MHA Massachusetts Hospital Association

Massachusetts Hospitals:

CRITICAL TO THE COMMONWEALTH AND THREATENED IN THE ECONOMIC DOWNTURN

Executive Summary

Massachusetts is experiencing an extraordinary economic downturn, as is the rest of the nation. At this critical moment, hospitals are uniquely situated to deliver essential care as well as to serve as employers of choice and engines of economic growth that help drive both the local and statewide economies. Given proper state government support, our hospitals can help stimulate the economy and sustain the commonwealth's historic expansion of access to healthcare coverage. Without proper support, both the economy and healthcare coverage will suffer.

This report makes the case that supporting hospitals is wise state health care and economic policy. Unfortunately Massachusetts' fiscal policy is currently going in the opposite direction. The state is cutting the resources hospitals need to benefit the commonwealth at a time when the federal government is sending billions of dollars to relieve the pressure that Medicaid expenditures place on the state budget. If the state uses these funds to reimburse hospitals at a fair and reasonable rate instead of reducing Medicaid payments, the state will generate additional federal funds, stimulate the economy, and protect healthcare coverage gains. It makes sense.

This report elaborates on three basic points:

1. A recent MHA survey on hospital financial performance shows a systemic decline in hospital finances.

- The median Massachusetts hospital **operating margin** declined to 0.3 percent in the first quarter of 2009, falling even further from the already low level of 0.7 percent at the end of FY 2008. With the recent stock market declines, investment income is no longer available to subsidize operating losses. The median **total margin** of Massachusetts hospitals fell to -1.1 percent in Q1 of 2009, down from 0.1 percent at the end of FY2008.
- Other important financial ratios are dropping as well. For example, days cash on hand has dropped by 20 days since fiscal year 2007.
- Sixty-four percent of Massachusetts hospitals report staffing cuts. Despite a reputation as a "recession-proof" sector of the economy, Massachusetts hospitals report that they have had to cut more than 1,000 positions in 2008, a number that will climb in 2009.
- The majority of hospitals also report that the current economic crisis has affected their capital projects: 79 percent of hospitals have postponed, cut back or cancelled their facilities' improvement projects. These projects involve replacement, renovation, or enlargement of critical building infrastructure that is needed to replace outdated, undersized, and aging "physical plants."

2. The Massachusetts health care reform law made a commitment to align physician and hospital payments with the cost of care, but:

- While progress was made initially, **MHA's current assessment is that the underpayments to hospitals will be larger in 2010 than before the reform law was enacted.** Recent and newly proposed payment cuts to hospitals will create an underpayment gap of approximately $500 million relative to the cost of care provided to Medicaid patients. On average, hospitals will be paid approximately 70 percent of cost.
- FY2009 MassHealth reimbursement rules for acute care hospitals will result in payment reductions of $93 million.
- Overall, MHA estimates that the current proposed FY2010 payment reductions to acute care hospitals will total **more than $260 million**, which is in addition to the FY2009 cuts. However, at the end of March, the Governor proposed to mitigate this by $40 million.

3. Under the recently enacted federal economic stimulus law, the commonwealth stands to gain $3.09 billion over the next two years in the form of increased federal Medicaid funding, but the full amount can only be gained if much of the proceeds are reinvested in the MassHealth program.

- The federal stimulus package increases the federal matching percentage to approximately 60 percent. For example for every million dollars spent on the MassHealth program, the net cost to the state is only $400,000. This is a tremendous return, especially when the healthcare economic multiplier effect is considered. Conversely, every million dollars cut from MassHealth payments for provider services saves Massachusetts only $400,000. Big Medicaid cuts can stifle this multiplier effect.
- MHA believes that the new Federal Medical Assistance Percentage (FMAP) funding should be placed in an account separate and distinct from the commonwealth's General Fund in order to maintain transparency, as was done in 2003.
- Also the increased FMAP funds should be used in large part to restore as many of the FY2009 Medicaid and healthcare cuts as possible, and prevent further cuts to this sector.

