The New Era of Healthcare for Hospital and Health System Capital Investment

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Going from physical to digital: Hospital and health system capital investments turn increasingly "soft" as the industry changes

By Helen Adamopoulos

As healthcare becomes more digital, data-driven and focused on value rather than volume, hospitals and health systems are directing an increasing share of their capital spending toward EHRs, analytics, population health management tools and other "soft" investments.

A recent *Becker's Hospital Review* survey of 29 healthcare organizations found 58.6 percent reported directing 20 percent or more of their capital spending toward soft investments, as opposed to traditional "hard" assets, such as equipment and buildings. Just over 10 percent of respondents said they spent more than $100 million on soft investments during the previous year. Additionally, 62 percent anticipated spending more on soft investments next year.

The rise of EHRs and population health management has made soft capital investments a major concern for healthcare leaders nationwide as they seek to find funding for new technology and quantify its returns. In an exclusive roundtable, five hospital and health system CFOs, one CAO and a healthcare finance expert discuss the rise of soft capital spending, the challenges and considerable costs of EHR installation and maintenance, and what the shifting state of capital investments means for bricks-and-mortar expenditures, among other issues.

The participants included Adam Anolik, CFO of Strong Memorial Hospital and Highland Hospital in Rochester, N.Y. (both part of University of Rochester Medicine); Katherine Arbuckle, senior vice president and CFO of St. Louis-based Ascension Health; Mark Bogen, senior vice president of finance and CFO of South Nassau Communities Hospital in Oceanside, N.Y.; David Ertel, CFO of Einstein Healthcare Network, based in Philadelphia; MJ Klimas, managing director at Banc of America Public Capital Corp; Matt Muhart, executive vice president and CAO of Memorial Healthcare System in Hollywood, Fla.; and Meredith Price, vice president of financial services and CFO of St. Joseph's Hospital Health Center in Syracuse, N.Y.

"Five years ago, even four years ago, we were at 10 percent..."

Katherine Arbuckle
Senior Vice President & CFO of St. Louis-based Ascension Health

Capital investment turns soft with the rise of EHRs

When asked how health IT and other soft investments have changed as a portion of their capital spending during the past five to 10 years, all of the CFOs said the amount they spend on technology has increased significantly with the installation of EHR systems. For instance, Mr. Muhart said Memorial Healthcare's historical IT spending level was in the range of 10 to 20 percent of all capital spending but rose to 30 percent during the system's EHR installation.

South Nassau has experienced the same trend, according to Mr. Bogen. From 2004 through 2009, the hospital spent an average of about 5 to 7 percent of its capital spending on soft investments. However, that number rose dramatically when the facility undertook its EHR installation. "We're now averaging, the last five years, about 18 to 20 percent of our capital dollars being invested in the soft capital world," he said.

Ascension has also seen its IT spending skyrocket with the advent of electronic records. "Five years ago, even four years ago, we were at 10 percent of our capital spending on IT," Ms. Arbuckle said. "We're now running at 22 percent."

Health IT and the need for continual investment

"As soon as you think, I've got this, I've got that, I've got everything..."

Mark Bogen
Senior Vice President of Finance & CFO of South Nassau Communities Hospital in Oceanside, N.Y.

The CFOs also said they don't expect soft capital spending to stop climbing anytime soon, as their organizations strive to keep their electronic systems up-to-date and adopt new tools to help with population health management. Ms. Price, for example, said St. Joseph's has seen growth in its soft investment spending including a recent go live with its electronic records system. She also anticipates IT spending will remain high going forward due to necessary updates and enhancements to the EHR system, as well as investments in analytical capabilities, data warehousing and other technologies.

"There's so much out there to look forward to in IT, so I definitely think the landscape has changed significantly with investments being made there," she said. "Investment in IT is something we'll continue to be focusing on."

At Einstein Health Network, Mr. Ertel reported the same trend. IT spending spiked from 20 percent to 40 percent with EHR implementation, and he predicts the percentage will remain high going forward: "It's going to be potentially heightened a little bit from that 20 percent to 25 to 30 percent."

