

Recommendations to:

Hennepin County Board of Commissioners

Presented By:

HCMC Governance Transition Committee

Irving Weiser, Chair

Sharon Sayles Belton, Transition Committee Member

Jeff Spartz, CEO, Hennepin County Medical Center

November 30, 2004

Presentation Outline

- **Background and Summary**
- The Process
- An Uncertain Future
- Transforming HCMC
- HCMC's Future
- Transition Phase Recommendations

History of the Process

In 2003, the
County Board
created the
HCMC
Governance
Task Force...

Irving Weiser, *Task Force Chair*
Chairman, RBC Dain Rauscher, Inc

Mark Bernhardson
City Manager, City of Bloomington

Susan Boren
Partner, Spencer Stuart

Albert Gallmon
President, Minneapolis Branch NAACP

Donald Jacobs, MD
*Chairman & CEO, Hennepin Faculty
Associates*

Bruce Lambrecht
President, Investment Management Inc.

Peggy Leppik
Member, Metropolitan Council

Gregory Pulles
Vice Chairman, TCF Financial Corporation

Sharon Sayles Belton
*Senior Fellow, Humphrey Institute of Public
Affairs*

Roger Siegal
Executive Director, AFSCME Council 14

Nikki Sorum
*Senior Vice President, Thrivent Financial
for Lutherans*

Jeff Spartz
*Chief Executive Officer, Hennepin County
Medical Center*

Gordon Sprenger
*Retired Chief Executive Officer, Allina
Health System*

Sandra Vargas
County Administrator, Hennepin County ³

Recommendations

On
September 2, 2003,
the Task Force
UNANIMOUSLY
recommended that
Hennepin County:

- Create a non-profit corporation
- Accelerate capital expenditures
- Enter into a formula-based payment for indigent care



Transition Committee Members

Irving Weiser;

Chairman, RBC Dain Rauscher, Inc. – *Transition
Committee Chair*

Mark Bernhardson;

City Manager, City of Bloomington

Gregory Pulles;

Vice Chairman, TCF Financial Corporation

Sharon Sayles Belton;

Senior Fellow, Humphrey Institute of Public Affairs

Nikki Sorum;

Senior Vice President, Thrivent Financial For Lutherans

In June 2004, the
County Board
created a smaller
five member
committee to
further develop
these
recommendations.

Transition Committee Charter*

The Board of Commissioners asked the Transition Committee to recommend ways to:

1. Preserve existing retirement benefits for existing employees
2. Remain accountable to the public and the County
3. Prioritize capital expenditures
4. Provide a consistent volume-driven internal formula for funding charitable care
5. Expand HCMC's market share
6. Estimate implementation costs and savings
7. Review strategic plan
8. Comment on a closer alignment of HFA and HCMC

Recommendations for HCMC's Future

Failure to act now will result in only 2 options down the road:

- **Privatization**
- **Elimination of core services**

- ❑ A specialized board with the necessary expertise for the complicated health care environment
- ❑ An opportunity to make operational and management decisions consistent with a competitive strategy
- ❑ An employment system designed to meet the needs of the hospital
- ❑ The ability to enter into innovative joint ventures

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From June through November

The members of the Transition Committee and HCMC leadership met regularly and sought considerable input.

- Nine meetings (2-4 hours)
- Six public forums
- Extensive participation by:
 - County Administration and Finance
 - The County Attorney's Office
 - HCMC Executive Staff
 - Outside Attorneys and Consultants
- Received input from:
 - County Department Heads
 - Human Services Group
 - Others

HCMC Employees

Employees express an openness to new approaches and a willingness to contribute their time and energy to maximize HCMC's future.

- Employee Input
 - Employee focus groups
 - Intranet
 - Dedicated voicemail
 - Nine employee forums
- Human Resources Review Process
 - Consultant analysis of retirement plan, benefits and compensation
 - Human resources systems review
 - Review and input by County Human Resources staff

Issues Discussed

Through this process, we heard concerns about and discussed solutions for the following issues:

- ❑ Vital role of HCMC's mission
- ❑ Why change is needed
- ❑ Future role of the County Board
- ❑ What governance change means to HCMC employees
- ❑ Continuation of benefits and compensation for current employees
- ❑ Continuation of services provided to the County

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Hennepin County Medical Center

