Southeast Georgia Health System
Key Operating Assumptions
For the fiscal year ending April 30, 2019

1. Patient Services

The Health System enters into the new fiscal year challenged by significant unfavorable events and trends experienced during the 2018 fiscal year with respect to Hurricane Irma, payor mix shifts, nursing agency and hospitalist premium costs, expensive specialty pharmaceuticals, and high dollar team member health claims. On a positive note, patient utilization continues to grow in both the inpatient and outpatient areas.

Uncertainty exists around the Affordable Care Act (ACA) enrollments, which had leveled off, have begun to decline slightly given that there remains only one ACA insurer in Georgia. The position taken by the State of Georgia with respect to the expansion of Medicaid under the ACA places our Health System and others throughout Georgia at a disadvantage compared to other providers in those states that have expanded Medicaid. These issues combined with the continued effects of "Sequestration", all during a time providers continue to move from volume-based reimbursement to value-based reimbursement, create a set of hurdles to be faced by the Health System in the 2019 fiscal year and beyond.

The Health System is pleased with the progress made over the course of the past year to keep costs in check. The Coastal Community Health affiliation, which became effective September 1, 2015, is expected to bring over $780,000 in benefits in the form of reduced operating costs in 2019 budget year.

The Health System weathered the effects of Hurricane Irma in September. The loss of revenue was approximately $4,545,000 along with the added $768,000 expense for premium pay, transportation and other hurricane-related costs. All told, this negatively impacted our operations for 2018 by $(5,313,000).

Expectations as to the Health System's responsibilities to manage patients even after they have been discharged, combined with pricing pressures from suppliers such as manufacturers of pharmaceuticals and IV solutions, require that we continue to seek opportunities to control costs in other areas. Given the normal inflationary pressures, as well as the "out-of-the-ordinary" price increases that the Health System faces, it is reasonable to expect that a charge increase is necessary. But the Health System remains sensitive to the impact that such increases might have, whether they be real or perceived, and we remain committed to more effective pricing transparency. It is with these factors in mind that it is recommended that our room & board rates and the majority of ancillary service patient charges be increased by 5.0%. Taking into consideration the areas not affected by the charge increase, the weighted average impact of the increase across the hospitals is 3.01%. Based on the latest Medicare MEDPAR data made available at www.ahd.com, the Health System's charge levels continue to compare favorably to other hospitals throughout southeast Georgia and northeast Florida.

The latest Consumer Price Index data indicates that overall prices increased by 2.2% over the course of the year, but that data is clearly impacted by the developments in the energy area where prices rose by 7.7%. During that same period, however, Medical Care Services rose by 1.8%, and the component of that index attributable to hospital and related services rose by 5.0%. The recommended charge increase is in line with inflation attributed to the services that we provide.

In addition to the core fixed costs of Health System operations, which are subject to broader market pressures over which the Health System has little control, the cost of drugs have increased further due to a change in the status of the Brunswick Campus under the 340B drug pricing program. As you recall, the Brunswick Campus lost its "DSH" status under that program on October 1, 2015 and re-qualified as a sole community hospital (SCH) beginning in January 2016, and as a result, the cost of drugs rose 65.7% from the 2015 to the 2018 fiscal year. Drugs are expected to rise an additional 7.35% for the 2019 fiscal year. Our largest component of cost, staffing and benefits, remain subject to regional and national trends. One of the largest challenges facing the Health System is the availability of registered nurses, which has contributed to the increased use of agency nurses and a rise in premium pay, so the recruitment and retention of nursing personnel has become an even more important strategic initiative. All of these costs are further impacted by our commitment to 24 hour per day, 7 day per week, service levels.

Capital spending over the last fiscal year remained within the targets set in our previous business planning process; however, the level of capital investments expected to be committed by the Health System to its master facility plan is likely to result in higher depreciation costs. Fortunately, savings associated with the 2015 and 2018 refinancing of our 2008 Series bonds and the benefits of a low interest rate environment should enable the Health System to maintain a favorable level of interest expense.

