

EVALUATION OF THE CERTIFICATE OF NEED APPLICATION SUBMITTED BY THC-SEATTLE, INC. PROPOSING TO AMEND CERTIFICATE OF NEED #1328

LONG TERM ACUTE CARE HOSPITALS

Long-term acute care hospitals (LTACHs) differ from general acute care hospitals in that they furnish extended medical and rehabilitative care to individuals who are clinically complex and have multiple acute or chronic conditions. An LTACH must be certified as an acute care hospital that meets criteria to participate in the Medicare program and has an average inpatient length of stay greater than 25 days. [source: American Hospital Association Long Term Care Hospital home page]

LTACHs also differ from nursing homes and rehabilitation hospitals in that their patients generally require a higher level of medical attention. The LTACH is designed to provide extended medical and rehabilitative care for patients who are clinically complex and have multiple acute or chronic conditions. Most patients in LTACHs have several diagnosis codes on their Medicare claim, which indicates that they have multiple co-morbidities and are less stable on admission than patients admitted to other post-acute care settings. Approximately one half of the patients in an LTACH have five or more diagnoses noted on their claims. [source: Prospective Payment Assessment Commission, 1996]

Under the current Medicare payment system, LTACH reimbursement is structured to compensate hospitals for the care of patients whose average length of stay exceeds 25 days. The reimbursement model for general acute care hospitals is not designed to compensate hospitals for this population. As a result, the LTACH is a model of care that provides an environment tailored to medically complex patients and is able to serve those patients under a reimbursement model that adequately covers the costs of treatment. LTACHs in a community enable existing hospitals to improve facility utilization by discharging patients to the LTACH who would otherwise be occupying intensive care, critical care, or other acute care beds for long periods of time and place them in a suitable clinical setting. As a result, the existing hospitals are able to free space to more effectively manage their daily caseload, particularly in intensive care unit (ICU) and critical care unit (CCU) settings, which are often subjected to highly fluctuating occupancy rates. Referral of suitable patients to an LTACH improves hospitals' ability to ensure that ICU and CCU beds are available. [source: American Hospital Association Long Term Care Hospital home page]

BACKGROUND INFORMATION

Kindred Healthcare, Inc. is the parent corporation of THC Seattle, Inc. THC-Seattle, Inc. is a Washington State, for-profit corporation whose primary business is to own, operate, or manage healthcare facilities throughout the United States. The majority of THC-Seattle's healthcare facilities, including those in Washington State, operate under the dba of "Kindred Healthcare, Inc." [source: Application, pp1-6; September 2, 2008, supplemental information, Appendix 1] For Certificate of Need purposes, the department considers THC-Seattle to be the applicant as defined under WAC 246-310-010.

For Washington State, THC-Seattle operates 9 healthcare facilities under the dba of Kindred Healthcare, Inc. The 9 facilities include one hospital located in King County, and 8 nursing homes located in the counties of Clark (1), Cowlitz (1), King (3), Pierce (2), and Whatcom (1). The 9 facilities are listed on the following page. [source: September 2, 2008, supplemental information, Appendix 1 and DSHS on-line nursing home directory]

King County Hospital
Kindred Hospital/Seattle

Clark County Nursing Homes
Vancouver Health and Rehabilitation Center/Vancouver

Cowlitz County Nursing Home
Northwest Continuum Care Center/Longview

Whatcom County Nursing Home
Bellingham Healthcare & Rehabilitation/Bellingham

Pierce County Nursing Homes
Lakewood Healthcare Center/Lakewood
Rainier Vista/Puyallup

King County Nursing Homes
Arden Rehabilitation & Healthcare/Seattle
First Hill Care Center, Seattle
Queen Anne Healthcare/Seattle

