The Regents of the University of California

COMMITTEE ON HEALTH SERVICES
July 16, 2003

The Committee on Health Services met on the above date at UCSF–Laurel Heights, San Francisco.

Members present: Regents Atkinson, Davies, Johnson, Kozberg, Lansing, Lee, Marcus, Sayles, and Seigler; Advisory member Pitts

In attendance: Regents Blum, Connerly, Hopkinson, Montoya, and Murray, Regents-designate Novack and Ornellas, Faculty Representative Binion, Associate Secretary Shaw, General Counsel Holst, Treasurer Russ, Senior Vice President Mullinix, Vice Presidents Broome, Gurtner, and Hershman, Chancellors Carnesale and Cicerone, and Recording Secretary Bryan

The meeting convened at 3:00 p.m. with Committee Chair Davies presiding.

1. **APPROVAL OF MINUTES OF PREVIOUS MEETING**

   Upon motion duly made and seconded, the minutes of the meeting of May 14, 2003 were approved.

2. **UPDATE ON MEDICAL CENTER, LOS ANGELES CAMPUS**

   Chancellor Carnesale recalled that the UCLA medical center had faced some serious challenges over the last decade, including the 1994 Northridge earthquake, the effects of which led to a construction project that includes the Westwood Replacement Hospital, Santa Monica Replacement Hospital, and three research facilities, at a cost of about $1 billion. In that same period there were dramatic adverse changes in the medical care marketplace, including declining reimbursement rates for services.

   Mr. Carnesale reported that in light of these challenges, The Hunter Group was engaged to analyze the status and long-term prospects of UCLA Healthcare, with the goal of charting a course of action that would strengthen the system’s infrastructure and improve overall financial performance. The consultants produced a report containing a comprehensive set of recommendations in the form of a Performance Improvement Plan. The plan’s primary recommendations address improving performance and productivity of the units that comprise the healthcare system; increasing cost efficiency related to billing, supplies, and data management; creating a new faculty practice plan that will provide all physician support services; transferring management of the primary care clinics to departments in the medical school; and creating a new management structure for the system. Each recommendation will be considered by a management group that includes
representatives from the medical school, the hospital, the practice plans, and the medical enterprise and is coordinated by Vice Chancellor for Finance and Budget Steve Olsen. It is presumed that the group’s recommendations will be implemented.

Vice Chancellor Olsen discussed the financing of the two hospital projects. He recalled that the Westwood Replacement Hospital, a 1 million gross-square-foot project designed by I.M. Pei, will be a state-of-the-art tertiary and quaternary care facility. In 2002 its cost was forecasted at $662 million. The new estimate is $667 million, with completion in March 2005 rather than September 2004, primarily because of changes in the schedule for making decisions about the purchase of medical equipment, a reflection of the fact that technology is changing so rapidly that the faculty want to ensure that the most up-to-date technology is acquired. Also, the State budget has had an impact on hiring decisions at the Office of Statewide Health Planning and Development, the agency that reviews the plans for seismic safety compliance. The University has been working closely with that agency to try to improve coordination.

Mr. Olsen reported that the second part of the project, the Santa Monica Replacement Hospital, although smaller at 500,000 gross square feet, is more complex. Portions of the hospital will be reconstructed, new parts will be added, and old parts will be demolished. The primary issue with this project has concerned the central plant. It has been completed, but problems that arose with the performance of the contractor led to a substantial delay, and the budget for the project has jumped from $265 million to $275 million.

Mr. Olsen discussed sources of financing. At the inception it was anticipated that the medical center would be generating adequate operating cash and debt capacity to deal with equipment purchases, but because of changes in the reimbursement environment, it has become necessary to pay more attention to the ways in which these are financed. To complete all aspects of the project, it will be necessary to finance $266 million from hospital operations and debt.

Mr. John Stone, of The Hunter Group, discussed the scope of the group’s project and ways in which to finance the cash needs of the hospitals. He reported that The Hunter Group’s comprehensive performance improvement plan for UCLA Healthcare activities addresses both the operations and the building program, which was examined with a view toward funding costs that will include replacing capital equipment. Hospital system operations were analyzed to find opportunities for generating revenue and containing expenses. The areas of leadership and organizational structure were examined with a view toward identifying key positions and unifying the practice plan. Finally, the possibility of relocating clinical operations was considered.

