

THE UNIVERSITY OF MICHIGAN
REGENTS COMMUNICATION

ACTION REQUEST

Subject: Proposed FY 2018 Clinical Enterprise Operating Budget (University of Michigan Health System (UMHS), including UM Health) and Proposed Michigan Health Corporation (MHC) Business Plan

Action

Requested: Approval

Background:

UMHS. UMHS refers to the clinical operations of Michigan Medicine, previously described as the Hospitals, Health Centers, and Medical Group or Clinical Enterprise. For FY 18, UMHS is targeting a 10.6% operating cash flow margin and 5.4% operating margin.

The proposed FY18 budget is predicated on several key assumptions:

- A. Accurate assumptions and successful activations of new patient care and administrative areas in FY 17 including the West Ann Arbor Health Center Parkland Plaza site, the relocation of certain Pathology functions to the North Campus Research Complex, and the continued planning associated with the pending activation of the Brighton Health Center in early FY 19.
- B. Active capacity management through existing inpatient and outpatient operations.
- C. Improved efficiency in cost per unit of service
- D. Revenue per case growth constrained by continued Federal and State funding changes and increased options for consumer-driven choices.

The proposed financial performance is consistent with the Strategic Financial Framework and aligns with the long-term plan to continuously improve the financial strength of UMHS, to levels necessary to support future strategic and routine capital investments.

UM Health. UM Health is the University subsidiary that contains the operations of Metro Health. For FY 18, UM Health is targeting a 5.3% operating cash flow margin and (0.3)% operating loss, excluding interest expense. Inclusive of interest expense, UM Health projects a (2.9)% operating loss for FY 18.

The proposed FY18 budget is predicated on several key assumptions:

- A. Continued investment in infrastructure and talent to support the long-term growth strategy.

- B. Active management of deployed initiatives to realize intended benefits.
- C. Improved efficiency in cost per unit of service


The proposed financial performance is consistent with the Strategic Financial Framework and aligns with the long- term plan to expand the reach of services provided by UM Health.

MHC. The Bylaws of MHC provide that MHC will annually submit a business plan to the Board of Regents for approval. MHC submitted its last business plan to the Board of Regents in June 2016.


The MHC Board of Directors and the MHC Sole Member Representative have unanimously approved the FY2018 Business Plan.

We recommend the Regents approve the proposed FY 2018 Clinical Enterprise Operating Budget and the Michigan Health Corporation Business Plan.

Respectfully submitted,



Kevin P. Hegarty
Executive Vice President and
Chief Financial Officer



Marschall S. Runge, M.D., Ph.D.
Executive Vice President
for Medical Affairs and Dean of the
Medical School

June 15, 2017

**UNIVERSITY OF MICHIGAN HEALTH SYSTEM
FY 2018 OPERATING BUDGET**

<i>Amounts in \$ M</i>	FY 18 Plan		FY 17 Estimated Actual	
Operating Revenue	\$3,864.2	3.7%	\$3,727.5	7.0%
Operating Expenses	\$3,653.9	3.9%	\$3,517.4	5.0%
Operating Margin	\$210.3		\$210.1	
Margin %	5.4%		5.6%	
Operating Cash Flow Margin	\$409.2		\$409.0	
Margin %	10.6%		11.0%	
Adjusted Cases	129,702	2.7%	126,286	3.9%
Inpatient Discharges	50,213	2.1%	49,178	0.8%
Occupancy	90.1%		89.3%	
Total Revenue per case (% vs PY)	0.9%		3.1%	
Total Expense per case (% vs PY)	1.1%		3.8%	

