Southwestern Vermont Medical Center
Operating Budget
Fiscal Year 2017

Southwestern Vermont Medical Center's (hereafter "SVMC" or "Medical Center") Operating Budget for Fiscal Year (hereafter "FY") 2017 has a planned operating gain of approximately $4.4 million or an operating margin of approximately 3.0%. The excess of revenues over expenses including non-operating activities is nearly $5.0 million.

Below is a high-level summary:

	FY 2016 Projected	***FY 2016 Budget***	***FY 2017 Budget***
Net patient service revenues	$147,356,927	$144,025,571	$152,792,211
Other operating revenues	2,730,510	2,022,823	2,811,549
Total operating revenues	*150,087,438*	*146,048,391*	*155,603,760*
Operating expenses	*146,569,515*	*141,665,763*	*150,974,771*
Operating gain	***3,517,923***	***4,382,632***	***4,628,989***
Non-operating revenues-net	747,393	600,000	605,000
Excess revenues over expenses	***$4,265,315***	***$4,982,632***	***$5,233,989***

Below are summary points of material interest included in the budget:

- Net patient service revenues are $8,766,643 or 6.09% more than the FY 2016 budget;
- The budget includes increased primary care access in Express Care and the Pownal Primary Care Center;
- Community practices will become SVMC practices in FY 2017, Gastroenterology and Urology;
- Medicaid provider based reimbursement will be discontinued resulting in a loss of revenues of over $2.7 million;
- Vermont Disproportionate Share Payments (hereafter "DSH") are budgeted at $727,909 or a decrease from FY 2016 amount by approximately $1,224,038;
- The effective charge / rate increase of 3.9% is being requested;
- Included in the budget is an increase in Medicare and Medicaid reimbursement for FY 2017;

- The pharmacy drug cost are budgeted to increase by approximately $4.3 million mainly due to the increased volumes and higher cost of oncology drugs in the Cancer Center which will result in additional net patient service revenues of $3.4 million;

- Full Time Employee Equivalents (hereafter "FTE's") of 756.7 are 8.8 FTE's higher than FY 2016's budget;

- A 3% salary increase was included, effective May 2017;

- The FY 2017 Capital Budget is $12,500,000.

Below are explanations of the changes to the FY 2017 budget when compared to the FY 2016 budgeted amounts.

Gross Patient Service Revenues

Total gross charges in the FY 2017 budget are increasing by $25,606,010 or approximately 8.5%.

Effective charge increase of 3.9%		$12,266,333
Increase primary care		2,277,370
Community practices joining SVMC		3,447,739
Preventive screenings – Hospital		2,601,034
Medical Oncology – pharmaceuticals		9,166,368
Orthopedic services		3,585,188
	Subtotal	*33,344,032*
Volume changes - inpatient		(6,210,423)
Volume changes - outpatient		(1,527,599)
Total change in gross patient service revenues		***$25,606,010***

The explanations to the changes in gross patient service revenues are included in the net patient service revenues section.

Net Patient Service Revenues

The increase in FY 2017 net patient service revenues budget is $8,766,641 or an increase of 6.09% when compared to FY 2016's budget.

The table below lists the significant changes when compared to FY 2016 budget:

Rate changes

Charge/rate increase to be realized *(effective rate 3.9%)*	$3,122,980	2.17%
Medicare rate increases	500,000	0.35%
Medicaid provider based billing revenues	(2,721,598)	-1.89%
Medicaid rate increase	1,200,000	0.83%
Decrease in Medicaid DSH payments	(1,224,738)	-0.85%
Decrease indigent care (*bad debt and charity care*)	598,334	0.42%
Subtotal rate changes	*1,474,978*	*1.02%*

Volume changes

Increased primary care, net	1,774,937	1.24%
Community practices joining SVMC	1,720,462	1.19%
Preventive care screenings – Hospital	1,036,072	0.72%
Medical Oncology – pharmaceuticals	3,400,388	2.36%
Orthopedics – inpatient, outpatient services and physician practice	2,311,640	1.61%
Other volume and payer mix changes	(2,952,836)	-2.05%
Subtotal volume changes	*7,291,663*	*5.07%*
Total change in net patient service revenues	***$8,766,641***	***6.09%***

The charge increase is budgeted at 3.9%

Realization of the charge increase of 3.9% is dependent on commercial insurance, Blue Cross and managed care volumes and the mix of services. Management determined that physician professional services, which are reimbursed mainly on a fee schedules, there is *no benefit* to the Hospital to increase these charges. Drugs sold, medical surgical supplies and other categories should not be increased since the Hospital's charges in these areas are comparable with other Hospital's in the region and are determined upon the cost of the products. The charge level of these services is approximately 35% of the total charge structure of the Hospital. The remaining 65% of charges will be increased 6%.

