Update to Payer-Specific Financial Analysis Of Nursing Facilities

Prepared for

American Health Care Association / Alliance for Quality Nursing Home Care

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Purpose

- To update The Lewin Group payer-specific financial analysis (released in March 2002) of the nursing facility industry using data collected from a purposive sample of providers .
- The prior study determined how a change in Medicare payments, related to the skilled nursing facility (SNF) prospective payment system (PPS) and the potential removal of the BBRA / BIPA add-on provisions, would affect responding nursing facilities' Medicare and total margins.
- The prior study also determined how a freeze in Medicaid payments brought on by state deficits would affect responding nursing facilities' Medicaid and total margins.
- This study update provides the impact of Medicare and Medicaid payments shortfalls on nursing facilities in 2003 and 2004.

Legislative Authority For Medicare Skilled Nursing Facility Payment Add-Ons

Legislation	Add-On	Removal Date
BIPA Section 312	16.67% increase applied to nursing component of all RUGs categories	October 1, 2002
BBRA Section 101	4% increase applied to the adjusted federal rate for FY 2002 to all RUG categories	October 1, 2002
BBRA Section 101 & BIPA Section 314	6.7% increase applied to the adjusted Federal per diem rate for rehabilitation group RUG categories	Triggered by the RUGs case mix refinement*
BBRA Section 101 & BIPA Section 314	20% increase applied to the adjusted Federal per diem rate to certain RUG categories	Triggered by the RUGs case mix refinement*

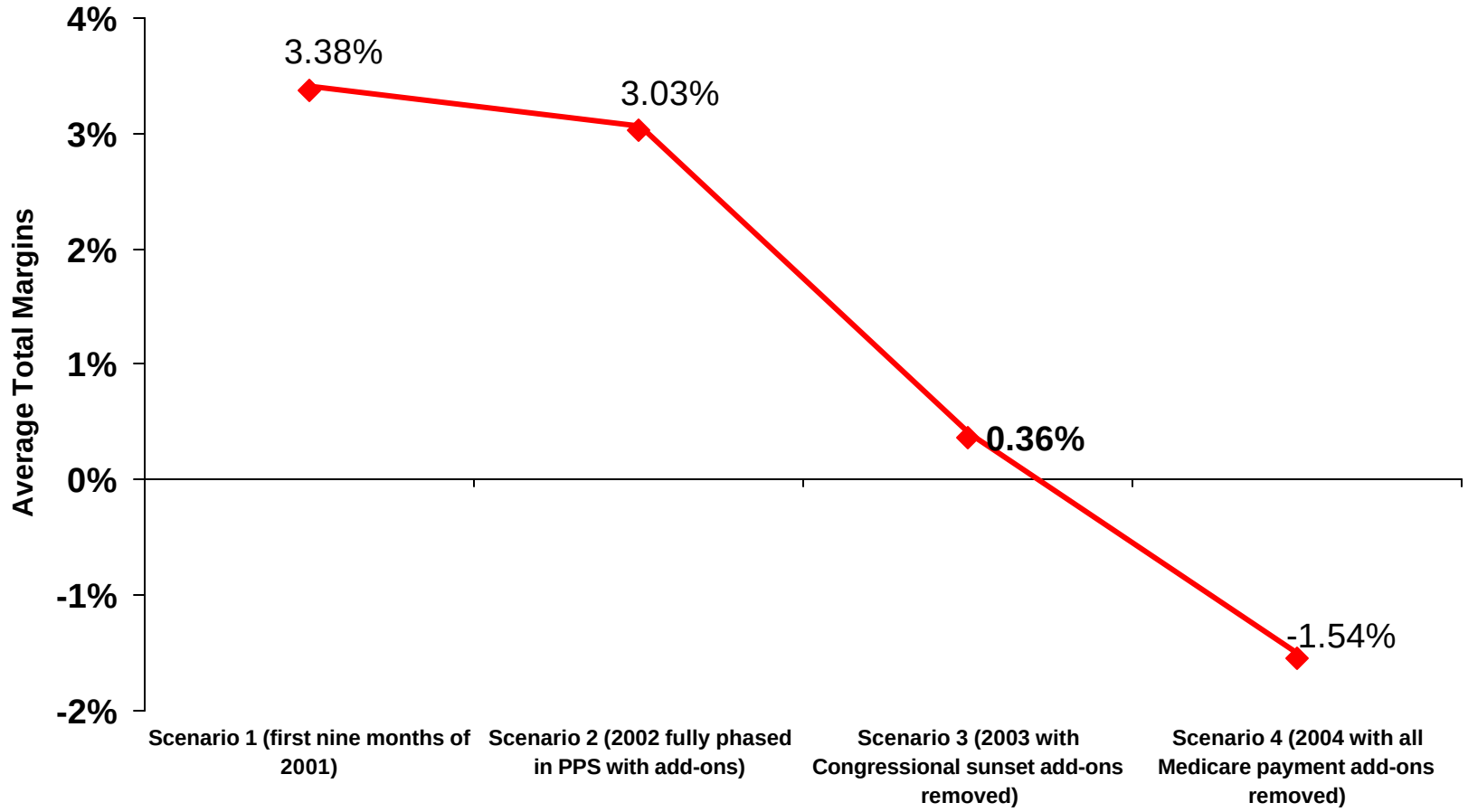
Source: 42 CFR Parts 410, et.al, "Medicare Program; Prospective Payment System and Consolidated Billing for Skilled Nursing Facilities-Update; Final Rule,"Federal Register, July 31, 2001.

