

HEALTHCARE OVERVIEW

BALANCING MISSION AND MANAGEMENT IN NOT-FOR-PROFIT HEALTHCARE PORTFOLIOS

Not-for-profit (NFP) healthcare providers comprise a distinct class of institutional investors, unique in their purpose and in the role that portfolio assets serve in the pursuit of their mission. NFP hospitals are charged with the perpetual provision and promotion of quality healthcare to their communities. This mission, along with tax exempt status, underscores the tension between the philanthropic aspects of their stated organizational purpose and the competitive financial realities of the healthcare industry; a tension likely to intensify as communities become more reliant on local providers for healthcare services. While investment objectives for other institutional investors (foundations, endowments, pension plans, etc.) are straightforward, the goals of NFP hospital portfolios are not only multi-faceted, but constantly changing. Proper consideration and recognition of the challenges facing the industry and the increasingly important role of the portfolio are crucial in the development and implementation of successful investment programs.

Investment portfolios serve three fundamental purposes within the institutional framework of not-for-profit healthcare organizations:

- **Investments serve as a primary funding source for future capital expenditures.** Portfolios set aside for the future replacement and replenishment of depreciating and obsolescing assets must achieve a return sufficient to grow capital at a rate in excess of the increases in the replacement costs of those assets.
- **Portfolios are vital to hospitals' access to capital through the public finance debt markets.** By virtue of its impact on various financial strength ratios including days cash on hand, cash to debt, etc., the portfolio plays a central role in the credit rating analysis. From this standpoint, healthcare investors must seek stability, but also a return in excess of their cost of debt in order to grow equity capital while ensuring future access to affordable debt capital.
- **Not-for-profit hospital income statements reflect the linkage between operating results and portfolio returns.** Given the uncertainty of the overall operating outlook for the health care industry, it is more important than ever for portfolio returns to complement operating strategy by enhancing or providing stability to operating results.

Designing investment programs that effectively serve all of these purposes is extremely difficult as each implies varying degrees of portfolio return targets, risk tolerance, time horizons, and liquidity. Too often, NFP healthcare investors fail to consider these perspectives as they develop investment policies and strategies, instead focusing more on capital markets and investment opportunities. In addition, investment programs now fall under intense outside scrutiny from various third parties including auditors and rating agencies introducing a host of practical considerations for portfolio implementation. These factors point to a growing need for hospital decision-makers to seek specialized expertise that can not only provide investment market insight and advice, but that also offers an acute understanding of the unique challenges that providers face.

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INVESTING FOR THE TOTAL CLIENT

- *Investment services*
- *Reporting services*
- *Business services*

Highland was organized in 1987 specifically to assist not-for-profit institutions in the development, implementation, and maintenance of treasury and investment management programs, and it has remained our primary focus since the firm was founded. One of our key strengths lies in our extensive experience in building customized investment programs tailored to the unique needs of each of our clients. With the dramatic changes we have witnessed in both investment markets and the healthcare industry, we recognize that now more than ever an integrated approach to portfolio design that incorporates both income statement and balance sheet considerations is critical. We believe our conservative, pragmatic investment philosophy with risk as its primary consideration along with a deep knowledge of the healthcare industry uniquely positions us to assist NFP hospitals in the design and management of their investment programs.

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