THE UNIVERSITY OF MICHIGAN
REGENTS COMMUNICATION

Approved by the Regents
July 19, 2007

REQUEST FOR ACTION

SUBJECT: Michigan Health Corporation (MHC) Annual Business Plan

ACTION REQUESTED: Approve the MHC FY2008 Annual Business Plan and Budget

BUSINESS PLAN:

The Bylaws of MHC provide that MHC will annually submit a business plan to the Board of Regents for approval. MHC submitted its last business plan to the Board of Regents in July 2006. Since that time, MHC has focused on the operations of its existing subsidiaries.

In September 1996, the Regents approved the initial business plan and capitalization for MHC in the amount of $30 million. As of June 30, 2007, MHC has committed $20.7 million to existing projects. MHC will begin its twelfth year of operations in fiscal year 2008 and is budgeting net patient revenues of $8.5 million.

At the June and July Board meetings, the Board of MHC and the Sole Member Representative unanimously approved the FY2008 Business Plan for submission to the Board of Regents.

APPROVAL REQUESTED:

The Board of MHC recommends that the Board of Regents approve the MHC FY2008 Annual Business Plan and Budget.

Robert P. Kelch, M.D.
Executive Vice President for Medical Affairs
Chair, Chief Executive Officer & Sole Member Representative, MHC

July 2007

MICHIGAN HEALTH CORPORATION
FISCAL YEAR 2008 ANNUAL BUSINESS PLAN

July 2007

TABLE OF CONTENTS

I. MHC OVERVIEW

A. Introduction

The Fiscal Year 2008 (FY2008) Business Plan for Michigan Health Corporation (MHC) provides an overview of the direction for MHC and its subsidiary organizations, as MHC begins its twelfth year of operation.

The subsidiary organizations are grouped as to whether they are consolidated or unconsolidated on MHC's financial statements. Consolidated subsidiaries are organizations in which MHC maintains greater than fifty percent ownership. Unconsolidated subsidiaries are organizations in which MHC maintains ownership of fifty percent or less.

An overview of MHC, an operational and financial assessment, and the MHC Fiscal Year 2008 Budget are included in this business plan. In the Operational and Financial Assessment section, information is provided regarding capital allocation, management of MHC, future subsidiaries and capitalization, and subsidiary financial performance reviews. The MHC Fiscal Year 2008 Budget section highlights elements of the FY2008 budget and is followed by the MHC FY2008 budget statements.

B. Structure and Governance

MHC is a non-profit, non-stock membership corporation solely owned and operated by the University. MHC, the University of Michigan Medical School (UMMS), and the University of Michigan Hospitals and Health Centers (HHC) comprise the University of Michigan Health System (UMHS). M-CARE was part of the Health System through December 31, 2006. The Executive Vice President for Medical Affairs is the Member Representative of MHC.

The MHC Board meets on a regular basis or as necessary to conduct business. The Board of Directors are: Robert Kelch, M.D., Executive Vice President for Medical Affairs (Chair and Chief Executive Officer); Douglas Strong, Executive Director of the Hospitals and Health Centers (Vice Chair and Chief Operating Officer); Timothy Slottow, Chief Financial Officer of the University (Treasurer); James O. Woolliscroft, M.D., Dean of the Medical School (Secretary); and Glenna Schweitzer, Assistant Provost and Director of the Office of Budget and Planning of the University.

All proposed activities that are presented to the MHC Board for approval are first reviewed and endorsed by the MHC Management Committee. The Committee is chaired by Douglas Strong, the Chief Operating Officer of MHC. Members of the Committee include an Associate Professor of Internal Medicine from the Medical School, the Senior Finance Director and Revenue Cycle Officer of the HHC, the Administrative Director for MHC and representatives from the University Tax Office and the Office of General Counsel. The performance of each MHC subsidiary organization is reviewed annually by the MHC Management Committee. In this process, the goals of each subsidiary and its overall performance are reviewed, and goals for the coming year are assessed.

MHC staff monitor the activities of the ventures on an ongoing basis. Financial statements from the ventures are reviewed monthly and various activities are tracked, including trend analyses. The MHC Administrative Director also attends board meetings for most of the subsidiary companies; actively participates in finance and operations committees; and interfaces regularly with venture representatives to assist with problem solving and assuring that venture and MHC needs are being met.

