

**DIVISION OF HEALTH PLANNING AND RESOURCE DEVELOPMENT (THURMAN)
FEBRUARY 2004**

CON REVIEW HG-CRF-1203-035

Alliance HealthCare System, Inc. d.b.a. Alliance HealthCare System

Construction of Replacement Hospital

Capital Expenditure: \$30,807,769

Location: Holly Springs, Mississippi

STAFF ANALYSIS

I. PROJECT SUMMARY

A. Applicant Information

Alliance HealthCare System, Inc., (AHS) is operated as a for-profit, short term acute care hospital licensed to operate 40 acute care beds, 20 of which are certified as a distinct part geriatric psychiatric unit. The hospital is under a lease between the Board of Supervisors of Marshall County, Mississippi, as lessor, and Alliance HealthCare System, Inc., as sub-lessee. Alliance HealthCare System, Inc., formerly Holly Springs Hospital, Inc., is a Delaware corporation authorized to do business in Mississippi. Alliance HealthCare System, Inc., has two corporate officers and is governed by a three-member board, and the hospital is governed by a five-member board. The governing boards and the company's board of directors are selected by the shareholders of AHS.

The hospital is managed by Progressive Medical Management pursuant to a management agreement by and between Alliance HealthCare System, Inc., and Progressive Medical Management. The management staff consist of an Administrator/Chief Executive Officer and a Chief Financial Officer, each of whom is employed by Progressive Medical Management. The hospital's geriatric psychiatric unit is managed by Medmanco Corporation.

AHS intends to establish a community advisory board that will be composed of members of the community, including the poor, handicapped, members of racial or ethnic minorities, women and the elderly.

AHS is licensed and certified by the Mississippi State Department of Health and certified for participation in the Medicare and Medicaid programs. Upon completion of this project, AHS will seek accreditation from the Joint Commission on the Accreditation of Healthcare Organizations. Also, the hospital has completed its Hill Burton obligations. AHS provides emergency services twenty-four (24) hours per day to all patients who present to the emergency department, regardless of their ability to pay.

B. Project Description

Alliance HealthCare System, Inc., requests Certificate of Need (CON) authority for the construction of a replacement hospital. The new facility is to replace the out-dated, inefficient building currently housing the hospital. The new building will be constructed as a state-of-the-art facility with the ability to expand and grow and will include completed space for its various existing departments, 40 private rooms for its acute care beds and shelled-in space for future growth.

The facility will be a two-story facility and will have 109,420 square feet of built-out space and 56,670 square feet of shelled-in space for a total of 166,090 square feet. Two (2) of the major parking areas will have 86 parking spaces with four (4) designated for the handicapped, which will be built at the front entrance. The site will have a total of 146 parking spaces located in 5 different parking areas. The new facility site will be located within one-quarter mile of the intersection of Highway 78 and Highway 7 South and near physicians' offices. The site encompasses between 18 and 19 acres and is owned by Medland LLC. Medland has agreed to enter into a long-term lease with AHS in the event AHS receives authority to construct the new facility.

Medland and Alliance HealthCare System will enter into a 50-year lease contract with a rental rate of \$7,500.00 per month for the first five years after commencement and at the beginning of the sixth year of the lease term, and thereafter the rental rate will be adjusted based on the cumulative consumer price index change in the prior five years. The Division of Licensure and Certification has approved the site.

The capital necessary to complete the project will be obligated upon receipt of a Certificate of Need. A copy of the Resolution adopted by the governing board of AHS is included in the application. It is anticipated that construction will be completed during the summer of 2005.

II. Type of Review Required

Projects which propose the construction of a replacement facility are reviewed in accordance with Section 41-7-191, subparagraph (1) (b), Mississippi Code of 1972 Annotated, and duly adopted rules, procedures, plans, criteria and standards of the Mississippi State Department of Health.

In accordance with Section 41-7-197(2) of the Mississippi Code of 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 March 4, 2004.

