

# Do's and Don'ts for Rural Hospitals Undertaking Major Facility Projects



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## Do's - Getting Started

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- Establish your financial parameters
- Plan with a 25-30 year horizon
- Build a team with experience in CAHs
- Understand that time is your enemy
- Finalize location acquisition ASAP (assuming replacement)
- Establish a communications strategy
- Prepare for significant commitment of senior leadership time



## Do's – Design Issues

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- Assess impact on strategic presence/image
- Consider financing implications
- Consider revenue potential
- Consider Medicare implications
- Consider long term operating / mtncce costs
- Listen to your architect
- Be realistic in expectations



# Factors Impacting Financial Parameters

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- Historical financial performance
- Community demographics
- Medicare issues – past vs. projected
- Operating issues – past vs. projected
- Potential impact on community and physician recruiting of improved facilities
- Facility design
- Replacement vs. renovation



# Rough Debt Capacity Guidelines

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- Cash flow (EBIDA) should be 175% X annual debt service
- Medicare may cover 50%-80% of annual debt service.
- What's the plan to earn the balance?
- Maximum debt capacity
  - 2 times annual net revenue
  - 8 times projected EBIDA
- Liquidity is critical
  - Most loan covenants will require 50-70 days cash



## Timing Issues

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- Construction inflation is outpacing debt capacity
- Medicare changes
- Interest rates and access to capital may not be as favorable
- Develop elements of the work plan simultaneously not serially



# Select Team Members with Experience with CAHs

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- Architect
- Construction Manager (at risk / agency)
- Project coordinator / financial adviser
- Feasibility consultant
- Campaign consultant
- Equipment consultant
- Underwriter
- Legal, CON, etc



## Location Issues - Strategic

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- Contributes to making a fundamental change in public's perception of the hospital
- Provides convenient access to pts and docs you seek to serve
- Will withstand the test of time – 50 years
- Location, location, location



## Location Issues - Tactical

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- Ideal site will have 20-40 acres
- Highly visible from major thoroughfares
- Desirable neighbors preferable
- Close access to utilities, road access
- Relatively level ground
- Flank gravitational pull of competitors
- Note all conventional land issues: clear title, environmental tests, flood plain



# Communications Strategy

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- Get information out in the community early
- Important to balance timing of land acquisition/option with communications strategy.



# Don'ts – Biggest Mistakes – Strong CAHs

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- Renovating a hospital that should be replaced
- Waiting on consensus
- Thinking the job can be done in phases
- Consuming scarce debt capacity without gaining a sustainable, strategic advantage
- Chasing governmental money when better options are available
- Engaging an architect without providing explicit financial parameters
- Selecting team members based on local politics



# Don'ts – Biggest Mistakes / Weaker CAHs

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- Starting to plan a \$25 m project when your maximum debt capacity is \$10 m
- Reluctance to make the hard choices
  - Close /segregate nursing home
  - Close money losing services
  - Tighten staffing
  - Raise rates
- Unwillingness to go to community for funds
- Paralysis



## Don'ts – Attitude of Paralysis

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“Our facility is outdated, we’re landlocked, we’re not really in the right location, prior projects haven’t really helped, our facilities still look dated, we’re about to spend a fortune just to keep the existing facility up to code.

**But** we can’t afford to do anything big.”



# Advantages Replacement?

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- Build with knowledge that things will change in 10 years. Flexible design
- Right size for projected operations
- Operating adjacencies – improved safety / efficiency
- Design for 21<sup>st</sup> century medicine not 1945
- MEP systems designed with 25 year lives difficult to replace in a 50 year old chassis
- Construction won't interfere with existing operations
- Consider impact on consumer, physicians, operations
- Often no more expensive than major renovation