In discussing hospital operations, Mr. Stone reported that the plan contained recommendations for improving revenue, cash flow, and productivity. He summarized the projected financial performance, noting that projected net income after the
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recommended interventions are carried out is $5 million for 2003, $35 million for 2004, and $55 million for 2005, but it will drop in 2006 and 2007. This is because, although the new Westwood facility will have opened, 100 patients will have been moved to Santa Monica, which has a much lower reimbursement rate. Net assets, however, important to the balance sheet of UCLA, will be increased significantly when the new facilities come on line. This is important from a debt capacity and borrowing standpoint. Cash position will be key. He reported that cash going into 2004 is expected to be $700,000 and to grow significantly; however, it will all go towards completing the project. A significant amount will be invested in ongoing capital expenditures, information technology, new equipment, and remodeling tied into the building program, causing a shortfall in cash at the end of 2004 of about $78 million. In 2005 the numbers will improve slightly. There will be a positive cash balance at the end of the year, but a fairly significant deficit will be carried into 2005.

Mr. Stone noted that The Hunter Group will continue to monitor the capital equipment list carefully to make sure there is no duplication. Some reduction in accounts payable is planned. Conservative assumptions have been used with respect to collections. Gifts for the project, which are pledged beyond 2010, will have to be borrowed against. It is expected that the donors will meet their obligations, but not within the time frame of the completion of the capital program. The capacity is there, but the hospital will have to pay the interest, which will affect the cash flow. Also factored in is some capital equipment leasing. Overall, it is anticipated that $125 million may need to be borrowed, in forms not yet determined that could include additional leases, short-term financing, and refinancing existing debt. This sum includes a $70 million shortfall in gifts, $15 million in additional contingency costs, $15 million as a hedge against a shortfall in the collection of existing pledges, a reimbursement of $15 million of insurance proceeds that were used in operations, and interest on the gift standby agreements. He stated that, although the future has many unknowns, it appears that, from the standpoint of this project, the medical center is in a solid financial position.

Mr. Stone turned to the issue of managing hospital beds in the service relocation. Westwood Replacement Hospital will have 427 medical and surgical beds and 27 psychiatric beds. Based on an average occupancy rate of 85 percent, it will be necessary to move 100 patients, as mentioned previously. Orthopedics, geriatrics, family medicine, and spine surgery will be consolidated at the Santa Monica hospital, and some services in surgery, pediatrics, and medicine will be moved there also. Even with that, Westwood will be stretched in its handling of tertiary and quaternary patients. It may be necessary eventually to move more programs to Santa Monica.

Mr. Stone concluded his remarks by stating that, although the medical center’s finances are in better order, some issues, such as the relocation of services and teaching programs, will continue to present challenges.

Chancellor Carnesale commented that measures are being taken and will continue to be taken to make the enterprise financially solid. Although some decisions will be unpopular, the mechanisms are in place to make and implement them.
Regent Lee believed that the medical center should concentrate on reaching a goal of having 15 days of cash on hand this fiscal year. Mr. Stone noted that addressing cash flow was part of his engagement, but he believed that to get receivables in health care to the level of payables could not be accomplished by any healthcare organization in the country. Vendors have more control over forcing the University to pay its bills than the University has over insurance companies to reimburse for services rendered. He stressed that the management and finance team at UCLA is very conscious of the need to reduce receivables and manage payables. He was optimistic that working with the Office of the President to determine how to finance and complete the project and put cash in the bank would result in having 15 days of cash on hand at the end of 2004.

In response to a question by Regent Kozberg, Mr. Stone reported that, because of the demand for pediatric beds at the Westwood hospital, in specific cases a few pediatric patients may be treated at Santa Monica. He noted that, in realigning the medical practices, The Hunter Groups was working with department chairs to determine how to structure Santa Monica to be a teaching hospital and handle the 100 patients who would move from Westwood. Although it had been decided originally to move orthopedics and geriatrics, other recommendations will be considered also.

Regent Kozberg recalled that the medical center had purchased several practices in previous years, and she asked about the future of those doctors. Mr. Stone noted that part of the engagement was to address what was known as the primary care network, which is being reduced in size, affecting some physicians. The primary care network will retain those physicians that are considered beneficial to the organization in its entirety. It has yet to be determined where community physicians in Santa Monica who are outside either the primary care network or the faculty may fit in. He reported that to this point the morale of the medical faculty has been relatively good; however, the reality that Westwood will be short of beds is just starting to hit the staff. Following a period when financial support for the various departments declined precipitously, the recent budget does provide some relief and has gone a long way towards helping. Chancellor Carnesale noted that the faculty have been engaged in the analysis and have understood the problems and how they must be solved. Regent Kozberg observed that, to halt speculation, the sooner the plan for the Santa Monica Hospital was disclosed to the community the better.

