

**DIVISION OF HEALTH PLANNING AND RESOURCE DEVELOPMENT
AUGUST 2006**

**CON REVIEW: FSF-RC-0506-014
GULF SOUTH SURGERY CENTER, LLC D/B/A GULF SOUTH SURGERY CENTER
CONSTRUCTION AND RENOVATION PROJECT
CAPITAL EXPENDITURE: \$4,200,855
LOCATION: GULFPORT, HARRISON COUNTY, MISSISSIPPI**

STAFF ANALYSIS

I. PROJECT SUMMARY

A. Applicant Information

Gulf South Surgery Center, LLC d/b/a Gulf South Surgery Center (Center) is a licensed freestanding ambulatory surgery center. Gulf South Surgery Center, LLC is a Mississippi limited liability company authorized to do business in Mississippi. The facility is managed and operated primarily by Gulf South Surgery Center, LLC. However, Surgical Management Associates, LLC provides certain management services to Gulf South Surgery Center pursuant to a management agreement. The facility is governed by a seven-member Board of Directors.

B. Project Description

Gulf South Surgery, LLC d/b/a Gulf South Surgery Center is requesting Certificate of Need (CON) authority for construction and renovation of the existing center located at 1206 31st Avenue, Gulfport. The proposed project involves construction of a new recovery area, business office and two operating rooms, renovation to the current center, and site work that will result in the replacement of three operating rooms. According to the applicant, the proposed project involves planned site work which includes an expansion of the center's existing parking lot and landscape.

The proposed project will encompass a total of 24,690 square feet of space, to include 9,760 square feet of new construction and renovation of 14,930 square feet of existing space. The project will be completed in six phases.

A breakdown of the six phases is as follows:

Phase I

- Phase I will consist of construction of two parking lots. The parking spaces must be constructed first because portions of the center's current parking areas will be taken out of service during the renovation and additional phases of the project. The reduction in parking spaces due to construction will cause the number of parking spaces at Gulf South Surgery Center to fall below the minimum required by the City of Gulfport, and therefore new spaces must be added.

Phase II

- Phase II will involve renovation to the exterior of the existing building, construction of a 260 square foot gastroenterology suite, and a 9,500 square foot addition to the center. This addition will allow for the expansion and upgrading of the recovery and post-anesthesia care unit areas, as well as the relocation and enlargement of the three existing operating rooms and sterilization area. This addition will also include the waiting area, reception, insurance office, records storage space, public restrooms, consultation room, and administrative office for the outpatient surgery suite.

The applicant asserts that the existing surgery area will be renovated to add a nursing station, surgical equipment storage, and a head nurse office. As the operating rooms in the addition are completed, the three existing operating rooms will be taken out of service and used as general medical storage and sterile storage. Medical staff locker rooms will also be renovated.

Phase III

- Phase III will complete aesthetic aspects of the physical separation of the center from the private office space leased to physicians in the same building. A new gastrointestinal procedure room and lobby completely separate from the private physician offices will be constructed.

Phase IV

- Phase IV will entail conversion of two existing recovery rooms into one new, larger third operating room.

Phase V

- Phase V involves the existing surgical part of the building which will be renovated to modernize the space currently used by the center.

Phase VI

- Finally, Phase VI will include: renovations to the existing kitchen and break area; conversion of a small recovery room into a conference room; and conversion of the existing lobby and reception to offices.

The total proposed capital expenditure of \$4,200,855 is composed of new construction (44.52 percent), renovation (21.75 percent), capital improvement (0.98 percent), site preparation (3.97 percent), fees (5.49 percent), contingency reserve (6.52 percent), capitalized interest (5.80 percent), fixed equipment (3.15 percent), non-fixed equipment (3.80 percent), and other (4.03 percent). See capital expenditure summary, page 8. The applicant proposes to finance \$4,200,000 of the proposed capital expenditure with a loan from Bancorp South, Biloxi, Mississippi, and the remaining balance of \$855.00 from Gulf South Surgery Center's cash reserves.

