

**EVALUATION OF THE CERTIFICATE OF NEED APPLICATION SUBMITTED BY
OLYMPIC PENINSULA KIDNEY CENTERS PROPOSING TO AMEND CERTIFICATE OF
NEED #1359 BECAUSE OF AN INCREASE IN APPROVED COSTS**

PROJECT DESCRIPTION

Olympic Peninsula Kidney Centers (OPKC) is a private, non-profit entity that provides dialysis services through three facilities located in Kitsap County. OPKC is governed by an 11-member Board of Directors comprised of medical, civic, and business leaders from the community. An appointed executive director and appointed administrator oversee day-to-day operations of OPKC. [source: OPKC Application, p1 and Appendix B]

Below is a listing of the three OPKC facilities in Kitsap County. [source: OPKC Initial Application, p1 and Appendix B]

Kitsap

OPKC-Bremerton

OPKC-Port Orchard

OPKC-Poulsbo

On November 9, 2007, the department issued Certificate of Need (CN) #1359 to OPKC approving the establishment of a new, 6-station dialysis center in Jefferson County. The approved site of the new facility is 2500 West Simms Way in Port Townsend. The capital expenditure associated with the project authorized under CN #1359 is \$518,700. [source: CN #1359]

On December 15, 2008, OPKC submitted this application proposing to amend CN #1359 because of an increase in the approved capital expenditure beyond those allowed. 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. Within its amendment application, OPKC identifies an increase in capital expenditure from \$518,700 to \$943,219, equating to 81.8% increase.

Although the costs of the project have increased beyond the allowable amount, the scope of the project and the location of the dialysis center have not changed. Within its most recent progress report for the project—December 2008—OPKC acknowledges an increase in the costs of the project and states it is “*holding tenant improvements pending [this] amendment decision.*” Initially the dialysis center was scheduled to open June 2008; within the amendment application, OPKC estimates it will begin operations in late 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

September 25, 2008	Letter of Intent submitted
December 15, 2008	Application submitted
December 16, 2008 - - January 21, 2009	Department's Pre-Review Activities 1 st screening activities and responses
January 22, 2009	Department Begins Review of the Amendment Application <ul style="list-style-type: none">• public comments accepted throughout review;• no public hearing conducted under the expedited review rules
February 11, 2009	End of Public Comment
March 3, 2009	Rebuttal Comments Submitted by OPKC
March 23, 2009	Department's Anticipated Decision Date
April 22, 2009	Department's Anticipated Decision Date with 30 day Extension
April 22, 2009	Department's Actual Decision Date

AFFECTED PERSONS

During the review of this amendment application, DaVita, Inc. (DaVita) sought and received affected person status under WAC 246-310-010. DaVita's affected person status is related to the department's review of OPKC's initial project. When OPKC submitted its initial application on February 28, 2007, two other dialysis providers also submitted applications proposing to serve dialysis patients in Jefferson County. The two providers were DaVita and Northwest Kidney Centers. The three applications were reviewed under concurrent review as outlined in WAC 246-310-282. Under the concurrent review, the department issued one single evaluation for all three projects. The department's initial evaluation, released on October 18, 2007, approved OPKC's project in its entirety and a portion of Northwest Kidney Centers project. DaVita's project was denied. For this amendment project, only DaVita sought and received affected person status.

SOURCE INFORMATION REVIEWED

- Olympic Peninsula Kidney Centers Amendment Certificate of Need application submitted December 15, 2008
- Olympic Peninsula Kidney Centers supplemental information received January 14, 2009
- DaVita, Inc.'s comments received February 11, 2009
- Olympic Peninsula Kidney Centers rebuttal comments received March 3, 2009
- Quarterly Progress Reports completed and submitted by Olympic Peninsula Kidney Centers related to CN #1359 [Reports for December 2007, March 2008, June 2008, September 2008, and December 2008]
- Olympic Peninsula Kidney Center's initial application requesting the establishment of a 6-station dialysis facility in Jefferson County submitted February 28, 2007
- All public comments, rebuttal comments, and supporting documentation related to Olympic Peninsula Kidney Centers initial application submitted February 28, 2007
- The department's October 18, 2007, initial evaluation approving Olympic Peninsula Kidney Centers initial application
- Quarterly Progress Reports completed and submitted by Olympic Peninsula Kidney Centers for its Poulsbo project; CNs #1307 and #1307A issued on June 3, 2005 and May 9, 2006, respectively [Reports for June 2005, September 2005, December 2005, March 2006, and June 2006.

