STROUDWATER

CRITICAL ACCESS HOSPITAL

FINANCIAL AND OPERATIONAL VIRTUAL CONFERENCE

June 2024

HOUSEKEEPING

Participants will be muted automatically. If you would like to ask a question or make a comment, please use the chat or Q&A feature.

All sessions will be recorded

Slides and recordings will be made available to all registrants following the webinar

A short survey will follow each conference session. Your feedback is very important to us, and we appreciate your time in helping us improve.

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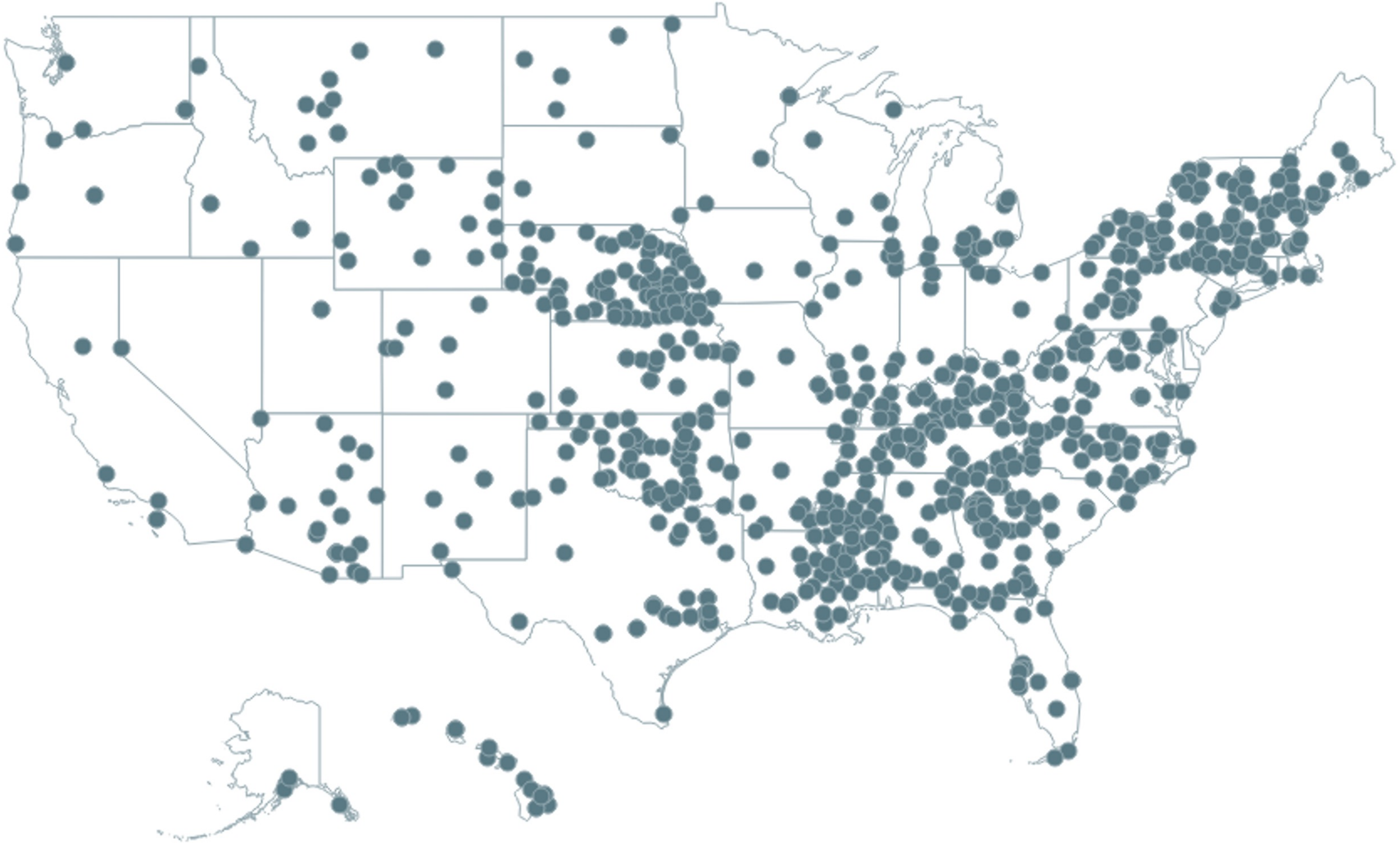

STROUDWATER ASSOCIATES CLIENTS SINCE 2017

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Real-world, mission-critical, actionable advisory services as you and your community navigate the dynamic risks of today's healthcare environment.

Stroudwater Associates is a leading national healthcare consulting firm serving healthcare clients exclusively. We focus on strategic, operational, and financial areas where our perspective offers the highest value.

We're proud of our 37-year track record with rural hospitals, community hospitals, healthcare systems, and large physician groups.

- **Strategic Advisory**
  - Strategic Planning
  - Mergers, Affiliations & Partnerships
  - Population Health Strategies
  - Physician-Hospital Alignment
  - Strategic Facility Planning
  - Capital Planning & Access
  - Post-Acute Care Strategy

- **Operational Advisory**
  - Performance Improvement & Restructuring
  - Provider Practice Operations Improvement
  - Revenue Cycle Solutions
  - Post-Acute Care Operations
  - Payor Contracting Advisory
  - Staffing & Productivity Improvement
  - Cost Report Reviews and Analysis

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Navigating Change: Strategies for Critical Access Hospitals in a Rising Rate Environment

THE IMPACT OF MARKET CHANGES ON FINANCING AND FEASIBILITY

The Hill-Burton Program

Created in 1946 with the primary purpose to provide federal funding to support the construction and expansion of healthcare facilities, especially hospitals, to meet the growing healthcare needs of communities.