C. Fiscal Year 2007 and 2008 Activities

During this past year, the MHC administrative staff focused on operational and financial reviews of the subsidiaries' performance; examined financial and cash flow relationships between MHC and UMHS and between MHC and its subsidiaries; and completed an MHC return on investment analysis. As a result of this focus and the needs of the subsidiaries, MHC accomplished the following during fiscal year 2007 (FY2007):

- Invested $333,000 in Central Michigan Community Hospital Radiation Oncology (CMCHRO) which initiated operations in September 2005. This completes the $1,000,000 investment funded by the Department of Radiation Oncology;

- Earned an estimated $445,000 from Great Lakes Lithotripsy, LLC;

- Received cash distributions of $1,762,000 from PMHC Cancer Center (PMHC);

- Returned more funds to HHC than transferred from HHC and renewed the master loan agreement with HHC;

- Had a positive return on the investment in MHC for the Health System with increased contributions in research funding, net income on professional revenue, and increased throughput and downstream net income for the HHC totaling approximately $7 million;

- Assumed financial reporting and accounting responsibilities of Michigan Health Management Corporation (MHMC) during its run out period, following the sale of M-CARE and the transition of M-CARE staff to other University positions;

- Amended the MHMC bylaws to transfer the responsibilities of the MHMC Board to the MHC Board;

- Worked closely with Renal Research Institute, LLC (RRI) and Michigan Dialysis Services, LLC (MDS) leadership to monitor and improve MDS financial and operational performance;

- Directed a review of MVNC to determine its best position in the Health System and the subsequent transition to transfer MVNC programs to HHC effective July 1, 2007;

- Worked with MDS and MVNC leadership in an effort to meet the FY2007 budget;

- Transitioned to a procedures testing process of MHC key areas with PricewaterhouseCoopers and assisted MDS and MVNC in addressing exceptions;

- Provided follow-up information to the Regents Finance, Audit and Investment Committee; and

- Implemented new University system changes in Human Resources and Financial Operations.

For FY2008, MHC administrative staff will focus on the following activities:

- Work with project representatives to develop specific financial goals for each venture;

- Work with the project representatives in aggregate to reach overall target margins for MHC in support of MHC's financial viability;

- Evaluate potential for new projects relating to the advances in technology and new projects resulting from changes in the UMHS and health care environment in general, particularly in the area of radiation oncology;

- Provide the follow-up necessary with internal and external units to close out MHMC;