* On April 23, 2002 HHS Secretary Tommy Thompson announced the RUGs refinement will be delayed until FFY 2004.

Skilled Nursing Facilities are also expected to face Medicaid rate cuts

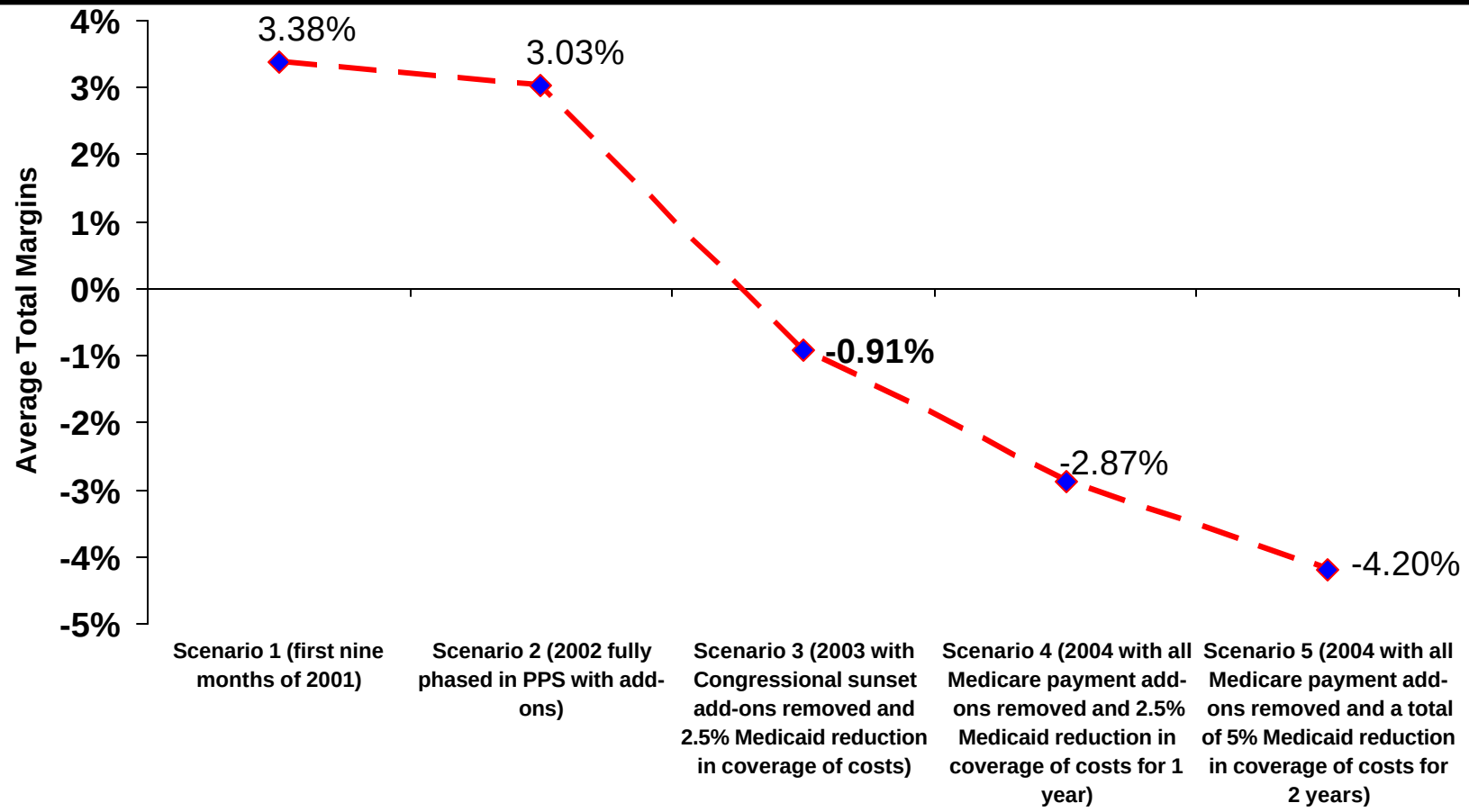
- About 44 states will consider freezing or reducing Medicaid reimbursements in the upcoming 2003 legislative sessions. *(National Conference of State Legislatures, "2003 Health Priorities Survey" January 2003)*
- Comment of a State Medicaid official "The budget situation next year (FY 2004) will be more difficult. It will be hard to avoid cuts next year." *(Vernon Smith, et.al., "Medicaid Spending Growth: Results from a 2002 Survey, Kaiser Commission on Medicaid and the Uninsured, September 2002)*
- In some states, such as California, reimbursement rates to health care providers are proposed to be lowered by 10 percent. (*Leighton Ku, et.al., "Proposed State Medicaid Cuts would Jeopardize Health Insurance Coverage for One Million People," Center on Budget and Policy Priorities, December 23, 2002*)

