

# **HARRIS HEALTH SYSTEM**

## **Special Called Board Meeting**

### **Fiscal Year 2021 Operating and Capital Budget**

**January 9, 2020**

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# **Harris Health System FY 2021 Operating & Capital Budget Executive Summary**

## **Harris Health System Budget – Fiscal Year 2021 (March 2020 to February 2021)**

The proposed Fiscal Year 2021 Operating and Capital Budget for Harris Health System demonstrates its dedication to patient safety and improving the quality of care for those most in need in Harris County.

The demand for services by the uninsured population of Harris County, coupled with the imperative to improve patient safety and outcomes, continues to strain existing capacity and resources. After accounting for inflationary increases (about \$50 million annually), Harris Health is choosing to strategically invest its limited incremental resources in FY 2021 to initiatives in patient safety as its first priority. Although growth in net patient revenue is expected due to the final phase-in in Medicare Disproportionate Share add-on payments, the increase will not be enough to offset inflation in labor, supplies and services costs. In addition, there was a loss of almost \$22 million in annual tax funding through a decreased tax rate for management and operations.

For these reasons, Harris Health System recommends a 1.0 percent operating margin for FY 2021, a departure from its strategic goal of a 2.0 percent bottom line. The proposed annual Operating Budget for the fiscal year ending February 28, 2021 reflects a margin of \$16.8 million, which underlines the ongoing effort to manage operations and 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 and the Harris County Hospital District Foundation.

## **A Look Back and a Look Ahead to FY 2021**

In keeping with its strategic promise to maintain a strong financial foundation, Harris Health has consistently delivered an average annual margin from operations of nearly 2 percent for the past four fiscal years 2017-2020. This achievement is a result of remarkable teamwork of Harris Health's staff members underpinned by the vision of its outgoing President and CEO, George V. Masi.

On this solid foundation, the organization built strength and has been able to support both planned changes and unexpected challenges of recent months. The two primary unplanned events that affected operations in FY2020 were a decrease in tax rate for management and operations, and significant resource requests in response to Centers for Medicare and Medicaid Services' (CMS) comprehensive survey of Harris Health in September 2019. Both events have far-reaching implications into FY 2021 and beyond, compressing both the revenue and the cost sides of the financial equation.

## **Significant Activities and Initiatives in FY 2021**

### **❖ Hard-wiring of CMS-mandated Process Improvements**

As referenced above, the formal review of Harris Health System's compliance with Medicare and Medicaid Conditions of Participation was prompted as a result of patient safety issues identified in a June 2019 inspection by the Texas Health and Human Services Commission (HHSC). In response to the on-site CMS survey in September, Harris Health submitted the Plan of Correction (PoC) to CMS on November 18. While the organization awaits a resurvey in the coming weeks, the path ahead has been clearly defined around the commitment to practices that support the highest quality care and patient safety throughout Harris Health.

To assure that the System is fully meeting Medicare's Conditions of Participation and that corrective actions are hardwired into everyday practices, Harris Health has already committed over \$15 million to patient safety in FY 2020 and is making an additional investment of more than \$20 million in FY 2021. This investment has been carefully negotiated and prioritized by the leadership team and represents but a portion of the total requests to support all of the best practice initiatives across the System. Throughout the year, leadership will continue to evaluate and reprioritize resources on a quarterly basis to achieve a sustainable balance of quality and cost, in a "fixed income" financial environment.

### **❖ Inpatient Platform Update**

The completion of the semi-private room conversion in March 2019 resulted in an additional twenty (20) medical/surgical beds coming online at Ben Taub Hospital in FY 2020. The beds provide much needed incremental capacity to support the operating room expansion as well as bed demands

driven by ER and direct admissions from Harris Health primary care and specialty clinics. In addition, a new 8-bed ICU opened at LBJ Hospital to add throughput capacity.

No new beds are expected to be added to the platform in FY 2021.

