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APPROVED:
Board of Directors
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STATEMENT TO THE MINNESOTA STATE LEGISLATURE REGARDING THE UNIVERSITY OF MINNESOTA HOSPITALS RECONSTRUCTION PROJECT

I. INTRODUCTION

The Citizens League appreciates the opportunity to appear before you and present our views on this proposal.

It is appropriate that the Citizens League speak to this issue because it involves a major new investment in our area's health care system -- a topic of long-time concern and involvement for our organization.

In 1970 the Citizens League was heavily involved in the discussions on the Hennepin County General Hospital, eventually contributing our ideas to the decision-making process that produced a linking facility to Metropolitan Medical Center.

In 1977 the League issued a study entitled, "More Care About the Cost in Hospitals." Its central finding was that the Twin Cities area has a very high quality and also a very large and expensive hospital system, whose expansion is essentially unrestrained at the moment, either by public control or by competitive forces in the health care market.

We believe that conclusion is still pertinent today and are working hard to provide you as policy-makers with strategies to further an appropriate mix of public planning and private competition.

Since 1977 we have continued to be actively involved in other areas of systemwide concern to the health care system, such as the controversial proposals of a Burnsville hospital and the Veterans Administration facility.

II. THE UNIVERSITY OF MINNESOTA SHOULD BE ALLOWED TO BUILD A SMALLER HOSPITAL NOW -- WITH STATE CREDIT. BUT STATE FINANCING FOR THE REST OF THE PROPOSAL SHOULD BE WITHHELD UNTIL MAJOR QUESTIONS ARE ANSWERED.

From the outset, you should know that we support this proposal. However, we are unable to support it in its entirety for reasons that will become clear to you later in this statement.

The University of Minnesota Hospitals has been an outstanding provider of medical care. Its national reputation is well known and well earned. It is an institution of which we can all be proud, as it continues to pioneer the far reaches of medical knowledge. Its work in heart and kidney transplantation and its recent research concerning toxic shock syndrome are all to be highly commended. We join the Health Board and many other groups in agreeing that much of the University's present plant is outdated and should be replaced in some form.

The issue, however, is not whether the University of Minnesota Hospitals should be rebuilt; rather, the question is how large that facility should be. The question confronting the Legislature is what state interest is furthered in the financing of this project.

Many of the attendant risks involved with this project need further consideration by the Legislature. Because of the risks, we recommend that the Legislature consider funding no more than a 450-bed hospital now, and evaluate the need for the rest, over time.

From the University's proposal, and our conversation with them, it is apparent that what is most urgently needed now, from their perspective, is the new 450-bed facility which they call "Unit J." Unit J represents the first phase of their two-phase proposal. (The second phase involves some remodeling of the existing facility.) We think that the Legislature should guarantee the state's credit for a facility no larger than Unit J without delay.

Because of the risks involved, however, we would urge that the Legislature leave open for now the question of a larger facility. Under the University's plan, even without state credit, they would have to make a decision on whether to go ahead with the remodeling of the existing facility by 1985. The Legislature could usefully postpone its decision on the need for the rest of the facility until then, using the interim years to thoroughly investigate the need for the remaining 250+ beds.

There are three major benefits to this "go-slow" approach. First, extending the use of state credit to no more than a 450-bed facility reduces the University Hospitals' bonding request by $60 million, in a year when the state faces severe financial problems and Legislature faces three times as many bonding requests as the level at which the state can most comfortably extend its credit. Second, it prevents additional excess capacity from occurring in the metropolitan area, a region already heavily overbedded. Third, and perhaps most important, it prevents the state and its taxpayers from fully committing themselves to this project (the largest single certificate-of-need expenditure in the state's history) until many important questions have been answered.

III. <u>THIS PROJECT PRESENTS SOME FINANCIAL RISKS TO THE STATE, TO YOU ITS POLICY LEADERS, AND TO MINNESOTA'S TAXPAYERS.</u>

Given the state's tight fiscal situation, a thorough examination of the financial risks involved in this sizable public investment is called for.

The Legislature should note that such a detailed financial analysis of the merits of this proposal went beyond the scope of the review conducted by the Metropolitan Health Board. The Health Board, like so many of the other HSAs around the country, simply does not have the kind of resources or staff to thoroughly evaluate questions of financial viability.

To the extent that such discussion has not occurred at the regional level, it is absolutely imperative that it occur at the state level.

A. <u>The unusual method of financing this proposal carries some risks.</u>

The University is proposing that the state of Minnesota issue general obligation bonds to finance the project, which would assure lower interest rates than if the University were to issue bonds itself. The University is proposing to pay off the bonds on a 30-year repayment schedule. However, the Minnesota constitution limits state general obligation bonds to 20 years. To stay within the technical requirements of the constitution, the University is proposing an initial bond issue be sold by the state with provision for a "balloon" payment after about 10 or 12 years. At that time the Legislature would be asked to finance the "balloon" payment by issuing a second 20-year bond issue. This process is known as "re-funding" the bonds.

Apparently, this would be the first time the state ever would have issued general obligation bonds with an explicit intention of paying them off with an addition "re-funding" bond issue. To permit state college dormitories to be paid for over a 40-year period from dormitory revenues, the state has issued 20-year general obligation bonds with a "balloon" payment in the final year. However, those bonds involved no pledge by the state to use a second bond issue to make the "balloon" payment, and were for a much smaller amount, about $6 million.

