



Financial Condition of Maryland's Hospitals

April 2013



Maryland is the only state in the United States in which all hospital charges are regulated by the state, rather than determined in the open marketplace.

As part of Maryland's 40-year-old rate setting system, the Health Services Cost Review Commission (HSCRC) is the independent entity charged with reviewing and approving hospital rates. By law, the HSCRC is required to ensure that:

- Total costs of all hospital services offered are reasonable;
- Aggregate rates for a hospital are related reasonably to the hospital's aggregate costs; and
- Rates are set equitably among all purchasers of care without undue discrimination or preference.

In determining the reasonableness of rates, the HSCRC is also required to provide rates that allow a hospital to provide, "on a solvent basis, effective and efficient service that is in the public interest" (Section 19-219 and 19-220 of the Annotated Code of Maryland).

Central to that task is an understanding of the financial condition of Maryland hospitals. This report provides information on the current financial status of Maryland hospitals. All data came from financial condition reports that hospitals are required to file with the HSCRC. In order to provide timely data for this report, as yet unaudited financial data is used for the most recent year.

42%

of Maryland's hospitals are losing money treating the patients they serve

KEY FINDINGS

The key findings of this analysis include:

- The financial condition of Maryland's hospitals is at one of the lowest points in the history of the rate-setting system.
- The aggregate Maryland hospital operating margin for the first eight months of fiscal year 2013 is 0.8 percent, meaning hospitals are barely breaking even on the care they provide.
- Twenty five of Maryland's 60 hospitals — 42 percent — have negative operating margins, meaning these hospitals are losing money treating the patients they serve.
- The HSCRC has approved hospital rate increases well below the rate of inflation for the last four years. For fiscal year 2013, the HSCRC approved a rate increase of only 0.3 percent, despite the fact that inflation was expected to increase 2.11 percent for the same period.

MARYLAND HOSPITAL FINANCIAL CONDITION — WEAK

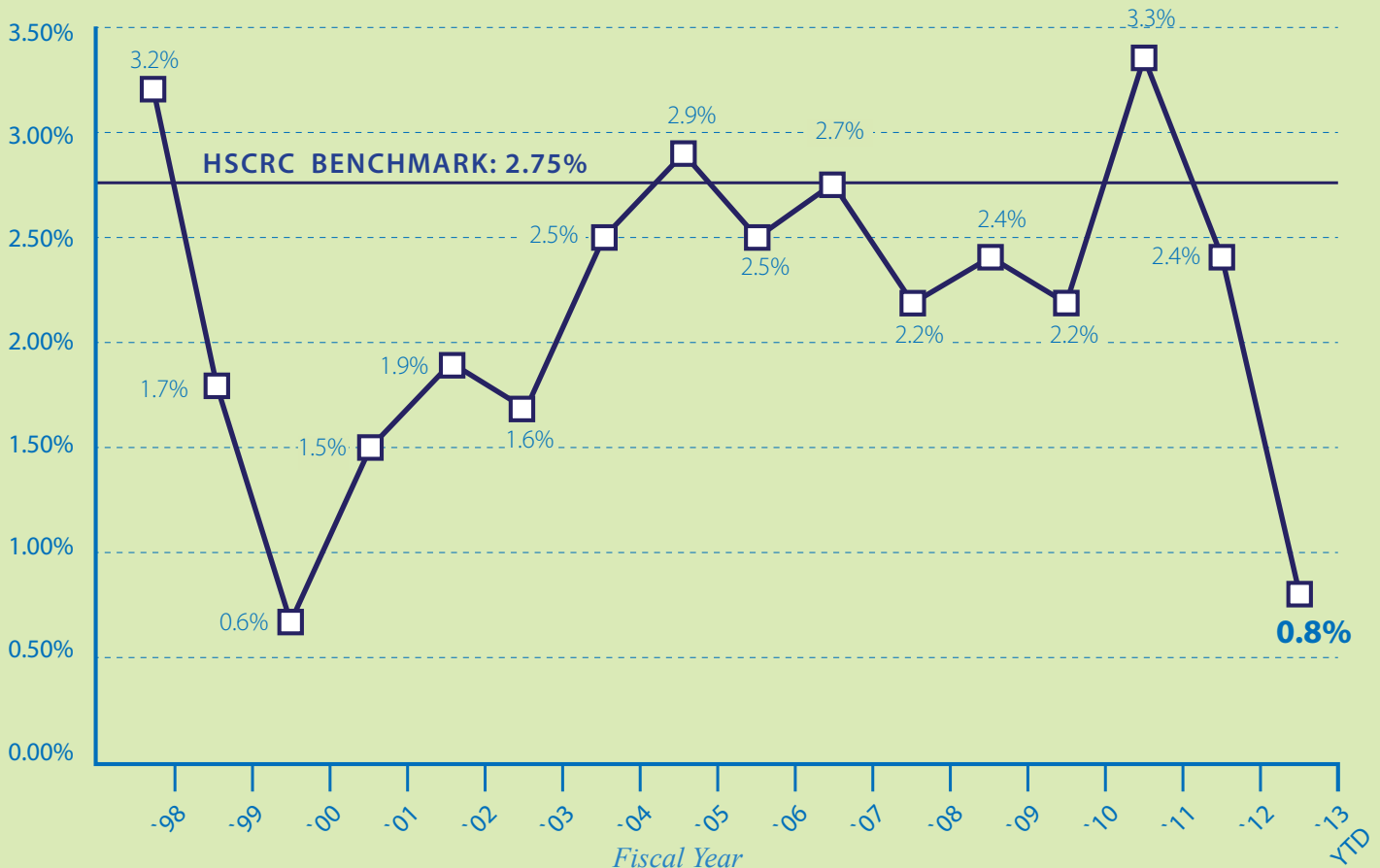
The financial condition of Maryland’s hospitals is at one of the lowest points in the history of rate regulation. The HSCRC is charged with setting the rates hospitals are allowed to charge in the state, but also is charged with ensuring the financial solvency of efficient and effective hospitals. The primary measure of that financial viability, set and used by the HSCRC, is the “operating margin” of Maryland’s hospitals. The operating margin is a measure of a hospital’s operating revenue compared to its operating expenses (Total Operating Revenue - Total Operating Expenses)/Total Operating Revenue).