It is this combination of factors, along with our commitment to provide needed services to community members within our primary service area of Glynn, Camden, McIntosh, Brantley, Wayne and Charlton counties, without regard to their ability to pay, which leaves us with no choice but to seek this increase in the rates we charge.

The recommended 5.0% charge increase will be implemented for the majority of inpatient and outpatient services, except for imaging services, an area that remains under competitive pressure. In addition we are recommending a 2.5% charge increase for physician fees within CHSI and 1.5% for the Senior Care Centers.

Patient volumes for the new fiscal year have been projected based upon the actual trends for the ten month period ended February 28, 2018. Management is pleased with the recovery that has occurred with respect to patient volumes, but remains cautious about future trends. It is anticipated that much of the higher levels of patient volumes experienced over the past year will continue, but Management remains somewhat conservative in its projection of patient utilization and service volume into the upcoming year. Following is a summary of the 2019 budgeted inpatient, outpatient and skilled facility utilization levels in relation to the Projected 2018 totals:

Inpatient

Admissions	14,212	+0.9% increase
Patient Days	70,463	+1.1% increase
Avg. Length of Stay	4.96	+0.2% increase
Avg. Daily Census	193.0	+1.1% increase

Outpatient

As expected, the majority of physician practices operated by the Health System that previously transitioned to an electronic medical record have returned to more reasonable levels of patient activity, contributing to a further rise in practice and hospital outpatient revenues. Given the robust recovery in outpatient volumes that continued into the past year, management has deemed it prudent to maintain outpatient revenue forecasts 1.0% higher than the levels projected for 2018.

However, with regard to physician revenue within Cooperative Healthcare Services, Inc., growth is expected due to the full year effects of the practice commitments made over the past year.

Skilled Nursing Facility

The 2019 budget anticipates the Senior Care Center in Brunswick will see occupancy range between 177 and 188 residents, for an average daily census for the year of 182.7. The maximum capacity of the Senior Care Center in Brunswick is 200. The census of the Senior Care Center St. Marys, which has a maximum capacity of 78 residents, is anticipated to increase from 66 currently to approximately 71 residents by the end of the 2019 fiscal year, resulting in an average daily census for the year of 68.8 residents.

2. Deductions from Gross Revenue

Medicare/Medicaid contractual adjustments represent 43.8% of total all-payor gross revenue. These allowances have been determined based upon a 1.5% change in Medicare rates in the inpatient hospital setting and a 1.0% change in Medicare rates in the outpatient setting. Medicaid inpatient rates are expected to remain unchanged; the 11.88% Medicaid add-on made available through the State of Georgia's provider tax is anticipated to continue. Other special reimbursements expected to continue include the Medicare add-on for Sole Community Hospital status; the Upper Payment Limit funding for skilled nursing facility and acute care hospital services, estimated at 95% of levels anticipated for 2019; and Indigent Care Trust funds, which have also been estimated at 95% of the annualized estimate for 2018, based on preliminary payment amounts. Other payment adjustments including value based purchasing, hospital readmissions and hospital acquired condition reductions are expected to have a net negative effect on net revenue for 2019, although the extension of the Medicare low volume add on should offset the impact of these items on the Camden Campus.

The Health System wide CMI is projected to rise from 1.5641 this year to 1.5857 in 2019. Any decrease in the CMI will have an unfavorable impact on our net revenues.

The proportion of insured to uninsured patient volumes has flattened, and the budget has been prepared on the assumption that the levels of uninsured patients experienced in 2018 will continue into 2019. As a result, projections for 2019 assume Charity Care, net of the benefit of Indigent Care Trust funds, to be 4.3% of gross revenue, while Bad Debts are estimated at 4.5% of gross revenue; the total allowance for uninsured/underinsured patients is projected to equate to 9.1% prior to the offset of Indigent Care Trust funds.

Other Revenue Deductions attributable to Blue Cross and other commercial insurance carriers represent 11.1% of total all-payor gross revenue.

