

**EVALUATION OF THE CERTIFICATE OF NEED APPLICATION SUBMITTED BY
FRANCISCAN HEALTH SYSTEM'S ST. ANTHONY HOSPITAL PROPOSING TO AMEND
CERTIFICATE OF NEED #1332 BECAUSE OF AN INCREASE IN APPROVED COSTS**

PROJECT DESCRIPTION

Catholic Health Initiatives is the parent corporation of Franciscan Health System (FHS). Through one of its subsidiaries, Catholic Health Initiatives that owns 118 health care facilities in 22 states. For Washington State, FHS is the subsidiary that owns or operates eleven health care facilities—four hospitals, three dialysis centers, a skilled nursing facility, an ambulatory surgery center, a Medicare certified hospice agency, and a hospice care center. The health care facilities are listed below. [source: CN historical files and Application, Appendix 1]

HOSPITALS

Enumclaw Regional Hospital, Enumclaw
St. Joseph Medical Center, Tacoma
St. Clare Hospital, Lakewood
St. Frances Hospital, Federal Way

HOSPICE AGENCY

Franciscan Hospice, Tacoma

HOSPICE CARE CENTER

FHS Hospice Care Center

SKILLED NURSING FACILITY

Franciscan Care Center, Tacoma

DIALYSIS CENTERS

Greater Puyallup Dialysis Center, Puyallup
St. Joseph Dialysis Facility, Tacoma
Gig Harbor Dialysis Center, Gig Harbor

AMBULATORY SURGERY CENTER

Gig Harbor Ambulatory Surgery Center

On May 26, 2004, the department completed review and approval of an application submitted by FHS proposing to establish a new, 80-bed hospital in Gig Harbor. Because the hospital would be located on a parcel of land that required either an environmental determination of non-significance or a final environmental impact statement, the department issued an "Intent to Issue a Certificate of Need" to FHS for the establishment of the hospital. On June 15, 2006, Certificate of Need (CN) #1332 was issued to FHS for the project. At that time, FHS notified the department that the new hospital would be named St. Anthony Hospital. The address of St. Anthony Hospital is 11567 Canterwood Boulevard Northwest in Gig Harbor. The capital expenditure associated with the project authorized under CN #1332 is \$94,563,078. [source: CN historical files]

Between the time of the initial approval (May 2004) and the date CN #1332 was issued (June 2006), FHS underwent an extensive land use approval process required by the City of Gig Harbor. Ultimately, the City of Gig Harbor required FHS to contribute several million dollars of unanticipated expense to cover the cost of road improvement for traffic mitigation. With these additional expenses, the project's costs increased to \$161,726,222, or an additional 71% from the approved capital costs. Under CN Program rules, if the capital costs of a project increase the greater amount of \$50,000 or 12% above the approved costs, an amended CN is required. As a result, FHS submitted this amendment application as required.

Although the costs of the project have increased beyond the allowable amount, the scope of the project and the location of the hospital have not changed. FHS continues to proceed with the project as approved. The hospital is scheduled to begin operations in early 2009.

APPLICABILITY OF CERTIFICATE OF NEED LAW

This project is subject to review under WAC 246-310-570(1)(e) because the costs of the project have increased beyond the amount allowable in WAC 246-310-570.

APPLICATION CHRONOLOGY

March 10, 2008	Letter of Intent submitted
June 4, 2008	Application submitted
June 5, 2008 through August 4, 2008	Department's Pre-Review Activities <ul style="list-style-type: none">• 1st screening activities and responses• 2nd screening activities and responses
August 5, 2008	Department Begins Review of the Amendment Application <ul style="list-style-type: none">• public comments accepted throughout review Reviewed under expedited review timeline; no public hearing conducted
August 25, 2008	End of Public Comment ¹
September 10, 2008	Pivotal Unresolved Issue (PUI) Declared
September 17, 2008	Applicant's Response to PUI ²
October 29, 2008	Department's Anticipated Decision Date
October 24, 2008	Department's Actual Decision Date

AFFECTED PERSONS

Two entities sought and received interested person status under WAC 246-310-010—MultiCare Health System and Swedish medical Center. Neither entity provided comments during this amendment review. No entities sought or received affected person status under WAC 246-310-010.

SOURCE INFORMATION REVIEWED

- Franciscan Health System's Certificate of Need Application submitted March 10, 2008
- Franciscan Health System's supplemental information received July 29, 2008
- Franciscan Health System's supplemental information received August 15, 2008
- Franciscan Health System's PUI documents received September 17, 2008
- Licensing and/or survey data provided by the Department of Health's Office of Health Care Survey
- Historical charity care data for years 2004, 2005, and 2006 provided by the Department of Health's Hospital and Patient Data Systems
- Progress Reports completed and submitted by Franciscan Health System related to CN #1332

CRITERIA EVALUATION

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. All terms and

¹ During the course of the amendment application review, no public comments were submitted.

