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News Release

City notified of three-spot upgrade in medical center bond status

Public Building Commission upgraded from Caa1- to B1 stable bond rating

ARKANSAS CITY, Kan. (October 11, 2016) — The City of Arkansas City was notified Thursday by Moody's Investors Service, Inc. that the lease rental revenue bond rating for the Arkansas City Public Building Commission will be upgraded from Caa1, with a negative outlook, to B1, with a stable 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 (SCKMC) new facility, which opened in March 2009 in Patterson Park Subdivision.

The $23.205 million in hospital financing was secured by an unconditional lease payment from the City, supported by its issuance of General Obligation (GO) bonds. SCKMC is responsible for making annual bond payments through its net revenues, with the aid of a pair of sales taxes.

The upgrade to B1 reflects citizens' approval of a new revenue source to support ongoing subsidies of SCKMC for debt service and potentially operations. Specifically, the upgrade reflects the recent passage of a 1-percent citywide sales tax dedicated to covering the hospital's debt service payments.

"The stable outlook reflects Moody's expectation that the recently implemented 1% sales tax dedicated to hospital debt service will sustain the majority of debt service payments on the lease revenue bonds," states a Moody's credit opinion issued last Wednesday. "The outlook further considers the City's ability to maintain operations while supporting the hospital debt, without the need to increase property taxes, and citizen support for the additional tax to support the hospital."

This new tax, the collection of which began Oct. 1, will allow SCKMC to focus on supporting its operations, recruiting additional physicians and becoming more financially solvent for the long term.

City's financial position remains strong

For immediate release

Cities in Kansas have an institutional framework score of Aa, which means they have a very strong capacity to meet their financial commitments. Among Ark City's financial strengths lauded by Moody's:

- The City has 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, with a small, rural tax base).
- There are two dedicated sales taxes to support hospital operations for another 10 years and they are expected to cover the majority of the remaining debt service payments.

The City currently maintains a fiscal fund balance of $1.35 million, equivalent to 12.8 percent of its revenues. Its cash on hand at the end of fiscal year 2015 was $4.7 million. Additionally, the City maintains an additional $6 million in its utility funds.

"Arkansas City's financial position, although improved, is expected to remain pressured given the historical need to subsidize hospital operations," Moody's reports.

The City has outlaid more than $1.3 million to SCKMC since August 2015, in the form of three loans and also covering the first payment due to Quorum Health Resources LLC, a health care consulting firm that is completing a financial, operational and strategic assessment of SCKMC this month.

The loans are repayable at an amount of $25,000 per month until they are repaid in full. In addition, SCKMC currently owes the City $340,747.68 in unpaid special assessments since February 2015.

The report also continues to praise City officials for decreasing the dependence on utility transfers.

"The City returned to stable growth as it began to generate surpluses strengthening reserves," Moody's writes.

"For many years, the General Fund was dependent on utility fund transfers for operations. Transfers from the Water, Wastewater and Sanitation Funds reimbursed the General Fund for some administrative expenses. Transfers from the utility funds have fluctuated from nearly $1.5 million to zero depending on the changes to property tax rates. The City continues to budget transfers for fiscal (year) 2016, but does not plan to utilize transfers from the utility funds for operations."

"We view the return to self-sufficiency of the General Fund after multiple years of dependence on the utility funds as positive," Moody's continues. "While fiscal 2015 reportedly ended with a surplus, continued financial pressure related to the hospital support from the City will continue to draw on reserves. Fiscal 2015 operating funds ended with a $335,000 draw on available reserves and ended the year with a balance of $1.35 million, or a modest 12.8% of revenues.

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"Due to continued loans to the hospital, the City is expecting to end fiscal 2016 with a draw and ending available reserve of only $939,000, or approximately 11% of budgeted revenues. Positively, the City adopted a surplus fiscal 2017 budget and expects to increase reserves by approximately $600,000."

"The expected surplus and reversal of draws on reserves is credited to the newly implemented hospital sales tax and the expectation of hospital self-sufficiency," Moody's concludes.

The investor service also addressed the impact of the Kansas property tax lid legislation that was passed in 2015 and amended in 2016. It stipulates that an increase in property tax dollars levied beyond the rate of inflation will require voter approval starting next year.

The 2016 amendment moved the date of tax lid implementation to January 2017 (affecting fiscal year 2018 budgets), changed the inflation benchmark to a five-year average, and added important exemptions such as public safety expenses and lease revenue bonds issued prior to July 1, 2016.

"The amended legislation continues to allow GO bonds to be exempt from property tax limits," Moody's writes. "Given the broadness of the exemptions included, we do not believe the lid will present significant financial or operational challenges for the City."

SCKMC's financial difficulties

SCKMC has experienced "strained hospital operations as demonstrated by multiple years of unstructured operations resulting in limited liquidity," states the Moody's credit opinion.

Unrestricted liquidity is very weak, Moody's reports — SCKMC only has $63,000 cash on hand, sufficient to fund 1.3 days' worth of operating expenses. Its assets cover approximately 60 percent of its liabilities. In addition, SCKMC has $628,978 held under bond indenture.

The hospital, now in its fifth year of operating losses, is unable to carry its total debt service. It has an elevated debt burden, a limited operating size with less than $20 million in revenue and, according to the investor service, "an outsize demand given location, demographics and nearby competition."