Included in the Hospital's charge increase is a provision for Health Reform Initiatives. The Hospital is continuing with its Transitional Care Program. Included in the operating budget is approximately $700,000 for this program. This program's mission is to assist in the management of high risk patients across the care continuum with the goal of decreasing emergency room visits, hospital admissions, and readmissions. The most recent public information available has SVMC's 30-day readmission rate at approximately 8% compared to the VAHHS data for the state of Vermont which over 12%. The second item included is approximately $400,000 a provision for population health reserves or costs for the implementation of Health Care Reform initiatives expected later this fiscal year or early FY 2017.

In addition, there are costs included in the budget related to the Hospital's Community Needs Assessment that includes many initiatives in the community, which will be funded through the Hospital as well as through the Hospital's parent organization Southwestern Vermont Health Care. To name a few initiatives they include continued financial support to the local free clinic, wellness, and community building initiatives, initiatives related to substance addiction and abuse, as well as others.

<u>Increase in Medicare</u>

Included in the FY 2017 budget is an increase in Medicare reimbursement for inpatient and outpatient services. The update factor used for inpatient was 0.80%. The inpatient services assumption will be effective October 1, 2016. The update factor utilized for outpatient services will be 1% effective January 1, 2017.

*Currently, there is **<u>no</u>** consideration included in the budget for potential changes in the Inpatient or Outpatient Prospective Payment rules or methodologies. These items are finalized after submission of the Hospital's budget to the Green Mountain Care Board.*

<u>Decrease in Medicaid</u>

In the spring of 2016, Department of Vermont Health Access (hereafter "DVHA") notified the hospitals in Vermont that they would be eliminating the billing for the 51X revenue codes or what is referred to Provider Based Billing, effective July 1, 2016. The reduction published by the DVHA was $2,721,598. To offset the loss of the fore mentioned monies DVHA is proposing an increase in the outpatient methodology of approximately $1.2 million for SVMC as modeled by management. The net loss to SVMC is approximately $1.5 million.

Decrease in Medicaid DSH payments

Medicaid DSH payments will decrease by $1,224,738 in FY 2017. This amount was confirmed in a letter received from the State of Vermont.

Decrease in indigent care

Total indigent care will decrease by $598,334 when comparing FY 2016's budget to FY 2017's budget thus increasing the net patient service revenues.

FY 2016 charity care budget was $2.0 million and the projected amount is approximately $657,812 less then budget. Based upon the current activity and factoring in an recent changes to the charity care program that expanded eligibility and increase scaled discounts that begin at the Medicaid payment levels for patients who meet eligibility the projected FY 2017 levels will be approximately $1.6 or a positive variance of $400,000. As with charity care the FY 2016 projected bad debt expense is under budget in FY 2016. In FY 2017, management anticipates to see a reduction in the provision for bad debt. This reduction is partially due to the anticipated changes in the charity care policy. The change in policy should encourage more patients to apply for charity care that might otherwise end up in bad debt. In addition, increased effort to collect deductibles and coinsurance at the time of service should further reduce the number of accounts that end up in bad debt cycle.

Expanded primary care access

SVMC's community needs assessment and access to primary care are areas, which more resources are required. Over the past years and in the FY 2017 budget SVMC is continuing, to add resources and address the primary care access shortfalls in Hospitals region, which includes portions of New York State and Massachusetts. In the FY 2017 budget, SVMC is budgeting to continue to expand primary care providers, associate providers and renovate facilities to improve access for patients in our service area.

In the FY 2017 operating budget the increase in primary care net patient service revenues are budgeted to increase by approximately $1.8 million.

Increased primary care access

Express Care (Bennington, VT) – As part of the primary care renovations in 2015, SVMC launched a same day appointment clinic to further provide primary care access and depressurize the emergency department. The clinic opened in February of 2015. Express Care provides access to physicians and associate providers for patients with minor conditions. The visit volume continues to grow and will generate approximately $866,000 in additional net patient service revenues in FY 2017 over the FY 2016 budget.

Several factors are driving this increase. The overall success of the program. Patient volumes continue to increase greater than management anticipated. Additionally, due to the timing of the actual opening of the program in the FY 2016 budget there was not adequate historical data to project the success of the program, thus creating a two-year budget variance.

Pownal Primary Care Clinic (Pownal, VT) – The Pownal Primary Care Clinic has a medical home team led by currently three physicians. In 2017, an associate provider will be added to the practice in order to provide additional primary care in our service area. In FY 2016, management anticipated utilizing one physician and one associate provider. The increase in visit volume will generate additional charge volume of approximately $1,073,000 of primary care collectable revenues over the FY 2016 budget.