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 an applicant's request for an amendment remains 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, Olympic Peninsula Kidney Centers 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 project submitted by Olympic Peninsula Kidney Centers proposing to amend Certificate of Need #1359 is not consistent with the applicable criteria of the Certificate of Need Program and an amended Certificate of Need is denied.

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

Based on the source information reviewed, the department determines that the applicant has not 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 October 18, 2007, evaluation supporting the issuance of CN #1359, the department concluded that this sub-criterion was met based on the following factors:

- 1) a review of OPKC's draft lease agreement provided in the initial application¹;
- 2) OPKC's historical audited financial reports; and
- 3) a review of OPKC's projected patient utilization for the new 6-station dialysis center in Port Townsend. This review included proposed revenues, expenses, and net loss for the new facility in year 1 (2009) and a net profit in years 2 and 3 (2010 and 2011).

[source: Department's initial evaluation, pp24-27]

Amendment Review

Within the amended application, OPKC provided documentation to demonstrate that its capital cost increase would not negatively affect its projected patient census or in-center treatments relied upon in the initial approval. OPKC also provided a breakdown of the increase in costs, noting those that would increase expenses at the new facility.² The cost that would have a substantial affect on the financial viability of the new facility is the lease costs.

OPKC also provided updated pro forma revenue and expense summaries and balance sheets used to demonstrate that the increase in expenses within the amendment application would not substantially affect the financial viability of the new 6-station facility or OPKC as a whole. Table 1 on the following page is a comparison of the new facility's third year of operation shown in the initial application (2011) and this amendment application (2011) using the updated capital costs.

[source: Department's initial evaluation, p24 and OPKC's January 12, 2009, amended supplemental information, Attachment 5]

¹ CN #1359 included a condition requiring OPKC to provide a copy of the executed lease agreement, consistent with the draft agreement provided in the application. [source: Department's initial evaluation, p9]

² The majority of the increases are one time expenses related to construction costs and equipment purchases, which are further evaluated in sub-sections (2) and (3) of this criterion.

Table 1
Olympic Peninsula Kidney Center's Jefferson County Dialysis Facility
Year 3 Only--Comparison

	Initial Application Year 3 - 2011	Amended Application Year 3 - 2011
# of Stations	6	6
# of Treatments ^[1]	3,314	3,314
# of Patients ^[2]	19	22
Utilization Rate ^[2]	3.16	3.66
Net Revenue ^[1]	\$ 800,252	\$ 800,252
Total Expense ^[1,3]	\$ 765,677	\$ 798,662
Net Profit or (Loss) ^[1]	\$ 34,575	\$ 1,590
Net Patient Revenue/Treatment ^[1]	\$ 278.54	\$ 278.54
Total Operating Exp./Treatment ^[1]	\$ 266.51	\$ 277.99
Net Profit (Loss) per Treatment ^[1]	\$12.03	\$ 0.55

[1] includes both in-center and home dialysis patients; [2] in-center patients only; [3] includes deductions for bad debt, charity care and allocated costs

As shown in the comparison table above, the increase in costs related to the lease decreases year 2011 net profit from \$34,575 to \$1,590, equating to the minimal profit of \$.055 per treatment. The amendment application also demonstrates a net profit in year 4 (2012) of \$29,197, which equates to \$9.33 net profit per treatment and a net profit in year 5 (2013) of \$49,336, which equates to \$14.46 net profit per treatment.

Related to this sub-criterion in the amendment application, DaVita provided comments noting that OPKC identified an increase in its capital costs because of two factors:

- 1) an increase in the square footage of the facility from 2,500 to 2,793; and
- 2) OPKC omitted an additional \$25 per square foot (psf) tenant improvement costs.