Removal Of Congressional Sunset Add-Ons Eliminates All Financial Surplus & Removal of All Payment Add-Ons Produces Negative Margins



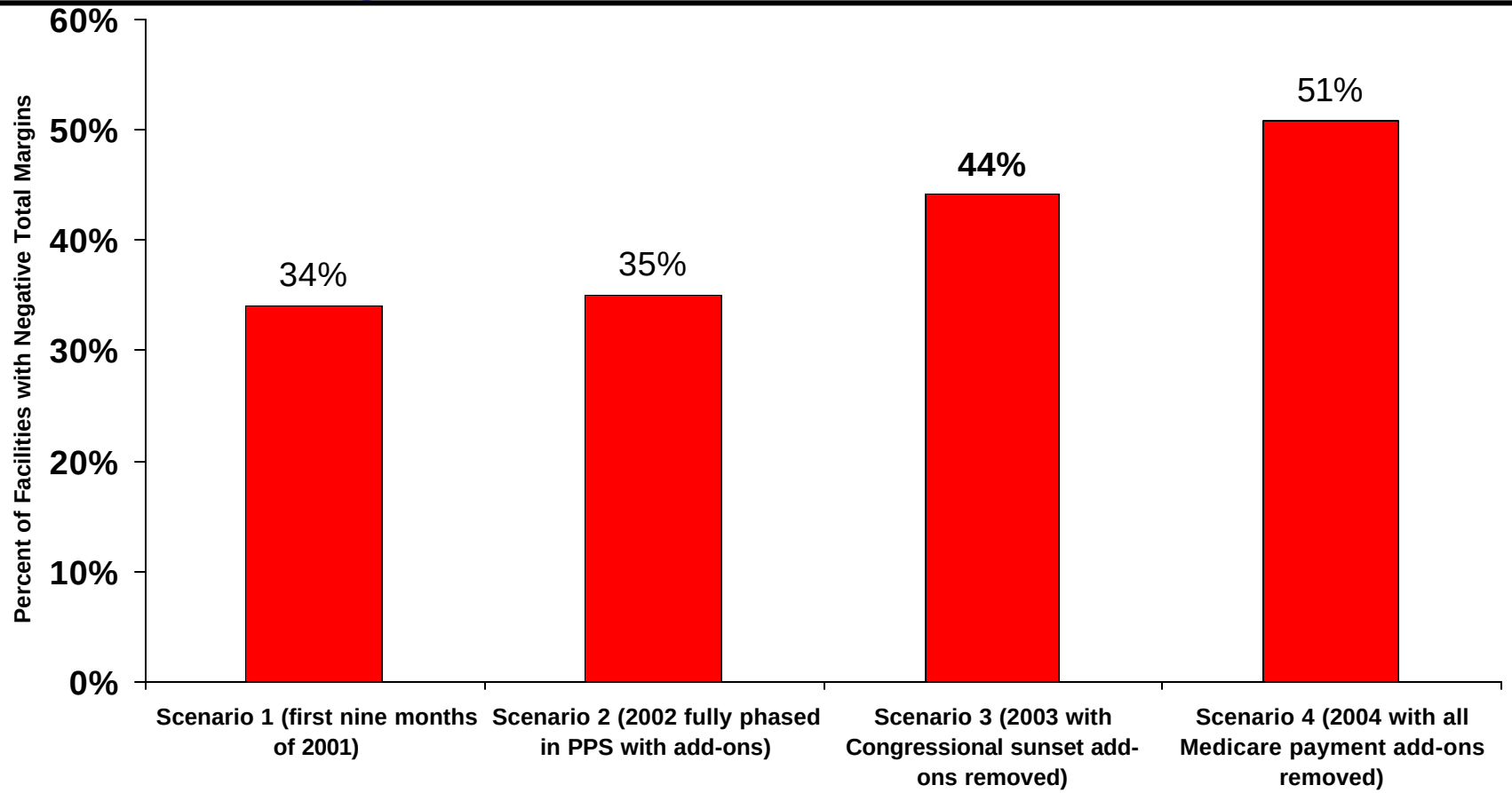
Source: The Lewin Group analysis of Lewin survey of 2,160 nursing facilities owned by Multifacility organizations. Computations are based on 2002 dollars.

Average Total Margins Further Deteriorate With Medicaid Payment Shortfalls



Source: The Lewin Group analysis of Lewin survey of 2,160 nursing facilities owned by Multifacility organizations.
Computations are based on 2002 dollars.
This assumes a continued variance of 2.5% between projected Medicaid rate increases and actual cost increases.
For Scenario 5, the total variance is 5%.

51% of Facilities Surveyed Would Experience Negative Total Margins With The Removal Of All Medicare Payment Add-Ons



