



STATE OF WASHINGTON
DEPARTMENT OF HEALTH

October 1, 2012

CERTIFIED MAIL # 7011 1570 0002 7808 7211

Glen Marshall, CEO and Superintendent
Kennewick General Hospital
900 South Auburn Street
Post Office Box 6128
Kennewick, Washington 99336

Re: CN #12-42

Dear Mr. Marshall:

We have completed our review of the Certificate of Need application submitted by Kennewick Public Hospital District proposing to amend Certificate of Need #1418E because of a change in the approved financing. Enclosed is a written evaluation of the application. For the reasons stated in this evaluation, the application submitted is consistent with applicable criteria of the Certificate of Need Program, provided the Kennewick Public Hospital District agrees to the following in its entirety.

Project Description:

This certificate approves the financing for the construction of Kennewick General Hospital-Southridge as stated in the application. The hospital is currently a Medicare and Medicaid provider and holds a three-year accreditation from the Joint Commission. Kennewick Public Hospital District intends that Kennewick General Hospital will continue participation in both the Medicare and Medicaid programs, and maintain services currently offered by the hospital. At project completion, Kennewick General Hospital will have two campuses. Below is a breakdown of acute care beds at each campus.

Southridge Campus	# of Beds	Auburn Campus	# of Beds
General Medical/Surgical	74	Pediatrics/ Obstetrics	27
		Level II ICN	10
Total	74	Total	37

Conditions:

1. Approval of the project description as stated above. Kennewick Public Hospital District further agrees that any change to the project as described in the project description is a new project that requires a new Certificate of Need.

2. Kennewick General Hospital will provide charity care in compliance with the charity care policies provided in this Certificate of Need application, or any subsequent polices reviewed and approved by the Department of Health. Kennewick General Hospital will use reasonable efforts to provide charity care in an amount comparable to or exceeding the average amount of charity care provided by hospitals in the Central Region. Currently, this amount is 2.01% for gross revenue and 4.52% for adjusted revenue. Kennewick General Hospital will maintain records documenting the amount of charity care it provides and demonstrating its compliance with its charity care policies.

Approved Costs:

The approved capital expenditure for this project is \$111,915,758.

You have two options, either accept or reject the above in its entirety. If you accept the above in its entirety, your application will be approved and a Certificate of Need sent to you. If you reject any provision of the above, you must identify that provision, and your application will be denied because approval would not be consistent with applicable Certificate of Need review criteria. Please notify the Department of Health within 8 days of the date of this letter whether you accept the above in its entirety. Your written response should be sent to the Certificate of Need Program, at one of the following addresses.

Mailing Address:

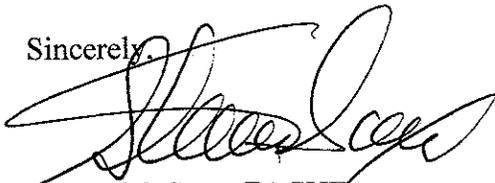
Department of Health
Certificate of Need Program
Mail Stop 47852
Olympia, WA 98504-7852

Other Than By Mail:

Department of Health
Certificate of Need Program
111 Israel Road SE
Tumwater, WA 98501

If you have any questions, or would like to arrange for a meeting to discuss our decision, please contact Janis Sigman with the Certificate of Need Program at (360) 236-2955.

Sincerely,



Steven M. Saxe, FACHE
Director, Health Professions and Facilities

Enclosure

cc: Department of Health, Investigations and Inspections Office

**EVALUATION DATED OCTOBER 1, 2012, OF THE CERTIFICATE OF NEED APPLICATION
SUBMITTED BY KENNEWICK PUBLIC HOSPITAL DISTRICT PROPOSING TO AMEND
CERTIFICATE OF NEED #1418 BECAUSE OF A CHANGE IN APPROVED FINANCING**

APPLICANT DESCRIPTION

Kennewick Public Hospital District (KPHD) is a public hospital district located in the city of Kennewick, within Benton County. KPHD owns and operates four healthcare facilities in Benton County. Below is a summary of the four facilities.

Name	Address	Type of Facility
Kennewick General Hospital	900 South Auburn Street Kennewick, 99336	Acute Care Hospital
KGH Medical Mall	521 North Young Street Kennewick, 99336	Medical office building with an ambulatory surgery center
Kennewick Home Health	18 North Auburn Street Kennewick, 99336	Medicare certified/Medicaid eligible home health agency
Benton Franklin Elder Services	10 North Washington Kennewick, 99336	Adult Day Care Provider

BACKGROUND INFORMATION AND INITIAL APPROVAL

This project focuses on Kennewick General Hospital (KGH) listed above. KGH is a public hospital that provides acute care services to residents of Benton and Franklin counties and surrounding areas. The hospital is currently a Medicare and Medicaid provider, holds a three-year accreditation from the Joint Commission and is a level III trauma hospital as part of the Tri-Cities Trauma Services with Lourdes Medical Center located in Pasco [Franklin County]. KGH is currently licensed for 111 acute care beds.

On March 15, 2010, Certificate of Need (CN) #1418 was issued to KPHD approving the construction of a new hospital at 3810 Plaza Way in Kennewick. The new hospital, known as the ‘Southridge Campus,’ would house 74 of the 111 licensed beds. The current Auburn Campus will house the remaining 37 acute care beds.¹ All 111 beds will be under one hospital license and broken down by campus as noted below. [source: CN #1418]

**Table 1
Kennewick General Hospital Acute Care Bed Breakdown by Campus**

Southridge Campus	# of Beds	Auburn Campus	# of Beds
General Medical/Surgical	74	Pediatrics/ Obstetrics	27
		Level II ICN	10
Total	74	Total	37

¹ When CN #1418 was issued, KGH was approved to operate 101 acute care beds. On October 4, 2010, CN #1427 was issued to KPHD approving the addition of a 10-bed level II intermediate care nursery (ICN) and obstetric service at the Auburn campus. The 10 bed ICN increased KGH’s licensed beds from 101 to 111.

CN #1418 approved the capital costs for the project at \$112,378,100. In the initial application that led to the approval of CN #1418, KPHD proposed to finance this project with two sources:

- 90% of the funding would be a Washington Health Care Facilities Authority (WHCFA) bond backed by the United States Department of House and Urban Development (HUD) using section 242 (242 program); and
- 10% of the funding would be KGH reserves.

[source: February 4, 2009, Initial evaluation, p7 & p9]

Due to rules of both WHCFA and HUD, KPHD had to receive approval of the new hospital project from certain legal entities, including the CN approval, before either would provide a commitment to the funding. As a result, there was no approval from either WHCFA or HUD that was included in the initial application or addressed in the evaluation. [source: CN #1418]

In the initial application, KPHD proposed to obtain funding for the project by November 2009. The Southridge campus would begin operations in January 2012. Using that timeline, KPHD expected its first year of operation with a two-campus hospital would be year 2012 and year three would be 2014. [source: KPHD initial application, p17]

AMENDMENT PROJECT DESCRIPTION

With this amendment application KPHD still intends to fund 10% of the costs with hospital reserves and proposes to change the funding source for the remaining 90% of the costs. The estimated capital costs identified in this amendment application is \$111,915,758, which is less than a 1% decrease in the capital costs. Rather than obtain a HUD loan for 90% of the capital costs, KPHD proposes to enter into two agreements with an LLC. The first agreement is a ground lease. Since KPHD already owns the site for the Southridge campus, this lease was established to allow construction on the land. The second lease is the Hospital Facility Lease. Under this lease, the LLC would fund and construct the new hospital, and then lease the completed hospital building back to KPHD. KPHD would be responsible for operations of the hospital and making the lease payments. [source: Amendment Application, p8]

Each entity involved in the proposed financing and a summary of responsibilities is shown below.

Kennewick WA 2012, LLC

- This LLC was established on June 28, 2012.
- Robert Baker is the sole member of this LLC.
- Under the 'Ground Lease Agreement' this LLC would lease the site for the new Southridge campus from KPHD. Kennewick WA 2012, LLC would in turn, obtain funding for the construction and development of the new campus estimated at \$99,915,758.
- Under the 'Hospital Facility Lease Agreement,' once the hospital is constructed, equipped, and ready to begin operations, KPHD would begin making lease/rent payments to the LLC.'