Difficult decisions must clearly be made to resolve the state's current fiscal emergency. But the MassHealth cuts are of such magnitude that hospitals and other providers cannot absorb them without affecting their mission, employment, current patient needs, and investments for tomorrow's patients. To prevent unintended consequences, the state should use the significant new federal Medicaid revenue to restore and prevent Medicaid and healthcare budget cuts.

Doing so will preserve the excellent provider access that is so important to Massachusetts patients and communities, and leverage federal matching revenues as a more effective stimulus to the state's economy, consistent with the purpose of the federal stimulus funds.

Introduction

Massachusetts' hospitals and healthcare system are world-renowned. Our healthcare excellence defines the region and makes us stand out compared to other parts of the country. Along with our education system, cultural and natural attributes, healthcare jobs and the quality of care that Massachusetts hospitals provide are among the state's main attractions.

All of us rely on our hospitals, even though they are often not in the forefront of our thoughts until we or our loved ones need them; then we want quick access to excellent care. In Massachusetts we have that access, but often take it for granted.

Now Massachusetts hospitals are at risk. As they are weakened our economy suffers, as does our state's ability to grow itself out of the current economic crisis.

New Medicaid funding from the federal stimulus package offers an opportunity to reverse the economic downward spiral that began last fall — an opportunity to leverage federal Medicaid dollars while investing in and sustaining the commonwealth's healthcare excellence, preserving good jobs, and taking advantage of the economic multipliers that extend to other sectors of the economy.

I: HOSPITALS ANCHOR THE HEALTHCARE DELIVERY SYSTEM IN THEIR COMMUNITIES

Hospitals are different from most other providers of care in that they are both the "ship and anchor" for whatever systems of care exist in a given community.

- Hospitals provide care for a wide variety and intensity of conditions, and for patients requiring the use of inpatient, outpatient, and ancillary capital facilities.
- Hospitals provide the 24/7 back-up and safety net for the entire community as well as for other care providers – including ambulatory surgery centers, physicians taking time off, nursing homes experiencing acute patient episodes, mental health facilities and providers, and more.
- They work to ensure the presence of a comprehensive complement of physicians and other health professionals to serve their communities
    - Through their role in the education of physicians, nurses, and technicians;
    - Through their research role (attracting and keeping the "best & brightest")
    - Through their recruitment and retention of physicians and other practitioners (including funding physician practices in many communities).
- Hospitals also subsidize alternative sources of primary care such as community health centers. They support, or, if needed, develop post-acute care for the community.
- As Health Information Technology enhances the interconnectedness of Massachusetts healthcare, our hospitals are at the center of these new networks.
- For many communities, the hospital's very existence serves as a community benefit, both as the essential medical provider and a major employer.

MASSACHUSETTS HOSPITALS:

- Serve as the health care safety net, available to provide care 24/7 to all patients, regardless of ability to pay.
- Serve as the anchor for emergency preparedness in the community.
- Train and maintain a highly skilled health care workforce, including doctors, nurses, technicians, and others.
- Assist low income and uninsured patients in obtaining coverage from the state's new health coverage programs.
- Support and coordinate public health and wellness programs in their communities.

II. HOSPITALS AND HEALTHCARE ARE KEY TO THE ECONOMIC RECOVERY

EMPLOYMENT

Hospitals are the largest component of the Massachusetts healthcare sector, and hospitals are major employers in every region of the state, providing jobs for all skill and economic levels. These jobs are challenging and fulfill an essential human need to reach out and help others. Our hospitals are employers of choice because they offer employment at both the highest level of a variety of professions, as well as great entry-level positions with well-supported training and educational opportunities for advancement. The hospital sector is an opportunity industry that employs high numbers of low-income residents, women and minorities.