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

A. State Health Plan (SHP)

The *FY 2004 State Health Plan* addresses criteria and standards which an applicant is required to meet before receiving CON authority for construction/replacement and relocation projects. As previously stated, this proposal involves construction/replacement of the applicant's current facility.

SHP Criterion 1 - Need

Alliance HealthCare System indicates that it is seeking authorization for the construction of a new facility to replace the out-dated, inefficient building currently housing the hospital. The new building will allow AHS the ability to expand and grow and will include completed space for its various existing departments, 40 private rooms for its acute care beds and shelled-in space for future growth. The new building has been designed to offer efficient flow of patients through the facility, to discourage and prevent the spread of infectious diseases among patients, to ensure a pleasant and comfortable surrounding for the patients and their families, and to separate the various departments within the hospital.

SHP Criterion 3 - Charity/Indigent Care

The applicant asserts that all residents of the area, including low income persons, racial and ethnic minorities, women, handicapped persons, other under-served groups, and the elderly have access to the services and will continue to have access to its services in the new facility. AHS provides emergency services twenty-four (24) hours per day to all patients who present to the emergency department regardless of their ability to pay. The applicant asserts that it will continue to provide a reasonable amount of charity and indigent care to its patients.

SHP Criterion 4 - Project Cost

Alliance HealthCare System submits that the cost of the proposed project's new construction (166,090 square feet) will be \$143 per square foot, which does not exceed the median construction costs for similar projects in the state. The equipment costs for the project do not exceed the median costs for equipment of similar quality by more than 15 percent.

B. General Review (GR) Criteria

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

GR Criterion 3 - Availability of Alternatives

According to the applicant, two alternatives to the replacement of the hospital were considered:

1. The hospital could continue operating in the existing building in its current location. This alternative was rejected because such decision would not be in the interest of the hospital's patients or the Marshall County community.
2. AHS considered renovating the building; however, to do so would be extraordinarily costly, estimated at approximately \$13 to \$14 million for renovation alone.

GR Criterion 4 - Economic Viability

The applicant forecasted a loss of \$251,611 for the first year of operation; a net income of \$154,658 and \$597,513 the second and third year of operation, respectively.

GR Criterion 5 - Need

The hospital is currently operating in limited, inadequate space for its 40 acute care beds. The existing physical plant prevents the Joint Commission on Accreditation of Healthcare Organizations from accrediting Alliance HealthCare System because the existing building has only a partial sprinkler system and a potential asbestos issue.

The layout of the existing facility is not conducive to easy physical access and the departments are disjointed and illogically located. The hospital is poised to offer additional obstetrical services but is prevented from doing so because of lack of space. In addition, the laboratory space is inadequate to house the necessary lab equipment needed to provide the hospital's patients with the best quality healthcare available. The emergency room department is too small to provide individuals with the privacy to which patients are entitled.

While the hospital abides by the HIPPA laws and its patients are given the privacy required under law, the privacy available is not optimal in the existing building. Furthermore, there is no additional space available for the hospital to expand on its present campus that would allow AHS sufficient space to conduct the services it renders in an efficient and convenient manner.

The mechanical systems that exist are out-dated, antiquated and a constant source of aggravation because of their never-ending need for substantial maintenance. For example, the thermostats for the heating and cooling do not work properly, the sprinkler system is limited and does not extend to all areas of the building, and the existing building restricts installation of a state-of-the-art HVAC system with environmental controls used to prevent the spread of infectious diseases.

In addition to the needs cited, the major reasons this project is needed are as follows:

1. The existing facility is out-dated and inadequate. The new facility will be a state-of-the-art facility that complements today's delivery of quality health care;
2. The new facility will provide adequate parking with security;
3. Better physical access to all of the hospital's patients;
4. Better and quicker access to other major hospitals in the event a transfer of a patient is necessary;
5. The new facility will have a significantly improved outpatient service department that provides convenient access, thereby relieving the patient of some of the stress associated with hospital services;
6. Allow AHS to attract specialty physicians;
7. The new facility will be easily accessed by all, including the handicapped and the disabled.