[source: Washington Secretary of State website; Amendment application p11; p27, & Attachment 3; and August 1, 2012, supplemental information, p1 & Appendix 1]

Kennewick Public Hospital District (KPHD)

- the hospital district is responsible for 10% of the funding for the project, which is estimated at \$12,000,000 and is primarily for equipment.
- Under the initial approval of CN #1418, KPHD has already funded architect and engineering fees of approximately \$4,500,000.
- KPHD leases the site to the LLC under the 'Ground Lease Agreement.'
- KPHD operates the hospital and makes the lease payments to the LLC under the 'Hospital Facility Lease Agreement.' At the end of ten years after the construction commencement date identified in the 'Hospital Facility Lease Agreement,' KPHD is obligated to purchase the LLC's interest in the premises for \$110,000,000. The 'interest' as used in the lease document includes the building and the land. At that time, Kennewick WA 2012, LLC will no longer have any property interest in the land or the building.

[source: Application, p11, p27; August 1, 2012, supplemental information, p7]

Because KPHD was unable to obtain financing as described in the initial application, the timeline for construction of the hospital and ultimate operations at two campuses has changed. If this amendment application is approved, KPHD expects the Southridge Campus would be operational by January 2014. Under this timeline, year 2014 is year one and 2016 is year three as a two-campus hospital. [source: Amendment Application, p16]

HISTORY AND VALIDATION OF CN# 1418

As previously stated, KPHD submitted the initial application on July 7, 2008, and the department approved the project on February 4, 2009. Because of the size of the construction project, the department could not issue a CN until either a determination of non-significance or a final environmental impact statement was submitted for the site.² This site requirement is identified as Condition #6 of the approval and was met on March 15, 2010.

CN #1418 was issued on March 15, 2010, and was valid from March 15, 2010 to March 15, 2012. On December 11, 2011, CN #1418E was issued extending the validity of CN #1418 from March 15, 2012, to September 11, 2012.³ During the review of this amendment application, the department recognized that CN #1418E would expire before the amendment review could be completed. As a result, Secretary Selecky granted a 30-day extension to the validity of CN #1418E, resulting in an expiration date of October 11, 2012.⁴

APPLICABILITY OF CERTIFICATE OF NEED LAW

This project is subject to review under Washington Administrative Code 246-310-570(1)(d) because the funding source for 90% of the project has changed.

² As stated in WAC 246-03-030(4).

³ WAC 246-310-580 allows for a six-month extension to the validity of an issued CN.

⁴ Revised Code of Washington 43.70.280(2).

EVALUATION CRITERIA

WAC 246-310-200(1)(a)-(d) identifies the four determinations that the department must make for each application. WAC 246-310-200(2) provides additional direction in how the department is to make its determinations. It states:

“Criteria contained in this section and in WAC 246-310-210, 246-310-220, 246-310-230, and 246-310-240 shall be used by the department in making the required determinations.

(a) In the use of criteria for making the required determinations, the department shall consider:

- (i) The consistency of the proposed project with service or facility standards contained in this chapter;*
- (ii) In the event the standards contained in this chapter do not address in sufficient detail for a required determination the services or facilities for health services proposed, the department may consider standards not in conflict with those standards in accordance with subsection (2)(b) of this section; and*
- (iii) The relationship of the proposed project to the long-range plan (if any) of the person proposing the project.”*

In the event the WAC 246-310 does not contain service or facility standards in sufficient detail to make the required determinations, WAC 246-310-200(2)(b) identifies the types of standards the department may consider in making its required determinations. Specifically WAC 246-310-200(2)(b) states:

“The department may consider any of the following in its use of criteria for making the required determinations:

- (i) Nationally recognized standards from professional organizations;*
- (ii) Standards developed by professional organizations in Washington state;*
- (iii) Federal Medicare and Medicaid certification requirements;*
- (iv) State licensing requirements;*
- (v) Applicable standards developed by other individuals, groups, or organizations with recognized expertise related to a proposed undertaking; and*
- (vi) The written findings and recommendations of individuals, groups, or organizations with recognized expertise related to a proposed undertaking, with whom the department consults during the review of an application.”*

The review for an amendment project is limited to only those criteria that would be affected by the amendment, provided that the amendment does not significantly alter the project. While KPHD’s funding sources have changed and the initial timeline is delayed, a significant portion of the approved project has not changed. The site, services to be provided at each campus, and number of beds at each campus have not changed. As a result, the department’s review will focus on applicable portions of need (WAC 246-310-210), financial feasibility (WAC 246-310-220), structure and process of care (WAC 246-310-230), and cost containment (WAC 246-310-240).⁵

⁵ Each criterion contains certain sub-criteria. The following sub-criteria are not discussed in this evaluation because they are not relevant to this amendment project: WAC 246-310-210(1), (3), (5), and (6); WAC 246-310-230(1) and (2); and WAC 246-310-240(2) and (3).

CN #1418 was issued with six terms and one condition, which are summarized below.

Terms

<u>Term #</u>	<u>Focus of Term</u>
#1	Draft 'Ground Lease Agreement'
#2	Draft 'Facility Lease Agreement'
#3 - #5	Documentation to be provided related to the HUD financing
#6	Environmental requirements for the site. This term had to be met before CN #1418 could be issued.

Condition

<u>Condition #</u>	<u>Focus of Condition</u>
#1	Percentage of charity care to be provided at the hospital. On February 27, 2009, KGH agreed to meet this condition and it is ongoing.

Only term #6 above was met. If this amendment application is approved, the previous terms that are not met would be superseded by any terms related to this project. While condition #1 is met, it would be updated using the most recent charity care data available. [source: CN #1418]

TYPE OF REVIEW

As allowed under WAC 246-310-570 the department accepted this project as an amendment to an existing Certificate of Need. This application was reviewed under an expedited review timeline as outlined in WAC 246-310-150.

APPLICATION CHRONOLOGY

<u>Action</u>	<u>Kennewick Public Hospital District</u>
Letter of Intent Submitted	March 20, 2012
Application Submitted	June 20, 2012
Department's pre-review activities including screening and responses	June 21, 2012, through August 6, 2012
Beginning of Review <ul style="list-style-type: none"> • public comments accepted throughout review; • no public hearing conducted under the expedited review rules 	August 7, 2012
End of Public Comment	August 27, 2012
Rebuttal Comments Submitted	September 12, 2012
Department's Anticipated Decision Date	October 2, 2012
Department's Actual Decision Date	October 1, 2012

AFFECTED PERSONS

Washington Administrative Code 246-310-010(2) defines "affected person" as:

"...an "interested person" who:

- (a) *Is located or resides in the applicant's health service area;*
- (b) *Testified at a public hearing or submitted written evidence; and*
- (c) *Requested in writing to be informed of the department's decision."*

Throughout the review of this project, one hospital sought and received affected person status under WAC 246-310-010(2):

- Kadlec Regional Medical Center – an acute care hospital located at 888 Swift Boulevard in Richland, within Benton County.

SOURCE INFORMATION REVIEWED

- Kennewick Public Hospital District's Certificate of Need application submitted June 20, 2012
- Kennewick Public Hospital District's supplemental information received August 1, 2012
- Public comments received by August 27, 2012
- Rebuttal comments from Kennewick Public Hospital District received on September 12, 2012
- Department of Health Hospital and Patient Data Systems Analysis received September 18, 2012
- Certificate of Need #1418 issued on March 15, 2010
- The department's February 4, 2009, evaluation approving the issuance of CN #1418
- Certificate of Need #1418E issued on December 19, 2011 extending the validation of CN #1418 from March 15, 2012, to September 11, 2012
- Licensing and/or survey data provided by the Department of Health's Investigations and Inspections Office
- Kennewick General Hospital's website [www.kennewickgeneral.com]
- Washington Secretary of State website [www.sos.wa.gov]
- Joint Commission website [www.jointcommission.org]
- Accreditation Association for Ambulatory Health Care website [www.aaahc.org]
- Eide Bailly, LLP website [www.eidebailly.com]

CONCLUSION

For the reasons stated in this evaluation, the application submitted by Kennewick Public Hospital District proposing to amend Certificate of Need #1418 because of a change in the approved financing is consistent with applicable criteria of the Certificate of Need Program, provided Kennewick Public Hospital District agrees to the following in its entirety.

