Real estate management in the healthcare sector

Institutions in the healthcare sector - hospitals, institutes, nursing homes and care homes - run no risks in terms of their real estate policy and investment decisions. This highly unusual state of affairs is not beneficial to ensuring that healthcare institutions are run in an entrepreneurial manner: customer-focused, with effective management and an innovative approach to real estate management.

The Minister for Health, Welfare and Sport wishes to change this situation. One of his intended approaches is to abolish the policy on capital costs. Healthcare institutions would then bear full responsibility for their real estate and their investments in this area. Decisions on real estate management and development could have consequences for the costs of interest and depreciation (the capital costs). The Minister takes the view that institutions would then have to take account of these consequences in the production and sale of their healthcare products (nursing, treatment, admission). They would be in competition with other institutions and as a result would have to keep their costs down. A return on real estate is clearly very important in this situation.

The Minister presented this plan in a paper submitted to the Lower House in March 2005. He intends to inform the House of his implementation strategy in 2006. Prior to this he has asked the Council for Public Health and Health Care (RVZ) for advice on the management of healthcare institutions. What requirements would any change in the system have to meet, what improvements are needed, and how can we bring them about? The RVZ answers these questions in this report.

What exactly does the Minister's plan involve? He wants to introduce 'integral defrayment of the costs of services' for all healthcare institutions. The price of care (for example, a diagnosis/treatment combination) would have to reflect all the costs incurred by the institution - staff, equipment and real estate. The government will shortly be setting 'standard capital charge components' (SCCCs) for each sector. These will be included in the institutions' cost defrayment. SCCCs can be to an institution's benefit or to its disadvantage. In order to reduce the risks to continuity of care, the Minister plans to create a safety net for weak institutions and to introduce the new system over a long period of time (up to 2012).

The RVZ started by examining the possible consequences of the Minister's plan.

1. If assets are valued too high on the balance sheet, the institution will face a book value problem.
2. A close correlation will be created between production - and so patient numbers - and funding of capital costs.
3. Funds will be raised from a wider range of sources: institutions will have to look beyond banks, considering options such as issuing bonds and shares.
4. Institutions will differ more widely in the methods they use to attract capital. The gap between strong and weak institutions will grow wider.
5. Both banks and insurance firms (on behalf of users) will be increasingly demanding as to the usability of real estate; this should lead to flexible and small-scale construction and a distinction between housing and care.
6. Institutions will be watched more closely by the financial markets and by bodies responsible for corporate governance.

7. A wave of mergers will hit the healthcare sector, and institutions will cooperate more closely on matters relating to real estate and capital. New providers will enter the sectors.
8. Property developers and housing corporations will take over healthcare real estate.

The RVZ has drawn up a list of twelve skills that healthcare institutions managers need to have in the light of this analysis. It has examined how far management teams already possess these skills, and what more needs to be done in this regard. Its analysis and investigations lead to the following responses to the Minister's questions.

Question 1
'What conditions does bearing responsibility for costs related to premises impose on the internal organisation of healthcare institutions?'

There are four general conditions:

1. Investments require a positive net market value.
2. Capital costs are higher where the operational risk is greater.
3. Institutions must have sufficient liquidity to meet their interest and capital repayment obligations.
4. They must hold sufficient equity, and their operating margins must therefore be higher.

From this we can derive twelve core skills for the integral management of real estate:
Management and governance
1. Corporate governance
2. Strategic planning
3. External stakeholder management

General management
4. Internal stakeholder management
5. Building up a track record
6. Managing margins
7. Managing allocation of capital
8. Bringing in adequate financial expertise

Investment planning
9. Investment selection
10. Balance sheet management
11. Valuation
12. Managing (working) capital

Question 2
'Does the internal organisation of healthcare institutions meet these conditions?'

Three-quarters of healthcare institutions already meet the conditions or will be able to do so within a short time. Some institutions need to improve their management skills. This is not surprising, as these skills have never been required of them. Once they have acquired these skills, the new situation will have a marked effect in ensuring that real estate skills evolve. Incentives must come from the market, not from government.
Many institutions are ready, but a quarter are not.

Question 3
'Where are improvements needed if the current internal organisation does not meet these conditions?'

Improvements to organisation and management are both necessary and possible. This is because healthcare institutions will be facing greater risks. Their protected position on the care purchasing market will disappear and they to raise funds to pay for their real estate from the market. Improvements will be needed in all core skills, but especially:
- corporate governance;
- strategic planning;
- external and internal stakeholder management;
- patient throughput management;
- investment policy;
- improving the asset portfolio.

Question 4
'What can be done if the management teams of institutions do not meet these conditions?'

As indicated, this far-reaching regime change is feasible without too much in the way of new government policy. The Minister for Health, Welfare and Sport can promulgate appropriate policies in the transitional period to smooth the introduction of the new system (for example, by setting up a knowledge centre and encouraging additional training). The RVZ also recommends a number of other activities, including:
- clarifying the situation with regard to SCCCs as quickly as possible;
- treating caring and curing activities in the same way;
- using subordinated loans as a transitional resource;
- abolishing the Healthcare Facilities Renovation Board;
- encouraging strategic real estate alliances between healthcare institutions.

The RVZ has also examined implementation of the Minister's plan. How, and in particular how quickly, can it be put into practice? Looking at the answers to the Minister's questions it is clear that implementation lies at the heart of the matter. The RVZ therefore advises the following:

1. There is broad support in the healthcare sector for this new approach, which is desirable and necessary. The transitional period should therefore be as short as possible. The new system should also be designed so that improvements come from the market rather than the government.
2. The government should adopt a hands-off attitude, accepting that some institutions will fall by the wayside while others will be created as a result of the situation. But as an immediate shift to the new situation could cause problems, the Minister might take these ideas on board:
   - the government should take account of the particular real estate situations of institutions when setting the SCCC rates;
   - as real estate risks impinge directly and fully on institutions, it is logical that they should take decisions as to how their profits are used so that they can prepare themselves properly for the new situation;
   - the government should welcome the creation of groups, associations, or other support systems aimed at spreading real estate risk.

3. The government should ease the transition by sticking rigidly to implementation of policy, including policies in related areas, and by actively deregulating and reducing the burden of administration in areas such as supervision.
4. Institutions that are ready for transition would be able to take this step earlier (as of 1 January 2007), with government support if necessary; they should be assisted to do so by being permitted to seek out additional sources of funding, for example.
5. Any problems should be handled as follows: the government should map the financial position of institutions as quickly as possible (before the end of 2006). An independent committee will assess requests for support from institutions. Only clear cases of unfairness can be resolved ad-hoc with government support. There must be no reward for management failure.
6. Institutions in difficulty will have until 1 January 2008 to get their house in order. From that date on the new regime will apply to all healthcare institutions.
7. New entrants will be given help by the government in the transition to the new situation.