Community based physicians

In the FY 2017, operating budget management is adding additional resources to improve services that were previously in the community:

- *SVMC Urology (Bennington, VT)* – In FY 2017 SVMC anticipates adding an additional urologist to the current urology practice that currently is an independent physician. This will insure the level of Urology Services in SVMC's service area and gain efficiencies both urologist, in our service area, now be managed by SVMC. Management anticipates the addition will result in approximately $1,100,000 of collectable revenue to SVMC's budget.

- *SVMC Gastroenterology (Bennington, VT)* – In FY 2013, a community-based physician left the service area. Since FY 2013, the Hospital has been actively recruiting a replacement. During the same period, a long stating Gastroenterologist at SVMC has been reducing his patient care time in anticipation of retirement.

  During this period, the management has been attempting to replace the community-based physician and find a replacement for the retiring physician. The search has been lengthy but after three years, SVMC has identified and hired two Gastroenterologist.

  The replacement of the community-based physician will increase revenues by approximately $675,000. With a void in the service for several years, a significant backlog of preventive and diagnostic services in our service will result area will an increase Hospital revenues (see summary below).

Improvements to physician services

- *SVMC Orthopedics (Bennington, VT)* – SVMC has identified a need to replace providers who have retired or otherwise left the practice. SVMC is anticipating employing three to four providers and two associate providers in Bennington. Previously there were five full time providers in the market place with two associate providers. There are currently two physicians and one associate providers. The addition of new providers is expected to generate an additional $264,000 of office revenues over the FY 2016-budgeted net revenue.

Volumes and payer mix

Inpatient volumes have decreased in FY 2017 compared to the FY 2016 budget. Total adult patient days are budgeted to decrease by 9.3% in FY 2017. The FY 2017 budget assumes the continued decline in the inpatient services due to the following:

- Continued improvement of the Hospital's readmission rate;
- Effectiveness of the Transitional Care Nursing program;
- Initiatives to reduce resource consumption during individuals hospital stays;
- Improved coordination with other community providers.

To negate some of the decline the FY 2017 budget assumes increased orthopedic volume over the year because of recruiting new physicians to the SVMC Orthopedics practice.

Outpatient volumes are budgeted to increase overall. Below summarizes the significant changes:

- Medical Oncology services continue to increase. The number of patients visits per patient and costs of pharmaceuticals have increased dramatically. Gross charges for oncology drugs will increased by nearly $9.2 million over the FY 2016 Budget;

- Outpatient operating room volumes will increase mainly due to due to the addition of the orthopedic physician;

- Endoscopy volumes are budgeted to increase due to a performance improvement initiative to clear up the caseload backlog. This will be accomplished by the recruitment the new gastroenterology physicians. Equipment has been purchased to open an additional procedure room to accommodate the volume;

- Laboratory volume is budgeted to increase over the FY 2016 budget due to increased testing for diseases caused by ticks borne diseases which are expensive tests and perform by an outside service;

- Outpatient observation care volume is budgeted to decrease by 15.5% in the FY 2017 budget;

- Other ancillary volumes such as EKG, diagnostic imaging, nuclear medicine and inhalation therapy are anticipated decrease from FY 2016 budgeted volumes;

- Emergency room volume is anticipated to decrease slightly from FY 2016 budget.

The increases and decreases in outpatient volumes overall create and volume variance when compared to the FY 2016 budget. These volumes changes are based upon most recent trend in SVMC's service area and subject to change.

Other Operating Revenue

Other operating revenue is budgeted to increase by nearly $800,000 in the FY 2017 budget primarily due to the implementation of the 304 Retail Pharmacy Program.

Operating Expenses

SVMC operating expenses are budgeted to increase by $9,309,008 or 6.6% compared to FY 2016 budget. During FY 2016, SVMC has made concerted efforts to reduce expenses in response to lower volumes in some areas and to prepare for anticipated healthcare reform.

Healthcare Reform Cost

SVMC's FY 2017 budget includes Healthcare reform costs. Included in the budget is approximately $700,000 for the continuation of the transitional care program. The purpose of the program is in assisting in the management of high-risk patients across the care continuum with the goal of decreasing emergency room visits, hospital admissions, and readmissions. This department includes clinical nurse specialists, pharmacist, and social worker.

The second item included is approximately $400,000 a provision for population health reserves or costs for the implementation of Health Care Reform initiatives expected later this fiscal year or early FY 2017.

Costs for the completion of the DH affiliation, for continued operational efficiency initiatives to reduce SVMC's expense structure, and costs to support Hospital's Community Needs Assessment at both the Hospital level and the corporate level.

