

# **Briefing Materials on the Acquisition of Watsonville Community Hospital February 8, 2022**

## **Pajaro Valley Healthcare District Project**

A not-for-profit entity formed through the collaboration of the County of Santa Cruz, the City of Watsonville, the Community Health Trust of the Pajaro Valley and Salud Para La Gente for the acquisition of Watsonville Community Hospital

# What is PVHDP?

- The Pajaro Valley Healthcare District Project (PVHDP) is a **nonprofit organization established to work towards community-led healthcare services in the Pajaro Valley.**
- PVHDP was formed for the purpose of forming a California Healthcare District and **acquiring Watsonville Community Hospital through a bankruptcy process.**
- The four originating Board Members are designees from:
  - County of Santa Cruz
  - City of Watsonville
  - Community Health Trust of Pajaro Valley
  - Salud Para La Gente

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# About California Healthcare Districts

- Created to address communities' health care needs
- A crucial part of California's health care system, healthcare districts meet the needs of
  - Communities with severe health care provider shortages
  - Uninsured Californians
  - Low-income seniors, adults, and children through Medi-Cal
  - Underserved populations
- Close community connections and services tailored to meet local needs
  - Healthcare Districts are crucial to making the Affordable Care Act and Medi-Cal expansion a success in California.
  - From specialized services for rural communities, to services tailored to the unique needs of diverse populations, to partnering with schools to keep children healthy, Healthcare Districts are innovating to deliver improved health care value for the local communities they serve.
- Openness, oversight and transparency
  - Local form of government, directly accountable to the communities they serve.
  - Residents elect the public boards that oversee local spending in pursuit of improved community health.
  - Operated and controlled by local voters who understand each community's concerns and ensure that each District is effectively meeting their local health care needs
  - Healthcare Districts must submit annual financial reports to the California State Controller and obey all state laws governing public records, record keeping, elections, and public access to documents.

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# The Watsonville Community

- 84% is Hispanic
- 80% of all households are families, 40% of all households earn under 50K
- 30% of the Watsonville population is 18 or under (pediatric)
- 30% of the population is childbearing age
- 60% of the population is working age
- The majority are essential workforce and work in agriculture, service, retail, healthcare and education.
  - 8400 employed as agriculture laborers, earning less than \$30K/year, majority live and work in the Pajaro Valley
  - Approximately 4000 work in supermarkets and retail, earning less than \$32K/year
  - Approximately 1000 work in the service industry in food preparation, buildings and grounds maintenance , earning less than \$35K/year



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# Situation Overview

- Watsonville Community Hospital (WCH) filed for Chapter 11 bankruptcy on December 6, 2021. It also issued WARN notices to employees warning of possible closure of the hospital.
- PVDHP decided that it's best course of action would be to form a **California Healthcare District**, because PVHDP believes that **community governance is crucial given the mission of the hospital**
- PVHDP finalized an Asset Sale Agreement with the WCH and this agreement was filed with the court – making PVHDP the “Stalking Horse” or lead bidder to buy the hospital. An auction will be held in February inviting other bids if there are any.
- Senator Laird has brought urgency legislation to form a new California healthcare district. Senator Laird will also be asking the appropriation committee to support the acquisition with funding as part the Governor's early action items in the budget.
- The bill for healthcare district formation, SB 418, has been unanimously (62-0) voted out of the Assembly and will be heard in the Senate Government and Finance Committee on February 2. It would go to the senate floor as early as the end of the week.

