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To ensure access to high-quality, patient-centered, cost-effective health care to Los Angeles County residents through direct services at DHS facilities and through collaboration with community and university partners.

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September 25, 2018

TO: Each Supervisor

FROM: Christina R. Ghaly, M.D.
Acting Director

SUBJECT: **DEPARTMENT OF HEALTH SERVICES' (DHS) FISCAL OUTLOOK**

This is to provide DHS' most recently updated fiscal outlook for Fiscal Year (FY) 2017-18 through FY 2020-21 (Attachment I).

The Department estimates a fund balance of $911.8 million for FY 2017-18 and $919.9 million for FY 2018-19. However, in FY 2019-20, due to a scheduled reduction of $108.0 million in Disproportionate Share Hospital (DSH) funding, the Department will start running a current year deficit and will need to use fund balance to cover the shortfall.

The current 1115 Waiver expires on December 31, 2020. Based on a recent policy statement issued by the Centers for Medicare and Medicaid Services (CMS) describing its new approach to calculating a Waiver's budget neutrality, the Department of Health Care Services (DHCS) believes there is a high probability that the current Public Hospital Redesign and Incentives in Medi-Cal (PRIME) and Safety Net Care Program (SNCP) will not be renewed.

If this occurs, a significant loss of revenue to DHS would result. DHS has been highly successful in achieving the clinical quality targets set forth in the PRIME program, earning approximately 99% of available funds each year of the program to date. For FY 2019-20, PRIME is valued at $171.0 million and the SNCP is valued at $106.8 million. In addition, the DSH reduction increases to $216.0 million in FY 2020-21. Under this scenario, for FY 2020-21, DHS expects the fund balance will be exhausted in order to cover the shortfalls, with an additional estimated deficit of $39.4 million.

Medicaid Managed Care Rule

Two revenue replacement programs, the Enhanced Payment Program (EPP) and the Quality Incentive Program (QIP), were designed in collaboration with DHCS to mitigate the impact of the Medicaid Managed Care rule's prohibition of directed payments.

Enhanced Payment Program

The EPP establishes a pool to supplement the base rates received by public hospitals through their managed care contracts. The funds are allocated to various hospital classes based on 90% capitated lives and 10% fee-for-service (FFS). DHS successfully argued that it should be in its own class which we believe will enhance DHS' ability to maximize EPP revenues. CMS approved the EPP pool amount for FY 2017-18, but the FFS rates and the percentage of supplemental payments for the capitation contract rates are still pending approval. DHCS expects to hear from CMS on these issues within the next two months. The estimated value for FY 2017-18 is approximately $391.6 million. DHS expects to receive the 2017-18 EPP funds during FY 2018-19.

Quality Incentive Program

The QIP program was also developed in collaboration with DHCS and will provide value-based payments based on clinically-established quality measures for Medi-Cal managed care enrollees. CMS approved the amount of QIP funding, approximately $320.0 million Statewide, for FY 2017-18. CMS has agreed that public hospitals can receive their full allocation if baseline data is submitted by a certain deadline. After the first year, the payments will be conditioned on the achievement of specific quality measures, distinct from but similar in nature to the types of measures in the current PRIME program, for Medi-Cal managed care enrollees.

At this time, a proposal to DHCS is being developed regarding the method of allocation of QIP funds among the State's public hospitals. Based on preliminary estimates, the estimated value to DHS for FY 2017-18 is approximately $70.0 million. The proposal will include a request that DHCS seek approval from CMS for the next four years of QIP, with an annual COLA, and a State option to revisit the program in two years.

While the pool amounts for both the EPP and QIP programs have been approved by CMS for FY 2017-18, the rates that will be used to draw down the funds have not yet been approved. Because the most important fiscal components of these two programs have not been approved by CMS, the estimated revenues for these programs could change materially.

<u>Pending CMS Approval</u>

Graduate Medical Education (GME) / Indirect Medical Education (IME) Proposal

The GME/IME program proposal would provide additional payments for public hospitals for Medi-Cal Managed Care beneficiaries. The proposed payments would cover Medi-Cal's share of the salaries and benefits of interns and residents receiving training at public hospitals, as well as certain indirect costs associated with their training. CMS returned the proposal to DHCS and is requiring that it be restructured to mirror Medicare's GME/IME payment methodology. Because of this, it is difficult to estimate the anticipated value of the GME/IME proposal, if it is approved. As a result, this fiscal outlook does not include GME/IME revenue estimates.

Changes in Overall Fiscal Outlook

Attached are several graphs that illustrate the changes in our revenues and expenses over the last several years and what is expected to occur in the upcoming fiscal years.

