MEMORANDUM

TO: Representative Mary Franson

FROM: Carl Vaagenes, Douglas County Hospital CEO

Nate Meyer, Douglas County Hospital CFO

DATE: 3/07/17

SUBJECT: HF559

Douglas County Hospital (DCH) is owned by Douglas County and is governed under government statutes as an enterprise fund of the county. DCH has nine Board of Director members with 5 of them Douglas County Commissioners. Last year, the DCH board asked that we explore the possibility of changing this structure to 501©3. After completion of the report it was decided to stay with current government structure. One of the follow-up actions that they asked us to do was to pursue legislation that would loosen the restrictions associated with Minnesota Statute section 118A in relation to allowable type of investments for government hospitals.

Douglas County Hospital is a capital intensive operation. Over the course of the past 10 years, DCH has made close to $80,000,000 in expenditures on building expansion, building acquisition, and equipment. To pay for this, it has done so with roughly half debt from borrowing and half cash from operations. DCH long term plan identifies over $250 million in building replacement in order to replace the 460,000 square feet of buildings in use today. On top of that, it would cost over $40 million to replace all equipment in use today. This is similar to most hospitals our size.

Hospitals run operations in anticipation of these large capital expenditures. The big items do not happen every year so cash balances are built up over the years until expended. This leaves cash balances that average 149 days cash on hand. Days cash on hand is a ratio identifying how many days a hospital could operate without any revenue but still pay all cash expenses. DCH currently operates above industry averages at 190 days cash on hand with average daily expenditures of $350,000. This cash balance has been built through successful operations and totals roughly $70 million.

Our peer hospitals that are not government owned have the ability to invest cash in options that are not restricted by Statute 118A. Our audit firm, Clifton Larson Allen, put together a list showing that DCH has averaged 4.60% less in return than peer facilities they audited from 2013 to 2015. This has lowered our investment returns by over $1 million per year in comparison to those peers.

If this legislation passes, DCH finance committee will draft written investment policies and procedures with recommendation that DCH Board of Directors approve. If approved, all investment decisions will be made by DCH finance committee upon recommendations of professional investment advisors.

The attached exhibits are for your reference:

Exhibit 1 – Financial impact – For the report referenced earlier that was done for DCH Board of Directors, an estimated impact through 2025 on investment income shows $43 million in additional cash using return assumptions shown for a government hospital vs. 501©3 hospital.

Exhibit 2 – Future Building and Equipment costs for DCH

Exhibit 3 – DCH Finance, Audit, and Compliance Committee Charter

Exhibit 4 - Legal Opinion Regarding Legislation

Exhibit 1:

The difference in interest revenue is driven by investment options under 501©3 vs. government owned facilities using historical averages of the former.

The sizing options of cash balances in the pro-forma's used the following:

Operating Pool: 25 Days Cash on Hand. This is cash used to fund daily working capital and capital equipment needs.
Short Term Pool: 50 Days Cash on Hand. These investments are meant for higher returns than the operating pool but are not as liquid. Cash from this pool funds debt requirements and capital purchases.
Long-Term Pool: These are funds that are designated for long term needs of the organization. The expected return in the pro-forma is 6% for the 501©3 option with a 10 year time horizon to capture the 1 or 2 market corrections based on historical swings in the market.

Based on those sizing options, the cash balance in each pool is the following at the end of 2016 when cash is expected to end the year at $68,941,861 with the expected returns:

Table A.

	2016 Cash Balance		Gov't Return %	501©3 Return %
Operating Pool	$8,997,067	25 Days Cash	0.50%	0.50%
Short Term Pool	$17,994,134	50 Days Cash	1.0%	2.5%
Long Term Pool	$41,950,660	>75 Days Cash	1.5%	6.0%
Total	$68,941,861			

Table B: Non-Operating Income (000's)

	2017	2018	2019	2020	2021	2022	2023	2024	2025
Gov't	$805	$823	$960	$1,106	$1,260	$1,426	$1,603	$1,790	$1,989
501©3	$2,940	$3,208	$3,985	$4,849	$5,800	$6,849	$8,001	$9,263	$10,643
Dif	$2,135	$2,385	$3,025	$3,744	$4,539	$5,422	$6,398	$7,472	$8,854

The overall difference in interest revenue over the 9 years is $43,773,251.

