Rangely Hospital District

Review of Future Cash Projections

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Overview of Project Request

Approximately eight years ago a new Hospital building was constructed to replace a dilapidated facility that was in danger of not passing further inspection to remain open. Since this was a new building with all new equipment there has not been much in the way of repairs or replacement equipment required. This along with the Medicare Cost Reimbursement, State Provider Fee funding and mill levy funds has allowed the District Hospital to be financially stable. As with any building and equipment as they age there will begin to be repair and replacement needs. At the same time the healthcare industry is seeing pressure on their fees and many insurance companies are decreasing or at least not increasing rates they reimburse Hospital and Physicians. These issues have caused management to look forward at their future cash needs to maintain the current level of services.

We were engaged to bring some outside review based on our vast industry knowledge of rural healthcare to review the past and current financial results. Based on these results we were asked to look at the projected future needs of the facility and how that might impact the cash flow. We were provided financial and statistical data for the last several years, compared this data to public information that is available and other industry data required to project the future needs of Rangely District Hospital. We also went on site to meet with management and tour the facility to gain a better understanding of the unique situation and how services are currently being provided.

Based on all this information we have included in this report our projections of the cash needs of the facility for the next five years and our review of the current services and how they impact the community.

Description of Current Health Services

You may not realize what has been created in Rangely but it is very unique for the healthcare business. What you have developed is an all-inclusive primary care health system for Rangely and Western Rio Blanco County. All things healthcare for this area are wrapped up in the Rangely District Hospital which might be better named Western Rio Blanco County Health System. With the construction of the new health facility over eight years ago you have provided the space and equipment needed to care for the residents of the Western Rio Blanco County for some time to come. The services include:

- Inpatient Hospital services for lower acuity needs
- Long-term care beds (Swing Beds)
- Outpatient Hospital services to include
    - Emergency Room – state of the art with Physician coverage
    - Ancillary Services, Physical Therapy, Lab, Radiology, etc.
    - Procedure Room for Scopes, etc.
    - Respiratory Therapy Services
- Home Care Services
- Clinic Operations with Physicians that live in the community
- Ambulance Services
- Assisted Living Space – Eagle Crest
- Retail Pharmacy – the only one in the area
- Dentist – Space in the facility for the local dentist, the only one in the area

Normally we see many of these services in separate organizations or at least not all run by the same administration and board. In this case it makes perfect sense to run them all together for better access to care for all the western part of Rio Blanco County. With the volume for each service rather low due to the population size it would not make good sense to duplicate the overhead for each service. This also provides a quality new space that can service these needs well into the future. The Hospital is set up under the Medicare system as a "Critical Access Hospital or CAH" that is paid cost for inpatient and outpatient services, you also qualify for cost-based reimbursement on the Ambulance service due to your distance to the next closest ambulance. By having this set up it has allowed the facility to be paid the most they can from Medicare for these services. We will discuss more about the dollars of this situation in the next section of this report. Currently we think the structure is set up perfectly for the unique situation in western Rio Blanco County.

Demographics and Economic Issues

Rangely District Hospital serves a unique part of the State of Colorado. It sits in the Northwest corner of the state in a location with only two main highways in and out of the area. Highway 64 with the closest other health facility being in Meeker on the eastern side of Rio Blanco County. Even though these two cities are only 60 miles apart the road is only a two-line highway that can be difficult to cover in the winter months. The other highway is 139 going south over Douglas Pass to Grand Junction. This is a two-hour trip on good weather days. Obviously since this road has a pass to navigate bad weather times can be a challenge to make the trip. These issues can make Rangely isolated many times during the year. As we explained earlier the comprehensive nature of the health services created by Rangely District Hospital is what is required for the unique geographic situation.

The four main areas for employment of the approximately 2,500 citizens in the western end of Rio Blanco County include, Oil/gas/Mining, Colorado Northwestern Community College, Government – i.e. city/county/schools and Rangely District Hospital itself. It is clear that Rangely District Hospital is the key to maintaining most of this employment base. Because Rangely District Hospital services are so comprehensive the loss of this operation would mean the loss of all healthcare on the west end of the County. We think the loss of these healthcare services would result in the following:

1. The oil/gas/mining operations would substantially cut back their operations and move the location of their employees to a place that has healthcare available.
2. The College is required to have healthcare facilities in their local community and would most likely have to consolidate their campus back to Meeker.
3. With the first two items taking place the reduction in population would have a big impact on the school systems employment as well.