- 174,000 – The number of people employed[1] at Massachusetts Hospitals*
  **excludes government-run hospitals (VA, state hospitals)*
- The creation of hospital jobs supports the creation of jobs in other industries because hospital employees purchase goods and services in the community-at-large—this is called a "multiplier." In Massachusetts the multiplier for hospital jobs is 2.1—which means each job at a Bay State hospital results in 2.1 jobs[2] in the economy as a whole. So the total number of jobs created both directly and indirectly by our hospitals is 365,400.
- In addition, Massachusetts' life sciences industry has emerged as an economic "super cluster" involving finance, information technology, healthcare services, university research centers, pharmaceutical, biotechnology and medical device enterprises. Hospitals are integral to the super cluster.
- In 2003, the Milken Institute created a Health Pole Index to depict the healthcare industry concentration in a given geographic location and the level of importance a metropolitan area healthcare industry concentration has in the context of the nation as a whole. Boston earned first place by ranking among the top 10 in most healthcare sectors[3].

TOP TWENTY METROPOLITAN AREAS BY HEALTH POLE
Total Health Care Employment, 2001

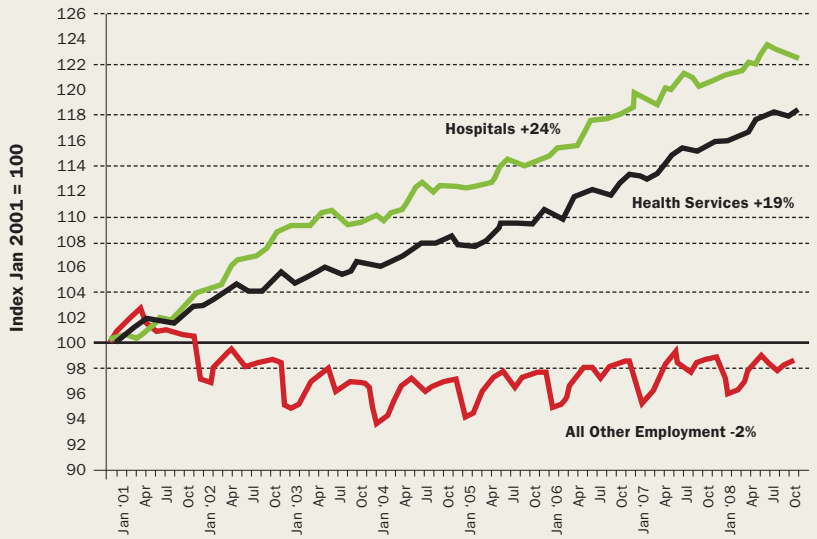
RANK	METROPOLITAN AREA	HEALTH POLE	RANK	METROPOLITAN AREA	HEALTH POLE
1	Boston, MA-NH	100.00	11	Pittsburgh, PA	36.26
2	New York, NY	99.85	12	Baltimore, MD	33.55
3	Philadelphia, PA	97.53	13	St.Louis, MO-IL	32.12
4	Chicago, IL	92.20	14	Cleveland-Lorain-Elyria, OH	31.23
5	Los Angeles-Long Beach, CA	55.15	15	Houston, TX	31.03
6	Washington DC-MD-VA-WV	48.18	16	New Haven-Meriden, CT	31.00
7	Detroit, MI	44.09	17	San Diego, CA	24.85
8	Nassau-Suffolk, NY	40.66	18	Rochester, MN	23.46
9	Newark, NJ	39.49	19	Tampa-St.Petersburg-Clearwater, FL	23.46
10	Minneapolis-St.Paul, MN-WI	36.29	20	Miami, FL	22.74

(Sources: Milken Institute, Economy.com.)

- 504,000 – People employed in direct care + medical industry + research[4] - that's **15.8 percent of total Massachusetts employment**

The healthcare sector is an economic mainstay in Massachusetts, historically providing stability and even growth during times of economic recession.

