>
<td>0%-19%</td>
<td>305</td>
<td>14%</td>
</tr>
<tr>
<td>20%-39%</td>
<td>538</td>
<td>24%</td>
</tr>
<tr>
<td>40%-59%</td>
<td>724</td>
<td>33%</td>
</tr>
<tr>
<td>60%-79%</td>
<td>507</td>
<td>23%</td>
</tr>
<tr>
<td>80%-100%</td>
<td>133</td>
<td>6%</td>
</tr>
<tr>
<td>Total</td>
<td>2207</td>
<td>100%</td>
</tr>
</tbody>
</table>
Distress is specified as a uni-dimensional index, with the probability of each event independent conditional on the index. Thus, given a value of the “Financial distress index” (FDI) the probability of each event differs only due to a constant determined by the overall prevalence of the event.

The equation is specified as

\[ \Pr(y_{kh,t+2} = 1) = f(X_{ht}\beta + \phi_k) \]

where \( y \) is an indicator variable that equals one or zero depending on the value of one of the 5 markers of financial distress (indexed by \( k \)), \( h \) denotes hospital, \( t \) denotes time, and \( X \) is a data matrix. Marker-specific constant \( \phi \) “shifts” the index. Note that the variable matrix for time \( t \) predicts distress markers for time \( t+2 \).
Preliminary results

By FDI Risk Level

Closure within One Year
Negative Net Assets
Decline in Net Assets
Negative Cash Flow Margin
2 Years Negative Operating Margin

Percent experiencing event

High
Mid-High
Mid-Low
Low

2003-2013
## Preliminary results

<table>
<thead>
<tr>
<th>Risk of financial distress</th>
<th>Number of Rural Hospitals</th>
<th>Percent</th>
</tr>
</thead>
<tbody>
<tr>
<td>High</td>
<td>228</td>
<td>11%</td>
</tr>
<tr>
<td>Mid-high</td>
<td>258</td>
<td>12%</td>
</tr>
<tr>
<td>Mid-low</td>
<td>852</td>
<td>39%</td>
</tr>
<tr>
<td>Low</td>
<td>834</td>
<td>38%</td>
</tr>
<tr>
<td>Total</td>
<td>2172</td>
<td>100%</td>
</tr>
</tbody>
</table>
Model results

- You have been given envelopes with preliminary results of the model: the CAHs in your state that are at mid-high and high risk of financial distress
- Face validity tests – let us know whether the model results reflect reality in your state
- Final model results will be incorporated in next version of the CAH Financial Indicators Report
What happens after a rural hospital closes?

Sharita R. Thomas, Brystana G. Kaufman, Randy K. Randolph, Julie R. Perry, Kristie W. Thompson, George M. Holmes, and George H. Pink

bit.ly/1QFEVo0
Conversion Models

- Urgent Care Clinic or Emergency Center
- Skilled Nursing Facility or Acute Rehabilitation Center
- Outpatient Facility or Primary Care Clinic
Urgent Care Clinic or Emergency Center

Urgent care clinic (5 hospitals):
• Operate 12 hours and 5-7 days per week
• Provide diagnostic, laboratory, and radiology services
• 2 facilities provide additional outpatient and specialty services

Emergency center (5 hospitals):
• Operate 24 hours and 7 days per week
• Provide diagnostic, laboratory, and radiology services
• 4 facilities provide additional outpatient and specialty services
Skilled Nursing Facility or Outpatient Rehabilitation Center

Skilled nursing facility (3 hospitals):
• Have a range of 46-111 beds
• Provide physical, occupational and speech therapy

Acute rehabilitation center (1 hospital):
• Individuals are transferred from the inpatient unit of nearby regional campus location
• Operate 8 hours and 7 days per week
• Physical, occupational and speech therapy
Outpatient facility (3 hospitals):
• Operate 10-24 hours and 3-7 days per week
• Provides diagnostic and laboratory services
• 1 offers specialty care like cardiology and women’s services

Primary care clinic (4 hospitals):
• Operate 8 hours and 5 days per week
• Focus on family medicine and preventive care
• 1 offers urgent care services on weekends
A Tale of Two Cities

Blowing Rock Hospital - Watauga and Caldwell Counties
- **Opened:** March 2005
- **Closed:** October 2013
- **Details:** Nonprofit, Micropolitan, CAH, 25 beds

Vidant Pungo Hospital - Beaufort and Hyde Counties
- **Opened:** February 2002
- **Closed:** June 2014
- **Details:** Nonprofit, Micropolitan, CAH, 25 beds
Demographic Comparison

Total Population*

Blowing Rock 133,728
VidantPungo 53,513

SAIPE 2012, Census Bureau. 2013
Annual County Resident Population Estimates by Age, Sex, Race, and Hispanic Origin: April 1, 2010 to July 1, 2013, U.S. Census Bureau. 2014
Health Status Comparison

- Socioeconomic
  - Education
  - Employment
  - Income
  - Violence
- Clinical Care
  - Uninsured
  - Health Services
  - Quality of Care
- Health Behaviors
  - Tobacco/Alcohol
  - Obesity Factors

1 = Top quartile, low need area
4 = Bottom quartile, high need area

Data from County Health Rankings, 2013
Timeline and Status

- **2007**: ARHS buys financially distressed Blowing Rock Hospital
- **2009**: ARHS makes multi-year plan to transition the hospital to a post-acute care facility
- **October 2013**: Blowing Rock Hospital discontinues Emergency Department and acute care services.
- Watauga Medical Center is less than 7 miles away

