



August 24, 2018

CBS Assembly Members:

As you approach this very important decision point at your meeting the evening of August 28, we would like to recap the RFP process, and review some developments since our August 8 special report to you.

**SCH Affiliation RFP Process:**

The RFP process has allowed you to cast a wide net to determine the level of interest among health systems and other organizations in affiliating with Sitka Community Hospital. That was a significant unknown prior to embarking on this process. Although several health systems expressed an interest in maintaining clinical relationships with SCH, most were not in a position to meet the requests and commitments outlined in the RFP. Only one respondent came close to fully responding to the RFP and meeting the prioritized goals established by the Assembly, although two others presented interesting alternative pathways to consider.

The SCH Affiliation RFP process and timeline you articulated is as follows:

- Anticipated RFP release date: March 30, 2018
- Preliminary Intent to Respond: April 16, 2018
- Phase 1 due date for proposals: May 18, 2018
- Phase 2 notice date of selected proposers: June 6, 2018
- Phase 2 site visits: completed by July 13, 2018
- Phase 2 due date for expanded proposals: July 27, 2018
- Phase 2 oral presentation date: August 7, 2018
- **Phase 3 selection date of preferred proposer: August 28, 2018**

As you approach the completion of Phase 2 activities and move into Phase 3, you have had the opportunity to review written proposals from proposers; hear two of the proposers deliver oral presentations; ask clarifying questions about the proposals; receive a side-by-side comparison from your consultants as to how proposals address the Assembly's goals of affiliation; and gather substantive community feedback from a well-attended Town Hall session.

The CBS Assembly is now at a critical juncture. While the intent of the August 28 meeting is to choose a proposer to move into Phase 3 of the affiliation process—which includes negotiation of a non-binding letter of intent, due diligence efforts, and further negotiation of the terms of a definitive agreement—it is your discretion to reject all current proposals and continue to assume financial and operational responsibility for SCH. In doing so, you must face the real possibility that opportunities with similar terms may not be available to you in the future due to:

- The time, effort, and resources proposers have already committed to the process;
- The uncertainty of extending the process into October, when there will be a new CBS Assembly in place; and
- The volatile financial and operating performance of SCH.

In your fiduciary capacity as Assembly members, you must assess what's in the best interest of the City and Borough of Sitka. This means balancing the emotional pull of the desire for “business as usual” against making a decision that represents significant change for the community but promises to mitigate future risk to CBS and assure continuity of healthcare services in Sitka.

### **Subsequent Developments:**

Since our August 8, 2018 report to you, there have been additional developments. Some key “take-aways” from the August 13 oral presentations by Quorum and SEARHC, as well as the Town Hall meeting on August 20, are presented below:

#### *Quorum:*

- Quorum expressed concern as to the overall financial condition of SCH and its long-term financial viability as long as Sitka remains a two-hospital town
- Quorum noted SCH's low number of days of cash, significant capital needs for IT and imaging equipment, and the large PERS liability
- Quorum management offered to manage SCH but, in the event that another proposal was accepted, offered an alternative proposal to provide transition management until a successful transaction could be executed

#### *SEARHC:*

- SEARHC expressed its commitment to provide long-term healthcare to the community, as well as the opportunity to expand service offerings
- SEARHC's current proposal is stronger than those previously entertained by the CBS Assembly, as it clearly articulates SEARHC's desire to be responsive to the Assembly's goals and the interests of the community
- SEARHC acknowledged that there should be a level of accountability related to commitments that either party makes and expressed its willingness, through the negotiation process, to define such levels of accountability

#### *Town Hall Meeting:*

There was excellent participation by the community at the Town Hall last week, with a broad array of opinions expressed. Community members were asked to work in groups to discuss what they liked and disliked about each proposal, and to capture any additional questions. The group sessions were followed by an “open mic” time. Through both activities, participants raised thoughtful and meaningful ideas

about every proposal. A summary of group and individual comments has been provided separately to Assembly members.

### **Summary:**

The purpose of the RFP process was to identify affiliation partners that meet the goals and principles adopted by the Assembly related to the provision of healthcare and mitigation of short- and long-term financial risk to the City. The Assembly now has sufficient information to choose a partner who fulfills that purpose. We would encourage the Assembly to continue to adhere to the RFP process and select an organization to move to Phase 3 negotiations.