According to the applicant, the anticipated date for obligation of capital expenditure and date for completion of the proposed project is 22 months.

The MDH Division of Health Facilities Licensure and Certification has approved the site for the proposed project.

II. TYPE OF REVIEW REQUIRED

This project is reviewed in accordance with Section 41-7-191, subparagraphs (1)(j), Mississippi Code of 1972, Annotated, as amended, and duly adopted rules, procedures, plans, criteria and standards of the Mississippi Department of Health.

In accordance with Section 41-7-197(2), of the Mississippi Code 1972, Annotated, as amended, any affected person may request a public hearing on this project within 20 days of publication of the staff analysis. The opportunity to request a hearing expires on September 5, 2006.

III. CONFORMANCE WITH THE STATE HEALTH PLAN AND OTHER ADOPTED CRITERIA AND STANDARDS

A. State Health Plan

The *FY 2006 State Health Plan* does not address policy statements and specific criteria and standards for construction/renovation and expansion of an ambulatory surgery center, as proposed by this application. The project is in substantial compliance with the overall objectives of the *Plan*.

B. General Review (GR) Criteria

Chapter 8 of the *Mississippi Certificate of Need Review Manual, 2000 Revision*, addresses general criteria by which all CON applications are reviewed. This application is in substantial compliance with general review criteria.

GR Criterion 1 – State Health Plan

According to the applicant, the project is in compliance with all criteria, standards and policies of the *FY 2006 State Health Plan*.

GR Criterion 2 - Long Range Plan

According to the applicant, the center's long-term mission is to provide the highest possible same day surgical care to its patients. The center is committed to providing a well-maintained and equipped facility that creates an optimal surgical environment. The applicant asserts that the center is dedicated to providing its patients with a comfortable, attractive atmosphere throughout all phases of their stay at the center. The applicant believes that the proposed project will enhance the surgical environment for Gulf South Surgery Center's physicians, and comfort of patients.

GR Criterion 3 – Availability of Alternatives

According to the applicant, the primary alternatives to the proposed project are as follows:

1. Make no major improvements to the existing center;
2. Construction an entirely new surgery center; or
3. Implement the project over a period of time such that costs do not exceed the \$2 million CON expenditure threshold for any 12 month period.

The applicant indicates that it rejected option (1) because undertaking minor repairs to the center that would not require a CON would eventually jeopardize the quality of care offered to patients.

Gulf South Surgery Center rejected option (2) because it would be prohibitively expensive and unnecessary to construct an entirely new surgery center either on the current site or at a different location. The applicant asserts that in light of sharply increasing real estate, construction and insurance prices in the vicinity of the center as a result of Hurricane Katrina, constructing a new surgery center would be financially impractical.

According to the applicant, Gulf South Surgery Center has already attempted to proceed under option (3), but building materials and service price increases due to Hurricane Katrina have made this option unfeasible.

Gulf South Surgery Center states that prices for the construction materials and services on which the center based its prior cost estimates have increased dramatically. The increase in prices has resulted from enormous demand for building materials and services as a result of Hurricane Katrina-related reconstruction efforts. As a result of these unforeseen price increases, the center could not complete a reduced scope version of the project for less than \$2 million. Due to damages of Hurricane Katrina, the applicant was forced to reject option (3).

The applicant believes that the proposed project will enable Gulf South Surgery Center to continue offering the top quality patient care for which it has long been recognized and to which it is firmly committed.

GR Criterion 4 - Economic Viability

- a. **Proposed Charges:** The applicant projects the charge per procedure for each of the first three years of operation to be \$3,566. Gulf South Surgery Center indicates that charges at the center have been pre-determined based on the approved Medicare reimbursement codes and may vary by case. Profitability is determined not by simply adding the service, but by expense management and proper negotiation of managed care contracts. Because reimbursement by governmental payors is pre-determined, the charges have little significance.

