Seeking FQHC Status by Reorganization vs. Merger:

Considerations for California Practices

CALIFORNIA HEALTHCARE FOUNDATION

FACT SHEET

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FACED WITH THREATS OF MEDI-CAL and Healthy Families cuts, rising practice costs, and uncertainty about health reform, many California physician practices and nonprofit clinics are looking for options to preserve their missions and operations.

There are a number of possibililties to consider, including seeking designation as a Federally Qualified Health Center (FQHC), merging into a large foundation, such as Palo Alto Medical Foundation, or being acquired and operating as a 1206b clinic associated with a district or city hospital.

FQHC status presents advantages, including more favorable reimbursement through Medi-Cal and Medicare, funding through Section 330 federal grants, and lower liability costs through federal tort limits. However, there are difficulties associated with this path, as the experience of Central Neighborhood Health Foundation illuminates [www.chcf.org]. Some organizations instead opt for merger with a nearby FQHC.

For practices that decide to pursue FQHC status, this fact sheet presents a framework for approaching the choice between reorganization as a new FQHC and merger with an existing one.

Goal clarification. The initial step is to clarify the practice's goals — beyond financial stability. For example, clinics that highly value independence may choose the reorganization option, while clinics that highly value expansion might lean toward merger as a quicker way to achieve that.

Market analysis. The second step is to conduct a market analysis in order to understand the clinic's position and options in the environment and to identify unmet needs that it may fill. A number of factors will affect a clinic's decision. For example, because FQHCs must invest significant resources in management systems and reporting, larger practices may be more interested in reorganizing as an FQHC than smaller ones. For practices with physicians close to retirement, merger may be a less costly way to preserve access for patients and ease the transition. For younger physicians, expanding the practice by linking into an existing FQHC may provide better coverage opportunities and improved work/life balance.

Early in their market analysis, all practices should initiate discussion with existing FQHCs. If a clinic chooses reorganization as a new FQHC, it must demonstrate support from the community and existing FQHCs. If the clinic decides to pursue merger, it will need to consider the following:

- **What do you have to offer a partner FQHC?** Among the most important assets could be patient relationships; a unique market position (geographic, cultural); practice assets; or service range.
- **What do you need from a partner FQHC?** Important assets might include: systems and scale of operations sufficient to support specialized expertise in compliance, billing, IT, HR or other functions; greater financial stability through access to grants; and wider scope of services, such as behavioral health.

The answers to these questions will help clinics to identify potential merger partners.

The following tables compare some pros and cons of merger versus reorganization (Table 1) and present a summary of the process and resources needed for each (Table 2). They are intended help practices compare the tradeoffs.

Table 1. Pros and Cons of Merger vs. Reorganization

PROs	MERGE WITH EXISTING FQHC	REORGANIZE AS NEW FQHC
Systems	• No need to invest separately in licensure, designation, systems, financial management, and reporting capabilities that are needed for operation as an FQHC	• Preserve more independent decision authority over medical model, systems, practice goals
Market position	• Immediate opportunity to expand geographic scope or deepen market position through merger	• No risk of blurring market image or loss of community goodwill • Potentially closer connection to community through required development of a community governing board with more than 50% users of your services
Scale of operations	• Additional colleagues in merged organization provide greater practice depth and opportunity for improved work/life balance	• Existing medical leadership and staff remain in place; no dislocation
Goals and plans	• Market analysis requires the practice to clarify strengths (what it can offer a partner) and development goals (what it needs from a partner)	• Application for FQHC designation requires market analysis (what unmet needs will it serve) and assessment of strengths and development goals against HRSA's stated criteria
Best if your goals (beyond economics) are to:	• Expand/deepen market position and scope of services quickly • Accommodate additional clinical (e.g., behavioral health on site, pharmacy), enabling (e.g., Medi-Cal application assistance), or administrative (e.g., compliance) services that require larger scale of operations	• Maintain practice independence • Achieve stability and growth from within
CONs	**MERGE WITH EXISTING FQHC**	**REORGANIZE AS NEW FQHC**
Costs, diversion, dislocation	• Costs, dislocation, and difficulties of transitioning to different systems (e.g., EHR, billing, financial management) in the merged organization	• Risk and cost of investing in new and more complex systems, management organization, and reporting required to satisfy multiple regulatory agencies • Steep learning curve requires significant time and focus on administrative matters; practice may suffer from diversion of MD focus and care availability
Independence	• By becoming part of a larger organization, must give up individual ability to make decisions about practice model, scope of services, personnel, systems, etc.	• Maintaining independence may be financially unsustainable if practice size does not support needed infrastructure investment
Other risks	• Merger talks may not come to fruition due to differences in goals, medical practice models, systems, or other factors • Merger may not achieve goals due to cost increases, practice frictions, or other reasons; merger likely will be hard and costly to unwind (terminate) after organizations come together	• Application may not be accepted due to questions about demonstration of market need, community support, organizational understanding and readiness to meet HRSA standards, or other reasons • Congress or HRSA may reduce or eliminate funding or authorization for start-up of new FQHCs • Expected financial benefits of FQHC reorganization may not be achieved if financial management, billing, and collections requirements are poorly understood or executed

