

January 30, 2018

The Honorable County Judge Ed Emmett  
Commissioner Rodney Ellis, Precinct 1  
Commissioner Jack Morman, Precinct 2  
Commissioner Steve Radack, Precinct 3  
Commissioner Jack Cagle, Precinct 4

**RE: Harris County Hospital District dba Harris Health System Fiscal Year 2019 Operating and Capital Budgets**

Dear Judge Emmett and Commissioners:

The attached document contains an Executive Summary of the background and assumptions supporting the proposed Fiscal Year 2019 Operating and Capital Budgets for Harris Health System, as well as the summary financial schedules referenced in the index. The narrative provides an overview of Harris Health's plan to maintain and improve access to healthcare services for the County's indigent population. While the health care environment at the national and state levels is still uncertain, we do not expect any significant changes occurring within the next twelve months that would impact Harris Health System's current operations.

We expect the number of individuals who receive patient care from our System to remain stable for FY 2019. The demand for services by the uninsured population of Harris County, coupled with inflationary pressures, will continue to challenge our existing capacity and available resources. Based upon our assumptions regarding revenue and service projections, we are anticipating an operating margin of \$24.3 million, which is 1.6 percent of total projected revenues, for the FY 2019 Budget. The proposed capital budget of \$77.5 million does not include the Ben Taub Operating Room and Trauma project, which is funded separately by the \$62.8 million of Certificates of Obligation issued in 2016. Management projects a stable cash flow performance for FY 2019 and maintenance of the required Days Cash on Hand under the Harris Health System revenue bond covenants.

Please contact me should you have any questions or need additional information.

Sincerely,



George Masi, President & CEO  
Harris County Hospital District d/b/a Harris Health System

**HARRIS HEALTH SYSTEM**

**Fiscal Year 2019 Operating and Capital Budget**

**Harris County Commissioners Court Meeting**

**February 13, 2018**

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# Harris Health System

## FY 2019 Operating & Capital Budget

### Executive Summary

#### **Introduction**

The proposed Fiscal Year 2019 Operating and Capital Budget for Harris Health System continues the focus on improving our community's health by delivering high quality healthcare to Harris County residents, maintaining financial strength to ensure our ability to serve our patients, and positioning Harris Health to succeed in an uncertain healthcare environment. The core purpose of Harris Health is to provide healthcare for Harris County's indigent population.

Concerning the expected payer mix for FY 2019, 59 percent of services will be provided to the uninsured; 20 percent to Medicaid patients, and 9 percent to low income Medicare patients. The remaining 12 percent of funded services will come from commercial insurance, as lower income patients obtain coverage through the federal health insurance exchange, automobile liens, Crime Victim and other state and local agency funds and workers compensation. Breaking down the Harris Health System patients served by citizenship, based on the historical average of data for the past three years, 60 percent of services are provided to U.S. citizens, 15 percent to legal immigrants and the remaining 25 percent to undocumented residents of Harris County.

The demand for services by the uninsured population of Harris County continues to challenge existing capacity and resources. Harris Health System has implemented several service enhancement strategies over the past several years, increasing access to primary and specialty care for the indigent. However, because increases in resources are barely keeping pace with increasing costs (the impact of inflation is about \$40 - \$50 million annually), the overall volume in FY 2019 is projected to be roughly the same. Although growth in revenue from patient services is expected, primarily due to an increase in Medicare Disproportionate Share add-on payments, the increase will only be enough to offset expected increases in labor, supplies and services costs, and the planned reductions in Medicaid Supplemental Payments. Thus, with few net incremental resources available, no additional growth in volume or services is expected in FY 2019.

#### **Health Insurance Marketplace Initiatives and Health Reform**

Effective March 1, 2016, Harris Health modified the Financial Assistance Program by reducing the income eligibility for free care from 200 percent of the federal poverty level (FPL) to 150 percent. The change was made to encourage all patients with income over 150 percent of the FPL to participate in the federally subsidized insurance

exchange, to improve the patient payer mix. Harris Health worked diligently with those patients impacted by the decision, assisting with Marketplace enrollment for those who were eligible.