**One of
America's
Best
Hospitals
for seven
years in a
row.**

- Provides many essential community and health care services
 - Medical education
 - Indigent care
 - Minnesota's only poison control center
 - Minnesota's only acute psychiatric emergency room
 - Minnesota's most active trauma center
 - Essential part of the region's response to disasters
- 95% of HCMC's revenues come from sources other than County property taxes
- Third largest hospital in the Twin Cities and one of the largest in the region

Barriers to Success

- ❑ Competition for attention and leadership of County's top management
- ❑ A human resources system designed for administration of the County rather than a medical center
- ❑ Limited ability to effectively engage in joint ventures
- ❑ Minnesota Open Meeting Law and Data Practices Act
- ❑ Operational decisions are vetted in a traditional policy setting environment

Like the more than 30 departments of Hennepin County, HCMC is governed by the County Board and the County Administrator.

Looking Forward

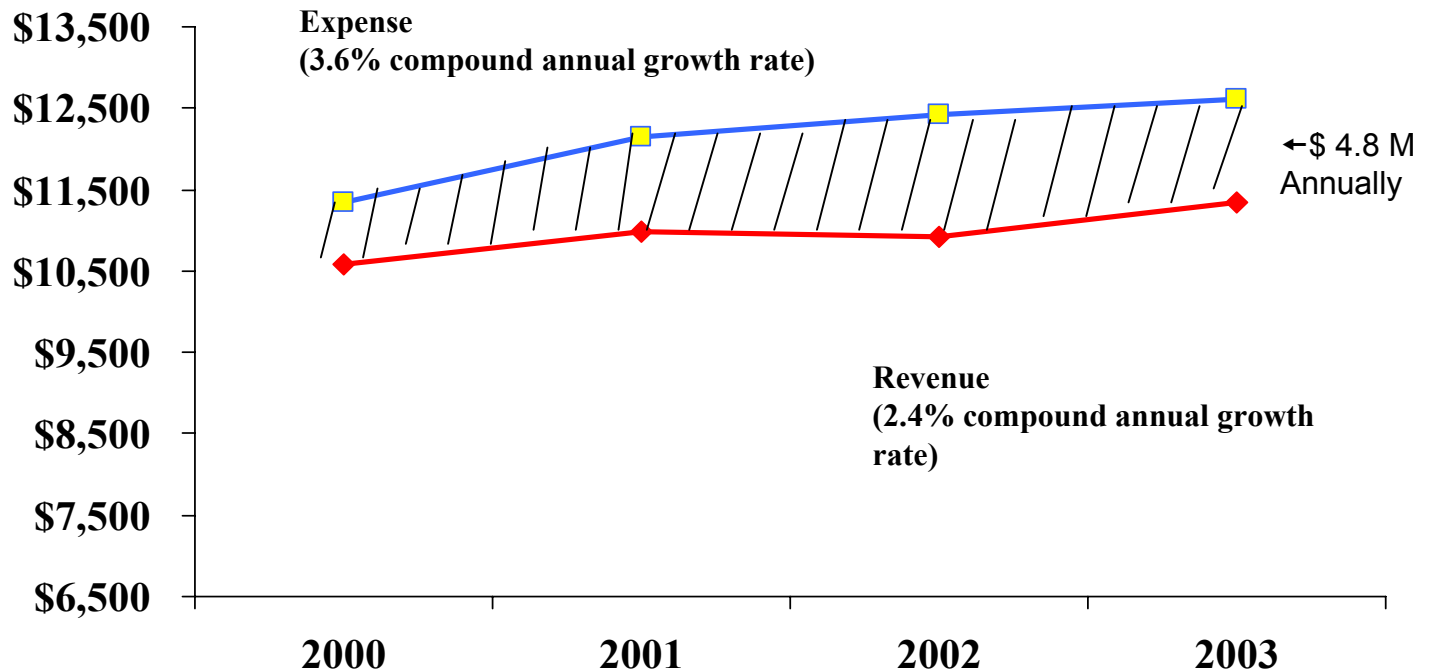
HCMC can best thrive long-term only with significant changes to the organizational model of the hospital.