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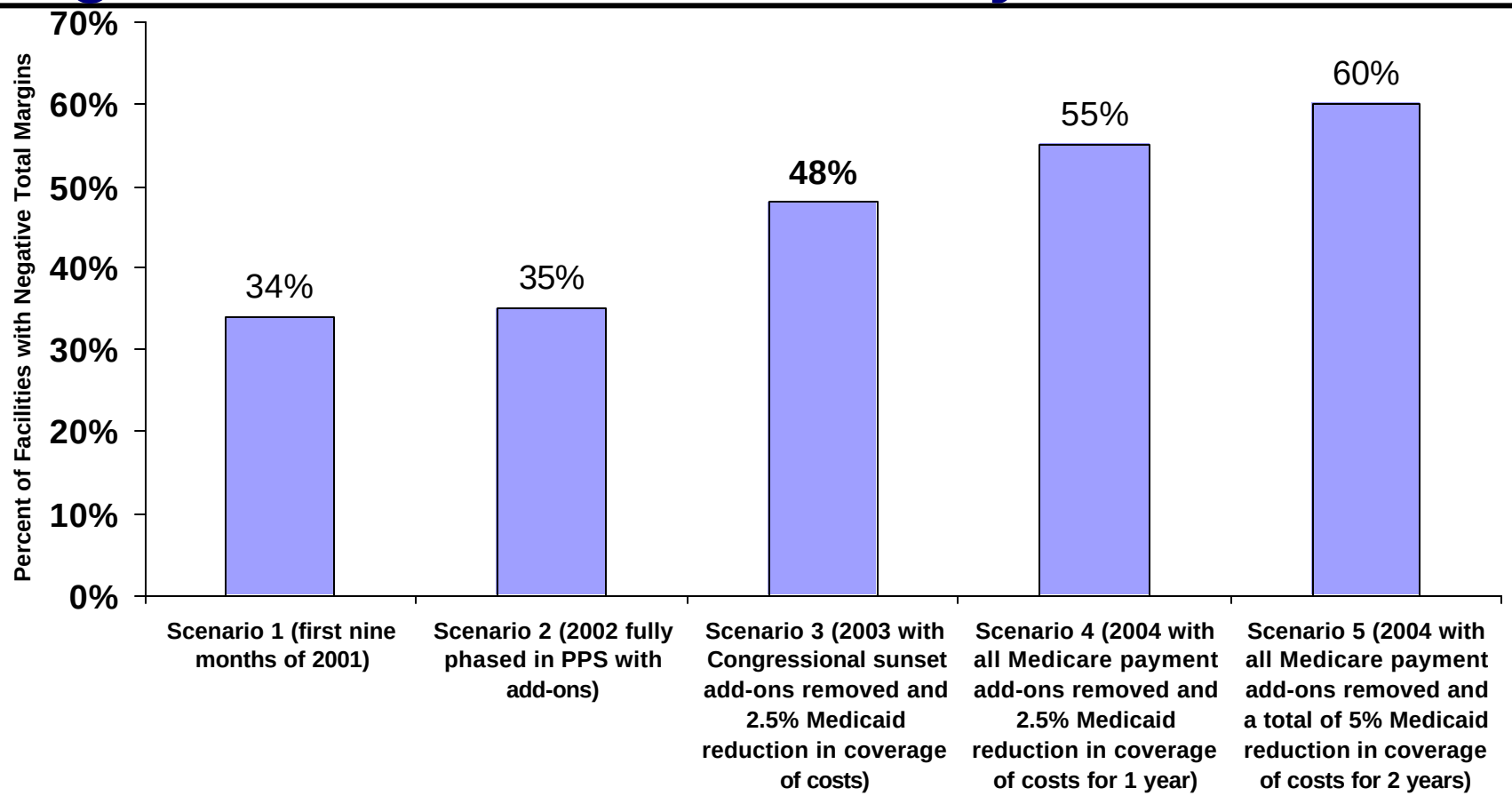
60% of Facilities Would Experience Negative Margins with a 5% Medicaid Payment Shortfall



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This assumes a continued variance of 2.5% between projected Medicaid rate increases and actual cost increases. For Scenario 5, the total variance is 5%.

Medicare Cross Subsidies Of Medicaid Underpayments Are Eliminated With The Removal Of Medicare Payment Add-Ons

	Medicare Part A		Medicaid		Other		Medicare Part B		Total[2/]
	Margin	Percent of Revenue	Margin	Percent of Revenue	Margin	Percent of Revenue	Margin	Percent of Revenue	Margin
Scenario 1 (first nine months of 2001)	21.6%	26%[1/]	-7.50%	49%	4.60%	23%	18.20%	2%	3.38%
Scenario 2 (2002 fully phased in PPS with add-ons)	20.5%	26%[1/]	-7.50%	49%	4.60%	23%	18.20%	2%	3.03%
Scenario 3 (2003 with Congressional sunset add-ons removed)	**11.2%**	**24%**	**-7.50%**	**51%**	**4.60%**	**23%**	**18.20%**	**2%**	**0.36%**
Scenario 4 (2004 with all Medicare payment add-ons removed)	3.6%	22%	-7.50%	51%	4.60%	24%	18.20%	2%	-1.54%

Source: The Lewin Group analysis of Lewin survey of 2,160 nursing facilities owned by Multifacility organizations. Computations are based on 2002 dollars.