- **2012**: Vidant buys financially distressed Pungo District Hospital
- **Sept 2013**: Vidant announced Pungo Hospital would close in 6 months
- **December 2013**: Vidant purchased 19.4 acres to build $4.2 million dollar multi-specialty clinic to replace hospital
- **March, 2014**: Beaufort County promised $2 million and Vidant offered $1 million in support
- **August 2014**: Belhaven Title VI complaint accepted against Vidant and Pantego Creek LLC
- **September 2014**: HHS investigates Pungo.
- Washington County Hospital is 30 miles away
Social Context: Blowing Rock

Community Involvement

- **Transparency**: early community involvement
  - town hall meeting minutes
  - Chamber of Commerce and community leaders actively involved

- **Social Action**: 2012 capital campaign to raise $10 million
  - Town pursued grants ($1.2 million water and sewer)
  - NC Transportation Secretary helped secure road grant ($2.58 million)
  - NC Rural Economic Development Center awarded town grant ($586,000)

Media Coverage

“transition,” “closing soon”

“It’s a great day for Blowing Rock.”

Social Context: Vidant Pungo

Community Involvement

- **Transparency**: discrepancy on community and public officials involvement:
  - Mayor says they were not informed or involved prior to the decision
  - Vidant says consulted with: Pungo Director’s Council (residents of Beaufort and Hyde, no regulatory voice) twice, and: lease holders, Pantego Creek, LLC
  - Pungo voting board has no members that reside or hold a practice in Beaufort or Hyde counties

- **Social Action**: Grassroots efforts
  - Committee
  - Social media
  - March to D.C.

Media Coverage

- “closing” ”outrage,” “rally,” ”save,” “economy. . .”

“Vidant's leadership is immoral. You don't make $100 million and close a critical access hospital.”

Finally

- We have presented a lot of data and discussed hospital closures in a detached and analytical way, but...
- Hospital closures affect people – patients and their families, practitioners, hospital staff, local businesses, and the community at large
- It is important to keep the human cost of hospital closures at the front of the discussion
If you hear of an actual or probable closure...

- You can get up-to-date data and information
- Submit information for possible inclusion in our database
How can SFCs help CAHs in financial distress?

Assist, facilitate, advise CAHs about survival strategies and tactics.
Hancock Regional Hospital in Greenfield IN has remained independent but cut costs by maintaining relationships with larger Indianapolis systems for services such as cardiac and cancer care as well as some primary care services.

Merger/acquisition

- At Mother Frances Hospital-Winnsboro in TX, the CAH is using its relationship with a larger system, Trinity Mother Frances, to grow its outpatient service offerings. After performing a community needs assessment and mapping out its area's future healthcare needs, the hospital added an orthopedic program using TMF specialists. "Over the past four years we've experienced growth every year in volumes."

Partnering with other organizations

- NRHA’s Outstanding Rural Health Organization Award winner, Sakakawea Medical Center and Coal Country Community Health Center. “This CAH and community health center serving patients in rural North Dakota have combined efforts resulting in a higher quality of care and improved financial gains. This success story demonstrates what can come from strong leadership, innovation and collaboration.”
Fundraising campaigns
Bankruptcy protection

- *Reorganization bankruptcy* (Chapter 13): debtors restructure their repayment plans to make them more easily met.

- *Liquidation bankruptcy* (Chapter 7): debtors sell certain assets in order to make money they can use to pay off their creditors.
Bankruptcy protection

Monroe Hospital, a 32 bed medical center in Bloomington IN filed for Chapter 11 bankruptcy protection citing debts over $100 million, while owning only $50 million in assets. Several months after the hospital went bankrupt, there was a sale approval to Prime Healthcare Services, a group that owns and runs a large network of health care facilities throughout the country.

State and county government

- “I think there is a growing awareness that with 5 percent of the rural hospitals having closed over the course of the past 24 months ... funding them differently and adequately is important. It is a priority for me, and in the House we have taken steps to secure their reimbursements for the next biennium,” he said.

- Rep. Four Price, a member of the Texas budget-writing House Appropriations Committee.

Cimarron Memorial Hospital (CMH), a 25-bed CAH in Boise City OK was experiencing severe financial hardship due to an annual operating loss of approximately $700,000. CMH engaged NewLight Healthcare to manage their hospital. Ralph Warren, Board Member of CMH, said “Even though they have only been here a short time they have found us a CEO and a CFO who are not only helping us financially, but in relationships with employees and the general public as well.”

http://newlighthealthcare.com/casestudies/hospital-turnaround
Other strategies and tactics

- Inform the community – not all may know of a crisis.
- Work with lenders – reschedule debt, ST financing.
- Solicit local business support – contracts, donations, CoC.
- Approach foundations – grants.
- Make board / management changes – does someone or some people need to be fired?
- Assess whether a hospital should transition to a new role.
- Finally, if the writing is on the wall, help the community to find new sources of hospital care and help the hospital staff find new jobs.
Next session: 1000-1045

- “SFC strategies to help CAHs in financial distress”
- Learn from other state Flex coordinators about how they are helping CAHs in financial distress
- Identify relevant strategies to help financially distressed CAHs in your state
North Carolina Rural Health Research Program

Location:
Cecil G. Sheps Center for Health Services Research
University of North Carolina at Chapel Hill
Website: http://www.shepscenter.unc.edu/programs-projects/rural-health/
Email: ncrural@unc.edu

Colleagues:
Mark Holmes, PhD
George Pink, PhD
Kristin Reiter, PhD

Ann Howard
Brystana Kaufman, MSPH
Denise Kirk, MS
Julie Perry
Randy Randolph, MRP
Sharita Thomas, MPP
Kristie Thompson, MA