This project relates to two healthcare facilities located in King County--Kindred Hospital and First Hill Care Center nursing home, both located in the city of Seattle. Kindred Hospital is an 80-bed LTACH located at 10560 Fifth Avenue Northeast in the city of Seattle. Kindred Hospital is licensed by the Department of Health's Office of Health Care Survey as an acute care hospital and reimbursed by both Medicare and Medicaid. The hospital is also fully accredited by the Joint Commission on the Accreditation of Health Care Organizations. [source: Initial evaluation, p6]

During the review of the initial THC-Seattle, project, First Hill Care Center was a 172-bed nursing home located at 1334 Terry Avenue in the city of Seattle. It was licensed by the Department of Social and Health Services and accepted both Medicare and Medicaid patients. [source: DSHS nursing home directory & CN historical files]

On August 25, 2005, Replacement Authorization (RA) #050 was issued to Kindred Nursing Centers West approving the replacement of 40 skilled nursing beds from First Hill Care Center to Kindred Hospital located on 5th Avenue in Seattle. Kindred Nursing Center also elected to relinquish the rights to 92 of the remaining 132 licensed beds. At project completion, First Hill Care Center would have 40 licensed beds at its Terry Avenue site and 40 skilled nursing beds at its 5th Avenue site.

On October 13, 2005, Renovation Authorization (RA) #051 was issued to Kindred Nursing Centers West approving the renovation of First Hill Care Center. Once 132 nursing beds—92 relinquished and 40 relocated—were removed from the site, RA #051 allowed the renovation of the empty space at First Hill Care Center to accommodate 40 LTACH beds from Kindred Healthcare.

On May 10, 2006, CN #1328 was issued to THC-Seattle, Inc approving the relocation of the 40 LTACH beds from Kindred Healthcare on 5th Avenue to the newly-renovated space at First Hill Care Center. At project completion, Kindred Healthcare will operate a 30-bed LTACH and First Hill Care Center would operate a 50-bed LTACH.

After approval of RAs #050 and #051 and CN #1328, Kindred Nursing Center and THC-Seattle elected to reduce its number of licensed nursing home beds by 10 at each site. The results of the reduction are shown on the following page.

	Kindred HealthCare	First Hill Care Center	# of NH Beds Relinquished
Before 8/25/05	80 LTACH beds	172 NH beds	Zero
RA #050	80 LTACH beds 40 NH beds	40 NH beds	92 nursing home beds
RA #051	No Change	40 NH beds & renovate empty space	
CN #1328	30 LTACH beds 40 NH beds	50 LTACH beds 40 NH beds	
December 2006 PR	30 LTACH beds 30 NH beds	50 LTACH beds 30 NH beds	20 nursing home beds

The issuance of RAs #050 and #051 were considered by Kindred Nursing Centers to be phase one of a two-phase project. Under this concept, phase one has commenced, but is not complete. Issuance of CN #1328 was considered phase two, and is the reason for this amendment application.

PROJECT DESCRIPTION

THC-Seattle submitted this application to amend CN #1328 for two reasons: The first reason is related to the capital costs of the project. In the initial review, THC-Seattle recognized that the three projects described above were connected, and the establishment of a new 50-bed LTACH in the newly renovated space at First Hill Care Center—the project authorized under CN #1328—could not be commenced until the projects authorized under RAs #050 and #051 were also commenced. All three projects include extensive new construction or renovation of existing space, and, therefore, require review by the Department of Health’s Construction Review Services and the city of Seattle.

CN #1328 was approved with a capital cost of \$10,683,481. Under 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. The changes required by Construction Review Services to meet acute care hospital and nursing home construction standards, coupled with the changes required by the city of Seattle, Seattle City Power and Light, and labor/material costs increases, resulted in a 106% increase in the capital costs to \$22,052,256.

The second reason THC-Seattle submitted this amendment application is related to Condition #2 attached to CN #1328, which states:

THC-Seattle, anticipates providing acute care services in the fifty new acute care beds at the First Hill campus by the end of October 2007. Under this timeline, year 2008 would be the facility’s first full year of operation. If the project is not complete by December 31, 2008, any remaining bed authorization not meeting licensing requirements shall be forfeited.