### ❖ **New Ben Taub Operating Rooms**

Ben Taub successfully completed the \$70 million operating room project in FY 2020 commemorated by a ribbon cutting ceremony on August 28, 2019. The much anticipated opening for business of the new 7-room OR suite is planned for February, 2020.

The new rooms will increase FY 2021 operative hours by 18%, which would result in an additional 1,700 cases and 4,500 related clinic visits.

### ❖ **Care Coordination (Outside Medical Services)**

Expansion of outside medical services for the indigent has been a strategic priority for Harris Health for the past year. Inpatient medical cases, psychiatric overflow volume, and hospice referrals have been outsourced where appropriate to assist with throughput and enhance inpatient capacity. New contracts with St. Joseph Medical Center for 10 medical beds and expansion of psychiatric beds at Harris County Psychiatric Center are being built into the FY 2021 budget. In addition, Harris Health will continue to outsource inpatient skilled nursing and rehabilitation care, dialysis, colonoscopy, and sleep studies for a total budget of \$36 million.

### ❖ **Specialty Care Expansion**

In keeping with the multi-year access improvement strategy by Ambulatory Care Services, specialty services have been added as planned in FY 2020 to existing health centers. Six specialty clinics—General Surgery, Urology, Neurology, Cardiology, Rheumatology, and Endocrinology—opened at two community clinic locations, El Franco Lee and Danny Jackson. The current projection for FY 2020 is 3,200 visits against the budgeted 3,500 visits.

The additional volume for FY 2021 is projected to be about 7,600 visits, or 25% of the long-term total, as services ramp up. Over the long term, the additional access is expected to increase appointments by 30,000 visits annually.

### ❖ **Health Insurance Marketplace**

Harris Health is in the third year of a program to subsidize the individual portion of the marketplace insurance premium for patients who qualify for both the Harris Health Financial Assistance program (resident of Harris County with income below 150% of the federal poverty level) and marketplace coverage under the Affordable Care Act.

The average monthly membership for calendar year 2019 has trended at approximately 13,000 individuals, projected to increase to an average of 15,000 for the 2020 marketplace year. For calendar

year 2020 (FY 2021 budget), the corresponding impact to reimbursement and premium cost is inflationary in nature and thus immaterial.

### ❖ **Other Strategic Initiatives**

A team from MD Anderson Cancer Center and Harris Health System has come together to forge a patient-centric relationship that will support the construction of a cancer care center on site at LBJ Hospital. The new cancer care center will provide all aspects of patient treatment in one physical location and will be the only one of its kind within that geographical area. Careful consideration has been given to plan a facility that will be able to expand to the patient demand over a 10-year projection. Based on the approved timeline, MD Anderson will begin its three-year fundraising activities in FY2021.

Another initiative spearheaded by Precinct 2 begins to address the shortage of adult acute care beds in the Northeast quadrant of Harris County, the status exacerbated by the closure of the East Houston Regional Medical Center following Hurricane Harvey. The dialog between Harris County, Harris Health and other parties to meet community need and locate associated funding is in the discovery phase at this time.

