Government of the District of Columbia
Office of the Chief Financial Officer

Natwar M. Gandhi
Chief Financial Officer

MEMORANDUM

TO:	**The Honorable Vincent C. Gray** **Chairman, Council of the District of Columbia**
FROM:	**Natwar M. Gandhi** **Chief Financial Officer**
DATE:	**June 29, 2010**
SUBJECT:	**Fiscal Impact Statement – "Not-for-Profit Hospital Corporation Establishment Emergency Amendment Act of 2010"**
REFERENCE:	**Draft Legislation received by the OCFO on June 25, 2010**

Conclusion

Although funds are sufficient in the FY 2010 budget and the FY 2011 to FY 2014 budget and financial plan to implement the provisions of the proposed legislation, an eventual foreclosure resulting in District ownership or acquisition of the hospital by settlement (which may occur independent of this legislation) is likely to have a negative impact on the District's budget and financial plan[1].

The purpose of the legislation is to authorize the District to keep the United Medical Center (UMC) operational. Because the hospital cannot meet its operating expenditures given its current revenue streams, it is likely that the District will have to continue to subsidize the hospital into the future. This would have budgetary and debt implications. The District will be required to include the financial operations of the hospital as a Component Unit of its Consolidated Annual Financial Report (CAFR), which could have negative implications for the District's financial position.

These and other concerns are detailed below.

[1] If the foreclosure results in the purchase of the hospital by a third party, the provisions of the legislation will not be implemented.

Background

The Not-for-Profit Hospital Corporation Establishment Amendment Act of 2010 (Act) sets up the legal framework of an independent nonprofit corporation of the District which may receive land, building and capital assets of UMC to be assumed by the District through foreclosure proceedings or as a result of a settlement with UMC's current owners. The Act establishes the size and responsibilities for the Corporation's Board of Directors and specifies nominating responsibilities for the various seats. In addition, the Act directs the Corporation to take necessary actions to continue hospital operations and specifies various responsibilities and governance provisions. Section 112 of the Act declares that assets and income of the Corporation shall be exempt from taxation by the District government. Finally, the Act establishes a nonlapsing, revolving fund within the District's accounts for payments received or made by the Corporation.

The District has previously enacted legislation concerning the hospital. In fiscal year 2008, the District entered into a partnership agreement with a subsidiary of Specialty Hospitals of America ("Specialty").[2] Under this agreement, the District provided $79 million of capital to the partnership which was then used to support Specialty's purchase and operations of the hospital, as follows:

- $30 million in a capital grant to fund capital equipment and renovations
- $20 million as a loan to fund working capital (the Working Capital Loan)
- $29 million as an acquisition loan (the Acquisition Loan)

The Working Capital Loan was to be repaid over a 10-year period at a rate of $2 million annually. Specialty diverted capital grant funds to make the initial repayment installment due May 1, 2008 and repaid the second installment out of unused amounts from the Acquisition Loan; the $2 million due in 2009 and the $1 million due on May 1, 2010 have not been paid. The Acquisition Loan was to be repaid from a Payment in Lieu of Taxes (PILOT) equivalent to real estate taxes on the hospital's land only, plus payments on future development which may occur on the site. After credit of some overpayments of real property taxes, this Acquisition Loan is approximately $325,000 in arrears. Under foreclosure, the District would forego future repayments of the Working Capital and Acquisition Loans.

In 2009, the District provided the hospital with an $11 million grant to fund emergency care pediatric facilities at the hospital. Additional District funding was authorized in February 2010 Healthy DC Equal Access Fund and Hospital Stabilization Emergency Amendment Act of 2010, which provided a $5.9 million grant to support delivery of acute care services for uninsured or under-insured individuals at the hospital.

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[2] See Fiscal Impact Statements on "East of the River Hospital Revitalization Act of 2007" (October 1, 2007) and "Resolution to Approve Contract Regarding Greater Southeast Community Hospital" (October 23, 2007)

Financial Plan Impact

While funds are sufficient in the FY 2010 budget and the FY 2011 to FY 2014 budget and financial plan to implement the provisions of the proposed legislation, the OCFO foresees a negative impact of owning and operating UMC, as discussed under "Concerns" below.

The legislation's tax exemption provision has no impact on the budget or financial plan because the hospital was previously exempt from real property taxes (and the OCFO has not included in its revenue estimates any estimates of PILOT payments on land or future development) and was not remitting corporate taxes.

