STUCK IN THE MIDDLE

Battered by COVID, Michigan’s midsize hospitals head for financial crunch

By Dustin Walsh | Crain's Detroit Business

Hillsdale Hospital recorded three consecutive years of losses prior to the COVID-19 pandemic. Record federal spending to stymie losses caused by government-led elective-surgery shutdowns reversed the course for the 96-bed hospital in southwest Michigan.

The hospital, led by CEO J.J. Hodshire, used the government funds to expand services in an attempt to raise margins. But it's a gambit. With federal funds drying up and other relief measures expiring, Hillsdale Hospital and other rural hospitals like it face an uncertain financial future as the state's health care industry continues to be paramount.

"If there is no margin, there is no mission," Hodshire said. "Most rural hospitals are plugging holes in a sinking ship. One-fifth of the U.S. population is on that boat. If we don't redesign and rebuild rural health care, we're sunk."

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Hillsdale is categorized as a "tweener" hospital — a midsize hospital with more than 26 inpatient beds but fewer than 200 at least 5 miles from another hospital. These hospitals fall in a reimbursement gray area. Tweener hospitals are ineligible for cost-plus-1-percent reimbursement for all Medicare and Medicaid services like smaller critical access hospitals, but are too small themselves to leverage the reimbursement negotiating power of a large health system.

There are 32 such hospitals in Michigan, mostly rural, but only a handful of truly independent hospitals in the category, like Hillsdale or Memorial Healthcare in Owosso or North Ottawa Community Hospital in Grand Haven.

More than 130 rural hospitals have shuttered since 2010 nationwide, more than 75 percent considered tweeners, creating a escalating gap in care for rural America, according to the National Rural Health Association. The closure of those hospitals led rural residents to have to drive an average of 30 additional miles for health care, according to the report.

Unless the reimbursement model changes, experts fear the growing rural hospital closure will strike hard in Michigan, hospitals like Hillsdale may close and irreparable holes will be torn in the economic fabric of rural counties.

"If this trend continues, you're going to see a whole different outcome for our communities," Hodshire said. "Production assembly lines will close and supply chains will be impacted dramatically. No factory wants to be in a town without health care. We're talking about loss of livelihood, loss of life."

TAKING A SLICE OF MY PIE

The trouble with tweeners began in the mid-1980s when Congress voted to reform the Medicare payment model from cost-based reimbursement, which pays hospitals the costs of services, to an inpatient prospective payment system, which pays a flat rate based on the diagnosis. Under that system, Congress set reimbursement for diagnosis and treatment of Medicare patients without accounting for cost of services or length of patient stay.

The model hit tweener hospitals hard because they typically see an older population, usually on Medicare, that is sicker and requires longer hospital stays to recover.

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An ICU patient room is pictured at Memorial Healthcare in Owosso.

More than 70 percent of Hillsdale Hospital's inpatients are on Medicare, for instance. Big health systems typically have a larger instance of patients with private insurance that helps recoup losses from Medicare patients.

In 1997, Congress saved many tweener hospitals when it passed the Balanced Budget Act, which created special provisions for some rural hospitals for a more cost-based reimbursement model. But most of those provisions were wiped out after the passage of the Affordable Care Act, colloquially known as Obamacare, in 2010. The plan was for Medicaid expansion to cover the shortfall, but the U.S. Supreme Court in 2012 ruled that mandatory Medicaid expansion for states was unconstitutional, blowing a hole in the funding model.

In 2016, Becker's Hospital Review identified 20 percent of the nation's rural hospitals — about 673 hospitals — were vulnerable to closure.

To avoid closing, rural tweener hospitals across the country began cutting services. Obstetrics was the fastest to be cut, according to the National Rural Health Association. Between 2010 and 2014, 7.2 percent of 306 hospitals reviewed by the association closed their obstetrics units, leaving pregnant women in rural communities to seek out alternative care.

The rise of outpatient care has also crippled rural hospitals already wounded from smaller reimbursement, said Brian Peters, CEO of the Michigan Health and Hospital Association.

