



Brief Case

Private Money for Public Hospitals

In light of the recent announcement by The Toronto Hospital that it will issue a \$300 million bond to finance the redevelopment of its capital assets, we present an outline of TTH's project and two other brief case studies of hospital refinancing strategies. Our CIBC authors point out that these examples – from Winnipeg, Vancouver and Toronto – are clearly the exception, and not the rule, when looking at what hospitals can do to finance capital improvements without relying on provincial government support. Only a limited number of hospitals in the country could consider these ideas as solutions to their financing challenges. However, many executives will be looking for new ways and innovative techniques to finance their hospitals — and with these initiatives will come new remedies. Michael O'Keefe of Newcourt Capital points out that shared services, outsourcing and other public/private partnerships allow public and donated funds to be focused on priority areas, while maintaining public control over the core assets to ensure accountability and protection of the public interest. The CIBC authors touched on this in their article in the last *Hospital Quarterly*.

In a related point, we note that business planning for hospitals is a complex undertaking. When preparing plans for large or not-so-large financings, executives will need to consider, and take into account, the risks that banks and other lenders will look at as they assess the attractiveness of hospital financings. These would include the following:

- policy changes by governments of the day and their impact on funding formulas;
- the strain of mergers, acquisitions, downsizing and other factors related to restructuring;
- the introduction of new costs and new risks — some unknown — which could raise an organization's risks and could increase the cost of long-term borrowing;
- the management capability from a sector that does not have a history of the accountability, reporting and investor relations

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demanding by bond holders and private lenders; and

- the challenge of building a business case for a hospital institution whose mission does not include making a profit.

Those hospitals large enough to consider issuing public bonds recognize that this strategy favours large financings, and so introduces a variety of complex structuring and pricing considerations not usually seen by hospital executives. This suggests the need for new hospital management expertise and the introduction of a treasury function to deal with interest rates, currency and other bond market risks.

The following cases are brief outlines only, yet they introduce the relatively new development of private capital for public hospitals. Those hospital executives and their advisors contemplating their hospitals' needs would do well to look to financial organizations for advice and counsel early in the process in order to understand the lenders' financial criteria and other requirements.

The editors of *Hospital Quarterly* look forward to more submissions of cases that reflect the innovations and remedies that necessity will inevitably create.

—Ed.



Brief Case

CASE ONE**VANCOUVER HOSPITAL & HEALTH SCIENCES CENTRE
PRIVATE FINANCING FOR A PATIENT CARE INFORMATION SYSTEM***By Danny Tulip and Steve Bow*

In 1996 the British Columbia Ministry of Health, and the Greater Vancouver Regional Health Board gave permission for The Vancouver Hospital and Health Sciences Centre to borrow \$29.1 million to finance a Patient Care Information System (PCIS). The submission followed an agreement with BC Tel to form a "Private-Public Partnership" in the initiative. The approval acknowledged that the initiative would allow the hospital to leverage-off technology and deliver the same level of service more efficiently. The hospital, under the Hospital & VGH Acts, is required to obtain ministerial approval for any external borrowing; and so the Ministry provided for all necessary legislative approvals.

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PROCESS

On the basis of the analysis, and the partnership with BC Tel, the Ministry approved the hospital's initiative, and request for borrowing, with the Debt Management Branch of the Ministry of Finance providing advice and assistance in arranging the debt in the name of the hospital.

The hospital ensured that all levels of government were involved in the evaluation and approval of the initiative. In his role as Minister of Employment and Investment, and again as Premier, the initiative and the Private-Public Partnership with BC Tel were discussed with Glen Clark. The Minister of Health, and all levels within the Ministry of Health, were involved with the project and its approval as well as extensive consultation with the unions through a Labour Adjustment Committee.

On behalf of the hospital, the Provincial Treasury issued a Requests For Proposals to a list of 16 major banks with which the Treasury has current facilities. Four banks responded. The loan was awarded to the bank offering the lowest cost of funds

for an unsecured, committed facility over a ten year term. The terms and conditions were also evaluated as secondary criteria. The cost of funds was only marginally above Government of BC interest rates.

The loan was negotiated on an unsecured basis. The financiers recognized the fact that VGH is a major player in the BC healthcare system, and that the hospital would remain within the system over the long term.

TERMS

The loan was a committed facility, which was identified in two (2) tranches. The first tranche was a revolving loan over the period of the project installation. The rates were set on short term Bankers Acceptance to mature at the end of the project installation. The funds are to be drawn down over the project installation, as required, with the facility to be fully drawn at project completion.

The second tranche was a ten-year loan with the option to either float at market rates or fix for the term of the loan. Given the fact that interest rates were at historic low levels, the hospital opted to fix forward the second tranche at the time of contract signing. Repayment of the debt is to be consecutive (monthly, quarterly, semi-annually or annually at the hospital option) payments amortized over the ten year term.