### *The Assessment of Status Quo*

As we laid out in our previous special report, the ability of SCH to achieve sustainable performance is highly unlikely, and the consequences of nonperformance are great and rest on the shoulders of CBS. To forego the opportunities that are before you to pursue a “wishful” status quo scenario exposes the City to significant liability that could otherwise be mitigated or transferred to a third party.

To reference the future of SCH as “wishful” may seem harsh and is in no way intended to disparage the very committed management team and employees that have made significant efforts to improve the performance of SCH and continue to provide the best possible care to the community. However, every consultant that has been engaged to evaluate the sustainability of SCH has either expressed a high degree of concern for its future as a competing hospital in a two-hospital town or has recommended considerable turn-around efforts that have since proven to be unattainable. Proposers to the current RFP have expressed similar concerns.

Community members have expressed concern about losing SCH and a lack of competition for healthcare in the Sitka community. This is not a new or unique issue in healthcare, as there is a long history across the U.S. of two-hospital communities that have had to make this decision. In most cases, these communities are being well-served and receiving outstanding care by the successor hospital. Sitka has the opportunity to have a similar experience.

As your consultants, we have taken a recent in-depth look at the financial condition of SCH. We have expressed our concerns in our report of August 8, 2018 but will highlight them below. Please refer to Appendix B of our report for further detail.

- *An objective comparison of SCH to Standard & Poor’s hospital viability index places the Hospital in the “highly vulnerable” category for every performance indicator.* Our prior report describes what would be necessary for the hospital to move to the “adequate” level of performance for each of the reported indicators. It is unlikely that SCH can ever be a viable organization if there are two hospitals operating in the City of Sitka.
- *The turn-around in operating performance necessary to achieve financial sustainability is highly unlikely.* Anything less than sustainable performance by SCH will place an additional financial burden on the City. Achieving the FY 2019 budget of SCH will require a \$2,200,000 turn-around from current performance. Although SCH has started its fiscal year off with a very strong July, it would require a similar level of performance for every ensuing month of the fiscal year to meet

budget. Historically, operations have been sporadic and unpredictable from month to month, and significant swings in volume are outside the control of management.

- *The cash position of SCH is extremely vulnerable.* As of the end of FY 2018, SCH held about \$3.3M or about 42 days of cash. Its current cash position is primarily the result of one-time benefits from cost report settlements, improvements in the collections of patient account receivable and the deferral of much needed equipment replacement. It is not the result of improved and sustainable operating performance.
- *FY 2019 will require the \$2,200,000 turn-around mentioned above just to break even on cash.* The additional commitment of capital to the Cerner EHR project of \$1,100,000 in FY 2019, plus an additional \$549,000 of operating expenses, limits the amount of cash available for other capital needs or to repay cost report settlements. Every dollar that the Hospital falls short of achieving break-even cashflow will need to be funded by CBS.
- *There is significant risk related to cost report settlements.* SCH currently has an outstanding liability to the Medicare program of \$600,000 that has not been factored in to future cashflow projections. Since SCH is highly dependent on cost reimbursement programs from both Medicare and Medicaid settlements, it has a high degree of risk related to uncertain cost report positions which could result in future liability. Any of these future potential liabilities could exhaust the Hospitals current cash reserves or create liability for the City.
- *Due to the recent capital and operating cost commitments to the Cerner EHR, other significant needs for capital have been deferred and will place greater pressure on future cash needs.* The total Cerner capital commitment exceeds \$5,000,000 over the next five years. The annual commitment to Cerner for capital far exceeds what SCH has spent on capital annually in the last several years. For the next five years, the Cerner project will consume most of the capital budget and other major capital needs will continue to go unmet.

All the risks outlined above should be carefully considered in determining future financial liability to the City. Given the hard work and commitment SCH management and staff have contributed toward turning SCH around and continuing to care for its patients, it's only natural that you would like to see them succeed and achieve long-term stability. However, the Assembly must assess the probability of success and the risk and exposure of failure—especially when it has a significant opportunity to limit and/or transfer significant components of risk through continuation of the RFP process.

We realize the decision before you is great. We are available to help you in any way we can to further explain the comments in our report or answer other questions you may have.

Regards,

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