² WAC 246-310-090 allows any affected person to comment on documents received by the applicant under PUI. Given that there were no affected persons for this project, no comments were received on the documents.

conditions of the initial approval that are not requested to be explicitly modified as part of the applicant's request for an amendment will remain in effect. Based on information presented in this amendment, this application is solely for the increase in capital expenditure. To obtain CN approval for this project, Franciscan Health System must demonstrate compliance with the relevant criteria found in WAC 246-310-220 (financial feasibility) and WAC 246-310-240 (cost containment).

CONCLUSION

For the reasons stated in this evaluation, the Franciscan Health System proposal requesting to increase the approved capital costs from \$94,563,078 to \$161,726,222 related to Certificate of Need #1332 is consistent with applicable criteria of the Certificate of Need Program. Provided Franciscan Health System agrees to the condition identified below, an amended Certificate of Need should be issued.

In the initial application, FHS provided documentation to demonstrate that St. Anthony Hospital and St. Joseph Medical Center would share a Medicare provider number and hospital license. On October 15, 2004, FHS submitted its 2nd quarterly progress report for St. Anthony Hospital. Within that report, FHS provided the following information.

“After reevaluating Medicare provisions, in light of passing of the Medicare Prescription Drug Bill, Franciscan Health System has elected that St. Anthony Hospital [will] operate with it owns Medicare provider number and independent hospital license rather than use St. Joseph Medical Center’s Medicare provider number and license. This action will not change any of the conditions in the intent to issue or Certificate of Need, nor any of the assumptions in the original Certificate of Need [application].”

The condition attached to CN #1332 related to the percentage of charity care provided at St. Anthony Hospital also referenced the percentage of charity care to be provided at St. Joseph Medical Center. In light of the change described above, approval of this project is contingent on Franciscan Health System's agreement to the following revised condition.

Condition:

St. Anthony Hospital must provide charity care in compliance with the charity care policies provided in its Certificate of Need application and the requirements of the applicable law. Franciscan Health System will use reasonable efforts to provide charity care at St. Anthony Hospital in an amount comparable to the average amount of charity care provided by all hospitals in the Puget Sound Region during the three most recent years. For historical years 2004-2006, these amounts are 1.89% of gross revenue, and 4.07% of adjusted revenue. Franciscan Health System will maintain records at St. Anthony Hospital documenting the amount of charity care it provides and demonstrating compliance with its charity care policies and applicable law.

The approved capital expenditure associated with the amendment project is \$161,726,222.

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

Based on the source information reviewed, the department determines that the applicant 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.

Initial Review

In its May 14, 2004, evaluation supporting the issuance of CN #1332, the department concluded that this sub-criterion was met based on the following factors:

- 1) a review of FHS and CHI's historical audited financial reports; and
- 2) a review of the FHS's projected patient utilization as an 80-bed hospital. This review included proposed revenues, expenses, and net profit for St. Anthony Hospital in years 2008 through 2010.

[source: CN historical files: Initial evaluation, pp19-23]

Amendment Review

Within the amended application, FHS provided documentation to demonstrate that its capital cost increase would not affect its projected patient census relied upon for the initial approval.

For charity care reporting purposes, the Department of Health's Hospital and Patient Data Systems (HPDS), divides Washington State into five regions: King County, Puget Sound (less King County), Southwest, Central, and Eastern. Located in Pierce County, St. Anthony would be one of one of 18 hospitals in the Puget Sound Region. According to 2004-2006³ charity care data obtained from HPDS, the three-year average for the Puget Sound Region is 1.89% for gross revenue and 4.07% for adjusted revenue. [source: HPDS 2004-2006 charity care summaries] Additionally, two of the four hospitals operated by FHS are located in the Puget Sound Region--St. Joseph Medical Center in Tacoma, and St. Clare Hospital in Lakewood.⁴ According to the 2004-2006 charity care data for these three hospitals, one FHS hospital--St. Joseph Medical Center--has historically provided charity care less than the Puget Sound Regional average, while the other has consistently provided charity care greater than the regional average.

In the initial evaluation, the department concluded that a condition related to the charity care is necessary to ensure that St. Anthony Hospital would provide the amount of charity care consistent with the average for the hospitals in the region. Within the amended application, there was no additional information provided that would change this conclusion. As a result, provided that FHS agrees to the updated charity care condition stated on page 3 of this evaluation, the department concludes this sub-criterion is met.

³ Year 2007 charity care data is not available as of the writing of this evaluation.

⁴ Both St. Francis Community Hospital and Enumclaw Regional Hospital are located in the King County Region.

(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.