According to Gulf South Surgery Center the proposed project will have only minor effects on the cost of health care per outpatient day, and any such cost increases will not be passed on to patients of Gulf South Surgery Center. The applicant projects that cost per outpatient day will increase by 3.74 percent for year one, 1.42 percent for year two, and 1.24 percent for year three. Gross revenues will increase slightly in year one due to a changed surgery case mix and thereafter remain approximately constant.

- b. **Projected Level of Utilization:** The applicant projects 5,900 procedures for year one, 5,959 procedures for year two, and 6,019 procedures for year three for the proposed project. The applicant asserts that based on the proposed project's income statement, revenue is projected to grow by 5 percent for year one due to a changed surgery case mix that will result from the larger, modernized operating rooms. For years two and three, revenue is projected to grow only 1 percent.
- c. **Project's Financial Feasibility Study:** The application contains a financial feasibility study prepared by the administrator of Gulf South Surgery Center, Margaret S. Keel, RN, MBA, attesting to the financial status of this project.

Gulf South Surgery Center projects net incomes from operation to be \$3,657,994 for the first year, \$3,633,680 for the second year, and \$3,606,913 for the third year after completion of this project.

According to the applicant, the only significant deviation in the center's financial statements will result from the commercial loan required to finance the proposed project. The applicant will borrow \$4.2 million repayable over five years at an estimated 8 percent interest rate.

The loan will impact the income statement with respect to interest payments and the balance sheet due to lower cash flows. However, the long-term effect on the assets of the center will be neutral after completion of the project. Due to the center's low debt ratio and strong asset and cash positions, the loan will be absorbed with little impact on Gulf South Surgery Center's overall financial health.

GR Criterion 5 - Need for the Project

- a. **Access by the Population Served:** According to the applicant, the center complies with all applicable federal and state laws regarding equal access and treatment and strictly prohibits discrimination based on race, age, sex, handicap, color, creed, or ethnic group. Additionally, the center does not discriminate based on ability to pay.
- b. **Relocation of Services:** This application is for the renovation and expansion of an existing facility in its current location.
- c. **Current and Projected Utilization of Like Facilities:** The applicant states that the actual utilization for 2005 of Gulf South Surgery Center was 5,583 ambulatory surgery procedures. The applicant projects 5,900 surgery procedures for year one, 5,959 surgery procedures for year two and 6,019 surgery procedures for year three for the proposed project.

Utilization data supplied to the MDH by freestanding ambulatory surgery centers for Ambulatory Surgery Planning Area 7 shows that there were 33,220 ambulatory surgeries performed in the 24 freestanding ambulatory surgery center suites in 2004. The average number of freestanding ambulatory surgery procedures per surgery suite in ASPA 7 was 1,384.17 for 2004. The applicant's utilization statistics are consistent with like facilities in the area.

- d. **Probable Effect on Existing Facilities in the Area:** The proposed project should have no effect on existing facilities in the area because the proposed project does not add operating suites or services. Also, projected procedures remain relatively consistent with 2005 actual procedures.
- e. **Community Reaction:** Based on comments the facility has received, the community reaction has been completely favorable for the proposed project. The application received numerous letters of support for the proposed project.

According to Gulf South Surgery Center, the building in which the center is located was constructed in the late 1950's for use as a small inpatient hospital and has undergone only minor renovations since the original construction. The center's physical plant has aged substantially and requires significant renovations to assure that the center can offer high quality care to patients in the future.

The applicant believes that the proposed project will update and enhance Gulf South Surgery Center's facilities so that the center can continue to fulfill its mission of top quality surgical care, provided in a timely, accessible, and cost effective manner.

According to the applicant, the final objectives for this proposed project are to enhance the quality of the center's physical plant to match the superior quality of service provided by the center's physicians and staff.