LEGACY AND IMPACT

- Over 8,000 facilities were constructed or upgraded under the Hill-Burton program
- Approximately $4.5 billion was allocated from 1946 to 1974
- The program led to a signifiant increase, adding approximately 400,000 hospital beds
- 35% increase in health accessibility in underserved areas
- On average, patients experienced a 20% reduction in distance to access healthcare services
- The program contributed to the training and employment of around 150,000 healthcare professionals
- Patient satisfaction scores saw an average increase of 15% post-implementation
- A 25% reduction in preventable diseases and conditions was observed
- The Hill-Burton program played a role in creating approximately 1 million jobs in the healthcare sector
- A 20% decrease in overall mortality rates associated with the program

Development Over Time

LATE 1940'S

Hill-Burton Program

1980'S

Prospective payment systems (PPS) limit capital for rural facilities

LATE 1990'S

Critical Access Hospital program created using cost-based payment

2000'S

Federal programs to enhance access to capital

Primary Sources of Capital

GOVERNMENT

USDA Community Facilities Loans

- Program growth from $300 million to $3.2 billion over the last 10 years
- Approximately half of existing portfolio in rural healthcare projects
- Current Direct Loan Rate - 3.5%
- Technical assistance program available in partnership with NRHA

New Markets Tax Credits

- Awards for capital investment in qualified areas that do not need to be repaid
- $3.5+ billion annually with 20% invested in rural communities
- Capital allocation is competitive based on impact
- 7-year reporting period

WALL STREET

Tax-Exempt Bonds

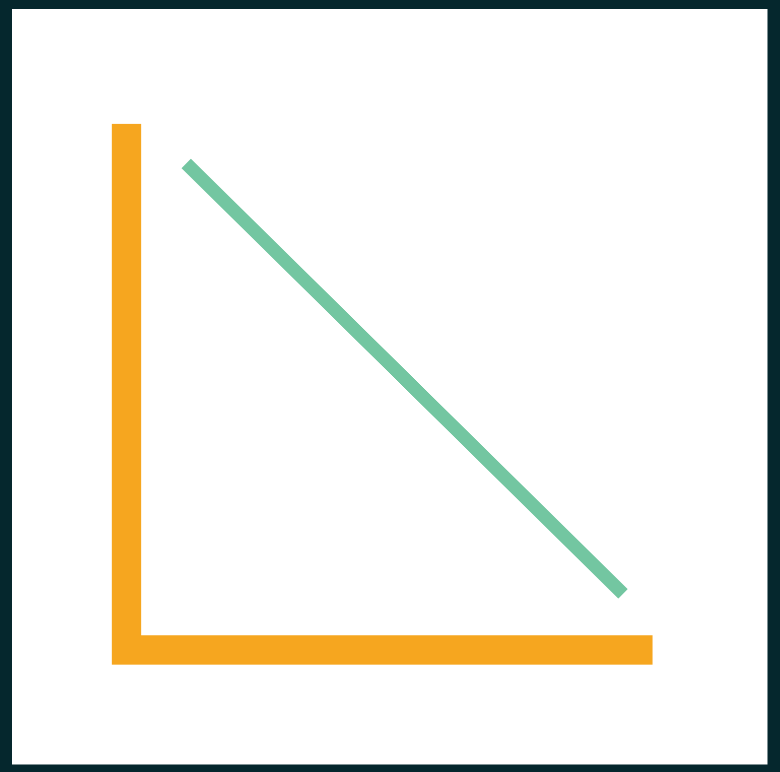
- Bonds sold to private and/or institutional investors
- May be backed by taxes or hospital revenues
- Typically non-rated “junk bonds,” unless affiliated with a larger healthcare system or supported by taxes

Key Factors for Accessing Capital

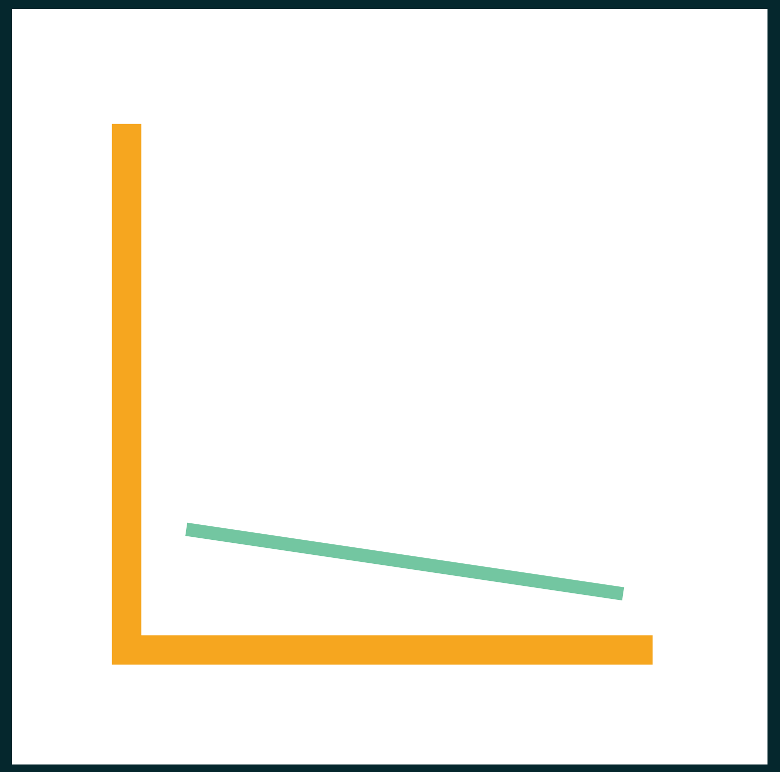
- Interest Rate
- Debt Total
- Payer Mix
- EBITDA Cash Flow

