Getting past stop

How to keep development projects moving forward in a challenging environment

By Brian R. Haapala

Filippo Brunelleschi, the renowned renaissance architect and engineer, is credited as the first to use perspective when he painted a building that was reflected over his shoulder onto a mirror in front of him. His first important commission was a hospital, where in today's world, perspective is everything.

Brunelleschi's hospital did not have to consider operating uncertainty, a turbulent capital market, strategic planning, or a shortage of doctors and nurses. We do. And this complexity and number of moving parts can be overwhelming. Keeping the pieces together requires an understanding of, and connection to, the strategic needs. The challenge — in fact, the imperative — is to lift the facility project and strategic plan off the page and enrich them within the context of a real, unpredictable world: to connect strategy to facility. Strategy-driven facility projects are the most likely to be funded and make the biggest impact.

Facility projects start with so much promise and excitement, yet many also end with divisiveness and frustration. Capital markets change. Scope changes monthly. Projects are scaled back to a fraction of the original concept. In the worst cases, the current plan is added to the archive of the projects from two, five, and seven years prior that didn't get past stop.

Facility plans are often stopped by operational issues that have crept up or changing priorities. With tight credit and falling investments, facility plans are also failing because the plan of finance rests

on a mode of access to capital that has become more limited, expensive and for some hospitals, non-existent. As execution of the plan is deferred, it atrophies until at one point it becomes meaningless. There are no easy answers, but there is a path forward.

- Re-examine the facility plan, not just for phasing or scope reductions, but strategically.
- Identify more sources of capital and update the plan of finance.
- Plan to hit the ground running when markets improve and develop a strategy for increased competition.

Rooks County Health Center in Rooks County, Kan.

Market analysis is more than demographics

With increased demands for capital comes an increased need for operating scale and efficiencies. In good times, the analysis of the service area is often taken for granted and dismissed in terms of its overall importance to the plan. Plans with a weak or incomplete study of the market are plans built on the proverbial foundation of sand.

Many talented organizations plan on the basis of dated and crude primary and secondary zip code service area definitions. When planning an $80 million facility investment, should the market analysis be based on the U.S. Postal Service's mail distribution system? When you can't afford anything more than $30 million now, how does the project continue to target the right market? Best practice market studies take a more granular approach and incorporate geographic information systems to display the analysis. A picture of the market is worth more than a thousand words to inform facility recommendations.

By incorporating geographic analyses of existing and potential customers, facility strategies are quantitatively-based on drive time convenience and target growth areas. When competitive positioning is added to the picture, opportunities and weaknesses are revealed, and urgency quickly replaces complacency.

Market assessments may begin and end with a static demographic analysis. This is a good starting point; however, changes to the population, both in terms of overall growth and in aging, are important for long-term planning. Most importantly, the market analysis should convert the size and mix of the population into service volumes and a demand forecast. Generic inferences about higher utilization rates among the older population are not as valuable as a specific volume study that informs the equipment and space needs for each modality and provides a link to the operations.