The Commercial Insurance payer mix has steadily increased for Harris Health System, as patients eligible for the marketplace have obtained insurance. Most of those continue to receive their care at Harris Health. Prior to the Affordable Care Act (ACA), commercial volume was only 1.9 percent of total services provided. That number rose to 2.9 percent in the first year that marketplace insurance was available in calendar 2014, then to 4.1 percent in 2015, and 5.8 percent of total services in 2016.

In October 2016, Harris Health received approval from the Board of Trustees to sponsor a program subsidizing Marketplace coverage for patients who have established eligibility for indigent care services from Harris Health (residents of Harris County, not insured, with income under 150 percent FPL) who also meet the qualifications for Marketplace insurance coverage. Harris Health enrolled and sponsored almost 4,000 patients during calendar 2017, who continued to receive their care at Harris Health. The commercial payer mix for the current Fiscal Year 2018 rose to 6.9 percent of total services.

During the most recent enrollment period for calendar 2018 (which correlates with Harris Health's budget for Fiscal Year 2019), approximately 10,000 patients are being enrolled and sponsored, an increase of over 6,000 from the prior year. The expected reimbursement impact (budgeted) for FY 2019 is \$13.3 million in incremental Net Patient Revenue related to the increased enrollment.

While the ACA suffered some destabilization in Congress last year, "repeal and replace" did not occur. It appears that there will be a continuation period for the current version of the Marketplace, hopefully with minimal disruption to millions of currently insured individuals who would be adversely affected by significant, abrupt changes. Therefore, the current assumption regarding the Marketplace for Harris Health System's FY 2019 budget is that coverage and reimbursement will be stable.

### **Summary of the Texas Medicaid 1115 Waiver**

The Centers for Medicare and Medicaid Services (CMS) approved a five year renewal of the Section 1115 Waiver for the Texas Medicaid program on December 21, 2017. The renewal period began October 1, 2017 and runs through September 30, 2022. For the first two years of the renewal period, the Uncompensated Care (UC) and Delivery System Reform Incentive Payment (DSRIP) pools will remain constant at \$3.1 billion per year for each pool, although the dollars could shrink if certain conditions are not met.

Distributions from the Uncompensated Care (UC) pool are based on each hospital's documented costs, and are subject to the statewide annual cap placed on the total available UC pool dollars under the terms of the Waiver. The net UC distribution for Harris Health for FFY 2018 is projected to be \$91 million. The UC revenues for future years should be relatively stable through the end of the Waiver term.

The DSRIP pool makes incentive payments associated with plans for transforming healthcare systems to improve clients' experience, increase quality and better manage costs in Medicaid and indigent programs. The incentive payments will no longer be tied to projects, but will be dependent on maintaining and/or achieving improvements in quality and outcomes performance metrics.

Harris Health recorded \$19.3 million in July 2017 for net DSRIP revenue related to the interim report for the sixth year of the Waiver. An additional \$52.3 million is expected to be recorded in January 2018 for the final DSRIP report for DY 6. Payments for future years will occur after each semiannual report required under the DSRIP program. It is expected that net revenue for future years will decline as it becomes more difficult to show continuing improvement in quality and performance measures.

### **Significant Activities and Events in FY 2018**

The flooding that followed Hurricane Harvey substantially impacted health system operations during the last week of August 2017, with some ongoing impact on the availability of inpatient beds at LBJ Hospital. Following remediation work related to water intrusion on several inpatient nursing units, all beds were back in service by the end of October 2017. As a result of the temporary bed closures, inpatient volume was lower than budgeted for that time period. In addition, Monroe Clinic, a primary care site, was flooded, but will be reopening in early 2018. Primary care clinic visits were also lower during FY 2018 as a result of the immediate impact of Harvey, as well as the Monroe clinic closure.

The Ben Taub OR project is in the midst of the operating room construction phase. The \$70 million project provides the necessary expansion of operative suites and supporting services on the second floor to support Level 1 trauma services at Ben Taub Hospital. Construction, which was funded by a 2016 bond issue, is going well and is expected to be completed in early calendar 2019.

