

**MISSISSIPPI STATE DEPARTMENT OF HEALTH
DIVISION OF HEALTH PLANNING AND RESOURCE DEVELOPMENT
MAY 2016**

**CON REVIEW MOB-C-0316-005
METHODIST LE BONHEUR HEALTHCARE
CONSTRUCTION OF MEDICAL OFFICE BUILDING
CAPITAL EXPENDITURE: \$6,568,860
LOCATION: OLIVE BRANCH, DESOTO COUNTY, MISSISSIPPI**

STAFF ANALYSIS

I. PROJECT SUMMARY

A. Applicant Information

Methodist Le Bonheur Healthcare ("Methodist") is a non-profit corporation located in the State of Tennessee and authorized to do business in the State of Mississippi. The entity currently owns and operates the 100-bed (67 licensed and operating) Methodist Healthcare-Olive Branch Hospital located in Olive Branch, DeSoto County, Mississippi. Methodist Le Bonheur has 22 officers and 11 Board Members. On February 25, 2016, the Office of the Secretary of State issued a Certificate of Good Standing to the entity certifying that it has continued authority to operate in Mississippi.

B. Project Description

Methodist Le Bonheur Healthcare ("Methodist") requests Certificate of Need (CON) authority to construct a 23,400 square foot two-story medical office building ("MOB") on property owned by Methodist and located in proximity to the Methodist Healthcare Olive Branch Hospital. The applicant does not propose new services or additional major medical equipment as a part of this application.

Methodist indicates that as the Methodist Healthcare-Olive Branch Hospital ("the Hospital") is now fully operational, numerous medical staff members need to secure office space in proximity to the Hospital so that they may provide the highest quality of care to their clinic patients and have timely access to patients who are in the Hospital simultaneously.

The applicant states that currently space on the fifth floor of the Hospital is leased to various physician practices; however, that space is the next space to be used to house inpatient beds as part of the Hospital's ongoing implementation of the 2010 Hospital CON. Therefore, the physician offices currently located there must be moved to another location. Once the proposed project is complete, physicians currently located on the fifth floor of the Hospital building will be relocated to the medical office building. In addition, the applicant states that other physicians in the

community who are practicing at the Hospital have requested space in the medical office building once it is constructed. Therefore, Methodist expects the MOB to be 100% occupied immediately once it is built and open for business.

The applicant's final objective for the project is to offer high quality health care services in the most efficient and economical setting for physicians and patients in the service area. Methodist states that the project embodies its mission, which is to partner with its physicians and collaborate with its patients and families to be the leader in high quality, cost effective health care.

The applicant does not expect the project to require additional staffing. Methodist states it already has pending space commitments from physicians and physician groups sufficient to render the MOB completely occupied.

The total proposed capital expenditure is \$6,568,860, at an estimated cost of \$232.54 per square foot (see Expenditure Summary for complete percentage breakdown of project). The applicant projects that the capital expenditure will be obligated by January 1, 2017 and the project is expected to be complete by January 1, 2018.

The applicant indicates the proposed capital expenditure will be funded with cash reserves.

The MSDH Division of Health Facilities Licensure and Certification issued a letter dated March 28, 2016, approving the site for the MOB project.

II. TYPE OF REVIEW REQUIRED

This project is reviewed in accordance with Sections 41-7-173, 41-7-191 (1)(j), and 41-7-193 of the Mississippi Code 1972, Annotated, as amended, and duly adopted procedures, plans, criteria, and standards of the Mississippi State 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 June 6, 2016.

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

A. State Health Plan (SHP)

The *FY 2015 State Health Plan* does not contain specific criteria and standards applicable to medical office buildings. However, the *Plan* states that “the Mississippi State Department of Health (“MSDH”) will review applications for a Certificate of Need for “... construction, renovation, expansion projects ...involving a capital expenditure in excess of \$2,000,000”.

The applicant affirmed that the proposed project will promote Mississippi’s health planning purposes as set forth in the *State Health Plan*, including the following:

- To improve the health of Mississippi residents;
- To increase the accessibility, acceptability, continuity, and quality of health services;
- To prevent unnecessary duplication of health resources; and
- To provide some cost containment.

