VALLEY MEDICAL CENTER FY 15 OPERATING AND CAPITAL BUDGETS

FF&A COMMITTEE

MAY 15, 2014

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UW MEDICINE STRATEGIC PLAN

Accountable Care Organization

1. Build Key Programs

New Programs/ Innovations in Care

- Diabetes & Obesity
- Digestive/GI
- Palliative Care
- Integrated Mental Health/Primary Care

Strategic Service Expansion/ Innovations Care

- Eye Institute
- Pain Center
- Vascular Center
- Regional Heart Center
- Organ Transplantation
- Obstetrics/Neonatal
- Neurosciences Institute
- Spine/Sports Musculoskeletal
- Oncology (SCCA)

Policy/ Advocacy

- Trauma System
- Safety Net Care
- Health Care Reform

Integration of Research Innovation Educational Innovation Clinical Innovation

2. Build Relationships & Provider Network

- Strategic Partnerships & ACO Development
- Primary & Secondary Care Expansion

3. Deliver Service Excellence

- Service Excellence
- Patients Are First
- Pillar Goals

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4. Deliver Quality, Safety, & Value Based Outcomes

- Patient Safety, Quality & Cost-Effective Outcomes
- Performance Improvement

5. Organizational Capability & Fiscal Integrity

- Long Range Financial Plan
- Workforce Development/HR
- IT Advancements
- Telemedicine

Financial Forecast

Future success is based on growth of clinics & outpatient services which will maintain inpatient utilization.

Major changes will come as healthcare reform enters year two:

- Demand for service
- Payment reductions
- Shift from volume to quality & patient satisfaction
- Move to Triple Aim

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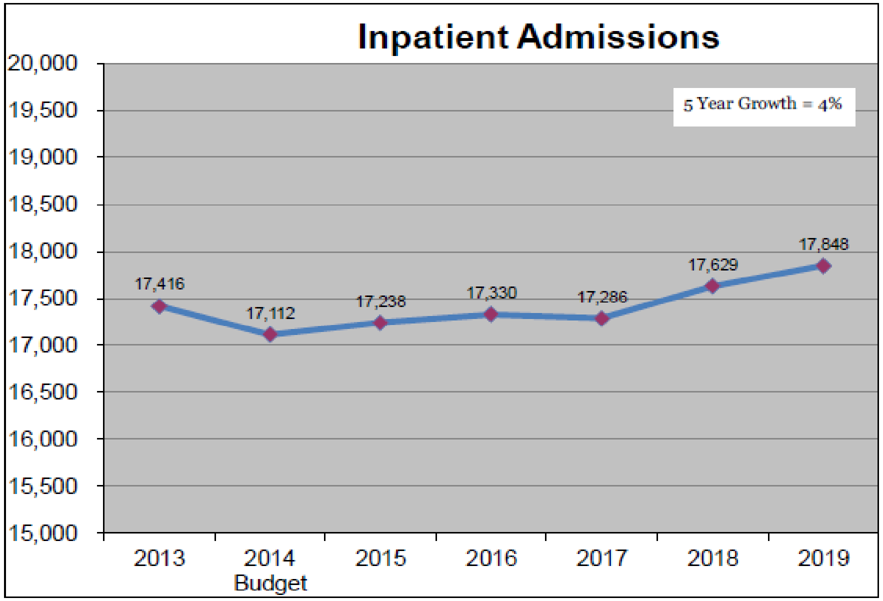
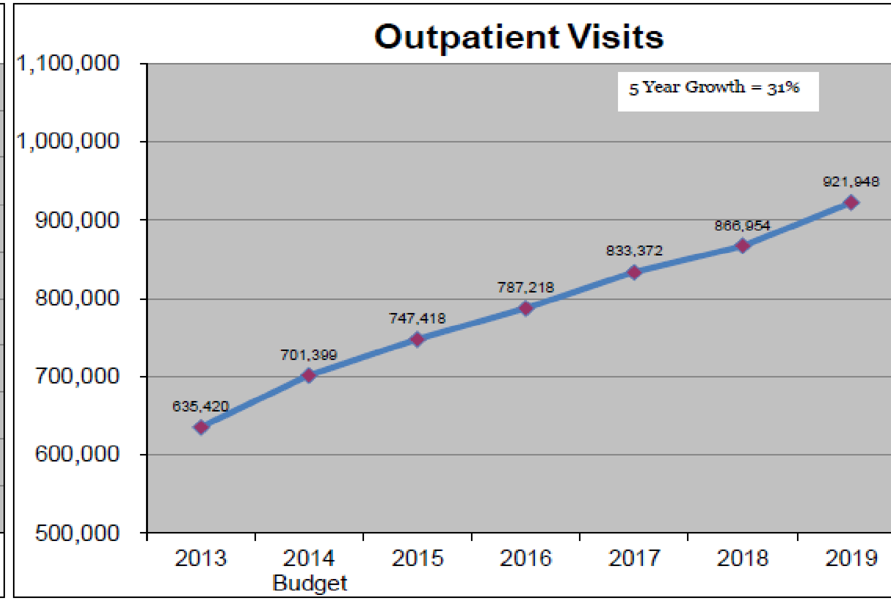
PROJECTED VOLUME GROWTH





- Existing inpatient volume is projected to grow at 1-2% annually

- Outpatient visits are projected to grow between 4% and 7% per year due to the following:
  - FY15 has a full year of volumes related to the IPV radiology joint venture
  - Additional growth at Maple Valley and Covington
  - Continued strategic focus on growing additional OP sites in FY16-FY19
  - Ancillary OP is anticipated to grow as a result of the increased clinic visits