Project Description:

This certificate approves the financing for the construction of Kennewick General Hospital-Southridge as stated in the application. The hospital is currently a Medicare and Medicaid provider and holds a three-year accreditation from the Joint Commission. Kennewick Public Hospital District intends that Kennewick General Hospital will continue participation in both the Medicare and Medicaid programs, and maintain services currently offered by the hospital. At project completion, Kennewick General Hospital will have two campuses. Below is a breakdown of acute care beds at each campus.

Southridge Campus	# of Beds	Auburn Campus	# of Beds
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		Level II ICN	10
Total	74	Total	37

Conditions:

1. Approval of the project description as stated above. Kennewick Public Hospital District further agrees that any change to the project as described in the project description is a new project that requires a new Certificate of Need.
2. Kennewick General Hospital will provide charity care in compliance with the charity care policies provided in this Certificate of Need application, or any subsequent polices reviewed and approved by the Department of Health. Kennewick General Hospital will use reasonable efforts to provide charity care in an amount comparable to or exceeding the average amount of charity care provided by hospitals in the Central Region. Currently, this amount is 2.01% for gross revenue and 4.52% for adjusted revenue. Kennewick General Hospital will maintain records documenting the amount of charity care it provides and demonstrating its compliance with its charity care policies.

Approved Costs:

The approved capital expenditure for this project is \$111,915,758.

CRITERIA DETERMINATIONS

A. Need (WAC 246-310-210)

Based on the source information reviewed and the applicant's agreement to the conditions identified in the "Conclusion" section of this evaluation, the department determines that Kennewick Public Hospital District has met the need criteria in WAC 246-310-210(2).

- (2) All residents of the service area, including low-income persons, racial and ethnic minorities, women, handicapped persons, and other underserved groups and the elderly are likely to have adequate access to the proposed health service or services.

Initial Evaluation Summary

In its February 4, 2009, initial evaluation supporting the issuance of CN #1418, the department concluded that this sub-criterion was met based on the following factors:

- 1) a review of KGH's admission policy, charity care policy, and projected sources of revenues, which included both Medicare and Medicaid revenues; and
- 2) the charity care condition attached to CN #1418 that required KGH to provide a percentage of charity care consist with the average charity care provided by the hospitals in the Central Region for the most recent three years [2005- 2007].⁶ At that time, the three-year average was 1.79% of gross revenue and 4.21% of adjusted revenue.

[source: Initial evaluation, pp5-6]

Amendment Application Review

KGH is currently a provider of health care services to residents of Washington State, including low-income, racial and ethnic minorities, handicapped and other underserved groups. As an acute care hospital, KGH also participates in the Medicare and Medicaid programs. To determine whether all residents of the service area would continue to have access to a applicant's proposed services, the department requires applicants to provide a copy of its current or proposed admission policy. The admission policy provides the overall guiding principles of the facility as to the types of patients that are appropriate candidates to use the facility and any assurances regarding access to treatment. The admission policy must also include language to ensure all residents of the service area would have access to services. This is accomplished by providing an admission policy that states patients would be admitted without regard to race, ethnicity, national origin, age, sex, pre-existing condition, physical, or mental status.

To demonstrate compliance with this sub-criterion, KPHD provided a copy of the Admission Policy currently used at the KGH Auburn campus. This policy would also be used at the Southridge campus. The policy was implemented in June 2008, and is considered by KPHD to be the most up-to-date policy. The policy outlines the process/criteria that KGH uses to admit patients for acute care services. The policy also includes the necessary language to ensure all residents of the service area would have access to services at KGH. [source: Application, Attachment 5]

The department uses Medicare certificate to determine whether the elderly would have access or continue to have access to the proposed services. KGH currently provides services to Medicare eligible patients. Documents provided in the application demonstrate that KGH intends to maintain this status at the hospital. For this project, a review of the policies and data provided for KGH

⁶ Page 5 of the initial evaluation states that 2003, 2004, and 2005 data was used to determine the average percentage of charity care for the Central Region. Documents in the initial application show that the historical charity care data used was years 2005, 2006, and 2007. KGH's historical percentage of charity care was below the three year regional average.

identifies the facility's financial pro forma includes Medicare revenues. [source: August 1, 2012, supplemental information, Appendix 5]

The department uses the facility's Medicaid eligibility or contracting with Medicaid to determine whether low-income residents would have access to the proposed services. KGH also provides services to Medicaid eligible patients. Documents provided in the application demonstrate that KGH intends to maintain this practice. For this project, a review of the policies and data provided for KGH identifies the facility's financial pro forma includes Medicaid revenues [source: August 1, 2012, supplemental information, Appendix 5]

The department uses a hospital's charity care policy to confirm that all residents of the service area including low-income, racial and ethnic minorities, handicapped and other underserved groups have, or would have, access to healthcare services of the applicant. The policy should also include the process one must use to access charity care at the facility.

To demonstrate its intent to continue to provide charity care to residents at KGH, KPHD submitted its Department of Health approved charity care policy that outlines the process a patient uses to access this service. Further, KPHD included a 'charity care' line item as a deduction from revenue within the pro forma financial documents for KGH. [source: Application, Attachment 5; August 1, 2012, supplemental information, Appendix 5]

For charity care reporting purposes, the Department of Health's Hospital and Patient Data Systems program (HPDS), divides Washington State into five regions: King County, Puget Sound (less King County), Southwest, Central, and Eastern. KGH is one of 21 hospitals located in the Central Region. To demonstrate that KGH has been meeting the charity care condition attached to CN #1418, KPHD provided the hospital's dollar amounts and percentages of charity care for KGH for years 2007, 2008, and 2009. The historical data demonstrates that KGH has been meeting the charity care averages for the Central Region. [source: Amendment Application, p9]

In this amendment application KPHD does not request removal of the charity care condition; however, three years have lapsed since approval of the initial project. The department will use the most recent charity care data to update the condition. According to 2008-2010⁷ charity care data obtained from HPDS, KGH is now providing more than the average charity care provided in the region. KGH's most recent three-year (2008-2010) percentages of charity care for gross and adjusted revenues are detailed in the table below.

**Table 2
Kennewick General Hospital Three-Year Charity Care Comparison**

	3-Year Average Central Region	3-Year Average KGH
Percentage of Gross Revenue	2.01%	2.14%
Percentage of Adjusted Revenue	4.52%	4.90%

RCW 70.38.115(2)(j) requires hospitals to meet or exceed the regional average level of charity care. The pro forma revenue and expense statements submitted by KPHD for KGH indicate that the hospital will provide charity care at approximately 2.36% of gross revenue and 4.53% of adjusted

⁷ Year 2011 charity care data is not available as of the writing of this evaluation.

revenue. The department acknowledges that KGH's three-year historical average is now above that for the region and KPHD projects to continue providing charity care at or above the regional average. However, to ensure that the charity care averages will be consistent with the regional averages, the department concludes that a condition related to the percentage of charity care to be provided at KGH is necessary if this project is approved.

No public comments were submitted for this sub-criterion. Based on the information above, the department concludes that a condition related to the percentage of charity care to be provided at KGH is necessary. With agreement to the condition regarding the charity care percentages, the department concludes that all residents, including low income, racial and ethnic minorities, handicapped, and other under-served groups would continue to have access to the services provided by KGH. **This sub-criterion is met.**

B. Financial Feasibility (WAC 246-310-220)

Based on the source information reviewed and the applicant's agreement to the conditions identified in the "Conclusion" section of this evaluation, the department determines that Kennewick Public Hospital District has met the financial feasibility criteria in WAC 246-310-220.

(1) *The immediate and long-range capital and operating costs of the project can be met.*

WAC 246-310 does not contain specific WAC 246-310-220(1) financial feasibility criteria as identified in WAC 246-310-200(2)(a)(i). There are also no known recognized standards as identified in WAC 246-310-200(2)(a)(ii) and (b) that directs what the operating revenues and expenses should be for a project of this type and size. Therefore, using its experience and expertise the department evaluates if the applicant's pro forma income statements reasonably project the proposed project is meeting its immediate and long-range capital and operating costs by the end of the third complete year of operation.

Initial Evaluation Summary

In its February 4, 2009, initial evaluation supporting the issuance of CN #1418, the department concluded that this sub-criterion was met based on the following factors:

- 1) a review of KGH's December 31, 2007, audited financial report;
- 2) a review of KGH's projected year 2014 (third year) balance sheet; and
- 3) a review of KGH's current (year 2007) and projected years (2012, 2013, and 2014) financial ratios.