Revenue by Category (Attachment II)

Due to the 2010 Waiver and the implementation of the Affordable Care Act, the Department experienced significant growth in Medi-Cal, Medi-Cal supplemental, and Waiver revenues. From FY 2012-13 to FY 2018-19, these revenues grew from approximately $1.9 billion to $2.9 billion and have consistently provided approximately 75% of the Department's patient care revenues. Currently, there is a much larger percentage of Medi-Cal revenue being derived from supplemental payments that have increased from about 8% in FY 2012-13 to over 19% in FY 2018-19.

Waiver Revenues (Attachment III)

As mentioned above, the 1115 Waiver expires December 31, 2020. DHCS believes that the SNCP and PRIME Waiver programs will not be renewed due to budget neutrality issues. A loss in PRIME and SNCP revenues represents a loss of approximately $261.0 million to DHS in FY 2020-21.

Under the current Waiver, the Global Payment Program (GPP) combines SNCP and DSH funds. DHS is assuming that the GPP, without SNCP funds, will be renewed. Under the Affordable Care Act, reductions in DSH allotments were set to begin in 2014 and continue over a period of seven years to account for the expected decrease in uncompensated care. Since that time, Congress has approved several delays to the start date for the DSH cuts, but in order to achieve the savings over a shorter time period, the annual reduction amounts have been increased. Under the last approved delay, the overall DSH cut was increased by approximately $1.0 billion. Under current law, the Department will see a DSH reduction of $107.0 million in FY 2019-20, with the cut amount increasing to $216.0 million in FY 2020-21 and ongoing. The combined loss of SNCP, PRIME and DSH funding will amount to almost $500.0 million annually.

Financial Overview (Attachment IV)

Attachment IV shows an annual expense increase of approximately 2.7 percent. The graph demonstrates that revenues are not keeping pace with expenses. The combined loss of DSH, SNCP and PRIME revenues amounting to nearly $500.0 million annually is the reason we expect a current year deficit to begin in FY 2019-20 requiring use of fund balance to cover the shortfall.

<u>Debt Service</u> (Attachment V)

DHS' projected debt service obligations increase significantly over the coming years, e.g., between FY 2010-11 and FY 2022-23, the debt service increases from approximately \$19.3 million to \$185.4 million. This increase is mostly due to the replacement of Harbor-UCLA Medical Center (H-UCLA MC). The Department has not previously carried a debt service over \$100.0 million.

<u>Fund Balance</u> (Attachment VI)

DHS' fund balance peaks in FYs 2017-18 and 2018-19. With the expected loss of PRIME, SNCP and DSH funding, DHS believes it will be necessary to exhaust the fund balance to cover the shortfall in FY 2020-21, with an additional estimated deficit of \$39.4 million.

<u>Upcoming Capital Projects and Deferred Maintenance</u> (Attachments VII and VIII)

In addition to the replacement of Harbor-UCLA MC, the Department has other capital projects scheduled, e.g., hospital campus-based recuperative care construction projects, LAC+USC – Women's & Children's Hospital Demolition, recuperative care and skilled nursing facility at Rancho Los Amigos National Rehabilitation Center, construction/remodeling of various clinical facilities, among others detailed in Attachment VII which will require funding or use of DHS' fund balance, accelerating the rate at which it is exhausted. There are also multiple critical deferred maintenance projects that have been identified for which funding will be necessary.

In closing, DHS closed FY 2017-18, and anticipates closing FY 2018-19 with an increased fund balance. Due largely to expected reductions in DSH beginning in FY 2019-20 and expected loss of revenue currently earned through the SNCP and PRIME components of the 1115 Waiver beginning in FY 2020-21, DHS projects it will need to rely on its fund balance to support its budget, with exhaustion of the fund balance by FY 2020-21. To help fund projected future shortfalls, DHS will continue working diligently with DHCS to develop other revenue programs. It will also continue its work on various internal initiatives that will help curb unnecessary expenditures in a manner that allows for ongoing strengthening of its core clinical services and role as a safety net provider for residents of Los Angeles County.

If you have any questions or need additional information, please let me know.

CRG:anw
Fiscal Outlook Sept 2018.docx
609:005

Attachments (8)

c: Chief Executive Office
County Counsel
Executive Office, Board of Supervisors

Attachment I

COUNTY OF LOS ANGELES - DEPARTMENT OF HEALTH SERVICES

FORECAST *

FY 2017-18 TO FY 2020-21

($ in Millions)