HEALTHCARE: STABILIZING FORCE IN ECONOMIC DOWNTURNS
Changes in Massachusetts Employment, Jan 2001 – Oct 2008



Note: data are not seasonally adjusted. (Source: MA DUA, Current Employment Series, 2007 benchmark, NAICS)

MASSACHUSETTS HEALTHCARE EMPLOYMENT IS:[5]

- **7 x** computer/electronics manufacturing
- **3 x** construction
- **2 x** finance, insurance & real estate
- **1.6 x** all manufacturing
- **1.5 x** education services
- **1.1 x** all federal, state & local employment

ECONOMIC RIPPLE EFFECT

Impact on Wages and Salaries:
Hospitals paid $11.4 billion in salaries and benefits to employees in 2007, according to the Massachusetts Division of Healthcare Finance and Policy. These payroll and benefit dollars are then spent in the community, generating income for other workers. Each dollar of earnings from a hospital job thus results in a total of $1.83[6] in earnings in the economy as a whole. That's $20.9 billion—the total amount of labor income supported directly and indirectly by hospitals.

Federal Research Dollars in Massachusetts:
Significant funds flow into Massachusetts for medical research, education, and services. Because of the unparalleled excellence of our hospital community, institutions of higher education and life sciences industry, the Bay State ranks second in the nation (to California) in grants from the National Institutes of Health (NIH), receiving $2.24 billion in 2007.

FEDERAL RESEARCH DOLLARS: MASSACHUSETTS

Agency	Funding (in thousands)	State Rank
National Institutes of Health	$2,236,110	2
Centers for Disease Control and Prevention	$163, 922	15
National Science Foundation	$396,417	3
Agency for Healthcare Research and Quality	$14,636	3
Total	**$2,811,086**	**3**

(Source: Funding from NIH, CDC, NSF and AHRQ, 2007)

The City of Boston, for 14 consecutive years, has led all U.S. cities whose institutions received NIH funding, garnering $1.6 billion in NIH grants in 2007.

Impact on Economy:
The goods and services hospitals purchase from other businesses create additional economic value for the community. In 2007, Massachusetts hospitals spent more than $20.1 billion[7] on goods and services, resulting in a total state economic output of $46.1 billion generated directly and indirectly by our hospitals.

III. JOBS AND SERVICES ARE NOW IN JEOPARDY AS HOSPITALS STRUGGLE TO COPE WITH ECONOMIC DOWNTURN

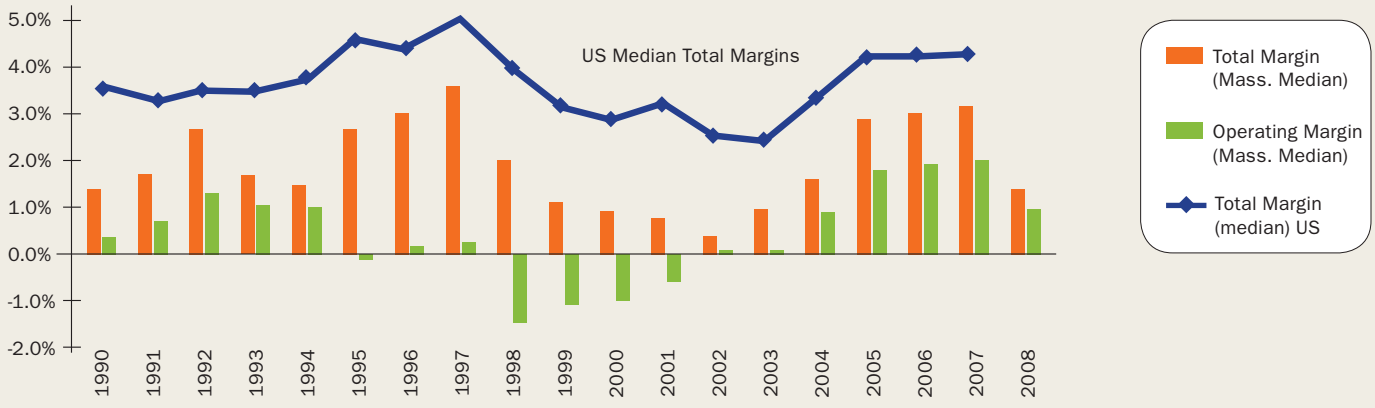
The national and state economic crises and repeated governmental cuts to healthcare have had a devastating impact on hospitals. Hospitals are facing additional loss of revenue as patients defer elective procedures, philanthropy slows, credit markets tighten, pension obligations explode, and investment income plummets.