### **Harris Health System Budget – FY 2019 (March 2018 to February 2019)**

The proposed annual Operating Budget for the fiscal year ending February 28, 2019 builds on the baseline performance of FY 2018, adding in the impact of inflationary

adjustments for salaries, supplies and services. The proposed budgeted operating margin for FY 2019 is \$24.3 million. Harris Health will remain focused on performance improvement initiatives, in the ongoing effort to manage operations and strive for a 2 percent margin target, to be able to reinvest in the infrastructure of the system.

The Harris Health System budget excludes the operating results for the Community Health Choice HMOs (Community Health Choice Texas, Inc. – the Medicaid Managed Care HMO; and Community Health Choice, Inc. – the Health Insurance Marketplace and commercial HMO) and the Harris County Hospital District Foundation.

### **Expected Patient Volumes for FY 2019**

Overall volume for Harris Health System has been relatively stable for the past two years, except for the dip in volume during Hurricane Harvey and the subsequent flooding, and is expected to remain stable for the upcoming Fiscal Year 2019 for all services but the primary care clinics.

Primary care clinic visits have declined from 901,962 in FY 2017 to a projected 851,407 in FY 2018. In addition to the impact from Harvey, there has been a large reduction in the number of outpatient visits by undocumented patients. Data for the first ten months of FY 2018 shows a 9.5 percent reduction from prior year, possibly due to the heightened fear of deportation. The expanded number of Federally Qualified Health Centers (FQHCs) also seems to be easing the demand for primary care services at Harris Health, although we do not have any specific data related to patients who may be utilizing an FQHC that may be more convenient. Budgeted visits are expected to continue to decrease to 821,588 in Fiscal Year 2019, following a reduction in the number of expected dental visits within the Harris Health System, with the expectation that some of the current dental volume will shift to the FQHCs in the community.

Harris Health is expecting a 1.7 percent increase in specialty clinic visits in Fiscal 2019, rising to 325,821 from the projected FY 2018 visits of 322,521. Resources are being reallocated to specialty care services to begin to address some of the longer wait times for certain specialty appointments.

Total combined emergency room volume for the Ben Taub Level 1 emergency center (Ben Taub is one of only two Level 1 trauma centers in Harris County), and the LBJ Level 3 emergency center (currently the busiest Level 3 center in the country) is projected to be 159,366 visits for FY 2018, down over 5,000 visits from the prior year, primarily due to the slowdown during Harvey. Budgeted volume for FY 2019 is expected to grow to 164,385 visits, returning to about the same level as FY 2017.

The total FY 2018 surgical cases are projected to be 23,265; again down slightly from the prior year due to Harvey. The budgeted volume for FY 2019 is 23,849 surgical cases – roughly the same as the FY 2017 volume (pre-Harvey). The new operating rooms being added at Ben Taub will not be completed until the beginning of calendar 2019.

Total outpatient visits are budgeted to decline slightly (mirroring the drop in primary care visits) to approximately 1.81 million for FY 2019; the projection for FY 2018 is 1.84 million total outpatient visits.

The total inpatient discharges plus outpatient observation cases decreased in FY 2018 from the prior year, as did patient days, due partially to the Harvey impact, as well as the near completion of the conversion of four bed wards to semi-private rooms. Total patient days and average daily census for FY 2019 are budgeted to be slightly higher – 4.9 percent more than FY 2018 – increasing from 206,022 to 216,179. The number of available inpatient beds will remain stable in FY 2019, and the effect of Hurricane Harvey is not expected to recur.

Budgeted births of 5,494 for FY 2019 are virtually the same as the 5,440 births projected for FY 2018.

## **Revenues**

Payer mix is expected to improve in FY 2019, as more patients enroll in Marketplace insurance as a result of the decision made last year to subsidize coverage for patients who have established eligibility for indigent care services from Harris Health. Net Patient Revenue is budgeted to grow from a projected \$399.0 million for FY 2018, to \$496.3 million in FY 2019, an increase of 24.4 percent. The increase is primarily due to a \$52 million increase in Medicare Disproportionate Share (DSH) add-on payments, as the federal government has modified the Medicare DSH allocation formula to recognize all uncompensated care provided by hospitals. Other factors include (1) an expected \$13 million increase from reimbursement for services provided to patients newly enrolled in Marketplace insurance, (2) a net increase of \$11 million related to the addition of a new Medicaid Supplemental Payment program – the Uniform Hospital Rate Increase Program (UHRIP), for which Harris Health will provide intergovernmental transfers (IGTs) to the state to draw down federal matching funds to enhance payments for services provided to Medicaid patients, and (4) miscellaneous other improvements in revenue cycle processes and reimbursement.