- Decreasing payments for patients enrolled in government programs
 - 39% of HCMC's patient base is enrolled in state insurance programs as compared to 10% for the average MN hospital
- Costs increasing at a greater rate than revenues make HCMC's future uncertain
- Historical underinvestment in:
 - HCMC employees has potential for eroding the talent pool
 - HCMC facilities and technology will create higher future capital needs for then current catch-up purposes

An Uncertain Financial Future

HCMC has historically seen chronic negative margins and continued underinvestment.

Net Patient Revenue and Operating Expense per Adjusted Discharge



Source: HCMC Internal Financial Records

Actions Taken in 2003-2004

- ❑ FTE reduction of 190 FTE's
- ❑ Capital expense of \$10 million--
depreciation of \$19 million
- ❑ Programmatic reductions, i.e. Social Work, Therapeutic Pool, Facilities, Chaplaincy, Interpreters, EMS Training, Library, and Information Desks
- ❑ Restricted employee education expenditures

The hard realities lead to under-investment in people and facilities.

Federal and State Revenue Reductions

Since 1997,
HCMC has
lost
significant
revenue
sources.

Federal:

Balanced Budget Act 1997 Per year
\$ 6.6 million

State:

2003 State Budget Crisis \$10.7 million

Total \$17.3 million

Future Risks to Revenues

HCMC
faces even
further
losses in
revenue
sources in
the future.

- ❑ \$9 million (per year) in InterGovernmental transfers
- ❑ Balancing of Federal budget deficit
- ❑ Balancing of \$1 billion State budget deficit
- ❑ Predicted increased cost of \$900 million for the state as a result of state government programs
- ❑ Financial pressures exerted by third party payors

Increasing Costs

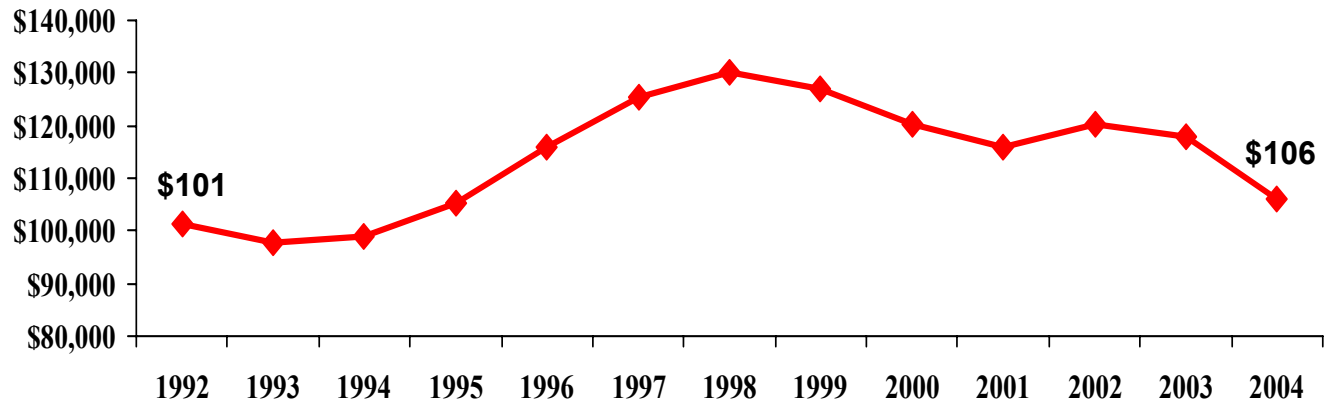
Local and national trends toward increasing costs have had a significant impact on HCMC.

- ❑ Growing shortage of health care workers
- ❑ Costs of new technologies
- ❑ More uninsured seeking services at HCMC
- ❑ Improvements to outdated and inefficient facilities
- ❑ Increased government regulations
- ❑ Underfunding of PERA

Undercapitalized Facilities

HCMC's facilities range in age from 30 to 80 years old.

HCMC Investment in Property, Plant, and Equipment (000's)



- County capital investment in HCMC in 2004 is nearly the same as it was in 1992.

Underinvesting in Employees

- Human resources at risk
 - Compensation not keeping pace
 - Benefits don't meet diverse employee needs
 - Professional education and development limited
 - Continued quality of health care professionals and staff at risk in a very competitive market

Number of health care jobs in Minnesota is going up, while the pool of qualified candidates goes down.

The Forecast

While we've
made ends meet
and held
property tax
support to a
minimum...

