EVALUATION OF THE CERTIFICATE OF NEED APPLICATION SUBMITTED BY SWEDISH HEALTH SERVICES PROPOSING TO AMEND CERTIFICATE OF NEED #1379A BECAUSE OF A CHANGE IN SOURCE OF FINANCING

APPLICANT DESCRIPTION

Swedish Health Services (SHS) is a not-for-profit corporation and a 501(c)(3) exempt organization with 100% ownership of Swedish Medical Center.[1] Swedish Medical Center is also a Washington private, not-for-profit corporation and a 501(c)(3) exempt organization. Swedish Medical Center provides Medicare and Medicaid acute care services at the following three campuses in King County.

SHS-First Hill Campus	747 Broadway, Seattle
SHS-Ballard Campus	5300 Tallman Avenue Northwest, Seattle
SHS-Cherry Hill Campus	500 – 17th Avenue, Seattle

The First Hill and Ballard campuses are operated under a single hospital license that combines both campuses. The Cherry Hill campus is operated under a single license separate from the other two campuses. Below is a brief description of each campus. [source: Department of Health's hospital licensing files and CN historical files]

SHS-First Hill Campus

This campus houses 697 acute care beds. Services provided at the First Hill campus include general acute care services, chemical dependency, rehabilitation, obstetrical, level 2 intermediate care, and level 3 neonatal intensive care. Additionally, the First Hill campus provides a variety of tertiary services, including adult and pediatric open heart surgery, pancreas, kidney, and autologous / allogenic bone marrow transplant, and specialized pediatric services. In 2007, Swedish Medical Center received Certificate of Need approval to establish a liver transplant program at its First Hill campus. The First Hill campus holds a three-year accreditation from the Joint Commission.[2]

SHS-Ballard Campus

Swedish Medical Center's Ballard campus is licensed for 133 acute care beds. Services provided at this campus include general acute care. The Ballard campus holds a three-year accreditation from the Joint Commission.

On November 19, 1993, Swedish Medical Center was issued Certificate of Need #1099 approving the establishment of a 30 bed transitional care unit (TCU) within space at the Ballard campus. At that time, the Ballard campus was licensed for 163 acute care beds. CN #1099 approved the redistribution of 30 acute care beds to skilled nursing use. From the implementation of CN #1099 to June 14, 2006, Swedish's Ballard campus operated 133 general medical surgical beds and 30 beds dedicated to skilled nursing. On June 15, 2006, Swedish Medical Center closed its 30 bed TCU and banked those beds under the full facility closure provisions of RCW 70.38.115(13) and

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[1] Swedish Health Services also has ownership percentages in a variety of other healthcare entities, such as home health, ambulatory surgery, and urgent care clinics. Since these entities are not pertinent to this project, they will not be discussed in this evaluation.

[2] The Joint Commission is an independent, not-for-profit organization that accredits and certifies more than 17,000 health care organizations and programs in the United States. Joint Commission accreditation and certification is recognized nationwide as a symbol of quality that reflects an organization's commitment to meeting certain performance standards.

WAC 246-310-396.[3] It is noted that Swedish Medical Center continues to pay the licensing fee for the 30 beds banked under full facility closure, however the 30 beds cannot be used for either skilled nursing or acute care use without prior Certificate of Need review and approval.

SHS-Cherry Hill Campus

With 385 acute care beds, this campus is operated under a separate hospital license from Swedish's First Hill and Ballard campuses. The Cherry Hill campus also holds a three-year accreditation from the Joint Commission. Services provided at the Cherry Hill campus include general acute care, rehabilitation, obstetrical, and adult open heart surgery. Swedish Health Services has obtained a PPS exemption for a 36-bed rehabilitation unit and a 36-bed psychiatric unit.[4]

BACKGROUND INFORMATION

On July 21, 2004, Swedish Health Services submitted an application to establish a 175-bed acute care hospital in the city of Issaquah, within King County. On May 10, 2005, the department denied Swedish's application.[5] After the completion of adjudicative and judicial appeals, on May 31, 2007, the department issued its remand decision related to Swedish's Issaquah Hospital project. The remand decision approved the establishment of a new 175-bed hospital with an estimated capital cost of $197,129,572. In the 2004 application, Swedish Health Services stated that it would fund the project with cash reserves. Further, SHS intended to fund the cash flow since the hospital was expected to operate at a loss in the first two years of operation. A review of SHS's 2003 audited financial report demonstrated that SHS had the funds available to fund the project and the cash flow. [source: CN Program's May 31, 2007, remand evaluation, pp21-22]

On June 14, 2010, CN #1379A was issued to SHS approving a change in the approved site. At the time, the site change was not expected to change any of the other approvals of the project. [source: June 14, 2010, amendment evaluation, p3]

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[3] The eight-year bed banking for these 30 beds expires on June 15, 2014.