**UM HEALTH
FY 2018 OPERATING BUDGET**

Amounts in \$ M

	FY18 Plan		FY17 Estimated Actual	
Operating Revenue	\$412.8	9.5%	\$376.9	
Operating Expenses	\$424.9	9.4%	\$388.5	
Operating Margin	(\$12.1)	4.6%	(\$11.6)	
<i>Margin %</i>	<i>-2.9%</i>		<i>-3.1%</i>	
Add: Interest Expense	\$10.7	-13.7%	\$12.4	
Operating margin (before interest)	(\$1.4)		\$0.8	
<i>Margin %</i>	<i>-0.3%</i>		<i>0.2%</i>	
Operating Cash Flow Margin	\$22.0		\$22.7	
<i>Margin %</i>	<i>5.3%</i>		<i>6.0%</i>	
Adjusted Cases	27,674	9.9%	25,184	
Occupancy	57.0%		53.1%	
Total Revenue per case (% vs PY)	-0.1%			
Total Expense per case (% vs PY)	-0.5%			

**Michigan Health Corporation
FY2018 Business Plan**

I. MHC OVERVIEW

Introduction

The Fiscal Year 2018 (FY2018) Business Plan for Michigan Health Corporation (MHC) provides an overview of the direction for MHC and its subsidiary organizations, as MHC begins its twenty-second year of operation. It also includes a summary of the history of MHC and highlights of FY2017 activities.

Structure and Governance

MHC is a non-profit, non-stock membership corporation solely owned and operated by the University. MHC is part of Michigan Medicine, University of Michigan Health System (UMHS).

The MHC Board meets on a regular basis and as necessary to conduct business. The Board of Directors is:

Chair and Chief Executive Officer

Marschall S. Runge, M.D., Ph.D., Executive Vice President for Medical Affairs, University of Michigan and Dean of the University of Michigan Medical School

Vice Chair and Chief Operating Officer

David A. Spahlinger, M.D., President of the University of Michigan Health System and Executive Vice Dean for Clinical Affairs of the University of Michigan Medical School

Treasurer

Kevin P. Hegarty, Executive Vice President and Chief Financial Officer of the University of Michigan

Secretary

Amy K. Dittmar, Vice Provost for Academic and Budgetary Affairs for the University of Michigan

Director

Carol R. Bradford, M.D., M.S., Executive Vice Dean for Academic Affairs of the University of Michigan Medical School

All proposed activities that are presented to the MHC Board for approval are first reviewed and endorsed by the MHC Management Committee. The Committee includes key individuals from UMHS, the University of Michigan Medical School (UMMS), MHC, and the University of Michigan (UM). This Committee is chaired by Bev Nugent, Administrative Director for MHC, and includes the following individuals:

Paul Castillo, Chief Financial Officer, Michigan Medicine
T. Anthony Denton, Senior Vice President and Chief Operating Officer, UMHS
Teri Grieb, Ph.D., Senior Director of Research, UMMS
Nancy Hobbs, Associate Vice President for Finance, UM
Edward Jennings, Tax Director, UM
Ella Kazerooni, M.D., Professor of Radiology, UMMS
Tiana Korley, Associate General Counsel, UM
Bev Nugent, Administrative Director, MHC
Travis Souza, Associate General Counsel, UM
Jeffrey Walker, Contracting Business Development Officer, UMHS

This Committee evaluates the business case for new venture activities, directs due diligence activities, and recommends the optimal placement of the activity in UMHS. The financial performance of each MHC subsidiary organization is reviewed by the MHC Management Committee and key milestones are periodically reviewed for larger ventures.

MHC staff monitors the activities of the ventures on an ongoing basis and actively participates in finance and operations committee meetings for many of the subsidiary companies. Financial statements from the ventures are reviewed and various activities are tracked, including venture performance trend reports which are presented to the MHC Management Committee and the Board. The MHC Administrative Director also attends board meetings for a number of ventures and interfaces with venture representatives to assist with problem solving and assuring that venture and MHC needs are met.

MHC Subsidiary Organizations' History and Highlights of FY2017

As MHC completes its twenty-first year of operation, the MHC Board has approved a total of twenty-eight subsidiary organizations since its activation in 1996 to support the missions and strategic plan of UMHS and UMMS. Fourteen subsidiaries, or proposed subsidiaries, have been terminated and fourteen subsidiaries are operational.