The calculated Medicaid DSH/UC revenue for FY 2019 of \$138.0 million is based on the latest published rules by Texas Health and Human Services Commission (HHSC), and the most recent distribution trends in the Medicaid DSH and UC pools. This estimate

represents a decline from the forecast of \$157.0 million for FY 2018. While the federal funding for Medicaid DSH is projected to decline in accordance with ACA regulations, the expected change – which means about \$10 million less for Harris Health – has a slim chance of being delayed by Congress early in 2018.

The FY 2019 estimate of \$50.8 million for net DSRIP revenue is based on the expected achievement of the new quality and performance based metrics for Demonstration Year (DY) 7 – October 2017 through September 2018 – the first year of the five year renewal term. Net DSRIP revenue is equal to the projected attained metric value, less intergovernmental transfers (IGTs) required to draw down the federal matching funds, less IGTs required to support private hospital projects that Harris Health has agreed to sponsor. The FY 2019 budget reflects a reduction of almost \$21 million from the FY 2018 net DSRIP revenue of \$71.6 million (the final DY 5 and DY 6 payments related to the project based DSRIP metrics of the original waiver).

Other Revenue budgeted for FY 2019 is expected to be \$71.5 million, a slight decrease from the FY 2018 projected amount of \$73.5 million; however no significant changes are expected in any of the major components. The largest part, the Network Access Improvement Program (NAIP), another Medicaid Supplemental Payment program, should be stable at about \$23 million, while the annual Tobacco Settlement revenue is projected to remain at roughly \$13 million.

Ad valorem tax revenues are budgeted to be \$713.6 million in FY 2019, compared to the current year projected amount of \$706.6 million. The increase reflects a small net increase in Harris County property values, after netting out the lost property values related to Hurricane Harvey and the subsequent flooding, utilizing the current tax rate of 17.000 cents per \$100 of property valuation for maintenance of operations.

The total Harris Health System revenue budget for FY 2019 is \$1.470 billion, an increase of about \$62.5 million, or 4.4 percent, from the projected FY 2018 revenues. The increase is attributable to the expected increase in Net Patient Service revenues, offset by the decline in DSH, UC and DSRIP payments.

## **Expenses**

Total Harris Health System expenses are expected to increase by a net 3.3 percent in Fiscal Year 2019, as the impact of inflationary increases in compensation, benefits and other expenses are partially mitigated by ongoing performance improvement initiatives, and a modification of the post-employment health benefit structure reduces the actuarial expense of the program in FY 2019 by about \$30 million.



Salaries are budgeted to increase by 4.2 percent in FY 2019 from FY 2018 projected expense. A targeted salary increase program of 3.0 percent, and a market adjustment pool have been included in the budget to keep up with the most recent movement in salaries for the healthcare industry. Turnover in FY 2018 has stabilized within industry norms, as compensation for key healthcare positions stays in line with the market. Total Full-time Equivalent (FTE) positions are projected to remain constant. Overtime and contract labor are also budgeted to remain relatively stable in FY 2019.

With the exception of Post-employment Health Benefits, employee benefit costs are budgeted to increase about 5.4 percent in FY 2019, primarily driven by projected increases in employee health claims costs. While 2018 claims have been lower than expected, we believe that FY 2019 claims will be more in line with longer term trends.

The required implementation of the new Government Accounting Standards Board (GASB) Statement 75 for post-employment benefits would result in an annual actuarial expense increase from \$58 million in FY 2018 to almost \$80 million in FY 2019, if there were no changes to the policy design. In an attempt to address that rapidly increasing funding obligation, Management is recommending a modification of the existing Retiree Healthcare Policy to better align Harris Health System's retiree benefits with industry benchmarks and be more financially sustainable for the organization from a short- and long-term perspective.