[4] Prospective Payment System (PPS) is a method of reimbursement in which Medicare payment is made based on a predetermined, fixed amount. The payment amount for a particular service is derived based on the classification system of that service (for example, diagnosis-related groups [DRGs] for inpatient hospital services). CMS uses separate PPSs for reimbursement to acute inpatient hospitals, home health agencies, hospice, hospital outpatient, inpatient psychiatric facilities, inpatient rehabilitation facilities, long-term care hospitals, and skilled nursing facilities. Since October 1, 1983, most hospitals have been paid under the hospital inpatient PPS. However, certain types of specialty hospitals and units were excluded from PPS because the PPS diagnosis related groups do not accurately account for the resource costs for the types of patients treated in those facilities. Facilities originally excluded from PPS included rehabilitation, psychiatric, children's, cancer, and long term care hospitals, rehabilitation and psychiatric hospital distinct part units, and hospitals located outside the 50 states and Puerto Rico. These providers continued to be paid according to Section 1886(b) of the Social Security Act, as amended by Section 101 of the Tax Equity and Fiscal Responsibility Act (TEFRA) of 1982. They are frequently referred to as TEFRA facilities or PPS exempt. These facilities are paid on the basis of Medicare reasonable costs per case, limited by a hospital specific target amount per discharge. Each hospital has a separate payment limit or target amount which was calculated based on the hospital's cost per discharge in a base year. The base year target amount is adjusted annually by an update factor. [source: CMS website]

[5] Overlake Hospital Medical Center (OHMC) also submitted an application to establish an acute care hospital in Issaquah. OHMC's project was also denied. Through the course of adjudication and judicial appeal, OHMC dropped its appeal. Since the OHMC application is not relevant to this amendment project, it will not be discussed in this evaluation.

PROJECT DESCRIPTION

With this application, SHS proposes to amend CN#1379A because of a change in the source of financing. SHS states no other changes to this project have occurred. [source: Application, pp8-15] As a result, this evaluation will only address the change in the funding source.

APPLICABILITY OF CERTIFICATE OF NEED LAW

This project is subject to review under WAC 246-310-570(1)(d) because the funding source for the project has changed.

CRITERIA EVALUATION

WAC 246-310-200(1)(a)-(d) identifies the four determinations that the department must make for each application. WAC 246-310-200(2) provides additional direction in how the department is to make its determinations. It states:

"Criteria contained in this section and in WAC 246-310-210, 246-310-220, 246-310-230, and 246-310-240 shall be used by the department in making the required determinations.

(a) In the use of criteria for making the required determinations, the department shall consider:

(i) The consistency of the proposed project with service or facility standards contained in this chapter;

(ii) In the event the standards contained in this chapter do not address in sufficient detail for a required determination the services or facilities for health services proposed, the department may consider standards not in conflict with those standards in accordance with subsection (2)(b) of this section; and

(iii) The relationship of the proposed project to the long-range plan (if any) of the person proposing the project."

In the event the WAC 246-310 does not contain service or facility standards in sufficient detail to make the required determinations, WAC 246-310-200(2)(b) identifies the types of standards the department may consider in making its required determinations. Specifically WAC 246-310-200(2)(b) states:

"The department may consider any of the following in its use of criteria for making the required determinations:

(i) Nationally recognized standards from professional organizations;

(ii) Standards developed by professional organizations in Washington state;

(iii) Federal Medicare and Medicaid certification requirements;

(iv) State licensing requirements;

(v) Applicable standards developed by other individuals, groups, or organizations with recognized expertise related to a proposed undertaking; and

(vi) The written findings and recommendations of individuals, groups, or organizations with recognized expertise related to a proposed undertaking, with whom the department consults during the review of an application."

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. While SHS's initial project was delayed, the site has changed [CN #1379A], and the source of funding has changed, the project was not significantly altered under CN rules. As a result, the department's review will focus on

financial feasibility (WAC 246-310-220) and cost containment (WAC 246-310-240). Additionally, all terms and conditions of the initial approval and the first amended approval that are not requested to be explicitly modified as part of an applicant's request for an amendment remain in effect.

CN #1379 and #1379A were both issued with a detailed description of the three phases of the project, two conditions, and no terms. The first condition related to the charity care to be provided at the new hospital; the second condition related to the number of beds to be added in each of the three phases, ending with a 175-bed hospital. The detailed description and both conditions were not requested to be amended in this application.

APPLICATION CHRONOLOGY

February 22 2010	Letter of Intent submitted
July 20, 2010	Application submitted
July 21, 2010, through October 3, 2010	Department's Pre-Review Activities • 1st screening activities and responses • Supplemental questions and responses
October 4, 2010	Department Begins Review of the Amendment Application • public comments accepted throughout review • no public hearing conducted under the expedited review rules
October 25, 2010	End of Public Comment
November 9, 2010	Rebuttal Comments Submitted by Swedish Health Services
November 29, 2010	Department's Anticipated Decision Date
November 29, 2010	Department's Actual Decision Date

AFFECTED PERSONS

Washington Administrative Code 246-310-010(2) defines "*affected person*" as:
"...an "*interested person*" who:

(a) Is located or resides in the applicant's health service area;
(b) Testified at a public hearing or submitted written evidence; and
(c) Requested in writing to be informed of the department's decision."