In FY2017, MHC focused on the operations of its existing ventures. This included working with Michigan Dialysis Services to initiate planning efforts for opening a third dialysis unit to meet the increased patient care needs and working with the radiation oncology joint ventures to address changing operational and organizational needs. The MHC Board also approved Paradigm securing additional investors.

Together Health Network (THN) is a state-wide provider network whose partners include Ascension Health and Trinity Health. UMHS joined THN as a complex quaternary healthcare provider in May of 2016. MHC became a five percent equity owner of THN in FY2017.

To support UMHS in providing concierge medicine, MHC formed Victors Care in the latter part of FY2017. Victors Care is wholly owned by MHC.

MHC Subsidiary Organizations' FY2018 Plan

MHC intends to continue to operate all of the subsidiaries noted on the June 2017 organization chart on the next page, throughout FY2018.

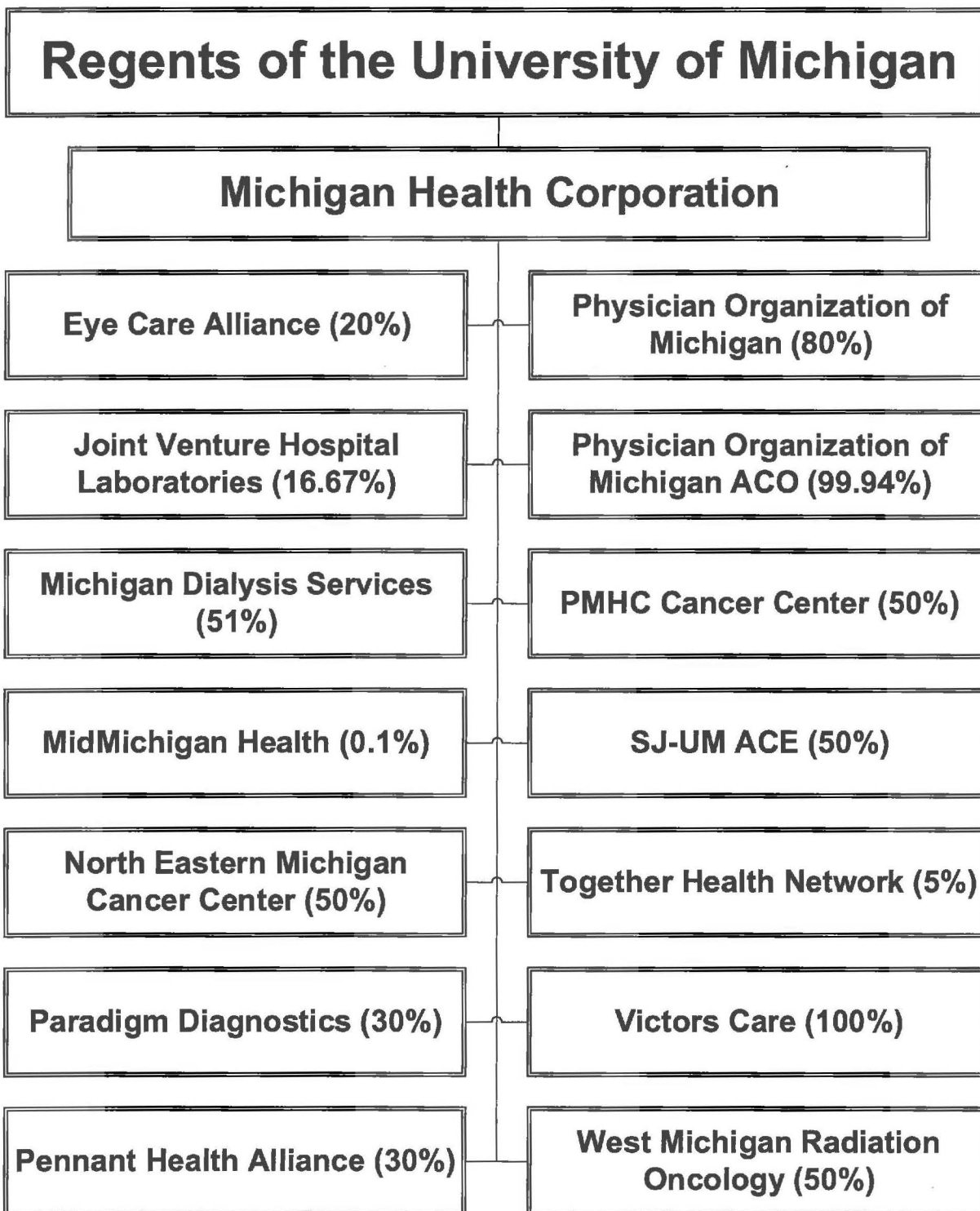
In FY2018, UMHS, through MHC, will receive additional Member Interest in MidMichigan Health increasing MHC's percentage to 12%. MHC will continue to have representation on the MidMichigan Health Board and on key committees.

