Module 5: Underwriting CHCs
Case Study #3 – CHC Requesting Capital to Acquire a Failing Hospital Satellite

Purpose of Case Study

CHCs most typically expand via constructing new facilities, renting new space, or through operational strategies, which can include scheduling efficiencies and expanding hours. CHCs can also expand by acquiring existing operations. Due to changes in the underlying economics of healthcare delivery, many community hospitals, which are often major providers of primary care in underserved communities, are coming under increasing financial pressure, some to the point of bankruptcy and closure. In these circumstances, CHCs can play a critically important role by acquiring the primary care assets of the hospital and thereby maintaining these services for their communities. The primary care assets of a closing hospital may include satellite facilities, which can be essentially identical in physical appearance to a CHC. They typically also include the hospital's Out-Patient Department (OPD), which is the classic hospital "clinic." There is not necessarily an obvious acquisition price in these circumstances.

This case study looks at the acquisition of a satellite facility by an FQHC from a bankrupt and soon-to-close hospital.

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?

Trudeau Family Health Center's Request to Acquire a Hospital Satellite

Summary of Financing Request
The Trudeau Family Health Center (Trudeau) seeks financing to expand by acquiring a failing satellite facility of a community hospital. Trudeau is requesting $1 million in 36-month bridge financing, which will cover initial operating expenses, with repayment coming from anticipated grants. Trudeau is also seeking approval to assume an outstanding balance of $5.54 million in tax-exempt bond financing. Trudeau was the sole party willing to assume the entire outstanding bond financing. The bonds were issued to build the facility, carry an interest rate of 4.5% and mature in 2024. The bond financing is secured by a first mortgage and uniform commercial code (UCC) liens on revenues, furniture, and equipment. The bridge financing would be secured by subordinated UCC liens.

Part I: Overview of Health Center

Business Profile – Trudeau Family Health Center
The Trudeau Family Health Center (Trudeau) is a 330-funded federally qualified health center (FQHC) that was founded in 1966. Under the current administrative and clinical leadership team, Trudeau has grown, over the last 11 years, from a single site, with 75 full time equivalent (FTE) employees providing 30,000 visits each year, to a $16.5 million three-site network employing 165 FTE employees providing more than 90,000 visits annually. In the process, Trudeau has obtained over $17 million in capital grants and loans to acquire, construct and/or rehabilitate, and outfit more than 38,000 square feet of health center space. Trudeau has additionally obtained and managed approximately $20 million in grants for a wide variety of community health programs, including $9 million as the lead agency in a 45-organization Safe Schools Healthy Children program. In cooperation with community partners, Trudeau has enrolled approximately 20,000 children into Child Health Plus and Family Health Plus by using facilitated enrollment strategies.

In expanding into a multi-site network, Trudeau has become experienced in taking over underperforming centers and turning them into active, viable centers. To date, it has assumed operations at two sites, which has increased patient visit volume from 3,000 to 40,000 over 5 years. In addition, Trudeau has built a new 22,000 square foot main site, where it has thus far expanded volume by over 30%. Over the past five years Trudeau's annual visit volume has grown by 55%.

The same leadership team responsible for Trudeau's growth over the past 11 years will be responsible for overseeing the re-development of the St. Anne facility.

The table below shows that Trudeau has significantly strengthened its financial position over the last two years, with the current ratio now at 1.35 and days cash at 21. Trudeau has net assets of $11.7 million, but they are primarily in the form of the health centers it owns (i.e., not liquid and available to support operations).

Business Profile – St. Anne Center (failing hospital satellite)
Caritas, the current operator of the St. Anne Center, is preparing to declare bankruptcy and close. If the proposed transfer to Trudeau fails, Caritas has indicated that it will abandon the St. Anne facility. If this occurs, the loss of this facility will displace some 4,000 patients and undermine the health status of area residents by reducing the availability of primary care services to the already seriously underserved residents of Southeast Queens. St. Anne's has 27 exam rooms and 4 dental operatories and is big enough to serve 15,000 to 20,000 patients. It has always operated far below capacity despite the well documented level of need in the community. The facility is newly appraised at $4.0 million.

Trudeau has prior experience taking over under-performing facilities in low-income communities and ramping up service volume to facility capacity. This circumstance, therefore, presents an opportunity to both preserve capacity and significantly expand services in an underserved community.