Throughout the review of this project, two entities sought and received affected person status under WAC 246-310-010(2).

- Overlake Hospital Medical Center – a 337 bed hospital located at 1035 - 116th Avenue Northeast in Bellevue, within King County; and
- Premera Blue Cross - a nonprofit Blue Cross Blue Shield licensed health insurance company based in Mountlake Terrace. Premera Blue Cross sells health insurance plans under the Blue Cross license in Washington State.[6]

[6] In all counties, except Clark County.

SOURCE INFORMATION REVIEWED

- Swedish Health Services' Certificate of Need amendment application submitted July 20, 2010
- Swedish Health Services' supplemental information received September 27, 2010
- Swedish Health Services' supplemental information received October 7, 2010
- Public comments submitted by Overlake Hospital Medical Center received August 23, 2010
- Public comments submitted by Overlake Hospital Medical Center received October 25, 2010
- Swedish Health Services' rebuttal comments received November 9, 2010
- The department's May 31, 2007, remand evaluation approving Swedish Health Services' initial application to establish a 175-bed hospital in Issaquah
- The department's July 2, 2007, "Intent to Issue a Certificate of Need"
- Quarterly Progress Reports completed and submitted by Swedish Health Services related to the department's "Intent to Issue a Certificate of Need" and CN #1379 [Reports submitted quarterly beginning in September 2007, and each quarter thereafter for years 2008 and 2009, plus March, June, and September 2010 quarterly report.]
- Certificate of Need #1379 issued on July 31, 2008
- The department's June 14, 2010, evaluation supporting the issuance of Certificate of Need #1379A
- Certificate of Need #1379A issued June 14, 2010
- Financial feasibility evaluation prepared by the Department of Health's Hospital and Patient Data Systems received November 18, 2010
- Joint Commission website [www.jointcommission.org]

CONCLUSION

For the reasons stated in this evaluation, the application submitted on behalf of Swedish Health Services proposing to amend Certificate of Need #1379A because of a change in the approved financing is approved, and an amended Certificate of Need should be issued.

In its May 31, 2007, remand evaluation, the department concluded that Swedish Health Services' project was consistent with application criteria of the Certificate of Need Program if the applicant provided written agreement with two 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 three phases of the project and the number of beds to be added at each phase. The intent of any condition related to phases 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.

In its June 14, 2010, evaluation, the department concluded that both of the conditions are relevant to the amended approval, and CN #1379A was issued with both conditions.

This amendment project does not request modification of either of the two conditions. As a result, the department's approval of this amendment project will include the two conditions as identified in the remand evaluation approving the project. The two conditions are restated below.

Conditions

1. Swedish Health Services' new Issaquah 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, Swedish Health Services 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 as of the writing of the department's original evaluation. For historical years 2001-2003, these amounts are 0.82% gross revenue and 1.44% adjusted revenue. Swedish Health Services 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. Construction of the facility is to be in three phases. Phase one shall consist of 80 beds. Phase two shall consist of 40 beds. Phase three shall consist of 55 beds. If phase three is not completed within seven years of the completion of phase one, any remaining bed authorization not meeting licensing requirements shall be forfeited. If construction of phase three consists of any amount less than the 55, the bed capacity meeting the licensing requirements at that time shall be the facility's final Certificate of Need authorized bed count.

With the change in financing from cash reserves to tax exempt bond financing, the capital expenditure increased from $197,129,572 to $210,944,529. This increase of $13,814,957 is solely related to the costs for securing financing and interim interest. The approved capital expenditure for this project is $210,944,529.

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.

WAC 246-310 does not contain specific WAC 246-310-220(1) financial feasibility criteria as identified in WAC 246-310-200(2)(a)(i). There are also no known recognized standards as identified in WAC 246-310-200(2)(a)(ii) and (b) that directs what the operating revenues and expenses should be for a project of this type and size. Therefore, using its experience and expertise the department evaluates if the applicant's pro forma income statements reasonably project the proposed project is meeting its immediate and long-range capital and operating costs by the end of the third complete year of operation.

SHS's Remand Evaluation Summary

In its May 31, 2007, remand evaluation supporting the issuance of CN #1379, the department concluded that this sub-criterion was met based on the following factors:

1) a review of SHS's projected hospital utilization as an 80 bed hospital (phase one), 120-bed hospital (phase two) and a 175-bed hospital (phase three). This review included proposed revenues, expenses, and net profit for years 2009 through 2018;
2) financial ratio analysis provided by the department's Hospital and Patient Data Systems (HPDS) dated May 5, 2005; and
3) a review of SHS's historical audited financial reports dated December 31, 2003.

[source: Department's remand evaluation, pp19-20]

SHS Amendment Application Review

In the initial application, the 175-bed hospital would be implemented in three phases.

Phase one included build out of space for 80 inpatient beds. Services to be provided in phase one include intensive care, acute care, pediatric, and OB/birthing. SHS did not intend to provide Level 2 intermediate care or Level 3 neonatal intensive care services. The 80-bed facility would also have 6 combined inpatient/outpatient operating rooms.