### **Uncertainties for FY 2021**

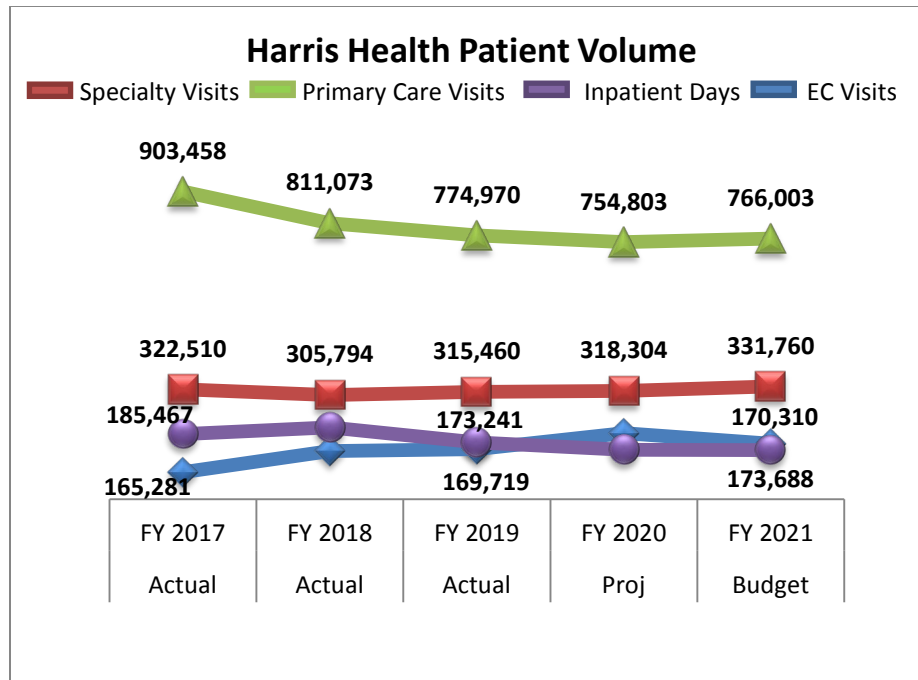
The probability of adding the responsibility for the jail health program to the Harris Health portfolio is under consideration by the Harris County at this time; negotiations about the agreement structure are ongoing. Funding is expected to reimburse Harris Health for managing the program while leaving operational responsibility within the Sheriff's Office.

The timing of the replacement of the Affiliated Medical Services (AMS) agreement with a separate contract for physician services between Harris Health and each of the two medical schools, Baylor College of Medicine and UT Health, continues to be a subject for negotiation. Tentative timeline for implementation is projected for July 2020, the beginning of a new academic year.

Lastly, the initial operational requests related to CMS response exceed available resources. In light of reduced tax funding, management will continue to evaluate and validate specific requirements throughout FY 2021.

## Expected Patient Volumes for Fiscal Year 2021

Overall volume for Harris Health is expected to remain stable in FY 2021. The trend has held relatively flat for the past four years, except for a notable drop in FY 2018 due to Hurricane Harvey.



For FY 2021, there will be no change in the indigent care policy (Financial Assistance Program) affecting patient volumes. Income eligibility criteria will be maintained at the 150% of the federal poverty level.

As total available beds stabilized, no new beds are expected to be added to the inpatient platform in FY 2021. The net impact to total patient days and average daily census for next fiscal year is estimated to be 3 percent higher than the run rate due to higher occupancy within a limited bed complement.

Changes in emergency room visits will be negligible, due to limitations in ER capacity and bed availability. Total combined emergency room volume for the Ben Taub Level I emergency center and the LBJ Level III emergency center is projected to be at about 173,500 visits, virtually unchanged from FY 2020.

Labor and delivery volumes have been stable for the past three years, and births are budgeted at the same level as current year.

For outpatient volume, no planned growth is anticipated in primary care clinics in FY 2021. A small increase of 11,000 visits over the current run rate is assumed based on filling existing provider vacancies. Demand will continue to be evaluated based on need and considering the availability of

