A New Approach to Hospital Funding – Public/Private Partnerships
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Funding a new hospital or major expansion has always been a challenge, but a relatively new funding model is starting to emerge that could have sweeping impact on the healthcare industry.

Public private partnerships, or PPP’s, are gaining traction as viable alternatives to traditional funding mechanisms. PPP’s are most closely associated with transportation projects in the U.S., but the private funding model is being used in Europe for other purposes, including hospitals.

Now, investors are looking at opportunities within the U.S. healthcare industry, meaning an influx of private capital may soon drive the next wave of hospital construction. A public private partnership is a system in which a hospital partners with a private firm for the design, build, financing, operation and maintenance of a new facility. On the surface, it may sound as if the hospital completely hands over the reigns. In reality, the hospital maintains complete administrative oversight while significantly streamlining many of the facets involved with building and maintaining a facility while transferring risk to the private company.

So how does it work? First, the private company must determine if a project is viable. Due diligence will analyze assets, projections, existing debt and the competitive climate. If the project is deemed viable, the private company enters into a contractual agreement with the hospital to provide services and brings both debt and equity partners. A new, dedicated company is then established. That organization brings all of the key players required to design, build, fund, operate and maintain the hospital to the table – investors, architects, construction companies and any required vendors for maintenance or operations. The private company is able to negotiate all contracts, set schedules and manage the entire process. The hospital is involved throughout the selection and design process and has oversight of key decisions, but the responsibilities and risk of day-to-day process management are eliminated.

Once the facility is complete, the hospital essentially leases it back from the private company for an agreed upon term. Once that term is complete, the hospital takes full ownership of the facility. The private company is responsible for the upkeep of the hospital, both from a maintenance and technological perspective in order to protect the asset. That means once a lease term is complete and the hospital takes ownership of the facility, it must be in as good or better condition than when it was constructed.

Why would a hospital want to pursue this type of arrangement? A PPP transfers a major portion of financial and contractual risk from the hospital to the private company. If construction costs escalate beyond original calculations, the hospital is not left to come up with additional cash. The price and terms have been negotiated as part of the
contract, and the private company typically guarantees those terms. The hospital need not dip into existing financial reserves, and there is little or no impact to the organization’s bond rating. Beyond the transfer of risk, a PPP speeds the process of building the facility. The funding source is secured, so there is no need to seek a bond referendum. The partnership provides a single-source agreement, meaning no procurement processes. Contract negotiations are handled by the private company, which is likely to be in a stronger negotiating position than the hospital administration. There is no cost to the hospital during the design/build process. Payments do not start until the facility is delivered.

Any number of operational services can be built into the agreement, further strengthening the single source approach. For example, food service, housekeeping, linen service and the like can be negotiated as part of the service agreement. Such services add stability to the operation, reduce administrative costs and lock in pricing.

What’s to keep the private company accountable? Both parties, the hospital and the company, are contractually bound and the private company is obligated to its debt and equity lenders to guarantee the costs and schedule. The hospital has a lease agreement to honor, but the company is bound to perform for the hospital by maintaining and protecting the facility - its asset. From a patient perspective, there is no impact.

While PPP’s are new to the healthcare industry in the U.S., there’s no doubt that they will help shape the competitive landscape in the near future. The financial challenges tied with traditional construction, combined with the ever-increasing need for new and expanded medical facilities in Georgia dictate that new approaches be explored. Public-private partnerships will help fill that void.