Some persons have questioned whether an explicit intention to pay off a "balloon" payment in state general obligation bonds with a second bond issue, so that the total repayment period can be more than 20 years, is fully consistent with the 20-year limit on general obligation bonds in the state's constitution.

B. <u>The long-range sufficiency of University Hospitals' revenues present some additional risks.</u>

The University's dominant means of repaying the state will be through hospital patient revenues. The question, then, is whether the Hospitals' occupancy will be high enough over the 30-year period to supply the needed revenues with which to repay the state.

The University assumes that they will. Judging from the Health Board s Project Review Committee's Report, however, that assumption deserves legislative scrutiny.

One key factor casting doubt over the University's ability to repay the state is the recent trend toward price-conscious purchase of medical care by HMO's, businesses, etc. That trend could work to the University's competitive disadvantage because:

* The University's prices are substantially higher than other providers.

* Other hospitals have an increased capacity to deal with medically-complex cases.

* Physicians are increasingly able to treat patients in their offices, rather than in hospitals.

Both Dr. Paul Ellwood of InterStudy and Larry Kaplan, M.D., a former University-affiliated physician, agree that these trends will have a major impact on the University.

Given these trends, the Metropolitan Health Board's Project Review Committee concluded that University Hospitals is at somewhat of a "watershed" point, in terms of volume levels. For that reason, as well as those cited above, they concluded that volume projections for future years should be examined "from a conservative perspective."

These trends <u>cannot</u> conclusively verify that the University Hospitals' volume will significantly decline during the next decade, or even during the 20-year life of the state GO bonds. But they do raise the question of a possible risk of that occurring -- to the state and its taxpayers -- affecting, as it would, the institution's ability to repay its debt to the state.

IV. THE STATE COULD POTENTIALLY FACE AN AWKWARD SITUATION WERE IT TO EXTEND ITS CREDIT TO THIS PROJECT AND THE INSTITUTION ENCOUNTERED FINANCIAL DIFFICULTIES.

In the event that the project did experience financial difficulties, the incentive to the state would be to prevent further subsidization by "protecting its investment." In that case, the state would be forced to play the dual role of (1) having an investment in the operation of the U of M Hospitals, a public body; and, at the same time, (b) exercising veto power over private institutions seeking to expand their share of a given health care market. The net effect would serve to shift, unequally, the long-term financial risks from the public to the private sector.

V. OTHER IMPORTANT QUESTIONS SHOULD BE ANSWERED BEFORE ANY CONSIDERATION IS GIVEN TO EXTENDING FURTHER STATE CREDIT TO THIS PROJECT.

A. Given the changing role of the University Hospitals, does this proposal affirmatively carry forward the state's major health care objectives?

University Hospitals was originally established to: (a) take care of indigent patients, and (b) to be a training hospital for future physicians. Both of these roles are much less central to the institution's mission now than they were. Medicare and Medicaid now allow indigent patients to be cared for elsewhere. Most of the state's medical education, which involves a hospital setting, takes place in other hospitals. As the institution has de-emphasized these roles, it has emphasized others -- post-graduate education, for example, and research and development. One of the major questions this application poses to the state and its policymakers, is whether to support this shift in emphasis.

Clearly, the University has a three-part mission -- healing, teaching and research. What should be explained, better than it has been, is which of the University's roles, or combination of them, merits state support, and why.

If healing, particularly high-specialty healing, is a major part of its mission, then we question why the University should not relinquish its low-specialty services to other hospitals, thereby eliminating some of the excess capacity that continues to plague the metropolitan area.

If teaching is a major component of the University's mission, then the projected national physician surplus, and the state's response to that issue, is a factor that should be considered.

Finally, if, as we believe, the case for University Hospitals rests on research, then it is well to ask whether this medical research and development function should be financed directly by the state or by other sources that have an interest in furthering medical technology. Is it the state's role to provide a $300 million laboratory for medical technological research?

However these questions are answered, it is important for the Legislature to ask them, since the state ought to make explicit its rationale for financing this project.

B. Has the state fully considered other possibly more cost-efficient options, given the size of this project?

The Legislature may also want to consider the opportunity to link two large public teaching hospital proposals together -- the University of Minnesota and the Veterans Administration Hospital. Based on some conversations that we have had with a high-ranking official at the Office of Management and Budget, it is apparent that there is considerable concern in Washington over the cost of that facility.

VI. THE LEGISLATURE SHOULD INITIATE A STUDY TO ANSWER THESE QUESTIONS TO ITS SATISFACTION.

Although we feel that the state should extend its credit to a smaller University hospital, a study should be done to assess in more detail the ongoing need for the remaining beds. Logically, this study should be done by the Legislature, since further subsidization would involve additional state financing.

It also seems apparent that we will not have the kind of information needed to judge the adequacy of the University's occupancy rate to generate the needed revenues to repay the state for several years. Therefore, the study might not have to be completed until, say, 1985.

We feel that the scope of any such study should contain the following component parts:

* A better definition of the University's role and the state's interest in supporting it.

* An assessment of the long-range impact on the University's occupancy rates by HMOs.

* A determination of the adequacy of the University's occupancy-generated patient revenues in repaying the state.

* An examination of whether linkages could be developed with other teaching institutions, such as Hennepin and Ramsey County Medical Centers, or other facilities such as the Veterans Administration Hospital.

The study should also explore trends affecting University or other teaching institutions nationally. To do so adequately might involve conversations with the Council of Associated American Centers, the Council of Teaching Hospitals, and other state legislatures that have financed such ventures.

If we can be of further assistance, we would be glad to accommodate you.

Thank you for your consideration of this statement.