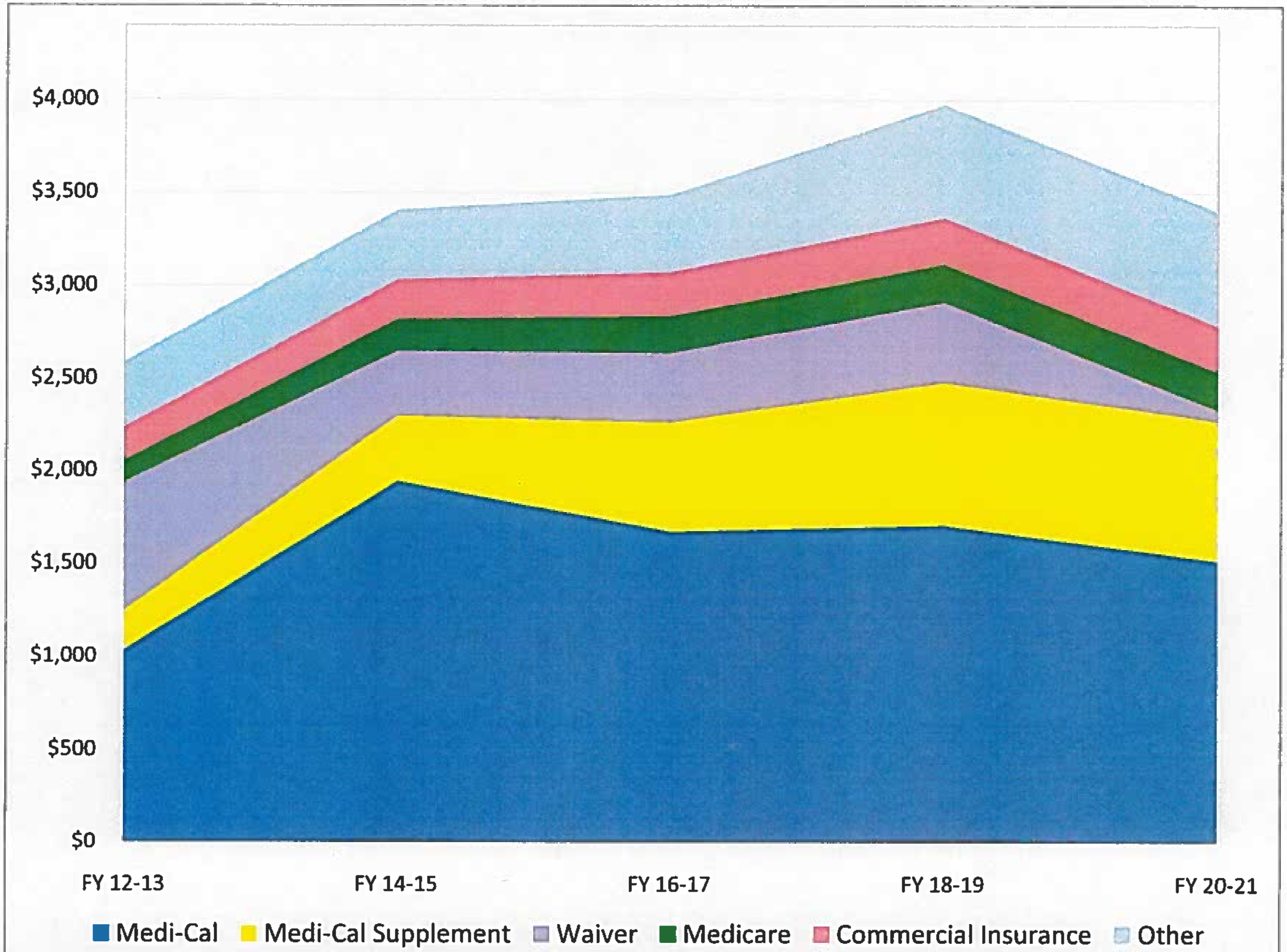
		Base Year		Year 1		Year 2		Year 3	
		A	B	C = A+B	D	E = C+D	F	G = E+F	
		FY 2017-18 Closing	Adjustments	FY 2018-19 Forecast	Adjustments	FY 2019-20 Forecast	Adjustments	FY 2020-21 Forecast	
	Expenses								
(1)	Salaries & Employee Benefits	$ 2,840.684	$ 132.325	$ 2,973.009	$ 79.174	$ 3,052.183	$ 74.991	$ 3,127.174	(1)
(2)	Net Services & Supplies	2,046.904	243.984	2,290.888	(9.528)	2,281.360	3.551	2,284.911	(2)
(3)	Other Charges - Debt Services	52.293	82.068	134.361	(66.698)	67.663	26.783	94.446	(3)
(4)	Other Charges - Other	38.417	31.574	69.991	-	69.991	-	69.991	(4)
(5)	Capital Assets	85.265	(24.735)	60.530	(5.047)	55.483	(26.392)	29.091	(5)
(6)	Operating Transfers Out + Capital Projects	60.910	13.361	74.271	25.500	99.771	(55.500)	44.271	(6)
(7)	Intrafund Transfer	(93.288)	(110.390)	(203.678)	(4.816)	(208.494)	(4.076)	(212.570)	(7)
(8)	**Total Expenses**	$ 5,031.185	$ 368.187	$ 5,399.372	$ 18.585	$ 5,417.957	$ 19.357	$ 5,437.314	(8)
	Revenues								
(9)	Medi-Cal Inpatient	397.090	21.714	418.804	2.927	421.731	4.247	425.978	(9)
(10)	Global Payment Program (GPP)	504.281	12.713	516.994	(80.780)	436.214	(214.829)	221.385	(10)
(11)	PRIME (Formerly DSRIP)	149.885	31.320	181.205	(27.181)	154.024	(154.024)	-	(11)
(12)	Enhanced Payment Program (EPP)	391.584	85.839	477.423	(16.930)	460.493	(4.837)	455.656	(12)
(13)	Quality Incentive Program (QIP)	69.575	3.131	72.706	3.272	75.978	3.419	79.397	(13)
(14)	Managed Care	727.476	(39.141)	688.335	(13.303)	675.032	(6.420)	668.612	(14)
(15)	Mental Health	59.605	3.365	62.970	(0.103)	62.867	(0.078)	62.789	(15)
(16)	Whole-Person Care	64.507	83.466	147.973	(23.397)	124.576	(62.288)	62.288	(16)
(17)	Medi-Cal Outpatient - E/R	101.850	2.746	104.596	1.839	106.435	2.022	108.457	(17)
(18)	Medi-Cal CBRC	208.549	14.521	223.070	4.428	227.498	4.518	232.016	(18)
(19)	Medi-Cal SB 1732	-	5.000	5.000	-	5.000	-	5.000	(19)
(20)	Hospital Provider Fee	14.666	-	14.666	-	14.666	-	14.666	(20)
