

June 2016

**Critical Condition:**

## **Reviving the Fiscal Health of the City's Public Hospitals Will Take State, Federal & Union Cooperation**

### **Summary**

New York City's public hospital system has confronted substantial budget threats in past years, but ongoing changes in the health care industry coupled with policy shifts in Washington may have pushed NYC Health + Hospitals to the steepest fiscal challenge it has faced in memory. Declining revenues—due to factors ranging from a decrease in inpatient care to changes propelled by the Affordable Care Act—coupled with rising expenses leaves the hospital system with a projected cash shortfall of \$6.1 billion over the 2016-2020 period. This shortfall exists even though the city has increased its support for NYC Health + Hospitals by \$558 million in 2016 alone for a total of \$2.4 billion of the system's roughly \$7 billion budget. City support is expected to remain above \$2 billion annually through 2020.

As a result, the de Blasio Administration and NYC Health + Hospitals have developed a plan for bringing the hospital system's costs and revenues into balance. But the success of this "Transformation Plan" is far from certain. Among our findings:

- The plan counts on programs that require federal and state approval to provide NYC Health + Hospitals with \$3.0 billion in aid over five years to help support the system's care for uninsured and Medicaid patients.
- As of June 2016, just under half of this aid (\$1.4 billion) had received the necessary approvals.
- The plan includes savings of \$444 million by 2020 by shifting towards more outpatient rather than inpatient care, but NYC Health + Hospitals has yet to determine how it will achieve this goal.

For the plan to succeed, state and federal cooperation—and aid—will be needed. Cooperation will also be needed from the public hospital system's labor unions if the plan's goals for achieving savings—without laying off staff or closing facilities—are to be met.

The budget recently adopted by the de Blasio Administration and the City Council continued the string of budget actions that have substantially increased the city's financial support of its public hospital system over the course of fiscal year 2016. Through increased subsidies and forgiven payments, the city will provide \$588 million in 2016 and a total of \$1.7 billion from this year through 2020 in additional fiscal relief to NYC Health + Hospitals (H+H) over the amount budgeted when the 2016 budget was adopted last June. (Unless otherwise noted, all years refer to city fiscal years.) Including payments for health care services, city support for H+H in 2016 totaled \$2.4 billion.<sup>1</sup>

Even after taking these city actions into account, H+H projects a cumulative operating deficit—as measured on a cash basis—of \$6.1 billion over the five-year period, 2016 through 2020. In April, the city published a long-term plan (the “Transformation Plan”) to eliminate this deficit with increased revenue and reduced costs to H+H. This brief updates figures on the city's subsidy to H+H (detailed in a previous [IBO report](#)) and provides an overview of H+H's Transformation Plan as it relates to the system's ongoing financial difficulties.

### Increased City Support of H+H in 2016

NYC Health + Hospital's long-term financial stability depends not only on the execution of H+H's internal initiatives, but also on several city budget actions. These actions build on the city's existing fiscal relationship with H+H. In past years the city has paid H+H for providing certain health care services to specific populations, provided H+H with an unrestricted subsidy, and funded part of its supplemental Medicaid. Supplemental Medicaid payments are funds that health care facilities providing care to high rates of Medicaid and uninsured patients may receive to compensate for the low service payments made on behalf of these patients (see [sidebar](#)).

The city also directly pays some of H+H's expenses: medical malpractice claims, employee health insurance, and debt service. (In theory the system reimburses the city for each of these expenses, but in some years the city opts to forgive NYC Health + Hospital's obligation to pay for one or more of these expenses.) In 2015, the city began paying for the system's increased expenses due to recently settled labor agreements. The city's net payments to H+H increased from \$492 million in 2009 to \$1.3 billion in 2015, driven largely by increased supplemental Medicaid payments by the city.

When the 2016 budget was adopted last spring, the city's net payments to H+H were set to increase to \$1.8 billion for this year. The 2017 adopted budget commits to forgiving some of H+H's reimbursement payments to the city, paying for additional labor agreement settlement costs, and increasing the city's unrestricted subsidy to H+H. These actions further increase the city's net payments to H+H in 2016 by \$588 million to total \$2.4 billion. While the increase in the unrestricted subsidy was only for 2016, the city will forgive debt service payments and cover increased labor agreement costs in future years.<sup>2</sup> In total these city actions will provide \$1.7 billion in additional fiscal relief to H+H from 2016 through 2020.

The city's annual financial support for H+H is budgeted to decline slightly in future years as fewer payments are forgiven and other payment streams decline. The city may be forced to increase this support if the Transformation Plan fails to eliminate H+H's deficit. In addition, the city is prepaying \$400 million of its 2017 payments to H+H in 2016 for accounting purposes, which provides H+H with additional cash on hand as it begins its Transformation Plan. The following section details these initiatives and calls attention to those savings and revenue that are uncertain.