Sensitivity Analysis

Identifies which factors have the biggest impact in comparing different scenarios.



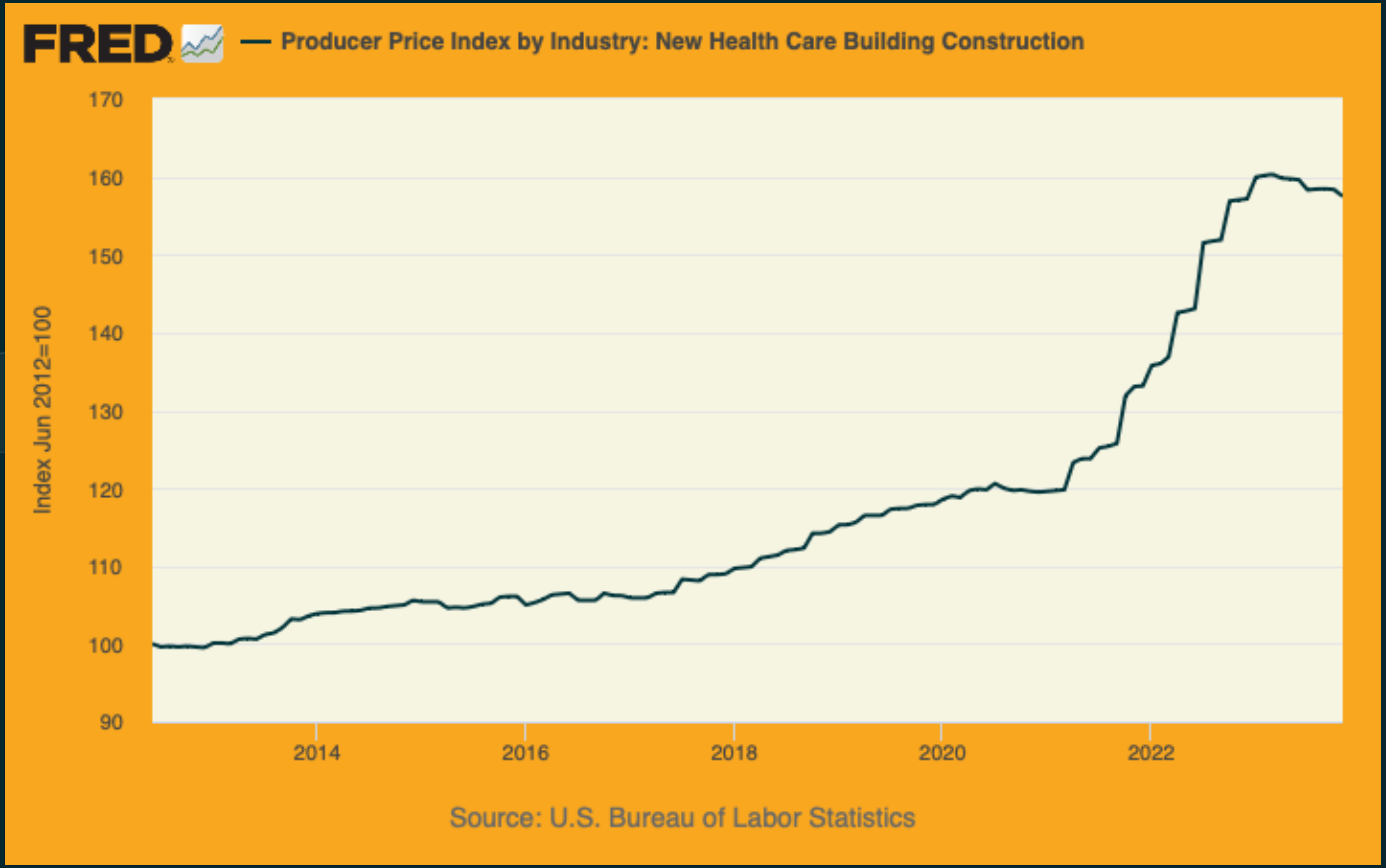
HIGH IMPACT



LOW IMPACT

MARKET UPDATE

Construction Cost Trends in Healthcare



SOURCE:
Bureau of Labor Statistics
Producer Price Index
June 2012-January 2024

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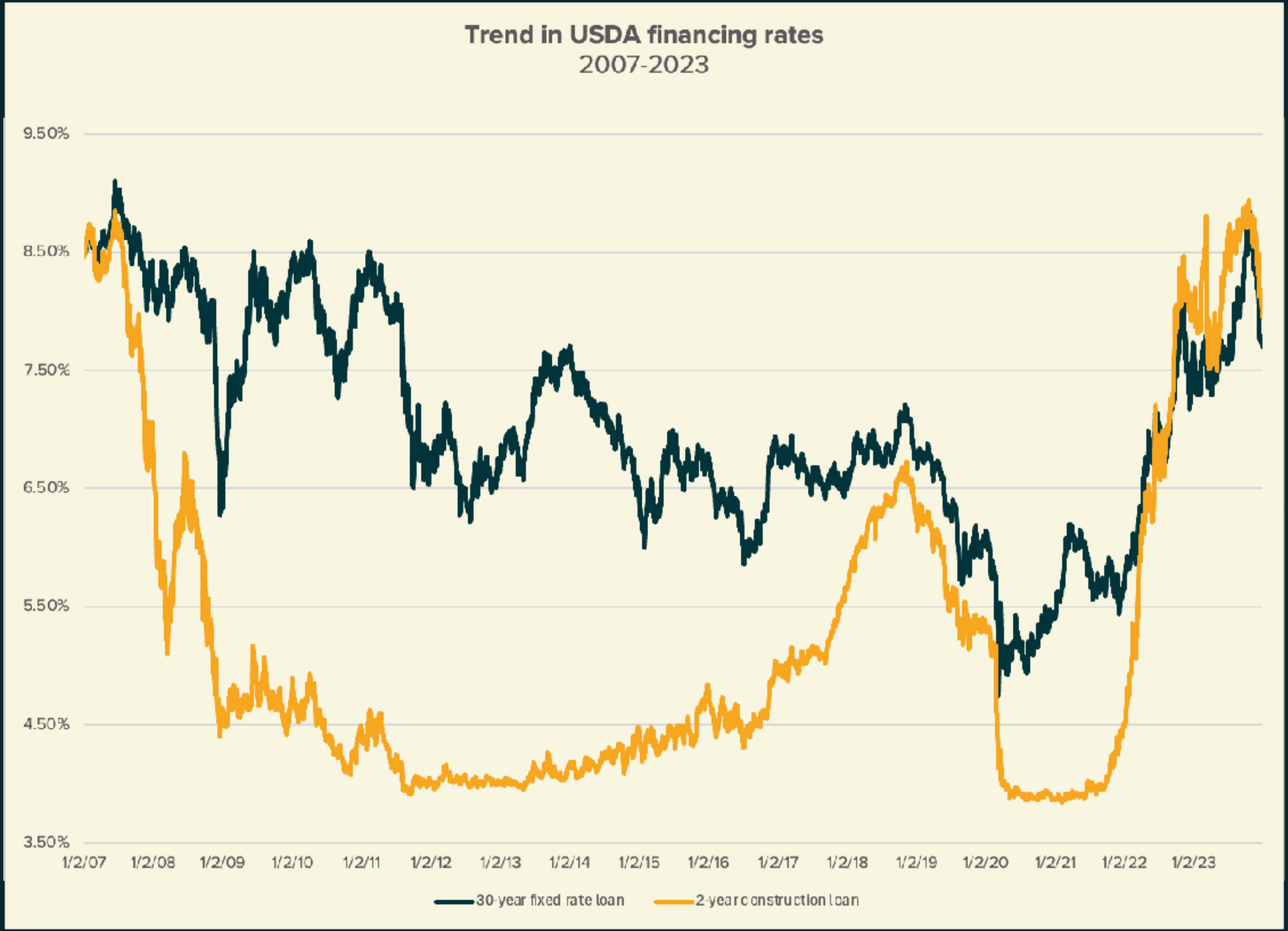
INTEREST RATE TRENDS

Market Update



Source: Daily treasury rate plus 375 basis point spread

Interest rate trends from 2007-2023 based on US Treasury

- 2-year construction loan (yellow)
- 30-year permanent loan (dark teal)

SCENARIO ANALYSIS - BASE CASE

Calculations & Key Variables

Total debt	$20,000,000
Interest rate	4.5%
Term	30 years
Total annual debt service payments	$1,228,000
First year principal	$328,000
Interest expense	$900,000

Change in net assets	$567,000
Existing interest & depreciation	$433,000
Available for debt service (EBITDA)	$1,000,000
Project depreciation	$1,006,000
Project interest	$900,000
Total new project costs	$1,906,000
Cost-based payer mix	45%
Cost reimbursement	$858,000
Historical EBITDA	$1,000,000
Project cost reimbursement	$858,000
Total funds for project debt service	$1,858,000

$$\frac{\$1,858,000}{\$1,228,000} = 1.51 \text{ Debt Service Coverage Ratio (DSCR)}$$

