



SPECIAL REPORT: Community Hospitals Tapped Out?

by Chip Reuben

While community hospitals may be fiscally challenged, careful planning and the right financial partner can help small facilities tap much-needed resources.

It is turbulent times for the nation's numerous community hospitals, often categorized as those with less than 250 beds. A recent white paper sponsored by Siemens Financial Services Inc identified six major areas of concern for America's community hospital leaders.¹ Not surprisingly, access to capital ranked among them. Moreover, the white paper notes a 2009 research report published by The Advisory Board Company, which found that 44% of hospitals surveyed by the American Hospital Association in 2008 classified capital from banks and financial services companies as "significantly harder to access today" than in previous years.¹

Where does this leave a small community hospital when it comes to acquiring capital to purchase an MRI, CT scanner, or new PACS system, for that matter? Indeed, another recent report shows that IT budgets are tight, too. "Healthcare Leaders React to the Changing Economic Times," published by Beacon Partners in 2010, summarizes the responses of more than 200 United States-based C-level health care executives, 40% of whom describe their institutions as community hospitals. More than 50% said they had to cut back on IT investments "due to the sour economy and reduced access to credit markets for financing."²

Times may be tough, but there are still financing solutions available to small hospitals. To tap the resources for your radiology purchases, first tap into the expert advice we uncovered.

Initial Assessment, the Planning Process

Careful planning in advance of acquiring equipment is one of the keys to long-term financial success. In order to get financing for the purchase, you need to plan properly. According to Martin E. Zimmerman, president and CEO of LFC Capital Inc, Chicago, "It is important to fit the equipment you choose to the likely volume of procedures you will do. Otherwise, it doesn't make economic sense. It is difficult to generalize, but it is safe to

say that a high-speed CT requires a good deal more scan volume to pay for itself than a less expensive scanner or refurbished equipment."

Zimmerman emphasized the need to think clearly and realistically about potential volume and the economics of the situation. "If the equipment is not the right fit for the market environment, then it is not going to be competitive and generate referrals." According to Zimmerman, "Consulting can be useful in assessing demand. Any assessment should be made independently from the manufacturer, whose fundamental objective is to sell the equipment. After all, the hospital must be able to provide the service on a profitable basis for long-term viability."

According to John Sandstrom, senior vice president and global general manager of the Healthcare Financing Group for Siemens Financial Services, "A bank or finance company wants to understand the needs for the capital and the expected capital project benefits (ie, a project cash flow or other financial projections). If the financing involves the acquisition of advanced medical equipment via a fair market value lease, they will also want to understand the expected life cycle of the technology and the secondary market for such equipment. Once the need for the capital has been fully determined by the lender, the lender will want 2 to 3 years of audited financial statements, plus any interim financial statements, in order to render a credit decision. The more information that is provided only helps in getting the best terms for financing. Upon a favorable credit decision, loan/lease documents will be prepared by the lender and sent to the hospital for signature. Upon execution of the loan documents, the capital is now available for the project to move forward. Funds associated with the loan/lease will typically be disbursed directly to the vendor(s) of choice associated with the capital project by the lender based on the borrower's indication of work/delivery being successfully completed by the vendor(s)."

Timing is another issue you need to bear in mind. "The timeline to obtain the loan/lease to complete this process varies depending on the type of financing and the size of the financing. For example, when executing a commercial loan/lease for a new ultrasound or nuclear camera (typically less than \$250,000), it may take 1 to 4 weeks to go from financing request to executed loan documents. When pursuing a commercial loan/lease for the acquisition of a new CT or MR scanner (\$500,000 to \$1.5 million, for example), it may take 3 to 8 weeks," said Sandstrom.

Regarding tax-free loans, Sandstrom had this advice, "For a tax-exempt loan/lease, the process includes some additional steps, and the timeline can be different than with a commercial loan/lease. In addition to the steps outlined above for a commercial loan/lease, if the borrower is a not-for-profit 501(c)(3) organization, they will have to obtain a qualified tax opinion regarding their ability to enter into a tax-exempt loan/lease and engage a conduit entity. If the borrower is a governmental 103(a) entity, they can enter the loan/lease without engaging a conduit, but will still have to obtain a qualified validity opinion regarding their ability to enter into a tax-exempt loan/lease. From a Siemens viewpoint, the more we know about the hospital's needs in both capital requirements and time frame, the better we can meet them."

Choosing a Financial Partner

Zimmerman offered some advice on the process by which community hospitals should seek financing for equipment. "When choosing a financial partner, it is always desirable to talk to several different prospective financial sources to obtain competitive bids. These [sources] might include the manufacturer's financing arm, your local bank, and an independent leasing firm."

According to Sandstrom, hospitals can turn to several specific types of financial experts. Loan officers from banks, financial sales representatives of manufacturer organizations, financial sales representatives from independent finance companies, independent financial sales brokers representing several finance entities, or independent financial advisors can be considered. "Each [entity] brings a unique value proposition to the table."