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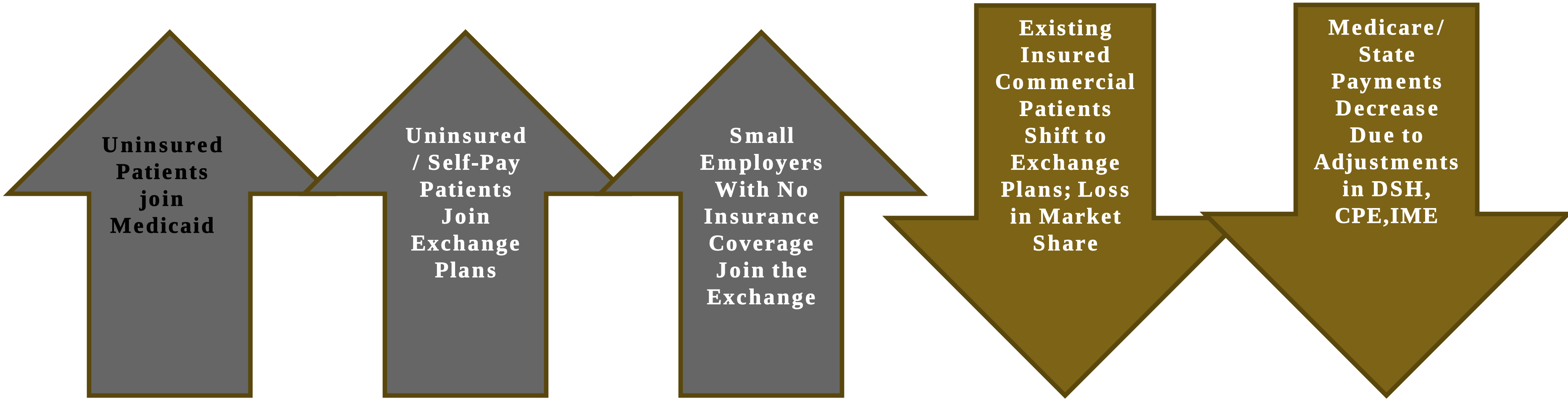
IMPACTS OF SHIFT FROM SELF PAY TO MEDICAID

Understanding the reimbursement impact of a shift in payer mix from one category to another.

- The Affordable Care Act (ACA) will change our traditional payor mix.
- Based on the reimbursement levels of the new exchange category contracts and the number of new Medicaid enrollees, gross and net revenues will change.
- This impact could be significant if the exchange population is large enough or if we are unable to negotiate to ensure that exchange-related contracts maintain a sufficient margin.



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FY14 RESULTS

- Net income from operations is projected to be $10.7 million at end of fiscal year compared to a budget of $9k.
- Operating margin is projected at 2.3% compared to a budget of 0%.
- Primary reasons operating margin has exceeded budget are:
  - Outpatient volumes, including hospital ancillary and urgent and specialty clinic volumes, have been greater than anticipated impacting net revenue by approximately $1.7 million.
  - Significant effort related to cost containment including implementation of performance improvements impacting net revenue and operating expenses by approximately $7 million.
  - Modifications to employee benefit expense impacting total operating expenses by approximately $2 million.

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CONTINUED CHALLENGES IN ECONOMIC ENVIRONMENT MOVING INTO FY15

- Federal Issues
- State Issues
- Commercial Payer issues
  - Pressure to reduce payment rates
  - Interest in risk sharing
- Medicaid Expansion and Health Care Exchanges – effective January 1, 2014
- Need for increased community access (i.e. growth)

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FY15 – INVESTING IN OUR FUTURE

Strategically, FY15 will be another year of positioning the medical center and the entire UW Medicine system for the future. Included in those plans are:

- Continued development of the UW Medicine Accountable Care Network, including organizational commitment to the "Triple Aim"
    - Reduce the Cost of Care
    - Enhance the Experience and Outcomes of Patients
    - Improve the Health of the Population
- Leveraging Patients are First structure and goals– patient experience, quality and fiscal responsibility
- IT Services investments including a common IT front-end (EPIC EMR), maximizing meaningful use incentive dollars and continued preparation for ICD-10 implementation
- Strategic clinical access investments and consistency with UW Medicine strategic plan
- Execution on Performance Improvement Initiatives

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FY15 OPERATING BUDGET ASSUMPTIONS

FY15 BUDGET

The FY15 budget goal is a total margin of 1.01% or $5.2 million, with an operating margin of 0.7% or $3.6 million.

The FY15 financial operating priorities include:

- Net revenue enhancement (revenue cycle)
- Overall expense reduction (cost per case mix adjusted discharge)
  - Supply Chain initiatives
  - Transformation of Care initiatives

FINANCIAL PLAN COMPARISON

	FY15 Budget	Financial Plan for FY15
Net Patient Revenue Growth	7.9%	1.5%
FTEs per Adjusted Occupied Bed	6.64	6.11
FTEs	2,583	2,491
Salaries and Benefits as a % of Total Net Revenue	58.9%	60.5%
Supply Expense as a % of Total Net Revenue	13.7%	13.2%
Operating Margin	0.7%	0.5%
Total Margin	1.0%	1.0%
Operating Expense per CMI Adjusted Admission	$9,110	$9,482