For the first six months of fiscal year 2013, the aggregate Maryland hospital operating margin was 0.8 percent. This is the second lowest level of financial performance for Maryland’s hospitals since 1998. Only one other time in the past 14 years have hospital operating margins been near this low point (Figure 1).

Of particular concern is that this measure of hospital financial performance falls far below the benchmark level of performance set by the HSCRC itself. In 2001, the HSCRC convened an expert task force with input from bond rating and capital investment experts, and developed a benchmark measure of 2.75 percent operating margin for Maryland hospital financial performance. Yet the hospital field has met that target only twice in the last 13 years.

Figure 1

Maryland Aggregate Hospital Operating Margin FY 1998 - FY 2013



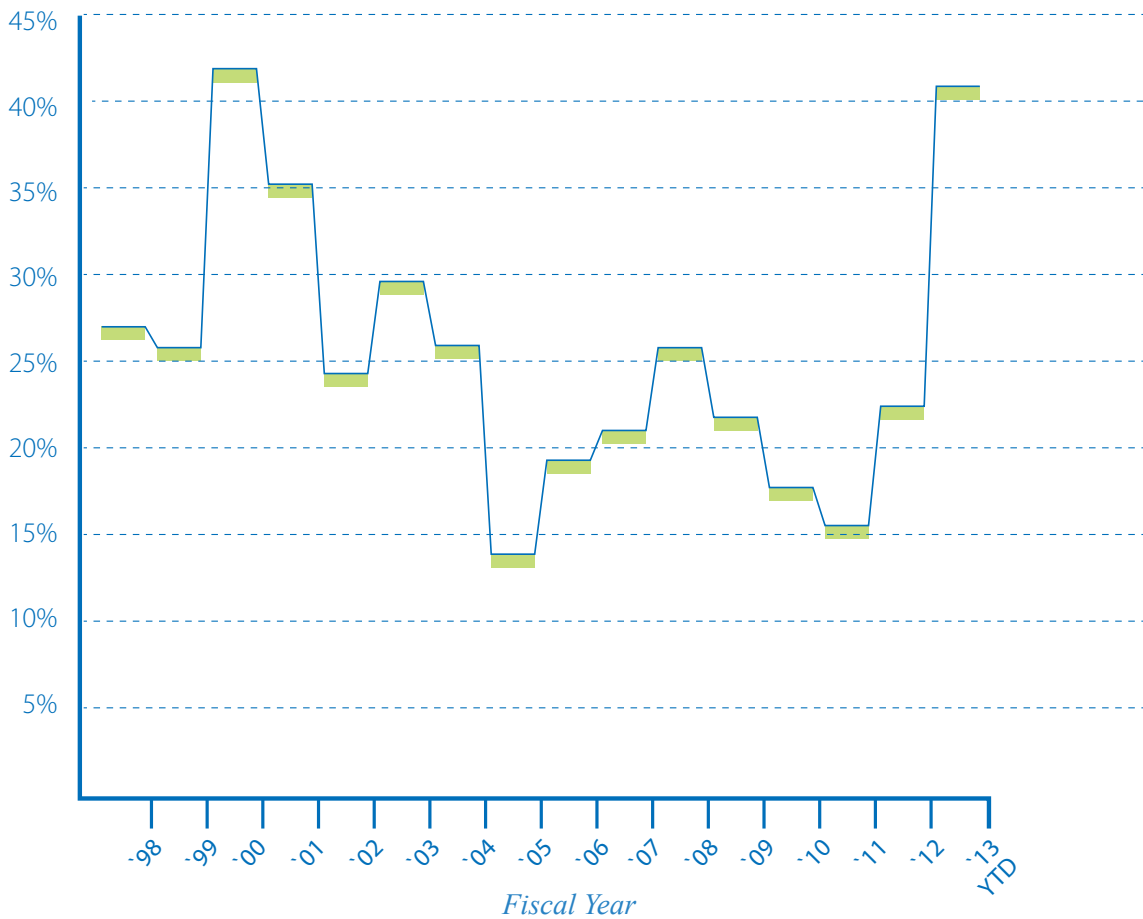
Source: MHA Unaudited Financial Conditions Report

LARGE SHARE OF MARYLAND'S HOSPITALS LOSING MONEY

Historically-low and dwindling operating margins are not isolated; they are a reality across the Maryland hospital field. Worse, there are a growing number of hospitals in the state operating at a loss. Since 2011, the share of Maryland's hospitals with negative operating margins – hospitals operating in the red – has climbed from 17 percent to over 40 percent (Figure 2). In the first six months of fiscal year 2013, 25 Maryland hospitals, or 42 percent, were operating at a loss. That means that four of 10 hospitals in the state are losing money on the care of the patients and communities they serve.

Figure 2

Percent of Maryland's Hospitals with Negative Operating Margins



Source: MHA Unaudited Financial Conditions Report

MARGINS ARE DECLINING FOR BOTH CORE HOSPITAL AND HOSPITAL-BASED PHYSICIAN CARE

Maryland's state rate-setting agency regulates the charges for what most think of as traditional hospital care. This is referred to as "regulated" hospital revenue. But over time, additional costs have been incurred by Maryland's hospitals for which no payment is received through the rate-setting system. These costs, in large part, are the costs hospitals incur in hiring physicians, paying physicians to serve "on-call" in the Emergency Department, supporting community-based physician practices in working with hospitals to care for patients, and more. Because they are excluded from the rate-

setting system, this is referred to as “unregulated” revenue. Of concern is that Maryland hospitals’ margins are now declining in both areas – in both their “regulated” and “unregulated” revenues, meaning growing losses overall. While historically, losses have been incurred by hospitals for the physician-related costs they must incur without payment, the decline in operating margins since 2011 is the result of broader, rapid deterioration in margins for core hospital services – those that are regulated. Regulated margins have declined to 3.2 percent and unregulated margins are negative 24.4 percent, yielding an overall operating margin of 0.8 percent in the first two quarters of fiscal year 2013 (Figure 3).

