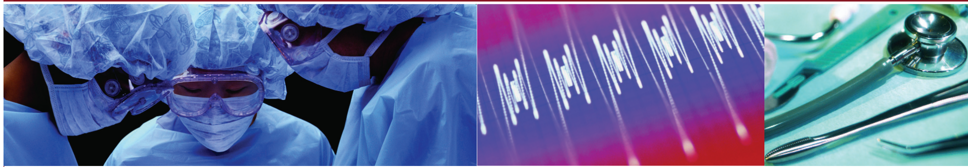

THE RECESSION IS REAL:

Ten Steps a Hospital CEO Should Consider Taking Now

Whether we are technically in a recession or not, there are significant economic signs reminiscent of the 1987 stock market crash. For those of you who did not live through that downturn as a health care administrator, we thought it would be helpful to outline some useful tips to consider in dealing with the financial rollercoaster that hospital CEOs now must face.

Recently, the debt crisis created by subprime mortgages has demonstrated the interdependence and vulnerability of our financial institutions. As this crisis winds its way through the housing and banking communities, hospitals and health care systems may become the next innocent victims. Some hospitals may find it difficult to finance new projects or complete existing transactions. Most health care systems should develop a contingency plan for a broad range of economic possibilities, considering short-term and long-term financial impacts. Described below are several issues to consider.

1. Evaluate your current tax-exempt financing to determine whether you have any auction-rate bonds with penalty provisions that are triggered in the event that an auction never occurs. This exposure is new to many CEOs and CFOs who do not regularly work with this type of debt instrument. While these bonds are priced at market and were always considered "almost as good as cash," they are not cash – especially when no auction takes place to determine the applicable interest rate. In such a case, many of these investments have penalty interest rates as high as 20 percent! This would be a good time to refinance these instruments, if possible.
2. Prepare for a hit to the bottom line caused by a decline in value of the hospital's investment portfolio. Continued vulnerability due to indirect exposure to subprime mortgages or other credit market assets must be assessed. Reviewing your investment portfolio and its allocation is a good step at this time.
3. Bear in mind the possible exposures of any defined benefit pension plans that may develop unfunded liabilities due to the decline in the plan's asset values. This possibility could have a significant impact on the hospital's bottom line as well as its available cash. Freezing or terminating a defined benefit pension plan in today's economic environment should be high on the list of proactive measures.
4. Consider the impact of a possible lower bond rating on the cost of borrowing. CFOs should project what would happen if the hospital's bond rating declines because of the hospital's deteriorating financial position. Consider a strategy to avoid a downgrade, such as the implementation of cost-savings measures.
5. Assess the impact of the downturn on hiring new employees. Will unemployment in other sectors make it easier to hire new employees at lower wages? While it is unclear what effect an economic downtown will have on hiring new nurses since this market is extremely regional, hospitals should consider developing a nurse recruitment program during this period of relative job insecurity.
6. Find out what opportunities are available to a hospital or health system that has access to cash. Are there key acquisition opportunities that would help the bottom line, such as a nearby hospital or outpatient service? Are there any key physician practices available for acquisition? Is there a market to monetize certain hospital assets, such as a dialysis program, lab or behavioral health program?
7. Determine how vulnerable the hospital's financial condition is to increased unemployment and its impact on the payer mix of the hospital. While some laid-off employees will take advantage of COBRA, many others will be unable to afford the cost of COBRA and will become uninsured. Strategies to work with patients who may qualify for Medicaid during this period should be considered.
8. Hospitals that are self-insured for medical malpractice and other exposures should evaluate the current investment exposure to subprime mortgages and other credit instruments and determine whether the decline in the overall value of the investment portfolio of the self-insurance program is manageable or whether additional funding to pay claims is required. Is it time to purchase third party insurance and cap the overall risk?
9. If the projected financial situation looks grim for your hospital, be objective and act quickly. Consider developing a contingent bankruptcy reorganization strategy. It is always better to consult bankruptcy counsel in advance to identify contingency plans even if a reorganization never occurs.
10. If your situation is tenuous but not so grim, explore strategic alternatives, including affiliation or other arrangements with a stronger hospital or health care system. It is always better to explore this option before the situation becomes critical and your options are limited.

These are just a sample of the key questions that should be considered in these uncertain economic times. Obviously, each hospital or health care system is different, but all hospitals are likely to be affected by this downturn. During a time which Alan Greenspan recently dubbed the worst economic crisis since World War II, hospital leaders need to have a clear vision of their institutions' vulnerabilities and opportunities in order to develop a clear plan to move forward.

If you have a question on this material or would like to discuss legal services, please contact us at healthcare@duanemorris.com.


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