- HCMC fiscally viable short term because :
 - Underinvestment in its facilities and technology
 - Underinvestment in its employees
- HCMC cannot postpone the inevitable increases in costs to continue its mission forever

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Eliminating Barriers

HCMC is not alone, over 60% of public hospitals nationally have undergone some type of governance reform.

- Change is needed to sustain financial viability and HCMC's mission long-term
 - A sole-purpose hospital board
 - Financial flexibility for day-to-day management
 - An employment model designed for hospitals rather than counties
 - Reporting and public accountability requirements that do not disadvantage HCMC in the market
 - Elimination of any limitations on joint ventures

The Sole Purpose Governing Board

The
Transition
Committee
recommends
creating:

*Hennepin
Healthcare
System, Inc.*

a public
benefit
corporation.

- 11 to 15 members
- Diverse experience including up to two County Commissioners and HCMC's CEO
- Board Chair will be a community representative
- HHS Board will meet at least six times a year (excluding committee meetings) with quarterly presentations to the County Board

Direct Public Accountability

The County Board requested that the Transition Committee identify the means for ensuring accountability to the County and the public.

- Financial Controls
- Explicit County Board Controls
- Reporting Requirements

Financial Controls

The County Board will have the right to approve HCMC's use of public funds.

- No ability to independently levy taxes
- County Board approval of:
 - Any debt incurrence*
 - Significant capital expenditures
 - Annual operating budget
 - Payment for uncompensated care
 - Significant joint ventures

* Excludes *de minimus* debt = capital leases that, on a cumulative basis, have an annual debt service of less than one percent of revenues (\$15 million present value). 28

Explicit County Board Controls

In addition, there should be explicit County controls over governance, financial, corporate form, and employment powers.

Hennepin County shall:

- Annually approve the slate of Board members up for election
- Approve changes to the mission and bylaws (affecting governance)
- Be able to remove entire HHS Board under specified circumstances
- Own all real property, which will then be leased to HHS
- Approve significant assignments, subleases
- Approve any merger, consolidation, or dissolution
- Confirm initial hiring of any new chief executive officer
- Approve creation of subsidiaries

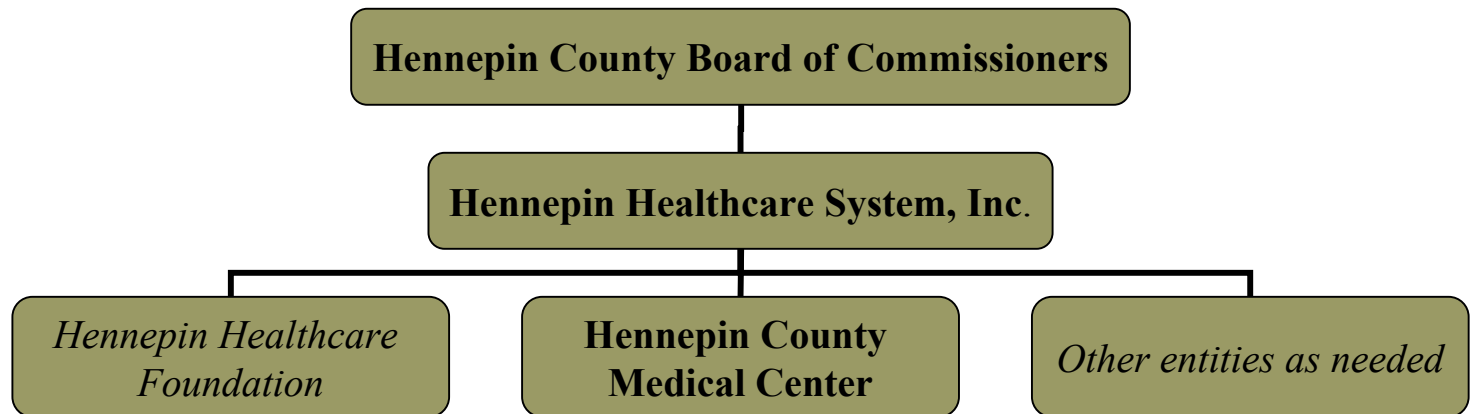
Public Reporting Requirements

- Public disclosure requirements similar to HCMC's competitors
- Quarterly presentations to County Board on health services plan, financial status, and provision of indigent care
 - Health Services Plan
 - An annual plan based on a population needs assessment.
 - Describes role HCMC will have in the community
 - New board will meet performance standards related to plan

To remain competitive, the new entity will be required to disclose the listed information instead of Minnesota Open Meeting Law and Data Practices Act.