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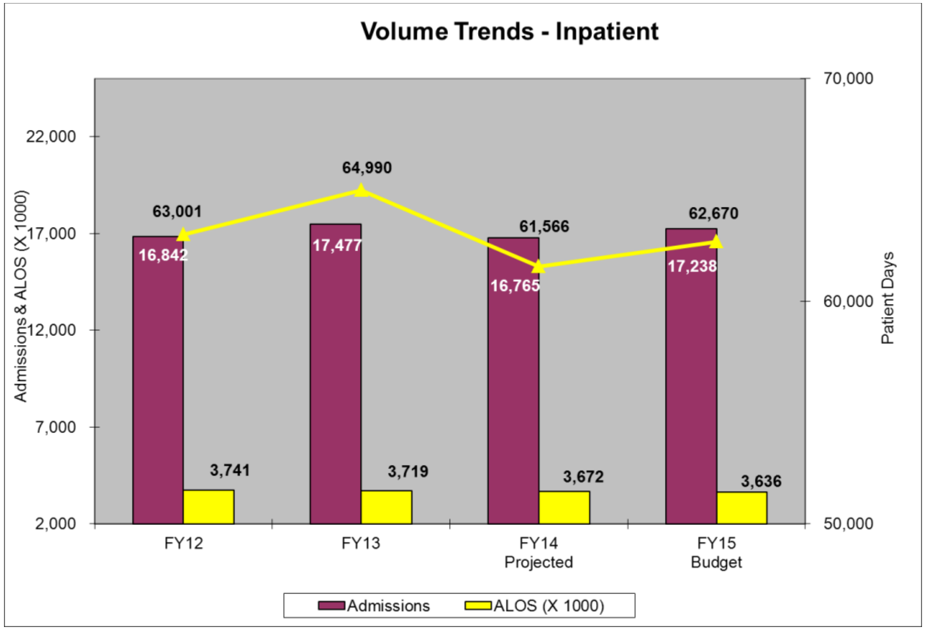
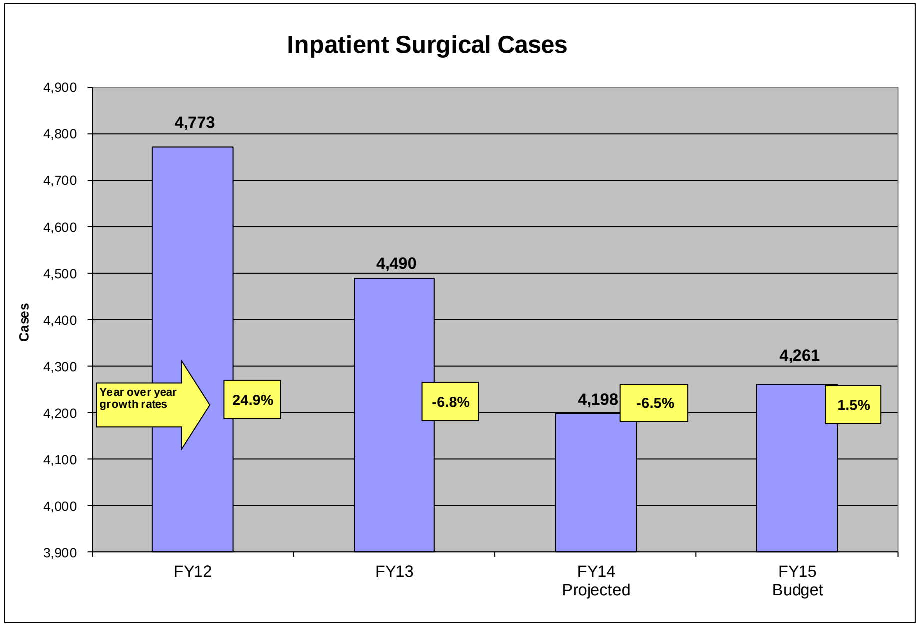
PROJECTED VOLUME GROWTH





- Inpatient admissions are projected to grow 2.8% from FY14 projected admissions due primarily to slight growth expected in general medicine/surgical areas.
- Inpatient surgical case volumes are projected to grow at 1.5% based on detailed work done to project volumes by surgeon, including additional cases based on new surgeon recruitment, specifically in Vascular Surgery.
- The increase in admissions includes an overall assumption that continued expansion within the Clinic Network will produce downstream hospital volume growth.
- Surgical growth assumptions include the full-year effect of several new surgeons brought on in FY14, specifically Urology and Vascular Surgery, along with replacements in Gyn and Neurology.