(21)	Federal & State - Other	58.613	20.734	79.347	(5.019)	74.328	0.541	74.869	(21)
(22)	OCD - Other	376.763	(13.260)	363.503	-	363.503	-	363.503	(22)
(23)	Other	85.866	(7.455)	78.411	2.686	81.097	2.590	83.687	(23)
(24)	Operating Trf In/Measure H	56.322	22.993	79.315	0.615	79.930	0.267	80.197	(24)
(25)	Self-Pay	8.197	0.422	8.619	-	8.619	-	8.619	(25)
(26)	ORCHID Incentive Payments	4.444	(0.339)	4.105	(4.105)	-	-	-	(26)
(27)	Medicare	221.483	(20.178)	201.305	1.469	202.774	1.832	204.606	(27)
(28)	Hospital Insurance Collection	94.999	1.550	96.549	-	96.549	-	96.549	(28)
(29)	In-Home-Supportive-Services (IHSS)	147.095	5.153	152.248	-	152.248	-	152.248	(29)
(30)	AB 85 Redirection	(231.081)	102.081	(129.000)	129.000	-	-	-	(30)
(31)	**Total Revenues**	$ 3,511.769	$ 336.375	$ 3,848.144	$ (24.582)	$ 3,823.562	$ (423.040)	$ 3,400.522	(31)
(32)	**Net Cost - Before PY**	$ 1,519.416	$ 31.812	$ 1,551.228	$ 43.167	$ 1,594.395	$ 442.397	$ 2,036.792	(32)
(33)	Prior-Year Surplus / (Deficit)	470.341	(229.541)	240.800	(240.800)	-	-	-	(33)
(34)	**Net Cost - After PY**	$ 1,049.075	$ 261.353	$ 1,310.428	$ 283.967	$ 1,594.395	$ 442.397	$ 2,036.792	(34)
	Operating Subsidy								
(35)	Sales Tax & VLF	381.663	(1.841)	379.822	-	379.822	-	379.822	(35)
(36)	County Contribution	651.305	19.180	670.485	10.497	680.982	13.800	694.782	(36)
(37)	Operating Trf In/Measure B	211.234	0.029	211.263	-	211.263	-	211.263	(37)
(38)	Tobacco Settlement	55.333	1.626	56.959	-	56.959	-	56.959	(38)
(39)	**Total Operating Subsidy**	$ 1,299.535	$ 18.994	$ 1,318.529	$ 10.497	$ 1,329.026	$ 13.800	$ 1,342.826	(39)
(40)	**Surplus / (Deficit) = (39) - (34)**	$ 250.460	$ (242.359)	$ 8.101	$ (273.470)	$ (265.369)	$ (428.597)	$ (693.966)	(40)
(41)	**Beginning Fund Balance**	$ 661.367		$ 911.827		$ 919.928		$ 654.559	(41)
(42)	Change	250.460		8.101		(265.369)		(693.966)	(42)
(43)	**Ending Fund Balance Surplus/(Deficit)**	$ 911.827		$ 919.928		$ 654.559		$ (39.407)	(43)