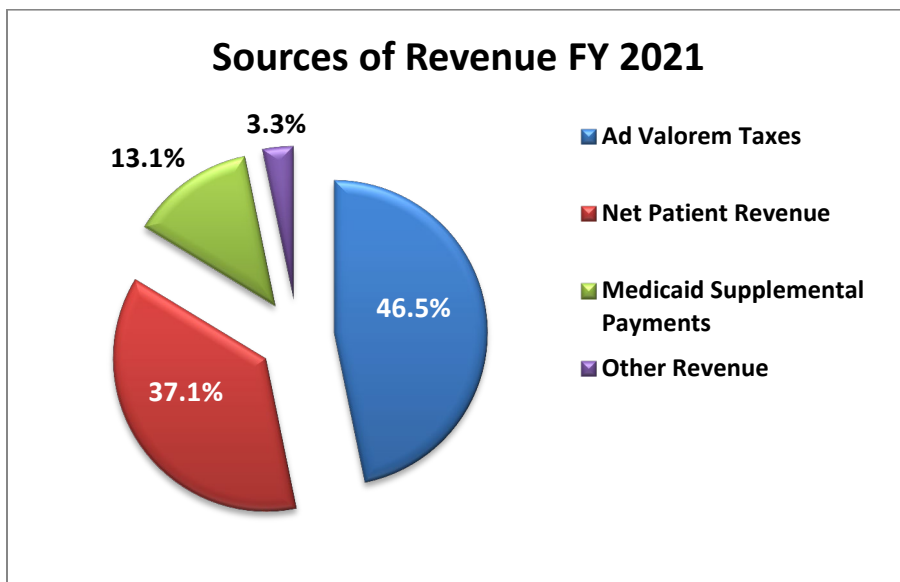
Federally Qualified Health Centers (FQHCs) and other partners in the service area, to optimize overall primary care access in Harris County.

As discussed earlier, specialty care visits are expected to see growth in certain service lines with the longest wait times. The planned increase of 13,500 visits includes 7,600 new specialty visits embedded at ACS primary care sites and 4,500 visits for surgical specialties at Ben Taub.

Surgery cases will increase by over 1,700 after the opening of the new Ben Taub operating rooms. After an initial ramp-up during the first half of the new year, the overall System surgical volume in FY 2021 will reach almost 25,400 cases.

## Revenues

The total Harris Health System revenue budget for FY 2021 is \$1.68 billion, an increase of about \$58 million, or 3.6 percent, from the projected FY 2020 revenues. The increase is attributable to the expected growth of Net Patient Service revenues (\$38 million), Medicaid Supplemental Payments (\$4.6 million), and a modest inflation in ad valorem tax revenues (\$19 million).



### ❖ Ad Valorem Tax

In October 2019, by order of the Harris County's Commissioners Court, the current tax rate for maintenance and operations of 17.000 cents per \$100 of property valuation defaulted to the effective rate of 16.491 cents. This decrease amounts to a loss of approximately \$22 million in tax support for the current fiscal year. Ad valorem revenues are projected to be around \$763 million in FY 2020; these estimates are subject to change based on actual tax collections coming in. For FY 2021, a slight 2.5 percent increase in Harris County property values, and Harris Health ad valorem budget, is assumed due to Houston's growing economy. However, the gap of over \$20 million in the tax base

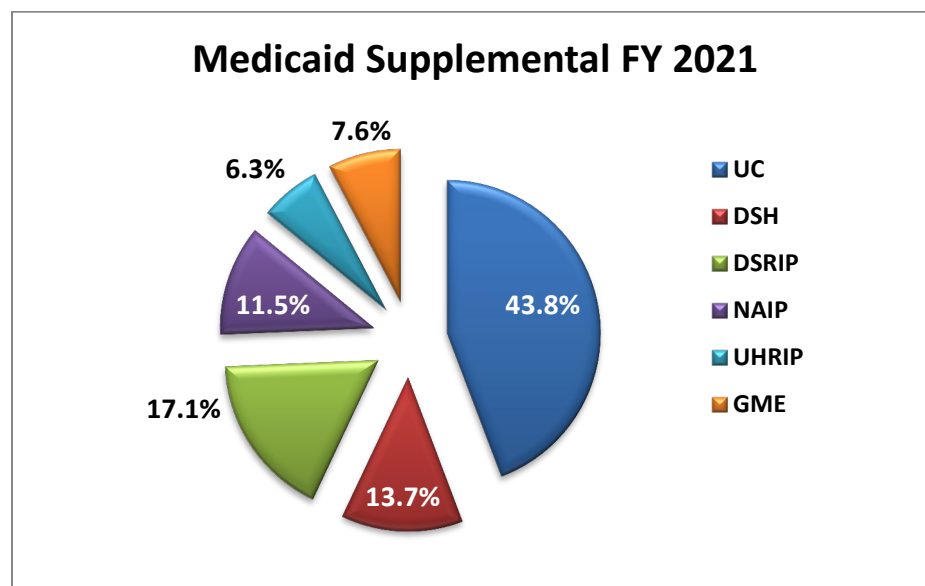
is not expected to close next year. This reduction, therefore, is built into the budgetary projection of \$782 million in tax funding in FY 2021.

