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## Case 16.1: Outer Limit Hospital

*Key concept: Computing payback, net present value, and internal rate of return for hospital capital investment*

**T**he Outer Limit Hospital is considering the capital financing for a new clinic for surfers that would operate from a manufactured housing unit (trailer) parked beside the beach on a vacant lot. The housing unit, with all necessary equipment, is estimated to cost \$280,000. The unit and equipment will have only a five-year life due to corrosion caused by the salty air. The seaside lot will be rented on an annual basis.

The Outer Limit Hospital tentatively plans to build a permanent replacement clinic near the beach by the end of the fifth year if clinic operations appear to warrant that investment. Regardless of whether the permanent clinic is built, plans are to close and scrap the manufactured housing unit and equipment at the end of their economic life. The salvage value is expected to approximately equal the disposal costs.

Yearly revenues and operating costs for the clinic are estimated as follows:

	Year 0	Year 1	Year 2	Year 3	Year 4	Year 5
Patient revenues		100,000	220,000	235,000	250,000	300,000
Operating costs	-280,000	100,000	100,000	100,000	125,000	150,000
Profit (loss)	-280,000	0	120,000	135,000	125,000	150,000

The Outer Limit Hospital applies a 20 percent cost of capital hurdle rate to risky projects of this type, and it would like the payback period to be within the first 50 percent of the project's life.

## Questions

1. What is the payback period for the project?
2. What is the net present value (NPV) of the project?
3. What is the internal rate of return (IRR) for the project?
4. Should the project be undertaken? Why or why not? Discuss factors that might influence the decision making.

Source: McKee Th. & McKee L.  
"Healthcare Applications. A Case-  
book in Accounting and  
Financial Management"  
pp. 205-206.