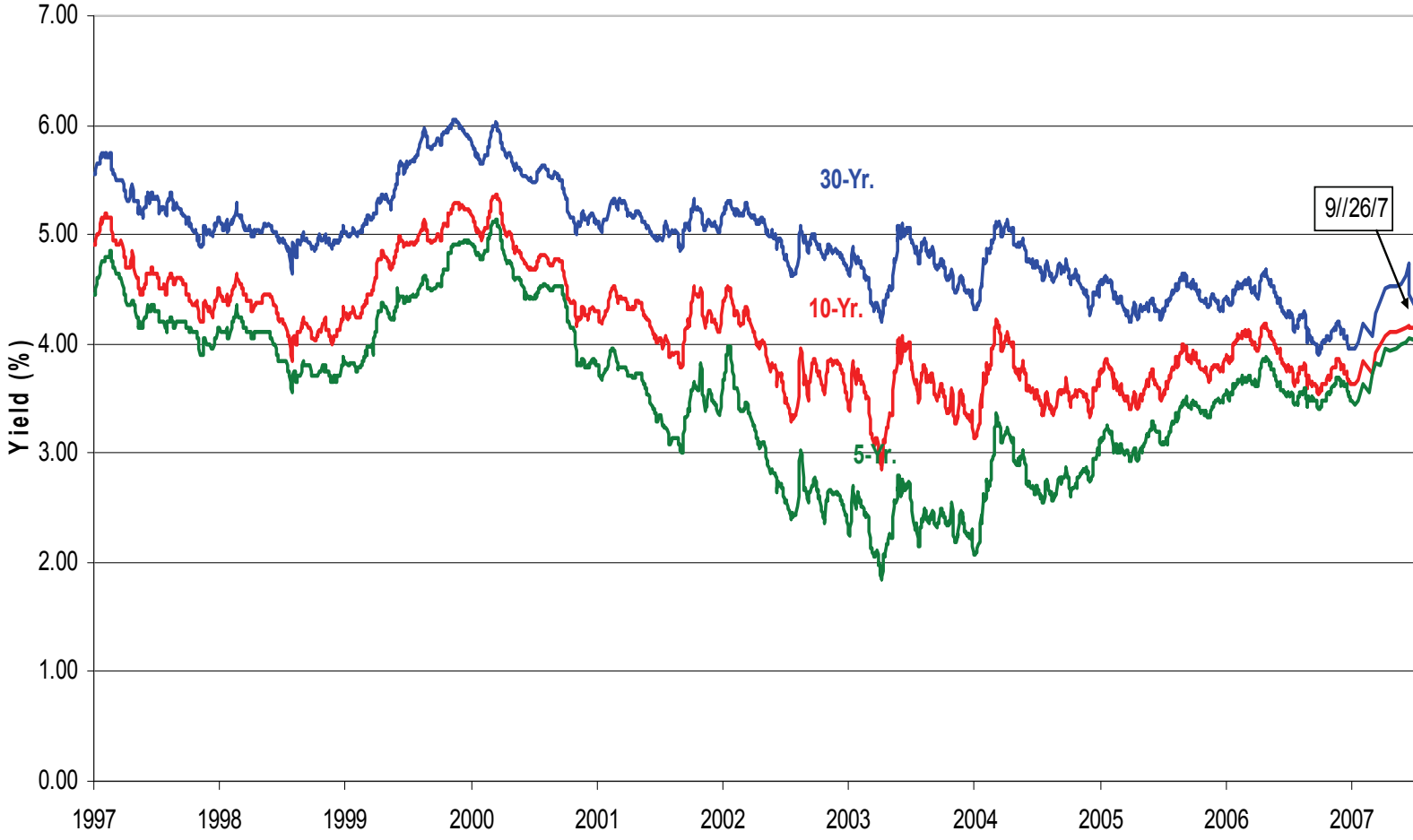
# Toughest Issue - What to Do With Old Building?