B. General Review (GR) Criteria

Chapter 8 of the *Mississippi Certificate of Need Review Manual, 2011 Revision*; addresses general criteria by which all CON applications are reviewed. This application is in substantial compliance with general review criteria contained in the manual.

GR Criterion 1- Consistency with the *State Health Plan*

The project is in substantial compliance with the overall objectives of the *FY 2015 Mississippi State Health Plan*.

GR Criterion 2 – Long Range Plan

The applicant states that the proposed project embodies Methodist’s mission, which is to partner with its physicians and collaborate with its patients and families to be the leader in high-quality, cost effective health care.

GR Criterion 3 – Availability of Alternatives

The applicant states that Methodist considered two other alternatives to the project: (1) not investing in an MOB on the Olive Branch campus or (2) building a larger MOB than the one currently proposed.

Methodist concluded that it would be a serious mistake not to invest in an MOB on the Olive Branch campus since an MOB has been a part of its overall plan since the beginning. In addition, the applicant states that Methodist evaluated the current need for space for physician practices related to the Olive Branch Hospital and the space needed to accommodate certain employed physicians who are currently located in the Hospital and determined that the proposed building is the appropriate size for the current need.

GR Criterion 4 - Economic Viability

The applicant asserts that the charges in this project will be the lease costs paid by tenants in the MOB. Methodist projects 100% occupancy of the MOB from the beginning based on its discussions and negotiations with physicians. It states that the revenues from the leasing of the space were calculated based on a per square foot lease charge of \$22, which is consistent with fair market value for similar space in the nearby geographic area.

Methodist projects that the MOB on its own will not be profitable within the three year operating period reviewed by the Department; however, Methodist has total operating revenues exceeding \$1.8 billion, and is prepared and able to absorb the projected \$169,000 annual loss attributable to the MOB.

The application contained a letter from Methodist's Executive Vice President Finance attesting to the financial feasibility of the project.

GR Criterion 5 - Need for the Project

The applicant states that the MOB is needed in order to facilitate efficient, high quality patient care and to fully complement Methodist's patient and family centered care model. The proposed MOB will enable the Medical Staff members of the Olive Branch Hospital to serve their clinic patients and their Hospital patients with the highest possible level quality of care.

Methodist asserts that, if approved, the project will have no impact on any existing similar facility rather it will be built specifically to serve the needs of physicians who are on Olive Branch Hospital's Medical Staff. The nearest similar facility is the Baptist DeSoto Hospital, which operates its own MOB.

GR Criterion 6 - Access to the Facility or Service

Methodist states that all of its services and facilities are entirely accessible to the entire population of relevant service area, including without any limitation the medically underserved portion of the population being served.

In addition, Methodist affirmed that the Olive Branch Hospital, through its Medical Staff, provides care without restriction to Medicare, Medicaid and medically indigent patients. The MOB will be physically accessible by all individuals, and will comply with all requirements for disable access.

GR Criterion 7 - Information Requirement

Methodist affirmed that it will record and maintain the information required by this criterion and make it available to the Mississippi State Department of Health within 15 business days of request.

GR Criterion 8 - Relationship to Existing Health Care System

Methodist asserts that, if approved, the project will have no impact on any existing similar facility rather, it will be built specifically to serve the needs of physicians who are on the Olive Branch Hospital's Medical Staff. The nearest similar facility is the Baptist DeSoto Hospital, and it operates its own MOB.

The applicant states that failure to place the requested MOB in proximity to the Olive Branch Hospital will impair the ability of the Medical Staff there to provide patient care in the most economic and efficient manner possible.

The Department received nine letters of support for the project. No letters of opposition concerning the proposed project were received.

GR Criterion 9 - Availability of Resources

Methodist projects 100% occupancy of the MOB based on its discussions and negotiations with physicians who are already members of the Olive Branch Medical Staff, many of whom are currently located in space in the Hospital. The applicant states that in order for the Hospital to continue its expansion under the 2010 CON for 100 beds, those physicians must relocate. Methodist states it already has pending space commitments from physicians and physician groups sufficient to render the building completely occupied.