Given the extensive construction review delays encountered, coupled with requirements by the city of Seattle, the project did not become operational by October 31, 2007, and will not be complete by December 31, 2008, as initially expected. This application requests to amend the above condition by extending the completion date by 18 months to April 2010.

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. THC-Seattle continues to proceed with the project as approved. The new 50-bed LTACH is scheduled to begin operations April 2010.

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. This project is also subject to review under WAC 246-310-570(1)(d) because the applicant requests to modify a condition attached to Certificate of Need #1328.

APPLICATION CHRONOLOGY

May 30, 2008	Letter of Intent submitted
June 27, 2008	Application submitted
June 28, 2008 through September 23, 2008	Department's Pre-Review Activities <ul style="list-style-type: none">• 1st screening activities and responses
September 24, 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
October 14, 2008	End of Public Comment ¹
October 29, 2008	Rebuttal documents received ²
November 18, 2008	Department's Anticipated Decision Date
October 24, 2008	Department's Actual Decision Date

AFFECTED PERSONS

No entities sought and received interested or affected person status under WAC 246-310-010.

SOURCE INFORMATION REVIEWED

- THC-Seattle's Certificate of Need Application submitted June 27, 2008
- THC-Seattle's supplemental information dated September 2, 2008
- Licensing and/or survey data provided by the Department of Health's Office of Health Care Survey
- Washington State quality of care data provided by Department of Social and Health Services
- Historical charity care data for years 2004, 2005, and 2006 provided by the Department of Health's Hospital and Patient Data Systems
- Out-of-State quality of care data provided by out-of-state providers
- Progress Reports completed and submitted by Kindred Healthcare related to CN #1328
- Progress Reports completed and submitted by Kindred Healthcare related to RA #050
- Progress Reports completed and submitted by Kindred Healthcare related to RA #051
- Data obtained from the Department of Health's Construction Review Services related to the projects authorized under CN #1328 and RAs #050 and #051

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

² Because no public comments were submitted, the applicant did not provide rebuttal documents.

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 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 application, neither the increase in capital expenditure nor the modification of the condition would alter the initial justification for the project. Therefore, to obtain CN approval for this project, THC-Seattle must demonstrate compliance with the relevant criteria found in WAC 246-310-220 (financial feasibility) and WAC 246-310-240 (cost containment).

CONCLUSION

In its April 28, 2006, initial evaluation, the department concluded that THC-Seattle's project was consistent with application criteria of the Certificate of Need Program if the applicant provided written agreement with two specific conditions. One of the conditions related to the amount of charity care to be provided at the new hospital. Approval of this amendment application would also include a condition related to the amount of charity care to be provided at the new hospital.

The second condition is related to the timelines identified in the initial application and is restated below.

THC-Seattle, anticipates providing acute care services in the fifty new acute care beds at the First Hill campus by the end of October 2007. Under this timeline, year 2008 would be the facility's first full year of operation. If the project is not complete by December 31, 2008, any remaining bed authorization not meeting licensing requirements shall be forfeited.

The intent of any condition related to timelines identified in an application is to ensure that a Certificate of Need holder will strive to commence and complete its approved project in accordance with the timelines identified in the application. If a project falls behind schedule for any reason, the condition also ensures that the Certificate holder will not "hold on" to any bed approvals to prevent any future applications for the same type of project.

This amendment project requests modification of the condition as state above. Consistent with the intent of the condition, the department acknowledges that THC-Seattle has begun construction of the projects authorized under RAs #050 and #051. Further, the applicant has begun some construction of the project authorized under CN #1328. As a result, the department's approval of this amendment project will require modifications to condition #2.

For the reasons stated in this evaluation, THC-Seattle's proposal to relocate 50 of its 80 LTACH beds from the north King planning area into the central King planning area at the First Hill campus is consistent with application criteria of the Certificate of Need Program, provided the applicant's agreement to conditions on the following page.