Initial Review

To evaluate this sub-criterion in the initial application, the department concluded this sub-criterion was met based on the following factors:

- 1) the total construction costs per square foot; and
 - 2) the department’s Hospital and Patient Data Systems staff analysis concluded that the costs for the project were comparable to past construction costs reviewed by that office.
- [source: CN historical files: Initial evaluation, p23]

Amendment Review

To demonstrate that its capital cost increase would not result in an unreasonable impact on the costs and charges for health services, FHS provided a breakdown of its revised construction costs and total construction costs per gross square foot. Table 1 below shows a comparison of the initial and revised construction cost breakdown. [source: Application, p31]

**Table 1
St. Anthony Hospital Initial and Amended Capital Cost Breakdown**

	INITIAL COSTS	AMENDED COSTS	% OF INC or (DEC)
Total Capital Costs	\$94,563,078	\$161,726,222	71%
Construction Cost	\$ 82,305,503	\$ 93,080,092	13%
Gross Square Footage	197,038	209,044	6%
# of Approved Beds	80	80	no change
Construction. per Gross Square Foot	\$475	\$445	(6%)
Total Cost per Bed	\$ 1,182,038	\$ 2,021,578	71%

As shown in Table 1 above, while the total costs for the project have increased 71% from the initial costs, construction costs did not increase proportionately. This comparison in Table 1 confirms the applicant’s assertions that the increase in costs is primarily due to the unanticipated costs of road improvement for traffic mitigation in Gig Harbor. The additional costs increase the total costs of the project—ultimately resulting in submission of this amendment application—but they do not substantially affect the building construction costs for this project. The additional road improvement work mandated by the city of Gig Harbor that caused this project’s costs to increase beyond allowable amounts is unexpected and unavoidable by FHS. Under these circumstances, the department concedes that the additional costs incurred by FHS for this project would not result in an unreasonable impact on the costs and charges for health services. This sub-criterion remains met.

(3) The project can be appropriately financed.

Initial Review

The approved capital expenditure associated with CN #1332 was \$94,563,078. The majority of the costs were associated with land purchase, site preparation, construction costs, and fixed/moveable equipment. In the initial application, FHS proposed to fund the project through a combination of FHS accumulated reserves (20%) and an internal loan through its parent corporation—Catholic Health Initiatives (80%). In the initial evaluation, the department concluded that the funding

sources were reasonable based on historical financial statements from both FHS and its parent corporation. [source: Initial evaluation, pp20-22]

Amendment Review

For this amendment application, FHS acknowledges that the capital costs of the project increased from the initial approval in May 2004, however, in that same timeframe, FHS’s own financial strength has improved. While the funding sources for this amendment project is still a combination of FHS accumulated reserves and an internal loan through Catholic Health Initiatives, the percentages of each funding source has changed. Table 2 below is a comparison of the initial and the amended funding sources.

**Table 2
St. Anthony Hospital Initial and Amended Funding Source Breakdown**

	INITIAL SOURCES	%		AMENDED SOURCES	%
FHS-Reserves	\$18,912,616	20%		\$115,577,356	71%
Catholic Health Initiatives Loan	\$ 75,650,452	80%		\$ 46,148,866	29%
Total Capital Costs	\$94,563,078	100%		\$161,726,222	100%

In the initial project, Catholic Health Initiatives would fund the majority of the project through an internal loan. In the amendment application, FHS intends to fund the majority of the project through its accumulated reserves.

During the course of reviewing the financial documents provided by FHS and summarized above, the department identified a need for further documentation related to this sub-criterion. On September 10, 2008, the department declared a pivotal unresolved issue (PUI) [WAC 246-310-160(2)(b)]. Under the PUI, the department requested clarification related to the estimated capital expenditure identified in the amended application. Consistent with the timeline identified in the PUI notice, FHS provided the required documentation. [source: department’s September 4, 2008, PUI notification and FHS’s September 17, 2008, PUI responses]

Specifically, FHS asserted in its application that \$7.8 million in capitalized interest should not be included in the estimated capital expenditure for the amendment project for two reasons.

- 1) The \$5.2 million in capitalize interest was not included in the capital expenditure during the initial review, therefore, for consistency, the \$7.8 million should also be omitted.
- 2) The \$7.8 million in capitalized interested is included in the balance sheets provided in the amendment application.

Capitalized interest is defined as *“the interest added to the cost of a self-constructed, long term asset. It involves the interest on debt used to finance the asset’s construction. The interest specified by the pronouncement is added to the cost of the project, instead of being expensed on the current period’s income statement. This capital interest will be part of the asset’s cost reported on the balance sheet, and will be part of the asset’s depreciation expense that will be reported in future income statements.”* [emphasis added] [source: Accountingcoach.com]

Based on the definition above, it is appropriate to include the capitalized interest within the balance sheet, however, inclusion on the balance sheet does not preclude inclusion of the capitalized interest in the estimated capital costs.

