

**Spectrum Health**

**Community Commitments Report**

**June 7, 2017**

Dear West Michigan Community,

As part of Spectrum Health's commitment to the community, and as part of our ongoing effort to share openly our compliance with the commitments we made in the Consent Decree, attached please find our demonstration of our financial compliance with (a.) our ongoing commitment to limit margins and (b.) our ongoing commitment to the underserved and medically needy.

Spectrum Health has committed to targeting a five-year rolling average total margin (which includes operating margin and investment income) for the merged system that does not exceed the average of Moody's and Standard & Poor's upper quartile total margins for other health systems nationally. Spectrum Health measures compliance with this commitment by comparing our five-year rolling average total margin to the Moody's Aa3 median total margin for freestanding hospitals, single-state & multi-state healthcare systems. We have included the most recent calculations, which demonstrate our compliance, in the attached report.

Spectrum Health also has committed to establish a fund to provide quality healthcare programs for the underserved in the community, which is budgeted in the amount of \$6.0 million per year. While a separate Community Advisory Committee provides for the ongoing allocation of this fund, we continue to represent that at least \$6.0 million has been included in the 2018 budget for this commitment, and that we have met our annual \$6.0 million spending requirement for the years up to, and including, 2017. We have included our most recent calculations, which demonstrate our compliance, in the attached report.

We take our commitments to the community very seriously and are steadfast in our determination to provide the information necessary for all stakeholders to be confident that their healthcare system has consistently executed the commitments made in the Consent Decree and has demonstrated the value that was anticipated when the merger of Blodgett Memorial Medical Center and Butterworth Health Corporation created Spectrum Health.

Sincerely,

A handwritten signature in black ink that reads "Ronald J. Knaus". The signature is written in a cursive, slightly slanted style.

Ronald J. Knaus  
Senior Vice President and Chief Financial Officer

## COMMITMENT TO THE UNDERSERVED

Spectrum Health has agreed to establish a fund to provide quality healthcare programs for the underserved in the community. As part of this, Spectrum Health has agreed to increase spending from a pre-merger level of approximately \$2.0 million to \$6.0 million per year.

### Assertions

- Actual spending for programs to the underserved as of March 31, 2017 was \$5.0 million. Annualized to year-end, this level of funding equates to \$6.7 million. Spectrum Health is projecting actual expenditures for fiscal year 2017 will be less than the annualized amount and is anticipating expenditures of approximately \$6.0 million as of June 30, 2017.
- As of March 31, 2017, Spectrum Health has expended funds above the cumulative amounts related to the Commitment to the Underserved. The annual commitment spending of \$6.0 million per year from the merger date through March 31, 2017 totals \$117.0 million compared with actual spending by Spectrum Health for the same period of \$121.7 million resulting in actual spending which is greater than commitments through March 31, 2017 of approximately \$4.7 million.
- The Healthier Communities Department provides services which are not specifically related to one particular program. These services are as follows:

**Direct Program Administration** includes goal and financial management, program oversight, reporting and community-wide committee participation.

**Planning, Development and Management** includes capacity building, program design and management. Administrative expenses primarily include salary and benefits for staff, maintenance expenses and administrative supplies.

**Program Evaluation** includes outcomes measurement for the programs. Rather than giving each program a budget to develop an outcomes measurement function, the function was centralized so that one department would coordinate, monitor and analyze outcomes to provide a more consistent and credible tracking and monitoring system.

Outcomes measurement expenses include salaries and benefits for staff that provide support, education, data collection and analysis to the various programs, along with computer equipment, supplies and evaluation materials.

Total program support, including Program Administration, Planning, Development and Management, and Program Evaluation represented 12.5% and 11.7% of actual total community commitment expenditures in fiscal years 2017 and 2016, respectively.

The following summarizes the breakdown between Administration and Evaluation:

	<b>Actual FY 2016</b>	<b>Projected FY 2017</b>	<b>Budget FY 2018</b>
Program Administration	\$140,111	\$141,838	\$141,900
Planning, Development and Management	249,086	252,157	252,267
Program Evaluation	315,105	354,355	355,458
<b>Total Program Support</b>	<b>\$704,302</b>	<b>\$748,350</b>	<b>\$749,624</b>

## **MARGIN COMMITMENT**

Spectrum Health has agreed to target a five-year rolling average total margin for the merged system not to exceed the average of Moody's and Standard & Poor's upper quartile total margins for other health systems nationally.