The results of a recent MHA survey on hospital financial performance show a systemic decline in hospital margins. The operating margin measures a hospital's net income from the core business of patient care. Hospitals need healthy margins to make critical investments in healthcare services and infrastructure. Bond rating agencies look for margins of at least 3 percent as essential indicators of financial health.

In Massachusetts, the median hospital operating margin[8] declined to 0.3 percent in the first quarter of 2009, falling even further from the already low level of 0.7 percent at the end of FY 2008.

With the recent stock market declines, investment income is no longer available to subsidize operating losses. The median total margin of Massachusetts hospitals[9] fell to -1.1 percent in Q1 of 2009, down from 0.1 percent at the end of FY2008.

MASSACHUSETTS ACUTE CARE HOSPITAL MEDIAN MARGINS 1990 – 2008



(Based on MHA publications 1990 – 1998 latest available DHCFP financial statements (1999 – 2008); MHA survey for 2008, n=53, US data from CHIPS/Ingenix (up to 2007))

Other financial indicators show a similarly alarming deterioration:

- **Days Cash on Hand:** This metric measures a hospital's cash reserves in terms of the number of days the hospital would continue to meet operating expenses even if it were to receive no additional cash revenues. The lower the number is, the more vulnerable a hospital is to disruptions in revenues or expenses. Days cash on hand for Massachusetts hospitals[10] has fallen from a median level of 86.6 days in 2007 to 74.9 days in 2008 and is at 66.7 days in the first quarter of 2009. Even more worrisome is the fact that 35 percent of hospitals reported a days cash on hand level that fell **below** what is required for a 'speculative grade' bond rating[11].
- **Long-Term Debt-to-Capitalization Ratio:** This indicator measures the degree of financial leverage of an entity or the fraction of a hospital's total assets that has been financed by debt rather than the hospital's equity funds. This ratio is used to assess the degree to which a hospital is leveraged and therefore might be unable to take on additional debt or meet scheduled debt service payments. Long-term debt-to-capitalization ratio for Massachusetts hospitals[12] has increased from a median level of 39 percent in 2007 to 47 percent in 2008 and is at 49 percent in the first quarter of 2009. A fifth of hospitals surveyed reported a ratio level higher than that required for a 'speculative grade' bond rating[13].
- **Debt Service Coverage Ratio:** This ratio is a widely used indicator of an organization's ability to cover its monthly debt payments—the higher the ratio, the better the hospital's financial condition and ability to meet its debt requirements. The median debt service coverage ratio for Massachusetts hospitals[14] has fallen from 3.0 in 2007 to 2.4 in 2008 and is at 1.9 in the first quarter of 2009. An alarming 45percent of hospitals surveyed reported a ratio level lower than that required for a 'speculative grade' bond rating[15].

EMPLOYMENT IMPACT

This across-the-board deterioration in the financial condition of hospitals means many facilities have been forced to consider drastic measures, including cutting services, implementing layoffs, or delaying capital improvement projects. According to MHA's survey, 24 percent of hospitals already have cut, or are considering cutting services, and 63 percent report staffing cuts. Despite a reputation as a "recession-proof" sector of the economy, Massachusetts hospitals report that they have had to cut more than 1,000 positions in 2008, a number that will climb in 2009. We estimate that for every million dollars cut from hospital funding, 16 jobs are directly threatened; with a 2.1 multiplier, 33 jobs are threatened directly and indirectly. Since Medicaid has cut $93 million from hospital payments in Fiscal Year 2009 and proposes to cut more than $260 million more for Fiscal Year 2010, the commonwealth could be facing a further loss of more than 10,000 jobs.