Sandstrom continued, "Hospitals' leaders should seek financing companies that have a fundamental understanding of the business of health care and the challenges of managing a community hospital. The financing company should also demonstrate a working knowledge of the hospital operation so they can easily understand how the needed capital is going to be deployed and immediately assess and appreciate the benefits to be achieved by the hospital. Financing companies that possess this knowledge will generally have a greater capacity to find a way to provide the needed capital."

Negotiating with the Manufacturer, Considering the Terms

Zimmerman offered further advice on negotiating with the manufacturer. "Once the equipment is decided upon, ask your financing source to help you assess the price based on their experience with the overall market so you can get the best discount available," said Zimmerman. "If you want a multiyear service contract, which is usually available at a discount to a 1-year contract, negotiate up front. It may be advantageous to prepay the multiyear contract if the extra discount is large enough." Zimmerman further elaborated, "There is quite a bit of flexibility about pricing in the [current] marketplace, particularly as one gets toward year-end."

According to Zimmerman, "It is important to recognize that the lowest costs are obtained by negotiating separately for the equipment first as if it were being purchased for cash, and to negotiate the financing separately, so that the financing and equipment costs can be evaluated independently. It is also important to ascertain the expected useful life and the cost of the asset. The typical financing term for expensive assets is 5 years in order to keep monthly costs affordable. "

On the topic of leasing equipment, Zimmerman said making the decision to buy or lease could depend on the anticipated life span of the equipment. "If the equipment is expected to last at least 7 years, it may be less expensive to own it in the end. But if the useful life is expected to be 6 years or less, then it is usually less expensive to lease. But the numbers need to be analyzed in each individual case." He explained that an independent lessor has the capability to remarket the equipment to avoid selling it at a loss.

Zimmerman offered some general advice for financing in today's current economic climate. "In today's world, it can be beneficial to finance or lease because interest rates are so low. Equipment financing costs are likely to remain attractive, particularly if inflation takes hold. Cash remains king and it is important to have enough of it on your balance sheet. The advantage of medium-term financing or leasing is that much of the debt is looked upon as long-term debt rather than current liabilities. This approach makes it easier to borrow for other purposes, because the hospital's financial position is healthier."

According to Sandstrom, a few different possible financing solutions can make sense for fiscally challenged facilities. One possibility is to "finance a smaller portion of the total cost of the project. For example, when a project involves making leasehold improvements to accommodate the planned acquisition of new equipment, pay cash for the leasehold improvements and only finance the equipment. This [approach] reduces the lender's risk and demonstrates a commitment by the hospital to the project." Other approaches include utilizing a shorter than typical term for the lending request or pledging additional hospital assets (if unencumbered) as collateral. "[These approaches] reduce the lender's risk and will help in getting the loan/lease approved," said Sandstrom. Hospitals can also "enter in sale-leaseback arrangements to 'monetize' owned assets as a way to generate capital to support planned capital projects."

The Credit Barrier

Sandstrom addressed the challenges hospitals might face when borrowing capital, and outlined his response by segmenting the market based on credit profile. First, he discussed institutions with investment grade credit. "Lenders in general continued to pursue this market segment throughout the financial downturn, looking to lend money to less risky borrowers, pursuing a 'flight to quality' approach. As the economy has improved, the tax-exempt bond market has become a viable option again for this segment. While capital is available to this segment, borrowing costs have gone up [since] September 2008."

Regarding hospitals with middle tier credit, "Lenders generally were still lending to this segment, but at much higher rates during the financial crisis. The tax-exempt bond market was generally unavailable to this segment. Alternative sources of capital are critical to ensuring continuation of capital project plans."

Borrowers with weak credit represented "generally a less attractive segment of the market, pre- and post-financial crisis. Borrowers must demonstrate positive improvement trends (even though financial performance may still be negative) and strong cash flow projections/financial benefits to be achieved via the planned capital project."

Multiple Financing Sources

"Some believe it is better to have one primary financing company. But the pitfalls of this approach have become painfully evident since September 2008," said Sandstrom. "In

today's market, having a working relationship with more than one financing company is a more prudent and practical approach."

According to Zimmerman, "We also recommend wherever possible to have several financing sources, and not rely exclusively on one source. Every lender has a concentration limit. Also, circumstances change, and the lender who may be aggressively pursuing business at one point in time might later back away from that market segment. With the volatility in the financial markets over the last few years, access to financing has been unpredictable at best. So it is advisable to have several sources of financing available, particularly those familiar with health care and its unique equipment market."



*John Sandstrom, senior
VP and global general
manager*



*Martin E. Zimmerman,
president and CEO*

Chip Reuben is a contributing writer for Imaging Economics.

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