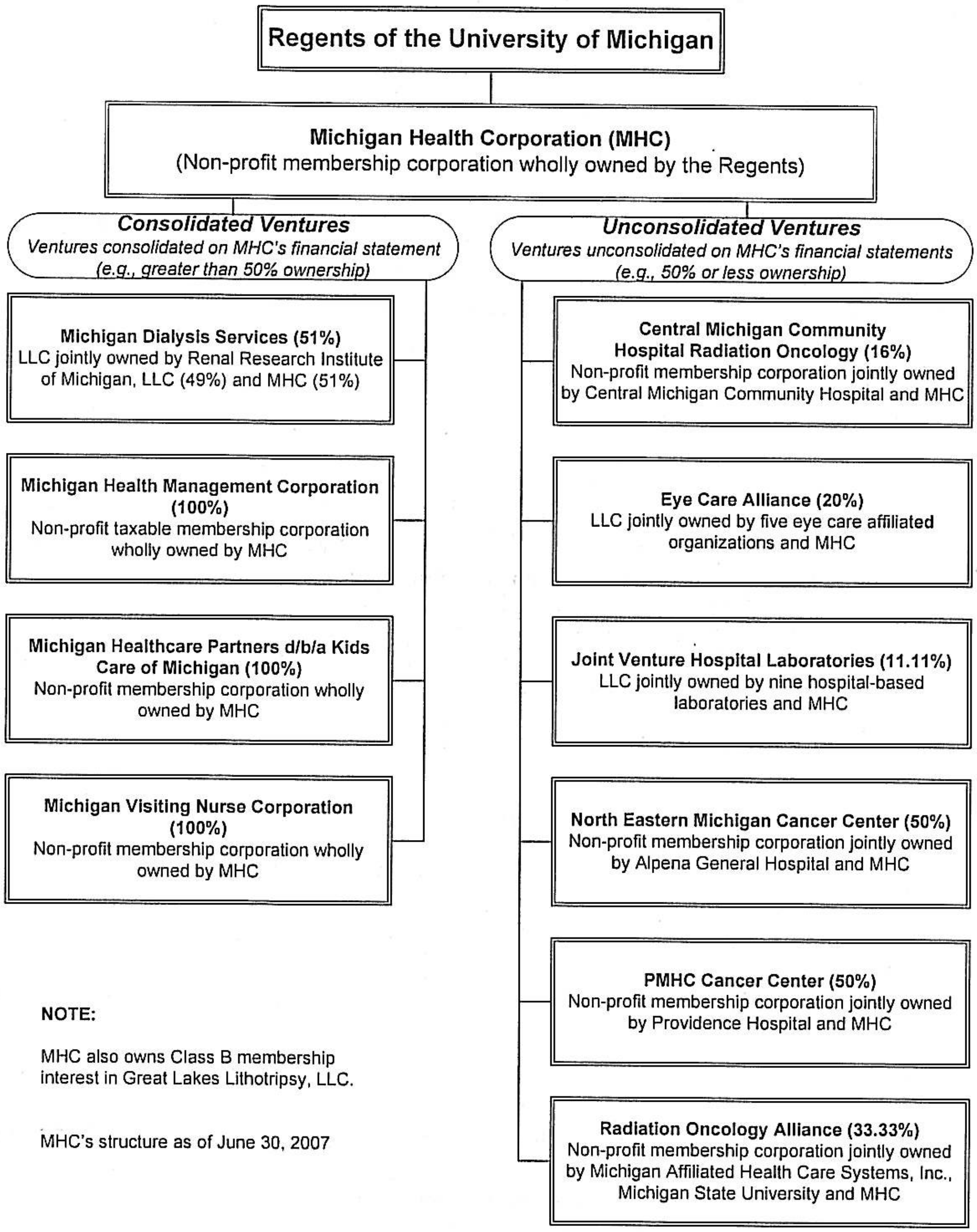
- Continue to work closely with MDS and RRI leadership to improve the financial reporting, operations and viability of MDS;

- Monitor changes in Eye Care Alliance (ECA) to assure Delta Vision continues to fund all costs previously covered by the partners; and

- Facilitate transition of MVNC from MHC to become a HHC department.

D. MHC Subsidiary Organizations

As MHC completes its eleventh year of operation, the MHC Board has approved a total of seventeen (17) subsidiary organizations since its activation in 1996. Seven subsidiaries, or proposed subsidiaries, have been terminated and ten subsidiaries are operational. The following chart shows each of the current subsidiary organizations under MHC. The subsidiaries are grouped as to whether they are consolidated or unconsolidated on MHC's financial statements. Consolidated subsidiaries are organizations where MHC maintains greater than a fifty percent ownership.



NOTE:

MHC also owns Class B membership interest in Great Lakes Lithotripsy, LLC.

MHC's structure as of June 30, 2007

II. OPERATIONAL & FINANCIAL ASSESSMENT

A. Capital Allocation

Capitalization for MHC is provided predominantly by a loan under the Loan Agreement with the HHC or equity transfers from HHC and the clinical departments of the Medical School. Decisions to provide capitalization to MHC subsidiary organizations through a loan or through an equity transfer from the MHC are made based on an evaluation of the needs of the system as a whole. This evaluation includes the prospects for a return on investment to MHC as well as to the Hospitals and Health Centers and/or the Faculty Group Practice of the Medical School.

As of June 30, 2007, $20.7 million of the initial capitalization has been committed to MHC and its subsidiaries, of which $19.2 million has been invested (See Table 1 below).

