Health Care Committee

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Overbedding, Hospital Closures and a Potential "Soft Landing" for Health Care Creditors: Recent Efforts in New Jersey

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Hospital and nursing home insolvencies, closures and bankruptcies have long occurred independent of the "normal" economic cycle of business bankruptcies and insolvencies. There are several obvious reasons for this. These institutions depend on the state and federal government and the regulatory framework of Medicare and Medicaid for a large percentage of their revenues, and they are required to provide services to those who cannot afford to pay for them. However, one economic driver of the health care insolvency crisis that is a little less intractable is excess capacity, or overbedding.

Nationwide, due to declining lengths of stay, a shift to outpatient services and the growing availability of private ambulatory care and surgical centers, the number of hospital beds necessary to support a community has been declining regularly over the last several decades. As a result, in New York (statewide), the hospital occupancy rate fell from 82.8 percent of certified beds in 1983 to 65.3 percent in 2004.[i] In New Jersey in 2005, only 20,000 of 25,000 licensed beds in general acute care hospitals were "maintained," *i.e.*, staffed for potential occupancy, and the average occupancy of maintained hospital beds was 74 percent in 2004.[ii] Excess bed capacity causes limited private, state and federal resources to be used inefficiently, *i.e.*, spread among many institutions that are paying occupancy and other costs for essentially empty space. By closing institutions and otherwise reducing beds, the remaining hospitals in an area can do better utilizing their maintained beds, thereby enhancing revenue by reducing expenses.

Market forces have partly addressed the problem. In New York state, 70 hospitals and more than 63 nursing homes have closed since 1983. [iii] In New Jersey, 18 hospitals have closed since 1995, with some liquidating under chapter 7 of the Bankruptcy Code.[iv] However, market forces are not enough to encourage necessary closures. In New York, the recent Berger Commission Report requires the reconfiguration and/or closure of 57 hospitals, or 25 percent of all hospitals in the state.[v] In New Jersey, to bring planning and structure to the process of deciding which hospitals to help and which to leave to market forces, and perhaps thereby encourage closure, Governor Corzine signed Executive Order 39 on Oct. 12, 2006, thereby creating the "Commission on Rationalizing Healthcare Resources." On June 29, 2007, the commission issued its interim report. Perhaps signaling a sea change in New Jersey's approach to excess capacity/overbedding,

the interim report states: "Hospitals in New Jersey are going through wrenchingly difficult times. One's response to these painful circumstances, however, should not be simply to maintain the *status quo*. Hospitals have closed in New Jersey and the nation, and additional hospitals will no doubt close as the need for health care evolves. Rather than setting as the goal preserving current facilities in precisely their current configuration, policymakers should instead examine health care delivery trends and the needs of the people of New Jersey…."[vi] The commission proposes that hospitals that are not viable, but also not essential to the provision of healthcare in the state, will be left to market forces, while essential hospitals in similar straits will be examined for possible financial support.[vii]

While New Jersey's commission, unlike the Berger Commission, has not been empowered to order the closure of hospitals, the state has previously taken the approach of providing incentives to encourage such closures. One recommendation made to the commission by the Hospital Alliance of New Jersey (HANJ) is that New Jersey's existing "Hospital Asset Transformation Program" be amended to "facilitate mergers and consolidations within the hospital community, empowering the N.J. Health Care Facilities Financing Authority (the financing authority) to assume debt service payments, refinance, pay off or pay down debt of institutions whose planned or recent mergers resulted in a closure of a redundant institution."[viii] By way of background, the Hospital Asset Transformation Program (the program) was established as a program of the financing authority in 2000. The program permits the financing authority to enter into a debt service support payment contract with the state treasurer where necessary to support or refinance existing debt of a facility that will close. It includes direct subsidies for debt service payments to surviving hospitals that have closed acute care facilities.[ix] As such, the program provides an incentive to closure: only through closure can a hospital receive assistance in paying off debts. The program also provides a soft landing for administrators, creditors, and the community once the closure occurs. However, to be eligible for asset transformation funds, a hospital must show that it is closing, or has closed *all* acute care services at a particular site. HANJ's recommendation suggests extending the program's assistance to encourage mergers and consolidations that result in a net reduction of beds. Perhaps the program should be extended to such situations, even where a complete closure of all acute care services does not occur. While it is not known at this time how the commission will react to HANJ's proposal when it issues its final report in December 2007, there are certainly, in the short term, many communities and creditors who could benefit from the "soft landing" that the Hospital Asset Transformation Program might provide. In the long term, it is the remaining hospitals and the people of New Jersey who will benefit from a more financially-sound health care delivery system, brought about by the reduction of overbedding.

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[i] Report of the Commission on Health Care Facilities in the 21st Century, dated Nov. 28, 2006, at p. 6 (hereinafter, the Berger Commission Report).

[ii] Interim Report, dated June 29, 2007, of the New Jersey Commission on Rationalizing Health Care Resources, at p. 8-9, hereinafter, (interim report).

[iii] Berger Commission Report at p. 4.

[iv] Amoroso, Henry J. and French, Terence, "Rationalizing Beds, Services, and Payments For New Jersey Hospitals," November 2006, at p. 12-13.

[v] Berger Commission Report at p. 10.

[vi] Interim Report at p. 5.

[vii] Interim Report at p. vii.

[viii] Suzanne Ianni, Executive Director, Hospital Alliance of New Jersey, "Examining the State of Our Health Care System: the Unique Challenges Facing Urban Hospitals and Their Importance in Our State," at p. 1.

[ix] New Jersey Register, Vol. 37, No. 12, June 20, 2005.