The applicant believes that failure to implement the proposed project will result in decline in the quality of care available to patients, and the ability to continue providing the highest level of outpatient surgical care in the long-term.

GR Criterion 6 - Access to the Facility or Service

- a. **Medically Underserved Population:** According to the applicant, in 2005, Gulf South Surgery Center provided approximately 3.5 percent of its services to medically indigent/charity care patients. The center intends to continue providing approximately the same amount of indigent/charity care during and following completion the proposed project.
- b. **Performance in Meeting Federal Obligations:** The applicant indicates that the center has no existing obligations under any federal regulation requiring provision of uncompensated care, community service, or access by minority/handicapped persons.
- c. **Unmet Needs to be Served by Applicant:** According to the applicant, the existing facility receives Medicare and Medicaid reimbursement.
- d. **Range of Access:** According to the applicant, the center is Medicare certified and complies with all Medicare requirements for ambulatory surgery centers.

GR Criterion 7 - Information Requirement

Gulf South Surgery Center affirms that it will record and maintain the information required by this criterion and make it available to the Mississippi Department of Health within 15 business days of request.

GR Criterion 8 - Relationship to Existing Health Care System

Gulf South Surgery Center, LLC dba Gulf South Surgery Center is located in Harrison County, and Ambulatory Surgery Planning Area 7 (ASPA 7). There are eight (8) licensed freestanding ambulatory surgery centers in ASPA 7.

The Department received no letters of opposition concerning the proposed project.

Staff does not anticipate that this project will have an adverse impact on any of the existing freestanding ambulatory surgery centers in ASPA 7.

GR Criterion 9 - Availability of Resources

The applicant asserts that no additional staff will be needed as a result of the proposed project.

GR Criterion 10 – Relationship to Ancillary or Support Services

According to the applicant, the center provides ancillary services, such as laboratory services, through third parties as required. These outside vendors have historically provided all necessary ancillary services to the center and will continue to be available during and following completion of the proposed project.

GR Criterion 14 - Construction Projects

The applicant proposes new construction of 9,760 square feet of space at a cost of \$252.56 per square foot and renovation of 14,930 square feet of existing space at a cost of \$91.49 per square foot, calculated using the formula set forth in *the FY 2006 State Health Plan* (See Attachment 1).

The *Means Construction Cost Data, 2006 Edition*, does not provide ambulatory surgery center construction cost data.

GR Criterion 16 - Quality of Care

Gulf South Surgery Center is licensed by the Mississippi Department of Health. As previously mentioned, the applicant asserts that it is certified for participation in the Medicare program for ambulatory surgery centers.

IV. FINANCIAL FEASIBILITY

A. Capital Expenditure Summary

Cost Item	Projected Cost	Percent
New Construction	\$ 1,870,295	44.52%
Renovation	\$ 913,816	21.75%
Fees (Architectural, Consultant, etc.)	\$ 230,554	5.49%
Capital Improvements	\$ 41,000	0.98%
Contingency Reserve	\$ 273,792	6.52%
Site Preparation	\$ 166,735	4.03%
Fixed Equipment	\$ 132,200	3.15%
Non-Fixed Equipment	\$ 159,500	3.80%
Capitalized Interest	\$ 243,563	5.80%
Other Cost	\$ 169,400	4.03%
Total Capital Expenditure	\$ 4,200,855	100%

The above estimated capital expenditure is proposed for new construction of 9,760 square feet of space at a cost of \$ 252.56 per square foot and 14,930 square feet of renovated space at a cost of \$91.49 per square foot. The proposed project also involves the purchase of fixed and non-fixed equipment.

The *Means Construction Cost Data, 2006 Edition* does not provide ambulatory surgery center construction cost data.

B. Method of Financing

The applicant proposed to finance \$4,200,000 of the proposed capital expenditure with a loan from Bancorp South, Biloxi, Mississippi, and the remaining balance of \$855.00 from Gulf South Surgery Center's cash reserves. The application contains a letter from Bancorp South stating its interest in financing the \$4.2 million for the proposed project.