For the initial application, it was clear that FHS identified the \$5.2 million in capitalized interest within its breakdown of capital costs. The department simply erred by not including it in the initial estimated capital expenditure for the project. This error must be corrected in the amendment application.

As a result, the initial approved capital expenditure of \$94,563,078 for this project should have been \$99,850,198.⁵ This amendment project allows correction of the estimated capital expenditure for CN #1332.

To determine compliance with this sub-criterion, the department reviewed June 2006 and 2007 historical financial statements for both FHS and Catholic Health Initiatives. [source: Department of Health's Hospital and Patient Data Systems (HPDS) review and Amendment application, Appendix 2]

FHS operates 11 healthcare facilities in Washington, and of those, four are hospitals. HPDS collects data on hospitals only. As a result, the financial health review based on data obtained from HPDS is limited to FHS's hospitals. FHS's portion of the total capital expenditure is \$115,577,356, or 71% of the total cost of the project. This amount equates to 22.31% of FHS's 2007 total hospital assets and 42.23% of FHS 2007 hospital board designated assets.⁶

FHS has undergone tremendous growth in the last couple of years, in fact, in March 2007, FHS became affiliated with Enumclaw Regional Hospital located in Enumclaw. Now that the affiliation is completed, FHS intends to replace the hospital at a site adjacent to the current site. As of the writing of this evaluation, FHS has contributed to the costs associated with the replacement facility. Additionally, FHS continues to fund moderate construction and remodeling project at its other hospitals. All of the projects have had some impact on the general financial health of FHS. Further review shows that while this project will also have a considerable impact to FHS, it will not adversely impact the reserves, total assets, total liability, or the general financial health of FHS in a significant way.

Catholic Health Initiatives' capital expenditure is projected to be \$46,148,866 or 29% of the total cost of the project. This amount equates to .48% of Catholic Health Initiatives' 2007 total assets and 2.81% of its 2007 board designated assets. This project will not have a significant impact to Catholic Health Initiatives' board designated assets, reserves, total assets, total liability or general financial health in a significant way. Further, if necessary, Catholic Health Initiatives has adequate reserves to fund the entire project directly.

Based on the information summarized above, the department concludes that the proposed financing continues to be appropriate, and this sub-criterion is met.

⁵ With capitalized interest appropriately included in the initial and amendment projects, the estimated capital cost increase is 62%, rather than the 71% identified in the project description portion of this evaluation.

⁶ 2007 data does not include Enumclaw Hospital.

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

Based on the source information reviewed, the department determines that the applicant 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.

Initial Review

In its May 14, 2004, initial evaluation, the department concluded that the project was the best option for the community, resulting in the approval of an 80-bed hospital in Gig Harbor. [source: Initial evaluation, pp25-27]

Amendment Review

Before submitting this application, FHS monitored its construction costs to determine whether the increase in specific areas of construction would be off-set by decreases in other areas of the project. The requirement by the city of Gig Harbor for FHS to contribute a substantial amount to cover the costs of road improvements, any decrease in other areas could not off-set the increase costs. FHS has moved forward with the project based on community support and financial commitments. The project is nearing completion. As a result, this amendment application was submitted. CN Program rules require an amended CN be issued prior to project completion.⁷ FHS submitted this application with enough time to allow an amended CN to be issued before the project is complete.

The department acknowledges that FHS is working toward implementation of the project approved under CN #1332. Data obtained from the Department of Health's Construction Review Services demonstrates FHS's assertion that it received approval to construct the 80-bed hospital in March 2007. FHS's progress towards completion is also evidenced by the updated information provided in the quarterly progress reports submitted by FHS. [source: Quarterly Progress Reports and CRS #8957]

Based on the information provided in the amendment application related to the rationale for the increased costs, the department concludes that the submission of amendment application is both prudent and appropriate. Further, the amendment application was submitted under the appropriate timeline to allow a decision on the application without jeopardizing licensure of the 80-bed hospital. This sub-criterion is met.

(2) In the case of a project involving construction:

(a) The costs, scope, and methods of construction and energy conservation are reasonable; and

Initial Review

In the initial evaluation for this project, the department concluded that the construction costs are reasonable when compared to construction costs of other full service hospital applications. [source: Initial application, p27]

⁷ WAC 246-310-570(2).

Amendment Review

Within the amended application, there was no additional information provided that would change this conclusion. Therefore, the department concludes that this criterion remains met.

- (b) *The project will not have an unreasonable impact on the costs and charges to the public of providing health services by other persons.*

This sub-criterion is re-evaluated within the financial feasibility criterion under WAC 246-310-220(2) and is considered met.