Market Description – Population Served by St. Anne Center
Patients of the St. Anne Center are predominantly low-income residents of Southeast Queens. Two recent studies document the primary care shortfall in these communities. Residents of Jamaica, the broader area encompassing Southeast Queens, have low household incomes, high poverty rates, and poor health status. The lack of primary care access often leads to higher rates of non-urgent emergency room use and higher levels of preventable hospitalizations. The rate for avoidable hospitalizations in Jamaica ranked 32nd out of 42 neighborhoods (i.e., 31 communities had lower rates of avoidable hospitalizations) according to the NYC Department of Health and Mental Hygiene.

The NYC Community Health Profile for Jamaica indicates that 24% of area residents report that their health status is "fair to poor" and that there is increasing disparity in the health status of the poor and minority residents of Jamaica as compared to residents of other more economically well-off NYC neighborhoods. Specifically:

- Asthma hospitalizations exceed those for residents of Queens and NYC as a whole.
- The infant mortality rate (the death rate for babies under one year of age) exceeds the infant mortality rates in Queens and NYC. Over the same time period, the number of babies born with low birth-weight has risen in Jamaica while remaining steady for Queens' residents overall.
- The death rate due to diabetes and the hospitalization rates for long-term diabetes complications and lower extremity amputations are almost twice the rates of Queens' residents and 50% higher than for NYC residents as a whole.

Trudeau has targeted for patient recruitment three large public housing facilities located nearby, which house over 3,400 residents. Persons living in public housing tend to be some of the poorest neighborhood residents and to have poorer health status indicators compared with residents of the surrounding community.

Business Plan – Proposal to Acquire the St. Anne Center
Trudeau has been working to identify all facility development, regulatory, and other activities needed to make the St. Anne acquisition a success; to reliably estimate the resources needed; and to approach funders to secure the start-up and renovation/outfitting capital needed to provide the foundation for successful operations. Trudeau has reached out to elected officials representing the St. Anne community and they have expressed their support for preserving the St. Anne Center. This is widely recognized as an excellent opportunity to finally realize St. Anne's potential.

Trudeau's business and facility development plans indicate a need for:

- **Operating Funds**: $1.0 million in pre-occupancy and initial occupancy expenses, to cover unreimbursed expenses as volume ramps-up; including contingency operating support for unforeseen expenses; and
- **Capital Expenditures**: $635,000 in capital for renovating and outfitting the center.

The Business Plan for St. Anne incorporates conservative initial volume projections. Although all the elements are present for a successful turnaround, the potential challenges must not be understated. The current owner's longstanding financial difficulties and the current crisis atmosphere have not only created a certain negative identity for the site, but have also already led to staff losses and a reduction of services provided.

The Business Plan assumptions are predicated on Trudeau receiving timely regulatory and reimbursement approvals and rate adjustments, effective at the start of Trudeau's operations at the St. Anne facility. Without these, the initial viability and long-term sustainability cannot be assured. Trudeau is working with New York State and the federal Bureau of Primary Health Care for help in realizing those assumptions. Both have expressed their support for this transfer. Previous experience with such situations indicates that there will be cash flow delays and, despite excellent due diligence conducted by Trudeau, there will be unforeseen problems and expenses. To date, Trudeau has received the following expressions of financial and regulatory support:

- The federal Bureau of Primary Health Care has indicated its support, pending documentation, of adding this facility to Trudeau's FQHC "scope of services." This will ensure that Trudeau will be able to take maximize advantage of the reimbursements available to FQHCs for Medicaid and Medicare eligible services and also receive federal malpractice coverage at no charge.

- New York State has indicated its willingness to provide emergency approvals to help make this transfer happen as quickly as possible, and to provide approximately $500,000 in capital support to Trudeau.

- Four foundations have indicated willingness to provide financial support.

- Trudeau's predominant Medicaid managed care plan will provide a facilitated enroller and an outreach worker to assist Trudeau in recruiting patients and maximizing insurance coverage. It will also pay for marketing costs, including advertisements on buses that pass by the site.

Part II: Financial Operations and Pro-Forma

Financial Condition – Historical Analysis
The Business Profile section highlighted how Trudeau's operations have grown over the last 11 years. Table 1 shows that Trudeau has significantly strengthened its financial position over the last two years, with the current ratio now at 1.35 and days cash at 21. Trudeau has net assets of $11.7 million, but they are primarily in the form of the health centers it owns (i.e., not liquid and available to support operations).