### ❖ Net Patient Service Revenue

Net Patient Revenue is budgeted to grow from \$585.6 million in FY 2020 to \$623.6 million in FY 2021. The ongoing change in the Medicare Disproportionate Share (DSH) add-on payment methodology is expected to add about \$38 million to net patient revenue in the coming year. This third and final portion of the three-year transition to the Medicare S-10 allocation methodology for Medicare DSH became effective October 1, 2019.

### ❖ Medicaid Supplemental Payments

Medicaid Supplemental Programs' revenues make up 13 percent of Harris Health's total revenue budget and include Medicaid Disproportionate Share (Medicaid DSH), Uncompensated Care (UC), Delivery System Reform Incentive Payment (DSRIP), Network Access Improvement Program (NAIP), Uniform Hospital Rate Increase Program (UHRIP), and Graduate Medical Education (GME) program funding. The aggregate Medicaid Supplemental Programs revenue is budgeted at \$220 million in FY 2021, up by \$4.6 million, or 2.1 percent, from FY 2020.



Federal cuts in Medicaid DSH funding have gone live in October 2019, FFY 2020. On December 17, the U.S. House of Representatives voted to delay reductions to hospitals' Medicaid DSH payments to May 23, 2020. The delay measure was included in the \$1.4 trillion spending deal that funded the government through federal fiscal year 2020 and averted a government shutdown. If the current level of funding is not extended past May 2020, the available distribution for Harris Health will drop 30 percent in FY 2021 compared to FY 2020. Given the lingering uncertainty, Harris Health has built an estimated reduction of \$14.6 million into the Medicaid DSH projections for FY 2021, for a total funding of \$32.5 million.

Harris Health's Uncompensated Care funding decreased in FFY 2019 due to the State-adopted methodology of increased allocation to non-hospital classes. Beginning in FFY 2020, the UC allocation methodology is based on the Medicare S-10 schedule, which is projected to return the uncompensated care allocation to FFY 2017 levels. At this time, the budget for Harris Health's UC in FY 2021 is estimated at over \$103 million, which is a \$27 million improvement compared to the current year.

The size of the DSRIP pool for Texas is changing in real time; the \$3.1 billion allocation approved for FFY2019 (DY8) has ended. Starting in October 2019, FFY2020 (DY9), the reduced pool size in DY9-10 will result in a 5.9 percent reduction in DY9 and 19.5 percent reduction in DY10, dropping to zero in the last year of the current program. The State is currently seeking proposals to replace the program when it expires, so as to maintain the current federal funding. A decline of over \$6 million in Harris Health's DSRIP revenue is expected in FY2021.

The Network Access Improvement Program has commenced its fourth year at Harris Health. Funding is expected to be stable at \$27 million for the foreseeable future.

The addition of the Uniform Hospital Rate Improvement Program was first introduced by the State in March 2018. It improved net Medicaid managed care reimbursement for Harris Health by \$14 million in FY2020. HHSC recently proposed a change to the format and structure of the program starting SFY2020, in September 2020. These changes do not affect the net benefit for the System, which is currently projected flat.