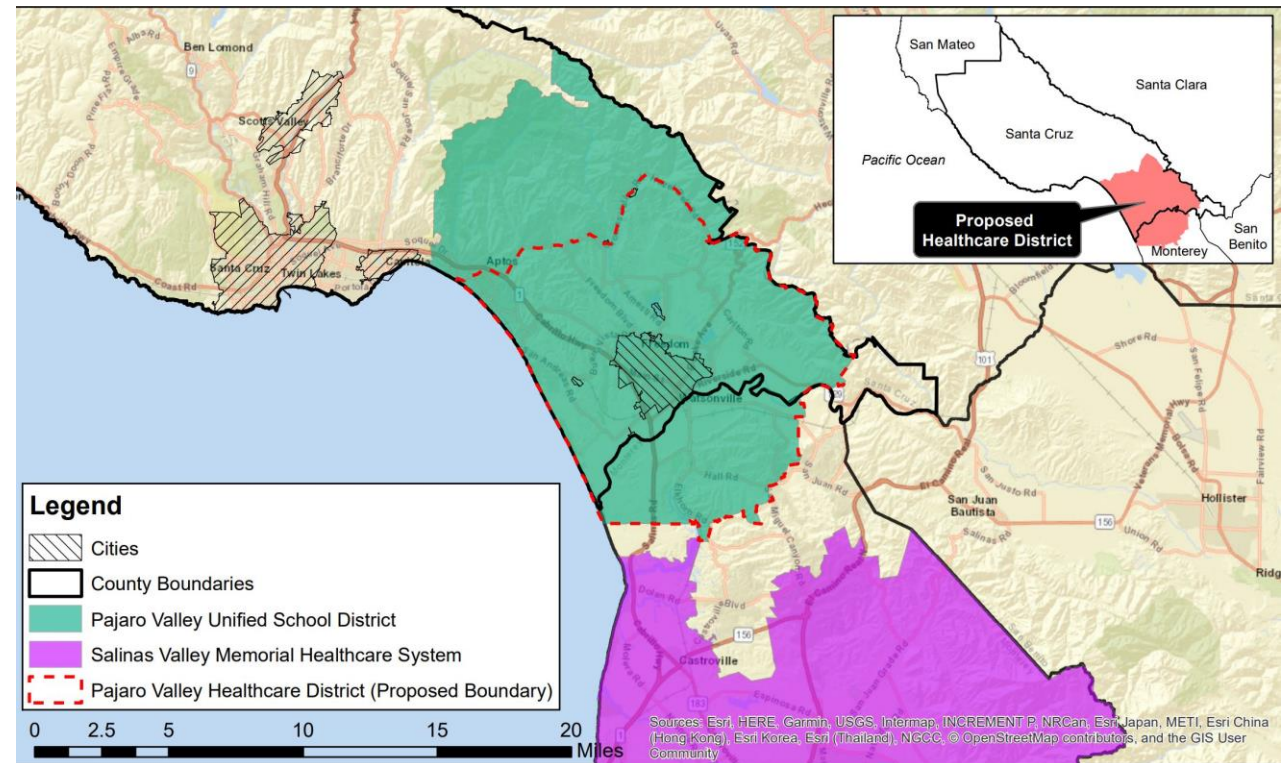
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# The Proposed District

- The proposed Healthcare District boundaries include Southern Santa Cruz County and a portion of Northern Monterey County and were based on the existing Pajaro Valley School District boundaries, except Aptos

## Pajaro Valley Healthcare District



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# Local Support

- The Board of Supervisors of the **County of Santa Cruz** has approved a total of \$5.5 million in funding for PVHDP and the acquisition.
- PVHDP has also **secured funding from the Community Health Trust of the Pajaro Valley, the Central Coast Alliance for Health, City of Watsonville, Dignity/Common Spirit and Kaiser Foundation Health Plan.**
- PVHDP has made requests for additional funding from Sutter Health, Salinas Valley Memorial Hospital, Stanford Healthcare/Stanford Children's, and the Community Hospital of the Monterey Peninsula
- PVHDP enjoys the support of organized labor, local businesses, political leaders and even competitors to the hospital. Below is only a partial list
  - **SEIU**
  - **Teamsters**
  - **California Nurse's Association**
  - **County of Santa Cruz**
  - **County of Monterey**
  - **Pajaro Valley Unified School District**
  - **Kaiser Permanente**
  - **Sutter Health**
  - **S. Martinelli & Co**
  - **City of Monterey**
  - **Driscoll's**
  - **California Association of Healthcare Districts**
  - **California Medical Association**
  - **Central Coast Alliance for Health**
  - **Catholic Charities Archdioceses of Monterey**
  - **United Way of Santa Cruz County**
  - **Community Foundation of Santa Cruz County**
  - **Graniterock**



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# Causes of Recent Financial Failure