DaVita also noted that the lease costs calculated using the lease agreement are not substantiated in OPKC's pro forma. [source: DaVita, Inc. February 11, 2009, public comment, p6]

In response to DaVita's comments, OPKC concurred that its lease expenses in the pro forma do not match those expenses in the agreement. To correct this error, OPKC submitted a revised pro forma revenue and expense statement for the Jefferson County facility, and balance sheets for OPKC as a whole. Noted changes in the revenue and expense statements include the total expenses and profitability for years 2009 through 2013. The department has determined that this submission constitutes an inappropriate modification of the application during the rebuttal portion of the review and the revised financial statements will not be considered in this review. [WAC 246-310-090, WAC 246-310-100(6), and WAC 246-310-170]

The amounts in the lease agreement cannot be substantiated in the pro forma revenue and expense statements provided in the amendment application. [source: Amendment Application, Exhibit G and January 14, 2009, supplemental information, Attachment 5] As a result, the project cannot be fully evaluated on its long-range capital and operating costs. Therefore, this sub criterion is not 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

In its October 18, 2007, evaluation supporting the issuance of CN #1359, the department concluded that this sub-criterion was met based on the following factors:

- 1) OPKC's basis for establishing its construction costs for the 6-station facility;
- 2) OPKC's projected sources of revenues, broken down by Medicare, Medicaid, and Insurance/HMO; and
- 3) a comparison of OPKC's costs per dialysis with recent dialysis projects reviewed by the department.

[source: Department's initial evaluation, p29]

Amendment Review

In its amendment application, OPKC identified a substantial construction cost increase from its initial estimate. The increase from \$250,800 to \$538,784 equates to a 115% increase in construction costs alone. [source: Amendment application, pp21-23]

OPKC provided the following rationale for the construction cost increases. [source: Amendment application, pp21-22]

- *The original budget was based on the estimated per square foot cost of OPKC's 2005-2006 Poulsbo project. The estimate used was not reconciled to actual final costs and also did not add in a \$25/square foot tenant improvement allowance provided by the owner.*
- *CMS adopted additional Life Safety Codes for outpatient dialysis facilities in August 14, 2008... Meeting these requirements added \$42,296 for sprinklers and related controls, and \$22,000 for walls, ceiling, chases and doors to meet a two-hour fire rating.*
- *The original construction estimate assumed costs at 2005 levels, not inflated to current levels.*
- *Plumbing and electrical bids for this project returned much higher than budgeted. [breakdown provided]*
- *The building owner does not provide an adequately sized sewer connection to the suite. A new sewer line must be routed around the outside of the building to the suite.*
- *Water line coming into the building is not large enough to support the fire sprinkler system being added in the suite. A larger connection to the water main is being added at OPKC expense.*

To demonstrate that the increase in construction costs would not result in an unreasonable impact on the costs and charges for health services as required under this sub-criterion, OPKC states.

"The projected capital and operating costs, as well as anticipated charges, will not have a material effect on the provision of health services other than a favorable impact on the access to and availability of outpatient dialysis services in Jefferson County."

[source: Amendment application, p23]

OPKC further states that its “*construction costs are based on bids from the architect, general contractor, and specialty subcontractors. Equipment costs are based on current quotes from manufacturers or vendors.*”

DaVita provided comments related to OPKC’s rationale for the construction cost increases, which are summarized below. [source: DaVita February 11, 2009, public comment, pp2-7]

Omitted Tenant Improvement Allowance

DaVita calculates that the \$25 psf omitted tenant improvement allowance equates to 21% of OPKC’s construction cost estimate.

Use of Outdated and Inaccurate Construction Cost Estimates

DaVita calculates OPKC’s use of 2003 cost estimate—rather than 2007 cost estimates—increases its project by 93%. DaVita also asserts that OPKC’s understatement of construction costs led to OPKC’s delays in implementation of this project.

Omission of costs for Published and Well-Know Safety Code Requirements

DaVita asserts that OPKC should have known about the upcoming changes in safety codes because the proposed codes, which were adopted in April 2008, became effective August 2008, and were published in February 2005—approximately two years before OPKC submitted its initial application for this Jefferson County project (OPKC’s initial application was submitted February 2007).

Omission of Known Equipment Costs

DaVita states that OPKC’s omission of a necessary telephone system, along with additional moveable and fixed equipment equates to a 35% increase in equipment. This percentage of increase does not take into account OPKC’s plans to install a more costly waste-processing system.

In summary, DaVita asserts that a number of the cost increases were known, or should have been known, by OPKC when it prepared the initial application. As a result, DaVita asserts that CN #1359 should be revoked under WAC 246-310-500(6). In this evaluation, the department does not revoke CN #1359.