Table 1. MHC Capital Allocation for Board Approved Subsidiaries

	MHC Approved Commitment	Net Changes	MHC Approved Commitment	MHC Investment	Net Changes	MHC Investment
	6/30/06		6/30/07	6/30/06		6/30/07
MHC Current Subsidiaries						
Central Michigan Community Hospital Radiation Oncology	$1,000,000		$1,000,000	$667,000	$333,000	$1,000,000
Eye Care Alliance	$333,800		$333,800	$309,800	$12,000	$321,800
Joint Venture Hospital Laboratories	$15,000		$15,000	$15,000		$15,000
Michigan Dialysis Services	$4,389,743		$4,389,743	$3,046,381		$3,046,381
Michigan Health Management Corporation	$600,000		$600,000	$600,000		$600,000
Michigan Visiting Nurse Corporation	$219,569		$219,569	$219,569		$219,569
North Eastern Michigan Cancer Center	$2,070,127		$2,070,127	$2,070,127		$2,070,127
PMHC Cancer Center	$6,497,685	($1,762,000)	$4,735,685	$6,497,685	($1,762,000)	$4,735,685
Radiation Oncology Alliance	$50,000		$50,000	$50,000		$50,000
Subtotal	**$15,175,924**	**($1,762 ,000)**	**$13,413,924**	**$13,475,562**	**($1,417,000)**	**$12,058,562**
Closed and Non-Active Ventures	$110,224		$110,224	$110,224		$110,224
MHC Administrative Operations*	$6,461,704	$676,121	$7,137,825	$6,352,825	$685,000	$7,037,825
Totals	**$21,747,852**	**($1,085,879)**	**$20,661,973**	**$19,938,611**	**($732,000)**	**$19,206,611**

* Includes a $210,000 investment in mobile Lithotripsy.

B. Management

The operation and management of MHC is provided through a Management Agreement with the University. As a result, the business, administrative and management services are provided by employees of UMHS. MHC has 2.90 full time equivalents dedicated to the operations, management and financial reporting of MHC.

PricewaterhouseCoopers, LLP, MHC's auditors, performed procedures testing of MHC's activities for the fiscal year ending June 30, 2006.

C. Future Capitalization and Development

The sole member representative of MHC, together with the Board of MHC, will allocate any additional capitalization for MHC for development of new MHC projects and subsidiary organizations up to the initially approved capitalization of $30,000,000. The initial approval in September 1996 made financing available through a combination of equity transfers and loan agreements between MHC and the Regents. The HHC was identified as the primary source of financing. Future capitalization for MHC is considered as part of the UMHS capital planning and allocation process.

The Board of MHC will continue to meet as necessary to review the status of its current subsidiaries and develop and approve new projects, based on the needs of UMHS and the changing health care environment. MHC will also continue to perform the necessary legal and financial due diligence for every new project it considers. All projects approved by MHC will remain consistent with and supportive of the University's missions and the purpose and intent of MHC. Future projects that MHC participates in during the term of this business plan will be reported to the Board of Regents as necessary.

D. Financial Performance of Subsidiaries

MHC subsidiaries are past their development and start-up stages and are now ongoing operations. MHC will continue to focus on operational and financial performance reviews and address what management and funding actions to take if subsidiaries do not meet their activity and financial goals. The most significant change planned for FY2008 will occur when all Michigan Visiting Nurse programs move to HHC effective July 1, 2007. As the result of a detailed task force review of the optimal location of MVNC within the Health System, it was determined that the Health System benefits are greatest if MVNC is placed in HHC.

Although MHC operates with a July 1 to June 30 fiscal year, many of MHC's subsidiaries operate with a different fiscal year. This creates timing difficulties in developing and reporting budgets and projections to MHC and particularly in developing the MHC Annual Business Plan. Currently, the subsidiaries are held accountable for the annual budgets approved during the year by MHC, not necessarily the revenue and expense reflected in the July to June period of the MHC Annual Business Plan.

The Consolidated Statement of Operations on page ten summarizes the projected net gain or loss for MHC as a whole and by venture. In FY2007, MHC is projected to have a favorable margin of

$1,209,829 that compares favorably to the actual margin of ($139,250) for FY2006. MHC Administration and all ventures, except MHMC, are projected to improve their financial performance over the prior year. Michigan Health Management Corporation's projected margin decreased ($82,394) due to the end of Partnership Health. Michigan Dialysis Services shows an improvement of $307,083 in margin, principally due to a $256,925 administrative credit related to billing performance. Michigan Visiting Nurses shows an improvement of $160,563, due to a one time Medicaid billing pay back of $138,281. Central Michigan Community Hospital Radiation Oncology shows an improvement in margin of $133,071 as the venture generated more activity than the prior year. North Eastern Michigan Cancer Center also continued to gain ground and showed an improvement in margin of $103,595. PMHC Cancer Center shows an improvement in margin of $613,639 favorable variance due to increased intensity-modulated radiation therapy procedures. Radiation Oncology Alliance improved its margin $64,154 as the treatments and revenue reimbursement continue to increase.