* The closing and forecast is net of IGTs and other double-counts, such as internal transfers and includes Correctional Health and Office of Diversion.

COUNTY OF LOS ANGELES – DEPARTMENT OF HEALTH SERVICES

Attachment II

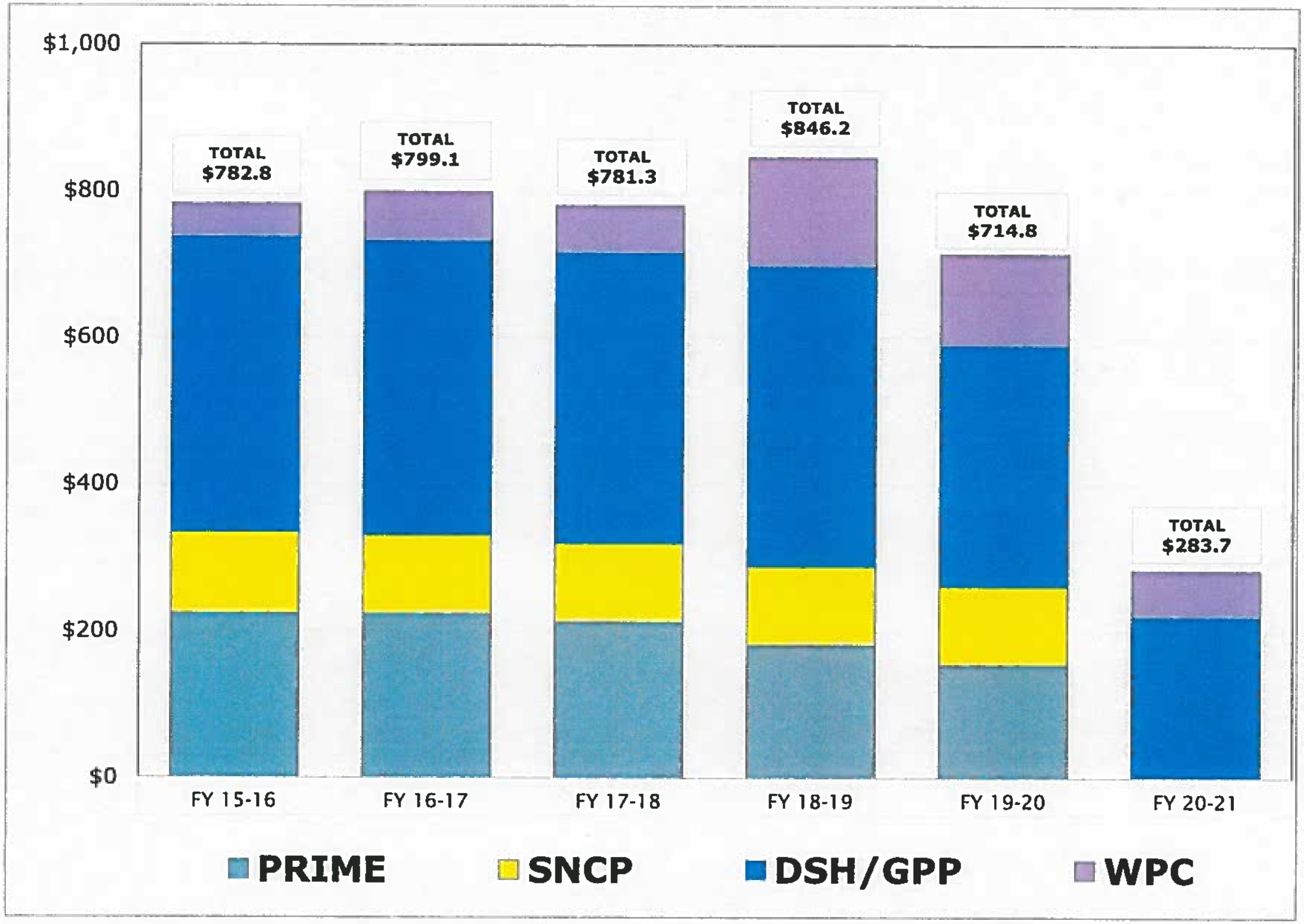
REVENUE BY CATEGORY
FY 2012-13 TO FY 2020-21
($ in Millions)



Attachment III

WAIVER REVENUES
FY 2015-16 TO FY 2020-21

($ in Millions)