The payor mix is estimated as follows:

	Hospital		
	Inpatient	Outpatient	CHSI
Medicare	57.0%	44.9%	39.2%
Medicaid	13.6	11.8	15.0
Blue Cross	9.8	16.7	19.6
Champus/Tricare	4.2	5.0	6.7
Other Commercially Insured	7.4	12.8	15.0
Uninsured	8.0	8.8	4.5
Total	100.0%	100.0%	100.0%

With regard to the physician practices, Medicare allowances have been provided for at 64.6 % of gross charges, while Medicaid allowances represent 65.1% of the related charges. The allowance provision for the other insured payors has been projected at 51.3% of charges, while the provisions for Charity Care and Bad Debt (4.2% of all CHSI charges) have been established to provide for a significant portion of uninsured accounts plus a portion of co-payment and deductible amounts otherwise owed by insured patients.

3. Human Resources and Employee Benefits

Personnel expenses (wages, benefits and contract labor) represent approximately 55.7% of net patient service revenue in 2019. Additional salary costs are included for certain physician practices which were added in 2018. Employed nurse staffing has been expanded in both the acute care and resident care settings from significant focus being placed on Team Member recruitment and retention. Contract labor, including agency nursing staff, as well as food service and environmental services staff, are projected to decrease by approximately 44.9%. The extent to which any salary increases might be considered and the timing of any increase will be affected by our real-time assessment of the economic environment.

Benefit costs are projected to increase by 5.9%, due primarily to the conversion of agency personnel to employed team members.

FTE's per adjusted occupied bed are budgeted to be 4.47 for the Brunswick Campus; 5.06 for the Camden Campus; and 5.84 System-wide, the last of which is affected by the physician practices and skilled nursing facilities.

4. Supplies

Supply costs are expected to remain flat as the inflationary factor and volume increases are offset by the cost savings through our updated Coastal Community Health, Inc. Group Purchasing Organization contract with Vizient and its network of Partners Cooperative, Inc. The cost of drugs and IVs is expected to increase by 5.2%, again with the inflationary factors being offset by Coastal Community Health Affiliation savings. Supply cost as a percentage of net patient revenue is projected to decrease in 2019, to 19.4% of net revenue, as compared to 19.9% in 2018.

5. Physician Fees

Physician Fees are proposed to decrease by 5.0% compared to the 2018 actual results. The primary specialties in this expense category are hospitalist, anesthesiologist and the stipend for emergency medicine. The Health System continues to recruit hospitalists which have favorably impacted the ability to manage the higher cost locum tenens fees.

6. Professional Fees

   Professional Fees are projected to decrease by 0.6% compared to 2018. A reduction in consulting fees in the Sterile Processing Department is the reason for the decrease in this area.

7. Insurance

   The Health System anticipates a 7.2% increase in insurance costs mostly due to increasing the reserves for professional liability claims, which were adjusted down in 2018. Due to the weather related issues experienced over the past few years, our insurance premiums are expected to increase approximately 2% for 2019.

8. Utilities

   With the current energy efficiency efforts in place we expect energy costs to remain at 2018 levels with a slight decrease of 0.4%.

9. Outside Services

   Outside Services are budgeted to decrease by 6.7%. Included in 2018 were Hurricane Irma transportation and evacuation costs. This includes contracted maintenance on certain imaging equipment that is no longer needed due to new agreements.

10. Depreciation/Amortization

    Depreciation expense is calculated based on the 2018 depreciation expense and the 2019 budgeted capital expenditure requests. We have included $6,000,000 for master facility plan equipment expenditures which will begin depreciating during the later end of fiscal year 2019. The timing of construction/renovation capital requirements associated with the Health System's master facility plan will not affect depreciation costs in 2019 as compared to 2018, although those investments will affect depreciation in later years.

11. Provider Tax / Other Expense

    The 2019 fiscal year budget once again includes a provision for the State of Georgia provider tax which was modified beginning on July 1, 2013. The combined financial impact of this tax and the tax on our skilled care providers is estimated to be $4,662,000 annually. Beginning in April of 2018, the Senior Care Center - Brunswick will no longer be required to pay the provider fee, which was offset by a $17.10 per Medicaid resident day deduction.