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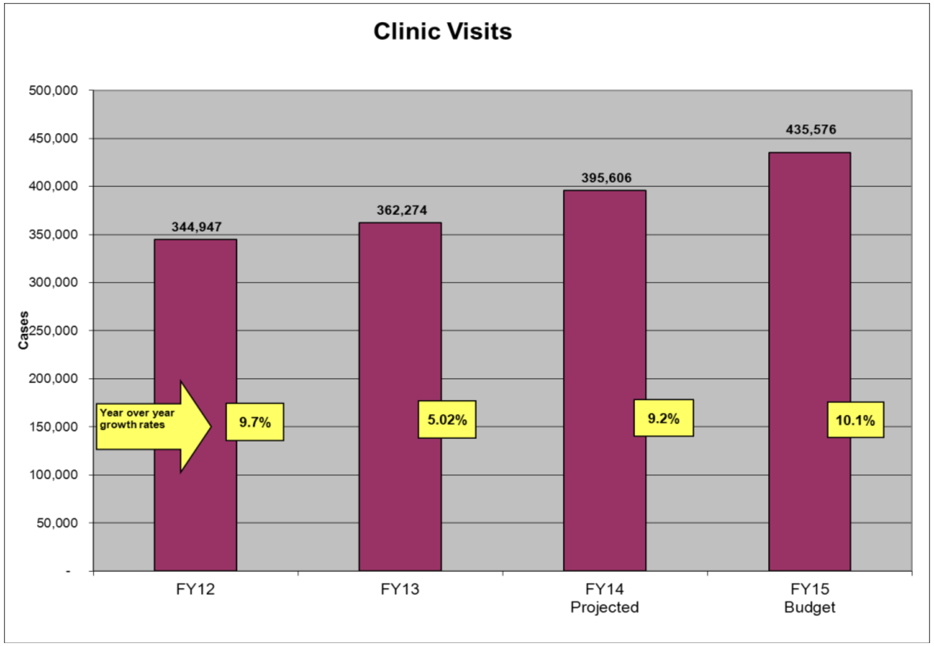
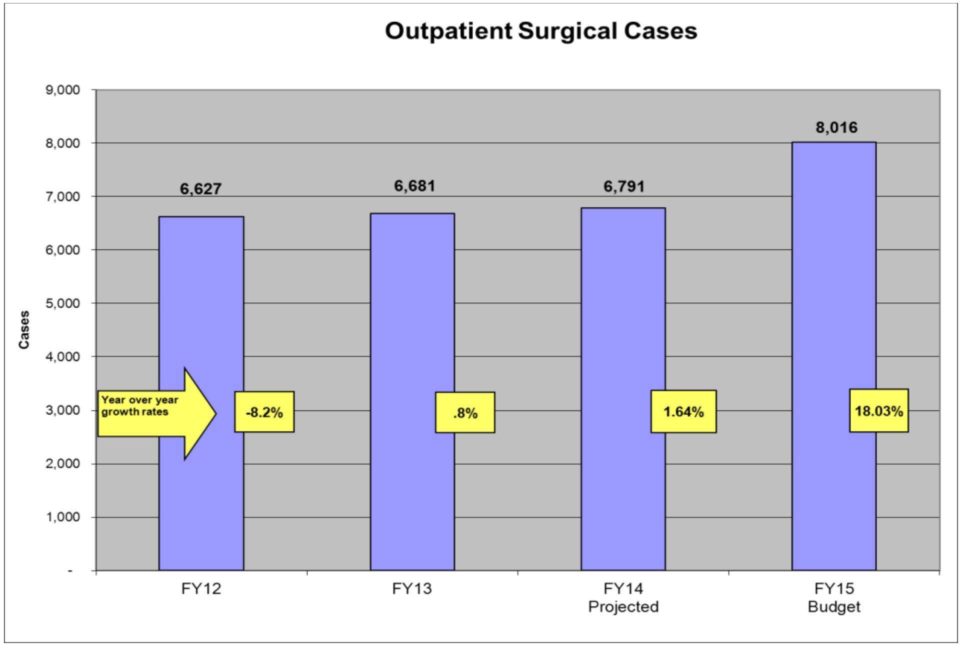
OUTPATIENT VOLUME





- Clinic Visits are projected to grow 10.1% from FY14 projected visits due primarily to the opening of the Maple Valley Primary and Urgent Care Clinics, along with expansion at North Benson Urgent Care and hiring of several new providers in areas such as Obstetrics, ENT, General Surgery, Podiatry, and Family Medicine.
- Outpatient surgical cases are projected to grow at 18% based on detailed work done to project volumes by surgeon, including additional cases based on new surgeon recruitment, specifically in General, Vascular, Ears/Nose/Throat and Orthopedic Surgeries.
- Surgical growth assumptions also include the full-year effect of several new surgeons brought on in FY14, specifically Urology and Vascular Surgery, along with replacements in Gyn and Neurology

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NET REVENUE ASSUMPTIONS

- Constraints on reimbursement by all payers are creating challenges in generating sufficient financial margins
- An overall price increase of 4% has been incorporated into the assumptions
- Reimbursement impacts by payer have been included as follows:
  - Medicare – Market basket increases, wage adjustments and pay for performance projections were included and resulted in slight increases in Medicare reimbursement. Decreases for Disproportionate Share dollars (DSH) were also included.
  - Medicaid – Effective July 1, 2014, Medicaid is expected to rebase both IP and OP payments. This assumption does not impact VMC on the inpatient fee-for-service side, and is unfavorable as it relates to outpatient. Also included is a 3% withholding for the HCA budget neutrality adjustment. No change for the Safety Net Assessment, Certified Public Expenditure (CPE) program, or DSH are assumed.
  - Commercial – nominal increases based on contracts that are currently in place as well as a small amount of realization of price increases.

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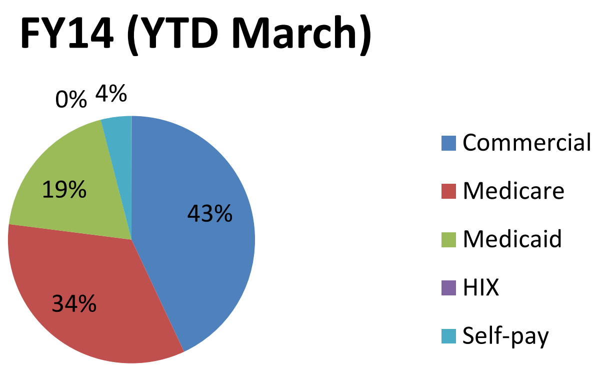
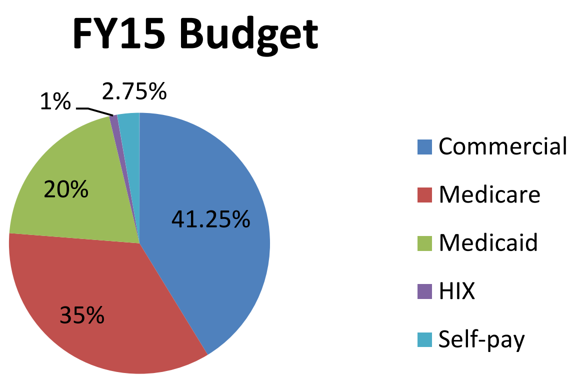
PAYER MIX AND MEDICAID EXPANSION

VMC has experienced an increase in the Medicaid payer mix beginning in January, 2014, due to the newly expanded Medicaid program

VMC is currently participating in a number of the exchange programs and is monitoring the volumes related to this business as it evolves.