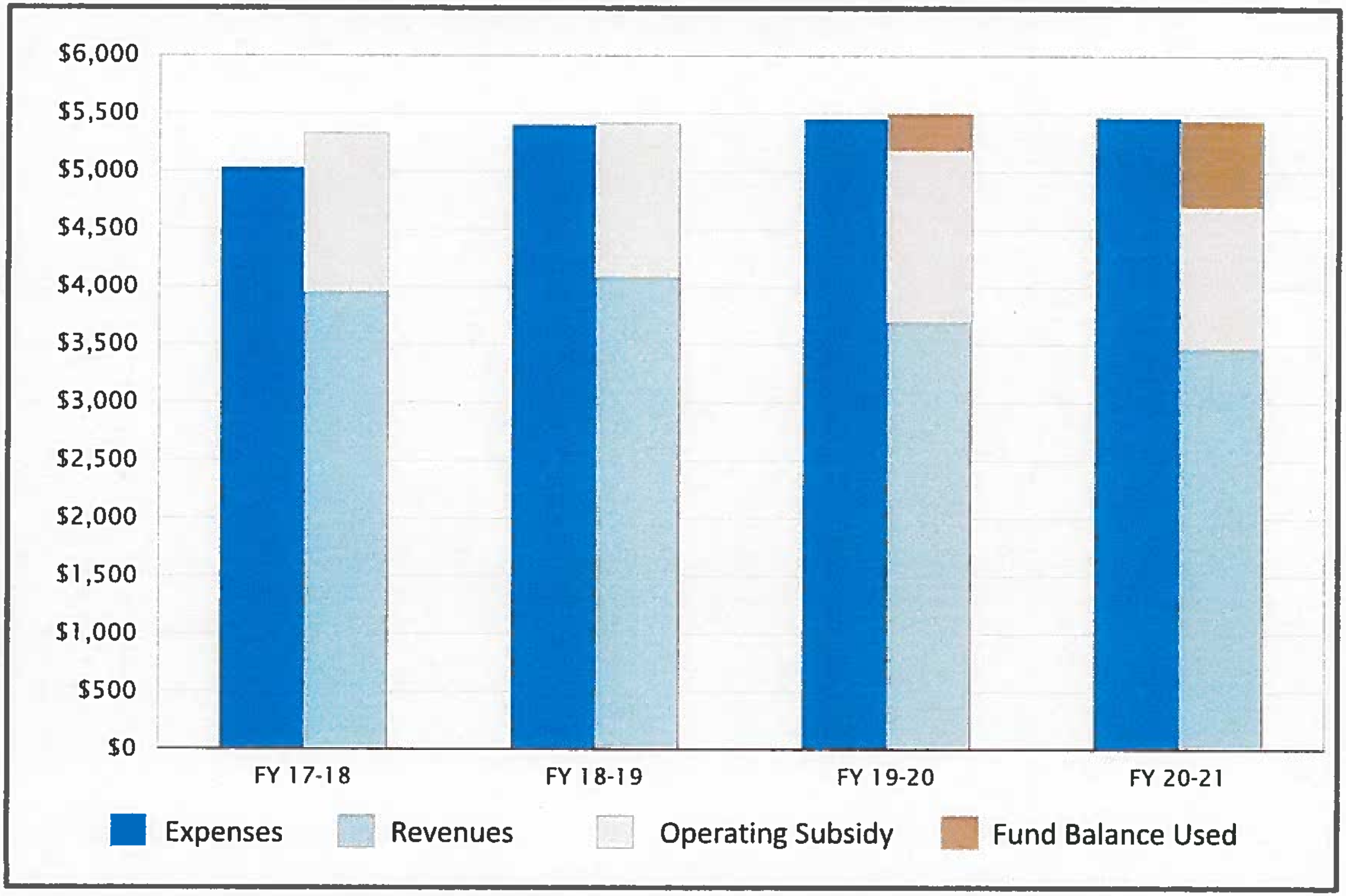
Attachment IV

COUNTY OF LOS ANGELES - DEPARTMENT OF HEALTH SERVICES

FINANCIAL OVERVIEW