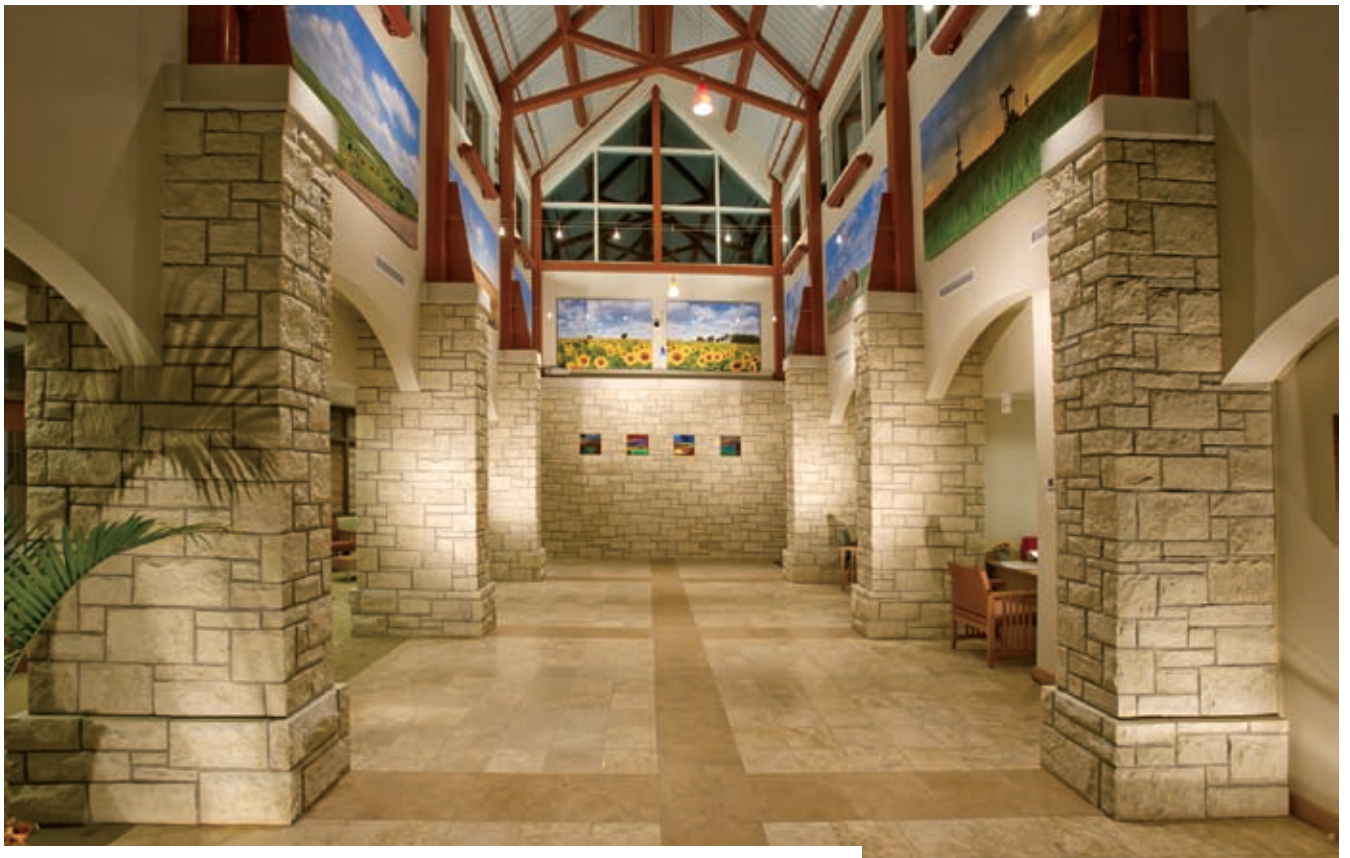
Real change in an incremental world

The shortages of physicians, nurses, and technical staff are well-documented, yet not fully appreciated in the development of many facility plans. This is particularly true when the plans are based solely on the perspective of the internal staff. While engaging these stakeholders is important, convincing them to break away from the status quo is a great challenge.

Statements such as, "we can make it work" or "if we just move this unit, it will be OK for a while," often represent incremental approaches that fail to address underlying problems. Many of these 'solutions' eliminate future options that are important to the overall strategy. And by sacrificing one critical adjacency, operating and staffing costs can increase. Remember, one incremental $65,000

>> There are more than enough reasons to act and the benefits are self-evident, right?

Looking at only the headline of the national study of hospital replacement projects supports that conclusion: average annualized growth in volumes was 11 percent. Those are growth numbers that most hospitals would like to duplicate." (Hospital Replacement Facility Study, Stroudwater, 2007)



Hospital Investments Rising

The annual hospital investment in facilities has grown at an average rate of over 7.5 percent per year since 2000 to the 2006 level of $43.5 billion. In addition another $25 billion has been invested in free-standing outpatient and ambulatory centers. (Source: 2000 through 2006 Annual Capital Expenditures Surveys, U.S. Census Bureau)

per year per full time employee over a 25 year depreciable life of a project represents over $3 million in future dollar outlays during that period. The accumulation of these costs over time can outpace an initial capital outlay. Incremental planning, applying band-aids, is costly in the long term.

A well-conceived facility is one that supports more efficient staffing and higher quality outcomes. This includes a strategic review of the organization's service offerings beginning with an evaluation of the hospital's alignment with its physician community.

Evaluating facility options among the full breadth of current and potential service offerings requires a strategic perspective. As important is an emphasis on a service line in support of a center of excellence. It may include a multi-site strategy to offload current demands or target specific areas for growth in market share. Or utilization of prime clinical space by non-core business lines can be targeted. Remember, lift the drawing off the page and move it into the community.

Competing for capital resources

If strategy is the foundation of getting past stop, what then could possibly get in the way? Money. Jim Collins argues passionately in *Good to Great for the Social Sectors* that money is not a sign of greatness for non-profit organizations, yet without access to capital, even the best strategic facility plans will die. It's okay to talk about money.

Few organizations have access to all the capital they need regardless of size and credit quality. Unfortunately, hospitals in today's environment have fewer capital options, all of which are more expensive in today's market. The cost and availability of capital is a reflection of the supply of credit and the risk premium that investors require on healthcare issues. The result: good hospital credits can also suffer. Estimates to update and replace existing hospital capacity and to meet a growing and aging population's needs reach as high as three quarters of a trillion dollars. That's a lot of facility projects to get past stop.

So what determines access to capital? Is it the historical financial performance? Is it the forward-looking pro forma? Is it the board of trustees' tolerance for risk? Yes, yes, and yes. Historical debt capacity studies are an appropriate starting place for determin-

Not Linking Plans to Strategy and Operations

A hospital was planning for double-digit growth in outpatient services, but didn't plan for growth in the medical office building to accommodate additional primary care to meet the needs of the growing community. Without a referral basis and medical staff development plan, the plan results in excess outpatient capacity.