Figure 3

Maryland “Regulated” vs. “Unregulated” Operating Margin



Source: FY 2009-2011 HSCRC Annual Financial Disclosures, FY 2012-2013 Monthly Unaudited Financial Reports

It is also important to note that there was no distinction made between regulated and unregulated margins when the HSCRC task force set its operating margin benchmark of 2.75 percent. Hospitals today are being asked to invest in new activities to ensure that patients are being treated efficiently and effectively: caring for short-stay patients in the outpatient, rather than the more

expensive inpatient setting; reducing the number of patients who are readmitted to the hospital within 30 days of their release; or reducing the use of Emergency Department care by making sure patient conditions are treated early in primary care physician offices. Changes like these require hospitals to ensure the availability of, and provide financial support for, local community physician practices. The losses incurred from these physician-support services must not be ignored in evaluating the financial health of Maryland’s hospitals.

4
years

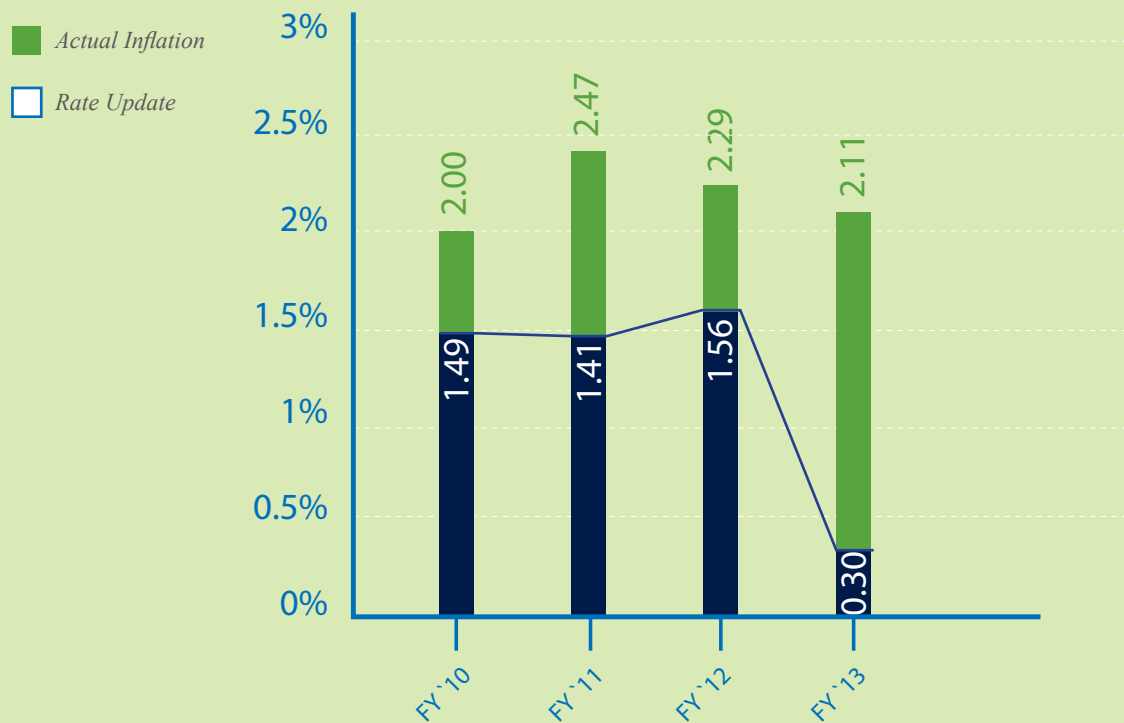
of below inflation
hospital rate increases

HOSPITAL RATE INCREASES HAVE BEEN WELL BELOW THE RATE OF INFLATION

One of the starting points for HSCRC decisions about appropriate hospital rate increases is the expected rate of increase in inflation – the increase in the prices of goods and services hospitals purchase and use to provide patient care. For the last four years, the HSCRC has approved hospital rate increases well below the rate of inflation, meaning that, since 2010, the increase in the prices hospitals are allowed to charge for services has not kept pace with the increase in the cost of those services. For fiscal year 2013, the HSCRC approved a rate increase of only 0.3 percent, despite the fact that inflation was expected to increase 2.11 percent for the same period (Figure 4).