III. MHC FISCAL YEAR 2008 BUDGET

The MHC Fiscal Year 2008 Budget was developed from each subsidiary's financial plan, MHC's financial statements, projected results of the subsidiary's operations, and known/planned changes for the coming fiscal year.

MHC's consolidated financial statements are displayed beginning on page nine. Highlights of those financial statements are identified below.

A. Schedule of Investments Summary

The Schedule of Investments displayed on page nine outlines the expected changes in approved capitalization for each subsidiary and MHC Administration from FY2007 to FY2008.

Currently, the MHC Board has approved commitments in the amount of $20.7 million, including $13.6 million to projects and $7.1 million to MHC Administration. Of this approved commitment, $12.2 million is approved to be transferred to the subsidiaries and $7.0 million to MHC Administration as of June 30, 2007. MHC will have secured $19.2 million for investment through $9.8 million as equity transfers and $9.4 million as loans. The $7.0 million for MHC Administration includes $5.1 million for interest costs.

Assuming the MHC Board approves all of the anticipated capital requests from its subsidiaries in FY2008, the total commitment level that the MHC Board will have approved for its subsidiaries and Administration will be $18.2 million. Of this approved amount, MHC is projecting to have transferred funds totaling $16.2 million as of June 30, 2008, with $2.0 million approved for future year transfers. With $18.2 million of the original $30 million capitalization designated for investment in current subsidiaries and MHC Administration, $11.8 million will be available for other projects or venture needs as of June 30, 2008.

B. Consolidated Statement of Operations Summary

The statement on page ten summarizes the FY2007 projected net margin and the FY2008 budget for MHC as a whole and by venture. This summary identifies the direct results of operations of the subsidiaries, but does not reflect ancillary benefits to the Health System such as increased research funding and professional net income or expanded patient care service opportunities for the Hospitals and Health Centers and the Medical School Faculty Group Practice. It is estimated that the activities of MHC and its subsidiaries contribute approximately $1.7 million net margin annually to other segments of the Health System.

MHC is budgeting an overall favorable net margin of $1,220,447 for FY2008 compared to a projected margin of $1,209,829 for FY2007. The primary reason for this change is the transfer of MVNC activity to HHC. In FY2008, all ventures are expected to have a positive net margin except ECA. ECA financial needs will be funded by Delta Vision and not the partners such as MHC.

C. MHC Consolidated Financial Statements

MHC consolidated financial statements follow on pages nine and ten.

Michigan Health Corporation
Schedule of Investments
Budgeted for June 30, 2008

	MHC Approved Commitment as of FY2007	Expected Changes in Commitment	MHC Expected Commitment as of FY2008	MHC Total Investment as of FY2007	Expected Changes in Investment	MHC Total Expected Investment as of FY2008
Consolidated Joint Ventures (A)						
Michigan Dialysis Services	$ 4,389,743	$ 0	$ 4,389,743	$ 3,046,381	$ 0	$ 3,046,381
Michigan Health Management Corporation	600,000	0	600,000	600,000	0	600,000
Michigan Visiting Nurses - Consolidated	219,569	(219,569) (C)	0	219,569	(219,569) (C)	0
Total Consolidated Joint Ventures	$ 5,209,312	$ (219,569)	$ 4,989,743	$ 3,865,950	$ (219,569)	$ 3,646,381
Unconsolidated Joint Ventures (B)						
Central Michigan Community Hospital Radiation Oncology	$ 1,000,000	$ 0	$ 1,000,000	$ 1,000,000	$ 0	$ 1,000,000
Eye Care Alliance	333,800	-	333,800	321,800	0	321,800
Joint Venture Hospital Laboratories	15,000	-	15,000	15,000	0	15,000
North Eastern Michigan Cancer Center	2,070,127	(75,000) (D)	1,995,127	2,070,127	(150,000) (D)	1,920,127
PMHC Cancer Center	4,735,685	(500,000) (D)	4,235,685	4,735,685	(1,000,000) (D)	3,735,685
Radiation Oncology Alliance	50,000	0	50,000	50,000	0	50,000
Total Unconsolidated Joint Ventures	$ 8,204,612	$ (575,000)	$ 7,629,612	$ 8,192,612	$ (1,150,000)	$ 7,042,612
Terminated Ventures						
Closed and Non-Active Ventures	$ 110,224	$ (2,347,235) (C)	$ (2,237,011)	$ 110,224	$ (2,347,235) (C)	$ (2,237,011)
Subtotal for All Ventures	$ 13,524,148	$ (3,141,804)	$ 10,382,344	$ 12,168,786	$ (3,716,804)	$ 8,451,982
Michigan Health Corporation - Administrative Activity	6,927,825	650,000 (E)	7,577,825	6,827,825	750,000	7,577,825
Mobile Lithotripsy	210,000		210,000	210,000		210,000
Funds Available to be Committed by the MHC Board	9,338,027	2,491,804	11,829,831			
Regental Approved Limit on Capital Investment	$ 30,000,000		$ 30,000,000			
Remaining Funds Not Currently Invested				$ 10,793,389	2,966,804	$ 13,760,193
Regental Approved Limit on Capital Investment				$ 30,000,000		$ 30,000,000