MHC's interest in Paradigm is not expected to change unless Paradigm secures additional capital from outside investors. MHC's interest could be decreased, depending on the level of these new investors.

A new Accountable Care Organization (ACO) is expected to become operational in January of 2019 in response to the alternative payment models that Medicare is implementing. MHC and the current Physician Organization of Michigan ACO (POM ACO) leadership are reviewing options for the new ACO and the potential impact on POM ACO.

In response to other healthcare changes, patient care needs, and as part of the UMHS strategic plan, MHC is investigating relationships with other hospitals, physician groups, healthcare providers, and healthcare organizations.

Michigan Health Corporation Joint Venture Ownership as of June 2017



NOTE: MHC also owns Class B membership interest in Great Lakes Lithotripsy and common stock shares in Vizient, Inc. (f/k/a VHA-UHC Alliance NewCo, Inc.)

The percentages reflect MHC's ownership interest in the venture.

II. MHC FINANCIAL PERFORMANCE FOR FY2017 AND BUDGET FOR FY2018

The MHC Fiscal Year 2017 Projection and Fiscal Year 2018 Budget were developed from each subsidiary's financial plan, MHC's financial statements, projected results of the subsidiary's operations, and known/planned changes for the coming fiscal year. MHC expects to end FY2017 with a favorable margin of \$6.3 million compared to a budget of \$4.2 million. This favorable variance is related to Michigan Dialysis Services (MDS). MDS has had a significant increase in activity and favorable adjustments from prior year activity that have been generating a favorable margin and providing MHC with significant cash distributions.

In FY2018, MHC is budgeting a favorable margin of \$3.1 million. The decrease in margin for FY2018 as compared to FY2017 relates to MDS and Victors Care start-up of new facilities and programs. As MDS' activity has increased, its two dialysis facilities have reached patient care capacity and MDS will be opening a new facility in Canton near the UMHS Canton Health Center. The start-up costs of the new facility will result in a smaller margin for MDS in FY2018. In addition, the development of Victors Care and the first six months of operations will have costs exceeding revenues by approximately \$760,000.

The impact of MHC's Member Interest in MidMichigan Health increasing from 0.1% in FY2017 to 12% in FY2018 on MHC's financial statements is being evaluated from a legal interpretation of MHC's stake in MidMichigan and the corresponding accounting treatment which then applies. Financial information will be included in MHC financial statements as it becomes available.

Investments Summary

MHC's maximum capitalization level for all ventures combined is \$45 million. MHC has made investments in ventures over the years and many ventures have not only repaid MHC the full investment amount, but have provided cash distributions in excess of the MHC original investment. It is projected that as of June 30, 2018, MHC will have an outstanding investment amount of \$8.8 million, leaving \$36.2 million of the approved capitalization available for investment in other ventures. The MHC cash balance is projected to be \$5.5 million as of June 30, 2017.