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Multiple Factors Drive Upswing of Bankruptcies, Closures Among Rural Hospitals.

LOS ANGELES — The number of Chapter 9 bankruptcies by rural hospitals has climbed over the past five years as populations shrink and federal reimbursements decline.

In the last five years, not including this year's first filing, 13 hospitals have filed for Chapter 9, said Matt Fabian, a principal with Municipal Market Analytics.

With the distress in the sector trending up, Fabian said, it was no surprise that the first Chapter 9 bankruptcy filing of the year is a rural healthcare district.

Surprise Valley Health Care District, a 26-bed hospital in Cedarville, a small northern California town near the Nevada border, filed for Chapter 9 bankruptcy protection on Jan. 4.

The hospital district's board declared a state of fiscal emergency ahead of the filing, saying area residents' "health, safety and well-being" would be put at risk without the bankruptcy protection because it would be unable to meet its financial obligations within 60 days, according to bankruptcy documents.

The hospital, which has no bond debt, has asked the Eastern District U.S. Bankruptcy Court in Sacramento to authorize a $1.5 million debtor-in-possession loan from CadiraMD, a Denver-based medical testing company with which it plans to partner. The loan is contingent on a number of factors including the sale of the hospital.

Surprise Valley HCD is the second rural California hospital to file Chapter 9 bankruptcy in recent months.

In the Central Valley, Tulare Local Health Care District, with $84.1 million in general obligation debt and $13.6 million of outstanding revenue bonds, filed for bankruptcy in early October. Its Tulare Regional Medical Center closed Oct. 29 and a hearing on a motion for summary judgment in the bankruptcy is slated for March 21.

"Bankruptcy is unlikely to impair the district's GO bond payments, though risk is elevated given the challenges facing the district," Moody's Investors Service said in a report Thursday. "Payments on the $84.1 million in GO debt should not be affected given legal and structural features of the district's GO bonds, which shield bondholders from hospital operations.

Tulare missed a principal payment of its revenue bonds in November. "Revenue bondholders will remain at greater risk for additional defaults during the bankruptcy process," according to Moody's (MCO).

Last year, Atoka County Medical Center in Oklahoma, the Gainesville Hospital District in Texas and the Kennewick Public Hospital District in Washington also filed for Chapter 9 bankruptcy protection.

Since 2010, 83 rural hospitals – or eight to ten a year – have closed, said Mark Holmes, the director of the North Carolina Rural Health Research and Policy Analysis Center.

Though iVantage Health Analytics puts the number of rural hospitals at risk of closing around 600, Holmes said he believes the number is much smaller.

The financial distress index that the North Carolina rural health policy center developed in 2015 estimates that 6% of the country's 2,264 rural hospitals are at risk of closure, Holmes said.

Financial indicators such as operating margin, benchmark performance and retained earnings are the strongest indicators of financial distress, but hospital size and market poverty rates are also influential, Holmes said.

The North Carolina rural health policy center also looks at the size of the community, how far the hospital is from competitors, market share and the area's unemployment rate, he said.

Fabian ticked off a list of challenges for rural hospitals that can make them a risky investment: They are small. They skew more toward reliance on reimbursement from the federal government and insurance, so they struggle with reimbursement rates. It's harder to keep them fully staffed. The patient numbers are more inconsistent. And the long-term demographics show Americans are moving out of rural areas.

Rural hospitals in states that expanded Medicare under the Affordable Care Act like California are considered at less risk because they qualify for a higher rate of federal reimbursements for poor and elderly patients, but that is only one factor of many that are impacting small town hospitals, said Todd Sisson, a Wells Fargo (WFC) senior portfolio analyst for healthcare.

"I have been cautious about hospital investments in non-expansion states, and California is the poster child for expansion policies, but small hospitals just have a hard time," Sisson said.

The Obama administration established a policy in which states that did not create ACA programs would not receive supplemental funding while states that did expand the number of poor and elderly served under their Medicaid programs do receive such funding.

The closures have been more heavily concentrated in southern states, but many factors that predate the ACA are pressuring those hospitals, Holmes said.

For more than 20 years, hospitals in the south have been less profitable than other areas of the country," Holmes said. "They tend to have smaller market sizes. Medicaid tends to pay less, and cover few people, in those states and reimbursements from private insurers are less."

In rural areas all over the country, population shifts have resulted in shrinking numbers and a high concentration of senior citizens.

Though older residents tend to use hospital services more, they make hospitals more dependent on reimbursement from the federal government, because many pay hospital bills with Medicare, Holmes said.

Holmes has taken note of the rural hospital bankruptcies in California, but his policy center has not studied what risk factors are specific to the state.

Technological changes are a factor pressuring rural hospitals everywhere. Medicare payments have shifted from a prospective system of fixed payments for a treatment to value-based payments tied to

efficiencies and performance, Sisson said.

“You need more sophisticated technology systems to track metrics to qualify for value-based care and smaller hospitals don’t have the balance sheet to pay for that,” Sisson said. “That is why you are seeing a lot of hospitals trying to merge with larger providers that have more supportive IT systems.”

That doesn’t always work for all small rural hospitals, because often larger systems, interested in adding hospitals, want them to act as satellites focusing on outpatient care, he said.

ACA also has resulted in more private practice physicians migrating to larger hospital systems, because the billing and insurance is more complicated under the system, Sisson said.

“We have seen a ramp up in merger activity and we expect it to continue, because reimbursements are going to continue to be stressed,” he said.

Changes in healthcare resulting in less time spent in hospitals and more treatments handled through out-patient procedures can also mean that rural hospitals have more beds than they need, Holmes said.

“My research indicates that the original purpose of healthcare districts was to encourage hospital facilities and healthcare in rural areas and allow them to borrow money through public finance and tax people,” said Ron Winters, a managing director for Healthcare Management Partners, a consulting company that specializes in turnarounds.

That idea might not be as relevant as when it originated in the early 20th century, Winters said.

“When the financings were originally done, it was a different environment, rural hospitals could be expected to earn a certain amount of money and pay off the debt,” Winters said. “Now, the life of the hospital could be shortened, so it doesn’t match the lifespan of the debt.”

As a municipal bond investor, Sisson said Wells Fargo (WFC) is more comfortable with larger, multi-state systems.

“We have high-yield funds, but we are cautious of rural hospitals in non-expansion states,” Sisson said.

It’s not just rural hospitals for which Municipal Market Analytics would throw down a caution flag, Fabian said, but also the cities that are served by the hospitals where they can be major employers and affect the local economy.

“Cities that are reliant on the rural healthcare provider should be seen as high risk,” he said.

By Keeley Webster

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