"Utilization has been mixed over the last few years as patient volumes shift to the outpatient setting from the inpatient setting," Moody's continues. Inpatient admissions equaled 1,017 in fiscal year 2015 — a 3-percent increase from fiscal 2014, but still underutilized.

The federal government provides the majority 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.

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"The hospital is also heavily reliant on (Medicare and Medicaid) equating to 59% of gross revenue in fiscal 2015, which has pressured revenue growth given ... low reimbursement increases," Moody's says.

Hospital administrators estimate 75 percent of local residents will visit the hospital for medical procedures and are implementing expense-saving initiatives. Moody's commends SCKMC's planning:

"We anticipate patient growth for the hospital to be modest as the community is not experiencing any population growth and other nearby communities offer similar services. Favorably, management reports ongoing efforts to strengthen services in an attempt to become more competitive with nearby facilities."

Factors that could lead to a further upgrade in the bond rating include:

- Material and sustained improvement of hospital operations and improved liquidity (which is the primary goal of the Quorum assessment);
- A merger with a stronger partner and guaranteed assumption of debt;
- Substantial growth of patient care.

Update on actions taken by SCKMC

Two major developments occurred this year to help to strengthen SCKMC's financial position.

First, Arkansas City recently passed a 10-year, 1-percent citywide special-purpose sales tax, the proceeds of which will be applied only to the payment of debt service previously incurred to construct and equip South Central Kansas Medical Center. The collection of the sales tax began Oct. 1.

Second, South Central Kansas Clinic (SCKC) recently achieved a Rural Health Clinic designation from the U.S. Department of Health and Human Services. It thus qualifies for increased Medicare and Medicaid services reimbursement.

As of Aug. 10, SCKC began transitioning all required documentation that allowed for increased reimbursement. Hospital administration now will begin to consider transitioning SCKMC's specialty clinic to the same Rural Health Clinic designation, to potentially increase its reimbursement, as well.

The recently implemented 1-percent sales tax, SCKC's Rural Health Clinic designation, and ongoing cost-cutting and efficiency measures are expected to return the hospital to balanced operations by the end of fiscal year 2017.

The existing half-cent sales tax, in addition to the new one-cent sales tax, is expected to net an additional $400,000 through the end of fiscal 2016, and $2.5 million in both fiscal 2017 and fiscal 2018, before the half-cent tax sunsets March 31, 2019.

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Beginning in fiscal 2019 — absent the continuation of the half-cent sales tax — the 1-percent sales tax is expected to net approximately $1.6 million, providing 87-percent coverage of the $1.88 million annual debt service (assuming no other increase in sales tax). The Rural Health Clinic and additional designations are expected to increase SCKMC reimbursements by approximately $400,000 per year.

SCKMC chief executive officer Virgil Watson Jr. has implemented several new strategies to address the medical center'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. In addition to the Rural Health Clinic, they include:

1. SCKMC also has been granted Sole Community Hospital status, another designation from the federal government that could increase its reimbursements and reduce its costs.
2. The 340B pharmacy program is also in place and several local pharmacies are partnering in the program, which reduces the cost of medications for local patients. SCKMC will continue to expand upon this program, potentially to include additional pharmacies and area physicians.
3. Coding and billing processes continue to be refined for faster and more accurate payments.
4. All physicians and multiple nursing staff members have participated in training for improved medical clinical documentation, which increases impatient reimbursement. The adjustments in documentation already have resulted in $69,000 in added revenue in the past 60 days.
5. A new physician, Dr. Willie Posey II, was recruited and began full-time practice last spring. He is an experienced internal medicine physician with a subspecialty in non-invasive cardiology. Additional recruitment activities are ongoing, primarily concentrated on family practice, and the hospital's continuously active recruitment initiatives remain paramount, as each new physician represents about $1.5 million annually in potential new revenues for SCKMC, on average.
6. SCKMC partnered with Integrity Healthcare Professionals in January to provide coverage through the hospital's emergency department. Integrity's providers have made a significant improvement to the public perception of the emergency room by focusing on patient communication. The group also recently started the "Integrity Call Back Care Program," which allows for emergency care providers to follow up with their patients after dismissal.

About the Public Building Commission

Comprising the five city commissioners and four other citizens, the Arkansas City Public Building Commission was created for the purpose of financing and constructing public buildings and facilities.

In 2009, based on overwhelming support from the citizens in a 2008 election question, the commission issued $23.205 million in revenue bonds, at a maximum interest rate of 7 percent, to construct South Central Kansas Medical Center's new 49-bed facility in Patterson Park Subdivision.

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About $21.175 million in outstanding Public Building Commission debt remains to be paid off.

That debt is backed by the full faith and credit of the taxpayers of Arkansas City. Payments on the bonds have been supported by SCKMC revenues and a half-cent general sales tax, approved in 2009 and set to expire in 2 1/2 years, which generates about $840,000 a year.

An additional one-cent special-purpose sales tax, approved May 24 by 80 percent of Arkansas City voters, took effect Oct. 1 and will last until 2026. It is expected to generate about $1.68 million annually.

The elected members of the Public Building Commission are Mayor Duane Oestmann, Vice Mayor Dan Jurkovich and Commissioner Jay Warren.

Appointed members are chairman David Billings, vice chairman Mike Munson, Chris Tackett, Commissioner Charles Tweedy III, Commissioner Karen Welch and Shandon Weston.

The commission generally meets on the third Tuesday of each September, and at other times as needed. It will meet again in October or November to receive the final report and analysis from Quorum.

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