Commencement of phase two is dependent on the 80-bed hospital's utilization. This phase includes the completion of the shelled-in space for 40 more beds and obtaining licensure for those beds. This phase also includes the addition of two more ORs, for a total of 8 combined inpatient/outpatient operating rooms.

Phase three is dependent on the successful utilization of phase two and includes the build out and completion of space for the remaining 55 beds. At 120 beds, the proposed hospital would increase its ORs by two for a total of 10 combined inpatient/outpatient ORs. The chart on the following page shows the configuration of all 175 beds in each of the three phases.

Service/Department	Phase 1 # of beds	Phase 2 # of beds	Phase 3 # of beds
Intensive care	12 beds	24 beds	32 beds
Acute care	52 beds	76 beds	112 beds
OB/birthing	8 beds	12 beds	23 beds
Pediatric	8 beds	8 beds	8 beds
Total Beds	80 Beds	120 Beds	175 Beds
Total ORs	6 in/out patient	8 in/out patient	10 in/out patient

In the initial application, SHS provided methodology and assumptions it used to project the revenue and expense statements for the hospital covering all three phases. As an 80-bed hospital, SHS projected 2,582 admissions and 10,189 patient days in year one of phase one. At that time, year one of phase one was anticipated to be year 2009. Admissions and patient days were expected to increase in year two of phase one (year 2010) to 4,267 and 16,840, respectively. SHS projected the hospital would operate at a loss in both of these years. By the end of year three of phase one (2011), patient days and admissions were projected increase to 6,066 and 23,937, respectively. For subsequent years four through ten, (2012-2018), SHS expected the hospital would continue to operate at a profit. However, the profit would slightly decrease the first year that all 175 beds would be operational (2016). [source: May 10, 2005, initial evaluation, pp39-40]

For this amendment project, SHS provided revised revenue and expense statements for all three phases. The years covered for this amendment project are 2012 (year one of phase one) through 2021 (year three of phase three). [source: Application, Exhibit 2]

In this amendment application, SHS also provided the methodology and assumptions used to project the revenue and expense statements covering all three phases. Below is a summary of that information. [source: Application, pp26-27]

General

- 2008 base year actual utilized for all revenue and expenses. Trended to 2010 for charges, reimbursement, and expenses
- Explicit adjustment for expected health care reform: 3.5% annual decrease to Medicare/Medicaid reimbursement from 2015 – 2021
- Financial model revised from original application to reflect bond financing, specifically the cost of issuance, the additional operating costs of bond interest, and the additional cash flow impact of principal payback
- Bad debt and charity care percentages of gross revenues set at initial certificate of need values

Project Capital Costs

- Revised capital costs of $210,944,529. This amount is calculated as shown below.

Approved capital expenditure for CN #1379	$197,129,572
Subtract reduction in land purchase costs for CN #1379A	$900,000
Add costs for tax-exempt financing	$14,714,957
Revised Capital Costs	**$210,944,529**

Program/Service Mix

- Outpatient cancer services (chemotherapy and radiation oncology), PET/CT, and retail operations (e.g. pharmacy) are excluded consistent with the initial application
- Portions of the medical office building containing pre-admission testing, outpatient rehabilitation, administration, and part of the hospital/clinic common area are included, consistent with the initial application

Patient Volumes

- The number of admissions and inpatient days excludes normal newborns[7]

Revenues

- Payer mix [shown in a table]
- Gross/Net Revenue is based on 2008 SHS history for all campuses grouped by the Swedish Issaquah service categories and adjusted by payer mix
- Swedish history filtered to represent expected Swedish Issaquah service mix
- Gross revenue includes both inpatient and outpatient revenue

Expenses

- Created a list of cost centers for Swedish Issaquah, then chose a proxy cost center from one of Swedish's 4 campuses: Swedish First Hill, Swedish Cherry Hill, Swedish Ballard, and Issaquah for each cost center
- Expenses were detailed down to the ledger type of account
- Created ratios from statistics to calculate variable expenses
- Corporate allocation set a 70% of allocation ratios for Swedish First Hill and Cherry Hill campuses

Tables 1A and 1B shown on the following page is a summary of the revised revenue and expense statements for all three phases. [source: Application, Exhibit 2]

[7] Normal newborns is diagnosis related grouping (DRG) 795, formerly DRG 391

Table 1A
Swedish Issaquah Hospital
Years 2012 – 2016 Revised Revenue and Expense Statement Summary

	2012	2013	2014	2015	2016
# of Beds	80	80	80	120	120
# of Admissions	2,362	4,267	6,066	7,900	8,402
# of Inpatient Days	9,322	16,839	23,936	31,174	33,157
Average Daily Census	25.54	46.13	65.58	85.41	90.84
% Occupancy	31.9%	57.7%	82.0%	71.2%	75.7%