GR Criterion 6 - Access to the Facility or Service

According to the applicant, all residents of the service area, including Medicaid recipients, charity/medically indigent patients, racial and ethnic minorities, women, handicapped persons, and the elderly have access to the services of the hospital and will continue to have access to the services of the hospital whether those services are outpatient or inpatient services. The hospital offers and will continue to offer services to patients in need of care regardless of race, age, creed, sex, or ethnic origin in full compliance with applicable state and federal regulations.

According to the applicant, during the last three years of operation, approximately three percent (3%) of the hospital's gross patient revenue (GPR) has been attributable to health care provided to medically indigent and charity care patients. This percentage does not include bad debt.

GR Criterion 7 - Information Requirement

The applicant affirms that it will record and maintain the requested information and make it available to the Mississippi State Department of Health within 15 days of request.

GR Criterion 8 - Relationship to Existing Health Care System

AHS is located in General Hospital Service Area 1 (GHSA), which contains 2,566 licensed acute care beds in the service area. This application does not propose new services in General Hospital Service Area 1.

GR Criterion 9 - Availability of Resources

The hospital does not anticipate the need to add any new employees as a result of the construction of the replacement hospital.

GR Criterion 10 - Relationship to Ancillary or Support Services

The hospital has projected an approximate six percent increase in utilization during the first year of operation in the new facility. Such increase will not result in any change in the costs or charges for such services. The hospital will be able to accommodate the increase in the use of the ancillary and support services.

GR Criterion 16 - Quality of Care

Alliance has a history of providing high quality medical care to the residents of its service area. It has in place a quality improvement program to ensure the delivery of the highest quality care to its patients in the most efficient and effective manner with the resources available. AHS is licensed and certified by the Mississippi State Department of Health and certified for participation in the Medicare and Medicaid programs.

IV. FINANCIAL FEASIBILITY

A. Expenditure Summary

Capital Expenditure Summary	
Construction Cost - New	\$ 20,791,760.00
Construction Cost - Renovation	\$ 0.00
Total Fixed Equipment Cost	\$ 1,244,857.00
Total Non-Fixed Equipment Cost	\$ 7,021,152.00
Land Cost	\$ 0.00
Site Preparation	\$ 0.00
Fees (Architectural, Consultant, etc.)	\$ 750,000.00
Contingency Reserve	\$ 1,000,000.00
Capital Interest (\$625,000 included in construction cost)	\$ 0.00
Other Cost	\$ 0.00
Total Proposed Capital Expenditure	\$ 30,807,769.00

The above estimated capital expenditure is proposed for new construction of 166,090 square feet of space at a per square foot cost of \$ 143.00. This construction cost falls within the median range for new construction projects listed in the Means Construction Cost Data, 2004 edition.

B. Method of Financing

The applicant proposes to finance the proposed project with a commercial loan in the approximate amount of \$31,000,000. A letter from the lending institution was included in the application.

C. Effect on Operating Cost

ASH projects a loss of \$251,611 for the first year of operation; a net income of \$154,658 and \$597,513 the second and third year of operation, respectively. See Attachment 1 for the applicant's Three-Year Projected Operating Statement and Utilization, Cost, and Charges.

D. Cost to Medicaid/Medicare

Based on the gross patient revenue projected in this project, the impact of the project on third party payers is as follows for the first year:

Cost to Medicaid/Medicare & Other Payers			
Payer Mix	Utilization Percentage	Patient Days	First Year Cost
Medicaid	15.0%	894	\$ 1,618,169.10
Medicare	55.0%	3,276	\$ 5,933,286.70
Other Payers	30.0%	1,787	\$ 3,236,338.20
Total	100.0%	5,957	\$ 10,787,794.00

The applicant projects 3 percent of gross patient revenues to be provided to charity/medically indigent patients and 7 percent to bad debt patients for the first years of operation.