1/ Closely matches the percent of Medicare revenue (25%) for large for-profit nursing facility companies cited in CMS, "Health Care Industry Market Update: Nursing Facilities," February 6, 2002, p.17.

2/ Total margins reflect earnings before taxes (EBT).

Total Margins Turn Negative With Medicaid Shortfalls

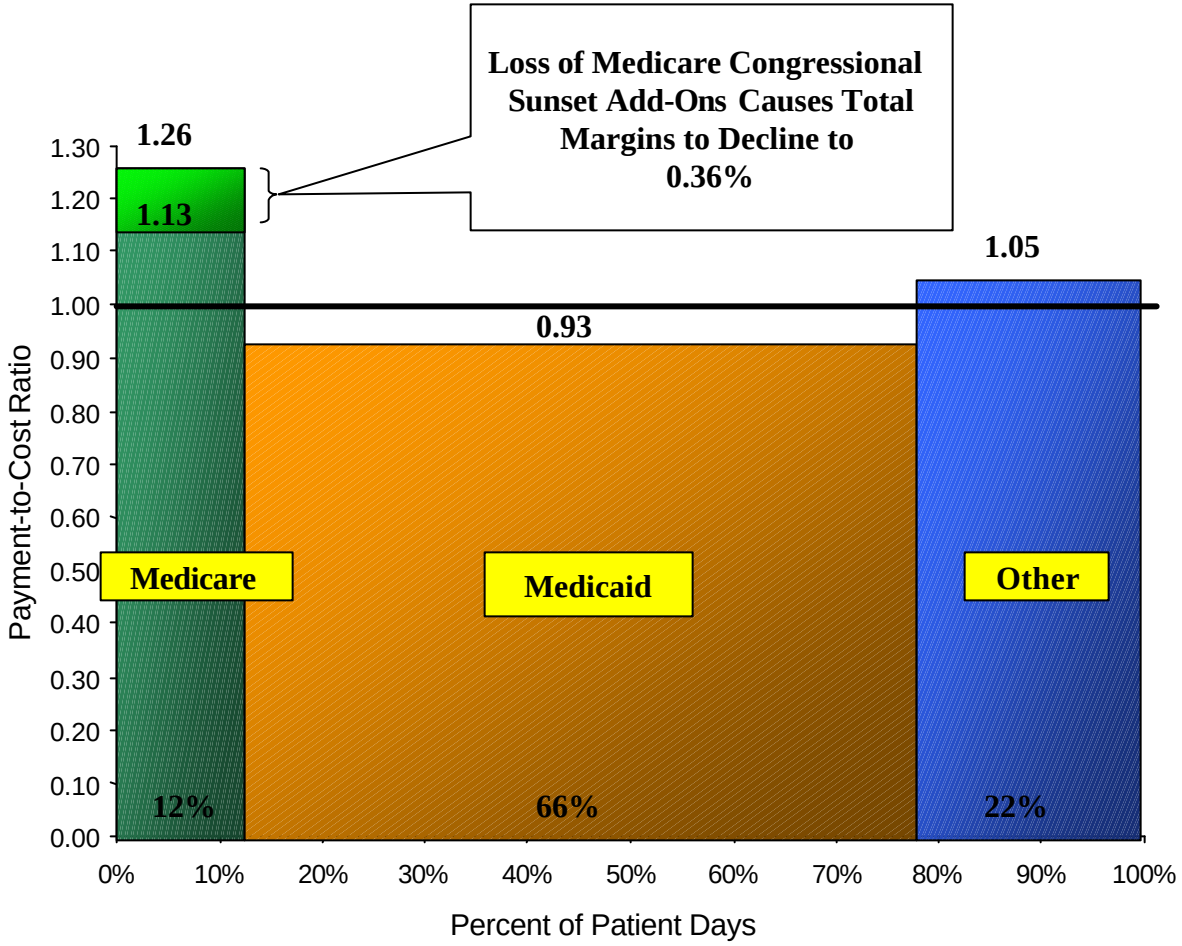
	Medicare Part A		Medicaid		Other		Medicare Part B		Total[2/]
	Margin	Percent of Revenue	Margin	Percent of Revenue	Margin	Percent of Revenue	Margin	Percent of Revenue	Margin
Scenario 1 (first nine months of 2001)	21.6%	26%[1/]	-7.50%	49%	4.60%	23%	18.20%	2%	3.38%
Scenario 2 (2002 fully phased in PPS with add-ons)	20.5%	26%[1/]	-7.50%	49%	4.60%	23%	18.20%	2%	3.03%
Scenario 3 (2003 with Congressional sunset add-ons removed and 2.5% Medicaid reduction in coverage of costs)	**11.2%**	**24%**	**-10.25%**	**51%**	**4.60%**	**23%**	**18.20%**	**2%**	**-0.91%**
Scenario 4 (2004 with all Medicare add-ons removed and 2.5% Medicaid reduction in coverage of costs for I year)	3.6%	23%	-10.25%	51%	4.60%	24%	18.20%	2%	-2.87%
Scenario 5 (2004 with all Medicare add-ons removed and a total of 5% Medicaid reduction in coverage of costs for 2 years)	3.6%	23%	-13.08%	50%	4.60%	25%	18.20%	2%	-4.20%