Likewise, with the "care and feeding" required post-implementation for the new records system, Mr. Muhart said his health system's soft spending level "will probably be in the 15 to 20 percent range" going forward, and Ms. Arbuckle doesn't see Ascension's dipping below 25 in the next few years. Similarly, at Strong Memorial and Highland, Mr. Anolik said he expects spending on soft investments to remain high — in the 20 to 25 percent range — as the hospitals overhaul their revenue cycle in the wake of implementing an EHR system on the clinical side.

"It's going to be potentially heightened..."

David Ertel
CFO of Einstein Healthcare Network, based in Philadelphia

Mr. Bogen, citing the need to continually invest in security systems and other structures, called EHRs "the single biggest black hole in the face of the healthcare world."

"As soon as you think, I've got this, I've got that, I've got everything…something else comes up," he said. "You need another module. You need another enhancement. It's really a money pit."

From coast to coast, healthcare providers are experiencing the same patterns of increasing IT costs that seem on track to remain high going forward, according to Ms. Klimas. EHR expenditures have proved "all-consuming" for her clients, and most anticipate another wave of essential technology related to data analytics and population health, she said: "That wave is going to break, and the result is going to be an ongoing increase in spending."

How health IT costs affect brick and mortar spending

Hard investments still account for most of the capital budget at many healthcare organizations: Of the providers Becker's surveyed, nearly 49 percent reported directing more than 50 percent of their capital spending toward traditional capital investments during the past year. But the growing need to invest in soft resources such as IT systems means traditional, bricks-and-mortar assets get a smaller share of the capital budget. Subsequently, some hospitals and health systems are cutting back on their spending on buildings and equipment — or face a difficult choice between spending on hard and soft priorities.

At South Nassau, Mr. Bogen said he plans to fund necessary building rehabilitation and renovations through a Federal Emergency Management Agency claim filed on behalf of Long Beach (N.Y.) Medical Center, which South Nassau acquired earlier this year. LBMC had been closed since October 2012 due to heavy flooding damage from Hurricane Sandy. However, without the funds from LBMC's claim, he said he would face a difficult choice: "Without these FEMA dollars, I would really be facing dilemmas about which poison to pick when there are so many competing priorities."

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Meredith Price
Vice President of Financial Services & CFO of St. Joseph's Hospital Health Center in Syracuse, N.Y.

Others are hoping to simply hold off for a while on any renovations or construction. Memorial Healthcare, for example, is done with most of its hard asset capital work for now, according to Mr. Muhart. "Going forward …unless there's a dramatic change in population that's putting demand on adding bed capacity, I think we're done for a little while with heavy bricks-and-mortar costs," he said.

However, the system will always have equipment-related costs, and "it's not exciting seeing a larger percentage of your capital budget being consumed by something that I think no legitimate CFO is going to put an ROI calculation behind," Mr. Muhart said.

"Going forward...unless there's a dramatic change in population..."

Matt Muhart
Executive Vice President & CAO of Memorial Healthcare System in Hollywood, Fla.

The challenging quest to quantify returns

In addition to balancing hard and soft spending needs, the difficulty of calculating return on investment came up during the discussion as another significant challenge for CFOs managing the increase in IT spending. "We love bricks-and-mortar projects because you can start with a baseline volume, and you can project based on demand," Mr. Muhart said. "Ultimately, if there is an ROI on the EHR, it's the opportunity to leverage the EHR to improve clinical outcomes for our patients. The digitization of the rich data being captured by the EHR can be mined to identify opportunities for improving care and efficiency, however, hospitals will need to make additional investments in business intelligence systems and infrastructure to fully realize the opportunities.

Strong Memorial and Highland actually did calculate an ROI for their EHR implementation to present to board members, based on expected costs and savings — and it wasn't positive, according to Mr. Anolik. However, they "clearly indicated it was for patient care, safety, those sorts of reasons," he said. "It was not just for dollars or cents… you've got to build in some of those indirect benefits."

St. Joseph's has tackled the ROI issue by forming multidisciplinary benefits realization teams, according to Ms. Price. These groups are working on six main projects to determine how the hospital can use its EHR system to achieve savings and create opportunities. One team, for instance, is focusing on reducing length of stay, while the other is delving into population health efforts. "They're…coming up with what's the measurement and how we're going to equate that to dollars that we're actually saving," she said. "I do feel fairly confident, with the information that's in the system, that we will be able to quantify those."