[source: Initial evaluation, pp6-8]

Amendment Application Review

This application proposes to amend CN #1418E because of a change in the source of 90% of the funding for the new hospital. To summarize the financing, KPHD would ground lease the land to Kennewick WA 2012 LLC. The LLC would fund and construct the Southridge campus. Once the facility was complete and ready for operations, the Hospital Facility Lease would become effective and KPHD would then be responsible for the lease payments and operating the Southridge campus. Construction of the Southridge campus is expected to be complete in two years. During the two-year construction of the Southridge campus, KPHD is not required to make lease payments under the facility lease but, Kennewick WA 2012 LLC is required to pay approximately \$10/year to KPHD under the ground lease. During the construction phase, KPHD expects to improve its cash reserves.

KPHD would begin making lease payments in mid-year 2014. [source: Amendment application, p8 & p17]

Before entering into the ground and facility leases with Kennewick WA 2012 LLC, in October 2011 KPHD contracted with Eide Bailly⁸ to prepare a feasibility study of the hospital district.⁹ The study covers years 2011 through 2016. The feasibility study also includes an historical review of the district's financial health, including KGH and the three healthcare facilities listed on page one of this evaluation. The feasibility study also includes a detailed explanation of the assumptions relied on by Eide Bailly to prepare the study. The object of this study was to present financial information in the form of financial statements. As a result, the study does not provide any opinions related to the financial health of KPHD or suggest changes in operations to improve its financial health. [source: August 1, 2012, supplemental information, Appendix 2]

To evaluate whether KPHD could meet its financial obligation during the construction of the Southridge campus, the department first reviewed the assumptions used by Eide Bailly in its study. The assumptions used are extensive and detailed. A summary of the assumptions is below. [source: August 1, 2012, supplemental information, Appendix 2; pp1-36]

Revenue and Expense Statement Assumptions

- Revenues include Medicare, Medicaid, commercial, and self-pay. The revenue line item includes other revenue derived from joint ventures.
- Deductions from revenue include bad debt, charity care, and contractual adjustments.
- Operating expenses include staff salaries/wages and employee benefits, KPHD physician growth plans, professional fees, supplies, purchased services (including utilities), insurance, rent, licenses/taxes, depreciation and amortization, and other expenses, such as advertising, travel, and dues/subscriptions.
- Non-operating revenues and expenses consist of gains on sale of assets, investment income, interest expenses, contribution revenue, and other non-operating revenue.

Balance Sheet Assumptions

- Assumptions include patient accounts receivable, other receivables/supplies/prepaid expenses, capital assets, investments in joint ventures, investments in land, and other long-term assets.
- Deferred financing costs refer to the issue costs of the districts existing bonds.
- Accounts payable is assumed at 31 days of expenses.
- Salaries/wages/accrued vacation and related liabilities are included.
- Long term debt includes KPHD's line of credit beginning in year 2010.

⁸ Eide Bailly LLP is a regional certified public accounting and business advisory firm headquartered in Fargo, North Dakota. The firm was founded in 1917 and provides services including assurance, tax, accounting services, employee benefits, financial services, forensic accounting investigative services and technology consulting. Eide Bailly LLP is ranked as a Top 25 CPA firm based on its size in the United States. Eide Bailly has a total of 19 offices in the following nine states: Arizona, Colorado, Idaho, Iowa, Minnesota, Montana, North Dakota, Oklahoma, and South Dakota.

⁹ It is noted that the feasibility study was prepared to evaluate a proposed lease transaction between KPHD and Northwest Institutional Partners, LLC for lease of the hospital. That transaction did not move forward; rather, KPHD chose to enter into the ground and facility leases with Kennewick WA 2012 LLC.

After reviewing the assumptions used by Eide Bailly and KPHD, the department concludes they are reasonable.

During the review of this application, Kadlec Regional Medical Center (Kadlec) provided comments related to the Eide Bailly study. Kadlec's comments were new comments submitted during rebuttal rather than in response to any public comments related to the application. As a result, Kadlec's comments related to the Eide Bailly study are considered inappropriate for rebuttal comments and cannot be considered in this review. [source: Kadlec rebuttal comments received September 11, 2012]

The department recognizes that the Eide Bailly study was ultimately prepared under the assumption that KPHD would enter into a financial relationship with Northwest Institutional Partners. However, the historical information reviewed in the study does not assume any financial relationship with another entity. Rather, the historical data is used as a basis for projections. Even though the study relies on a different financing arrangement for the projections, the department considers the historical data in the study to be reliable for KPHD as a whole.

In the initial evaluation, the department's Hospital and Patient Data Systems (HPDS) reviewed 2007 historical balance sheet for KPHD as a whole. In this application, HPDS compared the 2007 balance sheets (actual) with 2011 balance sheets (actual). That comparison is shown below. [source: September 18, 2012, HPDS analysis, p2]

Table 3
Kennewick Public Hospital District
Initial Application Balance Sheet for Year 2007

Assets		Liabilities	
Current Assets	\$ 22,368,552	Current Liabilities	\$ 10,856,215
Fixed Assets	\$ 29,941,461	Long Term Debt	\$ 19,541,080
Board Designated Assets	\$ 11,075,718	Other Liabilities	\$ 0
Other Assets	\$ 7,206,240	Equity	\$ 40,194,676
Total Assets	\$ 70,591,971	Total Liabilities and Equity	\$ 70,591,971

Kennewick Public Hospital District
Amendment Application Balance Sheet for Year 2011

Assets		Liabilities	
Current Assets	\$ 34,163,783	Current Liabilities	\$ 18,139,847
Fixed Assets	\$ 39,772,562	Long Term Debt	\$ 17,241,771
Board Designated Assets	\$ 2,391,243	Other Liabilities	\$ 2,051,806
Other Assets	\$ 12,523,664	Equity	\$ 51,417,828
Total Assets	\$ 88,851,252	Total Liabilities and Equity	\$ 88,851,252

Within this amendment application, KPHD provides the following statements. [source: September 12, 2012, rebuttal documents, p5]

"The [financing] plan defers payments by [KPHD] during the construction period, permitting [KPHD] to conserve its resources and improve its balance sheet. This plan is financially sound and one that KPHD can afford. ...KPHD is currently generating enough cash at its current location to make the necessary lease payments at Southridge, even with no additional patient volumes."

After comparing the balance sheet above, the department concludes that KPHD's balance sheet has improved from actual year 2007 when the initial project was reviewed to actual year 2011 in this amendment review. As a result, the department concludes that KPHD as presented has the sources to meet its financial obligation during the construction of the Southridge campus.

Beginning in year 2014, KPHD's financial obligations change. Under the ground and facility lease agreements, KPHD is required to make payments to Kennewick WA 2012 LLC of approximately \$9,800,000 per year. Ten years after beginning construction of the Southridge campus—or approximately year 2021—KPHD is obligated to purchase the Southridge campus from Kennewick WA 2012 LLC for \$110,000,000. [source: Amendment Application, Attachment 3]

To demonstrate it could continue to meet its financial obligations after construction of the Southridge campus, KPHD provided its 2014 to 2016 projected inpatient days. The department compared these projected inpatient days with those provided in KPHD's initial application. The table below shows the comparison. [source: August 1, 2012, supplemental information, p2]

Table 4
Comparison of Projected Patient Days
Projected Years 2014 through 2016

Year	Initial Application In Patient Days*	Amendment Application In Patient Days*	Percentage Difference
2014	23,869	23,374	-2.1%
2015	24,895	24,917	+0.09%
2016	25,966	26,462	+1.9%

*Excludes normal newborn patient days

As shown in the table above, there is no material difference in the projected inpatient days in the amendment application when compared to the initial application. In its initial evaluation, the department concluded that KPHD's projected inpatient days were obtainable. [source: Initial evaluation, p5]

During the review of this project, Kadlec provided concerns related to the projected patient days identified in the amendment application and used by KPHD as a foundation for its revenue and expense projections. Kadlec's concerns are discussed below.