12. Interest Expense

    The fixed-rate debt component of the remaining 2008 series bonds carry fixed rates ranging from 4.750% to 5.625% (2034 maturity). The 2015 series bonds carry fixed rates ranging from 4.0% to 5.0% (2034 maturity). While the Health System continues to enjoy extremely favorable interest rates on the Series 2008 variable rate bonds, the budget anticipates a gradual return of higher rates. The assumed variable rate for 2018 is 1.50% which was based on an assessment of interest futures. This rate excludes the letter of credit fee of 53 basis points and the remarketing fee of 7 basis points. The financing secured for the medical plazas in Brunswick and Camden are included, assuming an average outstanding balance of $12,200,000 at an average rate of 3.0%.

The overall cost of financing on the outstanding long term debt of approximately $287,200,000, inclusive of $133,000 of capital leases, as well as unamortized bond premiums and discounts, is estimated to be 2.8%.

13. Physician Development

The Health System has made substantial investments in its Medical Staffs in anticipation of the needs of the Community. It is expected that competition for a limited number of practitioners will require the Health System to continue with its physician recruitment strategy, to ensure sufficient availability of providers to meet the needs of the populations served by both of our Hospital Campuses. The Health System's future direction with respect to Medical Staff support is more fully enumerated in the Physician Development plan.

14. Investment Income

Investment returns on Designated Cash & Investments have been included at a rate based upon the objectives included in the Health System's Investment Policy. Specifically, an overall return of approximately 4.2% has been applied, based upon a target equal to 2.0% above the recent inflationary estimates (using the CPI index excluding food and energy which was 1.8%). The overall expectation has been apportioned between Non-Operating Revenue (interest and dividends) and Market Gain/Loss on Investments.

Southeast Georgia Health System
2020 & 2021 Operating Budget Assumptions

1. Patient Services Revenue

Service demands are projected to continue to increase in the near term future, particularly with regard to inpatient services. Historic trends would lead one to expect some growth in outpatient services. As such, revenue increases for the 2020 and 2021 fiscal years are projected based upon the following factors:

	2020		2021	
	Brunswick	Camden	Brunswick	Camden
Inpatient Revenues	+3.0%	+3.0%	+2.5%	+2.5%
Outpatient Revenues	+2.5%	+2.5%	+2.5%	+2.5%
Overall Patient Revenues	+2.8%	+2.6%	+2.5%	+2.5%

2. Deductions from Revenue

While there has been a great deal of discussion about healthcare reform on a national level, it is virtually impossible to estimate the impact that any changes might have in the near term. Therefore, payor utilization trends, including uninsured patient exposure, are forecasted to remain near current levels. A slight charge increase has been incorporated in the budget for the future years, but to the extent that charges rise at a slower pace than the payment rate changes promulgated on a federal and state level, the portion of gross revenue that allowances represent will decline. Following are the estimates used in the development of the projections for subsequent years:

2020 Fiscal Year

- Medicare/Medicaid contractuals are estimated at 40.7% of gross revenue.
- Charity care is projected to amount to 4.3% of gross revenue.
- Other Revenue Deductions are estimated to represent 11.1% of gross revenue.
- Bad Debts are projected at 4.5% of gross revenue.

2021 Fiscal Year

- Medicare/Medicaid allowances are projected to equal 40.7% of gross revenue.
- Charity care is projected to amount to 4.3% of gross revenue.
- Other Revenue Deductions are estimated to rise to 11.1% of gross revenue.
- Bad Debts are projected at 4.5% of gross revenue.

3. Operating Expenses

The components of operating expenses are expected to change at varying rates, resulting in an overall cost increase projection of 2.4% for 2020 and 2.3% for 2021. Salary costs are forecasted to rise at a pace of 2.5% in 2020 and 2021 and employee benefit costs are expected to rise by 2.0% in 2020 and 2.0% in 2021. Future benefits will be realized in personnel expense with the implementation of Kronos productivity management tools.

Existing arrangements should also help to maintain increases in other cost areas at or below 3.0%. It is anticipated that supply cost management will enable the Health System to effectively manage those cost increases, while capital expansion will result in a greater increase in depreciation costs and the market could play a role in insurance costs increasing at a slightly higher rate as well.