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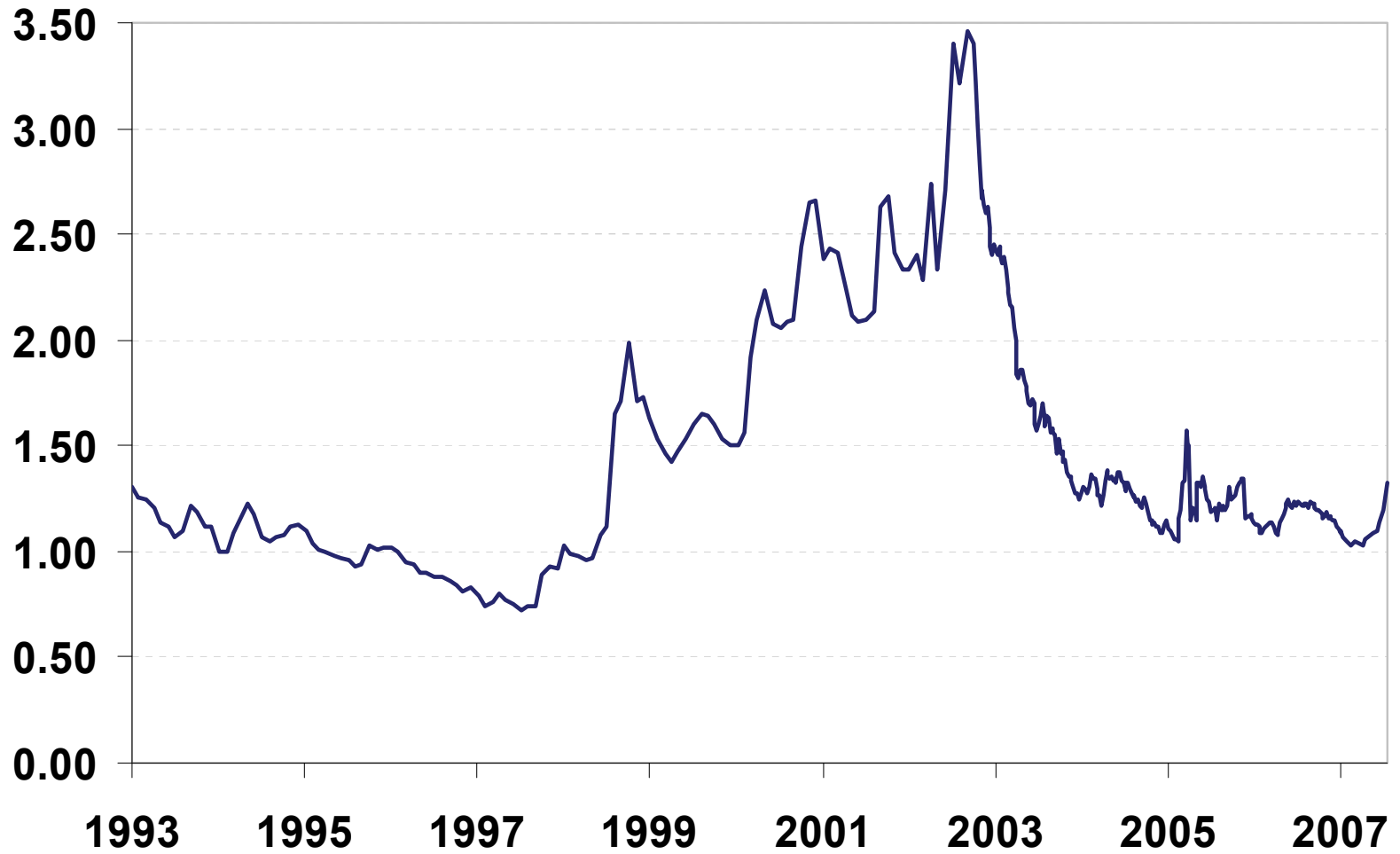
Board member quote:

“The community would understand it if we put another \$10-\$12 million in this old building, but they’ll think we’re crazy if we spend \$20 million to build new and abandon this facility. The easiest thing for us to do is to pass this problem along to the board that sits here 10 years from now, but it would be the wrong thing.”

# Historial AAA Muni Yields



# Credit Spreads BBB Over AAA



# Yield Spreads