KPHD projects its patient days would grow by 7.4% per year from its historic growth rate. Unless KPHD can achieve a patient-day growth rate of at least 4.5% per year, the third year of operation (2016) will show operating losses and the project must be denied

[source: Kadlec Regional Medical Center public comments received August 27, 2012, pp11-19]

- Over the last 10 years, KPHD patient days have grown by only 1.5% per year.
- Over the last 4 years, there has been no growth in patient days.
- The projected growth of 7.4% is five times the actual growth rate over the last 10 years.
- KPHD's growth is also based on the Benton/Franklin planning area population growth and patient day growth. Population growth has occurred, however, 2002–2011 CHARS data does not support patient day growth in the planning area. Benton/Franklin planning area patient days grew 1.6% annually from 2002–2011.
- KPHD's market share has remained flat over the last 10 years, so there is no reason to assume that KPHD's patient day growth would be higher than the planning area growth.

KPHD provided the following information in response to Kadlec's concerns summarized above.
[source: KPHD rebuttal comments received September 12, 2012]

- Patient day volumes identified in the amendment application are reasonable and only one measure of hospital volume.
- KPHD's inpatient days have been largely flat over the past several years because KGH is operating at capacity. The semi-private and current fixed unit configurations impact KGH's ability to admit more patients.
- Because of physical plant limitations and crowding at the Auburn campus, when census exceeds 55-60, KGH is forced to redirect inpatients to other hospitals or to hold/board them in the emergency department. Southridge will have all private rooms and allow for 50% more effective capacity.
- KGH has experienced growth in outpatient volumes, which grew by 19% in 2011.
- Between 2005 and 2011, KPHD successfully recruited over 50 physicians, which increases the volumes at KGH. Overall growth in patient volumes was 9.1% in 2011.
- Outpatient volumes are approximately 60% of the total volume.
- Southridge campus will also have 13 ED beds, which increases the total ER beds for KGH to 27.
- Visits to Kennewick Physician Clinics have more than doubled in the past 6 years—from 95,779 in year 2005 to 197,399 in year 2011.
- The department does not focus solely on inpatient days to determine the feasibility of a project.

Department's Review

A review of historical data provided by CHARS substantiates Kadlec's assertions that there has been little to no patient day growth at KGH and KGH's market share has also remained static. Kadlec is also correct that, generally speaking, a project of this size would have to show break-even or operating profits in year three to meet this sub-criterion. Since patient days are the foundation of the financial statements, the patient day growth assumptions must be obtainable.

KPHD is also correct that the department does not focus solely on inpatient days to determine the feasibility of a hospital project. For this project, KPHD, as a whole, would carry the financial burden, and therefore, must be considered financially reliable. KPHD includes KGH, as well as three outpatient clinics. Therefore, inpatient and outpatient data should be considered in this evaluation.

The department already reviewed the inpatient projections for KGH that were provided in this amendment application and determined that they were not significantly different than the projections provided in the initial application. As a result, the inpatient projections are considered obtainable.

KPHD also provided its outpatient visit projections at KGH which show an increase in each of the first three years of operation. The outpatient visit projections are based on KGH's historical outpatient visit growth and are also considered reasonable.

Finally, Kadlec asserts that because KGH's market share has been flat, KPHD should not assume an increase in market share. However, KPHD provided a reasonable response to this assertion. First, KPHD asserts that once KGH is a two-campus hospital, its market share percentage is expected to

increase because it would have the space for more patients, both in- and out-patients. Additionally, in the majority of hospital applications reviewed by the CN Program, when a hospital proposes to expand its physical structure or add new bed capacity, the applicant assumes an increase in market share. This concept is based on several factors:

- 1) more physical space=more patients
- 2) new physical space=more patients
- 3) more beds = less crowding/waiting=more patients

Additionally, this assumption of an increase in market share has been used by other applicants in the past and is considered to be reasonable for some hospital projects.¹⁰ Specific to this project, this assumption is reasonable because KGH is physically limited and cannot increase its market share at the current site without significant physical changes to the hospital.

Using its projected in- and out-patient days and increased market share discussed above, KPHD provided its Revenue and Expense Statement for years 2014 through 2016 for the hospital district. [source: August 1, 2012, supplemental information, Appendix 5] A summary of the statement is shown in the table below.

Table 5
Kennewick Public Hospital District
Projected Years 2014 through 2016

	CY 2014 Full Year 1	CY 2015 Full Year 2	CY 2016 Full Year 3
Net Patient Revenue	\$ 142,374,073	\$ 158,868,906	\$ 173,102,812
Plus Gains from Joint Ventures	\$ 1,011,000	\$ 1,011,000	\$ 1,011,000
Plus Other Revenue	\$ 1,369,351	\$ 1,410,431	\$ 1,452,744
Total Operating Revenue	\$ 144,754,424	\$ 161,290,337	\$ 175,566,556
Minus Total Expenses	\$ 129,012,353	\$ 142,561,982	\$ 151,338,126
Net Profit /(Loss)	\$ 15,742,071	\$ 18,728,355	\$ 24,228,430

The 'Net Patient Revenue' line item is gross inpatient and outpatient revenue, minus deductions for contractual allowances, charity care, and bad debt. The 'Gains from Joint Ventures' line item is revenue from joint ventures, such as Tri-Cities Cancer Center, Tri-Cities Laboratory, and High Desert Surgery Center. The 'Other Revenue' line item is primarily revenue from dietary and cafeteria revenue, purchase rebates, and educational services income. The 'Total Expenses' line item includes salaries and wages, amortization, and depreciation. As shown above, KPHD projected net profits in the three years shown. Based on the assumptions used by KPHD and the patient projections discussed above, the department concludes that the projected Revenue and Expense Statement is reasonable. Additionally, the department concludes KPHD has the resources to meet its financial obligation after the construction of the Southridge campus provided that the in-and out-patient projections are realized.

¹⁰ Some applicants that have used this assumption are Franciscan Health System, MultiCare Health System, Swedish Health System, and Providence Health System. While some of the projects have been new hospital projects and some have been bed addition projects, others have not included any increase in bed capacity, but still assumed an increase in market share.

In the initial evaluation, HPDS reviewed KPHD's projected balance sheet for year 2014. In this application, HPDS compared the 2014 balance sheets (projected) with 2016 balance sheets (projected). That comparison is shown below. [source: September 18, 2012, HPDS analysis, p2]

**Table 6
Kennewick Public Hospital District
Initial Application Projected Balance Sheet for Year 2014**

Assets		Liabilities	
Current Assets	\$ 27,043,000	Current Liabilities	\$ 14,384,000
Fixed Assets	\$ 115,038,000	Long Term Debt	\$ 109,142,000
Board Designated Assets	\$ 43,277,000	Other Liabilities	\$ 0
Other Assets	\$ 21,100,000	Equity	\$ 82,932,000
Total Assets	\$ 206,458,000	Total Liabilities and Equity	\$ 206,458,000

Amendment Application Projected Balance Sheet for Year 2016

Assets		Liabilities	
Current Assets	\$ 70,555,402	Current Liabilities	\$ 23,444,173
Fixed Assets	\$ 135,228,597	Long Term Debt	\$ 122,582,742
Board Designated Assets	\$ 3,042,034	Other Liabilities	\$ 0
Other Assets	\$ 12,182,063	Equity	\$ 74,981,181
Total Assets	\$ 221,008,096	Total Liabilities and Equity	\$ 221,008,096

After comparing the balance sheets above, the department notes that board designated assets are projected to be significantly less in year 3 for the amendment application than was projected in year 3 in the initial application. This reduction in board designated assets is likely the result of the financing option chosen by KPHD in this amendment application.

HPDS also provided a financial ratio analysis. The analysis assesses the financial position of an applicant, both historically and prospectively. The financial ratios typically analyzed are: 1) long-term debt to equity; 2) current assets to current liabilities; 3) assets financed by liabilities; 4) total operating expense to total operating revenue; and 5) debt service coverage. If a project's ratios are within the expected value range, the project can be expected to be financially feasible. Additionally, HPDS reviews a project's projected statement of operations to evaluate the applicant's immediate ability to finance the service and long term ability to sustain the service.