- Over the last 21 years of for-profit ownership, the hospital administration has changed 20 times.
- In 2019 it was sold to a company called Halsen Healthcare. The real estate was purchased by a Medical Properties Trust (MPT), a real estate investment trust, and then leased back to the hospital. The cost of the **lease was significantly above market** and Halsen Healthcare had never operated a hospital. Within a year, Halsen was in default. MPT exercised its rights under the lease to replace the board and bring in a new operator, Prospect Holdings, which also had a **high management fee**.
- In 2020 and 2021, during the COVID epidemic, with **rising costs of labor and supplies**, the hospital experienced significant losses. As of August 2021, WHC had a year-to-date cash flow shortfall of over \$17 million. It also became arrears in its obligations to suppliers, employees, and lenders.
- In order to staff the hospital, **traveling nurses were brought in at premium pay**. Physicians were also paid significant amounts of money to take call for the hospital.
- As a **stand-alone hospital**, it does not have the opportunities to negotiate favorable terms with vendors or payors
- Going into bankruptcy, the **billing and accounts receivable management system had failed** and there is as much as \$10 mm in uncollected fees otherwise due the hospital for inaccurate or incomplete claims.

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# Vision for the Future

## The Past

- **For-profit, stand-alone** operation has prevented the hospital from investing in care systems outside the hospital
- **Lack of systems, technology** and financial incentive has prevented the hospital from creating integrated and seamless information exchange that follows the patient
- **The primary care infrastructure in Watsonville is fragmented.** While Sutter Health, Dignity and Kaiser have a primary care presence in Watsonville, patients have historically been sent elsewhere for hospital care
- There is a **large FQHC**, Salud Para La Gente, in Watsonville serving the MediCal population. Historically its relationship with the hospital **has been arms length.**



## The Future

- A **community owned and governed** inpatient and outpatient facility that is **aligned with many partner organizations** in service to the local population -- from prevention to acute care
- A collaborative care model that addresses the **social determinants of health**, and improves **quality** at every step of the patient's journey
- Through information technology, financial alignment and collaborative clinical care, the patient has a well coordinated and **"integrated" care experience – locally in their community**



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# Business Plan for Future Success

- **Short Term Objectives** – based on available information and in a compressed timeframe, conduct sufficient due diligence to build a **path toward profitability**. Identify initiatives that close the gap in operating margin
- **Intermediate Term Objectives** – build a business plan from the “ground up” looking at the health care needs of the community and strengthening and building service lines that meet its needs.
- **Long Term Objectives** – Create **Strategic Plan** that builds the elements needed **to achieve vision** (e.g., an integrated care model that fosters wellness, prevention and produces improved health outcomes)



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# Path Toward Profitability

- PVHDP's financial due diligence and forecasting has been carried out by leading healthcare management consulting firms
  - Health Management Associates
  - Kauffmann Hall
- Significant progress made by existing management and restructuring firm puts the hospital on a trajectory toward profitability.
- Our current business plan **shows EBITDA loss of \$22.7M in 2021 turning positive by 2023 and growing to ~7.5% margin by 2026.**
- Detailed assumptions in the business plan are included in the appendix to this document



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# Major Drivers of Change

**NPR = Net Patient Revenue**  
**QAF/DSH = Supplemental payments made based on quality and the “disproportionate” share of MediCal and Medicare**

**HMA = Health Management Associates, a national financial services firm with specific expertise on government program reimbursement**

**EBITDA = Earnings Before Interest, Taxes, Depreciation and Amortization**

Hospital volume to returning to pre-COVID levels and Kaiser growth drive NPR growth in 2023+

Supplemental revenue (from HMA); New “other” operating revenue from bed leases for **Adult Psych and SNF**

Expense savings in various categories assumed beginning in FY 2022

EBITDA improves meaningfully from 2022 to 2023 with margins improving each year of the projection