Conditions

1. Kindred Hospital must provide charity care in compliance with the charity care policies provided in this Certificate of Need application and the requirements of the applicable law. Specifically, Kindred Hospital will use reasonable efforts to provide charity care in an amount comparable to the average amount of charity care provided by all hospitals in the King County Region (less Harborview) during the three most recent years. For historical years 2004-2006, these amounts are 1.33% gross revenue and 2.40% adjusted revenue. Kindred Hospital will maintain records at the facility documenting the amount of charity care it provides and demonstrating compliance with its charity care policies and applicable law.

2. In the amendment application, THC-Seattle, anticipates providing acute care services in the fifty new acute care beds at the First Hill campus by the end of April 2010. Under this timeline, year 2010 would be the facility's first full fiscal year of operation. If the project is not complete by April 31, 2010, any remaining bed authorization not meeting licensing requirements shall be forfeited.

Provided the applicant's agreement with the above conditions, a Certificate of Need should be issued. The approved capital expenditure for this project is \$22,052,256.

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 April 28, 2006, evaluation supporting the issuance of CN #1328, the department concluded that this sub-criterion was met based on the following factors:

- 1) a review of THC-Seattle's and Kindred Healthcare's historical audited financial reports; and
- 2) a review of the THC-Seattle's projected patient utilization as a 50-bed LTACH. This review included proposed revenues, expenses, and net profit for the new hospital in years 2008 through 2010.

[source: CN historical files: Initial evaluation, pp25-26]

Amendment Review

Within the amended application, THC-Seattle 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 King County, the new LTACH would be one of one of 20 hospitals in the King County Region. According to 2004-2006³ charity care data obtained from HPDS, the three-year average for the King County Region is 1.33% for gross revenue and 2.40% for adjusted revenue. [source: HPDS 2004-2006 charity care summaries] In the initial evaluation, the department concluded that a condition related to the charity care is necessary to ensure that THC-Seattle 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 THC-Seattle agrees to the updated charity care condition stated on page 6 of this evaluation, the department concludes 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.

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, pp27-28]

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

Amendment Review

To demonstrate that its capital cost increase would not result in an unreasonable impact on the costs and charges for health services, THC-Seattle 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: Initial evaluation, p28 and Amendment application, p21]

Table 1
THC-Seattle Initial and Amended Capital Cost Breakdown

	INITIAL COSTS	AMENDED COSTS	% OF INCREASE
Total Capital Costs	\$ 10,683,481	\$ 22,052,256	106%
Construction Cost	\$ 8,510,481	\$ 16,687,132	96%
Gross Square Footage	41,448	42,070	1.5%
Beds/Stations/Other (Unit)	50	50	no change
Total Const. per Gross Square Foot	\$205.33	\$396.65	93%
Total Cost per Unit	\$ 213,669.62	\$ 441,045.12	106%

As shown in Table 1 above, to accommodate the construction requirements, an increase in the gross square footage of the LTACH was necessary. The total costs for the project increased 106% from the initial cost and 96% from the initial construction cost, which includes an increase in square footage. THC-Seattle provided a detailed explanation of the increased construction costs within the amendment application; portions of the explanation are restated below. [source: Application, pp7-8]

“THC-Seattle encountered several unanticipated issues during its CRS [Construction Review Services] permit process. For example, CRS required that the [new] hospital comply with the rules and codes pertaining to a long-term care facility within a hospital as noted in WAC 246-320-765. [The new hospital] will obtain an acute care license, the same held at Kindred-Hospital Seattle at its 5th Avenue site. The facility was [initially] designed as an acute care hospital in accordance with hospital licensure standards, and it required significant alternations and exemption approvals in order to meet the requirements of a long-term care facility while continuing to meet the operating requirements of an acute care hospital. This change in the scope of work accounts for approximately \$4.0 million of the cost overrun.