Note: Projected cost to third party payers is based on total allowable cost the first full year of operation. Applicant projects that there should be no additional cost to third party payers since the hospital is a PPS-reimbursed facility and since the charges will not increase.

V. RECOMMENDATIONS OF OTHER AFFECTED AGENCIES

The Division of Medicaid was provided a copy of this application for review. No comments were received regarding the project's impact on the Medicaid program. Outpatient services are paid as outlined in the State Plan.

VI. CONCLUSION AND RECOMMENDATION

The project is in substantial compliance with the criteria and standards for construction and relocation as contained in the **2004 State Health Plan**; Chapter 8 of the **Certificate of Need Review Manual**, May 13, 2000 revisions; and all adopted rules, procedures, and plans of the Mississippi State Department of Health. The Division of Health Planning and Resource Development recommends approval of this application submitted by Alliance HealthCare System, Inc.

Attachment 1

AHS Three-Year Projected Operating Statement

EXPENSES	YEAR 1	YEAR 2	YEAR 3
Salaries	\$ 3,053,463.00	\$ 3,198,866.00	\$ 3,344,269.00
Employee Benefits	\$ 439,145.00	\$ 460,057.00	\$ 480,968.00
Supplies	\$ 1,027,414.00	\$ 1,094,006.00	\$ 1,141,571.00
Professional Fees	\$ 579,064.00	\$ 609,476.00	\$ 639,888.00
Other Fees	\$ 34,613.00	\$ 36,187.00	\$ 37,760.00
Repairs & Maintenance	\$ 45,313.00	\$ 65,138.00	\$ 67,970.00
Leases & Rentals	\$ 346,005.00	\$ 357,642.00	\$ 369,278.00
Utilities	\$ 325,619.00	\$ 415,619.00	\$ 505,619.00
Insurance	\$ 32,023.00	\$ 33,479.00	\$ 34,934.00
Management Fees	\$ 600,000.00	\$ 600,000.00	\$ 600,000.00
Bad Debt	\$ 366,667.00	\$ 383,333.00	\$ 400,000.00
Taxes - Non Income	\$ 27,592.00	\$ 28,847.00	\$ 30,101.00
Other Operating Expenses	\$ 1,067,373.00	\$ 1,115,889.00	\$ 1,164,406.00
TOTAL EXPENSES	<u>\$ 7,944,291.00</u>	<u>\$ 8,398,539.00</u>	<u>\$ 8,816,764.00</u>
Inpatient Revenue	\$ 7,600,470.00	\$ 8,233,843.00	\$ 8,867,215.00
Outpatient Revenue	\$ 8,042,501.00	\$ 8,712,709.00	\$ 9,382,918.00
Other Operating Revenue	\$ 365,740.00	\$ 365,740.00	\$ 365,740.00
Total Revenue	<u>\$ 16,008,711.00</u>	<u>\$ 17,312,292.00</u>	<u>\$ 18,615,873.00</u>
Revenue Deductions	<u>\$ (5,472,528.00)</u>	<u>\$ (5,928,572.00)</u>	<u>\$ (6,384,616.00)</u>
Net Operating Revenue	<u>\$ 10,536,183.00</u>	<u>\$ 11,383,720.00</u>	<u>\$ 12,231,257.00</u>
Less Depreciation	\$ (1,539,963.00)	\$ (1,539,963.00)	\$ (1,539,963.00)
Less Interest	\$ (1,303,540.00)	\$ (1,290,560.00)	\$ (1,277,017.00)
NET INCOME (LOSS)	<u>\$ (251,611.00)</u>	<u>\$ 154,658.00</u>	<u>\$ 597,513.00</u>

* Applicant projects approximately 7 percent of gross revenue for bad debt patients, and 3 percent for medically indigent and charity care patients.