# Niagara Health System (NHS)

## Advice to Management and the HNHB LHIN on Options for an Operating Cash Recovery Plan

Prepared By: Michael S. Young CA

Executive Vice President, Sunnybrook HSC

# Terms of Engagement

- Asked by the MoHLTC and HNHB LHIN to assist NHS in developing options for an operating cash recovery plan.
- Deliverables to HNHB LHIN and NHS:
  - The key deliverable will be a Summary of Options, with pros/cons and key requirements to make each option feasible.
  - In addition, will provide a Summary of Observations and General Recommendations that derive from these observations.
- What this is not:
  - Not another review.
  - Not an evaluation of further savings opportunities (although further savings are likely necessary).
  - Not a specific implementation strategy for any given cash recovery option (professional assistance in developing the go-to-market strategy, materials and negotiations will be required).

# Engagement Objectives

- Provide options to create a sustainable operating cash recovery plan that:
  - Does not negatively impact patient safety.
  - Protects patient access to appropriate local services.
  - Reduces or eliminates the LHIN/MoHLTC cash advance requirement.
  - Maximizes the ability to pay down any debt (or cash advance) over a reasonable period of time.
  - Minimizes any requirement for LHIN/MoHLTC new one-time or ongoing funding.

# Approach to Engagement

- Review of relevant previous reports:
  - HCM Presentation of Operating Review (Dec 2007)
  - Highlights of Kitts Review of HIP (Oct 2008)
  - Hay Review of Reviews (Dec 2008)
- Review of relevant other materials:
  - 2008 Audited Financial Statements
  - Hospital Improvement Plan [HIP] (Jul 2008)
  - CFO Report to Board (Nov & Dec 2008)
  - Internal Daily/Monthly Cash Flow Report
  - Capital Equipment Summary 2006-2008
  - BOM & TD Borrowing Term Sheets
  - Other material as requested

# Approach to Engagement cont ...

## Discussions with:

| | |
|---|---|
| Debbie Sevenpifer, CEO NHS | James Lanoue, Partner Deloitte & Touche |
| Angela Zangari, CFO NHS | Brian Allard , Partner E&Y Orenda |
| Bala Kathiresan, COO NHS | Richard Simms, Managing Dir E&Y Orenda |
| Pat Mandy, CEO HNHB LHIN | Richard Wilson, Kitts Review Team |
| Alan Iskiw, Senior Director HNHB LHIN | Chris Helyar, Hay Review Team |
| John McKinley, ADM MOHLTC | |
| Betty Lou Souter, Chair NHS Board | |
| Mary Turner, Vice-Chair NHS Board | |
| Steve Hudson, Chair Resource & Audit, NHS Board | |

# Observations

1. NHS Management and Board appear committed to implementing the clinical changes and savings identified in the July 2008 HIP.
   - Concern that $20.3 (ED Visits & ALC) may not be fully achievable and is dependent on investments outside of NHS. [Beyond scope of this engagement]

2. NHS is reliant on a significant & increasing LHIN/MoHLTC cash advance.
   - Given the HIP and lack of positive cash flow, it is unlikely that NHS could currently restructure this debt in any meaningful way. [See Options]

# Observations cont ...

3. HIP is based on assumptions that are likely no longer valid (i.e. LHIN/MoHLTC 3% economic increase).
   - High risk of not achieving bottom line results contemplated in HIP, without further actions. [See General Recommendation #1]

4. HIP is a multi-year implementation plan.
   - Concern that one-time funding is not being provided for in-year deficits consistent with the approved HIP (resulting in NHS digging a deeper hole as they take agreed upon corrective actions). [See General Recommendation #2]

# Observations cont ...

5. NHS is almost totally dependent on the Foundation for capital equipment.
   - NHS is not currently generating cash from operation. [See General Recommendation #3]

6. NHS appears to focus on working capital shortfall rather than the cash shortfall.
   - Many hospitals that are cash solvent have working capital concerns. Focusing on the longer term working capital concerns de-emphasizes the more urgent cash challenge that exists at NHS. [See General Recommendation #4]

# General Recommendations

1. NHS should revisit the assumptions in their July 2008 HIP and provide an update to section 12 that takes into account changes in funding, cost assumptions, and identifies further actions required to achieve the committed bottom line results for each year.

2. NHS should work with the HNHB LHIN to obtain MoHLTC one-time in-year funding for operating deficits incurred as per approved HIP, including restructuring costs.

# General Recommendations cont ...

3. The NHS cash recovery plan should plan for $5M of capital equipment funded from cash from operations. Foundation funds should supplement this basic requirement in order to begin to address any capital equipment deficit.