Exhibit 2

Douglas County Hospital Future Building Replacement Costs and Equipment Costs

	Sq. Ft	Current Replacement Cost per Sq. Ft	Replace Cost 10 Year @ 4% Inflation	10 Year Replacement Cost
1955 – 2001 Building	244,000	$300	$444	$108,336,000

	Sq. Ft	Current Replacement Cost per Sq. Ft	Replace Cost 30 Year @ 4% Inflation	30 Year Replacement Cost
2010 Building	129,486	$300	$973	$125,989,878

	Sq. Ft	Current Replacement Cost per Sq. Ft	Replace Cost 15 Year @ 4% Inflation	15 Year Replacement Cost
Alexandria Clinic	67,000	$200	$360	$24,120,000
Osakis Clinic	7,690	$200	$360	$2,768,400
Northwest Campus	12,000	$200	$360	$4,320,000

Major Moveable Equipment:

Equipment Age	Purchase Cost	Replace today after 4% inflation
Prior 1986	$29,728	$100,015
1986 – 1995	$1,202,142	$2,856,373
1996 – 2005	$7,031,990	$12,036,181
2006 – 2015	$22,654,284	$26,747,630
Total	$30,918,144	$41,740,199

Total:	**$307,274,477**

Exhibit 3

Finance, Audit and Compliance Committee Charter

I. PURPOSE

The Douglas County Hospital (DCH) Finance, Audit and Compliance Committee (Committee) shall be responsible for providing oversight assistance to the Board of Directors in fulfilling its responsibilities in assessing:

A. Significant risks and exposures impacting DCH, unless covered by another oversight or governing body.
B. Key financial policies and procedures, relative to their alignment with DCH policies, standards and guidelines.
C. The consolidated financial statements, relative to understanding implications of both DCH's financial condition and its results of operations;
D. The long-range financial plan, relative to appropriate budgeting and future planning for operating and capital needs;
E. The external audit process, relative to reliable systems of operational, financial and compliance internal controls;
F. The corporate compliance plan, relative to compliance and appropriate ethical conduct with all applicable laws and regulations;
G. Other key financial and compliance topics.

The Committee shall review the financial statements, relative to the position of DCH in regard to financial condition and results of operations. The Committee shall be responsible for maintaining open communication with the Board, the external auditors and management.

II. COMPOSITION

A. Number of Members: Minimum of six members, with at least three members from the Board (two duly elected commissioners and one community-at-large board member).

B. Appointed: Committee members are appointed by the Chair of the Board of Directors

C. Re-appointed: Committee members are re-appointed by the Chair of the Board of Directors

D. Term of Membership: three year term with alternating three-year cycles, not to exceed three consecutive terms (or nine years)

E. Staff Support: Chief Financial Officer (Lead); Compliance Officer; Controller (or similar position, if applicable); Chief Executive Officer, and County Auditor

F. Non-member Attendees: External Auditors

III. **VOTING**

A. Quorum: Simple majority of the members

B. Number of Votes Needed: Majority of the members present

IV. **MEETINGS**

A. Frequency: At least six times per year

B. Agenda Responsibility: CFO, Compliance Officer, and Committee Chair

C. Attendance Requirements: Member must attend more than half of the meetings per year

D. Minutes: Report delivered to Board. Minutes maintained by the DCH Executive Assistant or designated individual.

V. **OFFICERS**

A. Chair: The Committee Chair shall be appointed by the Chair of the Board and shall be a member of the Board

Exhibit 4

Minnesota Hospital Association

2550 University Ave. W., Suite 350-S
St. Paul, MN 55114-1900

phone: (651) 641-1121; fax: (651) 659-1477
toll-free: (800) 462-5393; www.mnhospitals.org

March 8, 2017

Carl Vaagenes
Chief Executive Officer
Douglas County Hospital
111 E. 17th Avenue
Alexandria, MN 56308

Dear Carl:

I understand there has been some question about whether current language in Minnesota Statutes Section 144.581, Subd. 1 provides sufficient authority for public hospitals – including county hospitals like Douglas County Hospital operated under Minnesota Statutes Chapter 376 – to invest funds in a broad variety of investment vehicles. Because Section 144.581 includes terms that are not defined and subject to differing interpretations, many public hospitals have been hesitant to make investments that could arguably be prohibited by other sections of Minnesota law.

While Section 144.581 authorize public hospitals to "own shares of stock in business corporations" this language is vague with respect to the types of entities where public hospitals may invest. The vagueness arises with respect to the term "business corporation." "Business corporation" is not defined by Section 144.581 or any Chapter of Minnesota law. Minnesota law does, under Chapter 302A, establish the Minnesota Business Corporation Act, which establishes substantial standards and requirements for entities wishing to be incorporated under the laws of the state of Minnesota.

Therefore, the lack of specificity in the definition of the term "business corporations" makes the statute ambiguous with respect to investments. It could be interpreted to allow investment in any business entity with stock, or only those entities established pursuant to the Minnesota Business Corporation Act, or it could refer to some other undefined class of entities.

Because of the ambiguity of Section 144.581, many public hospitals, based on advice from legal and investment advisors, consider themselves constrained by the provisions of Minnesota Statutes Section 118.04. Section 118.04 clearly limits investment of public funds held by government entities, as that term is defined in Section 118.01, certain highly secure investment vehicles outlined in Section 118.04. Because Section 118.01 appears to conflict with potential interpretations of Section 144.581, many hospitals have chosen to interpret the statutes conservatively and have shied away from broad public investments.

House File 559 introduced during this legislative session and supported by Douglas County Hospital would help resolve the ambiguity and provide comfort to government officials, hospital trustees and administrators, and the general public.

Sincerely,

Ben Peltier
Vice President, Legal and Federal Affairs
Minnesota Hospital Association