Why Create Hennepin Healthcare System?

County Board retains major decision-making authority of public policy issues, which are appropriate for the political process.



An Employment Model for a Hospital

Under the
current
Hennepin
County Civil
Service
model...

- ❑ Recruiting process takes 3-4 times longer than competitors
- ❑ Job classification and reallocation process takes 3-6 times longer
- ❑ 270 job classes for HCMC
- ❑ Compensation rewards only longevity and not performance in an environment where accountability is critical

New HHS Employment Model

- A human resources system designed for the needs of a hospital
- Ability to establish a culture that rewards superior performance, as well as tenure
- Compensation and benefits that encourage retention of valuable employees
- Ability to create a new defined contribution pension plan for future employees, if necessary and desirable

Flexibility in the design of benefits, compensation, and job organization will allow HCMC to attract and retain the best employees.

Transition of HCMC's Current Employees

- PERA participation will continue for existing employees
- Transferred employees will have:
 - Service from their most recent hire date with the county
 - Current vacation and sick pay balances
 - Pay Equity
 - Veterans Preference
 - Minnesota Charitable Hospitals Act
- Existing employee representation (union) will continue; hospital negotiates future labor agreements directly

The County Board asked how existing retirement benefits for existing employees would be maintained.

Contract for Indigent Care

- The Transition Committee took into consideration the following principles:
 - A simple, logical formula that is flexible
 - HCMC must remain motivated to qualify uncompensated care recipients for alternative aid programs
 - County retains authority for HCMC's mission and its admission and treatment policy
 - Hennepin County will pay HCMC for care provided to County residents

The County Board asked for a description of the “consistent volume-driven internal formula for funding charity care.”

Volume-Based Formula

Hennepin County will reimburse HCMC for uncompensated care provided to Hennepin County residents at a rate equal to the lesser of:

- 95% to 99% of Medicaid payment rates (negotiated annually) or
- HCMC's actual costs

Approximately 84% of the uncompensated care provided to HCMC inpatients is provided to residents of the seven county metro area.

Strategic Expansion & Market Development

- Several initiatives currently underway
- To maximize opportunities HCMC needs to update the Strategic Plan and develop a Master Facilities Plan
- New governance and organizational model will provide the expertise and flexibility needed to:
 - Develop and monitor strategic and operational plans
 - Foster innovative partnerships, including alignment with HFA
 - Create a foundation

The County Board asked for an “aggressive plan for expansion of HCMC market share.”

Capital Expenditures

In response to the County Board's request for a method to determine the priorities for capital expenditures:

- Fitch Rating Service report demonstrates:
 - Strong correlation between healthy organizations and level of capital expenditures
 - Based on median spending levels for last eight years, HCMC has been undercapitalized by \$72 million*
- HCMC
 - Is in need of significant capital investment for new technologies
 - Is in need of significant renewal of its physical plant

* Numbers based on the Fitch Rating Service median for hospitals across the country.

Preliminary Capital Plan

HCMC staff with the assistance of Hennepin County Administration have prepared a five-year capital plan.

- HCMC needs \$250 million in capital over next five years
 - HCMC operations can generate \$140 million
 - Remaining \$110 million may be financed through bonds with:
 - HCMC operations assuming responsibility for \$50 million
 - The County assuming responsibility for \$60 million

Capital Allocation

The
Transition
Committee
felt it needed
more
information.

- In order to better determine the appropriate priority allocation for capital, HCMC needs to:
 - Complete an updated Strategic Plan
 - Complete a Master Facilities Plan

Implementation Costs

- Upfront Costs: \$300,000-\$400,000
 - Passage of legislation
 - Creation of HHS
- Other Costs: < \$700,000
 - Will occur incrementally
 - Most costs are associated with conducting business as a hospital
 - Costs will be minimized because the HHS board will be able to capitalize quickly on opportunities

The County Board
asked for an
estimate of
implementation
costs and ...

Operational Opportunities

... ongoing savings.