Source: The Lewin Group analysis of Lewin survey of 2,160 nursing facilities owned by Multifacility organizations. Computations are based on 2002 dollars.

1/ Closely matches the percent of Medicare revenue (25%) for large for-profit nursing facility companies cited in CMS, "Health Care Industry Market Update: Nursing Facilities," February 6, 2002, p.17.

2/ Total margins reflect earnings before taxes (EBT).

Nursing Homes Still Dependent on Medicare to Subsidize Losses from Federal/State Medicaid Program



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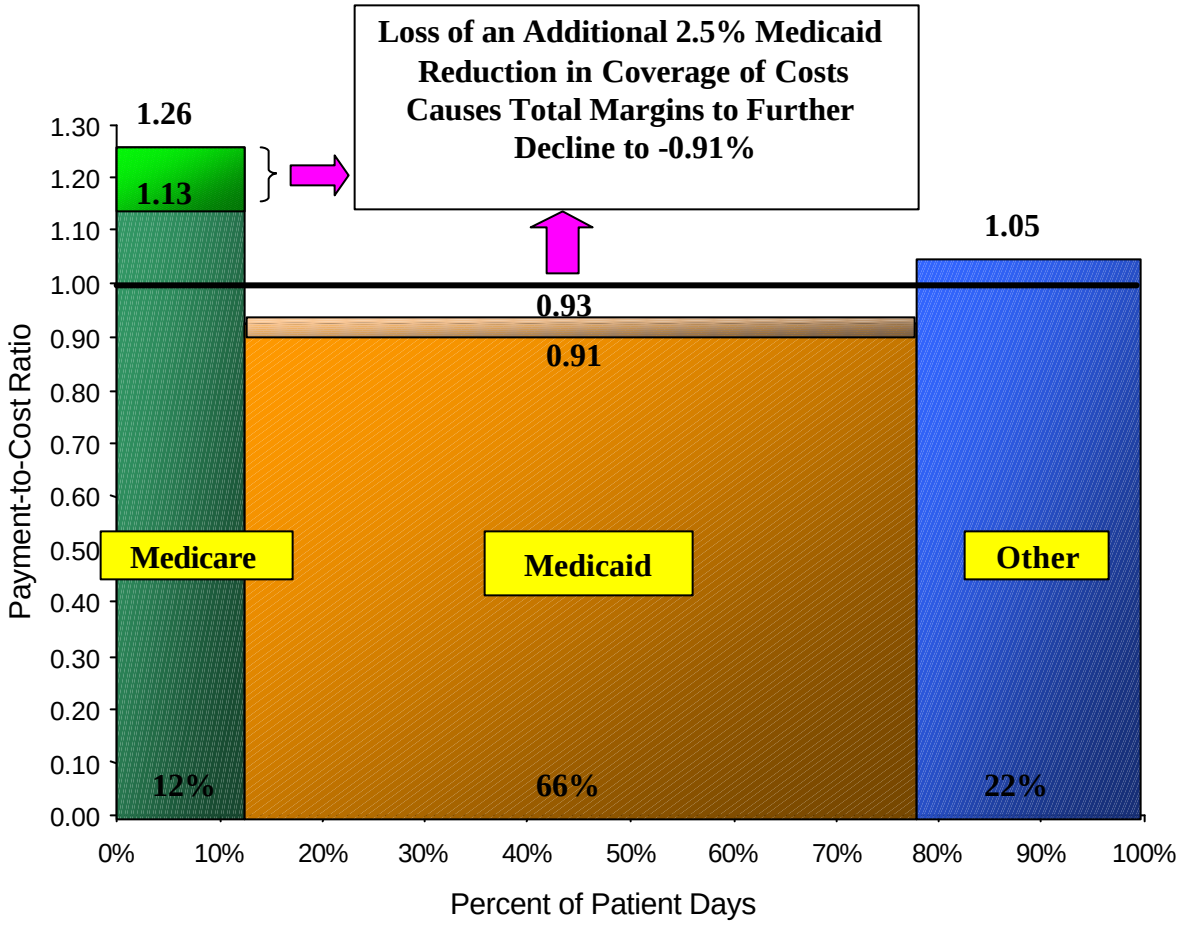
Removal of Medicare Payment Add-Ons Precludes Facilities from Mitigating the Effects of Medicaid Shortfalls



