

Alan P. Richman

## the tax support of independent community hospitals

**Independent, community hospitals in the United States face a double conundrum in their quest to remain financially viable.**

They have a dire need to modernize their facilities and to recruit new physicians, and in most cases, they cannot accomplish the latter without the former. Historically, a significant number of independent, community hospitals are, at best, marginally profitable from operations, while others struggle just to achieve positive cash flow. The situation is exacerbated by state budget difficulties and growing sentiment toward reductions in federal support for hospitals. These conditions further limit the ability of community hospitals to self-finance essential facility and staff improvements, leaving them vulnerable to purchase overtures from for-profit companies or not-for-profit hospitals.

Independent hospitals, whether not-for-profit or municipally owned, provide rural communities with more than just emergency and acute care services on a shoestring budget. Most local hospital boards are governed with an imperative to provide a continuum of healthcare services to their residents. Many financially subsidize and operate clinics, nursing homes, and senior housing. Although these expanded services enhance the local economy, the capital demands of community hospitals often exceed their financial resources.

Tax support is one potential solution for municipal and even certain not-for-profit hospitals. Taxes can provide supplemental revenue to fund physician recruitment and debt service for capital improvements. Targeted tax support allows a community to retain the benefits of a modern hospital while directing dollars into the local economy. Most communities are not eager to raise taxes, and hospitals that pursue this strategy need a comprehensive plan that includes

financial and operational analyses, community outreach, and low-cost financing, such as the Federal Housing Administration (FHA) Section 242 Hospital Mortgage Insurance Program.

### **Strategic Plan**

Hospitals should evaluate the demand for health-care services in their communities and formulate a plan to deliver that care. This plan is particularly important for independent hospitals that are losing patients and struggling to retain physicians. An effective plan includes the following elements.

*Market analysis.* Community hospitals should target their capital investment toward physicians and services that meet the needs of the population. An analysis of local demand will help hospital administrators decide how they can best allocate and develop service lines and recruit physicians.

*Financial forecast.* An accounting firm can use the market analysis to issue a five-year financial forecast that determines the revenue-generating capacity for the hospital services the community requires. The forecast should include a project budget based on a master plan from the hospital or architect, a physician recruitment budget, and debt-financing assumptions.

*Calculation of debt capacity.* The financial forecast allows a hospital's financial adviser to determine initial debt capacity, which may or may not be sufficient to finance the hospital's capital projects. If the required level of contributed capital exceeds the hospital's financial means, the hospital needs to look elsewhere to fund the gap. The municipality may provide the answer through local tax support in the form of a one-time contribution or a dedicated annual tax pledge that supplements the hospital's revenue.

## The Case for Tax Support

Municipally owned or not-for-profit hospitals may seek financial support from their communities through dedicated taxes, although this approach usually is politically unpopular. Hospital administrators should do their research and tailor their marketing strategies before they approach elected officials and constituents.

One significant hurdle is that residents often believe if hospitals are run properly, they should earn enough money to support themselves. To combat this belief, hospital leaders need to educate the community about the operations and financial realities of hospitals, and make a case for the tax support of vital community services.

**Capital improvements.** An old hospital may be well run, but it still needs capital investment to grow. Old facilities limit the scope of services that can be offered and make it difficult to recruit physicians. Often, an investment in new services and physicians will ensure the hospital's success, and findings from the strategic plan should support this premise.

**Limited tax support.** A limited, dedicated tax can supplement hospital operations and enhance debt capacity while capping the amount of taxes a single resident must pay. Taxpayers need to understand that an unlimited general obligation tax is not required because a hospital is a revenue producer.

**Local control over health care.** When citizens and their elected officials provide monetary support to an independent hospital, they are committed to maintaining the hospital and its ancillary businesses, even in difficult financial times.

**Taxpayer benefits.** In the short term, capital projects create construction jobs and increase local spending. In the long term, a modern hospital encourages economic growth by creating healthcare and related jobs. Regional economic growth is another benefit because business owners want to relocate to areas that offer good healthcare services.

## Low-Cost Financing

To independently finance their capital needs, community hospitals need to leverage their operating income and tax revenue with the most cost-effective debt option. Numerous factors can influence eligibility for financing programs and debt options, including a hospital's credit profile, local and state laws, project timelines, and proposed use of loan dollars.

The FHA's Section 242 Mortgage Insurance Program administered by the Department of Housing and Urban Development (HUD) provides eligible community hospitals with federal mortgage insurance, which can be used to obtain capital funding via low-interest, AAA Ginnie Mae collateralized loans and FHA-insured municipal bonds. HUD's FHA 242 mortgage insurance commitment is an excellent marketing tool for a hospital to use in presenting its case for tax support to the community and its elected officials. Beginning with HUD's underwriting process, the relationship among HUD, the hospital, and its community is mutually beneficial. The community benefits from HUD's up-front and ongoing financial and operational due diligence, while HUD views the financial backing of the residents and the oversight of the municipality as major credit pluses.

For small hospitals, an alternative funding option is a U.S. Department of Agriculture direct loan. Although this loan's availability is subject to federal budget allocation, it is an alternative with similar benefits to HUD: low interest rates, reasonable security covenants, and reliable loan servicing.

## A Lifeline for Hospitals

Increasingly, community hospitals are under pressure to survive. Independence and prosperity are not mutually exclusive for many community hospitals, as long as they receive a little revenue support for new facilities and additional physicians. Dedicated limited taxes can provide the lifeline hospitals need to preserve community health care and enhance the local economy. ●

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