Table 2. Process and Resources Needed

	MERGE WITH EXISTING FQHC	REORGANIZE AS NEW FQHC
Clarify goals	• Determine relative importance of independence, growth, geographic coverage, and other factors	• Determine relative importance of independence, growth, geographic coverage, and other factors
Initial market analysis	• Analyze your market position and available partners • Assess potential interest on the part of existing FQHCs	• Assess your market position; quantify the gaps in availability of services you will fill (e.g., geographic, economic status, ethnic) • Assess potential support from existing FQHCs
Process steps after initial analyses	**1.** Governance-level discussion with potential partners — can be informal **2.** Letter of intent (outlines the intent of the parties to study merger; outlines goals, scope of study, sharing of information, timetable, and confidentiality)[*] **3.** "Due diligence" analysis (to assess the potential benefits and risks of merging, for both parties; among the issues: • Valuation of practice assets • Compatibility of systems • Managed care contracts and successorship provisions • Projection of financial results of integrated operation[†] **4.** Meetings/development of definitive agreement; several meetings likely will be needed to review the due diligence analysis and reach agreement on issues such as the following:[* †] • Asset transfer and any payment between parties • Investments to be made by either party (if any) • Parties' respective roles in decisions on matters such as employee salaries and benefits, medical records transfer and conversion, and unwinding procedures **5.** Transaction — action steps to achieve the merger, such as: • Transition provider numbers • File applications for recognition of the additional site(s) as part of the FQHC • Make any facility modifications necessary to meet FQHC/clinic standards • Transition employee and patient records • Transition managed care contracts to the merged entity	**1.** Form governing board more than 50% made up of users of your services[*] **2.** Develop application for FQHC designation showing how the organization will meet the federal requirements for health centers, including:[†] • Provide the full scope of services required • Meet unique needs of underserved populations in a clearly defined geographic service area • Achieve, measure, and report quality improvement The application also must include letters of support from existing FQHCs **3.** Develop and demonstrate ongoing capabilities in clinical and financial record-keeping, management, and reporting required by HRSA[†] **4.** Transition from for-profit to nonprofit legal and tax status[*] **5.** Obtain state licensure and certification as a primary care clinic
Resources needed and transition costs	• Due diligence analysis[†] • Facilitation of merger discussions[†] • Legal: transition from for-profit practice into FQHC nonprofit structure and development of merger agreements[*]	• Legal: nonprofit incorporation[*] • Board development • Development of additional services to meet full scope (potentially)[†] • Development of new systems or adjustment of existing ones to meet HRSA and other agency requirements[†] • Development of applications for FQHC status and certification as a primary care clinic[†]

*Legal assistance needed.
†Analysis/facilitation assistance typically needed.

More Resources

The California Catalyst Fund was created by the California HealthCare Foundation (CHCF), in partnership with the Nonprofit Finance Fund (NFF) and other funders. It is a restructuring fund designed to underwrite technical assistance for clinics involved in existing partnerships or developing new ones: www.nonprofitfinancefund.org.

California Department of Public Health: Information on requirements for licensure as a primary care clinic and the licensure application: www.cdph.ca.gov.

US Department of Health and Human Services, Bureau of Primary Health Care:

- A summary of the requirements for the federal Health Center Program: www.bphc.hrsa.gov.
- A revised and updated set of instructions for applying: www.bphc.hrsa.gov.
- A web guide for newly started FQHCs and FQHC Look-Alike clinics: www.bphc.hrsa.gov.

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About the Foundation

The California HealthCare Foundation works as a catalyst to fulfill the promise of better health care for all Californians. We support ideas and innovations that improve quality, increase efficiency, and lower the costs of care. For more information, visit us online at www.chcf.org.