

Physicians United

A Proposal for Hospital Operation for Palm Drive Hospital

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Introduction and Background

Palm Drive, founded in 1941, is an independent, non-profit facility operated by the Palm Drive Health Care District. In 1974, the Hospital was reconstructed at its present site, and in 1991, extensive renovations were completed. Palm Drive Hospital was licensed for 37 beds, five intensive care beds and the remainder medical-surgical beds. The Hospital provides a full range of primary acute care services including respiratory care, emergency care, intensive care, and outpatient ambulatory care services.

The Hospital is supported by revenues from inpatient and outpatient services as well as by parcel taxes (since 2003) paid by residents in the Health Care District's service area. In addition, the Palm Drive Health Care Foundation, a nonprofit organization, supports the Hospital by seeking charitable bequests and directing fundraising activities.

Palm Drive Hospital states in its mission statement that it exists to deliver access to quality and compassionate health care services responsive to the needs of its community.

The vision of Palm Drive Hospital is to be the gateway for community access to a continuum of health care services. Palm Drive Hospital will distinguish itself through:

- Providing quality health care services at Palm Drive Hospital to assure appropriate access to local care for the communities it serves.
- Developing partnerships among physicians who serve to align incentives, attract new medical providers, and strengthen the Hospital's capability to provide and manage the care of their patients.
- Encouraging a culture that supports employees and providers in developing their skills and resources to design complementary health services to better meet the needs of Palm Drive Hospital's communities.
- Being resourceful in integrating skills and resources to design complementary health services to better meet the needs of Palm Drive's communities.
- Creating opportunities to share programs and services with other health systems that are cost effective in improving quality and accessibility of services.

Physicians United seeks the opportunity to continue the vision and the mission of Palm Drive Hospital in a manner designed to meet the needs and the realities of the 21st century, while respecting the history of the hospital in the community.

The landscape of the healthcare industry has undergone drastic changes, resulting from increasingly complex regulation, changes in the way revenues are generated, and technology changes occurring at blinding speed. Many of the changes have made it difficult or impossible for smaller hospitals to operate profitably in a full service model. Some analysts predict that one in three small hospitals (of generally the same size as Palm Drive) will close within the next few years, unable to make the changes necessary to operate profitably under the new rules, revenue models, and patient expectations.

Physicians United believes that they understand what is needed to succeed in the current framework of regulation and insurance to provide extraordinary care in a sustainable, profitable way. The group of physicians proposes a plan which respects the realities of providing health care services in Sonoma County and seeks to preserve critical urgent and emergency services to our communities in the west county, while limiting or eliminating services that have not been profitable for Palm Drive Hospital.

Framework and Organization

Physicians United would move immediately to begin the process of reopening the emergency room, preferring, if logistically possible, to take over operations in a seamless manner on the morning of April 29, 2014. The operations going forward initially would be the intensive care unit, radiology, the lab, and an outpatient and specialty surgery center, with at least 5 inpatient beds staffed by nursing personnel with the appropriate requisite credentials. The hospital will also provide dietary services as required under law for a hospital with inpatient beds.

Under management by Physicians United, the hospital will operate as a 24-hour facility for emergency and inpatient care, with specialty surgery services taking place in the timeframe from 6:00am to 3:00pm. The new model would envision transferring patients needing longer term care to other local hospitals, which are designed to more efficiently provide longer term care consistent with the mission and vision of Palm Drive Hospital.

While it is not possible to state the exact date that individual services will be available at the hospital after the Physicians United offer is accepted, the shorter the duration of time the hospital has ceased operation, the shorter amount of time it will take to reorganize services and reopen the doors. The prospective operations will be limited as described above, but the quality of care will never be compromised. The hospital's current license, which is currently suspended, will be renewed. The renewal of the current license is believed to be consistent with the Physicians United vision for the hospital and the most expedient path to reopening the hospital. Physicians United also intends to continue using the services of the Huron Healthcare Group to assist in designing and implementing the

structure of the hospital going forward. We believe that the continued involvement of Huron will be a distinct asset to the management of the transition process of Palm Drive from a failing local hospital to a model for local healthcare in the 21st century.