Gross Revenue	$248,750,535	$385,941,465	$497,964,092	$606,959,461	$640,733,660
Minus Deductions	$157,197,363	$245,080,272	$317,357,050	$389,637,276	$413,567,059
Net Revenue	**$91,553,172**	**$140,861,193**	**$180,607,042**	**$217,322,185**	**$227,166,601**
Expenses	$94,471,029	$124,251,391	$147,357,096	$172,237,201	$180,284,021
Plus Corporate Allocations	$11,984,310	$18,438,730	$23,641,462	$28,447,474	$29,736,108
Total Expenses	**$106,455,339**	**$142,690,121**	**$170,998,558**	**$200,684,675**	**$210,020,129**
Net Profit or (Loss) btid	**($14,902,167)**	**($1,828,928)**	**$9,608,484**	**$16,637,510**	**$17,146,472**

Table 1B
Swedish Issaquah Hospital
Years 2017 – 2021 Revised Revenue and Expense Statement Summary

	2017	2018	2019	2020	2021
# of Beds	120	120	175	175	175
# of Admissions	8,930	9,508	10,116	10,777	11,466
# of Inpatient Days	35,241	37,520	39,921	42,527	45,248
Average Daily Census	96.55	102.79	109.37	116.51	123.97
% Occupancy	80.5%	85.7%	62.5%	66.6%	70.8%

Gross Revenue	$676,560,657	$715,840,848	$758,398,818	$804,940,548	$852,834,626
Minus Deductions	$438,999,721	$466,869,538	$497,083,091	$530,126,501	$564,308,470
Net Revenue	**$237,560,936**	**$248,971,310**	**$261,315,727**	**$274,814,047**	**$288,526,156**
Expenses	$187,770,434	$194,432,710	$206,625,473	$215,108,986	$225,065,916
Plus Corporate Allocations	$31,096,727	$32,590,344	$34,206,229	$35,973,159	$37,768,074
Total Expenses	**$218,867,161**	**$227,023,054**	**$240,831,702**	**$251,082,145**	**$262,833,990**
Net Profit or (Loss) btid	**$18,693,775**	**$21,948,256**	**$20,484,025**	**$23,731,902**	**$25,692,166**

As shown in Table 1A and 1B above, the revised statements continue to show a net loss in the first two years of operation for phase one (2012 and 2013), and a profit in each of the subsequent years (2014 through 2021). As in the initial statements, SHS anticipates a slight decrease in profits for year one of phase three, which is the first year that all 175 beds are operational (2019). [source: Application, Exhibit 2]

To determine whether SHS would meet its immediate and long range capital costs, the department's Hospital and Patient Data Systems (HPDS) reviewed current and projected balance sheets. Historical year [2009] for Swedish Health Services as a whole and year three/phase three

[2021] for the Issaquah hospital are shown in Tables 2A and 2B below. [source: HPDS analysis, p2 and October 7, 2010 supplemental information, Exhibit 1]

Table 2A
Swedish Health Services Balance Sheet for Year 2009

Assets		**Liabilities**	
Current Assets	$ 439,273,379	Current Liabilities	$ 261,035,553
Fixed Assets	$ 1,071,892,880	Long Term Debt	$ 635,326,160
Board Designated Assets	$ 404,405,878	Other Liabilities	$ 73,324,287
Other Assets	$ 43,812,655	**Equity**	**$ 989,698,792**
Total Assets	**$ 1,959,384,792**	**Total Liabilities and Equity**	**$ 1,959,384,792**

Table 2B
Swedish Issaquah Hospital Balance Sheet for Projected Year 2021

Assets		**Liabilities**	
Current Assets	$ 145,015,317	Current Liabilities	$ 33,468,662
Fixed Assets	$ 106,121,926	Long Term Debt	$ 126,566,717
Board Designated Assets	$ 0	Other Liabilities	$ 0
Other Assets	$ 37,117,634	**Equity**	**$ 128,219,498**
Total Assets	**$ 288,254,877**	**Total Liabilities and Equity**	**$ 288,254,877**

To assist the department in its evaluation of this sub-criterion, HPDS provided a summary of the short and long-term financial feasibility of the project, which includes a financial ratio analysis. The analysis assesses the financial position of an applicant, both historically and prospectively. The financial ratios typically analyzed are **1)** long-term debt to equity; **2)** current assets to current liabilities; **3)** assets financed by liabilities; **4)** total operating expense to total operating revenue; and **5)** debt service coverage. If a project's ratios are within the expected value range, the project can be expected to be financially feasible. Additionally, HPDS reviews a project's projected statement of operations to evaluate the applicant's immediate ability to finance the service and long term ability to sustain the service.