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IMPACT OF CASH FLOW

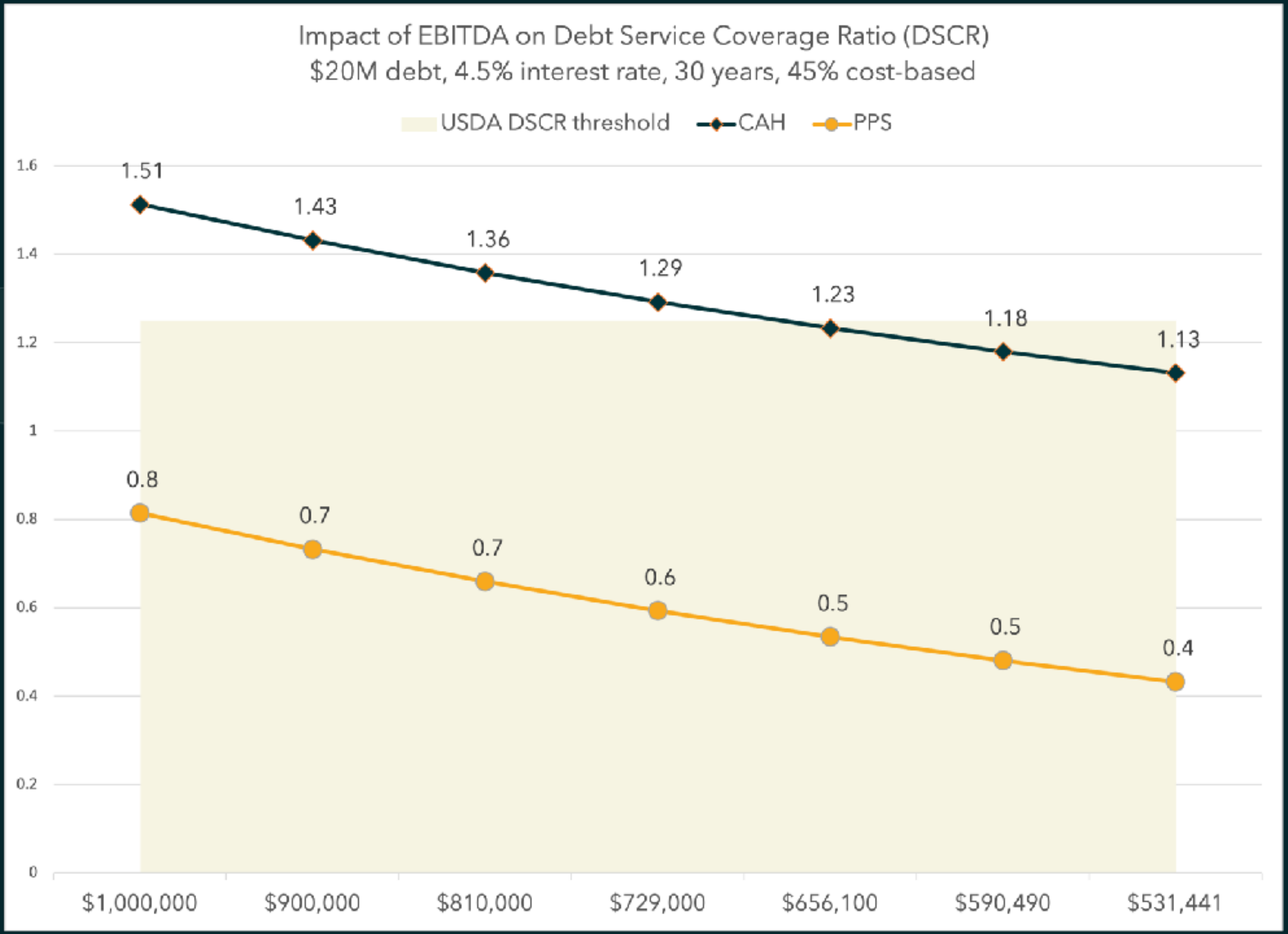
Chart shows the impact of declining EBITDA on the coverage ratio keeping other variables constant (see chart title)