Faculty Representative Pitts commented that when medical services and faculty are split among sites, services of every type tend to be duplicated and faculty are forced to shift back and forth. He acknowledged the importance of involving the department chairs in the analytical process, but he believed that other faculty, who would likely be doing the traveling between the two hospitals, should also be involved. An active process where the faculty have the opportunity to help with the planning will avoid ending up with a dual system and disenchanted providers trying to be academicians in adverse circumstances.

Regent Montoya asked about the status of the Iris Cantor Women’s Health Center. Provost Levey assured her that the center, which is located in the 100 Medical Plaza,
will continue unchanged. In response to a further question, he stated that the low bid for construction of La Kretz Hall of Science came in above the budget, requiring bidding to be reopened. Regent Montoya asked why Mr. Eli Broad decided to donate $100 million to establish an institute with Harvard and MIT rather than with UCLA, which she had read would have been his preference. Chancellor Carnesale explained that the decision was reasonable, given the specific kind of program to be developed. He noted that Mr. Broad had been very generous to UCLA in other ways, including endowing the Broad Art Center.

In response to a question from Regent Montoya about capacity at the Westwood replacement hospital, Mr. Stone reported that there would be 517 beds, including 15 in shelled space on the third floor. Of the 502 remaining beds, 75 will be for neuropsychiatric patients, leaving 417 for medical and surgical patients. It is difficult to predict inpatient activity. He pointed out that there had been a phenomenal increase in the number of patients during the past three years; since 1997-98 the census of Westwood has grown by 25 percent.

Regent Seigler asked about the collection of gifts and whether it is likely to be affected adversely in the future. Mr. Stone responded that $50 million had been pledged for the project and would be received after the completion of construction, $26 million had yet to be raised, and $224 million was in hand. Chancellor Carnesale reported that in general for the campus there had been remarkably little change in the level of giving, despite the turndown in the economy.

In answer to a further question from Regent Seigler, Mr. Stone explained that collections for services rendered for professional care were as good as could be expected, given the economy. There is a big gap, however, between charges and costs. Negotiations to improve rates continue for the Santa Monica hospital. Also, obtaining a single license could help offset some of the losses. Every medical center in the University’s system is reliant on State funding, and although each has a contingency plan should that funding end, it would be impossible to respond if changes in support were major. The UCLA Medical Center relies somewhat less on State funding because it lacks sufficient Medicare patients and is not a “disproportionate share” hospital.

Provost Levey commented that, in general, lack of financial support for the school of medicine had made it more difficult for a number of the clinical departments to invest in new programs. In light of this, the health services have forged new partnerships and have reorganized internally. It has been necessary to reassess how to achieve various clinical aims.

Committee Chair Davies was interested in pursuing some of the assumptions upon which the reported $125 million cash shortfall was based. He was concerned that the shortfall may turn out to be larger and that a $15 million contingency fund for cost overruns may turn out to be insufficient, given the size of the project. Although the Westwood hospital is over 60 percent complete and the Santa Monica hospital is over
20 percent complete, there is still room for unexpected cost increases. Mr. Stone commented that, within his analysis and in the context of what is known, the number amount seemed appropriate. Mr. Olsen noted that the limitation is market access rather than the balance sheet. Regent Davies stated that he would prefer to borrow a larger amount, obtaining the best terms possible with the help of the Treasurer, and to string the debt out further, if necessary.

President Atkinson commented that The Hunter Group had done a great job over a long period. Observing that the size of private giving for the project had been stunning, he inquired about the experience that other medical centers with complex medical programs, services, and an educational mission, have with respect to state support. Mr. Stone responded that The Hunter Group had worked mostly in private healthcare, which relies more on gifts and less on state support and that he was not in a position to comment on the adequacy or inadequacy of support within California. Provost Levey believed that too heavy a burden was being placed on local institutions required to fund such an enormous project. He believed that much more State support would be needed in future to accomplish similar undertakings. President Atkinson recalled that when he arrived in 1980, the University had a policy that all private giving would go into endowments and the like and not into building programs, which at the time were funded by the State. Now much of the money donated to the University is being used for the building program.

The meeting adjourned at 4:10 p.m.

Attest:

Associate Secretary