In order to increase efficiency and improve quality, most administrative services, including medical billing, will be outsourced to third party providers, allowing hospital staff to concentrate on patient care and to reduce the number of full-time equivalent employees to help keep overall administrative and regulatory costs down. These services will be contracted by and be the responsibility of Physicians United, and the costs for these services are built into the financial model presented in this proposal.

The proposal by Physicians United initially intends to use the entire facility, less the 32-bed inpatient ward. This ward may or may not be necessary to the venture in the future, either in its current form, which is not likely, or in some other manner to respond to a demonstrated need for the community for additional services which will be complimentary, sustainable, and within the mission and vision of Palm Drive Hospital.

Physicians United will contract with Huron Healthcare Group at the outset to manage the operations and establish best practices for the ongoing operation of the hospital. Physicians United believes that engaging the best professionals will save money overall and will give the hospital the best foundation for successful future operations.

Physicians United is a group of medical professionals with a history of working with Palm Drive Hospital, as well as successful outside practices. The startup cost funding is coming from unencumbered funds derived from the successful operation of their outside practices. Physicians working at Palm Drive will be compensated based on personal production with a sliding scale formula resulting in baseline production producing a fair compensation with additional physician production earning significant incentives.

Physicians United expects additional staff to consist of 10 full-time staff members plus additional part-time staff, as necessary to meet the needs of patients and the community. The sharp difference in staffing from the past is attributed to eliminating positions which were administrative (which will be provided in the management contract with Huron) restructuring services and scheduling to reduce staffing inefficiencies and eliminating unnecessary services and the positions which were attributed to those services.

The ongoing operations of the hospital will be the responsibility of Physicians United, but Physicians United understands the ongoing interest of the District Board in overseeing the operations and will welcome the structured input of the District Board, Physicians United

proposes quarterly meetings between the management committee of Physicians United and the District Board during the length of the contract.

Physicians United requests that the Hospital District repair and maintain the structure and exterior of the facility during the period of the contract at its cost, with Physicians United taking responsibility for the interior maintenance of the hospital. To the extent that any physical remodeling of the building is required, Physicians United expects that the owner of the building make reasonable alterations at its cost.

During the startup period, Physicians United requests a rent of \$1 per year, with an annual review to determine whether the arrangement is acceptable going forward. In addition, the startup funding is expected to be recovered during the period of the contract through profitable operation and improved cash flow. Physicians United requests that the return of the startup funding of \$3,000,000 be guaranteed by the Hospital District during the term of the contract and secured with a lien on the hospital property.

Financial Proforma and Comprehensive Business Plan

Funding to restart the hospital will exceed \$3,000,000, which has already been committed to Physicians United by a member of the group. Sustainable, profitable operations are expected to be attained within the first year of operation. See following proforma financial information. All questions regarding the financial information can be referred to Dillwood Burkel & Millar LLP, CPAs (DBM). DBM will be operating in concert with Physicians United to maintain the books and records of the organization and the ongoing hospital operations which will be open for the review of the District Board at any time during normal business hours. Physicians United looks forward to an open and honest relationship with the District resulting in a successful venture and long term sustainable healthcare services to the west county.

Exhibit I. Three-Year Projected Profit and Loss (Cash Basis)

For the Years Ending June 30,	2015	2016	2017
Gross Charges	\$ 65,909,091	\$ 69,204,545	\$ 72,664,773
Contractual Adjustments	(45,374,091)	(47,642,795)	(50,024,935)
Net Patient Revenues	<u>20,535,000</u>	<u>21,561,750</u>	<u>22,639,838</u>
Non-operating Revenue			
Tax Revenues	<u>2,000,000</u>	<u>2,060,000</u>	<u>2,121,800</u>
	<u>2,000,000</u>	<u>2,060,000</u>	<u>2,121,800</u>
Total Revenue	22,535,000	23,621,750	24,761,638
Expenses			
Physician's Fees	4,390,000	4,521,700	4,657,351
Salaries and Benefits	5,600,000	5,768,000	5,941,040
Purchased Services and Professional Fees	2,575,000	2,652,250	2,731,818
Equipment Rental	510,000	525,300	541,059
Supplies	4,300,000	4,429,000	4,561,870
Insurance	390,000	401,700	413,751
Utilities and Other	320,000	329,600	339,488
Total Expenses	<u>18,085,000</u>	<u>18,627,550</u>	<u>19,186,377</u>
Net Income	<u>\$ 4,450,000</u>	<u>\$ 4,994,200</u>	<u>\$ 5,575,261</u>