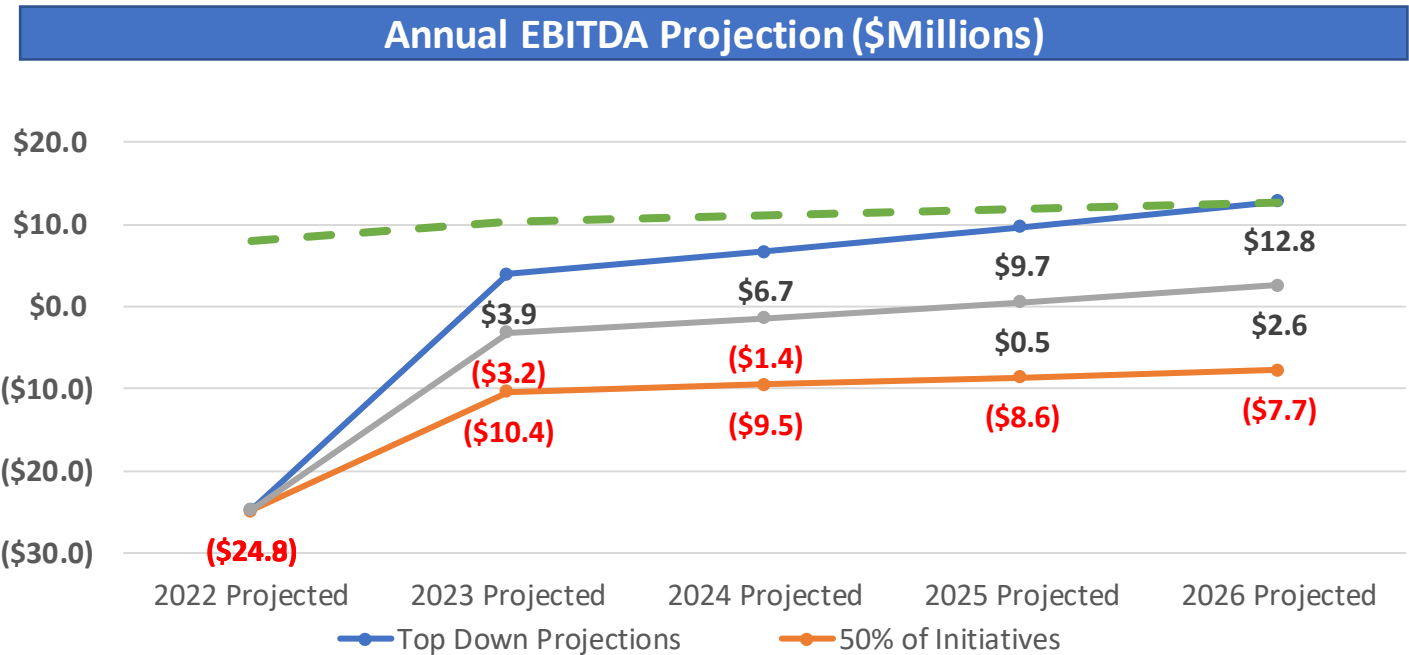
FY Ending September 30 (\$Millions)	Actual	Projection					2021-2026 CAGR
	2021	2022	2023	2024	2025	2026	
Net Patient Revenue	\$91.6	\$107.7	\$142.6	\$154.4	\$167.0	\$180.3	14.5%
QAF/DSH Revenue	\$22.5	\$22.9	\$23.5	\$23.5	\$23.5	\$23.5	0.9%
Other Operating Revenue	\$1.4	\$1.0	\$1.7	\$6.7	\$6.9	\$7.0	37.9%
<b>Total Operating Revenue</b>	<b>\$115.5</b>	<b>\$131.6</b>	<b>\$167.8</b>	<b>\$184.7</b>	<b>\$197.4</b>	<b>\$210.8</b>	<b>12.8%</b>
<i>% Growth</i>	<i>0.0%</i>	<i>13.9%</i>	<i>27.5%</i>	<i>10.1%</i>	<i>6.9%</i>	<i>6.8%</i>	<b>0.0%</b>
Salaries and Wages	\$60.5	\$76.6	\$80.2	\$91.9	\$100.3	\$109.2	12.5%
Benefits	\$17.5	\$18.7	\$17.1	\$17.4	\$17.6	\$17.9	0.4%
Registry	\$9.8	\$6.2	\$5.4	\$5.4	\$5.4	\$5.4	-11.2%
<i>Labor Subtotal</i>	<i>\$87.7</i>	<i>\$101.5</i>	<i>\$102.7</i>	<i>\$114.7</i>	<i>\$123.4</i>	<i>\$132.5</i>	<b>8.6%</b>
<i>% Growth</i>	<i>0.0%</i>	<i>15.8%</i>	<i>1.1%</i>	<i>11.7%</i>	<i>7.6%</i>	<i>7.4%</i>	
<i>Benefits as a % of Salaries</i>	<i>28.9%</i>	<i>24.4%</i>	<i>21.3%</i>	<i>18.9%</i>	<i>17.6%</i>	<i>16.4%</i>	
Supplies/Drugs	\$12.3	\$13.8	\$12.6	\$12.8	\$13.0	\$13.2	1.4%
Purchased Services	\$13.5	\$12.4	\$12.4	\$12.4	\$12.4	\$12.4	-1.7%
Professional Fees	\$7.0	\$7.2	\$7.4	\$7.4	\$7.4	\$7.4	1.2%
Other Expenses	\$7.5	\$9.5	\$18.2	\$15.2	\$16.0	\$17.0	17.7%
QAF Expense	\$6.9	\$6.5	\$6.7	\$6.7	\$6.7	\$6.7	-0.6%
Management Fees	\$3.3	\$3.0	\$3.0	\$3.0	\$3.0	\$3.0	-1.9%
MPT Lease	-	\$2.5	\$3.0	\$3.0	\$3.0	\$3.0	-
<i>Other Operating Expense</i>	<i>\$50.5</i>	<i>\$54.8</i>	<i>\$63.3</i>	<i>\$60.5</i>	<i>\$61.5</i>	<i>\$62.6</i>	4.4%
<i>% Growth</i>	<i>0.0%</i>	<i>8.6%</i>	<i>15.5%</i>	<i>-4.5%</i>	<i>1.7%</i>	<i>1.9%</i>	
<b>Total Operating Expense</b>	<b>\$138.2</b>	<b>\$156.4</b>	<b>\$166.0</b>	<b>\$175.2</b>	<b>\$184.9</b>	<b>\$195.1</b>	<b>7.1%</b>
<i>% Growth</i>	<b>\$0.0</b>	<b>13.1%</b>	<b>6.2%</b>	<b>5.5%</b>	<b>5.5%</b>	<b>5.6%</b>	
<b>EBITDA</b>	<b>(\$22.7)</b>	<b>(\$24.8)</b>	<b>\$1.8</b>	<b>\$9.5</b>	<b>\$12.5</b>	<b>\$15.7</b>	
<b>% Margin</b>	<b>-19.7%</b>	<b>-18.8%</b>	<b>1.1%</b>	<b>5.2%</b>	<b>6.3%</b>	<b>7.4%</b>	
Net QAF/DSH Benefit	\$15.6	\$16.4	\$16.8	\$16.8	\$16.8	\$16.8	
EBITDA excluding QAF/DSH	<b>(\$38.3)</b>	<b>(\$41.1)</b>	<b>(\$15.0)</b>	<b>(\$7.3)</b>	<b>(\$4.3)</b>	<b>(\$1.1)</b>	