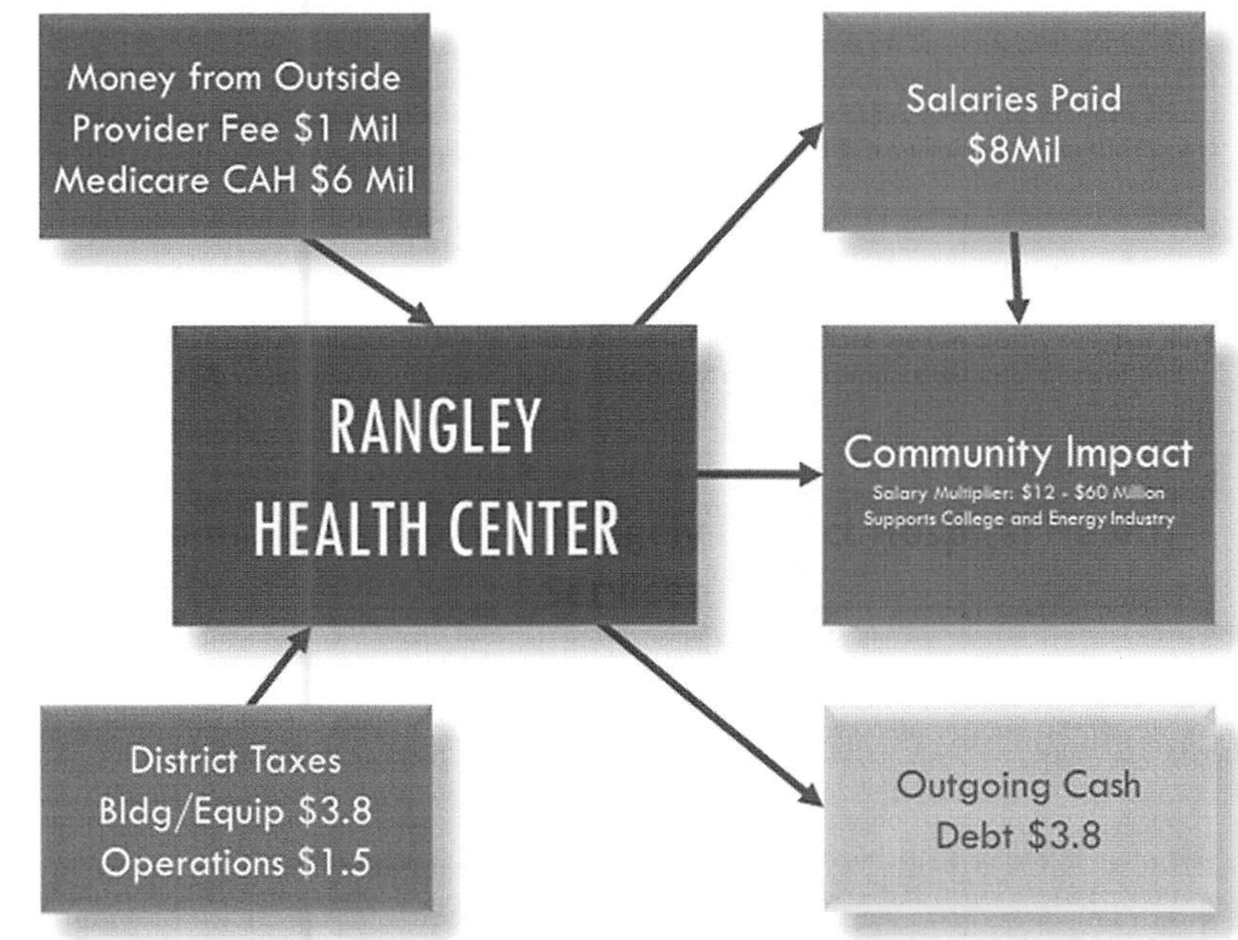
Many Universities have done studies that show in a rural community the local Hospital is one if not the most important economic driver in a rural County. This is more than likely one of the best examples of that issue with the comprehensive services that could be lost if Rangely District Hospital were to close or even substantially reduce their available services.

