



Module 5: Underwriting CHCs Case Study #2 – CHC Requesting Capital to Expand

Purpose of Case Study

To assist CDFIs in learning to evaluate the risks associated with an ambitious health center expansion project, relative to the health center's prior scale and performance.

Instructions

As part of your preparation for the *Financing Community Health Centers* Workshop, please read the narrative and financial projections of the proceeding case study. As you are reviewing the case study, evaluate the strengths, risks, and mitigants for a CDFI considering the financing request. Be prepared to respond to the following questions:

Please answer the following questions during the **small group discussion**. (25 minutes)

1. What are the main strengths of the project and borrower?
2. What are the main weaknesses or areas of risk?
3. What additional information should the CDFI request for its underwriting/due diligence review?

Please answer the following questions during the **large group discussion**. (25 minutes)

4. What are the major business assumptions that are driving the projections and the factors critical to the success of the project?
5. What major concerns do you have as a potential lender to this project?

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ABC Health Center's Capital Project Financing Request

Summary of Financing Request

ABC Health Center (ABC) seeks financing for the proposed relocation and expansion of its main clinical facility in downtown Hometown USA. The preliminary project budget including hard costs, soft costs, financing costs, and contingencies is estimated at \$13,654,814 for the 45,000 square foot new facility. The project budget includes the recent purchase, by ABC, of the site for \$1.1 million. ABC has received a \$5 million federal capital grant from the Health Resources Services Administration (HRSA). ABC has \$110,000 to contribute to the project. ABC is seeking a construction/permanent loan totaling \$8,544,814 to complete the capital structure. ABC expects to begin construction in September 2011 and complete the project by the end of 2012. The first year of operations in the new facility is expected to be 2013.

Part I: Overview of Health Center

Business Profile

ABC is a Federally Qualified Health Center (FQHC) that has been providing healthcare services to mostly low-income residents of greater Hometown for 18 years. ABC provides a wide array of primary healthcare services including: pediatric, OB/GYN, adult medicine, podiatry, and immunizations. ABC also provides dental services, vision services, and behavioral health care. ABC receives an annual operating grant from HRSA in exchange for providing its services without regard for the patients' insurance status or ability to pay for care. ABC currently operates 4 clinical facilities in greater Hometown. In calendar year 2010, ABC served nearly 28,000 patients, the vast majority of whom were classified as low-income persons (earning less than 200% of the federal poverty level).

Management

ABC's management team is comprised of a Chief Executive Officer (CEO), a Chief Financial Officer (CFO), and a Chief Medical Officer (CMO). The CEO has served in that role for more than 10 years and previously served as the CFO for 6 years. The current CFO has served in that capacity for just over one year after working in finance for a large hospital for 7 years. The CMO has been a fixture at ABC since it first opened its doors. ABC is governed by a Board of Directors that by law must have current health center patients comprising at least 51% of the directors.

Market Description

The primary target population is the low-income, uninsured, underinsured, and underserved residents of greater Hometown. Residents of the service area struggle with a complex web of socio-economic challenges including high poverty rates and significant health disparities. Nearly 44% of residents in the service area live in households with incomes below 200% of the federal poverty level; approximately 6% of adults are unemployed and looking for work; and approximately 24% of the population is uninsured. Over 97% of ABC's patients have incomes below 200% of the Federal Poverty Level. Sixty-four (64%) percent of ABC's patients report a Hispanic ethnicity and 19% of the patient base is African American.



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The Project

The capital project involves the relocation and expansion of ABC's main (leased) clinical facility in downtown Hometown to a nearby downtown site located at 1000 Main Street. The finished facility will contain 45,000 square feet of clinical and administrative space. The expanded facility will accommodate 2 additional physicians, 1 additional dentist, 1 new dental hygienist and .5 new behavioral health provider. ABC also anticipates increased support staff including nurses, and medical/dental assistants. In all, ABC expects to increase its enterprise-wide staffing from 126 full time equivalents (FTEs) in 2011 to 140 FTEs by 2015. ABC expects to increase billable visits by 25,000 once it reaches stabilized operations, which it expects to achieve within three years of placing the new facility into service. The new facility is designed to facilitate Level 3 Patient Centered Medical Home certification, improving health outcomes and the overall patient experience. The investment will also enable ABC to complete full implementation of its Electronic Medical Records system.

Table 1: Sources and Uses of Project Funds

<i>Sources of Funds:</i>	
Grants/Contributions for Capital	\$ 5,000,000
Loan	8,544,814
Cash/Equity from ABC	110,000
Total Sources of Funds	\$ 13,654,814
<i>Uses of Funds:</i>	
Real Estate Related Costs	\$ 1,100,000
Total Hard Costs	10,166,664
Total Soft Costs	1,515,600
Total Equipment Costs	872,550
Total Uses of Funds	\$ 13,654,814

Part II: Financial Operations and Pro-Forma

Introduction

The following financial overview documents ABC's historical financial performance based on the last four years of audited financial statements. The historical analysis is followed by five year pro-forma financial projections assuming the new facility is completed and placed into service. The pro-forma includes a projected balance sheet, income statement, and cash flow statement, as well as supporting schedules that include patient volumes and revenue, staffing, and key financial ratios.