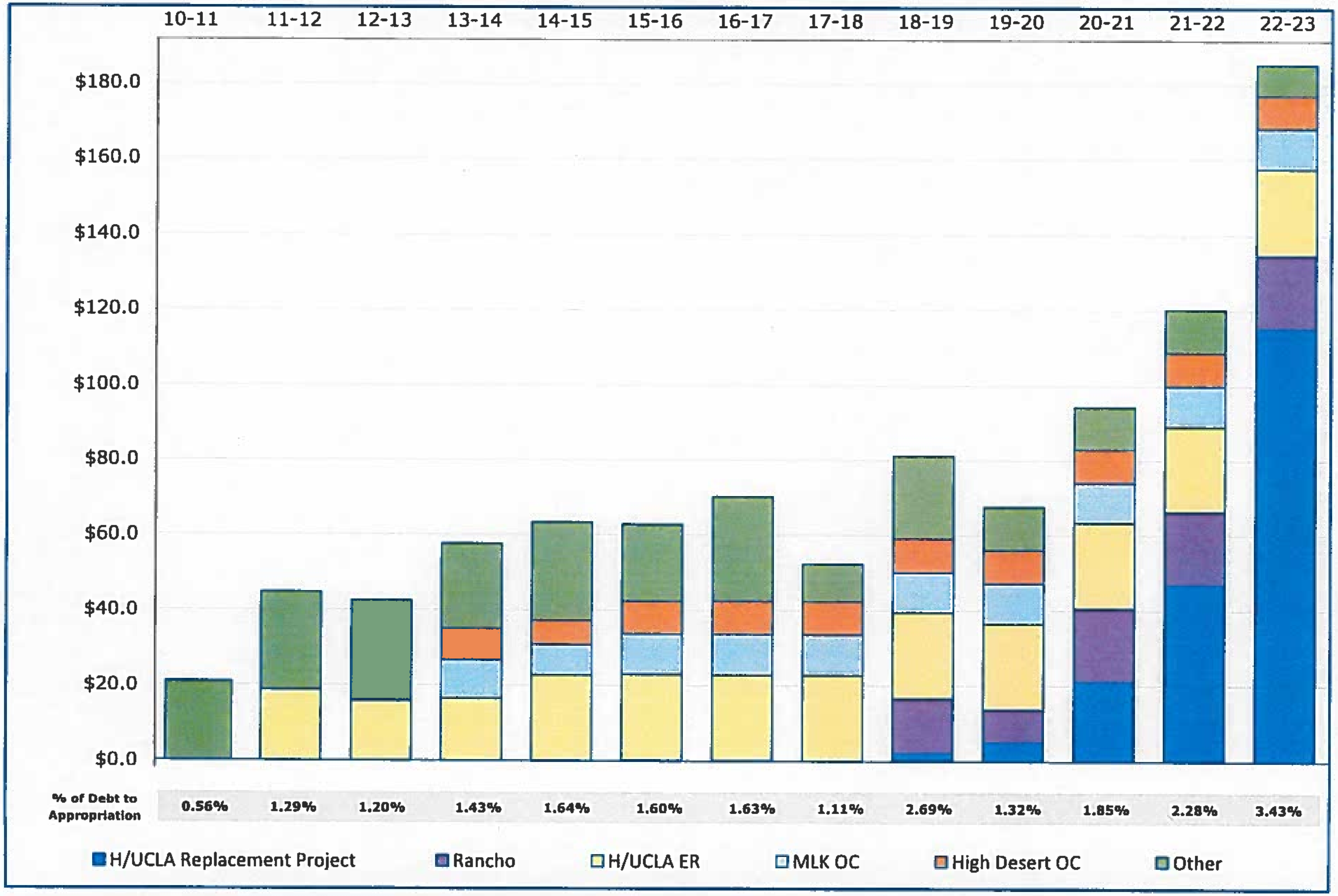
FY 2017-18 TO FY 2020-21

($ in Millions)



Attachment V

DEBT SERVICE
FYs 2010-11 to 2022-23
($ in Millions)