There is currently an assumption in the FY15 budget that the payer mix will be higher for Medicaid and lower for self-pay, replicating January-March 2015 actual payer mix. Management will continue to monitor payer mix changes monthly.





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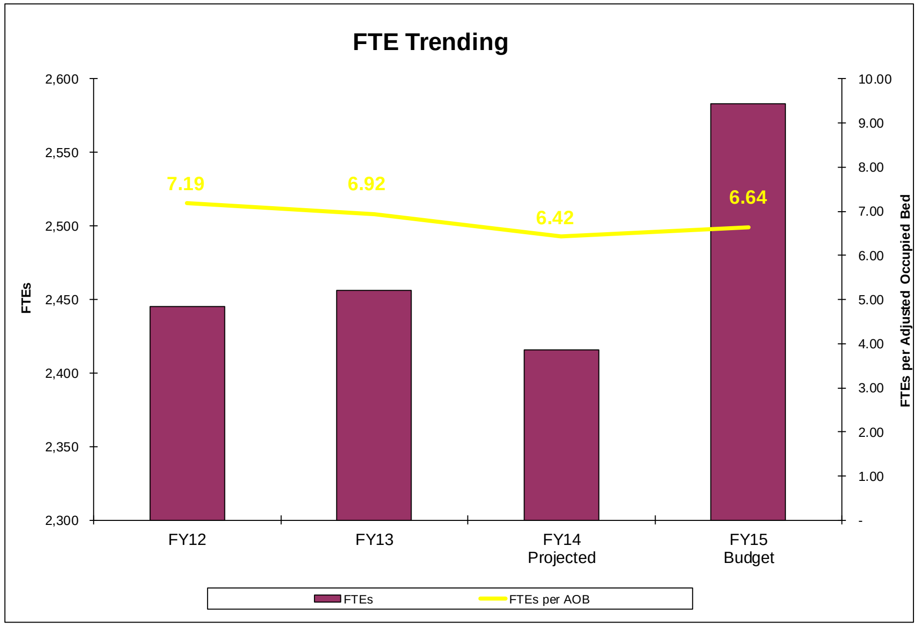
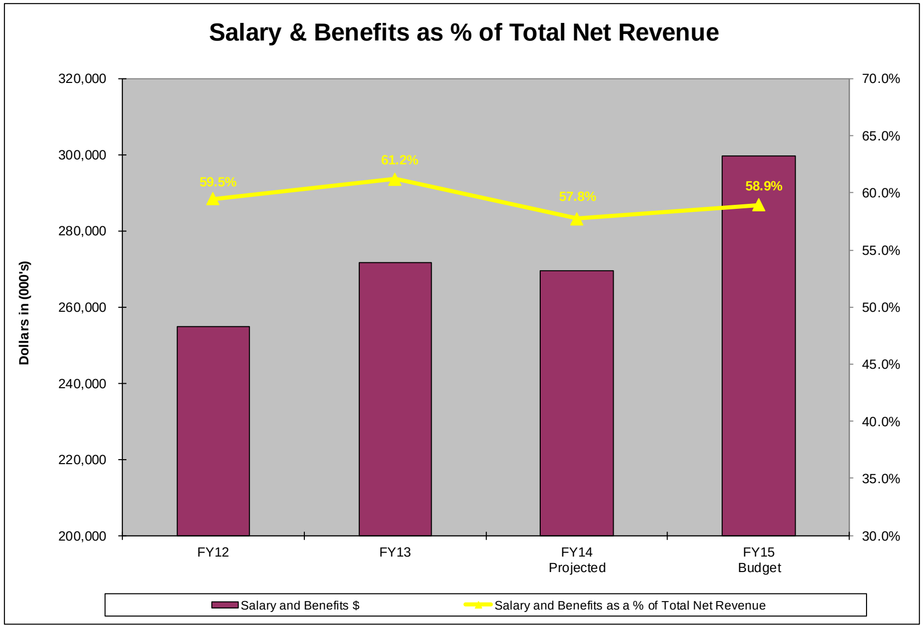
LABOR EXPENSE TRENDING





- The FY15 budget assumes a 7% increase in FTEs primarily related to expansion in the Clinic Network.
- Salaries and benefits were adjusted for anticipated union and merit increases (averaging approximately 3%) in FY15, along with the effects of changes in the retirement and medical plans.