Exhibit II. Three-Year Projected Expenses as a Percentage of Net Patient Revenues

For the Years Ending June 30,	2015	2016	2017
Physician's Fees	21%	21%	21%
Salaries and Benefits	27%	27%	26%
Purchased Services and Professional Fees	13%	12%	12%
Equipment Rental	2%	2%	2%
Supplies	21%	21%	20%
Insurance	2%	2%	2%
Utilities and Other	2%	2%	1%
Total Expenses as a % of Net Patient Revenues	<u>88%</u>	<u>86%</u>	<u>85%</u>

Exhibit III. Projected Profit and Loss (Cash Basis) for Fiscal Year Ending June 30, 2015

	ER	Intensive Care	Outpatient Surgical	Imaging	Lab	Pharmacy	Total Operating	Non Operating	Total
Gross Charges	\$ 10,000,000	\$ 3,000,000	\$ 27,409,091	\$ 13,000,000	\$ 6,500,000	\$ 6,000,000	\$ 65,909,091	\$ -	\$ 65,909,091
Contractual Adjustments	(6,900,000)	(2,070,000)	(18,809,091)	(8,970,000)	(4,485,000)	(4,140,000)	(45,374,091)	-	(45,374,091)
Net Patient Revenues	3,100,000	930,000	8,600,000	4,030,000	2,015,000	1,860,000	20,535,000	-	20,535,000
Non-operating Revenue	-	-	-	-	-	-	-	2,000,000	2,000,000
Tax Revenues	-	-	-	-	-	-	-	2,000,000	2,000,000
Total Revenue	3,100,000	930,000	8,600,000	4,030,000	2,015,000	1,860,000	20,535,000	2,000,000	22,535,000
Expenses									
Physician's Fees	1,400,000	220,000	2,520,000	150,000	100,000	-	4,390,000	-	4,390,000
Salaries and Benefits	1,500,000	800,000	600,000	1,000,000	1,000,000	700,000	5,600,000	-	5,600,000
Purchased Services and Professional Fees	60,000	80,000	430,000	200,000	300,000	5,000	1,075,000	1,500,000	2,575,000
Equipment Rental	-	-	110,000	200,000	100,000	100,000	510,000	-	510,000
Supplies	500,000	300,000	1,500,000	900,000	500,000	600,000	4,300,000	-	4,300,000
Insurance	50,000	50,000	250,000	20,000	20,000	-	390,000	-	390,000
Utilities and Other	50,000	60,000	120,000	50,000	20,000	20,000	320,000	-	320,000
Total Expenses	3,560,000	1,510,000	5,530,000	2,520,000	2,040,000	1,425,000	16,585,000	1,500,000	18,085,000
Net Income (Loss)	\$ (460,000)	\$ (580,000)	\$ 3,070,000	\$ 1,510,000	\$ (25,000)	\$ 435,000	\$ 3,950,000	\$ 500,000	\$ 4,450,000

Exhibit IV. Projected Profit and Loss (Cash Basis) for Fiscal Year Ending June 30, 2016