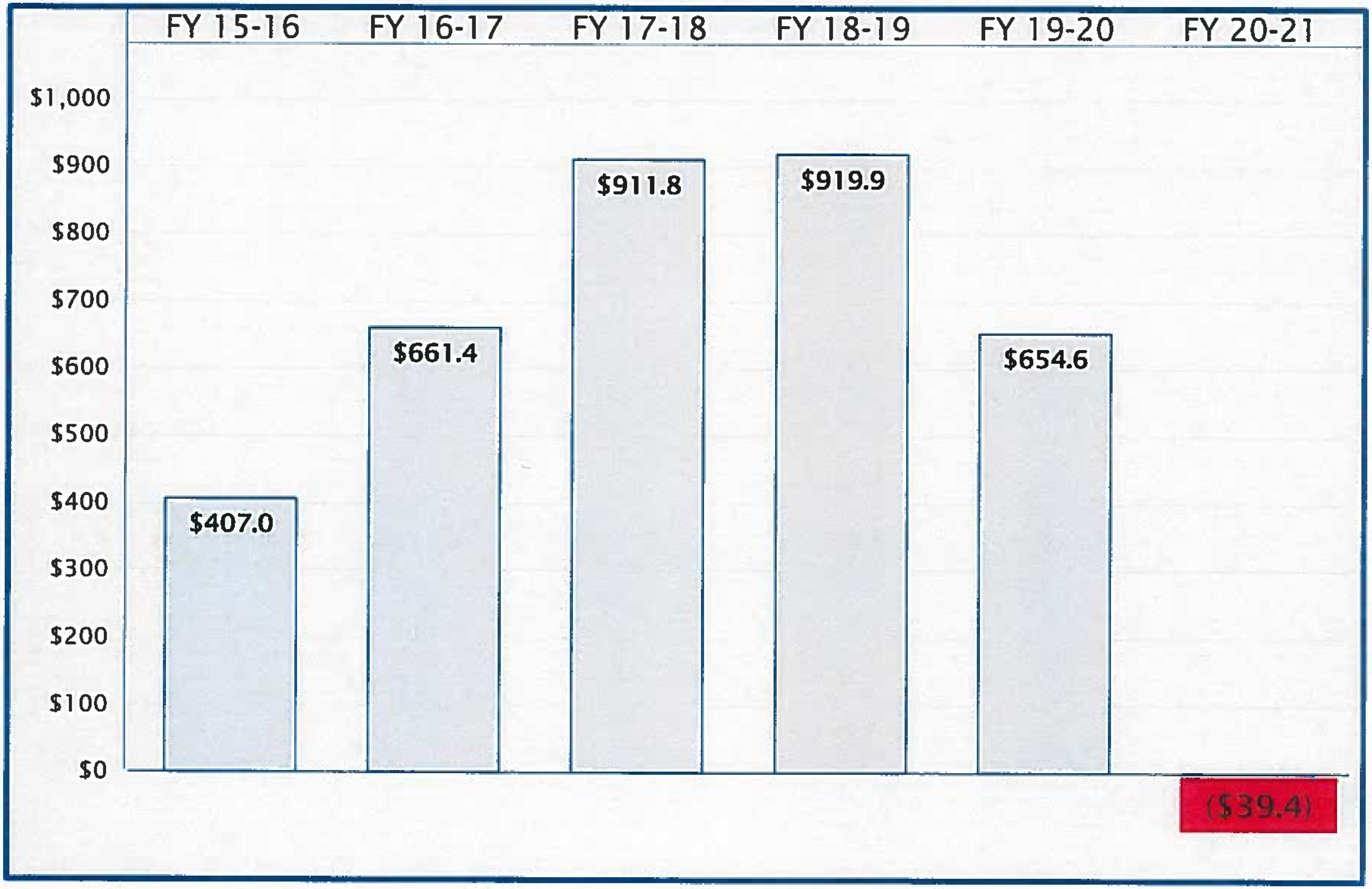


Note: H/UCLA Mental Health Inpatient and Outpatient Debt Service of $20.4 million per year is not included.

Attachment VI

FUND BALANCE
FYs 2015-16 to 2020-21

($ in Millions)



Attachment VII

EXAMPLES OF UPCOMING CAPITAL PROJECTS

	DESCRIPTION	COST ESTIMATE
1	LAC+USC – Women's & Children's Hospital Demolition	$37.0M
2	MLK- Demolition of Augustus F. Hawkins	$22.0M
3	Roybal CHC HVAC Upgrades	$14.0M
4	Countywide USP 800 Pharmacy	$6.0M
5	LAC+USC Child Care Center Replacement	$5.5M
6	MLK OC – Red Bag Storage Relocation Project	$3.9M
7	LAC+USC Courtyard Elevator/Stair	$2.5M
8	OVMC- Hospital HVAC and Humidifier Upgrade	$2.5M
9	OVMC – GI Procedure Room	$1.7M
10	H-UCLA- B-400 Pharmacy Expansion	$1.5M
11	LAC+USC OPD Fire Barrier Separation	$1.5M
12	LAC+USC Parking Structure #12 Emergency Repairs	$1.5M
13	RLANRC – Building 900-Recuperative Care and SNF	TBD
14	LAC+USC MC - Recuperative Care	$1.0M
15	OV-UCLA MC - Recuperative Care	$5.0M
16	AV - Recuperative Care	$3.0M-$5.0M
17	Curtis Tucker HC Remodel	$2.0M
18	New North Hollywood Clinic	TBD

Attachment VIII

EXAMPLES OF UPCOMING DEFERRED MAINTENANCE

	DESCRIPTION	COST ESTIMATE
1	H-UCLA Elevators	$9.1M
2	Humphrey CHC – Building Repairs	$7.3 M*
3	Ferguson Admin. – Exterior/Interior Building Repairs	$7.0M*
4	Mid-Valley CHC- HVAC and Roof Repair	$6.0M
5	LAC+USC - Sink Countertop Replacement IPT Building	$3.0M
6	MLKOC Central Plant – Electrical Repairs	$2.2M*
7	Hudson CHC – Exterior Building	$1.0M*
8	HSA Building – Mechanical System Repairs	$1.9M

*Estimated dollar amounts are for construction only.