> **"It was not just for dollars or cents..."**
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> Adam Anolik
> CFO of Strong Memorial Hospital and Highland Hospital in Rochester, N.Y. (both part of University of Rochester Medicine)

At South Nassau, Mr. Bogen believes the greatest value that comes from electronic records is identifying, measuring and correcting variability in costs. However, his efforts to quantify that value are still in their infancy. "I've shied away from discussing it either at the senior management level or at the board level about any concrete ROI," he said, and indicated he won't discuss the ROI in those arenas until he's comfortable in his ability to identify the returns of reducing variability.

IT investments make financial leaders in the healthcare industry uncomfortable because it's hard to see the quantifiable, solid returns, according to Ms. Arbuckle of Ascension. Her system doesn't track specific returns on its EHR, although there are 27 metrics in place to track whether clinicians and operators are making use of the system (e.g., through medical alerts). She agrees there is definitely value in soft investments, particularly concerning reduction in care variations — but translating that benefit into numbers seems out of reach: "How well are we able to capture that and quantify it as a return? I'd say our ability is limited."

Finding the funds for soft investments: Debt versus cash

As they tackle the challenges of implementing and maintaining the technologies necessary to thrive in the new healthcare landscape, hospital and health system leaders must also decide how to finance their growing soft investments. Of the 29 hospitals and health system finan-

cial leaders who responded to the Becker's survey, 65.5 percent said they haven't taken on debt to finance a soft capital investment, and 58.6 percent said they wouldn't do so.

The CFOs that participated in the roundtable reported a mix of financing approaches. For example, Ms. Price said St. Joseph's opted for public financing for its $50 million Epic and EHR system implementation project. "It is important to have well thought out plans surrounding the decision to finance these investments," she said. "We were able to use a combination of taxable and tax exempt bonds for the project. The other critical thing is having ongoing discussions with your tax attorneys" to define the life and costs of the hardware.

While South Nassau has tended to self-finance everything, Mr. Bogen felt his hospital's cash, at the time, was tied up in its defined benefit plan, and there just wasn't enough to finance the EHR system. "Because of all of these competing short-term cash calls, I wasn't able to finance it as we have historically done," he said. Therefore, South Nassau ended up choosing a medium term capital credit product outside of the Master Trust Indenture (MTI).

Others, however, chose cash instead of debt. Mr. Ertel said Einstein Healthcare was "at the other end of the spectrum" compared with South Nassau and St. Joseph's in that it financed its EHR out of cash on hand. Ascension did the same, according to Ms. Arbuckle.

> **"A lot of our providers are taking...a look at their recent [capital] spending, to see if there's a way they can monetize [these assets] to put some cash back on the balance sheet."**
>
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Because of the relatively short lifespan of IT systems, Strong Memorial and Highland chose the cash route as well, partly because the hospitals have had to reinvest in bricks and mortar at the same time that they implemented new technology, Mr. Anolik said: "We've always elected to not finance any of the soft investments through debt here."

Ms. Klimas said the CFOs' answers provided a "perfect representation" of what she has observed across the country. However, Ms. Klimas stated medium term, amortizing credit alternatives are becoming an increasingly appealing source of capital for soft investments, since borrowers can monetize cash payments they made at some point in the past. "For taxable financing of your EHR, you can go back months or maybe years," she said, adding that the process can lead to a bump in days cash on hand. "A lot of clients are seeing that having additional cash on the balance sheet is a very attractive end position."

Conclusion

Ultimately, the need for soft assets that will facilitate population health management and help providers thrive in a rapidly changing industry isn't going away anytime soon, according to Ms. Klimas. Although hospital and health system financial leaders face significant challenges in prioritizing hard and soft capital projects and quantifying returns, they can also find ways to turn rising IT investments into fiscal strength. "These hits associated with health information technology and EHRs will just keep coming," she said. "A lot of our providers are taking advantage of this opportunity to take a look at their recent [capital] spending, to see if there's a way they can monetize [these assets] to put some cash back on the balance sheet." ■