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# Press Release

## City notified of 'significant' downgrade in hospital bond status

*Public Building Commission downgraded from Ba1- to Caa1- bond rating*

ARKANSAS CITY, Kan. (June 24, 2015) — The City of Arkansas City was notified Wednesday, June 24, 2015, by Moody's Investor Service, Inc. that the bond rating for the Arkansas City Public Building Commission will be downgraded from Ba1, with a negative outlook, to Caa1, with a negative outlook.

The Public Building Commission, which comprises the five city commissioners and four other members of the public, is the entity that issued the debt service for South Central Kansas Medical Center's new 37-bed facility, which opened in March 2009 in Patterson Park Subdivision.

The $26.2 million in hospital financing was secured through the issuance of General Obligation bonds, which are backed by the full faith and credit of the City. SCKMC is responsible for paying one of the two annual bond payments through its net revenues. About $22 million remains to be paid off.

A Moody's representative described Wednesday's action as a "significant rating action."

### City's financial position strong

The City of Arkansas City itself has an institutional framework score of Aa, which means it has a very strong capacity to meet its financial commitments. Among its financial strengths praised by Moody's:

- The city has modestly improved financial performance, with now-balanced operations and growth in available liquidity.
- The city's utility fund performance is strong, with a stable financial position.
- The local economy is stable (though limited in growth prospects).
- There is a dedicated sales tax to support hospital operations for another four years, although in Moody's opinion, it is insufficient to stem the facility's financial decline.

For immediate release

"Although Arkansas City's financial position has recently improved, the fate of the hospital could significantly alter this given the city's unlimited GO commitment to support debt service," the investor services states in a report issued June 24.

The city also was praised for ending the standard practice of transferring money from its utility funds to its general fund in fiscal year 2014. "We view the return to self-sufficiency of the General Fund after multiple years of dependence on the utility funds as positive," Moody's states in its report.

The city currently maintains a fiscal fund balance of $1.2 million, equivalent to 14.9 percent of its revenues, with an additional $700,000 expected to be added to that amount in fiscal year 2015.

Its cash on hand is $1.687 million, with an available liquidity of 16 percent of revenues.

## Hospital financial difficulties continue

South Central Kansas Medical Center's "operations have weakened substantially," according to Moody's. Wednesday's rating downgrade "reflects the harsh impact a non-payment by the hospital would have on the city's tax burden and general operations," which Moody's estimated potentially could consume 25 percent of current city operations if it did not raise new revenues.

The negative outlook on the bond rating reflects Moody's expectation that hospital operations will remain pressured in the new term and unlikely to sustain debt service payments, in its opinion.

Of the three possible actions that could occur to improve the rating or outlook, only the first, "material and sustained improvement in hospital operating margins and growth in liquidity," is feasible at this time.

New SCKMC chief operating officer Virgil Watson has made that goal his top priority in his first six months on the job, with the hospital's next bond payment approaching in August.

The hospital is now in its fourth year of operating losses, is unable to carry its total debt service, and has flat inpatient volume and only 26 percent average occupancy, in Moody's assessment.

It had 984 inpatient admissions in fiscal year 2014, a 10.5-percent decline from two years ago.

But emergency room visits (4.6 percent), outpatient visits (4 percent) and outpatient surgeries (34 percent) have increased over the past two years.

The federal government provides 59 percent of SCKMC's gross revenue through Medicare (43 percent) and Medicaid (15.7 percent) reimbursements, but sweeping changes to those services in the past five years and a continued refusal by the State of Kansas to expand Medicaid coverage have contributed heavily to the hospital’s precarious financial position.

The hospital experienced negative operating margins of -8.5 and -7.7 percent, respectively, in fiscal years 2013 and 2014, although operating cash flow margins were positive in both years.

Unrestricted liquidity is very weak, Moody’s states — it only has $117,000 cash on hand, sufficient to fund 2 1/2 days’ worth of operating expenses. Its assets cover approximately 60 percent of its liabilities.

## Hospital taking action; effects take time

“While we are disappointed with the downgrade, we are not completely surprised and believe our picture is not as grim as Moody’s has it appear,” Watson said Wednesday.

“We have been working hard since I came on board in January to improve our current financial situation, and have made some progress.”

Watson has implemented several new strategies to address the hospital’s revenue issues and is hopeful they will begin to make significant contributions to the hospital’s bottom line before the end of this year. They include:

1. SCKMC has applied for a Rural Health Clinic designation and Sole Community Hospital status, both designations from the federal government that could increase its reimbursements and reduce its costs.

2. Beginning in January 2016, it will apply to receive grants as part of the 340 B pharmacy program, which is contingent on achieving Sole Community Hospital status.

3. Billing is being streamlined to bring in more timely and increased revenues.

4. The hospital elected in 2014 to outsource its housekeeping, dietary consultation and laundry services.

5. SCKMC has implemented a new telehospitalist program that should help to increase overall admissions, and a new physician will come on board in August. The hospital’s continuously active recruitment initiatives remain paramount, as each new physician represents about $1.5 million annually in potential new revenues, on average.

“Through four months of fiscal 2015, management reports some improvement in performance and expects to report a negative operating margin of approximately -3.0%,” Moody’s states in its report.