For Certificate of Need applications, HPDS compared the projected ratios with the most recent year financial ratio guidelines for hospital operations. For this project, HPDS used 2008 data for comparison with current year 2009 for SHS as a whole, and projected years 2019, 2020, and 2021 for the Issaquah hospital. The ratio comparisons are shown in Table 3 on the following page. [source: HPDS analysis, p3]

Table 3
Current and Projected HPDS Debt Ratios for Swedish Health Services & Hospital

Category	Trend[8]	State 2008	Current SHS 2009	Projected Issaquah 2019	Projected Issaquah 2020	Projected Issaquah 2021
Long Term Debt to Equity	B	0.526	0.837	1.853	1.323	0.987
Current Assets/Current Liabilities	A	1.878	1.934	2.889	3.609	4.333
Assets Funded by Liabilities	B	0.436	0.433	0.694	0.622	0.555
Operating Expense/Operating Revenue	B	0.950	0.969	0.922	0.914	0.911
Debt Service Coverage	A	4.694	8.200	2.275	2.413	2.552
Definitions:	**Formula**					
Long Term Debt to Equity	Long Term Debt/Equity					
Current Assets/Current Liabilities	Current Assets/Current Liabilities					
Assets Funded by Liabilities	Current Liabilities + Long term Debt/Assets					
Operating Expense/Operating Revenue	Operating expenses / operating revenue					
Debt Service Coverage	Net Profit+Depr and Interest Exp/Current Mat. LTD and Interest Exp					

Comparing SHS's most current (2009) ratios with the statewide ratios (2008) revealed that the long term debt to equity ratio is out of range, however, the board designated assets are very strong, which offset this ratio. The operating expense to operating revenue is slightly low, but within an acceptable range.

Comparing the Issaquah hospital's projected ratios show all ratios are out of range, however they are improving significantly as the assets and equity improves each year. After evaluating the hospital's projected ratios and statement of operations for years 2010-2021, staff from HPDS provided the following analysis. [source: HPDS analysis, p3]

> *"...The reason the ratios start out of range is that from an accounting standpoint, the hospital is starting new, with the full debt and depreciation load that brings. Also, Swedish-Issaquah does not use Board Designated Assets, the funds are kept at the parent corporation. Swedish Health Services strong asset base helps secure this project. CON 2021 fiscal year end ratios for Swedish-Issaquah are acceptable and Swedish-Issaquah hospital is breaking even in the third year of operation."*

Given that the other ratios are within the normal range, the current assets to current liabilities ratio is not of concern for this project.

Overlake Hospital Medical Center (OHMC) provided extensive comments related to this sub-criterion. Specifically, when comparing the revenue and expense statements summarized above with the statements provided in the 2005 initial application, OHMC noted several differences. A summary of the differences and OHMC's comments is below. [source: OHMC, August 23, 2010, public comments, 2-3; October 25, 2010, public comments, p3-8]

Revisions in outpatient projections

OHMC states that SHS acknowledges that its revised outpatient forecasts are at the center of the changes in the financial projections. OHMC asserts that SHS did not provide enough explanation of the changes or the assumptions used to make these changes. Finally, OHMC asserts that the

[8] A is better if above the ratio, and B is better if below the ratio.

explanation that SHS provided related to the change in outpatient projections is flawed, cannot be substantiated, and is unreliable.

Revisions in inpatient projections
OHMC notes that the inpatient market shares in the East King planning area is principally shared between OHMC, Evergreen Hospital Medical Center, Snoqualmie Valley Hospital, and some downtown Seattle hospitals.[9] OHMC asserts that SHS based its revised inpatient projections, in part, on its outpatient services currently provided in the planning area. OHMC asserts that this is not a reliable factor to be used in projecting inpatient projections.

Increase in revenue projections
OHMC challenges SHS's revenue projections because the assumptions used are different than those used in its initial application. OHMC asserts that SHS's assumptions cannot be considered reliable without extensive supporting backup documentation.

Significant changes in expense line items
OHMC asserts that SHS is attempting to hide its true expenses for the hospital by making the hospital appear to be in better financial health than it would be. One example of this action is that SHS did not simply add its interest expense incurred for the tax-exempt financing to its pro-forma revenue and expense statement provided in the initial application. Rather, SHS revised the statement, added in the interest expense, and submitted it without explanation of the changes. OHMC further validates this assertion by pointing out that SHMC no longer lists its 'corporate allocation' expenses under operating expenses, rather the allocation costs are below the Net Income (Loss) line item.

In response to OHMC's concerns summarized above, SHS provided additional detailed information, which is also summarized below. [source: SHS November 9, 2010, rebuttal responses, pp3-15]

Revisions in outpatient projections
SHS acknowledges that it updated its entire financial statements using updated information. For example, SHS states that when its initial application was prepared and submitted in 2004, it used actual 2002 financial statistics from its existing Ballard campus as the foundation Issaquah hospital model. At that time, SHS believed this approach to be reasonable, yet conservative. For this amendment application, SHS revised it financial forecasts to reflect more current volume, revenue, and expense statistics, rather than just adjusting its 8-year old statics and assumptions.

Specific to outpatient projections, SHS used the HealthCare Advisory Board's Outpatient Market Forecaster. This tool is considered to be more accurate and sophisticated for outpatient projections. SHS also accounted for the existing outpatient providers for east King County residents.