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# Earnings relative to Lending Guidelines

- Hospitals measure profitability based on a cash flow calculation called “**Earnings before Interest, Taxes, Depreciation and Amortization**” - “**EBITDA**”
- EBITDA requirements for credit-worthiness can vary, would be about 6-8%<sup>(1)</sup>



- If the identified initiatives are successful, **the hospital is projected to generate positive EBITDA by FY23, and to achieve the lender benchmark by 2026.**

1. EBITDA Target of 6.1% based on Moody’s BBB medians.

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# Capital Need

- Capital requirements include acquisition funding, the administrative costs of the project, capital and ongoing working capital
- For the bankruptcy bid qualification hearing on 2/14, PVHDP needs to show liquidity to support 2 months of working capital (~\$5 mm)

## Capital Requirements

Description		
<b>Acquisition Cost:</b>		
Purchase Price	\$	9,000,000
Debtor in Possession Financing during Bankruptcy	\$	25,000,000
Employee Benefit Liabilities	\$	11,000,000
Sales Tax, Misc Closing	\$	2,000,000
Cure Costs for Assumed Contracts	\$	3,000,000
<b>Total Acquisition Cost</b>	<b>\$</b>	<b>50,000,000</b>
<b>Admin and Consulting Costs:</b>		
Legal Fees	\$	800,000
Financial Consultants	\$	400,000
Project Management	\$	150,000
Legislative Advisors	\$	30,000
Communication Management	\$	25,000
Administrative Support	\$	20,000
<b>Total Admin and Consulting Cost</b>	<b>\$</b>	<b>1,425,000</b>
<b>Working Capital</b>		
Deficit Funding and Capital Investment	\$	25,000,000
<b>Total Working Capital</b>	<b>\$</b>	<b>25,000,000</b>
<b>Grand Total</b>	<b>\$</b>	<b>76,425,000</b>

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# Request to the State of California

- Of the \$76 million required funding for the acquisition and transition of WCH, PVHDP is urgently requesting \$40 million from the State of California as part of the early action portion of the 2022-2023 budget
- Time is of the essence as the sale is subject to the bankruptcy proceeding and the sale hearing is scheduled for February 22, 2022
- Remaining funding will be secured from the County of Santa Cruz, the County of Monterey, the Central Coast Alliance for Health, the Community Health Trust of the Pajaro Valley, Kaiser Permanente, local not-for-profit healthcare provider organizations and private philanthropy.