We have included a diagram showing the direct financial impact Rangely District Hospital has on the community as follows:

1. Outside dollars coming into the community
    a. Provider fee money from the state of Colorado - $1 million
    b. Medicare money from their Critical Access Hospital Status - $6 million
2. Current District Taxes to support the isolated operations
    a. Bond levy for new building and equipment, sunsets 2025 $3.8 million
    b. Operation taxes $1.5 million
3. Outgoing cash for Bonds, directly from the bond levy above $3.8 million
4. Outgoing cash for salaries to run the comprehensive services $8 million

Many studies have been conducted on the impact of a Hospital's salaries on the local community. Each of these studies claims to justify the number of times these salaries turnover in a community to support the local economy with those numbers ranging from 1.5 to 7 times the salary amounts. That would mean that the Hospital's own salaries paid supports between $12 and $60 million dollars in the local community. Obviously the actual for Rangely would be somewhere in the middle of these numbers which would have a large impact on the local businesses. This is one place we can clearly see that if the Health Services were lost you would not only lose this direct economic impact but also much of the other business as well with the Energy and Education sectors.

Economic Impact of the Rangely District Hospital Health Services



Cash Projections 2018 – 2022

We have attached to this report our projected cash position of Rangely District Hospital from years ended 2018 to 2022. Based on these projections we would expect given no changes in the operations or tax revenues the District will run out of cash mid-point in 2021. The major assumptions used for these projections includes:

1. Net patient service revenue increases limited to 2%. This is due to the current environment in the industry where Medicare, Medicaid and Commercial Insurance pricing is not going up to try and hold the line on the overall healthcare spending. We feel any increases will be limited to some small inflationary amounts.

2. Salaries are estimated to increase 3% each year as many of the staff have not had consistent salary increases. We feel the increases will be required to maintain the licensed staff required for the health services as other parts of the state are paying sign on bonuses to attract staff.

3. Other operating expenses are also expected to increase by 3% per year based on current inflationary price increases we are seeing in the industry.

4. Depreciation is expected to level off at $2,500,000 per year. This is a combination of the reducing depreciation on the new structure and equipment put in that new structure plus the replacement equipment that will be required as the facility starts to age. Since the construction of the new facility and addition of the new equipment with that construction management has enjoyed a period of time that required little replacement equipment or major repairs to the building. Based on our discussions with management and touring of the facility we do think the building and equipment will now start to need some major repairs and replacement equipment. Those additions and repairs are expected to be $1.1 million per year into the future to maintain the facilities in their current condition. The depreciation on the new capital expenditures should replace the decreasing depreciation on the current facilities for a constant amount over the next few years.

5. Interest is based on the bond amounts that are due to pay off in 2026.

6. Property taxes for the bond levy will remain in place through 2015 when they will accumulate to the amount need to completely pay off the bonds and then the taxes will be terminated. The taxes available for operations are expected to only have a small increase over the next few years, no new projects are known that would change these amounts.

7. In the 2017 year there were some catch up payments received from Medicare on the cost-based reimbursement for previous years that increased our cash, those changes have been incorporated into the Net Patient Service Revenue for 2018 – 2022.

As you can see from the projections the major change in the cash flow is the need to now start to repair and replace aging building and equipment. If this is not done the facilities could very quickly become out of compliance for certification standards. This is no different than when someone moves into a newly constructed home and about 10 years later things start to need to be replaced or repaired.

Other possible changes for the future

There are at least two items with a potential for change that could negatively affect these projections.

340(b) Drug Pricing

In the past the federal government put in place a 340(b) program that allowed facilities such as Rangely District Hospital to purchased outpatient drugs at substantially reduced rates to help save on their cost structure. When the program was implanted the savings to the facility was around $400,000 per year and has since dropped to only $250,000 due to federal regulation changes. We feel this program is under the potential for being completely cut in one of the upcoming budgets at the federal level. If this does occur it will place an additional cash reduction of the $250,000 in that year.