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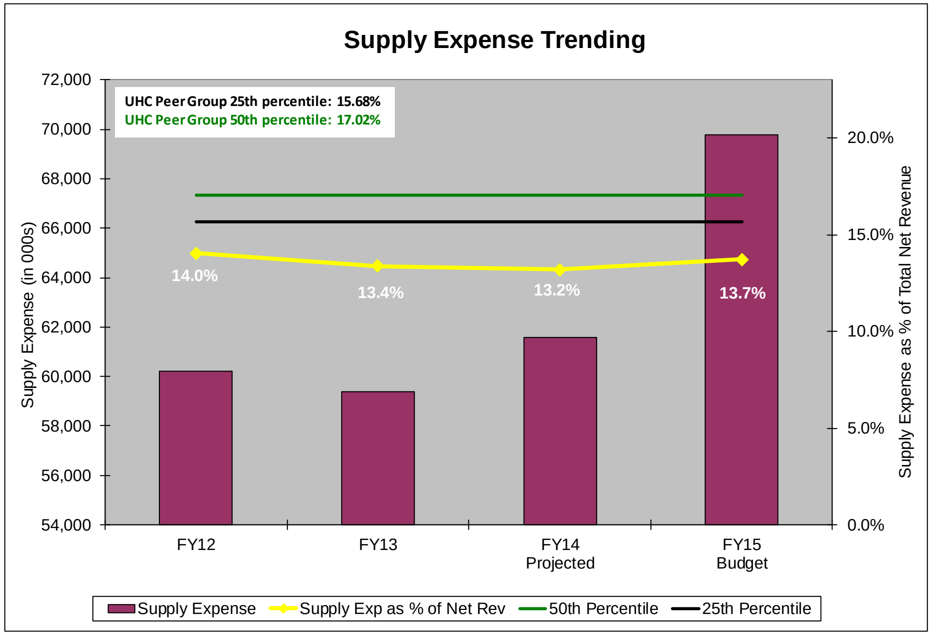
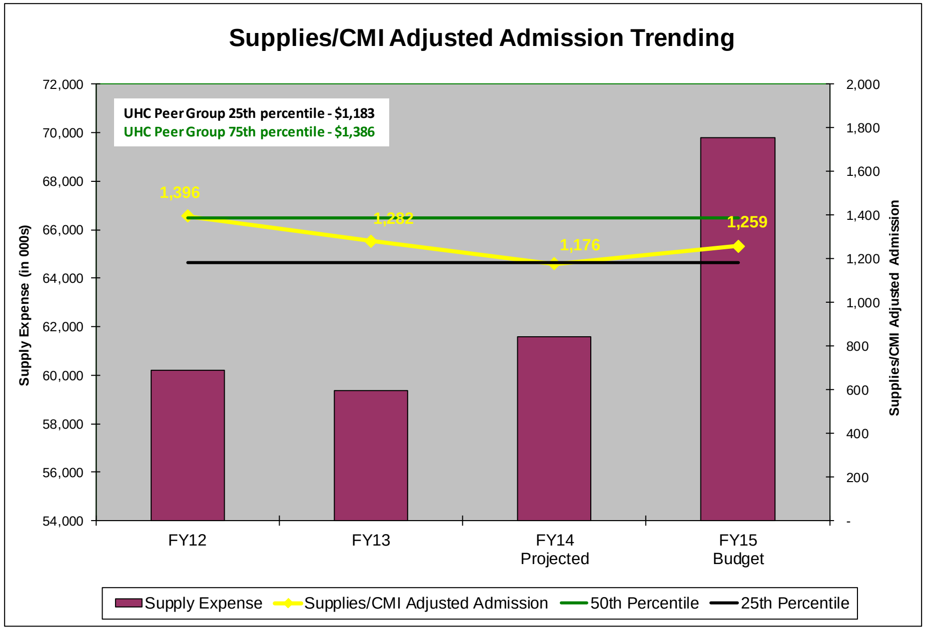
SUPPLY EXPENSE





- Drug expense inflation is budgeted at 5%, Medical Supplies at 3% and Other Expenses at 2%, prior to Performance Improvement Initiatives.
- Supply expenses are also increasing in FY15 due to the expansion of the 340B pharmaceutical program, as well as re-classifying blood products as a supply rather than a purchased service.
- Management also evaluates supply expense per CMI adjusted discharge as it takes into account other important factors that influence results.

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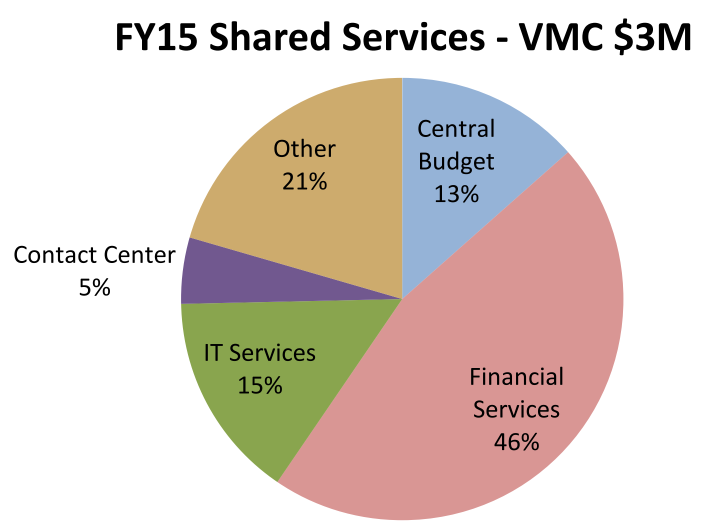
ALLOCATIONS AND OTHER EXPENSES

There are a number of allocations and system related expenses that have been included in the budget. Total allocations represent .6% (or $3.2 million) of total operating expenses for FY15.