CAPITAL CUTBACKS

The majority of hospitals also report that the current economic crisis has affected their capital projects: 79 percent of hospitals have postponed, cut back or cancelled their facilities' improvement projects. These projects involve replacement, renovation or enlargement of critical building infrastructure that is needed to replace outdated, undersized and aging physical plants. Some of these facilities were built more than three decades ago and must be upgraded to meet patient needs and current safety and efficiency requirements. One indicator of the imperative to replace and renovate our hospitals' aging facilities is the fact that the median age of Massachusetts hospital buildings in 2006 was 11.4 years, compared with 9.7 years nationally—our facilities are 17 percent older than the national average.

67 percent of hospitals surveyed reported that their clinical technology projects have been cut back, postponed or cancelled altogether, while 61 percent report that information technology projects have been impacted.

IV. STATE HEALTHCARE POLICY PUSHING IN THE WRONG DIRECTION

While difficult choices have been – and continue to be – made at the state level to cope with budget shortfalls, hospitals have been hurt significantly by state budget cuts. As the financial condition of hospitals continues to degrade, hospital jobs and services are in jeopardy. Coverage expansion under the commonwealth's landmark health reform law cannot be sustained unless there is adequate funding to pay for care.

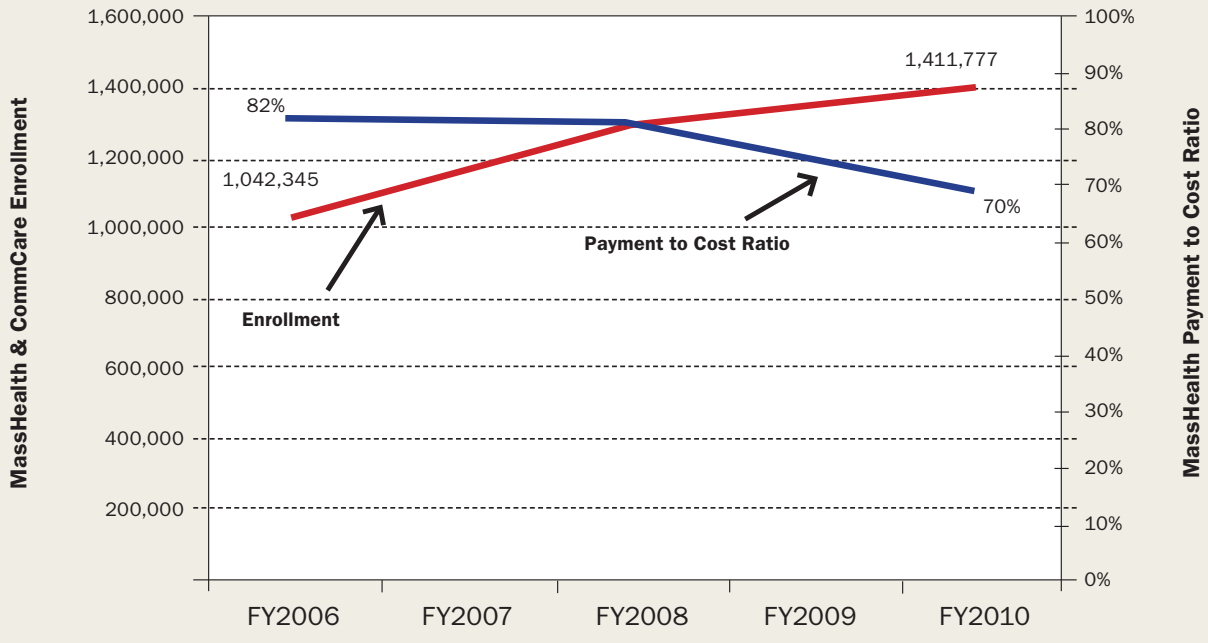
In 2006, one of the legislature's key priorities in the historic healthcare reform law was to increase Medicaid payments to hospitals and physicians over time so that payments would be more aligned with the cost of care. While progress was made initially, **MHA's current assessment is that the underpayment gap for hospitals will be larger in 2010 than before the reform law was enacted**. The level of the payment cuts to hospitals will create an underpayment gap of approximately $500 million relative to the cost care provided to Medicaid patients. On average, hospitals will be paid approximately 70 percent of cost.