<b>Changes in City Financial Support to NYC Health + Hospitals Since the 2016 Adopted Budget</b>						
<i>Dollars in millions</i>						
	<b>2016 Budgeted</b>	<b>2017 Planned</b>	<b>2018 Planned</b>	<b>2019 Planned</b>	<b>2020 Planned</b>	<b>Five-Year Total</b>
Budgeted in 2016 Adopted Budget	\$1,785.1	\$1,943.0	\$1,768.7	\$1,721.7	\$1,817.7	\$9,036.2
Added Through June 2016	588.0	238.2	273.4	291.5	\$316.2	1,707.4
City Subsidy Increase	160.0	0.0	0.0	0.0	\$0.0	160.0
Labor Agreement Subsidy Increase	91.3	58.3	100.5	112.9	\$112.9	476.0
Payment Forgiveness	336.7	179.9	172.9	178.6	\$203.3	1,071.4
<b>Budgeted in 2017 Adopted Budget</b>	<b>\$2,373.1</b>	<b>2,181.2</b>	<b>2,042.2</b>	<b>2,013.3</b>	<b>\$2,134.0</b>	<b>10,743.6</b>

SOURCE: Mayor's Office of Management and Budget  
 NOTE: Fiscal years 2016 and 2017 adjusted for prepayment.

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## Net City Payments to NYC Health + Hospitals, Budgeted, 2016-2020

Dollars in millions

	2015 Actual	2016 Budgeted	2017 Planned	2018 Planned	2019 Planned	2020 Planned
<b>New York City Payments to H+H</b>	<b>\$1,809.2</b>	<b>\$2,373.1</b>	<b>\$2,181.2</b>	<b>\$2,042.2</b>	<b>\$2,013.3</b>	<b>\$2,134.0</b>
Collective Bargaining	85.0	181.1	202.4	267.7	285.8	285.8
Debt Service	212.5	225.9	179.9	172.9	178.6	203.3
Employee Health Insurance	21.1	24.9	24.9	24.9	24.9	24.9
Medical Malpractice Claims	123.4	140.0	140.0	140.0	140.0	140.0
Medical Malpractice Repayment	17.3	17.3	17.3	17.3	17.3	17.3
Payments for Services Provided by H+H	117.1	278.3	263.2	268.3	271.6	274.9
Supplemental Medicaid (DSH + UPL)	1,131.3	1,062.8	1,092.1	889.7	834.1	826.8
Unrestricted City Subsidy	100.9	442.8	261.4	261.4	261.0	361.0
<b>H+H Payments to New York City</b>	<b>(\$300.9)</b>	<b>\$0.0</b>	<b>(\$164.9)</b>	<b>(\$164.9)</b>	<b>(\$164.9)</b>	<b>(\$164.9)</b>
<b>Net New York City Payments to H+H</b>	<b>\$1,508</b>	<b>\$2,373</b>	<b>\$2,016</b>	<b>\$1,877</b>	<b>\$1,848</b>	<b>\$1,969</b>

SOURCE: Mayor's Office of Management and Budget

NOTES: Fiscal years 2016 and 2017 adjusted for prepayment. NYC Health + Hospitals' payments to New York City reimburse the city for some of its subsidy to H+H, so they are shown as negative since they decrease the net subsidy.

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### Transforming H+H

Recent changes in the health care system and government policies have, and will continue to, compound the issues that have long created financial trouble for NYC

Health + Hospitals. H+H and the city have developed a Transformation Plan to eliminate the H+H deficit by addressing some of these issues. This section outlines the factors contributing to H+H's low levels of patient revenue, declines in nonpatient revenue, and increases in expenses

### Supplemental Medicaid

The Medicaid program is the public health insurance program for people with low incomes and certain disabilities; it is run by states and authorized by the federal government. In New York, the federal government funds half of the Medicaid program and states and localities divide paying for the other half of the program. Medicaid reimbursement rates are typically lower than those of private health insurers and lower than the cost of providing care. Federal law allows states to pay health care facilities that see high shares of Medicaid and uninsured patients—often referred to as safety net facilities—additional payments beyond direct reimbursement for services. These payments are made at the discretion of the state or locality and are matched by federal funds at the rate of one to one in New York State. The supplemental Medicaid funds received by NYC Health + Hospitals are funded half by the federal government, with the city providing almost the entire other half of these payments. These payments consist largely of Upper Payment Limit (UPL) and Disproportionate Share Hospital (DSH) payments.