GR Criterion 14 - Construction Projects

- a. **Cost Estimate:** The application contains a cost estimate prepared by a professional corporation, licensed to do business in Mississippi.
- b. **Schematic Drawing:** The application contains a schematic drawing of the proposed project.
- c. **Space Allocations:** The applicant submits that space will conform to

applicable local and state licensing standards.

- d. **New Construction Projects:** This project involves 23,400 square feet of new construction.
- e. **Cost per Square Foot:** The applicant estimates the cost of new construction to be \$232.54 per square foot (see Attachment 2) which is slightly above the high costs of projects listed in the Means Building Construction Cost Data. The *Means Building Construction Cost Data, 2015, Edition*, lists new construction costs for medical offices ranging from \$124 (where 20% of projects cost less) to \$190 (where 25% of projects cost more) per square foot. The applicant submits that there are two primary reasons that the cost for this project exceeds the cost listed in the Means Data Index: (1) the situation of the building on the available property calls for a two-story building instead of having a one floor footprint. According to the applicant, two story buildings involve a number of expenses that are not present in single storied construction such as stairwells, elevators, the need for deeper pilings for building stability, etc. (2) this building is being placed next to the west bank of a "blue line stream" and certain accommodations needed to be made in that situation which elevated the site prep costs somewhat. Finally, the applicant states that it has included a 10% inflation allowance on the building.

GR Criterion 16 - Quality of Care

Methodist Healthcare-Olive Branch is in compliance with the *Minimum Standards for the Operation of Mississippi Hospitals*, according to the Division of Health Facilities Licensure and Certification, MSDH. Methodist states that to the extent that the leasing physicians and physician practices are members of the Hospital Medical Staff, those physicians must have satisfied a rigorous credentialing process designed to ensure that only physicians of the highest levels of competence and professionalism are permitted to practice with and provide care to patients of Methodist.

IV. FINANCIAL FEASIBILITY

Capital Expenditure Summary

	Item	Cost (\$)	Percent (%) of Total*
a.	Construction Cost -- New	\$4,212,000	64.12
b.	Construction Cost -- Renovation	0	0
c.	Capital Improvements	0	0
d.	Total Fixed Equipment Cost	50,000	0.76
e.	Total Non-Fixed Equipment Cost	0	0
f.	Land Cost	337,500	5.13
g.	Site Preparation Cost	0	0
h.	Fees (Architectural, Consultant, etc.)	336,960	5.12
i.	Contingency Reserve	842,400	12.82
j.	Capitalized Interest	0	0
j.	Other Building Costs	690,000	10.50
k.	Other Project Development Fees	<u>100,000</u>	<u>1.52</u>
	Total Proposed Capital Expenditure	<u>\$6,568,860</u>	<u>100.00</u>

*Percentages may not compute due to rounding.

The above capital expenditure is proposed for construction of a new medical office building. The proposed project involves approximately 23,400 square feet of new space at an estimated cost of \$232.54 per square foot (see Attachment 2). The costs for projects listed in *The Means Building Construction Cost Data, 2015 Edition*, ranged from \$124 to \$190 per square foot, with a median cost of \$154 per square foot.

The application contained a letter from the Methodist's Executive Vice President Finance attesting to the financial feasibility of the project.

B. Method of Financing

The applicant proposes to finance the proposed capital expenditure with cash reserves of Methodist Le Bonheur Healthcare.

C. Effect on Operating Cost

The Hospital's three-year projected operating statement is presented in Attachment 1.

D. Cost to Medicaid/Medicare

The applicant projects the cost to third party payors as follows:

Payor Mix	Utilization Percentage (%)	First Year Revenue (\$)
Medicare	41	\$ 2,819,247
Medicaid	21	1,451,335
Commercial	30	2,020,207
Self Pay	0	0
Charity Care	8	521,183
Other	0	0
Total	100	*\$ 6,811,972

*Staff determined that the applicant's calculations were off by \$1.00.