Source: The Lewin Group analysis of Lewin survey of 2,160 nursing facilities owned by Multifacility organizations. Computations are based on 2002 dollars.

Summary Facts

- With removal of Congressional sunset add-ons, total margins for the surveyed facilities decline from **3.38%** (2001 pre-PPS total margin) to **0.36%**.
- If Congressional sunset add-ons are not restored and the RUGs refinements are implemented, then total margins for surveyed facilities are estimated to decline to -1.54%.
- If all Medicare payment add-ons are removed **and** the rate of increase in Medicaid payment rate is reduced by 2.5% for one year, total margins are estimated to decline to -2.87% and for two years (total of 5%) the total margin are estimated to decline to -4.20%.
- **44%** of industry is currently operating with negative margins. That number could climb to 60% if Congressional add-ons are not restored, RUGs are refined, and rate of increase in Medicaid payment rates is reduced by a total of 5% for 2 years.

Summary

- With the removal of BBRA and BIPA Medicare payment add-ons the industry is no longer in fiscal equilibrium. This is because expiration of the add-ons virtually eliminates Medicare's cross-subsidization of care to Medicaid recipients. Failure to restore Medicare funding to 2002 levels could result in financial insolvency within the industry.
- Prompted by growing state deficits, state freezes in Medicaid nursing facility payments may exacerbate the industry's financial insolvency and threaten access to and quality of care for Medicaid recipients as well as Medicare beneficiaries.

Policy Implications

- Access to an essential health care service would be at risk if Medicare does not continue to cross-subsidize Medicaid payment shortfalls.
- Inadequate financial resources will impact the abilities of facilities to attract and retain qualified staff. Meeting the specialized needs of higher acuity patients will be difficult.
- To the extent that the balance among cost cutting, product delivery, and fiscal solvency proves unsustainable, a series of fiscal consequences would ensue:
  - In the short-run, the first round of BBA related bankruptcies recently experienced would be followed by another round of bankruptcies, thereby resulting in forced asset sales and facility closures.
  - In the long run, the unintended consequences of near term budget reductions would result in a lack of capital required to modernize and replenish physical plants and equipment, acquire new technologies and to meet changing community health care needs. This comes at a time when an aging population will require and demand complex medical services within the nursing facility setting.