Revisions in inpatient projections
Since the projected was approved in 2005, SHS has developed a cost center based forecasting model for its Issaquah hospital. Instead of choosing which existing SHS campus would be most similar to the Issaquah hospital campus and using that campus's statistics for the basis for the projections, SHS forecasted its Issaquah financials on a cost center specific basis. More clearly

[9] OHMC does not identify which hospitals located in downtown Seattle.

stated, SHS selected the most analogous cost center among its other campuses for the Issaquah hospital projections.

Increase in revenue projections
SHS used 2008 actual statistics for revenues and expenses as the foundation for the revised forecast model for its Issaquah hospital. This approach is considered by SHS to be more reflective of the current times, rather than basing this amendment application on 8-year old, outdated statistics and assumptions.

Significant changes in expense line items
Using the updated model as described above, SHS presented its cost allocations differently than was presented in its initial application.

Department's Review
As stated in the background section of this evaluation, SHS initially submitted its application to establish a 175-bed hospital in three phases on April 6, 2004. The department initially denied the project on May 10, 2005. On May 31, 2007, more than two years after the initial denial, the department released its remand evaluation as directed by the King County Superior Court judge. On June 14, 2010, more than five years after the initial denial, the department released its amendment evaluation approving the change in site for the hospital. In all, more than six years have elapsed since the initial application was prepared and submitted to the department for review. During this time, many changes have occurred in the healthcare industry and in the economy.

When SHS submitted this application for a change in the funding source, it appropriately updated its financial projections. During the screening of this application, the department requested extensive documentation and explanations regarding those changes. Additionally, OHMC was afforded the opportunity to provide extensive comments twice on this amendment project, where it focused on the financial information in the application.

Based on the time that has lapsed since SHS prepared its initial application and SHS's explanations and documentation supporting its changes in its financial statements, the department concludes that SHS's approach is reasonable and appropriate.

Based on the information above, the department concludes that the immediate and long-range operating costs of the project can be met. 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.*
WAC 246-310 does not contain specific WAC 246-310-220(2) financial feasibility criteria as identified in WAC 246-310-200(2)(a)(i). There are also no known recognized standards as identified in WAC 246-310-200(2)(a)(ii) and (b) that directs what an unreasonable impact on costs and charges would be for a project of this type and size. Therefore, using its experience and expertise the department compared the proposed project's costs with those previously considered by the department.

SHS's Remand Evaluation Summary

In its May 31, 2007, remand evaluation supporting the issuance of CN #1249, the department concluded that this sub-criterion was met based on the following factors:

1) SHS's basis for establishing its construction costs for the 175-bed hospital; and
2) construction cost analysis provided by HPDS dated May 5, 2005.
   [source: Department's remand evaluation, pp20-21]

SHS Amendment Application Review

In this amendment application, SHS states the change in the funding from cash reserves to tax-exempt bonds results in no significant change in the capital costs, other than those directly related to the bond financing. Costs directly related to bond financing include costs for securing financing and interim interest for a combined increase of $13,814,957. [source: Application, p21]

SHS also states that the project is in the early stages of building out phase one and costs will increase and decrease as the project moves forward. SHS intends to closely monitor the costs of the project. Further, if the capital costs of the project ultimately exceed the 12% of the approved costs, SHS would submit another amendment application. [source: November 9, 2010, rebuttal documents, p5]

HPDS also compared SHS's costs and charges to the year 2009 statewide average and determined that they are reasonable. [source: HPDS analysis, p4]

Based on the information above, the department concludes this sub-criterion remains met.

(3) The project can be appropriately financed.

WAC 246-310 does not contain specific source of financing criteria as identified in WAC 246-310-200(2)(a)(i). There are also no known recognized standards as identified in WAC 246-310-200(2)(a)(ii) and (b) that directs how a project of this type and size should be financed. Therefore, using its experience and expertise the department compared the proposed project's source of financing to those previously considered by the department.

SHS's Remand Evaluation Summary

In its May 31, 2007, remand evaluation supporting the issuance of CN #1379, the department evaluated SHS's funding for the project. In the initial application, SHS intended to fund the project through its cash reserves. The department concluded that this method of funding was reasonable and this sub-criterion was met based on the following factors:

1) SHS's phase-in approach to build the new hospital over the course of eight years;
2) SHS's basis for establishing its construction costs for each of the two identified sites; and
2) SHS's historical financial analysis provided by HPDS dated May 5, 2005.
   [source: May 31, 2007, remand evaluation, pp21-22]

SHS Amendment Application Review

In the initial application, SHS identified a capital cost to build all three phases of the hospital to be $197,129,572, and SHS intended to fund the project with cash reserves. This amendment application was submitted because SHS changed its funding source from cash reserves to tax exempt bond financing. The change in financing also increases the capital costs for the project because capitalized interest is included in the identified capital expenditure.

SHS provided a table comparing the costs in the initial application and the costs in this amendment application. [source: Application, p21] A summary of that information is shown in Table 4 below.