As stated above, in the initial review, the department concluded that OPKC’s project met this sub-criterion based, in part, on OPKC’s basis for establishing its construction costs for the 6-station facility. It is clear with this amendment application that OPKC substantially underestimated its construction costs. In its initial application, OPKC stated its “*construction costs were based on OPKC’s recent experience in creating satellite facilities.*” [source: OPKC initial application, p21]

OPKC’s construction cost experience and expertise in the initial application has been show to not be reliable. With the exception of providing invoices related to the lease agreement, no other documentation was provided to support the increase in costs associated with this amendment application. OPKC’s statement above regarding a demonstration that the increase in construction costs in this amendment application would not result in an unreasonable impact on the costs and charges for health services is a ‘cut and paste’ quote from its initial application. Given the submission of this amendment application, it is clear that the initial construction costs were unreliable.

In conclusion, OPKC did not provide any documentation to demonstrate that the 83% increase in capital expenditure or the 115% increase in construction costs alone would not result in an unreasonable impact on the costs and charges for health services as required under this sub-criterion. This sub-criterion is not met.

(3) The project can be appropriately financed.

Initial Review

The approved capital expenditure associated with CN #1359 was \$518,700. The majority of the costs were associated with construction (48%) and fixed/moveable equipment (44%). In the initial application, OPKC proposed to fund the project through accumulated reserves. The department concluded that the funding sources were reasonable based on historical financial statements from OPKC. [source: Department's initial evaluation, p30]

Amendment Review

OPKC does not change its funding source for this project. Even though the capital costs will increase 81.8% from its initial costs, OPKC still intends to fund the project from its reserves. Given that the Jefferson County facility will be part of the parent OPKC entity and the capital amount is not considered an advance or a loan, repayment of the cost is not required.

Since the issuance of CN #1359, OPKC has not received any other approvals from the Certificate of Need Program for the establishment of dialysis centers. As a result, the department would expect OPKC's balance sheets to demonstrate OPKC's financial viability to be at least equal, or better, than the balance sheets reviewed in the initial application.

To demonstrate compliance with this sub-criterion, OPKC provided its June 2007 and June 2008 audited financial statements, years 2009 through 2011 projected consolidated revenue and expense statements, and year 2009 through 2011 projected balance sheets.³ [source: Amendment application, Appendices O & P].

OPKC also provided a cost comparison of a bank loan financing alternative. That cost comparison demonstrates that funding this project through OPKC's reserves continues to be the lower cost option. [source: Amendment application, pp23-24]

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

³ As stated in sub-section (1) of this criterion, OPKC acknowledged an error in its pro forma financial statements for the Jefferson County facility. To correct this error, OPKC submitted a revised pro forma revenue and expense statement that the department previously concluded cannot be used in the review of this amendment project. In addition, OPKC submitted a revised pro forma balance sheet. The pro-forma balance sheet is not used in this portion of the evaluation to determine whether a project can be funded. OPKC did not submit any revisions to its audited financial statements, which are used to evaluate this sub-criterion.

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

Based on the source information reviewed, the department determines that the applicant has not 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 October 18, 2007, initial evaluation, the department concluded that need for dialysis access in Jefferson County was demonstrated, and OPKC's initial application was the only project proposing to locate dialysis stations in the county, rather than in the adjacent Clallam County. As a result, the department concluded that OPKC's project was the best alternative when compared to the two competing projects submitted by DaVita and Northwest Kidney Centers. [source: Department's initial evaluation, pp40-41]

Amendment Review

In its amendment application, OPKC provided a duplicate of the 'Cost Containment' section from its initial application. [source: Amendment application, pp28-29] While the information provided in the initial application was pertinent at that time, it does not address any options considered regarding the increase in costs for this amendment application, nor does it demonstrate that establishment of OPKC's Jefferson County facility continues to be the best alternative with an 81.8% increase in capital costs. Again, OPKC's 'cut and paste' approach is inadequate.

Additionally, the department determined that OPKC's amendment project did not meet the criteria outlined in financial feasibility section of this evaluation. As a result, this sub-criterion is not 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. [source: Department's initial application, p41]

Amendment Review

Within the amended application, there was no information provided to demonstrate compliance with is sub-criterion. Therefore, the department concludes that this criterion is not 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 not met.