Salaries and wages -- non-physician

In developing the FY 2017 salary and wage budget, FTE's are only due to increase due to physician practices needs and wage increases. A 3% wage increase effective May 2017 was included in the FY 2017 budget.

The table below identifies the changes in salary and wage expense compared to the FY 2016 budget:

Compensation increase FY 2017	$1,339,353
Expanded and enhanced services—new FTE's	339,259
Others hospital and medical group changes	20,848
Total change (amounts rounded)	***$1,699,460***

Below is a summary of FTE's.

	FY 2016 Projected	***FY 2016 Budget***	***FY 2017 Budget***	***Variance Budget to Budget FTE***	***Variance Budget to Budget %***
Total SVMC (non-physician)	***750.0***	***747.9***	***756.7***	***8.8***	***1.2%***

Management will be monitoring the FTE's closely related to volumes in FY 2017.

Physician fee/salaries, contracts, and fringes

This category of expense is increasing by $1,624,900 in FY 2017 when compared to the FY 2016 approved budget. The table below will provide some of the highlights to the changes in this classification of expense.

New providers and associate providers to improve access and enhance services	$3,160,000
Planned PSA expense reductions	(1,500,000)
Compensation rate changes and other reductions	(35,100)
Change in physician fee/salaries, contracts and fringes	***$621,272***

Below is a summary of Provider FTE's.

	FY 2016 Budget	***FY 2016 Projected***	***FY 2017 Budget***
Physician	***67.28***	***67.58***	***72.05***
Assoc. Provider	***16.32***	***14.96***	***15.06***
Total FTE's	***83.60***	***82.54***	***87.11***

Employee Benefits

In the FY 2017 operating budget, employee benefits budget is to increase $1,482,256 or approximately 12.2% over FY 2016 budget. The employee benefit expense represents approximately 29.3% of salary costs. The FY 2017 budget assumes an increase in the self-insured claims experience in the employee health insurance program. In addition, SVMC anticipates an increase in pension plan expense.

Provider Tax

The absolute dollar amount of the increase over FY 2016 budget is $471,291 or 5.6%. The provider tax has more than *doubled* from $4,224,089 to $8,945,341 since FY 2009.

Depreciation and Amortization Expenses

The depreciation and amortization expense will be budgeted at $6,104,254 or a decrease of approximately $160,000 from FY 2016's budget. The FY 2017 Capital Budget of $12.5 million, an assumption that all FY 2017 capital budget will all be acquired as planned as well as the depreciation expense on assets currently in service.

The Capital Budget of approximately $12.5 million in FY 2017 will be funded from cash and cash generated from operations. In summary, the Capital Budget is allocated as follows:

Large capital projects	$2,500,000
Large infrastructure projects	3,750,000
Routine information technology	1,000,000
Routine capital needs	5,250,000
Total	***$12,500,000***

<u>*Other operating expenses*</u>

Other operating expenses in the FY 2017 operating budget are increasing by $4,373,160 or approximately 10.2%. The table below highlights some of the significant changes:

	Amount
Pharmacy and drugs sold	$4,277,821
Laboratory	511,927
Med/Surg Supplies sold	644,192
Administration	(884,060)
Dietary	(293,590)
All others	116,870
Total increase	***$4,373,160***

- Pharmacy and drugs sold – Medical oncology drug increases;
- Laboratory – cost related send out referral laboratory testing for tick born diseases;
- Medical surgical supplies sold – increased expenses due to anticipated increase in orthopedic surgical volume.
- Administration – primarily related to decrease in dues and expense related to affiliation costs and others;
- Dietary – savings related to efficiency program and lower inpatient days;

Greater detail can be provided upon request.

<u>***Proposed or Potential Certificate of Need (hereafter "CON")***</u>

SVMC is currently completing a CON application for the Central Utility Plant. Management is anticipating the possible filing of two CON's in the short term. A Dental Clinic is being evaluated based upon the Hospital's Community Needs Assessment and a Wound Care Clinic based upon needs in our community. Disclosure of costs would be premature at this time.

These amounts are above the routine capital of the organization, which has ranged from $6.0 million to $7.5 million per fiscal year.

Management in the coming years will be evaluating <u>*significant*</u> changes to the physical plant of the Medical Center and changes to its current computer platform that will require CON's. Estimates are not available at this time.

<u>Non-operating gains and losses</u>

The non-operating gains and losses are mainly out of the control of management. Investment earnings on the funded depreciation are driven by market and economy. No gain or loss on the interest rate swap was budgeted. The budget also includes $250,000 of contribution income.

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If there are any questions or comments, please do not hesitate to contact Stephen D. Majetich, Chief Financial Officer at 802.447.5011