Difference in the two lines is the impact of CAH cost-based payments

Shaded area reflects the typical USDA 1.25x debt service coverage required

Debt service coverage declines with decreased cash flow

Approximately $656K EBITDA needed to meet 1.25x USDA threshold in this scenario



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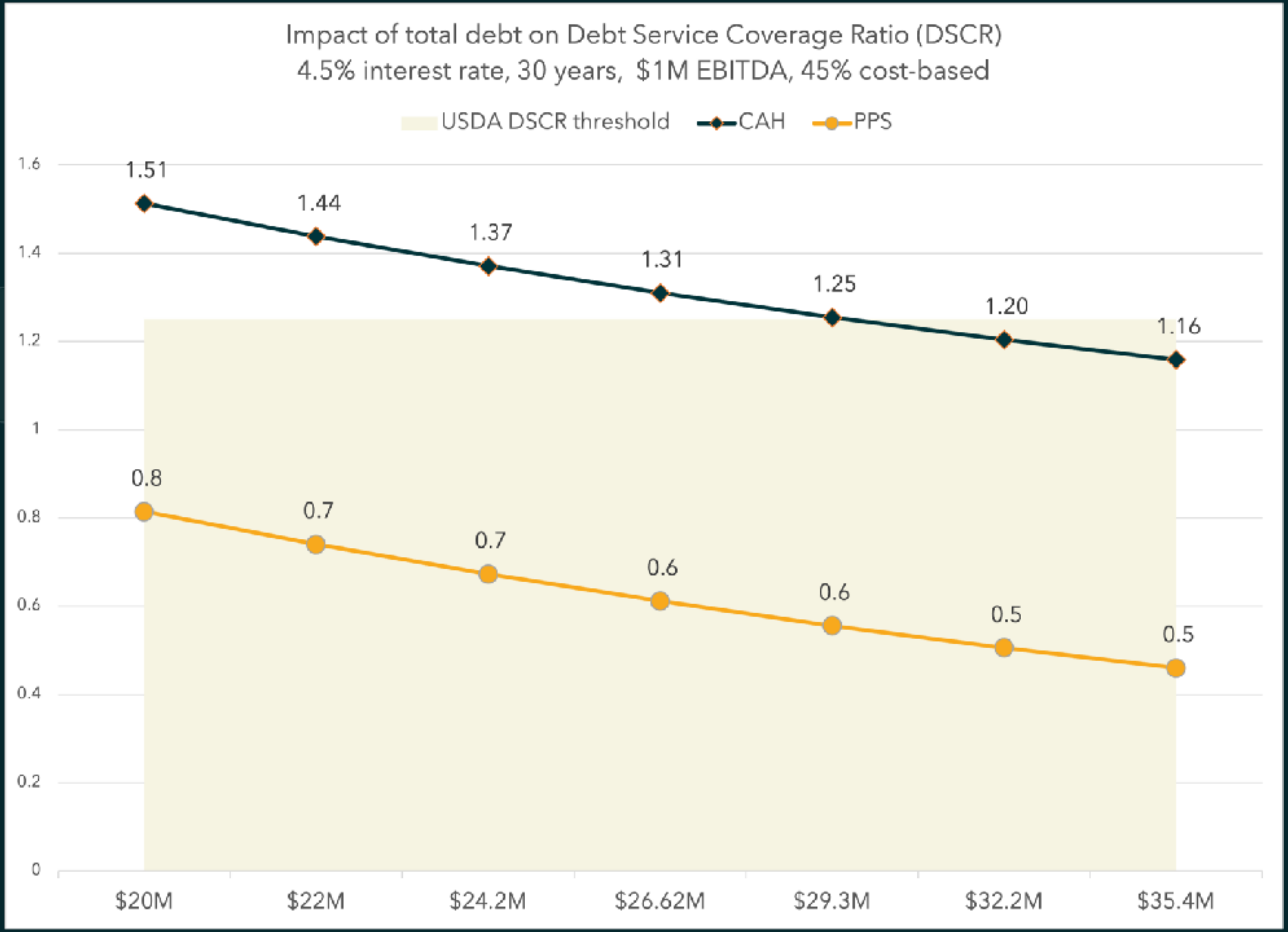
IMPACT OF TOTAL DEBT

Coverage ratio declines with increased total debt

$29.3 million in debt supported at USDA 1.25x threshold in this scenario

Similar sensitivity to impact of cash flow in prior scenario



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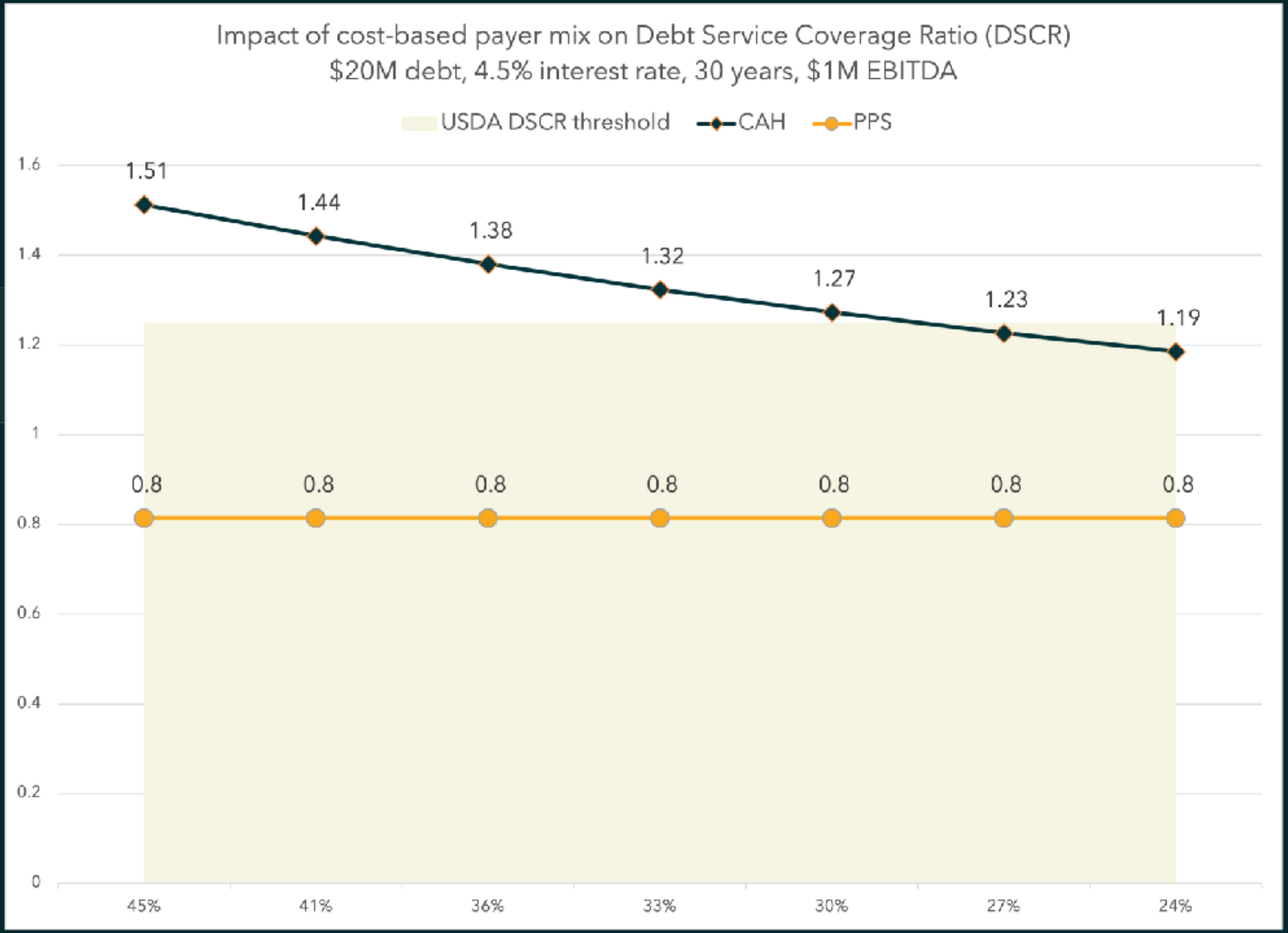
IMPACT OF PAYER MIX

