



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.



TRANSFORMING PORTFOLIOS. ADVANCING MISSIONS.

Highland Associates, Inc. is an independent institutional investment advisor headquartered in Birmingham, Alabama. Highland was founded specifically to help develop, implement and maintain investment management programs for institutions. We serve a national client base of investors including not-for-profit healthcare organizations, foundations, endowments, defined benefit plans, defined contribution plans, and high-net worth individuals. Please visit the website at www.highlandassoc.com to learn more.

HIGHLAND ASSOCIATES
2545 HIGHLAND AVENUE SOUTH
SUITE 200
BIRMINGHAM, ALABAMA 35205
P. 1-800-405-7729 / (205) 933-8664
F. (205) 933-7688

ST LOUIS:
7733 FORSYTH BLVD.; SUITE 1103
CLAYTON, MO 63105
P. 314-296-6171

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. Notwithstanding, NFP healthcare organizations often have multiple pools of capital (short-term reserves, long-term operating portfolios, and defined benefit plans), each with differing objectives, time horizons, and risk tolerances. It is imperative for NFP healthcare organizations to take an enterprise-wide view of risk and avoid building portfolios in a vacuum. Incorporating multiple pools of capital into Highland's enterprise risk model helps integrate all key factors into the decision-making process and present a clearer picture of the organization's financial profile.

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. Highland provides that expertise. Our firm was founded more than 30 years ago to focus specifically on NFP healthcare organizations and to provide the dedicated expertise today's healthcare investors are seeking.

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