The city of Seattle has classified the project as substantial alteration due to the planned building improvements and major system upgrades. Substantial alteration classification requires that the building undergo additional renovations to meet current seismic codes. The seismic upgrade requirements account for approximately \$2.0 million of the cost overrun.

The Seattle City Power and Light is requiring an underground transformer vault for three transformers. The applicant did not anticipate this requirement in its initial project budget. The underground transformer vault accounts for approximately \$1.3 million of the cost overrun.

The cost of materials, labor, and furniture has increase significantly over the past three year, since the application submission in July 2005. The increase in the cost of materials, labor, and furniture accounts for approximately \$2.9 million of the cost overrun.”

The explanation above and the comparison in Table 1 confirm the applicant’s assertions that the increase in costs is primarily due to the unanticipated changes required to meet state, city, and county requirements. Even with the increase in costs, the department concludes that costs for the project continue to be comparable to past construction costs reviewed by the department. Based on the information provided above, the department concludes this sub-criterion remains met.

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

Initial Review

The approved capital expenditure associated with CN #1328 was \$10,683,481. The majority of the costs were associated with construction and fixed/moveable equipment. In the initial application, THC-Seattle proposed 100% funding with its parent corporation—Kindred Healthcare—accumulated reserves. In the initial evaluation, the department concluded that the funding source was reasonable based on a review of historical financial statements from Kindred Healthcare. [source: Initial evaluation, p29]

Amendment Review

For this amendment application, THC-Seattle acknowledges that the capital costs of the project increased from the initial approval in April 2006, however, in that same timeframe, Kindred Healthcare’s own financial strength has improved. The funding sources for this amendment project is 100% accumulated reserves of THC-Seattle’s parent corporation—Kindred Healthcare.

To demonstrate that the funding is available, THC-Seattle provided a copy of its most recent audited financial reports for years 2005 through 2007. [source: Application, Appendix 5] The capital expenditure of \$22,052,256 represents 2.18% of year 2007 current assets and 1.06% of year 2007 total assets for Kindred Healthcare.

After reviewing Kindred Healthcare audited financial reports the department concludes that use of accumulated reserves is the most prudent approach, and would not negatively affect Kindred Healthcare Inc.’s total assets or general financial health. Based on the information provided above, the department concludes this sub-criterion remains met.

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 April 28, 2006, initial evaluation, the department concluded that the project was the best option for the community, resulting in the approval of a new LTACH by relocating 50 of THC-Seattle’s 80-beds to a new site. At project completion, THC-Seattle would be operating a 30-bed LTACH at its existing site on Fifth Avenue in Seattle and a new 50-bed LTACH within space of First Hill Care Center on Terry Avenue in Seattle. [source: Initial evaluation, pp36-37]

Amendment Review

Before submitting this application, THC-Seattle 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. Given the construction requirements by the city of Seattle and the department's Construction Review Services, any decrease in other areas could not off-set the increase costs. In order to move forward with this project, THC-Seattle had to commence the two projects authorized under RAs #050 and #051. Those projects are commenced, continue to move toward completion, with an expected completion date of January 2010. For this project, THC-Seattle continues to receive the same support from the healthcare community it received during the initial review, and THC-Seattle continues to work toward completion of this project.

CN Program rules require an amended CN be issued prior to project completion.⁴ THC-Seattle submitted this application with enough time to allow an amended CN to be issued before the project is complete.

The department acknowledges that THC-Seattle is working toward implementation of the project approved under CN #1328. Data obtained from the Department of Health's Construction Review Services demonstrates THC-Seattle's assertion that it received approval to begin construction on portions of the project in February 2008. THC-Seattle's progress towards completion is also evidenced by the updated information provided in the Certificate of Need quarterly progress reports submitted by Kindred Healthcare. [source: Quarterly Progress Reports and CRS #8998]

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 50-bed LTACH. 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 recent LTACHs reviewed by the department. [source: Initial evaluation, p37]

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.

⁴ WAC 246-310-570(2).