Financial Condition (Balance Sheet – Historical Analysis)

At fiscal year-end 2010, ABC had total assets of \$6.37 million, total liabilities of \$2.9 million and net assets of \$3.46 million. The following tables show trends for key components of the health center's balance sheet.



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- **Cash Position & Days Cash on Hand:** ABC's cash position has ranged from a high of 115 days in FY 2007 to a low of 70 days in FY 2010.

Table 2: Cash Position and Days Cash on Hand

Cash Position	FY2010	FY2009	FY2008	FY2007
Unrestricted Cash and Investments	\$ 2,279,810	\$ 2,768,546	\$ 2,682,514	\$ 3,025,648
Growth Rate	-17.70%	3.20%	-11.30%	Base Year
Days Cash on Hand	69.61	87.1	92.02	114.8

- **Accounts Receivable (AR) and AR Days:** Over the four-year time period, ABC has shown a strong ability to turn its patient receivables into cash, ranging from 17 days to 31 days.

Table 3: A/R and A/R Days

Patient Accounts Receivable	FY2010	FY2009	FY2008	FY2007
Net Patient Accounts Receivable	\$ 258,074	\$ 294,591	\$ 341,774	\$ 324,050
Growth Rate	-12.40%	-13.80%	5.50%	Base Year
Day Accounts Receivable	16.63	19.94	25.52	30.78

- **Current Ratio:** ABC's current ratio has remained strong throughout the period.

Table 4: Current Ratio

Current Ratio	FY2010	FY2009	FY2008	FY2007
Current Assets	\$ 3,503,540	\$ 3,870,200	\$ 3,791,147	\$ 3,798,481
Current Liabilities	\$ 832,783	\$ 912,423	\$ 600,063	\$ 668,414
Current Ratio	4.20	4.24	6.32	5.68

- **Leverage Ratio:** Leverage has increased from a low of .18 in FY 2007 to .84 in FY 2010, driven largely by ABC's assumption of new debt in FY 2010 to purchase land for the proposed new facility.

Table 5: Leverage Ratio

Leverage Ratio	FY2010	FY2009	FY2008	FY2007
Total Liabilities	\$ 2,915,295	\$ 1,978,151	\$ 1,922,022	\$ 668,414
Total Net Assets	\$ 3,456,293	\$ 3,812,562	\$ 4,003,349	\$ 3,819,145
Leverage Ratio	0.84	0.52	0.48	0.18



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Operating Performance (Income Statement and Operating Metrics Review)

ABC's revenues and expenses both grew by approximately 24% over the period, with slight variations in each year. As a result, operating margins were close to zero in each year, with slightly negative margins in three of the four years.

Table 6: Operating Margins

Operating Margin	FY2010	FY2009	FY2008	FY2007
Total Revenue	\$ 11,969,622	\$ 11,554,975	\$ 10,790,843	\$ 9,660,550
Growth Rate	3.60%	7.10%	11.70%	Base Year
Total Expenses	\$ 12,032,675	\$ 11,730,178	\$ 10,728,745	\$ 9,668,414
Growth rate	2.60%	9.30%	11.00%	Base Year
Change in Net Assets-Operating	\$ (63,053)	\$ (175,203)	\$ 62,098	\$ (7,864)
Operating Margin	-0.53%	-1.52%	0.58%	-0.10%

According to Universal Data System patient encounter information, visits grew 5.5% from 2008 to 2010, but the number of total patients was essentially unchanged.

Table 6: Total Patients and Visits

Patients/Visits	2010	2009	2008
Total Patients	27,697	28,141	27,683
Patient Growth Rate	-1.60%	1.70%	
Total Visits	77,132	79,135	73,127
Visit Growth Rate	-2.53%	8.20%	

Revenue Mix

Net patient service revenue (NPSR) grew 47% over the time period, while grants and contracts grew by 34%. Overall, operating revenue grew by 24%. By FY 2010, NPSR represented 47% of overall revenues, and grants and contracts represented 45%.