Harris Health's benefits consulting firm (Alliant Insurance Services) and actuarial firm (BPS&M) have provided guidance to Management in the development of a three-phase Retiree Healthcare Strategy, as summarized below:

Phase 1 – March 1, 2018 Elimination of Retiree Healthcare plan offerings for new hires and any current employees not in full time status as of March 1, 2018.

Phase 2 – January 1, 2019 Implementation of Medicare Advantage Plans for Post-65 Retirees and Medicare primary Disabled Pre-65 Retirees and Retiree Disabled Dependents.

Phase 3 – no later than January 1, 2023 Move to an employer funded Health Reimbursement Account (HRA) for all Retirees and their eligible dependents, which will allow Retirees freedom of choice to select healthcare through the Marketplace, through private policies, or Medicare/Medicaid coverage that best meets their individual needs.

The net result of the policy change will be to maintain the post-employment health benefit for all current employees, while reducing the actuarial risk for Harris Health; in the process, reducing the annual expense to \$27 million for Fiscal Year 2019.

Supply expense is budgeted to increase 5.3 percent in FY 2019 due to inflation, particularly in pharmaceutical costs, from a projected \$205.2 million in FY 2018 to budgeted expense of \$216.1 million in FY 2019.

The Medicaid Services IGT and Physician Services Expenses are budgeted to increase to \$245.8 million in FY 2019, up from the FY 2018 projected amount of \$227.9 million. About \$9 million of the increase is due to the reassignment of certain provider expenses back to Harris Health System from Harris County Clinical Services, Inc. during FY 2018. The key assumption facilitating the relative stability in the IGT cost is that the current financing of the private hospital Uncompensated Care program will be extended beyond Federal Fiscal Year 2018 (September 2018). If that assumption does not hold true, Harris Health's cost for this category could increase by as much as \$63 million for FY 2019 and beyond. In the event that should occur, Harris Health would prepare and submit a budget amendment based on the revised assumptions.

Purchased services are budgeted to increase from a projected \$125.4 million in FY 2018 to \$138.8 million in FY 2019, maintaining the current cost infrastructure with some inflationary impact, as well as planning for the incremental premium subsidies related to the incremental Marketplace enrollment of eligible Harris health patients.

Depreciation and interest expense for FY 2019 is budgeted at \$66.0 million for FY 2019, which is a small increase from the projected cost of \$63.8 million for FY 2018. No other significant changes are anticipated in the capital infrastructure during FY 2019.

Total operating expenses for Harris Health are budgeted to increase from the projected \$1.400 billion in FY 2018, to \$1.446 billion for FY 2019, an increase of \$46.4 million or 3.3 percent.

The result is a budgeted net operating margin of \$24.3 million, or 1.6 percent, for FY 2019, compared to the projected margin of \$8.1 million, or 0.6 percent, for FY 2018. Analysis of cash flow for FY 2019, including the proposed capital budget expenditures discussed below, reflects a stable cash flow performance for the year, maintaining the minimum required days cash on hand for Harris Health's Letter of Credit covenants.

Community Health Choice, Inc. and Community Health Choice Texas, Inc., Harris Health's wholly owned Marketplace and Medicaid HMOs, are currently projecting a combined margin of \$19.0 million on total premium revenue of \$1.65 billion for its calendar year 2018 budget, along with \$5.8 million of budgeted capital expenditures. Those figures are not included in the Harris Health System budget.

## **Capital Expenditures**

For the FY 2019 Capital Budget, Harris Health is continuously assessing its facilities, equipment and technology to determine the priorities for replacement, repair and any new acquisitions. The ongoing quarterly process includes representatives of the medical staff from both Baylor College of Medicine and UT Health. The assessment and prioritization process addresses patient safety, obsolescence, new technology, building safety and code compliance requirements. The capital budget recommendation is \$77.5 million for FY 2019, about 143 percent of the prior year depreciation of \$54.0 million.

## **Conclusion**

Together, the Fiscal Year 2019 Operating Budget and the Fiscal Year 2019 Capital Budget represent Harris Health's dedication to continuing to improve the health status of the residents of Harris County. The increased cost of maintaining services will be partially mitigated by management efforts to increase efficiency and productivity, and reduce expenses, through performance improvement initiatives. The proposed budget will allow Harris Health System to continue to fulfill the mission of providing high quality healthcare for Harris County residents.