- **IT Services**
- **UW Medicine Central Budgets**, which include Compliance, Marketing, Advancement, Credentialing and Executive leadership
- **Financial Services,** which include Accounting, Finance, Patient Financial Services, ICD-10, Cost Reporting, Governmental Programs, Contracting and Revenue Cycle
- **Other allocations**, which include Human Resources, Professional Liability Insurance, Risk Management and the Transfer Center



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COST PER CMI ADJUSTED ADMISSION

Operating Expense per CMI Adjusted Admission

	FY14 March Annualized	FY15 Budget	FY15 LRFP
NUMERATOR			
Operating Expense	**$456,177,000**	**$ 505,086,000**	**$470,611,000**
DENOMINATOR			
Case Mix Index	1.40	1.42	1.37
Net Admissions	16,765	17,238	17,238
OP Adjustment Factor	2.23	2.27	2.10
Adjusted Admissions	37,397	39,046	36,227
CMI Adjusted Admissions	**52,356**	**55,446**	**49,631**
RESULT			
Operating Exp/CMI Wtd Adj Admission	**$8,713**	**$9,110**	**$9,482**

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PERFORMANCE IMPROVEMENT INITIATIVES

Included in the FY15 Operating Budget are the following performance improvement initiatives (both new and carryover from FY 2014)

- Revenue cycle initiatives of $11.2 million for continued revenue enhancements, including further shift of self pay patients to Medicaid, continued impact of healthcare exchanges, and improved charge capture, denials management, contract management and point of service cash collections.
- Supply chain initiatives of $0.4 million focus on supply reductions primarily in surgical supplies.
- Transformation of care initiatives of $3.6 million focusing on 340B Pharmacy Program Expansion and other operational opportunities.

These initiatives, totaling $15.2 million, will be tracked, measured and reported on a monthly basis throughout FY15.

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NON-OPERATING REVENUE AND EXPENSES

- Non-operating revenue and expenses include the following:
  - Property Tax Revenue of approximately $17. 2 million
  - Interest and amortization expense on outstanding debt issues of $18.1 million
  - Investment income, including the Build America Bond subsidy, estimated at $3.2 million.
  - Other net expense of $0.7 million – includes all medical office building revenue and expense, and other non-operating transactions (property gain/loss).

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BOND COVENANTS

- VMC has two types of bond indebtedness:
  - Limited Tax General Obligation bonds (LTGOs)
  - Revenue bonds

- As the LTGOs are backed by property tax revenues, there are no specific financial coverage ratios required for any of these debt issues.
- Revenue bond financial coverage ratio:
  - Net income available for debt service must be at least 1.25x the maximum annual debt service on outstanding revenue bonds.
  - Coverage Level – FY13 – 2.21x
  - Coverage Level – FY14 as of March 2015 – 6.57x
  - Coverage Level – Budget FY15 – 5.42x

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FY14 PROJECTED VS. FY15 BUDGET

March 2014 Projected Operating Income (Dollars in 000s)	**$**	**10,724**
Revenue		
Volume Increases (Net Revenue Impact)		14,063
Commercial Contract Changes & Price Increases (Net Revenue Impact)		12,588
Net Revenue Performance Improvements		8,131
Other Revenue Changes		6,984
Payor Mix Degradation		-
Total Revenue		**41,766**
Salary & Benefits		
Benefit and Salary Inflation		(15,942)
Increase and/or Changes in FTEs		(14,243)
Performance Improvements		
Total Salary & Benefits		**(30,185)**
Non-Salary Expense		
Medical Supplies and Drug Expenses		(6,928)
Purchased Services and Other		(8,968)
Performance Improvements		(3,228)
Total Non-Salary Expense		**(19,124)**
Capital Expenses		
Depreciation		400
Total Capital Expenses		**400**
2015 Budgeted Operating Margin	**$**	**3,581**

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FY15 OPERATING BUDGET SUMMARY

(in 000s)	FY12 Audited	FY13 Audited	FY14 Projected	FY15 Budget	% Change YTD Actual vs. Budget
Total Patient Revenue	$ 1,192,078	$ 1,255,937	$ 1,391,621	$ 1,496,003	7.5%
Total Deductions	(786,462)	(839,613)	(953,249)	(1,022,842)	7.3%
	66.0%	*66.9%*	*68.5%*	*68.4%*	*-0.2%*
Net Patient Revenue	405,616	416,324	438,372	473,161	7.9%
Other Revenue	22,958	27,285	28,529	35,506	24.5%
Total Net Revenue	428,574	443,609	466,901	508,667	8.9%
Expenses					
Salaries, Wages & Benefits	254,898	271,597	269,643	299,827	11.2%
Supplies and Other	149,825	157,399	153,893	173,018	12.4%
Depreciation	32,529	32,440	32,641	32,241	-1.2%
Total Expenses	437,252	461,436	456,177	505,086	10.7%
Income from Operations	$ (8,678)	$ (17,827)	$ 10,724	$ 3,581	-66.6%
Operating Margin	*-2.0%*	*-4.0%*	*2.3%*	*0.7%*	-69.3%
Nonoperating Income (Expense)	3,295	829	344	1,574	357.6%
NET INCOME	$ (5,383)	$ (16,998)	$ 11,068	$ 5,155	-53.4%