Table 7: Revenue Mix

Revenue	FY2010	FY2009	FY2008	FY2007
Net Patient Service Revenue	\$ 5,586,693	\$ 5,319,066	\$ 4,822,077	\$ 3,790,302
% of Total Revenue	46.70%	46.00%	44.70%	39.20%
% Growth Rate	5.00%	10.30%	27.20%	Base Year
Grant & Contract Revenue	\$ 5,370,649	\$ 5,436,947	\$ 5,067,683	\$ 4,017,378
% of Total Revenue	44.90%	47.10%	47.00%	41.60%
% Growth Rate	-1.20%	7.30%	26.10%	Base Year
Other Operating Revenue	\$ 1,012,280	\$ 798,962	\$ 901,083	\$ 1,852,870
% of Total Revenue	8.50%	6.90%	8.40%	19.20%
% Growth Rate	26.70%	-11.30%	-51.40%	Base Year
Total Operating Revenue	\$ 11,969,622	\$ 11,554,975	\$ 10,790,843	\$ 9,660,550
% Growth Rate	3.60%	7.10%	11.70%	Base Year



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Payer Mix

ABC has experienced a positive shift in its payer mix, with 41% of patients covered by Medicaid by 2010, well above the state median. At the same time, uninsured patients (self-pay) has decreased as a percentage of all patients, representing 46% of patients by FY 2010—well below the state median.

Table 8: Payer Mix - % of Patients

Payer Mix	% Of Patients			
	2010	2009 State	2009	2008
All Medicaid	40.50%	24.60%	40.90%	35.70%
Medicare	5.20%	5.90%	3.80%	4.10%
Other Public	3.00%	4.60%	2.40%	2.50%
Private Insurance	5.60%	8.90%	6.00%	6.30%
Self-Pay	45.60%	56.00%	46.90%	51.40%

As a proportion of collections, Medicaid was the dominant payer in all years, representing 68% of NPSR collections in 2010.

Table 9: Payer Mix - % of NPSR Collected

Payer Mix	% Of Total Collected			
	2010	2009 State	2009	2008
All Medicaid	68.40%	55.40%	73.80%	73.60%
Medicare	3.70%	9.70%	3.50%	4.20%
Other Public	6.60%	6.80%	3.20%	3.00%
Private Insurance	2.70%	7.60%	3.30%	2.30%
Self-Pay	18.70%	20.40%	16.90%	16.90%



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Expense Structure

Personnel-related expenses are the largest category of expenses for ABC by far, utilizing 74% of revenues in FY 2010. This category includes salaries, fringes, and contracted services (including non-medical services such as accounting, legal, etc.).

Table 10: Operating Expenses

Operating Expenses	FY2010	FY2009	FY2008	FY2007
Salaries & Related Expenses	\$ 5,879,289	\$ 5,312,100	\$ 4,820,480	\$ 4,175,371
% of Total Revenue	49.10%	46.00%	44.70%	43.20%
% Growth Rate	10.70%	10.20%	15.50%	Base Year
Contracted Services	\$ 1,482,790	\$ 1,771,150	\$ 1,267,426	\$ 1,213,234
% of Total Revenue	12.40%	15.30%	11.70%	12.60%
% Growth Rate	-16.30%	39.70%	4.50%	Base Year
Fringe & Payroll Taxes	\$ 1,511,612	\$ 1,335,926	\$ 1,189,576	\$ 919,634
% of Total Revenue	12.60%	11.60%	11.00%	9.50%
% Growth Rate	13.20%	12.30%	29.40%	Base Year
Total Personnel Expense	\$ 8,873,691	\$ 8,419,176	\$ 7,277,482	\$ 6,308,239
% of Total Revenue	74.10%	72.90%	67.40%	65.30%
% Growth Rate	5.40%	15.70%	15.40%	Base Year
Total Operating Expense	\$ 12,032,675	\$ 11,730,178	\$ 10,728,745	\$ 9,668,414
% Growth Rate	2.60%	9.30%	11.00%	Base Year

Productivity

The table below analyzes some of ABC's productivity statistics, comparing its performance to other centers, using data from ABC's 2008-2010 UDS reports and the 2009 State Rollup Report.

Table 10: Operating Expenses

Productivity Statistics	2010	2009 State	2009	2008
Medical Visits / Medical FTE's	1,393	1,151	1,349	1,338
Medical Visits / Physician	4,475	4,056	4,621	3,983
Medical Visits / Midlevel Provider	3,473	3,020	3,898	3,205
Med Visits / All providers (mid and phys)	3,938	3,613	4,252	3,526
Physicians as a % of All Providers	46%	57%	49%	41%
Total Visits per User	2.78	3.72	2.81	2.64
Tot Visits per Tot FTEs	680	535	649	624
Dental Visits / Dental FTE	2,173	2,226	2,504	2,706
Dental Visits / Medical Visit	0.42	0.16	0.43	0.4
Admin. & Facility Staff / Total Staff	18%	23%	17%	19%
Total Admin., Facility & Patient Support / Total Staff	39%	41%	39%	38%

Pro-Forma Projections

The health center has provided the attached financial projections, assuming a construction start of September 2011 and construction completion by December 2012.