BUILDING THE BUSINESS CASE

As a result of the size of the hospital, and its senior management's experience in private-sector financing, all analysis on the project was conducted internally. The hospital also utilized "targeted expertise" to validate the expected operating benefits, assess the "best of breed" within clinical systems, and apply an independent evaluation by its partner (BC Tel), to confirm its analysis.

The analysis showed that the project had a significant return on investment over its life. Given the cashflow timing and the fact that the return exceeded external borrowing rates, the most favourable option was for the hospital to borrow the required investment and repay over the term of the project.

The alternative would have been to request the funding from the Ministry of Health, on the same basis as that used for other capital projects. Given the scarcity of capital funds and the competing demands of other projects, the external debt option was the most likely to obtain the approval for this urgently required project.

In addition, it was critical that the project secured all funds, as the initiative could not proceed on a stop/start basis. Government-funded capital projects often proceed in this fashion, based on the level of tax-supported debt that is available to the government.

The project will generate a significant return on investment through the operating benefits that result. The consolidation of the Laboratory provided an immediate benefit, and an early

injection of funds for the integration of all clinical systems. The installation of the PCIS then allowed the hospital to establish a seamless and integrated view of care delivery, redesign the entire patient-care delivery process and eliminate the inefficient paper system currently employed at the hospital. As a result, the hospital could treat the same level of patients, more efficiently, with the same or better quality of care. In addition the operating savings that would be generated are far in excess of the required external debt servicing.

(Editor's note: More background and details about this project can be found in *Hospital Quarterly*, Summer 1998.)



DANNY TULIP

Danny Tulip is Vice President Finance and Planning at Vancouver Hospital and Health Sciences Centre.

Steve Bow is Director, & Financial Services at Vancouver Hospital and Health Sciences Centre.

CASE TWO **THE TORONTO HOSPITAL POSITIONS ITSELF FOR THE FUTURE** **\$350 MILLION REDEVELOPMENT AND RENEWAL PROJECT** **FUNDED BY BOND ISSUE**

By Alan R. Hudson

The Toronto Hospital began positioning itself for the future in 1991 by designating four priority programs: cardiac sciences, neurosciences, transplantation and oncology. Recently, we added a fifth priority program focusing on primary and ambulatory care. The designation of our priority programs laid the groundwork for the hospital's latest initiative: an ambitious \$350,000,000 redevelopment and renewal project funded by a structured bond issuance.

Over the past few years, one of the major changes in healthcare delivery has been the shift of routine patient care to the community close to where patients live and work. As a result, highly specialized services are becoming centralized and regionalized in tertiary facilities. The Toronto Hospital's foresight in designating its priority programs prepared it for the shift; however, what is crucial to maintaining and fulfilling our role as an ultra-specialized centre is a world class, state-of-the-art health sciences facility.

The Toronto Hospital conducts its activities in 21 buildings and wings over three separate sites. The patchwork of buildings has resulted in inefficient patient flow, services not provided in contiguous space and ineffective patient care. Furthermore, the buildings have become outdated, outmoded

- with the oldest building close to 100 years - and expensive to maintain. In fact, more than 5 percent of the hospital's revenues of \$650,000,000 is devoted to repairing and maintaining deteriorating buildings.

MEETING THE MISSION

In times of fiscal restraint, the hospital is no longer efficient and responsible with its scarce capital dollars. But more importantly, the age and patchwork design of the facility have an impact on patient care. Likewise, the hospital's operating rooms, diagnostic suites and research facilities have been neglected over the years. These factors were beginning to threaten the hospital's mission and vision "to provide exemplary patient care and foster excellence in healthcare deliver, research and teaching" and "to be an internationally recognized health sciences centre."

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PROPOSING THE CASE

The hospital's Board of Trustees submitted a proposal and business case to the Premier of Ontario, Mike Harris, outlining the innovative financing for redevelopment. Known as Project 2003, the five-year redevelopment plan would see the demolition of several buildings, the construction of new ones and renovations to others. The plan was examined in detail by both the Finance and Health Ministries. The hospital will continue to work closely with the government throughout Project 2003.

Project 2003 will be financed by issuing \$300,000,000 in public bonds that would be amortized over 25 years; the remaining \$50,000,000 of the redevelopment plan will be raised through private-sector partnerships and the disposition of redundant property. The annual debt repayment for the bonds will be paid through savings resulting from operational efficiencies and the reallocation of the hospital's capital budgets. Funding streams for patient care will not be affected by the plan.

The availability of this capital allows the hospital to complete

the renovation and rebuilding program in five years rather than dragging the rebuilding out over many years at great cost.

(Editors note: At the time *Hospital Quarterly* went to press the bond was not yet issued. Details of the issue and information on the processes followed will be made available in our next issue and on www.longwoods.com)



Alan R. Hudson, MB, FRCS(C), is President and CEO of The Toronto Hospital.