The source for this benchmark is Moody's Outlook, where the median total margin based on 2015 data for freestanding hospitals, single-state & multi-state healthcare systems with an Aa3 bond rating was used. The worksheet on page five was included in order to demonstrate Spectrum Health's five-year rolling average total margin in comparison with the benchmark.

### **Assertions**

- The actual total margin for Spectrum Health System as reflected in the fiscal year 2017 statements, as of March 31, is 6.0%.
- The five-year average total margin for Spectrum Health System for the period including actual 2013, 2014, 2015, 2016 and year to date 2017 (through March 31, 2017) is 6.6%. The five-year average median Moody's total margin for freestanding hospitals, single-state & multi-state healthcare systems with an Aa3 bond rating is 7.9%.

## **FISCAL YEAR 2018 BUDGET REVIEW**

Our proposed budget and supporting documentation is provided in support of our assertion that the financial commitment to the underserved is incorporated into the fiscal year 2018 budget and that the total margin for the overall system is within the established benchmark per the Margin Commitments.

### **Assertions**

- Spectrum Health attests that \$6.0 million is included in the budget for fiscal year 2018 as part of our commitment to the underserved.
- Spectrum Health's total margin as reflected in the fiscal year 2018 budget is 3.7%. The five year rolling average total margin including actual 2014, 2015, 2016, year to date 2017 (through March 31, 2017) and budget 2018 is 5.7% compared to the five-year average median Moody's total margin for freestanding hospitals, single-state & multi-state healthcare systems with an Aa3 bond rating of 7.9%.

## Spectrum Health System & Affiliates

### Total Margin Calculation - Total System

Through Budget Year Ended 6/30/18

(in thousands)

	<b>Audited</b>	<b>Audited</b>	<b>Audited</b>	<b>Audited</b>	<b>Unaudited</b>	<b>Proposed</b>	<b>Five Year</b>	<b>Actual</b>	<b>Budgeted</b>
	<b>6/30/13</b>	<b>6/30/14</b>	<b>6/30/15</b>	<b>6/30/16</b>	<b>Nine Months</b>	<b>Budget</b>	<b>Average</b>	<b>Five Year</b>	<b>Five Year</b>
					<b>Ended</b>	<b>6/30/18 (A)</b>	<b>Moody's</b>	<b>Average</b>	<b>Average</b>
					<b>3/31/17</b>		<b>Median (F)</b>	<b>Margin (C)</b>	<b>Margin (D)</b>
Total operating revenue (B)	3,928,511	4,107,828	4,625,176	5,220,515	4,213,703	6,104,526		4,419,147	4,854,350
Total non-operating income (expense)	110,501	188,156	80,036	(57,682)	126,433	54,539		89,489	78,296
Total revenue	4,039,012	4,295,984	4,705,212	5,162,833	4,340,136	6,159,065		4,508,635	4,932,646
Total operating expenses	3,725,103	3,960,081	4,337,901	4,950,789	4,081,457	5,933,657		4,211,066	4,652,777
Total margin	<u>313,909</u>	<u>335,903</u>	<u>367,311</u>	<u>212,044</u>	<u>258,679</u>	<u>225,408</u>		<u>297,569</u>	<u>279,869</u>
Total margin % (E)	7.8%	7.8%	7.8%	4.1%	6.0%	3.7%	7.9%	6.6%	5.7%

(A) Per proposed Budget 2018

(B) Fiscal 2013 has been restated to conform to the Fiscal 2014 presentation of Priority Health investment income as non-operating revenue

(C) Five year average margin based on actual results for 2013 through March, 2017

(D) Five year average margin based on actual results from 2014 through March, 2017 plus Budget for 2018

(E) The total margin % (or excess margin as referred to by Moody's) is calculated as follows based on Moody's formula:

(total operating revenue less total operating expenses plus non-operating income) divided by (total operating revenue plus non-operating income).

(F) Moody's represents the median excess margin for freestanding hospitals, single-state and multi-state healthcare systems with an Aa3 rating