For Certificate of Need applications, HPDS compares the projected ratios with the most recent year financial ratio guidelines for hospital operations. For this project, HPDS used 2010 data for comparison with historical year 2011 for KGH. Year 2010 data was also used as comparison for projected years 2014 through 2016 for KGH. The ratio comparisons are shown in the table below. [source: HPDS analysis, p3]

**Table 7
Current and Projected HPDS Debt Ratios for Kennewick General Hospital**

Category	Trend *	State 2010	KGH 2011	KGH 2014	KGH 2015	KGH 2016
Long Term Debt to Equity	B	0.554	0.335	1.861	1.822	1.635
Current Assets/Current Liabilities	A	2.283	1.883	2.508	2.620	3.010
Assets Funded by Liabilities	B	0.434	0.398	0.683	0.682	0.661
Operating Expense/Operating Revenue	B	0.947	0.982	0.891	0.884	0.862
Debt Service Coverage	A	5.876	2.830	1.980	2.023	2.362
Definitions:	Formula					
Long Term Debt to Equity	Long Term Debt/Equity					
Current Assets/Current Liabilities	Current Assets/Current Liabilities					
Assets Funded by Liabilities	Current Liabilities + Long term Debt/Assets					
Operating Expense/Operating Revenue	Operating expenses / operating revenue					
Debt Service Coverage	Net Profit+Depr and Interest Exp/Current Mat. LTD and Interest Exp					

* A is better if above the ratio; and B is better if below the ratio.

Comparing KGH's year 2011 ratios with the most current statewide ratios revealed that the Long Term Debt to Equity ratio is better than the average statewide ratio. However, the Current Assets/Current Liabilities, and Debt Service coverage ratios are significantly out of line with the statewide ratio. This could be due to KPHD's focus on reducing long term debt rather than short term debt.

After evaluating the hospital's projected ratios and statement of operations, staff from HPDS provided the following analysis. [source: HPDS analysis, pp2-3]

"Three of the ratios projected in 2016 are out of range. All three, Long Term Debt to Equity, Assets Funded by Liability, and Debt Service Coverage, are out of line because the lease payment does not decrease the principle of the debt during this time frame. The other ratios are appropriate for a project like this. [KGH] is projected to make a profit in year 3. [KGH's] financial health overall is average when compared to other hospital in Washington State."

During the review of this project, Kadlec provided its own financial ratio analysis of KGH and concluded that this amendment project fails four of the five ratios and, therefore should be denied. [source: Kadlec Regional Medical Center public comment, pp26-27]

In response, KPHD states that it is not unusual for HPDS to perform a financial ratio analysis on a large construction project for a hospital, and then conclude that *"the ratios are appropriate for a project like this."* Usually in these kinds of projects, the ratios will initially show a major shift, then show a steady improvement in years two and three after opening. [source: KPHD rebuttal documents, p18]

Department's Review

The financial ratio analysis is one piece of a financial review provided by HPDS. The ratio analysis takes into account a hospital's current financial status and its expected financial status three years after the project is completed. Specific to this project, HPDS concluded that KGH's current (2011) ratios

were acceptable. Some of KGH's projected ratios were outside the preferred range. The HPDS discussion of these ratios is noted in the previous section. They are still considered acceptable.

Finally, Kadlec has submitted CN applications where the HPDS ratios were considered to be outside the range, however, HPDS also considered the project to be financially acceptable. As a result, Kadlec is familiar with the ratio review and the considerations that HPDS includes in the review.¹¹

Additionally, throughout HPDS's financial review of this project, HPDS states that the financial health of KGH would not be negatively affected by this amendment project provided KPHD's patient day projections can be met. In the initial application, KPHD projected to increase the patient days at KGH by increasing its market share by approximately 3%. KPHD did not rely solely on population projections in the Benton/Franklin planning area for its increase, rather, KPHD expected to recapture patients that were traveling outside the planning area (outmigration) to achieve its market share growth. In the initial evaluation, the department concluded that KPHD's patient projections were obtainable. Since the projections have not materially changed from the initial application, the department concludes that the patient projections continue to be obtainable. This sub-criterion is met.

Based on the information above, the department concludes that the immediate and long-range operating costs of the project can be met. **This sub-criterion is met.**

(2) *The costs of the project, including any construction costs, will probably not result in an unreasonable impact on the costs and charges for health services.*

WAC 246-310 does not contain specific WAC 246-310-220(2) financial feasibility criteria as identified in WAC 246-310-200(2)(a)(i). There are also no known recognized standards as identified in WAC 246-310-200(2)(a)(ii) and (b) that directs what an unreasonable impact on costs and charges would be for a project of this type and size. Therefore, using its experience and expertise the department compared the proposed project's costs with those previously considered by the department.

Initial Evaluation Summary

In its February 4, 2009, initial evaluation supporting the issuance of CN #1418, the department concluded that this sub-criterion was met based on the following factors:

- 1) a review of KGH's projected revenues, expenses, and net profits for projected years 2012-2014;
- 2) a review of KGH's projected revenue, expenses, and net profits per patient day for projected years 2012-2014; and
- 3) a review of KGH's projected revenue, expenses, and net profits per adjusted patient day for years 2012-2014.

[source: Initial evaluation, pp8-9]

¹¹ CN application #09-28A submitted by Kadlec Regional Medical Center proposing remodel at the hospital and establishment of a level III neonatal intensive care unit. HPDS's review provided the following statement: "When a hospital is in a building phase and for a few years after, the ratios will be poorer, other thing(s) being equal, than a hospital that has not been through a building phase." Basically, while Kadlec Regional Medical Center's ratio were outside the range in the first few years following the extensive remodel at the hospital, HPDS concluded the ratios were reasonable.

Amendment Application Review

As stated in the project description section of this evaluation, KPHD submitted this application because of a change in approved financing. KPHD intends to maintain all services at KGH, however, the services would be offered at two separate campuses. As indicated in the pro forma projections and further demonstrated within the application, KPHD does not intend to increase charges for health services or change the payer mix. [source: Amendment application, p26]

This amendment application identifies a slight decrease in the estimated capital costs. In the initial approval, HPDS compared the costs per bed in the initial application to the cost per bed in this amendment application. The table below shows the comparison.

Table 8
Kennewick Public Hospital District
Initial and Amendment Applications Cost Per Bed Comparison

Initial Application		Amendment Application	
Total Capital Expenditure	\$112,378,100	Total Capital Expenditure	\$111,915,758
Number of Beds	74	Number of Beds	74
Capital Cost per Bed	\$1,518,622.97	Capital Cost per Bed	\$1,512,375.11

As shown above, there is not a significant difference in the capital costs. HPDS provided the following review.

"The costs shown are within past construction costs reviewed by this office. Also construction cost can vary quite a bit due to type of construction, quality of material, custom vs. standard design, building site and other factors."

No public comments were submitted for this sub-criterion. Based on the information provided above, the department concludes that the cost of the project will not result in an unreasonable impact on the costs and charges for health services within the service area. **This sub-criterion is met.**

(3) *The project can be appropriately financed.*

WAC 246-310 does not contain specific source of financing criteria as identified in WAC 246-310-200(2)(a)(i). There are also no known recognized standards as identified in WAC 246-310-200(2)(a)(ii) and (b) that directs how a project of this type and size should be financed. Therefore, using its experience and expertise the department compared the proposed project's source of financing to those previously considered by the department.

Initial Evaluation Summary

In its February 4, 2009, initial evaluation supporting the issuance of CN #1418, the department concluded that this sub-criterion was met based on the following factors:

- 1) a review of KGH's financing arrangements using a WHCFA bond backed by a HUD 242 program loan for 90% of the funding;
- 2) a review of KGH's December 31, 2007, audited financial report to confirm the funds were available for the remaining 10% of the funding;
- 3) a review of the draft Ground Lease Agreement between KPHD (lessor) and Mid-Columbia Regional Healthcare (lessee);
- 4) a review of the draft Facilities Lease Agreement between Mid-Columbia Regional Healthcare (landlord) and KPHD (tenant);

- 5) a review of the draft Regulatory Agreement used by HUD as a loan application to be completed before borrowing of funds is approved.
- 6) a review of the Approval Covenants for HUD Section 242 Mortgage Insurance agreement between Mid-Columbia Regional Healthcare (borrower) and HUD (lender);
- 7) a review of the draft Rider to Regulatory Agreement for HUD Section 242 Mortgage Insurance between Mid-Columbia Regional Healthcare (borrower) and HUD (lender);
- 8) three terms related to the HUD financing attached to CN #1418;
- 9) one term related to the draft Ground Lease Agreement attached to CN #1418;
- 10) one term related to the draft Facility lease agreement attached to CN #1418; and
- 11) one term related to the environmental requirements for the site. This term had to be met before CN #1418 could be issued.