Table 1: Summary of Historical Financial Position

	FY 2008	FY 2009	FY 2010	FY 2011 (unaudited)
Total Operating Revenues	$ 13,136,308	$ 15,062,331	$ 17,044,361	$ 17,116,701
Operating Margin (%)	0%	(-1.8%)	10.10%	6.20%
Total Assets	$ 18,506,020	$ 19,717,571	$ 20,116,626	$ 20,012,927
Net Assets	7,824,504	9,025,374	10,739,313	11,735,097
Total Debt	6,945,558	6,260,550	5,900,966	6,102,374
Days Cash on Hand	5	1	7	21
Current Ratio	0.7	0.53	1.23	1.35
Debt Service Coverage Ratio	0.21	0.25	3.47	2.72

Financial Condition – Projected Operating Performance Based on St. Anne Acquisition
The *Business Plan* for operating the St. Anne Center is predicated on the key assumptions outlined below. The anticipated results are shown on the Financial Projection Summary in Exhibit 1. Though the St. Anne facility has the capacity for 50,000 – 60,000 visits annually, the business plan projections are based on a lower growth rate that will achieve a sustainable operation. The plan assumes Trudeau will triple service volume over a five year period at St. Anne. The plan adds additional staff as providers become increasingly productive and patient volume builds.

There will be no purchase price for the facility. Caritas will transfer the facility to Trudeau and Trudeau will assume the existing bond financing, with a monthly debt service obligation of $47,500. This obligation is built into the business plan and the cash requirements.

1. **Personnel Services and Provider Productivity:** The number of FTEs is expected to triple over five years. Salaries are projected to increase at 3% annually and fringe benefits are estimated at 28% of annual salaries. These assumptions are consistent with Trudeau's current contract with its unionized employees. There are currently 8 FTE employees at St. Anne under a different union contract with a higher benefit rate.

Table 2: Projected FTEs

Staff Position	Current	Projected Year 1	Projected Year 2	Projected Year 3	Projected Year 4	Projected Year 5	Year 1 Salary
Site Administrator	0.5	0.5	0.5	1	1	1	$ 95,000
Subtotal Admin	0.5	0.5	0.5	1	1	1	
Primary Care MD	1.5	3	4	5	6	6.75	$ 135,000
Dentist	1	1.25	2	2	2	2	$ 100,000
Subtotal Providers	2.5	4.25	6	7	8	8.75	
RN/Manager	1	1	1	1	1	1	$ 75,000
LPN	1	2	2	2	3	3	$ 40,000
Medical & Dental Assistants	2.6	4	5.5	7	8.5	10	$ 35,000
Subtotal Clinical Support	4.6	7	8.5	10	12.5	14	
Subtotal Non-Clinical Support	3.5	10	11	11	13	13	$ 35,000
TOTAL	**11.1**	**21.75**	**26**	**29**	**34.5**	**36.75**	

As shown in Table 2, the number of providers is projected to double in the first two years of operation and increase incrementally over the next three years.

As demonstrated in Table 3, provider productivity is expected to rise gradually over the first three years, as the patient base builds. After year 3, it will be consistent with current provider productivity levels for the Trudeau network overall.

Table 3: Projected Provider Productivity

Provider Productivity	Projected Year 1	Projected Year 2	Projected Year 3	Projected Year 4	Projected Year 5
Primary Care Physician	3,500	3,900	4,200	4,200	4,200
Dentist	1,500	1,900	2,100	2,100	2,100

2. **Visit Volume**: Trudeau expects to triple volume at the St. Anne facility over the first five years. Though building on a base of the 11,000+ visits Caritas provided at the St. Anne Center in 2011, they have been conservative in estimating initial volume and subsequent growth at the St. Anne facility under Trudeau auspices. Caritas has already shut certain services at St. Anne, notably dental. In addition, given the current dysfunction at St. Anne due to Caritas' financial difficulties, Trudeau anticipates it will encounter unknown costs and challenges. Accordingly, they do not anticipate immediate growth, and have been careful not to underestimate the initial costs of this undertaking.

   Trudeau will undertake aggressive outreach and marketing to draw in new patients to St. Anne. The plan projects to increase visit volume to 32,000+ annual visits by the end of Year 5. The goal, however, is to exceed projections and expand volume until it reaches the facility capacity of 50,000 – 60,000 visits annually.