Figure 4

Actual Inflation vs. Maryland Hospital Rate Update

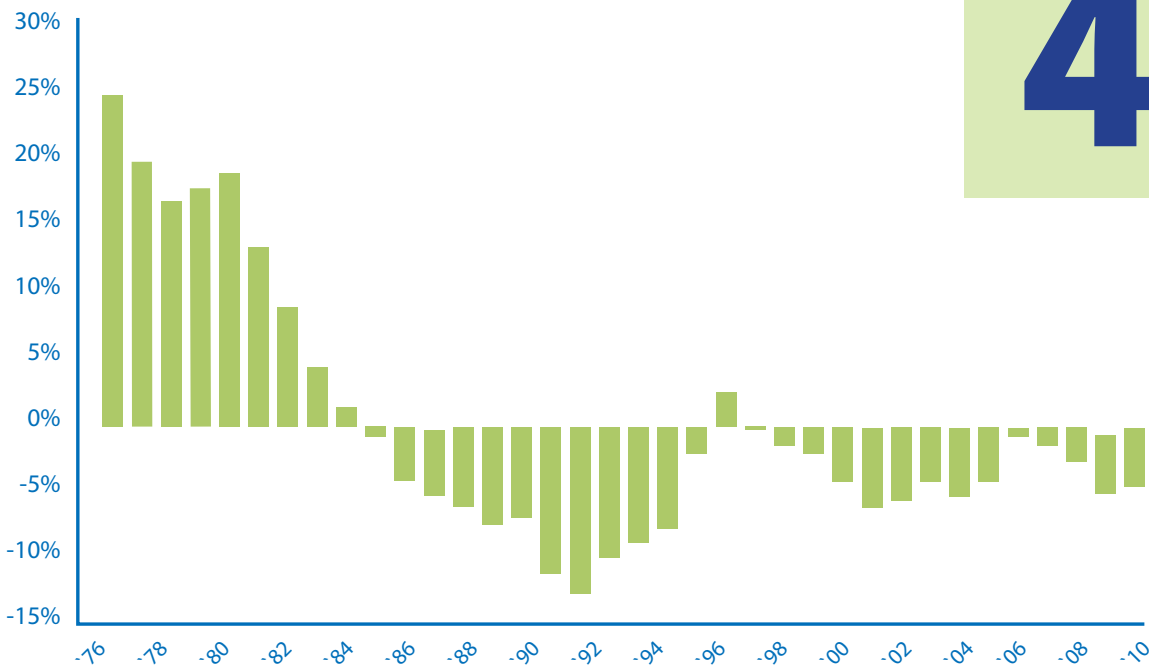


Source: Actual Inflation Data: IHS Global Insights; Rate Update: HSCRC Annual Update documents

To make ends meet, Maryland’s hospitals have had to cut back on spending for patient care, in an attempt to provide care at an even lower cost. In fact, Maryland’s hospitals have done just that, outstripping the nation in the cost of caring for patients. In 1976, the cost of caring for a hospitalized patient in Maryland was 25 percent higher than the national average cost. Using Maryland’s rate-setting system, the cost of that care has been reduced. Today, the cost of caring for a hospitalized patient in Maryland is 4 percent below the national average (Figure 5).

Figure 5

Cost Per Adjusted Admission: Maryland vs. Nation



The cost of caring for a hospitalized patient in Maryland is **4% below** the national average.

Source: Health Services Cost Review Commission

IMPLICATIONS

Maryland’s hospitals have been challenged to achieve stability in these circumstances; the stress is now evident in financial performance indicators and these historically low operating margins. Hospitals have made dramatic reductions to expenses in almost every area: supplies, materials, improved business operations, and delayed renovations. But less-than-inflation pricing cannot be sustained. The single largest expense for a hospital is the people they employ – the nurses, technicians and others who provide patient care. Less-than-inflationary increases mean less-than-inflationary pay increases for these employees. And as the largest private sector employer in Maryland, with nearly 100,000 workers, continued underfunding harms hospitals as well as the overall Maryland economy. If the overall outlook does not improve and resources continue to be cut, the next step will be a critical examination of jobs and service reductions. In setting reasonable rates in the state of Maryland, HSCRC policy decisions must take into consideration more carefully the seriously declining status of hospitals’ financial condition.



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