State of Colorado "Provider Fee" Program

This is a program where each Hospital is charged a "provider fee" which is then put into the state's Medicaid program which can receive a match of federal funds on those new dollars into the program. The combined state and federal dollars are then reallocated to the Hospitals as new Medicaid funding of which Rangely District Hospital currently receives approximately $1 million dollars each year. We have two separate risks of these funds in the future one from the state and another at the federal level. The state over the last few years has argued in the legislature where these funds should be classified and if they can be used for other state needs other than the Hospitals. Just last year these funds were set aside in their own fund for the Hospitals, but we continue to monitor this battle each year in the state legislature to keep the funds isolated just for the Hospitals. The other issue is these funds create an additional match of dollars from the federal government and they have been looking at these programs not just in Colorado but around the country to see if the federal government wants to continue to allow Hospitals to basically self-fund these additional payments on the back of the federal government. We have seen new programs in other states being denied by the federal government and there is some discussion about re-looking at the other programs, like Colorado's, approved in the past to be eliminated. If this program was eliminated this would be another $1 million per year hit to the cash flow.

The combination of these two issues that have a more than likely possibility of occurrence would increase the cash need by approximately $1.25 million per year over what we have projected in the attached financials.

Conclusions and Recommendations

Much of this change is just due to the normal aging of any new structure that begins to require upkeep. I spend a great deal of my time working with "distressed hospital operations" where they have not planned such as you are doing now and usually call when they are on the verge of running out of cash or have already run out of cash. One might just say to cut the operating expenses if the cash is decreasing like any other business would do but in a Health delivery system such as what you have that is not easily done and maintain the services as expected. We did look at the personnel numbers by department and what management has done over the last couple years in anticipation of this issue coming up in the future. We found there is not much left to cut in the way of salaries or FTEs and maintain the current level of services. To keep all the services in tack as they are today we feel there needs to be at least another $1.5 million per year in tax revenues but with the potential for the two other cuts we discussed earlier we would be more comfortable with an additional $3 million in available tax revenue per year that only has to be fully accessed if necessary. Understanding that the current bond levy tax last year is 2025 so there would only be a few years of overlap of the additional taxes to bridge the gap between this current need and the expiration of the bond levy amount. At that point the amount of tax revenues would be approximately the same as they are currently, but we just don't think your current projections of cash losses will allow you to wait for the bond levy to go away before you implement a new tax.

So one might ask what happens if the new taxes are not put in place over the next couple years? I have been involved in dozens of other facilities where just that has happened, and the cash was depleted, here is what will start to take place over the next two to three years and beyond:

1. Required equipment replacements will be put off and risk loss of services due to adequate equipment not being available. I have one facility we work with that has been using a portable X-Ray for the last two years since they sent their normal C-Arm out for repair and could not afford to pay for those repairs and get it back into the Hospital. This is the kind of things you will be faced with in the future if no funds are available for replacements.
2. Upkeep of your very nice building will be put off and that could cause additional damage and potential violation of licensing requirements.
3. You will start to lose your best staff members when the salaries are not increased to keep pace with the industry, replacement will be difficult.
4. Then you will get to the point of cutting entire service lines most likely starting with the ones that are not interdependent on other services, i.e. assisted living, home health care, cutting back on clinic hours to reduce physician cost, cutting or reducing physical therapy services. We really don't think you can cut many more of the service lines due to them being so interdependent that at this point it will be to just close all the services.

Your community has built a wonderful health system that works very well for your location. This system includes all the emergency services needed in the area as well as the primary care needs all wrapped into one package for efficiency purposes. At the same time this causes a risk since if there is not supplemental funding due to the population size of your location the entire operation could be lost. I have been in this industry for almost 40 years working with healthcare in rural American and I can say without a doubt this is the best set up I have ever seen to supply the community with just what they need at the lowest cost possible. I think the community is at a point of needing to provide the necessary public funds to maintain these great services that really drive the economic engine for the area or you risk losing it all over the next several years. I don't see a middle ground here since the services are so interdependent upon each other.

Our suggestion would be to go after at least a $3 million dollar increase per year that would only be an increase for a few years until the bond levy $3.8 million goes away. I would also suggest, if legally possible, to build into the tax that this be an annual request of how much is to be taxed based on that year's need up to the $3 million but not required to tax the full $3 million if it is not needed for that year.