[source: Initial evaluation, p3 and pp9-12]

Amendment Application Review

With this amendment application KPHD still intends to fund 10% of the costs with hospital reserves, but proposes to change the funding source for 90% of the cost. The estimated capital costs identified in this amendment application is \$111,915,758, which is less than a 1% decrease in the capital costs. Rather than obtain a HUD loan for 90% of the capital costs, KPHD proposes to enter into a ground lease for the land with a new LLC. The LLC would fund and construct the new hospital, and then lease the completed hospital back to KPHD under a facility lease. KPHD would be responsible for operations of the hospital and making the lease payments. [source: Amendment application, p8 & p17]

To demonstrate compliance with this sub-criterion, KPHD provided its actual year 2011 balance sheet. After reviewing the balance sheet, HPDS staff concluded that KPHD has the sources to meet its financial obligation during the construction of the Southridge campus.

KPHD states that it has already funded architect and engineering fees for the project, totaling approximately \$4.5 million. KGH will fund, from reserves, the remaining new equipment costs estimated at \$12 million. KPHD states that KGH currently generates approximately \$15.6 million in cash annually, which could be used to fund the capital expenditure. In addition to the \$10.8 million currently in reserves, KPHD estimates that KGH will generate at least an additional \$25 million before the new hospital opens, which could also be used to fund the equipment costs at the Southridge campus. [source: August 1, 2012, supplemental information, p4]

KPHD provided its projected revenue and expense statements and balance sheets to demonstrate that it would generate the cash to fund its portion of the capital costs.

For the remaining 90% of the capital costs, KPHD has already entered into a contract with Kennewick WA 2012 LLC for a ground lease and a facility lease. Below is a summary review of each lease agreement. [source: Application, Attachment 3]

Ground Lease Specifics:

- KPHD is the landlord.
- Kennewick WA 2012 LLC is the tenant.
- Commencement Date: April 20, 2012
- Initial Terms: 60 years
- Renewal Term Options: Two 10 year terms (total of 20 years)
- Rent: \$10/year plus interest (approximately 3%) paid by tenant to landlord.

Hospital Facility Lease Specifics:

- Kennewick WA 2012 LLC is the landlord.
- KPHD is the tenant.
- Commencement Date: April 20, 2012
- Initial Terms: 30 years from occupancy with an obligation to purchase after 10 years
- Rent: \$9,804,912/year base rent plus 2.5% rent increase each year paid by tenant to landlord. Rent obligation begins either 1) completion of the facility; or 2) two year after construction starts, whichever is earlier.
- Ten years after construction starts (approximately 2021) KPHD is obligated to purchase the facility and land leases for \$110,000,000.

During the review of this project, Kadlec provided extensive comments related to both leases and questioned whether KPHD has the authority to enter into the facility lease agreement under the public hospital district statute.¹² [source: Kadlec public comment received August 27, 2012]

Related to the legality of whether KPHD has the authority to enter into the lease agreement, the department defers to the hospital district's Board of Commissioners and counsel to research and comply with the hospital district statute as it applies to this lease. The Board of Commissioners had the fiduciary responsibility to ensure these lease agreements were legally appropriate before approval. This evaluation will not address any legal issues raised by Kadlec.

Kadlec's remaining comments focus on the facility lease's purchase terms and default remedies. Kadlec states that the facility lease is 'one-sided' because it benefits the landlord (LLC) rather than KPHD and the '*rent amount is out of scale, especially when combined with the purchase price.*' KPHD would pay nothing for approximately two years during the construction of the facility. At the end of the two years, KPHD begins paying rent, which continues for eight years, and totals approximately \$86 million. At the end of eight years, KPHD is obligated to purchase the facility for \$110 million. Since the LLC is expected to spend only \$100 million to construct and make the hospital operational, Kadlec speculates that the additional \$96 million that would be paid over the first 8 years is effectively a financing cost of 9.6% per year and is much too high for a public project.

Kadlec is also concerned about the potential consequences if KPHD should default on the facility lease agreement or if the LLC, for whatever reason, does not complete the construction of the hospital as required under the lease agreement. Kadlec asserts that KPHD could lose its hospital under default. Kadlec speculates that KPHD could be replaced by a new tenant if KPHD defaults and the LLC could enter into a new lease with an out-of-state, for-profit hospital company.

KPHD provided responses to Kadlec's concerns. While KPHD agrees that the financing arrangement with the LLC is creative, KPHD states that the financing, and specifically the facility lease agreement, is reasonable and practical, and in some ways preferable to the HUD financing arrangement approved in the initial application. This position by KPHD is based on the Eide Bailly financial study completed in October 2011 and the district's Board of Commissioners review and approval of the financing transactions.

¹² Revised Code of Washington 70.44.

KPHD states it intends to exercise its option to purchase the Southridge campus under the facility agreement in year 2021. At that time, KPHD expects that its balance sheet and cash reserves would be improved. KPHD would pay \$30 million with cash reserves and finance the remaining \$80 million [of the \$110 million owed] at an interest rate of 6.0% or less over ten years. KPHD provided its amortization schedule for this plan.

KPHD also states that the terms and total project costs are reasonable and consistent with or superior to other recent CN financings of new hospital construction. KPHD cites four such recent projects, excluding KGH, and then compares its own financing costs and arrangements with each of the four projects.¹³ Based on this comparison, KPHD concludes that even with the inclusion of the financing costs of the project, KPHD's project is less costly on a per-bed basis than three of the four projects.¹⁴ In conclusion, KPHD asserts that the financing is reasonable and it would not have an unreasonable impact on the charges at the hospital.

Department's Review

Excluding KGH, the department has reviewed two other projects that include this type of a lease / leaseback arrangement.¹⁵ Both projects were reviewed and approved based on the applicant's assertions and documentation demonstrating that the financing is reasonable. This amendment application is similar to those applications in some respects. The differences in this application lie within the facility lease agreement. One difference is that the LLC assumes all financial responsibility for the construction of the facility and requires no rent payments until the construction is complete. This portion of the lease appears to be beneficial to KPHD to allow it to improve its financial status before obligating to the lease payments at the end of construction. The requirement by KPHD to purchase the facility at 110% of the construction costs is unusual, and appears to be more beneficial to the LLC. This is the portion of the lease agreement that seems to cause Kadlec's concern.

Kadlec's concerns are reasonable, if KPHD defaults on the facility lease agreement. However, KPHD asserts that the lease payments can be met with its projected net revenues. The net revenues are directly tied to KPHD obtaining its projected patient days. Within the initial evaluation, the department concluded that the projected patient days, while ambitious, are obtainable. In this amendment application, the department concluded that the projected patient days are not substantially different than those identified in the initial application. As a result, the department also concludes that the projected patient days in this amendment application are also ambitious, but obtainable. Provided that KPHD can achieve the projected patient days and associated net revenue, the financing for this project can be considered appropriate. **This sub-criterion is met.**

¹³ The recent projects include Swedish Health Services-Issaquah campus, PeaceIsland Medical Center, MultiCare Health System-Covington Hospital, and Snoqualmie Valley Hospital.

¹⁴ PeaceIsland Medical Center, MultiCare Health System-Covington Hospital, and Snoqualmie Valley Hospital.

¹⁵ Coulee Community Hospital and Snoqualmie Valley Hospital.

C. Structure and Process (Quality) of Care (WAC 246-310-230)

Based on the source information reviewed and the applicant's agreement to the conditions identified in the "Conclusion" section of this evaluation, the department determines that Kennewick Public Hospital District has met the structure and process of care criteria in WAC 246-310-230(3), (4), and (5).

- (3) *There is reasonable assurance that the project will be in conformance with applicable state licensing requirements and, if the applicant is or plans to be certified under the Medicaid or Medicare program, with the applicable conditions of participation related to those programs.*

WAC 246-310 does not contain specific WAC 246-310-230(3) criteria as identified in WAC 246-310-200(2)(a)(i). There are known recognized standards as identified in WAC 246-310-200(2)(a)(ii) and (b) that a facility must meet when it is to be Medicare certified and Medicaid eligible. Therefore, using its experience and expertise the department assessed the applicant's history in meeting these standards at other facilities owned or operated by the applicant.