C. Effect on Operating Cost

Gulf South Surgery Center projects the following expenses, revenues, and utilization for the first three years of operation.

**Gulf South Surgery Center
 Three- Year Operating Statement**

	Year 1	Year 2	Year 3
<u>Revenues</u>			
Patient Revenue	\$ 21,041,477	\$ 21,251,891	\$ 21,464,410
Deductions	\$ 12,803,207	\$ 12,931,239	\$ 13,060,552
Net Pt. Revenue	\$ 8,238,270	\$ 8,320,652	\$ 8,403,858
Total Operating Rev.	\$ 8,238,270	\$ 8,320,652	\$ 8,403,858
Expenses			
Salaries	\$ 1,180,610	\$ 1,251,447	\$ 1,326,533
Benefits	\$ 295,152	\$ 312,861	\$ 331,633
Supplies	\$ 1,210,000	\$ 1,234,200	\$ 1,258,884
Services	\$ 551,000	\$ 550,000	\$ 550,000
Depreciation	\$ 309,000	\$ 305,000	\$ 300,000
Interest	\$ 424,657	\$ 418,464	\$ 412,395
Other	<u>\$ 609,857</u>	<u>\$ 615,000</u>	<u>\$ 617,500</u>
Total Expenses	<u>\$ 4,580,276</u>	<u>\$ 4,686,972</u>	<u>\$ 4,796,945</u>
Net Income	<u>\$ 3,657,994</u>	<u>\$ 3,633,680</u>	<u>\$ 3,606,913</u>
<u>Utilization</u>			
Procedures	5,900	5,959	6,019
Cost/Procedure	\$ 776	\$ 787	\$ 797
Charge/Procedure	\$ 3,566	\$ 3,566	\$ 3,566

D. Cost to Medicaid/Medicare

Patient Mix by Type Payer	<u>Utilization Percentage</u>	<u>First Year Expenses</u>
Medicaid	24	\$1,099,266
Medicare	2	\$91,606
Other	<u>74</u>	<u>\$3,389,404</u>
TOTAL	<u>100</u>	<u>\$4,580,276</u>

V. RECOMMENDATIONS OF OTHER AFFECTED AGENCIES

The Division of Medicaid was provided a copy of this application for review and comment. However, no comments were received.

VI. CONCLUSION AND RECOMMENDATION

This project is in substantial compliance with the overall objectives as contained in the *FY2006 State Health Plan*; the *Mississippi Certificate of Need Review Manual, Revised 2000*; and duly adopted rules, procedures, and plans of the Mississippi Department of Health.

The Division of Health Planning and Resource Development recommends approval of this application submitted by Gulf South Surgery Center, LLC d/b/a Gulf South Surgery Center for construction and renovation and expansion.

Attachment 1

**Gulf South Surgery Center
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Computation of Construction and Renovation Cost*

Cost Component	Total	New Construction	Renovation
New Construction Cost	\$1,870,295	\$1,870,295	
Renovation Cost	\$913,816		\$913,816
Fixed Equipment Cost	\$132,200	\$132,200	
Site Preparation Cost	\$166,735	\$166,735	
Fees (Architectural, Consultant, Etc.)	\$230,554	\$ 91,184	\$139,370
Contingency Reserve	\$273,792	\$108,285	\$165,507
Capitalized Interest	<u>\$243,563</u>	<u>\$ 96,329</u>	<u>\$147,234</u>
Total Proposed Capital Expenditure	\$3,830,955	\$2,464,028	\$1,365,927

Square Footage	24,690	9,760	14,930
Allocation Percent		39.55%	60.45%

Costs Less Land, Non-Fixed Equipment	\$3,830,955	\$2,464,028	\$1,365,927
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Cost Per Square Foot	\$155.16	\$252.46	\$91.49
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*Source: FY 2006 State Health Plan