Table 4: Projected Visit Volume

Visits	Projected Year 1	Projected Year 2	Projected Year 3	Projected Year 4	Projected Year 5
Primary Care	9,990	15,519	20,825	25,025	28,175
Dental	1,781	3,760	4,200	4,200	4,200
Total	**11,771**	**19,279**	**25,025**	**29,225**	**32,375**

3. **Payor Mix**: The *Business Plan* assumes that volume growth will come largely from the low-income, underinsured and uninsured residents of Jamaica and the neighborhoods that comprise Southeast Queens. These are the same segments of the population that Trudeau targets at all of its centers and that comprise the majority of the patients who currently use St. Anne. It is projected that the payor mix at St. Anne under Trudeau auspices will be the same as Trudeau's current mix (shown below), which means a shift to include higher percentages of both self-pay and Medicaid-insured patients than currently seen at St. Anne.

Table 5: Trudeau and St. Anne's FY 2011 Payor Mix

Trudeau Center		Medicaid FFS	Medicaid Managed Care	TOTAL Medicaid	Medicare	Commercial Insurance	Self Pay	Total
TOTAL Trudeau	Visits	14,413	48,605	63,018	3,573	14,098	9,537	90,226
	% of Total	16%	54%	70%	4%	16%	11%	100%
Total St. Anne	% of Total	25%	37%	62%	12%	24%	2%	100%

4. **Reimbursement Rates**: The projections are based on Trudeau's current net reimbursement. Medicaid rates are increased for inflation by 2% annually; all others are held flat.

5. **Other Revenues**: Trudeau plans to initiate independently-operated WIC, pharmacy and specialty services over time, but no revenues from these sources are projected.

Sources and Uses for St. Anne Acquisition

Trudeau is seeking $1.0 million in one-time operating funds and an estimated $635,000 in capital to support the start-up of Trudeau at St. Anne.

1. **Initial Operating Expense Funds**: Trudeau will need approximately $1.0 million in operating capital to cover the projected loss in the first year, to meet the ramp-up cash flow requirements, and to provide contingency funds to cover unforeseen costs and challenges which are likely to occur given the current dysfunction at St. Anne due to Caritas' financial difficulties. The projections assume a 3-year loan, interest-only, at an interest rate of 5.0%, to be repaid from operations, or earlier, upon receipt of grants Trudeau is seeking in connection with this acquisition. The loan would be unsecured.

   Although the operating loss, on an accrual basis, is estimated at $500,000 in the first year, the additional cash need is based on the significant cash flow lags that will occur. The facility is breakeven or better on an accrual basis in the second and following years. The cash need is

$850,000 in the first year and $150,000 in the second year. The cash flow requirements are summarized in Exhibit 2.

2. **Capital Expenditures**: Trudeau will need to fund repairs to the St. Anne facility, including roof repair or replacement, to replace/upgrade select equipment and furniture, and to replace/upgrade systems, including telephone and health information technology systems, to be compatible and integrated with those at Trudeau's other centers. The projected capital budget, which is preliminarily estimated at $635,000, is detailed in Table 6. Trudeau has engaged an architect and contractor to develop a more precise estimate.

   The capital improvements will take place while the facility is operating. The current underutilization of the facility will enable Trudeau to provide services in one portion of the building while renovating another. Services can then move to the renovated portion while the rest of the facility is renovated.

Table 6: Trudeau @ St. Anne's Estimated Capital Budget

	Uses	Total Budget
1	Property Acquisition (see note below)	$ -
2	Construction/Renovation (Estimate)	
2.1	Renovation	250,000
2.2	Signage	15,000
2.3	**Total Construction Costs**	**265,000**
3	**Construction/Design Contingency (at 15% of Total Construction Costs)**	**40,000**
4	**Moveable Equipment and Furniture**	**275,000**
5	Professional Services, Insurance & Government Fees	
5.1	Architect/Engineer/Expediting	30,000
5.2	Environmental Assessment (Phase I, Asbestos, Lead)	1,500
5.3	Surveys	
5.4	Appraisals	
5.5	CON Consultant	15,000
5.6	Liability and Property Insurance	
5.7	Title Insurance	
5.8	NYSDOH CON Fee	1,250
5.9	NYC Permits and filing fees	2,500
5.1	Legal Fees	
5.11	Soft Cost Contingency (10% of above costs)	5,000
5.12	**Total Fees**	**55,250**
6	**SUB-TOTAL CONSTRUCTION, EQUIPMENT & FEES**	**635,250**
7	**TOTAL CAPITAL COSTS**	**$ 635,250**

Summary of Financial Projections

Tables 7 and 8 below summarize the projections for Trudeau's acquisition of the St. Anne facility. The projections show that, if Trudeau maintains operations at its current sites at levels comparable to its 2011 results, Trudeau can carry the new site. To do so without draining its cash will require cash infusions as described in the *Sources and Uses for St. Anne Acquisition* section.