Architecture firms partner with hospitals on feasibility

As rural communities across the country struggle with how to provide access to critical hospital services, hospital administrators and local leaders may find answers from an atypical source: architecture firms to provide development strategies to administrators. Some of the services include financial modeling and forecasting to public and private funding options, as well as the traditional architectural services of master planning and design.

One such firm is Miller Architects of Oklahoma City, Okla., a full service architectural and interior design firm that provides planning, architectural and interior design services on an array of project types, and actively partners with hospitals from feasibility through to completion of construction.

Launched in 1998 by President Darin Miller, the firm is currently involved in seven community expansion and replacement hospital projects across the U.S.

Miller says his firm has developed a business strategy to help many communities address operational strategies and programming needs as well as locate the most advantageous funding sources before the design phase of the project begins.

"Over the past 15 years we've designed and built many hospitals and healthcare facilities across the country, but a few of our hospital projects that were successful from an architectural standpoint, ultimately failed because communities had not properly planned for the management and operations aspect after construction was completed," said Miller.

The type of construction typically used in the '40s and '50s can make the prospect of renovation more costly than new construction. The advancing technology of current building materials often provides economic and operational advantages that exceed any attempt to alter or supplement the existing hospitals through renovation. New construction avoids service interruptions as well as managing health and safety codes.

ing the access to capital. By comparing the operations, accumulated cash balances, existing debt levels, and operating factors to the benchmarks, the debt capacity range is quickly estimated.

But the historical debt capacity does not take into account the impact of any current or new strategies or the risks of new competitive threats. The availability of capital for facilities is also increasingly linked to operations — to be more precise, quality. Rating

A tale of two case studies

CASE #1

MARKET ANALYSIS CASE STUDY

Situation: Decision to renovate or replace a main facility.

Approach: An assessment of the local market. While it was well-known that the population growth was in a remote part of their service area, there was a lack of understanding about how the threat of new competition and subsequent loss of volumes would devastate the hospital's finances.

Solution: The Board immediately put its main campus plans on hold and developed an aggressive ambulatory center strategy in the growth area to both grow and protect its market presence.

Results: The hospital has arranged funding and contracted for the schematic design of the facility.

CASE #2

FINANCING CASE STUDY

Situation: A Midwestern hospital completed a master facility plan and identified $80 million in needed investment, while the debt capacity was pegged at $50 million based on lackluster financial performance historically.

Approach: Rather than accept an incremental investment approach that would not re-position them strategically in the market, the hospital looked for alternatives.

Solution: Upon finding that its contracts were substantially below the dominant regional competition, the hospital entered into a dialogue with third party payers.

Results: Faced with the prospect of losing all negotiation position if the hospital were to consolidate with the dominant player, the payers agree to substantial rate increases effectively funding the debt capacity gap.

agencies are aware of macro-trends and the move toward payments for quality, and they are increasingly asking about this performance. Why would facility plans include an evaluation of quality? Considering the trajectory of healthcare financing, why not?

The analytical bar is being raised to access the credit markets successfully. Simulation analysis has been used widely in other industries to account for uncertainty in the internal or external environment; while in healthcare single point estimates and limited scenario planning are the historical norm.

The best plans have leaders and champions

Trustees are inundated with information about the impending demise of the healthcare system and insolvable operational challenges regularly. Some trustees compensate with highly risk-averse decision-making.

Justifying the case for investing in a new facility is a long educational process. Starting this too late in the planning process is simply a mistake. Not involving the medical staff is another common mistake. Over-involving other stakeholders in the planning process is also a hazard. Getting people appropriately engaged and maintaining this interest and enthusiasm is no small task.

Winning 'hearts and minds' to get past stop requires two things: making the plan relevant to their individual or group needs and concerns, and establishing a vision for meaningful change. The former depends largely on how the problem is framed and the latter depends on what solution is found.

Upon hearing a new idea for the first time, we instinctively ask ourselves how this will be relevant to our lives. If it is irrelevant, we may politely listen, but action is not required. Conversely, if the problem is described to us in a way that makes it important to my business, then I'll be more attentive and active.

An important challenge in developing a plan, or reinvigorating a stalled plan, is to find a way to connect with multiple and diverse stakeholders on issues that resonate with them. The failure to connect the problem to the right set of issues, internal and external, fuels support for the status quo. Make it relevant.

Once stakeholders are active and engaged, leadership must be sure they are moving in the same direction. Disorganized interests do not result in forward movement. A lack of alignment in the planning process results in projects that get delayed and then die.

There is no silver bullet solution and some projects are simply dead. Other projects can be re-framed and redirected toward new objectives. These situations are always difficult. Trustees are frustrated. The executive management team is nervous. A lot of sunk costs have been expended. And no one feels any closer to a solution.

Addressing the fundamentals of strategy and linking the facility plan to the business plan is the recommended course to bypassing 'stop' altogether. Pick up the mirror and look at what's around the building. ■

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