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# Capital Sources

Description	Budget	Committed	Yet to be Committed
County of Santa Cruz	\$ 5,500,000.00	\$ 5,500,000.00	\$ -
County of Monterey	\$ 3,000,000.00	\$ -	\$ 3,000,000.00
Community Trust of Pajaro Valley	\$ 9,000,000.00	\$ 4,650,000.00	\$ 4,350,000.00
* Kaiser Foundation Health Plan	\$ 3,000,000.00	\$ 3,000,000.00	\$ -
Sutter Health	\$ 250,000.00	\$ -	\$ 250,000.00
City of Watsonville	\$ 100,000.00	\$ -	\$ 100,000.00
Dominican Hospital / Common Spirit	\$ 300,000.00	\$ 300,000.00	\$ -
State of California	\$ 40,000,000.00	\$ -	\$ 40,000,000.00
Central Coast Alliance for Health	\$ 3,000,000.00	\$ 3,000,000.00	\$ -
Provider Funding (Salud, Stanford, CHOMP, SVMH, etc)	\$ 8,550,000.00	\$ 150,000.00	\$ 8,400,000.00
Other Fundraising (Community Foundation, Blue Shield Foundation, Family Offices)	\$ 3,725,000.00	\$ -	\$ 3,725,000.00
<b>Total Funding</b>	<b>\$ 76,425,000.00</b>	<b>\$ 16,600,000.00</b>	<b>\$ 59,825,000.00</b>

\* Kaiser Foundation Health Plan has also agreed to contribute their information technology platform and electronic health record, HealthConnect (EPIC)

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# Two Paths

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- If PVHDP and the newly formed district are not successful in acquiring the hospital during the bankruptcy process, the hospital will likely close, leaving tens of thousands of low-income residents without access to hospital services.
- If PVHDP and the newly formed district are successful in acquiring the hospital, there is an opportunity to build better healthcare infrastructure for the community and achieve our vision for better health.



# Appendix: Business Plan Detail

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# Financial Improvement Detail

Initiative (\$ Thousands)	Description	EBITDA Projection					2021-2026
		2022	2023	2024 <sup>(1)</sup>	2025 <sup>(1)</sup>	2026 <sup>(1)</sup>	CAGR <sup>(2)</sup>
Baseline		(\$41.3)	(\$41.5)	(\$42.5)	(\$43.7)	(\$45.0)	2.1%
Supplemental		\$16.4	\$16.8	\$16.8	\$16.8	\$16.8	0.7%
<b>Baseline Subtotal</b>		<b>(\$24.9)</b>	<b>(\$24.7)</b>	<b>(\$25.7)</b>	<b>(\$26.9)</b>	<b>(\$28.2)</b>	<b>2.8%</b>
% Growth			-1.1%	4.3%	4.5%	4.7%	0.0%
Cath Lab	Online in FY22, fully ramped in Sep. '22	(\$0.1)	\$2.2	\$2.3	\$2.3	\$2.4	2.7%
Wound Center	Online in FY22, fully ramped in Feb. '22	\$0.0	\$0.2	\$0.2	\$0.2	\$0.2	3.0%
Wage increases limited to current CBA	3%	\$0.0	\$1.5	\$1.6	\$1.6	\$1.7	5.0%
Benefits Administrator Change	More effective carrier	\$0.3	\$1.2	\$1.2	\$1.3	\$1.3	43.0%
Revenue Cycle 1	FY22 Initiative - March 2022 Start	\$0.0	\$3.2	\$3.3	\$3.4	\$3.5	3.0%
Revenue Cycle 2	FY23 Initiative	\$0.0	\$1.8	\$1.9	\$1.9	\$1.9	2.5%
Supply Chain Savings	Supply Chain Contract Negotiations	\$0.0	\$1.5	\$1.5	\$1.5	\$1.5	1.5%
Managed Care Contracts	Commercial and Managed Care Contract Negotiations	\$0.0	\$0.9	\$0.9	\$1.0	\$1.0	3.0%
Physician Call Coverage	\$3M of revenue for physician call subsidy	\$0.0	\$3.0	\$3.0	\$3.0	\$3.0	0.0%
Kaiser Partnership - Minimum Spend	Increase in minimum spend to \$20M, ramps to \$25M by 2026	\$0.0	\$5.0	\$5.7	\$6.6	\$7.5	14.5%
Kaiser Partnership - Supplies Savings	10% Supply Expense Savings	\$0.0	\$1.3	\$1.3	\$1.4	\$1.4	1.5%
Scheduling Efficiency	Increase scheduling efficiency	\$0.0	\$1.4	\$1.4	\$1.4	\$1.4	1.5%
MOB Sublease	New Tenants to lease 45K sqft of unused space	\$0.0	\$0.8	\$0.8	\$0.9	\$0.9	2.0%
ADC Increase (Non-Kaiser)	ADC increase by 10 by 2026	\$0.0	\$2.5	\$5.1	\$8.0	\$10.9	63.5%
Skilled Nursing	Third Party Bed Lease for 15 Beds	\$0.0	\$0.0	\$2.0	\$2.0	\$2.1	2.0%
Acute Psych Services	Third Party Bed Lease for 20 Beds	\$0.0	\$0.0	\$3.0	\$3.1	\$3.1	2.0%
<b>Initiative Subtotal</b>		<b>\$0.2</b>	<b>\$26.5</b>	<b>\$35.3</b>	<b>\$39.4</b>	<b>\$43.9</b>	-
<b>Grand Total</b>		<b>(\$24.8)</b>	<b>\$1.8</b>	<b>\$9.5</b>	<b>\$12.5</b>	<b>\$15.7</b>	