"Outpatient care creates less revenue than inpatient care," Peters said. "Large tertiary hospitals have a very robust mix of inpatient and outpatient care. That's on top of all the transplant, heart surgery and orthopedic services that supplements the losses they see in outpatient care. Smaller hospitals don't have that luxury, so more outpatient care in their portfolio creates more losses."
Outpatient care has grown from less than 30 percent of hospital revenue nationally in 1996 to at least 50 percent today, according to advisory firm Deloitte. Outpatient services now account for 75 percent to 80 percent of revenue for tweener War Memorial Hospital in Sault Ste. Marie, for instance. Increasingly, providing health care services is less profitable and for large health systems, that's not a major problem. Large systems like Beaumont, Spectrum and Henry Ford are able to generate massive returns on investments. The money coming in the door is invested and the returns pay down any potential losses. Beaumont, for instance, ended 2020 with $3.49 billion in cash and investments, translating to the system being able to operate for 307.3 days without receiving a single cent of reimbursement. "These systems have a rainy day fund and a mechanism to make it through any troubles," Peters said. "Smaller independent hospitals don't have that at their disposal, so if something like surgical volume drops, they can be in a difficult spot just making payroll."

JOIN OR DIE

All of these issues mean tweener hospitals have been left with few choices for survival. Of the 32 tweener hospitals in the state, 27 have merged with larger health systems to pool resources and reduce overhead costs. Joining a large system allows tweener hospitals to enjoy the overall systems negotiating power and cash flow.

CEO David Jahn said the hospital simply couldn't sustain the costs of providing health care any longer.
"It's been a struggle for years," Jahn said. "We need to serve our community, but we need the financial resources that are needed to do so and we just don't have them. We were operating day-to-day, week-to-week and month-to-month. We were down to one family doctor and one general surgeon. Then add in the nursing shortage. We just weren't going to make it."
Jahn also said with dwindling finances, recruitment became even more difficult, compounding the reimbursement issue.
"We can only afford one or two physicians in a specialty, so that left them on call pretty much 24/7," Jahn said. "Work-life balance is a real issue in rural hospitals, and that makes recruitment even tougher. They get no relief here. They can get more money and more time off in larger urban areas."

War Memorial merged with Mid-Michigan Health, which is affiliated with Ann Arbor-based Michigan Medicine, to fill in the financial holes and offer more comprehensive health care services, Jahn said.

"From a clinical perspective, we'll be able to have their resources at our fingertips, instead of having to develop them on our own," Jahn said. "All of a sudden we have a whole system worth of specialties we can rely on and use their administrative processes and supplier contracts. We can now redirect our focus on patient care and less on administrative burden."
Peters said linking up with a larger system doesn't eliminate the reimbursement challenges at rural tweener hospitals but it does alleviate some pressures. It's possible all remaining independent hospitals will have to join larger systems to remain viable, but even then, the risk of closure still exists.
"The volume-based approach to reimbursement has always been a problem and that doesn't go away," Peters said.

RESISTANCE THROUGH INVESTMENT

Hillsdale Hospital is taking a divergent approach for survival, not by cutting services or joining a new system, but by investing heavily in new services.
The hospital opened a pain management clinic in February 2021, dedicating an entire floor to the clinic and an advanced wound care and hyperbaric medicine clinic in January.
"A lot of my colleagues believe the only way to survive is to cut (services)," Hodshire said. "That's a vicious cycle. Once you send a patient to a larger system, you lose them forever. I want to invest, to keep our patients here. My goal is to keep as many patients here as I can."
To maintain services, Hillsdale is splitting the salary of full-time specialty physicians, such as urologists, with other independent hospitals in the area, like Oaklawn Hospital in Marshall.
It has also signed contracts with local prisons to provide health care services.

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"We have to look at alternative ways to get additional revenue," Hodshire said. "The rural health model needs to change, but I can't count on the government to give us a surplus."
Still, the clock is ticking on Hillsdale and the other tweeners. Hillsdale is turning around a 2 percent margin on its $70 million in patient revenue, but that's largely because Congress has continued a moratorium on Medicare sequestration throughout the pandemic.

Starting in 2013, Medicare payments were cut 2 percent as required by the Budget Control Act in an effort to save $1.2 trillion. Congress suspended that cut in 2020 and extended it last year. Sequestration will return to 1 percent at the end of May and back to 2 percent by July, effectively wiping out any margin Hillsdale is currently enjoying.
"We do all of this for the community benefit, but if sequestration comes back, we're going to hurt," Hodshire said. "We are living on a razor's edge every day. Every decision I make has a major consequence if I get it wrong. We're facing down the most difficult time of operations in our history."

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