4. The NHS working capital shortfall will be addressed when/if the Ministry addresses working capital across the province. NHS should focus their Board reporting on cash position.

# Core to Every Option

- The need for the LHIN/MoHLTC to address "in-year funding" to the agreed upon HIP deficit amount to prevent continued cash deterioration as NHS achieves it's agreed upon targets. [General Recommendation #2]
- The requirement for NHS to achieve it's committed HIP (including further savings actions as required), such that cash is generated as a part of this cash recovery plan.

# Option 1

Description: Continued full reliance on LHIN/MoHLTC cash advance for operating cash.

| PROS (P) | CONS (C) |
| --- | --- |
| (P1) LHIN/MoHLTC cash advance is an interest-free loan to NHS, reducing further pressure on NHS operating budget. | (C1) This option provides no plan for repaying such cash advance.<br><br>(C2) No incentive for NHS to take responsibility to manage NHS's own debt plan.<br><br>(C3) The current cash advance is already disproportionate to the annual funding base for NHS. |

Requirements: This option requires the LHIN/MoHLTC to be prepared to continue to act as "banker".

**Conclusion: Not Recommended**

# Option 2

Description: LHIN/MoHLTC to provide one-time funding, sufficient to cover existing cash advance (approx. $90M).

| PROS (P) | CONS (C) |
|---|---|
| (P1) Eliminates the entire cash advance requirement, with no interest expense requirement adding to operating budget. | (C1) Precedent setting, creating a line-up of other hospitals with cash advances and structured debt that believe they should be funded. |
| (P2) Allows NHS management/Board to focus completely on HIP and go-forward solutions. | (C2) Does not create a management or governance culture of accountability and ownership for managing current debt. |
| | (C3) Difficult to defend this payment in anyway besides a "bail out". |
| | (C4) Requires one-time LHIN/MoHLTC funding expenditure of approx. $90M. |

Requirements: This option requires the LHIN/MoHLTC to set precedent for "bailing out" hospitals in severe financial difficulty.

**Conclusion: Not Recommended**

# Option 3

Description: NHS to debt finance the full $90M of cash advance.

PROS (P) CONS (C)

(P1) Eliminates entire cash advance requirement.

(P2) Makes NHS management/Board responsible for managing all fiscal aspects of the organization.

(C1) Maximum interest expense – significantly more pressure to the NHS operating budget (*$5M in year 1).

(C2) Unlikely that NHS could successfully borrow this amount without Ministry guarantee.

(C3) The cash flow required to support this option will require NHS to obtain additional funding of *$12M/year for debt service alone (vs. $6.7M/year in Option 4).

Requirements: This option likely will require a Ministry guarantee as well as a significant increase in LHIN/MoHLTC annual operating funding for NHS.

**Conclusion: Not Recommended**

* 10 Amortization Term @ 6% Fixed Interest Rate

# Option 4

Description: NHS to debt finance $50M; LHIN/MoHLTC to provide cash advance of $40M; NHS to first repay debt and then cash advance.

| PROS (P) | CONS (C) |
| --- | --- |
| (P1) Creates a balance between long-term debt and MoHLTC. | (C1) Balances between interest expense & interest-free cash advance (*$2.6M in year 1 and reducing rapidly). |
| (P2) Makes NHS management/Board responsible for managing all fiscal aspects of the organization. | (C2) With the appropriate cash flow plan and additional LHIN/MoHLTC funding, should be achievable without guarantee. |
| | (C3) The cash flow required to support $50M of debt financing, $40M declining cash advance, and provision for capital equipment requires *$15.2M in total. |

Requirements: This is a 16-Year cash recovery plan. The requirements of this option are outlined further on following slides.

**Conclusion: Recommended (there are also several variations available on this Option – slide #22)**

* 10 Amortization Term @ 6% Fixed Interest Rate

# Option 4 Requirements cont ...

1. In order for NHS to go-to-market for long-term debt, it must have a viable cash flow plan for interest and principle repayment.

2. NHS cannot become cash flow positive without additional LHIN/MoHLTC base funding.

3. Based strictly on debt/cash advance service and a reasonable capital equipment budget, the required base funding increase is $15.2M. (This amount should not be interpreted as representing a definitive "appropriate" funding level for NHS, as that amount is dependent on future LHIN/MoHLTC funding policy).

# Option 4 Requirements cont ...

4. The recommended base funding increase should be evaluated against HBAM or other funding parameters for reasonability.

5. Short-term Interest rates are currently very attractive, however given the nature of the debt required, it is recommended that fixed rate borrowing be considered to stabilize against interest rate fluctuation.