Coverage ratio declines with lower cost-based payer mix

Approximately 28% cost-based payer mix leads to USDA 1.25x threshold in this scenario

Less sensitive than both cash flow and total debt

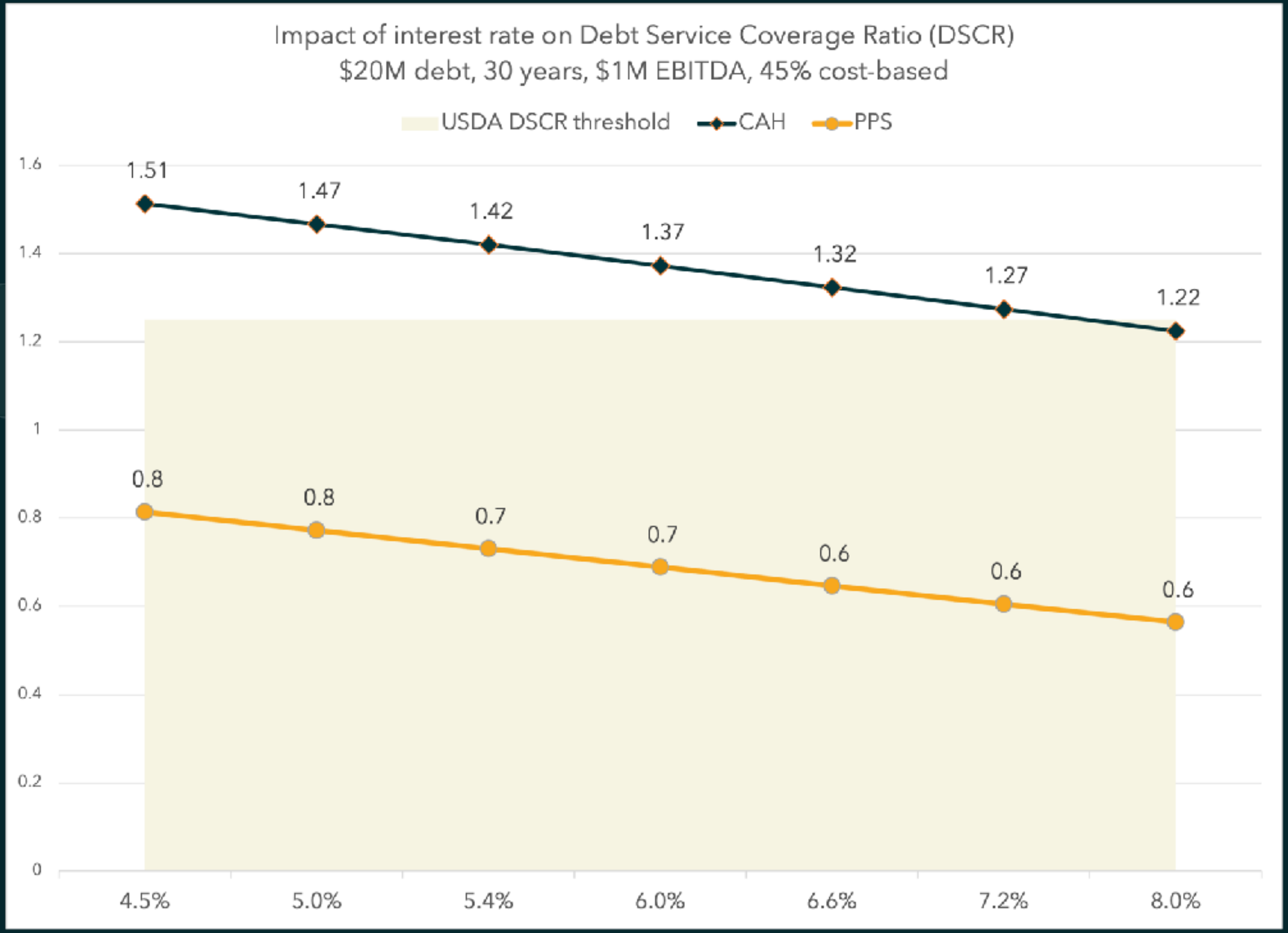


IMPACT OF INTEREST RATE

Coverage ratio declines with increased interest rate

Approximately 7.5% interest rate supported at USDA 1.25x threshold in this scenario