Concerns

The proposed legislation may impact the District's consolidated financial position as well as the budget and financial plan due to the current and expected outlook for the hospital. While the legislation does not specify any financial transfer to the Corporation for the purposes of supporting hospital operations, it is difficult to foresee how the Corporation will maintain service provision at the hospital without additional subsidy, at least in the short term. The OCFO is concerned about the following:

1. *Liabilities of United Medical Center:* In order for the Corporation to legally begin operating the hospital, it will likely be required to acquire some of the existing liabilities of UMC. These liabilities currently include approximately $26 million of accounts payable and accrued payroll (including over $5 million in payroll taxes), as well as a number of lawsuits stemming from unpaid invoices. Although certain liabilities may be terminated in a foreclosure action, at least $7 to $9 million of outstanding accounts payable can be attributed to vendors who must continue providing services to the hospital. The litigation obligations are more difficult to estimate, and some litigation liabilities may not convey with the hospital, whether by settlement or foreclosure.

2. *On-going funding needs could put a negative pressure on the District's budget and financial plan*: Although the legislation does not specifically allocate funding to the Corporation, it is likely that the District will be asked to contribute funds required to finance current operations. Currently, without the District's grant proceeds, the hospital has insufficient cash to pay expenses as they arise, and the hospital projects to draw the remainder of the $5.9 million granted to it under the Healthy DC Equal Access Fund and Hospital Stabilization Emergency Amendment Act of 2010 by September, 2010. The OCFO estimates the hospital's current monthly operating deficits (without use of grant proceeds) are between $750,000 and $1.25 million, or approximately $9 to $15 million annually. In addition, there could be temporary or permanent loss of certain Medicare and insurance reimbursements as a result of the transfer. Although projected increase on certain payments described below may bring the hospital close to or above stable operating revenues, they may be insufficient to pay down accumulated debt carried forward (such as liens imposed by the Internal Revenue Service and the State of

Maryland) and the need for significant additional capital improvements at the hospital facility.

3. *The District's Chief Financial Officer cannot effectively oversee the financial operations of the hospital*: Although the District's Chief Financial Officer will have one seat on the board of the Corporation, the legislation does not provide for an agency fiscal officer appointed by the District's Chief Financial Officer. Unlike the governance of the Washington Convention and Sports Authority, the Corporation may adopt budgets and enter into debt arrangements over the opposition of the District's CFO. With neither a veto of the District's Chief Financial Officer with respect to debt issuance, nor assignment of a District agency fiscal officer, the operations of the hospital may have a detrimental impact on the financial position of the District. Additionally, because the hospital has not completed a financial audit for its fiscal year 2009 (Jan 2009 - Dec 2009) (and due to disputes between the District and the hospital's parent corporation), transfer of the hospital's assets and liabilities to the Corporation may be especially difficult to incorporate into the District's 2010 Consolidated Annual Financial Report.[3] ,

4. *Borrowing needs by the hospital could count towards the debt cap:* The proposed legislation notes that any borrowing by the hospital against hospital revenues would not be considered general obligation debt of the District, and therefore would not count towards the District's debt cap. However, given the negative operating cash flow of the hospital, the Corporation's debt could potentially be viewed by creditors as District debt due to the history of subsidy. The Corporation may not be able to borrow without District credit support, which would count against the debt cap.

Potentially mitigating factors of the hospital's on-going funding needs include the following possible increased sources of revenue identified by management for the near-term:

a. expected increased federal funding for Medicaid Disproportionate Share Hospital payments and service reimbursement rates;
b. planned opening of a new pediatric ward in conjunction with Children's National Medical Center;
c. planned agreement with insurance provider to accommodate additional childbirths; and
d. potential partnership with St. Elizabeths hospital for geriatric psychiatric services.

However, the revenue impact of these initiatives will be highly dependent on their successful implementation. Difficult challenges remaining for the hospital include: optimizing provider reimbursement procedures; addressing material remaining capital needs; and transitioning, if necessary, out of services previously licensed to and operated in conjunction with Specialty.

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[3] As a discretely presented component unit, the residual equity of the hospital will not impact the fund balance of the primary government (the District). That is, UMC's financial statements would be presented separately in the District's CAFR and not be folded into the District's general fund.