DSH payments are block subsidies for hospitals that see high rates of uninsured and Medicaid patients. The

federal government determines the total DSH funds it will provide to the state and the state determines the value of these subsidies for each hospital based on a complex methodology. The federal Affordable Care Act is set to reduce the total DSH funds states receive beginning in 2017. UPL payments are increases in the Medicaid reimbursement rates for providers who see a lot of Medicaid patients. A locality or state can decide to provide UPL payments to almost any provider and then must negotiate with the federal government to determine the higher reimbursement rates. But the share of Medicaid payments eligible for UPL rates are set to decline in the coming years as the state transitions its Medicaid program into a managed care model.

In the case of H+H, New York State determines the value of its DSH payments and the city determines its UPL payments through the rates it is willing to pay and able to negotiate with the federal government. The city's annual combined DSH and UPL payments to H+H increased from \$65 million in 2003 to \$1.1 billion in 2015. Total DSH and UPL payments increased from 3 percent of H+H's total Medicaid revenue in 2003 to 33 percent in 2015. The federal and state policy shifts noted above are projected to decrease H+H's total supplemental Medicaid receipts from \$2.4 billion in 2015 to \$1.4 billion in 2020.

and then details the related Transformation Plan initiatives to address these difficulties.

**Increase Low Patient Revenue.** Inpatient admissions are declining at hospitals nationwide as the use of preventive and outpatient care grows. H+H has experienced stagnant patient revenue because of declining inpatient admissions without a parallel increase in outpatient visits. From 2011 through 2015, inpatient admissions at H+H facilities dropped by 13 percent—from almost 200,000 in 2011 to 172,000 in 2015—while outpatient visits remained relatively constant. Slight increases in revenue from outpatient services have only barely offset decreases in revenue from inpatient services.

This decline in inpatient visits and lack of growth in outpatient visits has been particularly detrimental to H+H because the system already receives low reimbursements for the services it provides. H+H provides services for disproportionately high shares of Medicaid and uninsured patients as compared with the general New York City population. While only 24 percent of the New York City adult population is enrolled in Medicaid and 14 percent is uninsured, 45 percent of visits to H+H facilities are by Medicaid enrollees and 25 percent of visits are by the uninsured.<sup>3</sup>

The Medicaid program typically provides lower reimbursement for services than private insurance programs and the uninsured may provide little or no payment for the services they receive. In addition, H+H is losing some of its Medicaid patients to other hospital systems—as these patients recognize their choices in providers throughout the city—and is maintaining its share of uninsured patients.

H+H plans to increase patient revenue not by reversing the decline in inpatient admissions, but by boosting outpatient service availability and by receiving greater reimbursement for providing services for Medicaid and uninsured patients. It assumes H+H can maintain its current patient base and does not depend on H+H caring for substantially more patients or on receiving higher payments from private insurers.

H+H expects nearly \$1.6 billion in increased patient revenue through 2020. Most of the procedural and policy changes needed to achieve this revenue have already received the necessary approval from state and federal agencies. Since last year, H+H has received approval to receive increased reimbursement rates in exchange for providing higher quality care to its Medicaid managed care patients and for all Medicaid beneficiaries within some of its clinics. H+H also plans to increase its revenue from providing care to its currently uninsured patients by enrolling those eligible in insurance and by receiving additional federal funds for providing health care to those who cannot enroll in health insurance. The plan to receive additional federal funds for providing care to the uninsured—an anticipated \$306 million over five years—has not yet received necessary federal approval.

**Recapture Declining Nonpatient Revenue.** As noted above, H+H sees a disproportionately high number of Medicaid and uninsured patients. Supplemental Medicaid funds are meant to enhance payments to such providers because their reimbursement for patient care is low, but a combination of state and federal policies will reduce these payments in the immediate future. Federal policy will decrease Disproportionate Share Hospital (DSH) funds nationally beginning in 2017 and the state's transition

<b>NYC Health + Hospitals Transformation Plan, Budgeted, 2016-2020</b>						
<i>Dollars in millions</i>						
	<b>2016 Budgeted</b>	<b>2017 Planned</b>	<b>2018 Planned</b>	<b>2019 Planned</b>	<b>2020 Planned</b>	<b>Five Year Planned</b>
Initiatives to Address Declining Patient Revenue <sup>3</sup>	\$65.0	\$350.0	\$338.0	\$384.0	\$419.0	\$1,556.0
Internal Initiatives	40.0	67.0	97.0	143.0	178.0	525.0
Requiring Outside Government Approval—Approved	25.0	265.0	145.0	145.0	145.0	725.0
Requiring Outside Government Approval—Unapproved	0.0	18.0	96.0	96.0	96.0	306.0
Initiatives to Address Declining Nonpatient Revenue	31.9	208.7	484.8	672.9	544.8	1,943.1
Requiring Outside Government Approval—Approved	31.9	163.2	221.8	193.0	58.9	668.8
Requiring Outside Government Approval—Unapproved	0.0	45.5	263.0	479.9	485.9	1,274.3
Initiatives to Address Excess Costs (Internal)	0.0	119.0	399.5	551.0	666.0	1,735.5
Additional Revenue-Generating Initiatives (Internal)	58.2	101.4	84.3	60.3	169.6	473.8
<b>TOTAL</b>	<b>\$155.1</b>	<b>\$779.1</b>	<b>\$1,306.6</b>	<b>\$1,668.2</b>	<b>\$1,799.4</b>	<b>\$5,708.4</b>
SOURCE: Mayor's Office of Management and Budget						
<i>New York City Independent Budget Office</i>						