V. RECOMMENDATIONS OF OTHER AFFECTED AGENCIES

The Division of Medicaid was provided a copy of this application for review and comment. Effective September 1, 2012, the Division of Medicaid changed the methodology by which outpatient services are reimbursed so that the cost incurred subsequent to that date will no longer affect outpatient payments. Also, effective October 1, 2012, the Division changed the methodology by which it reimburses inpatient services so that the cost incurred subsequent to that date will only affect cost outlier payments. According to the Division of Medicaid, the estimated increase in cost outlier payments resulting from this CON cannot be determined at this time. The Division of Medicaid opposes this project.

VI. CONCLUSION AND RECOMMENDATION

This project is in substantial compliance with the overall objectives of the *FY 2015 Mississippi State Health Plan*; the *Mississippi Certificate of Need Review Manual, 2011 Revision*; and duly adopted rules, procedures, and plans of the Mississippi State Department of Health.

The Division of Health Planning and Resource Development recommends approval of the application submitted by Methodist Le Bonheur Healthcare for the construction of a medical office building.

Attachment 1

Methodist Le Bonheur Healthcare Three-Year Operating Statement (with Project)			
	Year 1	Year 2	Year 3
Revenue			
Patient Revenue:			
Inpatient	\$ 3,269,746	\$ 3,372,930	\$ 3,484,779
Outpatient	3,542,225	3,654,008	3,775,177
Gross Patient Revenue	\$ 6,811,971	\$ 7,026,938	\$ 7,259,956
Charity Care	\$ 382,576	392,629	403,993
Deductions from Revenue	4,617,769	4,763,487	4,920,887
Net Patient Revenue	\$ 1,811,627	\$ 1,870,822	\$ 1,936,076
Other Operating Revenue	\$ 149,858	\$ 151,753	\$ 153,684
Total Operating Revenue	\$ 1,961,485	\$ 2,022,575	\$ 2,088,760
Expenses			
Operating Expenses:			
Salaries	\$ 781,334	\$ 807,231	\$ 832,892
Benefits	173,042	179,413	185,759
Supplies	435,598	454,417	473,626
Services	21	21	22
Lease	19,564	20,313	21,096
Depreciation	121,037	134,615	150,134
Interest	15,226	23,179	22,044
Other	343,778	350,148	357,594
Total Expenses	\$ 1,889,601	\$ 1,969,337	\$ 2,043,166
Net Income (Loss)	\$ 71,884	\$ 53,238	\$ 45,594
Assumptions			
Inpatient days*	368,190	370,989	372,199
Outpatient days*	398,872	401,905	403,215
Procedures	0	0	0
Charge/outpatient day	\$ 9	\$ 9	\$ 0
Charge per inpatient day	\$ 9	\$ 9	\$ 0
Charge per procedure	\$ 0	\$ 0	\$ 0
Cost per inpatient day	\$ 0	\$ 0	\$ 0
Cost per outpatient day	\$ 0	\$ 0	\$ 0

**Attachment 2
 Methodist LeBonheur Healthcare
 Construction of Medical Office Building
 Calculation of Construction/Renovation Cost**

Cost Component	Total	New Construction	Renovation
New Construction Cost	\$4,212,000	\$4,212,000	
Renovation Cost	\$0		\$0
Total Fixed Equipment Cost	\$50,000	\$50,000	\$0
Total Non-Fixed Equipment Cost	\$0		
Land Cost	\$337,500	\$337,500	
Site Preparation Cost	\$0	\$0	
<i>Fees (Architectural, Consultant, etc.)</i>	\$336,960	\$336,960	\$0
<i>Contingency Reserve</i>	\$842,400	\$842,400	\$0
<i>Capitalized Interest</i>	\$0	\$0	\$0
<i>Other</i>	\$790,000	\$790,000	
Total Proposed Capital Expenditure	\$6,568,860	\$6,568,860	\$0
Square Footage	23,400	23,400	0
<i>Allocation Percent</i>		100.00%	0.00%
Costs Less Land, Non-Fixed Eqt., Other	\$5,349,200	\$5,441,360	\$0
Cost Per Square Foot	\$228.60	\$232.54	#DIV/0!

Source: Mississippi Certificate of Need Review Manual, Revised 2011 and FY 2015 MSHP.