Notes:

(A) Consolidated joint ventures are entities where MHC has an ownership percentage greater than 50%.
(B) Unconsolidated joint ventures are entities where MHC has an ownership percentage up to 50%.
(C) Transfer of MVNC to HHC.
(D) Ventures making repayments of a portion of their loan principal or making cash distributions to MHC in FY2008 include: NEMCC-$150,000 and PMHC-$1,000,000.
(All of these transactions will be used to decrease the loan between HHC and MHC.)
(E) MHC Admin's additional $650,000 is approved with approval of the business plan.

Michigan Health Corporation
Consolidated Statement of Operations
ProForma Summary of Net Gain / (Loss) by Joint Venture
as of June 30, 2008

	FY2006 Actual	FY2007 Projection	FY2008 Budget
Consolidated Joint Ventures			
Kids Care of Michigan	$ 0	$ 0	$ 0
Michigan Dialysis Services (51.00%)	(100,400)	206,683	89,418
Michigan Health Management Corporation	74,613	(7,781)	2,029
Michigan Visiting Nurses - Consolidated	(313,865)	(153,302)	0
Net Gain / (Loss) in Consolidated Joint Ventures	$ (339,652)	$ 45,600	$ 91,447
Unconsolidated Equity in Joint Ventures			
Central Michigan Community Hospital Radiation Oncology (16.00%)	$ (141,262)	$ (8,191)	$ 3,520
Eye Care Alliance (20.00%)	(28,203)	(27,272)	(9,000)
Joint Venture Hospital Laboratories (11.11%)	(49)	(2)	0
NEMCC (50.00%)	49,630	153,225	177,300
PMHC Cancer Center (50.00%)	609,404	1,223,043	1,088,337
Radiation Oncology Alliance (33.33%)	63,762	127,916	31,365
Equity in Net Gain / (Loss) in Unconsolidated Joint Ventures	$ 553,282	$ 1,468,719	$ 1,291,522
Michigan Health Corporation - Administrative Activity	(352,880)	(304,490)	(162,522)
Total Excess Revenue / (Expenses)	$ (139,250)	$ 1,209,829	$ 1,220,447

Notes:
- MHC ownership interest shown in parenthesis after venture name, if less than 100%.
- Kids Care was terminated September 30, 2004 and final transactions related to cost settlement were processed in FY2006.
- MDS is projected to receive a $256,924.62 credit in June 2007 on management fees for the year.
- MHMC's Partnership Health Program ended May 31, 2006. Final expenses shown in FY2007, while FY2008 budget includes licensing fees and UIP interest. Cash balance is retained to maintain TPA license and pay bank fees and licensing fees.
- MVNC is moving to HHC effective July 1, 2007.
- CMCHRO venture started operations in September 2005 and activity is slowly improving.
- ECA is anticipating no cash call in FY2008; any financial needs to be covered by Delta Vision.
- PMHC is doing much better than anticipated due to increased IMRT procedures.
- MHC Administration changes are caused primarily by change in interest rate on loan from HHC and significant payments in FY2007 and FY2008, partially offset by increasing share of University overhead due to fewer active consolidated ventures over which to allocate this expense.