The main goal of healthcare reform to expand coverage has largely been successful, but progress on closing the gap has turned for the worse. This funding gap is disappointing – and concerning – because coverage expansion under reform cannot be sustained unless there is adequate funding to pay for care. Adequate funding helps avoid the need to shift government payment responsibilities onto the private sector. A recent Milliman study stated that government underpayment increases private sector premiums by 11% for a family of four.

Many policy makers have stated that the rise of healthcare costs must be addressed if our coverage gains are to be sustained. But hospitals do not control all the factors that drive costs – far from it. So, simply cutting payments to hospitals as the solution to escalating healthcare costs is neither fair nor effective. Reducing state payments to hospitals is not equivalent to reducing healthcare costs, it simply shifts the state's costs to hospitals that will be forced to reduce employment and services and shift some of the state's costs to the private payers.

The reality is that there are multiple contributors to the rising costs for care. Hospitals are aggressively working to address their share of the cost problem. MHA and hospitals have been, and will continue to be, involved in a variety of initiatives to improve healthcare quality and reduce costs. However, solving the cost issue in Massachusetts will require all stakeholders to be part of the solution. Insurers, employers, hospitals and even consumers need to be involved, and it will also require leadership at the state level.

MEDICAID UNDERPAYMENT TREND COMPARED TO MASSACHUSETTS COVERAGE EXPANSION TREND
FY2006-FY2010



FISCAL YEAR 2009 HOSPITAL PAYMENT REDUCTIONS

The Executive Office of Health and Human Services (EOHHS) Medicaid reimbursement rules for acute care hospitals will result in payment reductions of $93 million in FY2009. The payment reductions include:

- Medical education funding reduced;
- Use of an older base year to develop inpatient rates and substitution of a lower inflation factor than the CMS market basket factor;
- Restoration of the so-called "efficiency standard," which artificially lowers the state-wide average cost used to develop inpatient rates;
- Rate adjustments for qualifying specialty, pediatric, and high public payer hospitals were eliminated;
- On outpatient rates, the CMS market basket inflation factor was again substituted for a lower factor and a health reform payment adjustment was eliminated;
- Supplemental Medicaid DSH payments to high public payer and pediatric hospitals eliminated;
- Pay for Performance payments contained in the 2008 RFA (the contract between the state and hospitals serving Medicaid patients) and scheduled to be paid in FY2009 were reduced;
- Payment for psychiatric care and physician services were also reduced.
- **MHA estimates that the total cuts to acute care hospitals in FY2009 will total $93 million.**

FISCAL YEAR 2010 HOSPITAL PAYMENT REDUCTIONS

Fee-for-Service

In FY2010, the administration proposes further payment reductions to hospitals built upon the FY2009 cuts. MHA estimates that total new reductions to MassHealth fee-for-service payments will be more than $80 million.

The payment reductions include:

- All of the above continued;
- Medical education funding eliminated;
- Special payments for long hospital stays (outliers) reduced;
- Community pricing adjustment;
- RFA 09 P4P scheduled to be paid in FY2010 will be reduced;
- Non-payment for hospital re-admissions, hospital acquired infections;

EOHHS will provide an additional $12 million payment to qualifying specialty hospitals. It is expected that these payments are intended for high public payer and pediatric hospitals.