Least sensitive variable analyzed



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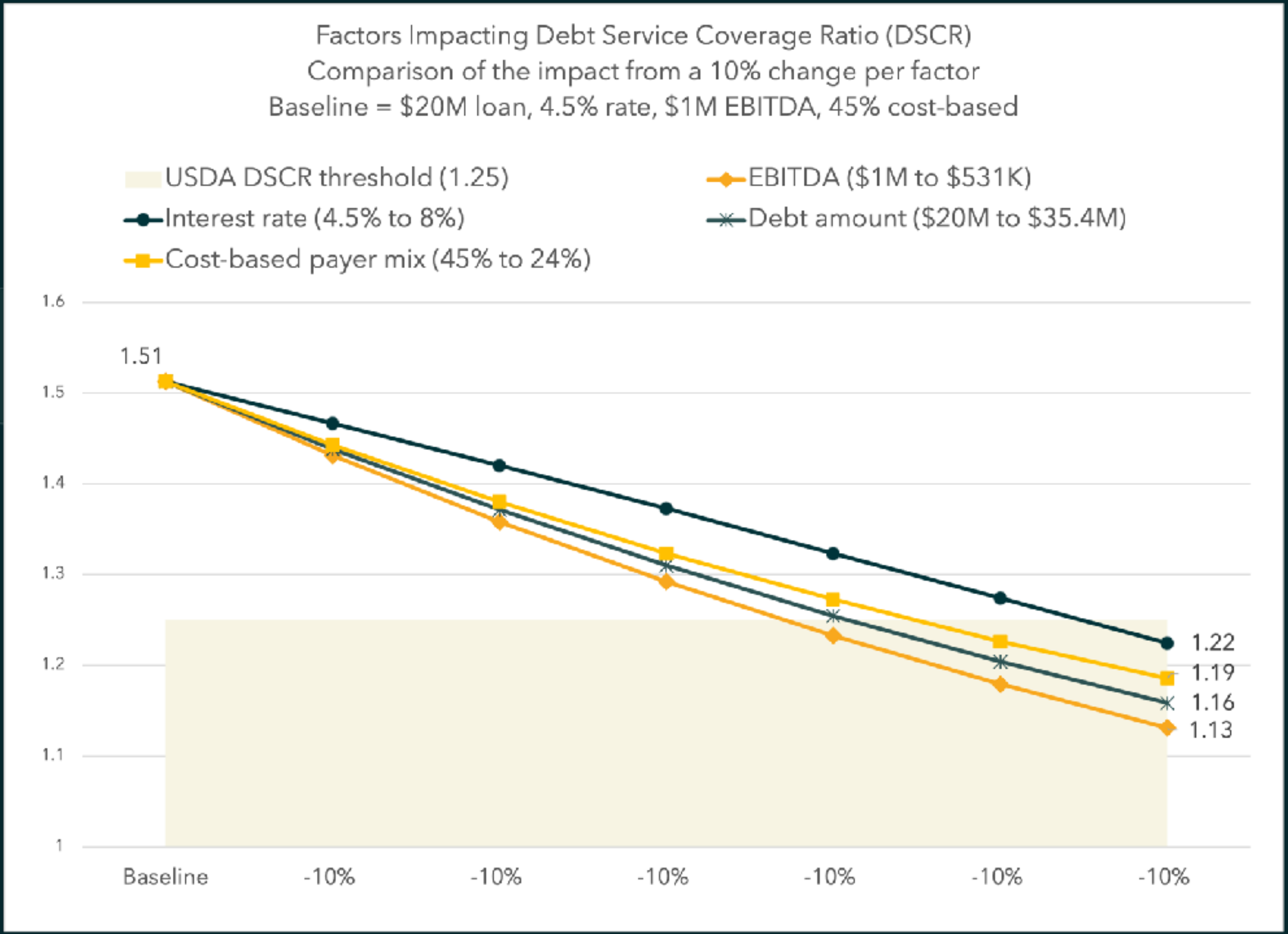
COMPARISON SUMMARY OF FACTORS IMPACTING DEBT SERVICE COVERAGE

Shows all results side-by-side

Order of sensitivity/importance (least to most):

- Interest rate
- Payer mix
- Total debt
- EBITDA cash flow



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Summary of
Key Takeaways:

MARKET SUMMARY

- Interest rates get a lot of attention but are least important factor impacting project feasibility
- Higher debt from healthcare construction inflation is among the most important factors
    - Costs moderated in 2023 but are projected to increase in the future
    - Inflation increases the costs of inaction and risk putting needed investments further out of reach

ORGANIZATIONAL NEXT STEPS

- Incorporate facility investment into the long-term strategic plan
- Assess debt capacity for addressing needs over time
    - Seek USDA/NRHA technical assistance for help to identify debt capacity and improve EBITDA if insufficient
- Work with the design team to size projects efficiently and cost effectivelly

Any questions?

Brian Haapala has served as a trusted advisor to health executives for over two decades, with a focus on developing transformative and sustainable healthcare systems in rural communities. As the CEO of Stroudwater Capital Partners, he works to develop and finance rural health investments nationally.

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