Table 7: Trudeau Projections Without Cash Infusion

St. Anne Alone			
	Year 1	Year 2	Year 3
Total Revenue	$ 1,943,063	$ 3,000,738	$ 3,835,084
Total Expenses	2,439,188	2,973,638	3,433,836
SURPLUS (DEFICIT)	(496,126)	27,100	401,248
Debt Coverage Ratio	0	0.91	1.55

Table 8: Trudeau Projections With Cash Infusion

Trudeau Network with St. Anne				
	FY 2011	Year 1	Year 2	Year 3
Total Revenue	$17,116,701	$19,402,098	$20,808,954	$21,999,464
Total Expenses	16,120,913	19,043,728	20,076,315	21,049,593
SURPLUS (DEFICIT)	995,788	358,370	732,639	949,871
Debt Coverage Ratio	2.72	1.45	1.72	1.85

Exhibit 1
Trudeau @ St. Anne
Financial Projections Summary

Income Statement

	Year 1	Year 2	Year 3	Year 4	Year 5
REVENUES					
Patient Service Revenue	$ 1,589,063	$ 2,623,638	$ 3,434,884	$ 4,047,743	$ 4,525,067
BD/CC Revenue	-	-	-	-	-
Grants, Contracts & Other	354,468	377,568	400,668	400,668	400,668
Total Revenue	1,943,531	3,001,206	3,835,552	4,448,412	4,925,736
EXPENSES					
Personnel Services	1,424,989	1,864,966	2,248,042	2,732,486	3,044,454
Operating Expenses	518,250	626,601	718,549	795,176	861,579
Total Expenses	1,943,239	2,491,567	2,966,591	3,527,662	3,906,033
Earnings Before Interest & Depreciation	292	509,639	868,961	920,750	1,019,703
Interest	357,199	343,321	328,495	312,663	295,749
Depreciation	138,750	138,750	138,750	138,750	138,750
SURPLUS (DEFICIT)	**-495,657**	**27,568**	**401,716**	**469,337**	**585,204**

Debt Service Coverage

	Year 1	Year 2	Year 3	Year 4	Year 5
Earnings Before Interest & Depreciation	$ 292	$ 509,639	$ 868,961	$ 920,750	$ 1,019,703
Annual Debt Service	561,228	561,228	561,228	561,228	561,228
Coverage Ratio	**0**	**0.91**	**1.55**	**1.64**	**1.82**

Exhibit 2
Trudeau @ St. Anne
Projected Cash Flow Requirements

	Year 1	Year 2	Year 3	Year 4	Year 5
Revenues:					
Patient Services	$ 1,589,063	$ 2,623,638	$ 3,434,884	$ 4,047,743	$ 4,525,067
Grant/Other Revenue	354,000	377,100	400,200	400,200	400,200
Total Revenues	1,943,063	3,000,738	3,835,084	4,447,943	4,925,267
Expenses:					
Total Expenses prior to Depreciation	2,300,438	2,834,888	3,295,086	3,840,325	4,201,782
Excess (Deficit) of Revenue over Expenses Prior to Depreciation	(357,376)	165,850	539,998	607,618	723,485
Depreciation	138,750	138,750	138,750	138,750	138,750
Excess (Deficit) of Revenue over Expenses	(496,126)	27,100	401,248	468,868	584,735
Additions:					
Depreciation	138,750	138,750	138,750	138,750	138,750
Revenues Received for the Prior Year	-	326,250	440,010	576,497	678,681
Expenses Recorded but Not Paid	43,188	52,217	59,879	66,265	71,798
Deductions:					
Contingency	(250,000)	-	-	-	-
Revenues Earned but Not Received	(326,250)	(440,010)	(576,497)	(678,681)	(782,860)
Principal Payments	(204,029)	(217,907)	(232,733)	(248,565)	(265,479)
Expenses Paid for the Prior Year		(43,188)	(52,217)	(59,879)	(66,265)
Cash Flow:					
Increase (Decrease) in Cash	(1,094,467)	(156,788)	178,440	263,255	359,361
Cash at the Outset of Operations	250,000				
Cash Need for Period	**844,467**	**156,788**	-	-	-