Initial Evaluation Summary

In its February 4, 2009, initial evaluation supporting the issuance of CN #1418, the department concluded that this sub-criterion was met based on the following factors:

- 1) a review of KGH's quality of care history since November 2008;
- 2) the results of KGH's Joint Commission survey completed on August 11, 2008; and
- 3) a review of KGH's home health agency's quality of care history since November 2008.

[source: Initial evaluation, p13]

Amendment Application Review

KPHD owns and operates a hospital, hospice agency, and ASC in Washington State and does not own or operate any out-of-state facilities. The Department of Health's Investigations and Inspections Office (IIO) conducts quality of care and compliance surveys for the types of healthcare facilities operated by KPHD. Records indicate that since 2009, IIO completed a total of four compliance surveys for KGH and its hospice agency.¹⁶ None of the compliance surveys revealed significant deficiencies for the facility. Additionally, KGH is currently accredited by the Joint Commission. [source: facility survey data provided by the Investigations and Inspections Office and Joint Commission website]

KPHD's ASC, known as High Desert Surgery Center, is located in a medical office building off-site from the Auburn campus. Since 2009, IIO has not surveyed the ASC, however, the ASC holds a current accreditation from the Accreditation Association for Ambulatory Health Care.¹⁷ High Desert Surgery Center received its accreditation on September 8, 2008, and the accreditation is valid until March 8, 2015. [source: September 11, 2012, e-mail from Robin Yu of AAAHC]

¹⁶ KGH hospital survey = Joint commission KGH survey 2008 and 2011; state survey = 2010. KGH hospice agency survey = 2012.

¹⁷ The Accreditation Association for Ambulatory Health Care is a private, non-profit organization formed in 1979. They develop standards to advance and promote patient safety, quality care, and value for ambulatory health care through peer-based accreditation processes, education, and research. A certificate of accreditation is awarded to organizations that are found to be in compliance with AAAHC Standards. AAAHC currently accredits more than 5,000 organizations in a wide variety of ambulatory health care settings including ambulatory surgery centers, community health centers, medical and dental group practices, medical home practices, and managed care organizations, as well as Indian and student health centers, among others.

No public comments were submitted for this sub-criterion.

Based on the compliance history of KPHD owned and/or operated healthcare facilities, there is reasonable assurance that KGH would continue to operate in conformance with applicable state and federal licensing and certification requirements. **This sub-criterion is met.**

(4) The proposed project will promote continuity in the provision of health care, not result in an unwarranted fragmentation of services, and have an appropriate relationship to the service area's existing health care system.

WAC 246-310 does not contain specific WAC 246-310-230(4) criteria as identified in WAC 246-310-200(2)(a)(i). There are also no known recognized standards as identified in WAC 246-310-200(2)(a)(ii) and (b) that directs how to measure unwarranted fragmentation of services or what types of relationships with a services area's existing health care system should be for a project of this type and size. Therefore, using its experience and expertise the department assessed the materials in the application.

Initial Evaluation Summary

In its February 4, 2009, initial evaluation supporting the issuance of CN #1418, the department concluded that this sub-criterion was met based on the following factors:

- 1) a review of the documents provided in the application to improve overall operation of the hospital, increase the size of ancillary and support services, and accommodate new technology; and
- 2) a review of the documents provided in the application demonstrating coordination with community healthcare providers, including physician offices/clinics.

[source: Initial evaluation, pp13-14]

Amendment Application Review

Currently, KPHD operates four separate health care entities at four separate sites. KGH operates at only one site—the Auburn Campus. The initial evaluation approved the relocation of 74 acute care beds from the Auburn Campus to the new Southridge Campus, thus operating KGH at two separate campuses. For this sub-criterion, KPHD states there are no changes related to ancillary and support services and coordination resulting from this amendment application. [source: Amendment application, pp34-35]

No public comments were submitted for this sub-criterion.

After reviewing the amendment application, the department concludes that approval of this project is not expected to change the relationships in place with the health care providers in the area since it does not involve a reduction in services for the planning area. Based on the information provided in the application, the department concludes that approval of this project will not result in an unwarranted fragmentation of services. **This sub-criterion is met.**

- (5) There is reasonable assurance that the services to be provided through the proposed project will be provided in a manner that ensures safe and adequate care to the public to be served and in accord with applicable federal and state laws, rules, and regulations.

Initial Evaluation Summary

In its February 4, 2009, initial evaluation supporting the issuance of CN #1418, the department concluded that this sub-criterion was met based on the sub-criterion that was addressed in sub-section (3) above. [source: Initial evaluation, p14]

Amendment Application Review

This sub-criterion is addressed in subsection (3) above and is met.

D. Cost Containment (WAC 246-310-240)

Based on the source information reviewed and the applicant's agreement to the conditions identified in the "Conclusion" section of this evaluation, the department determines that Kennewick Public Hospital District has met the cost containment criteria in WAC 246-310-240.

- (1) Superior alternatives, in terms of cost, efficiency, or effectiveness, are not available or practicable.

To determine if a proposed project is the best alternative, the department takes a multi-step approach. Step one determines if the application has met the other criteria of WAC 246-310-210 thru 230. If it has failed to meet one or more of these criteria then the project is determined not to be the best alternative, and would fail this sub-criterion.

If the project met WAC 246-310-210 through 230 criteria, the department would move to step two in the process and assess the other options the applicant or applicants considered prior to submitting the application under review. If the department determines the proposed project is better or equal to other options the applicant considered before submitting their application, the determination is either made that this criterion is met (regular or expedited reviews), or in the case of projects under concurrent review, move on to step three.

Step three of this assessment is to apply any service or facility specific criteria (tie-breaker) contained in WAC 246-310. The tiebreaker criteria are objective measures used to compare competing projects and make the determination between two or more approvable projects which is the best alternative. If WAC 246-310 does not contain any service or facility criteria as directed by WAC 246-310-200(2)(a)(i), then the department would look to WAC 246-310-240(2)(a)(ii) and (b) for criteria to make the assessment of the competing proposals. If there are no known recognized standards as identified in WAC 246-310-200(2)(a)(ii) and (b), then using its experience and expertise, the department would assess the competing projects and determine which project should be approved.

Step One

Initial Evaluation Summary

In its February 4, 2009, initial evaluation supporting the issuance of CN #1418, the department concluded that this sub-criterion was met based on the applicant's ability to meet the review criteria in WAC 246-310-210, WAC 246-310-220; and WAC 246-310-230. [source: Initial evaluation, p14]

Amendment Application Review

In this amendment evaluation review, the department concluded that KPHD met the review criteria in the applicable sections of WAC 246-310-210, WAC 246-310-220; and WAC 246-310-230. Therefore, the department moves to step two below.

Step Two

Initial Evaluation Summary

In its February 4, 2009, initial evaluation supporting the issuance of CN #1418, the department concluded that this sub-criterion was met based on the a review of the two options considered and rejected before submitting the application. [source: Initial evaluation, p14]

Amendment Application Review

Within this amendment application, KPHD states it did not consider any other alternatives other than filing this amendment application. Once KPHD recognized that the HUD financing described in the initial application was not going to be available, other funding options were considered. KPHD states that relinquishing CN #1418 was not considered and option because construction of a new facility at a site other than the existing site is necessary for KGH to remain a viable hospital in the planning area. The existing site is landlocked and remodel or expansion at that site is not an available option.

Once KPHD finalized the financing options within this application, KPHD met with department staff to confirm that an amendment application was required.

Department's Review of Alternatives

Based on the discussion above, other than the option of relinquishing CN #1418, KPHD had no other option than to submit this amendment application. If other financing options were considered by the district commissioners, they were not identified or discussed in this amendment application.

KPHD asserts there is a need for this facility and that this financing option is the best option for the hospital. KPHD does not intend to reduce the services provided at the hospital and no changes in the type or scope of services to be provided at KGH are anticipated. KPHD intends to maintain its charity care percentages at KGH and has submitted documentation to support this intention.

Step Three

This step is used to determine between two or more approvable projects which is the best alternative. This step did not apply to the initial project and does not apply to this amendment project.

No public comments were submitted for this sub-criterion.

Based on the requirement of KPHD to submit an amendment application because of a change in the approved financing and the hospital commissioners' requirement to comply with the public hospital district rules and regulations, the department concludes that that the financing arrangements appropriate. **This sub-criterion is met.**