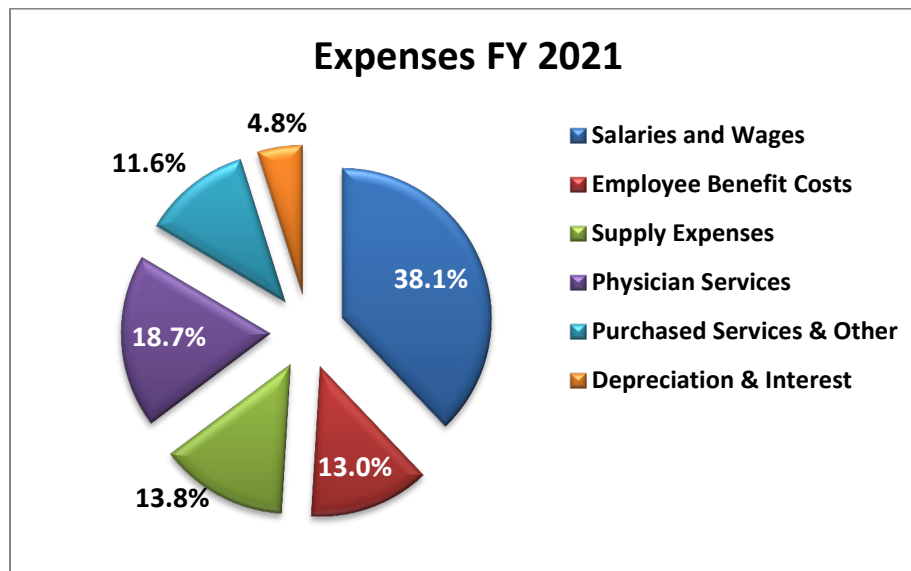
The Graduate Medical Education program is a new State initiative approved by CMS in October 2018. It allows for recovery of some GME costs, which resulted in the net benefit to Harris Health in FFY2019 of \$18 million. Now in its second year, the program is projected at \$16.4 million for FFY2020.

#### ❖ Other Revenue

Other revenues are projected to remain stable at over \$55.5 million, or 3.3 percent of the total Harris Health budget. The largest, annual Tobacco Settlement revenue, is projected to continue at just under \$14 million in FY 2021.

## Expenses

Total Harris Health System operating expense is projected to increase by 5.1 percent or \$80.7 million, from \$1.58 billion in FY 2020 to \$1.66 billion in FY 2021. After accounting for \$50 million in annual inflation of 3.2 percent, Harris Health is choosing to strategically invest over \$20 million in patient safety across the platform in FY 2021. As discussed earlier, this investment comes on the heels of the already committed \$15 million in related initiatives above and beyond the current year's expectations.



Salaries are budgeted to increase by 5.3 percent, or \$31.7 million in FY 2021, to a total of \$633.8 million. Average salary increases are proposed at 3.0 percent, and market and other adjustments at 0.5 percent annually. Benefits will grow by a net 4.0 percent, or \$8.3 million, in FY 2021 to \$217.1 million. In addition, nursing-specific market adjustments of over \$4 million will begin to phase in starting in January 2020, in order to keep up with the competitive healthcare market in Houston. The combined result is a budgeted increase of 4.9 percent in salary and benefit costs, with adjustments for volume.

Physician services are budgeted to increase to \$311.5 million in FY 2021, up by almost \$27 million from the FY 2020 projection of \$284.6 million. The new Local Provider Participation Fund (LPPF) has replaced the Harris Collaborative program and the Medicaid IGT model. The elimination of the private UC funding model in July 2019 accounts for a return of roughly \$300 million in annual direct physician costs onto Harris Health's books. Other non AMS provider costs are not significant, and are assumed to remain stable. It is expected that in the future, some incremental physician service cost for charity patients will be recoverable as revenue under Uncompensated Care. It is premature to share estimates as the State is just beginning to work on the DY9 UC applications and methodology at this time.

Supply expense is expected to increase less than 3.0 percent to \$229.3 million in FY 2021, mostly due to lower than usual inflation in inpatient pharmaceuticals. According to Premier Inc., inpatient pharmaceutical costs are expected to rise by 2 percent in the coming fiscal year. Likewise, outpatient inflation has slowed down indicating that efforts to control prescription drug spending may be producing a positive effect. At Harris Health, the added benefit of the robust Drug Recovery Program is expected to continue to mitigate increasing medication cost.