Medicaid Managed Care

State government pays acute hospitals in many ways for care provided to Medicaid enrollees. They are paid directly for services provided through a contract process known as the "RFA". Hospitals are also paid by managed care organizations (MCOs) which manage the care of some 400,000 Medicaid enrollees in Massachusetts. Currently the Medicaid MCOs are BMC Health Net, Network Health, Neighborhood Health Plan, and Fallon Community Health Plan.

MassHealth has proposed a new policy that will reduce payment rates that Medicaid MCOs make to hospitals. This payment reduction is one of many FY2010 MassHealth budget assumptions. While not spelled out in the governor's budget document, a MassHealth budget summary document clearly proposes to require all "MCO-participating hospitals to contract at no more than MassHealth Fee-For-Service (FFS) rates."

Because MassHealth fee-for-service rates reimburse care significantly below cost, this policy will be devastating to many hospitals, especially those with high concentrations of Medicaid patients. **Based on a survey of our membership, MHA estimates the total annual impact of this policy will be a loss of approximately $200 million.** A great majority of hospitals reported that these payment reductions would affect their ability to continue as providers in the MCO's network, which could affect access. Many hospitals would also have to further reduce services and employment because of this projected loss.

Overall, MHA estimates that the current proposed FY2010 payment reductions to acute care hospitals will total **more than $260 million**, which is in addition to the FY2009 cuts. However, at the end of March, the Governor proposed to mitigate this by $40 million.

V. OPPORTUNITY: UNPRECEDENTED FEDERAL MEDICAID RELIEF

Under the recently enacted federal economic stimulus law, the commonwealth stands to gain $3.09 billion over the next two years in the form of increased federal Medicaid funding.

Medicaid is a joint federal-state program and its costs are shared approximately equally in Massachusetts. The American Recovery and Reinvestment Act of 2009 (ARRA) included a provision to increase the federal share of state Medicaid expenditures by approximately 10 percent, depending on the rate of increased unemployment in Massachusetts.

MHA estimates the "Federal Medical Assistance Percentage" (FMAP) will range from 58.8 to 61.6 percent for Massachusetts compared to the historic 50-percent match. The enhanced rate will be effective for 27 months beginning retroactively as of October 1, 2008. The federal Government Accountability Office estimates that Massachusetts will receive an additional $3.09 billion during this time period.

MHA believes the new FMAP funding should be placed in an account separate and distinct from the commonwealth's General Fund in order to maintain transparency, as was done in 2003. Secondly, the increased FMAP funds should be used in large part to restore as many of the FY2009 Medicaid and healthcare cuts as possible, and prevent further cuts to healthcare.

Under the federal stimulus package, the increased federal matching percentage allows for a 60 percent federal reimbursement for every dollar spent on the MassHealth program. The net cost to the state is only 40 cents. This is a tremendous return, especially when the healthcare economic multiplier effect is considered. Conversely, every dollar cut from MassHealth payments for provider services saves Massachusetts only 40 cents. Big Medicaid cuts can stifle this multiplier effect.

Difficult decisions must clearly be made to resolve the state's current fiscal emergency. Hospitals are doing their part by absorbing losses while maintaining service levels, but the MassHealth cuts are of such magnitude that hospitals and other providers cannot absorb them without affecting their mission, employment, current patient needs, and investments for tomorrow's patients.

In order to prevent unintended consequences, the state should use the significant new federal Medicaid revenue to restore and prevent Medicaid and healthcare budget cuts.

References:

1, 4,5 BLS/DUA Q1 2008 Quarterly Census of Employment & Wages (ES-202 data)

2, 6,7 American Hospital Association, Beyond Healthcare, The Economic Contribution of Hospitals, January 2009

3 America's Healthcare Economy, Ross C. DeVol, Milken Institute August 2003

8, 9,10,12,14 Using data for 50 hospitals that reported Q1 2009 margins and financial ratios to MHA (includes both acute and non-acute hospitals)

11, 13,15 Standard and Poor's U. S. Not-For-Profit Healthcare System 2008 Median Ratios Report August 2008

MARCH 31, 2009