ALAN R. HUDSON

CASE THREE **MANITOBA'S HEALTH SCIENCES CENTRE** **\$100 MILLION FOR REFINANCING AND FUNDING** **TEACHING FACILITIES**

By Robert M. Callander and Tim Murray

In 1996, a group of urban hospitals in the Winnipeg area, known collectively as the "Health Sciences Centre," was seeking to borrow \$100,000,000 to refinance existing bank indebtedness and to provide funding for its teaching facilities.

The Health Sciences Centre is made up of two tertiary-care facilities and five acute-care centres including the Health Sciences Centre itself and St. Boniface General Hospital. The dilemma faced by hospital financial management was how to finance these objectives at a reasonable rate of interest without the obligation being supported by a direct and explicit Province of Manitoba guarantee.

The solution, as structured and arranged by CIBC Wood Gundy (and noted in the Summer 1998 issue of *Hospital Quarterly*, p. 25), was for the Health Sciences Centre to issue a five-year \$100,000,000 debenture, and to arrange for a European bank wishing to increase its exposure to Canadian provincial debt to purchase the debenture from the proceeds of a publicly syndicated Euro-Canadian bond financing. The financing was similarly arranged by CIBC Wood Gundy.

The European bank purchased the debenture on the strength of (1) a repayment arrangement whereby the Minister of Health received from the Health Sciences Centre an assignment of a portion of the total funds payable by the Ministry of Health each year to the Health Sciences Centre in an amount equaling the total of principal and interest due to the investor in that year, and (2) a "comfort letter" from the Province of Manitoba which stopped short of guaranteeing repayment but

which reiterated the Province's policy of providing for the debt repayment of its healthcare facilities and which indicated that the Province was not at that time considering ceasing its funding of parts of the Health Sciences Centre.

The result was that the Health Sciences Centre was able to obtain this financing at a cost that was lower than its existing bank debt, the Province did not need to provide a guarantee of the obligation, and the investor was able to achieve a favourable return on its investment, one that was commensurate with the Health Sciences Centre's risk profile.

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BUSINESS PLANNING

A key point to raise when discussing the financing of hospital capital developments relates to the importance of business planning. Regardless of whether the hospital's business plan is produced by the hospital itself or with the assistance of a lender or other advisor, the importance of such a document cannot be understated. This is especially true in a funding environment where provincial governments are reluctant to fund 100 percent of the project let alone provide their guarantees.

In situations where a lender does not have recourse to the provincial government, and where the source of repayment for a good portion of such a facility will be cash flows actually generated by the hospital, the lender is relying on that hospital's future ability to actually generate these cash flows. A business plan including financial-statement forecasts will greatly assist the lender in determining whether such cash flows can be generated, and if repayment is possible.

Clearly, business planning will be very important to a hospital that has a \$50,000,000 capital-development budget, \$35,000,000 of which is provincially funded and \$5,000,000 which is foundation funded. (see *Hospital Quarterly*, Summer, 1998, p. 22) Lenders seeking to lend this hospital the remaining \$10,000,000 will use the business plan to make assumptions about and perform sensitivity tests on the stability of the hospital's cash flows, the required term of the loan and the availability of sources of repayment such as ancillary revenues. A judgment will also be made about the hospital's future ability to repay and service the debt without negatively impacting its ability to offer the programs and services that it has traditionally provided the community.

In short, preparing a comprehensive business plan will not

only greatly add to the knowledge and understanding of the hospital's administrators, it will also greatly assist the lender in making the determination about whether such a project can be financed, and if so, how such a facility should be structured. It should be stated, however, that a comprehensive business plan is just one "piece of the puzzle" to be analyzed by a lender, and there are many other criteria that need to be considered.

Increasingly, financings such as that in the Health Sciences Centre example and those discussed elsewhere in this issue will become the rule rather than the exception. To the extent these arrangements make badly needed capital-development funds available to hospitals, these innovative approaches can provide value to a healthcare system in transition. **R**

(Editor's note: More background and details about this project and the relationships between banks and hospitals can be found in *Hospital Quarterly*, Summer 1998.)



Robert M. Callander is a Director in CIBC's Corporate Finance Group at the Bank's head office in Toronto.

ROBERT M. CALLANDER



Tim Murray is an Assistant Manager in CIBC's Corporate Finance Group at the Bank's head office in Toronto.

TIM MURRAY



Illustrations

Cover: *Radiation*, 1989 Acrylic on canvas (76.2 x 101.6 cm) by Robert Pope

Page 10: *Conference*, 1990 Acrylic on canvas (61.0 x 91.4 cm) by Robert Pope

Dr. Jock Murray, Dean, Dalhousie University Medical School notes: "As a physician, I find Robert Pope's art powerful, disturbing, humbling and wondrous. All of us who work with the sick have a great deal to learn from his art." Both illustrations are reprinted with the kind permission of the Robert Pope Foundation. For more information contact Mr. William Pope at (902) 684 9129.

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