- New revenue streams
 - “Smart growth” in new markets/strategic investing
 - Joint ventures
 - Foundation
- Operational Opportunities
 - Timely decision-making
 - Rigorous cost management
 - More effective human resource management
 - Continuous redesign

No One Silver Bullet

These changes will ensure a future for HCMC that is better for the community, HCMC employees, and HCMC patients.

- Under this model, HHS will be able to:
 - In three years, demonstrate at least \$4 million in annual sustainable savings
 - In five years, achieve a sustainable operating margin of 2-4%
 - In five years, implement a working plan to make consistent capital reinvestments of 5-8% of annual operating budget

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HCMC's Future

Today HCMC
is one of
America's
Best
hospitals.

- These changes will:
 - Ensure the continuation of HCMC's mission
 - Enable the provision of essential services to the community
 - Strengthen HCMC's position as a center for medical education

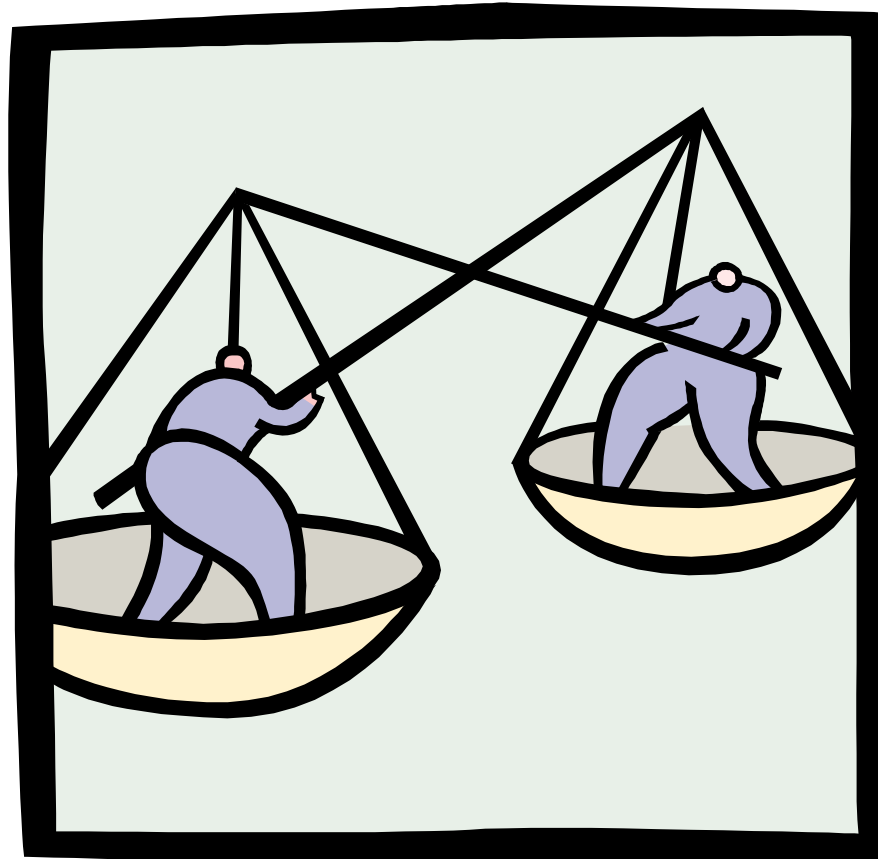
Summary of Recommendations

- This is not a “spin off” or privatization of the hospital
- A safety net subsidiary of the County
 - A hospital-specific governing board with expertise to quickly respond to the dynamic health care market
 - Human resources system designed for the delivery of health care
 - Reinforcing a culture that continues to emphasize health care quality with higher standards for performance and accountability
- Reduce legal obstacles to competitiveness

These are the
UNANIMOUS
recommendations
of the Transition
Committee.

Finding the Appropriate Balance

This is a great solution because it balances all of the stakeholders needs.





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Transition Process

We recommend
targeting

**January 1,
2006**

as the
implementation
date for the new
governance
model.

- **ASAP:** Approval of resolution and enabling legislation
- **Spring 2005:** Legislature adopts enabling legislation
- **March 31, 2005:** Interim/transition board formation
- **Summer 2005:** Strategic plan
- **Summer and Fall 2005:** Human resources development
- **Summer and Fall 2005:** Affiliation agreements
- **January 1, 2006:** Install new HHS Board and transfer of all active employees

Thank You

Q&A