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FY15 CAPITAL BUDGET

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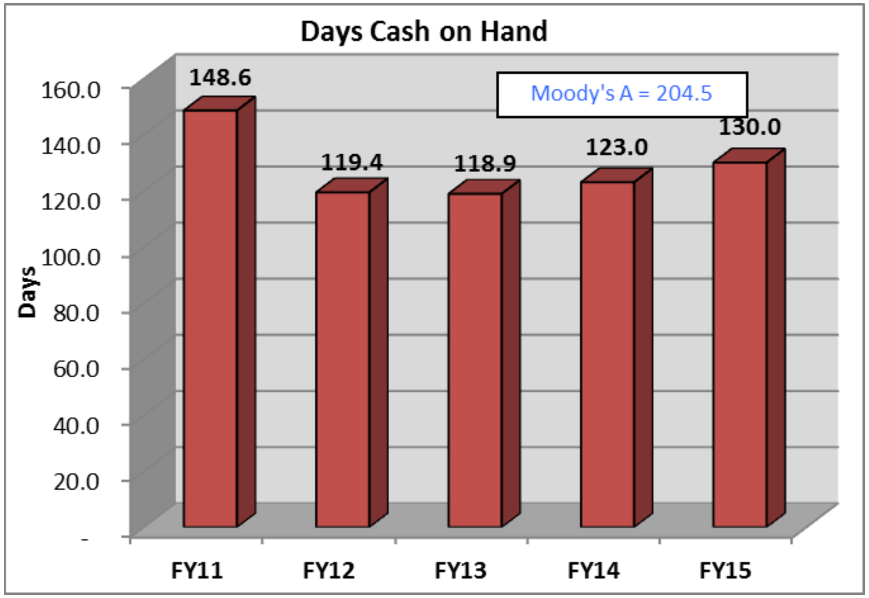
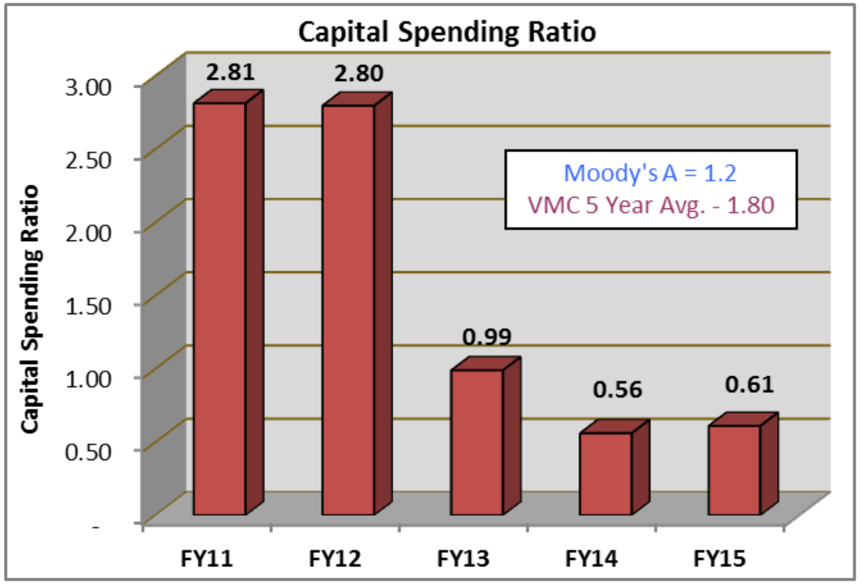
KEY CAPITAL RATIOS

- Capital investment levels are evaluated based on comparison to key industry ratios and benchmarks, as well as margin targets
- Historical values for key ratios and benchmarks are as shown:



Days Cash = Cash / (Operating Expense – Depreciation) / 365



Ratio of Capital Expenditures to Depreciation Expense

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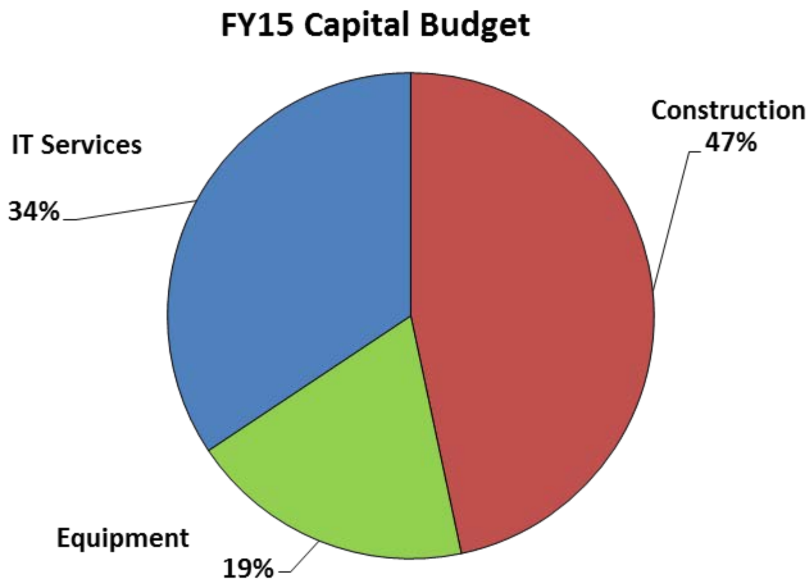
CAPITAL BUDGET HISTORY

- VMC's capital history reflects block funding for 3 major areas:
  - Construction
  - Equipment
  - IT Services

Five Year Capital History ($ in 000s)	CY11	CY12	FY13	FY14	FY15
Construction	26,811	32,825	14,900	8,105	9,100
Equipment	6,081	5,207	2,463	3,714	3,700
IT Services	39,515	29,084	18,376	3,187	6,700
Core Capital Budget	**72,407**	**67,116**	**35,739**	**15,006**	**19,500**

FY15 CAPITAL BUDGET OVERVIEW



VMC proposes a $19.5 million core capital budget for FY15.

Significant projects include:

- Expansion of North Benson Urgent Care Clinic
- Renovations to certain Lab and Outpatient Radiology areas
- IT initiatives and upgrades to ancillary systems
- Equipment for new programs/physicians and growth
- Equipment purchases on expiring leases

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FY15 BUDGET PLAN RISKS

Global Risks

Volume and Strategic Growth

Implementation of Strategic Initiatives

Management of Expenses

Impacts of Healthcare Reform

VMC

Achievement of Budgeted Patient Volumes

Payer Channeling and Rate Compression

Management of Expenses

Medicaid Expansion

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REQUEST FOR APPROVALS

- Management recommends approval of the FY15 operating margin of $3.6 million, which represents a 0.7% operating margin and $5.2 million or 1.0% total margin.

- Management recommends approval of the FY15 capital budget of $19.5 million.

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