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Health Care

by Bill Wilson

2008 Rural Hospital Renovation Study Report

*In Summer 2008, Lancaster Pollard, Critical Access Group, McClure and Associates and Graham Construction surveyed rural community hospitals that had renovated or expanded in the past three years to learn more about the projects' scopes and impacts on health care delivery. The results were presented at the National Rural Health Association's annual conference in October.*

Hundreds of Hill-Burton era hospitals face the challenges of maintaining 50-year old buildings while medical service models continue to evolve. Since standing still is essentially moving backward, hospitals have two basic options: build a replacement facility or renovate and/or expand existing facilities. Excellent studies have been conducted regarding replacement hospitals, but not all communities can afford to build new, and not every board can get comfortable with taking on that financial and operational risk.

The goal of this Study was to review the experiences of hospitals that recently pursued renovations and ex-

**What was the project's purpose(s)?**

Expand Existing Services	100%
Aesthetic Improvements	80%
Recruit/Retain Professional Staff	60%
New Services	40%

pansions, and to provide hard data to track the impact of major renovations on small facilities.

Major areas reviewed included Project Impact, Financial and Utilization Trends and Lessons Learned. The respondents' project scopes were between \$1 million and \$17 million. Expansions and renovations were generally focused on improving outpatient services. Specific examples included new specialty clinics, radiology departments and rehabilitation services.

**The Results**

Overall, the community hospital respondents succeeded in completing their projects and maintaining their

**What effect did the project have on the following areas?**

	Surpassed Expectations	Met Expectations	Below Expectations	Uncertain/NA
Physician Referrals	40%	50%	0%	10%
Market Share	30%	50%	10%	10%
Physician Retention	30%	50%	10%	10%
Physician Recruitment	30%	50%	0%	20%
Nursing Staff Retention	10%	50%	10%	30%
Community Satisfaction	40%	30%	0%	30%

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financial strength. Of note, they experienced significant growth in outpatient services. Almost all noted challenges associated with undertaking a project and the need for prudent planning.

## Brand New, or Rebrand Old?

Hospitals and their bankers face key underwriting issues when deciding whether to build or rebuild.

The true cost of staying in the current location:

- How old is the building?
- Is adjacent land available? At what cost?
- Can the hospital continue operations where it is?
- What is the competitive impact of staying put?

The true cost of moving:

- What other land is available?
- How much will site costs ultimately total?

Available and required financial resources must be determined. Initial development costs are significant: Hospitals need a minimum liquidity level in cash and investment reserves to maintain a cushion once the project begins. Equity alternatives like federal programs, capital campaigns, and direct or indirect tax support can be considered.

## The team players

As noted by Study participants, hospitals pursuing even limited renovation projects should engage investment bankers, architects and contractors experienced with rural health care, and do so early on. A full and competent project team will have a process that can swiftly address known pitfalls as they arise, assist in anticipating the project risks, and help build conservative assumptions.

Team members include the hospital leadership and its representative team leader, who coordinate the current facility's building analysis and manage all site studies, testing and equipment planning; the health care operational analyst, responsible for strategic planning and space usage considerations; the financial consultant, often the investment or mortgage banker, who helps the hospital determine how much it can borrow, which financing option is best given the goals and the markets, and who also executes the financing; and the architectural and construction team, which should be able to provide early conceptual estimates and a maximum price guarantee, and keep the project on schedule.

## Current Financing Availability

At publication, credit markets remain tight, but financing is still available. The Federal Housing Administration's Section 242 Mortgage Insurance program is an excellent option in such a market, providing a guarantee on, in some cases, up to 100% of hospital debt. Tax-exempt bonds can be used, and processing time has been reduced.

Bank qualified loans are a viable option in this market, generally for amounts of \$10 million or less. The recent federal decision to insure deposits of up to \$250,000 will hopefully re-energize banks' lending appetites because depositors should be less likely to withdraw their assets. Finally, bank letters of credit remain a viable credit enhancement option whose structure has withstood the market swings. With properly articulated strengths, hospitals still should be able to access letters of credit, especially now that Federal Home Loan Bank legislation offers new lending opportunities for local banks.

Many hospital projects are critical and cannot wait for optimal capital markets. Study results suggest that through well-coordinated renovation and expansion projects, hospitals can meet community and medical staff expectations and increase utilization while limiting financial risk.

## Lessons Learned

The key lesson noted by renovating hospitals was that a hospital should take the planning of its renovation or expansion every bit as seriously as that of a full replacement facility. While hospitals eventually met project expectations, as well as positive financial and utilization results, Study participants offered several suggestions to make the process smoother. The most consistently noted issues were challenges experienced during the renovation itself.

Study participants recommend:

- Begin using a project team approach early on to assist with the development process.
- Plan ahead to accommodate patient flow and operations during the actual renovation.
- Choose taking more time to plan versus rushing to save money.