**HARRIS HEALTH SYSTEM**  
**Statement of Revenues and Expenses**  
**Fiscal 2019 Proposed Budget**

	Actual	Projected	Budget
Revenue (\$ in millions):	FY 2017	FY 2018	FY 2019
1. Net Patient Service Revenue	\$ 390.8	\$ 399.0	\$ 496.3
2. DSH/Uncompensated Care	160.8	157.0	138.0
3. Other Operating Revenue	52.1	52.9	55.0
4. Total Operating Revenue	<u>603.7</u>	<u>608.9</u>	<u>689.2</u>
5. Net Ad Valorem Tax Revenue	698.8	706.6	713.6
6. Net DSRIP Revenue	46.4	71.6	50.8
7. Net Tobacco Settlement Revenue	7.8	13.4	10.7
8. Interest Income & Other	6.3	7.2	5.8
9. Total Nonoperating Revenue	<u>759.4</u>	<u>798.8</u>	<u>781.0</u>
10. Total Net Revenue	<u>\$ 1,363.0</u>	<u>\$ 1,407.7</u>	<u>\$ 1,470.2</u>
Expense (\$ in millions):			
11. Salaries and Wages	\$ 519.6	\$ 555.1	\$ 578.2
12. Employee Benefits	210.1	222.3	201.0
13. Total Labor Cost	729.7	777.4	779.2
14. Supplies	202.7	205.2	216.1
15. Medicaid Services IGT/Physician Services	215.9	227.9	245.8
16. Purchased Services	121.0	125.4	138.8
17. Depreciation, Amortization & Interest	69.2	63.8	66.0
18. Total Operating Expenses	<u>1,338.5</u>	<u>1,399.6</u>	<u>1,446.0</u>
19. Operating Income (Loss)	<u>\$ 24.5</u>	<u>\$ 8.1</u>	<u>\$ 24.3</u>
20. Total Margin	1.8%	0.6%	1.6%

**HARRIS HEALTH SYSTEM**  
**Statistical Highlights**  
**Fiscal 2019 Proposed Budget**

Volume:	Actual FY 2017	Projected FY 2018	Budget FY 2019
1. Primary Care Clinic Visits	903,458	853,114	821,588
2. Specialty Clinic Visits	322,510	320,521	325,821
3. Total Clinic Visits	<u>1,225,968</u>	<u>1,173,635</u>	<u>1,147,409</u>
4. Total Emergency Room Visits	165,281	159,366	164,385
5. Total Surgery Cases	23,814	23,265	23,849
6. Total Outpatient Visits	1,900,096	1,842,268	1,808,903
7. Births	5,988	5,440	5,494
8. Inpatient Cases (Discharges)	33,510	31,593	34,055
9. Outpatient Observation Cases	<u>14,199</u>	<u>13,540</u>	<u>14,240</u>
10. Total Cases Occupying Patient Beds	<u>47,709</u>	<u>45,133</u>	<u>48,295</u>
11. Inpatient Days	185,467	176,910	185,536
12. Outpatient Observation Days	<u>27,626</u>	<u>29,112</u>	<u>30,643</u>
13. Total Patient Days	<u>213,093</u>	<u>206,022</u>	<u>216,179</u>
14. Average Daily Census - Harris Health	583.8	564.4	592.3
<b>15. Payor Mix (% of Charges):</b>			
16. Charity & Self Pay	60.1%	60.7%	58.7%
17. Medicaid & Medicaid Managed	20.6%	20.2%	20.2%
18. Other Third Party Payers	19.2%	19.2%	21.2%

**HARRIS HEALTH SYSTEM**  
**Capital Budget Summary**  
**Fiscal 2019 Proposed Budget**  
**(\$ in millions)**

<b>Category Totals</b>	<b><u>FY 2019</u></b> <b><u>Budget</u></b>
Facility Projects	\$ 28.4
Information Technology	\$ 20.9
Medical Equipment	\$ 23.5
Capital Lease, Other	\$ 1.7
Emergency Capital	<u>\$ 3.0</u>
<b>Total FY2017 Capital Budget</b>	<b><u><u>\$ 77.5</u></u></b>