From: Laret, Mark
Subject: From the CEO: UCSF Medical Center and the Economic Environment
Date: Tuesday, December 09, 2008 2:04:16 PM

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Dear Colleagues:

The negative economic news seems to just keep coming, and last weekend President-Elect Obama said the economic climate will almost certainly get worse before it gets better. Today, I would like to share my perspective on the economic situation as it affects UCSF Medical Center. The bottom line is that we are in a relatively secure position right now but we will likely face great challenges in the coming years. In this email, I will cover the major factors – both good and bad – that we face. Next week, I will follow with an email discussing actions we are taking and are considering to ensure that we not only weather this economic storm, but emerge from it stronger than ever.

Background

Just to review, UCSF is a $1.3 billion per year, self-supporting hospital. That means it costs about $3.5 million to operate the medical center every day. 99.5% of our revenue comes from patients and their insurance, including Medicare and Medi-Cal. The other 0.5% comes from the State of California, which provides a total of $9 million for support of certain teaching activities – about 3 days worth of expenses.

Each year, we set a financial goal to keep between 5% - 6% of our total revenue – a profit of about $70 million. This is the source of money we use to buy new equipment, remodel our aging facilities, implement our UCare IT system and ultimately help us build our new Mission Bay hospital facilities. Ours is a “capital intensive” business – meaning that in order to remain a modern teaching hospital, we must make sufficient profits to continue making capital investments.

Our Situation

Our situation today is mixed. On the positive side, we have two major advantages: we continue to have unprecedented demand for our services, a testament to our

strong medical staff and specialty programs. Second, our reimbursement from Medicare, Medi-Cal and commercial insurance for the care we provide is relatively stable at this point. As we look forward, there is even some hope that we might see some increases in Medi-Cal with the new administration.

On the negative side, we are operating at capacity, so until we add beds at Mission Bay in 2014 our ability to increase patient care revenue is limited to becoming more efficient with the resources we have.. Further, I am concerned that as companies lay off employees, we may see fewer higher reimbursing commercially insured patients. Employers may react to big increases in healthcare insurance premiums by steering employees into high-deductible health plans, which could make employees more hesitant to use our services. I also expect bad debts and charity care to rise. And while the Medical Center's State support is relatively limited, because of the State's dire financial circumstances some part of that will likely be cut. Relative to our peers nationally, our labor and supply costs are high, even when adjusted for the San Francisco wage index and the acuity of our patients. This makes us vulnerable as federal, state and commercial payers strive to contract with the least expensive providers of care.

Finally, on top of everything else, we will begin making contributions to the University of California pension program this next July. I expect the employer contribution to start at 4% next July, which will represent a new cost of over $25 million per year for the Medical Center. This contribution probably will increase in coming years to 10% or more, increasing our annual expenses by $60 million or more.

These pension contribution increases will also be experienced by the rest of the campus, including the Schools of Medicine, Nursing, Pharmacy and Dentistry, and they will be challenged to cover those expenses.

Implications

I am optimistic that even in this difficult economic environment, we can achieve our financial goal for this fiscal year. I believe this because we added 16 beds this year to accommodate patient demand; there are no major reductions in reimbursement expected this year; we are doing a better job of cost control; and we do not have to make pension contributions until next year.

However, I am concerned that next year's budget will be difficult for UCSF Medical Center. The pension contribution will be a significant new cost to us. We will have increased labor and supply costs, and we will be operating at capacity. As we have seen in past economic slowdowns, we have already experienced delays in payments from commercial insurance and Medi-Cal (as a result of the state budget delay), and we expect more of the same next year.

In the next few months, we will be working together to develop an action plan for addressing these economic factors that we know will face UCSF Medical Center over the next several years. Some will be easier to implement, and some will be more difficult. Perhaps the biggest change we must come to terms with is the change from a strategy of expansion and investment that we have pursued over the past several years to a strategy focused on smarter use of our existing resources, improving efficiency, stripping out waste, and increasing accountability at every level. The process may be challenging, but with everyone's help, the end result will almost certainly further elevate UCSF Medical Center and better secure our future.

I will share thoughts about our action plan in next week's email. As always, thank you for your continuing support of UCSF Medical Center and our patients.

Sincerely,
Mark R Laret
CEO