Purchased services are budgeted to decrease by \$8.7 million solely due to a change in the accounting standard for leases, GASB #87, effective next fiscal year. Based on preliminary estimates, almost \$13 million in lease expense will move to amortization cost as most leases transition to capital assets. Aside from the effect of the new rule, however, Harris Health's purchased clinical services are projected to grow, most notably in the area of care coordination with outside partners as discussed earlier.

Depreciation, amortization, and interest expense for FY 2021 is budgeted at close to \$80 million, which includes a planned increase of \$13 million from the adoption of the lease accounting standard. Together, both purchased services and depreciation/amortization cost will see a projected \$8 million increase for a combined budget of \$273 million.

Overall, total operating expense budget for Harris Health is projected at \$1.66 billion in FY 2021. The result is a budgeted net operating margin of \$16.8 million, or 1.0 percent, for FY 2021. Analysis of cash flow for FY 2021, 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.

## **Capital Expenditures**

The overall Capital Budget proposal for FY 2021 is \$121.8 million, of which \$75.8 million is routine capital funded from operations, and \$46 million to be raised from the issuance of Certificates of Obligation (\$36 million) and from the HCHD Foundation (\$10 million).

Harris Health is continuously assessing its facilities, equipment and technology to determine the priorities for replacement, repair and any new acquisitions. The assessment and prioritization methodology addresses patient safety, building safety and code compliance requirements, planned equipment obsolescence, and new technology. The routine capital budget represents 140 percent of the prior year depreciation of \$54.0 million.

In addition to its routine capital commitment, Harris Health intends to fund another \$46 million in capital improvements for the Ben Taub Emergency Center renovation, the purchase and installation of certain medical equipment in Harris County's jail facilities, and the purchase and installation of an upgraded Epic Systems medical record system in Harris County's portion of facilities in connection

with the future provision of healthcare services in the facilities. The Commissioners Court is scheduled to approve the resolution authorizing the issuance of debt on February 25, 2020.

## **Conclusion**

Together, the Fiscal Year 2021 Operating Budget and the Fiscal Year 2021 Capital Budget represent Harris Health's unwavering commitment to patient safety and advancement in the health status of the residents of Harris County. The increased cost of maintaining services and improving patient quality in an environment of decreased tax support will make for a very challenging year ahead. The proposed 1.0 percent operating margin of \$16.8 million will allow Harris Health System to continue with its infrastructure modernization and delivery of high quality healthcare to Harris County residents.

**HARRIS HEALTH SYSTEM**  
**Statement of Revenues and Expenses**  
**Fiscal 2021 Proposed Budget**  
(\$ in millions)

	Actual	Projected	Budget
Revenue:	FY 2019	FY 2020	FY 2021
1. Net Patient Service Revenue	\$ 477.8	\$ 585.6	\$ 623.6
2. Medicaid Supplemental Programs	194.5	215.6	220.2
3. Other Operating Revenue	27.1	32.6	30.6
4. Total Operating Revenue	699.4	833.8	874.4
5. Net Ad Valorem Tax Revenue	739.0	763.0	782.1
6. Net Tobacco Settlement Revenue	15.2	13.8	13.8
7. Interest Income & Other	12.1	12.4	11.1
8. Total Nonoperating Revenue	766.3	789.2	807.0
9. Total Net Revenue	\$ 1,465.7	\$ 1,623.0	\$ 1,681.4
Expense:			
10. Salaries and Wages	\$ 556.3	\$ 602.1	\$ 633.8
11. Employee Benefits	204.1	208.8	217.1
12. Total Labor Cost	760.4	810.8	850.9
13. Supplies	208.4	223.6	229.3
14. Physician Services (Medicaid Services IGT)	250.9	284.6	311.5
15. Purchased Services	157.1	201.7	193.0
16. Depreciation, Amortization & Interest	64.5	63.1	79.9
17. Total Operating Expense	\$ 1,441.3	\$ 1,583.8	\$ 1,664.5
18. Operating Income (Loss)	\$ 24.5	\$ 39.2	\$ 16.8
19. Total Margin	1.7%	2.4%	1.0%