1. Forecasted years based Force 10 Global Assumptions
2. For initiatives starting in FY23, CAGR was calculated based on 4 years

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# Financial Improvement Detail

<p>In 2019, the hospital's cardiac catheterization equipment failed. New equipment was ordered prior to the bankruptcy and will be fully installed by mid-2022, restoring volume previously lost.</p>	<p>The wound care services at the hospital were provided in partnership with an outside company. The fees for the outside company have been eliminated with no change in service</p>	<p>Previous budgets and forecasts suggested a 5% annual inflation rate in wages. Current collective bargaining agreements call for an average wage increase of 3%. These contracts will be recognized by the buyer.</p>	<p>It is believed that the costs of administering self-funded insurance benefits for employees could be reduced without a reduction in coverage levels provided to employees</p>	<p>There are two revenue cycle initiatives that will result in improved financial performance. The first involved transitioning from two vendors to one, thereby improving efficiency. The second is reducing the rate of denial for submitted claims.</p>
<p>WCH has recruited a Stanford-trained hand surgeon who will relocate to the area later this year</p>	<p>There is a significant need for acute psychiatric beds in the County. Assumes third party operator</p>	<p>The cath lab will enable interventional radiology procedures to be performed locally</p>	<p>Increase in Worker's Compensation services</p>	<p>Imaging – increased imaging associated with increased medical and surgical volume</p>
<p>It is assumed that the hospital be able to standardize purchasing and increase compliance.</p>	<p>The plan assumes a 3% increase in payment rates from managed care organizations in addition to a previously assumed inflation rate of 3%</p>	<p>Through the bankruptcy process, contracts with physicians will be restructured yielding a targeted savings of \$3 mm per year</p>	<p>Kaiser Permanente uses WCH as part of its network in Santa Cruz County. WCH intends to renegotiate its contract with KP to provide a minimum spending level of \$20 mm in 2023, increasing to \$25 mm in 2028.</p>	<p>It is assumed that WCH will be able to purchase drugs and supplies through the purchasing agreements held by KP</p>
<p>It is assumed that the District will adopt new scheduling practices, eliminating the inefficiencies of offering half time shifts</p>	<p>Assumed increase in lease revenue for buildings on the hospital campus. Space likely occupied by the County of Santa Cruz and Salud Para La Gente</p>	<p>It is assumed that post-bankruptcy, volumes at the hospital for non-Kaiser will return to pre-COVID levels</p>		

## Pajaro Valley Healthcare District Project

A not-for-profit entity formed through the collaboration of the County of Santa Cruz, the City of Watsonville, the Community Health Trust of the Pajaro Valley and Salud Para La Gente for the acquisition of Watsonville Community Hospital