	ER	Intensive Care	Outpatient Surgical	Imaging	Lab	Pharmacy	Total Operating	Non Operating	Total
Gross Charges	\$ 10,500,000	\$ 3,150,000	\$ 28,779,545	\$ 13,650,000	\$ 6,825,000	\$ 6,300,000	\$ 69,204,545	\$ -	\$ 69,204,545
Contractual Adjustments	(7,245,000)	(2,173,500)	(19,749,545)	(9,418,500)	(4,709,250)	(4,347,000)	(47,642,795)	-	(47,642,795)
Net Patient Revenues	3,255,000	976,500	9,030,000	4,231,500	2,115,750	1,953,000	21,561,750	-	21,561,750
Non-operating Revenue	-	-	-	-	-	-	-	2,060,000	2,060,000
Tax Revenues	-	-	-	-	-	-	-	2,060,000	2,060,000
Total Revenue	3,255,000	976,500	9,030,000	4,231,500	2,115,750	1,953,000	21,561,750	2,060,000	23,621,750
Expenses									
Physician's Fees	1,442,000	226,600	2,595,600	154,500	103,000	-	4,521,700	-	4,521,700
Salaries and Benefits	1,545,000	824,000	618,000	1,030,000	1,030,000	721,000	5,768,000	-	5,768,000
Purchased Services and Professional Fee	61,800	82,400	442,900	206,000	309,000	5,150	1,107,250	1,545,000	2,652,250
Equipment Rental	-	-	113,300	206,000	103,000	103,000	525,300	-	525,300
Supplies	515,000	309,000	1,545,000	927,000	515,000	618,000	4,429,000	-	4,429,000
Insurance	51,500	51,500	257,500	20,600	20,600	-	401,700	-	401,700
Utilities and Other	51,500	61,800	123,600	51,500	20,600	20,600	329,600	-	329,600
Total Expenses	3,666,800	1,555,300	5,695,900	2,595,600	2,101,200	1,467,750	17,082,550	1,545,000	18,627,550
Net Income (Loss)	\$ (411,800)	\$ (578,800)	\$ 3,334,100	\$ 1,635,900	\$ 14,550	\$ 485,250	\$ 4,479,200	\$ 515,000	\$ 4,994,200

Exhibit V. Projected Profit and Loss (Cash Basis) for Fiscal Year Ending June 30, 2017

	ER	Intensive Care	Outpatient Surgical	Imaging	Lab	Pharmacy	Total Operating	Non Operating	Total
Gross Charges	\$ 11,025,000	\$ 3,307,500	\$ 30,218,523	\$ 14,332,500	\$ 7,166,250	\$ 6,615,000	\$ 72,664,773	\$ -	\$ 72,664,773
Contractual Adjustments	(7,607,250)	(2,282,175)	(20,737,023)	(9,889,425)	(4,944,713)	(4,564,350)	(50,024,935)	-	(50,024,935)
Net Patient Revenues	3,417,750	1,025,325	9,481,500	4,443,075	2,221,538	2,050,650	22,639,838	-	22,639,838
Non-operating Revenue	-	-	-	-	-	-	-	2,121,800	2,121,800
Tax Revenues	-	-	-	-	-	-	-	2,121,800	2,121,800
Total Revenue	3,417,750	1,025,325	9,481,500	4,443,075	2,221,538	2,050,650	22,639,838	2,121,800	24,761,638
Expenses									
Physician's Fees	1,485,260	233,398	2,673,468	159,135	106,090	-	4,657,351	-	4,657,351
Salaries and Benefits	1,591,350	848,720	636,540	1,060,900	1,060,900	742,630	5,941,040	-	5,941,040
Purchased Services and Professional Fee	63,654	84,872	456,187	212,180	318,270	5,305	1,140,468	1,591,350	2,731,818
Equipment Rental	-	-	116,699	212,180	106,090	106,090	541,059	-	541,059
Supplies	530,450	318,270	1,591,350	954,810	530,450	636,540	4,561,870	-	4,561,870
Insurance	53,045	53,045	265,225	21,218	21,218	-	413,751	-	413,751
Utilities and Other	53,045	63,654	127,308	53,045	21,218	21,218	339,488	-	339,488
Total Expenses	3,776,804	1,601,959	5,866,777	2,673,468	2,164,236	1,511,783	17,595,027	1,591,350	19,186,377
Net Income (Loss)	\$ (359,054)	\$ (576,634)	\$ 3,614,723	\$ 1,769,607	\$ 57,302	\$ 538,868	\$ 5,044,811	\$ 530,450	\$ 5,575,261