**HARRIS HEALTH SYSTEM**  
**Statistical Highlights**  
**Fiscal 2021 Proposed Budget**

<b>Volume:</b>	<b>Actual FY 2019</b>	<b>Projected FY 2020</b>	<b>Budget FY 2021</b>
1. Primary Care Clinic Visits	774,970	754,803	766,003
2. Specialty Clinic Visits	315,460	318,304	331,760
3. Total Clinic Visits	1,090,430	1,073,107	1,097,763
4. Total Emergency Room Visits	169,719	173,528	173,688
5. Total Surgery Cases	22,531	23,669	25,381
6. Total Outpatient Visits	1,764,025	1,743,109	1,768,605
7. Births	5,407	5,338	5,427
8. Inpatient Cases (Discharges)	29,477	29,549	30,573
9. Outpatient Observation Cases	13,961	15,176	15,552
10. Total Cases Occupying Patient Beds	43,438	44,725	46,125
11. Inpatient Days	173,241	164,715	170,310
12. Outpatient Observation Days	33,800	35,846	35,856
13. Total Patient Days	207,041	200,561	206,166
14. Average Daily Census	567.2	548.0	564.8
15. Payor Mix (% of Charges):			
16. Charity & Self Pay	54.6%	54.1%	53.4%
17. Medicaid & Medicaid Managed	22.8%	21.8%	21.8%
18. Medicare & Medicare Managed	10.8%	11.7%	11.7%
19. Other Third Party Payers	11.8%	12.4%	13.1%

**HARRIS HEALTH SYSTEM**  
**Capital Budget Summary**  
**Fiscal 2021 Proposed Budget**  
(\$ in millions)

Category Totals	<u>FY 2021 Budget</u>
Facility Projects	\$ 50.5
Information Technology	\$ 12.4
Medical Equipment	\$ 9.3
Other	\$ 1.6
Emergency Capital	<u>\$ 2.0</u>
Routine Capital Budget	<u>\$ 75.8</u>
Certificates of Obligation (Debt Issue)	\$ 36.0
HCHD Foundation	<u>\$ 10.0</u>
Other Sources of Capital Budget	<u>\$ 46.0</u>
Total FY2021 Capital Budget	<u><u>\$ 121.8</u></u>

**HARRIS HEALTH SYSTEM**  
**Healthcare for the Homeless**  
**Statement of Revenue & Expenses**  
**Fiscal 2021 Proposed Budget**  
**(\$ in thousands)**

1. Clinic Visits	13,240
2. Grant Revenue	\$ 4,024,029
Expense:	
3. Salaries & Wages	\$ 2,616,275
4. Employee Benefits	<u>696,174</u>
5. Total Labor Cost	3,312,448
6. Supplies	141,632
7. Purchased Services	1,030,422
8. Depreciation	<u>99,180</u>
9. Total Operating Expense	<u>\$ 4,583,682</u>
10. Operating Income (Loss)	<u><u>\$ (559,653)</u></u>

**HARRIS HEALTH SYSTEM**  
**The Ambulatory Surgery Center at LBJ**  
**Statement of Revenue & Expenses**  
**Fiscal 2021 Proposed Budget**  
**(\$ in thousands)**

1. Cases	3,996
2. Net Patient Revenue	\$ 1,535,194
Expense:	
3. Salaries and Benefits	4,628,345
4. Supplies and Services	4,771,820
5. Depreciation and Overhead	7,829,290
6. Total Operating Expense	<u>\$ 17,229,455</u>
7. Operating Income (Loss)	<u><u>\$ (15,694,260)</u></u>