# Option 4 Requirements cont ...

6. Recommended base funding increase has been calculated as:

| | |
|---|---|
| Principle & Interest on $50M LT Debt | $ 6.7M * |
| Ongoing HIP Deficit 2012/13 based on LHIN directive | $ 3.5M ** |
| Provision for Capital Equipment Budget | $ 5.0M |
| Total Base Budget Increase | $ 15.2M |

7. As previously stated this option requires NHS to commit to, achieve, and maintain a balanced budget prior to additional LHIN/MoHLTC base funding increase.

* To be applied to Cash Advance when LT Debt has been repaid, or otherwise if Modified Option is implemented.

** Based on December 22, 2008 LHIN Directive to maintain an Urgent Care Centre at the Fort Erie site.

# Option 4 Requirements cont ...

8. NHS must also commit to maintaining an annual surplus after additional LHIN/MoHLTC base funding increase, in order to repay LT Debt & Cash Advance and invest in required capital equipment.

9. HNHB LHIN and MoHLTC must be willing to accept perception of further cost reduction activities, while HNS continues to generate a surplus for cash purposes.

# Sample Debt Repayment Schedule

| | LT Debt | | | | Cash Advance | | |
|---|---|---|---|---|---|---|---|
| Year | Opening | Principle | Closing | Interest | Opening | Principle | Closing |
| 1 | (50.0) | 3.8 | (46.2) | 2.9 | (40.0) | - | (40.0) |
| 2 | (46.2) | 4.0 | (42.2) | 2.7 | (40.0) | - | (40.0) |
| 3 | (42.2) | 4.2 | (38.0) | 2.5 | (40.0) | - | (40.0) |
| 4 | (38.0) | 4.5 | (33.5) | 2.2 | (40.0) | - | (40.0) |
| 5 | (33.5) | 4.8 | (28.7) | 1.9 | (40.0) | - | (40.0) |
| 6 | (28.7) | 5.1 | (23.6) | 1.6 | (40.0) | - | (40.0) |
| 7 | (23.6) | 5.4 | (18.2) | 1.3 | (40.0) | | (40.0) |
| 8 | (18.2) | 5.7 | (12.5) | 1.0 | (40.0) | - | (40.0) |
| 9 | (12.5) | 6.1 | (6.4) | 0.6 | (40.0) | - | (40.0) |
| 10 | (6.4) | 6.4 | - | 0.3 | (40.0) | - | (40.0) |
| 11 | | | | | (40.0) | 6.7 | (33.3) |
| 12 | | | | | (33.3) | 6.7 | (26.6) |
| 13 | | | | | (26.6) | 6.7 | (19.9) |
| 14 | | | | | (19.9) | 6.7 | (13.2) |
| 15 | | | | | (13.2) | 6.7 | (6.5) |
| 16 | | | | | (6.5) | 6.5 | - |

# LHIN/MoHLTC Funding for Option 4

| $ Millions | 2007/08 | 2008/09 | 2009/10 | 2010/11 | 2011/12 |
|---|---|---|---|---|---|
| [illegible] | (17.8) | (11.5) | (9.1) | (5.3) | (3.5) |
| [illegible] | (0.0) | (6.7) | (6.7) | (6.7) | (6.7) |
| [illegible] | (2.0) | (2.0) | (3.0) | (5.0) | (5.0) |
| [illegible] | (19.8) | (20.2) | (18.8) | (17.0) | (15.2) |
| | | | | | |
| [illegible] | 15.2 | 15.2 | 15.2 | 15.2 | 15.2 |
| [illegible] | 4.6 | 5.0 | 3.6 | 1.8 | 0 |
| [illegible] | 19.8 | 20.2 | 18.8 | 17.0 | 15.2 |

As outlined, this option anticipates in-year (2008-09) funding of $17.8M to cover HIP approved deficit. Should this funding not be available the details of LT Debt and Cash Advance will need to be revised to reflect an increased opening position.

In-year funding increase does not include: general economic increase, PCOP funding, etc …

# Potential Modifications of Option 4

- Modified from 10-year to 15-year LT Debt
  - Allows for $1.7M/annum of Cash Advance to be repaid in parallel to LT Debt (Cash Advance balance would be $23M by year 10).
  - This should be a staring position for LT Debt negotiations, however given the uncertainty of 10-year projections, the market may require the Ministry to take a secondary position as per original Option 4.
- Reduce 16-year timeframe of plan
  - Requires additional LHIN/MoHLTC Funding (16-years is a long time, and a more comfortable timeframe would be 8-10 years. This should be considered in the context of what HBAM indicates may be an appropriate funding level).