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# Rethinking the Status of Publicly Owned Hospitals

Publicly owned hospitals (also known as governmental hospitals) comprise a significant percentage of not-for-profit hospitals in the United States. According to American Hospital Association statistics, there are 923 hospitals owned by city or county healthcare districts or state or local governments, compared with 2,987 non-governmental, not-for-profit community hospitals.

As the industry navigates continuing payment pressures and expense inflation, public ownership of hospitals can confer certain advantages. These include benefits such as defined governance roles with public representation, access to a taxing authority, access to supplemental payment programs available to government entities, and sovereign immunity protections from certain tort claims—including medical malpractice lawsuits—which lower insurance costs.

As hospitals and health systems focus on growth to combat the industry's fundamental financial challenges, public ownership may place governmental hospitals at a disadvantage. Often subject to the transparency requirements of state "sunshine" laws, which require public strategic planning and execution discussions (and the public disclosure of competitively sensitive information), publicly owned hospitals compete at a disadvantage relative to organizations whose strategic initiatives are not subject to similar disclosure requirements. Additionally, public ownership governance structures may emphasize political considerations and election cycles over competencies and decision-making that align with the organization's long-term strategic goals. Longer governance cycles associated with private ownership can improve board continuity and align with multiyear strategic investment decisions. Public ownership may also impose geographic constraints, limiting the ability of a hospital to pursue growth initiatives.

Given these considerations, executives and board leadership of publicly owned hospitals should regularly ask the question, "Does our current status best position the organization to achieve our mission and fulfill our promise to the community over the long term?" In recent years, more executives and boards are saying "no."

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Our data on merger and acquisition (M&A) activity indicates that over the past five years (2019 – 2023), between 6% and 14% of annual M&A transactions involved a publicly owned hospital that was merging with another—often a non-government owned—not-for-profit hospital or health system. Additionally, publicly owned hospitals and health systems are evaluating conversion to private not-for-profit structures as an alternative mechanism to more effectively compete and pursue strategic growth.

## Alternatives to a public ownership model

For organizations that are considering a change in status, recent activity has defined several alternatives:

- **Divest assets to de-risk exposure to a volatile healthcare environment.** Operating an acute care hospital has always been difficult, and those difficulties have compounded in recent years. Kaufman Hall *National Hospital Flash Report* data indicates that while financial and operating conditions have improved from an extremely challenging period in 2022, approximately 40% of hospitals across the country are still operating with negative margins. Public ownership entities may decide that divesting healthcare assets to another health system, not-for-profit or for-profit, avoids the risks inherent in maintaining a hospital.

  This alternative may cause concerns about loss of local control over the community's healthcare needs, but one option is to use the proceeds from a sale to establish a community foundation dedicated to funding those needs. These foundations typically have local governance and the ability to define their own mission, vision, and grant-making priorities, and provide an alternative to fulfilling the public entity's mission.



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- **Enter into a partnership with another healthcare system.** Partnership may provide an opportunity for a publicly owned hospital to access new or complementary capabilities and enhance the services it provides to its community. Pursuing a partnership often requires a change to publicly owned status; partners may be concerned, for example, about having their strategic plans and initiatives made public in states or localities with strong “sunshine law” requirements for publicly owned entities. But these partnerships can also offer flexibility on governance, allowing continued local input on community healthcare decision-making through partner board representation, local board fiduciary responsibilities, or advisory council participation. The potential to enhance the organization’s service offering, compete more effectively, and retain local influence may best position the organization to fulfill its promise to the community.
- **Convert to an independent, 501(c)(3) organization.** Apart from a sale or partnership transaction, a publicly owned hospital may wish to convert to 501(c)(3) not-for-profit status to better enable the organization to pursue strategic growth initiatives. A change of status may:
  - Free the organization from geographic restrictions, allowing it to grow regionally
  - Provide more flexibility in physician alignment models and joint venture opportunities, specifically in outpatient settings such as ambulatory surgery centers
  - Offer a more streamlined opportunity to pursue partnerships with other healthcare providers to add or enhance the organization’s capabilities

Converting to a not-for-profit status offers an alternative to improve the competitive position of the organization while retaining governance and management control.

## Additional considerations

Pursuing any of these options will require a thoughtful and sophisticated evaluation process and communications plan, working closely with local officials, physicians, and community members. In all cases, the decision must be closely aligned with the needs of the community, and the executive team and board must be able to clearly articulate how the decision best positions the organization to fulfill its promise to the community and enhance long-term viability.

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It is also very possible that, after considering the alternatives to public ownership, the executive team and board will decide to continue with a public ownership model. By going through a thoughtful and open analysis of the alternatives, however, the board will have fulfilled its fiduciary obligation to protect the organization’s—and the community’s—best interests and the executive team will have tested how its strategic goals and long-term viability align with various ownership models.

There is no requirement for a publicly owned hospital to wait for an event that may trigger the need to reconsider its ownership status. In fact, the best time for this analysis is when the organization has time to be proactive: when there are no operational or financial crises that might force decision-making or limit the organization’s strategic alternatives. Instead, executive teams and boards should consider making an ownership model analysis a regular part of their strategic planning process.

***For more information, contact Rob Gialessas at rgialessas@kaufmanhall.com.***



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