of its Medicaid program into managed care decreases H+H's ability to receive Upper Payment Limit (UPL) funds (see sidebar for additional detail). H+H projects that its supplemental Medicaid receipts will decline from \$2.4 billion in 2016 to \$1.4 billion in 2020.

New York State and federal agencies have already approved Medicaid waiver agreements to recapture some of these losses, but H+H is also depending on amendments to these agreements to further increase their supplemental Medicaid receipts. H+H aims to recapture \$1.9 billion of the roughly \$2.1 billion it will lose in aggregate supplemental Medicaid payments from 2017 through 2020. The majority of this anticipated revenue (\$1.3 billion) depends on future state and federal approval. Specifically state and federal agencies must approve changes to New York's DSH allocation methodology and amendments to the existing Medicaid waiver and state plan.

In addition to efforts to increase supplemental Medicaid payments, H+H is also planning to increase revenue through its health insurance company, MetroPlus. H+H's budget assumes \$374 million in increased revenue over five years from expanded MetroPlus enrollment and greater usage of H+H facilities by its enrollees. H+H also plans to repurpose some of its existing sites for new uses such as housing or retail and has budgeted \$100 million in projected revenue from these efforts.

**Decrease Costs.** H+H reports high costs as compared with other New York City hospitals for the hospital-based procedures it performs.<sup>4</sup> This may be due to staffing levels, as well as the price H+H pays for some medical and other supplies. Ongoing initiatives to reduce staff through attrition and improve supply and pharmacy costs aim to save H+H \$220 million annually by 2020.

In addition to its ongoing cost issues, H+H's staffing and maintenance expenses have continued to grow, even as usage of its facilities has declined in recent years. As inpatient admissions decreased by 13 percent from 2011 through 2015, total staffing expenses grew by 11 percent. Since H+H is not planning on substantial increases in admissions or visits in the future the hospital system must adjust its expenditures to correspond to the usage of its facilities. NYC Health + Hospitals plans on transitioning towards providing more preventive and ambulatory care and less acute hospital-based inpatient care. Through this shift H+H aims to increase the health of its patients

and decrease costs. Providing more outpatient care is financially sensible both in the immediate years—as running a clinic is less expensive than running a hospital—and over the long term as many patients who receive preventive care need less emergency and acute care over time.

Although the Mayor has explicitly precluded closing entire hospitals, dismissing staff, or privatizing services, H+H has already begun reducing staff through attrition and plans to further reduce personnel and other maintenance expenses by downsizing inpatient and other underused services. H+H plans on saving \$444 million annually by 2020 by shifting towards more outpatient and less inpatient care; however, H+H has not yet determined its specific plan for doing so. While these plans will not depend on approvals by outside government agencies, H+H must quickly identify the facilities involved and what services will change. H+H must also continue to work with its labor unions to achieve these savings goals.

### Cooperation Needed to Raise Revenue, Reduce Costs

H+H plans to eliminate its deficit by increasing its patient and nonpatient revenue sources and by reducing costs. Over half (52 percent, or \$3.0 billion) of the anticipated fiscal relief from the Transformation Plan initiatives is dependent on state or federal action. While just under half of this amount (\$1.4 billion) has already received approval, the balance (\$1.6 billion) is contingent on the approval of new or amended agreements with state and federal agencies. As such, the plan's success depends not only on the execution of its internal initiatives and agreements with labor unions, but also on cooperation from state and federal agencies. In addition, H+H must quickly create a specific plan for downsizing its inpatient care and expanding its provision of outpatient care to achieve its projected expense reductions.

*Prepared by Erin Kelly*

### Endnotes

<sup>1</sup>Adjusted for prepayment.

<sup>2</sup>In the preliminary budget plan released in January 2016, the city shifted \$204 million annually from its supplemental Medicaid budget to the H+H unrestricted subsidy because of anticipated declines in federal matching payments. This shift increased the unrestricted subsidy and decreased supplemental Medicaid funding in 2016-2020, but did not affect the city's anticipated total payments to H+H.

<sup>3</sup>H+H Finance Committee Reports; Department of Health and Mental Hygiene Community Health Survey, 2014.

<sup>4</sup>IBO analysis of 2014 New York State SPARCS database.

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