Table 4
Swedish Health System- Issaquah Hospital Project
Initial and Amended Capital Cost Comparison

Item	Initial Costs	Amendment Costs
Land Purchase	$18,400,000	$17,500,000
Site Preparation	$4,000,000	$4,000,000
Construction Costs	$109,150,865	$109,150,865
Moveable Equipment	$15,903,754	$15,903,754
Fixed Equipment	$12,832,874	$12,832,874
Architect / Engineering Fees	$18,000,127	$18,000,127
Consultant Fees	$1,804,296	$1,804,296
Supervision & Inspection	$3,599,823	$3,599,823
Costs for Securing Financing	$0	$4,218,891
Costs of Interim Interest	$0	$10,496,066
Washington State Sales Tax	$12,272,836	$12,272,836
Other (Permits, CN filing fees)	$1,164,997	$1,164,997
Total Estimated Capital Costs	**$197,129,572**	**$210,944,529**

As shown in the table above, for this project, SHS anticipates no changes in the capital costs, other than those directly related to the bond financing.

SHS intends to obtain two 30-year tax-exempt bonds for this project. The first bonds would be for $97,131,377 and obtained in the approximately the fourth quarter of year 2010. The interest rate for this bond series is 5.49%. The second bonds would be for $113,813,152, and obtained in approximately the second quarter of year 2011. The interest rate for this bond series is 5.61%. SHS states that multiple bond financing is most prudent and cost effective because its limits incurring debt on money before the expenditures are made. [source: Application pp13-14; September 27, 2010, supplemental information, pp1-2]

Once SHS elected to fund the project with tax exempt bonds, consistent with Certificate of Need rules, costs for securing financing and interim interest must be included in the capital costs, for a combined increase of $13,814,957.

SHS provided the following explanation for initially considering the change in funding source. [source: October 7, 2010, supplemental information, p2]

> *SHS experienced a significant downturn in its asset position during the year 2008 as a result of the market collapse. This can be verified in its audited financial statements for the years 2008 and 2009 included as Exhibit 5 in the amendment application. As a result, while still in a very strong financial position, Swedish's overall liquidity position was diminished. The timing and magnitude of this downturn affected the original decision to fund Swedish Issaquah Hospital with accumulated reserves. Stated another way, the opportunity costs of 'cash flowing' the new hospital, given the size of its capital*

requirements and timing, became significantly greater after the market collapse. Swedish experienced a diminished asset position, yet in addition to the new hospital, it still had many other competing uses for its accumulated reserves. This included current and planned routine capital expenditures of millions of dollars each year for Swedish Health Services' existing operations, capital typically funded from accumulated reserves."

Given the downturn in the economy and resulting downturn in SHS's assets, continuing to fund the project with cash reserves required borrowing capital to fund routine projects. This action results in debt accumulation for other capital expenditures. SHS determined it would be less costly to obtain tax exempt bonds once for a long-lived project, rather than multiple times for smaller projects with much shorter useful lives. Additionally, one long-lived project would have better financial terms than many smaller projects. [source: October 7, 2010, supplemental information, pp1-3]

Once SHS concluded that it would debt finance the project, SHS considered, and ultimately rejected, the option of debt financing with sources other than tax-exempt bonds—specifically through commercial loans. Since commercial loan financing carries a higher debt cost when compared to tax-exempt bonds, this option was rejected. [source: October 7, 2010, supplemental information, p2]

In summary, because of its current financial position after the market collapse, SHS selected the tax exempt bond financing because it was considered the most efficient and least costly given the size and timing of the project and taking into consideration other competing uses for its cash reserves.

OHMC raised concerns related to this sub-criterion. During the 2005 initial review of both SHS and OHMC's projects to establish a new hospital in Issaquah, representatives of SHS, including its chief financial officer, submitted written comments outlining the benefits of cash reserve funding proposed by SHS versus 90% tax-exempt bond financing proposed by OHMC. Given the statements made by SHS's representatives in 2005, OHMC asserts that the long term viability of SHS may be compromised if it changes its funding source from cash reserves to 100% tax-exempt bonds. [source: OHMC, October 25, 2010, public comments, p4 & Exhibit A]

In response to OHMC's comments, SHS reiterated its assertions that tax-exempt bond financing is the best option in light of the downturn in market conditions that occurred after the project was initially approved in July 2007.

To determine whether the funding continues to be available, the department reviewed SHS's most recent quarterly financial data submitted to the department's Hospital and Patient Data Systems office. The historical financial data covers full year 2009. Based on SHS's historical financial review, even with the recent downturn in the economy, SHS continues to be in strong financial health. [source: Full year 2009 quarterly financial reports obtained from HPDS] This sub-criterion remain is 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.

To determine if a proposed project is the best alternative, the department takes a multi-step approach. Step one determines if the application has met the other criteria of WAC 246-310-210 thru 230. If it has failed to meet one or more of these criteria then the project is determined not to be the best alternative, and would fail this sub-criterion.

If the project met WAC 246-310-210 through 230 criteria, the department would move to step two in the process and assess the other options the applicant or applicants considered prior to submitting the application under review. If the department determines the proposed project is better or equal to other options the applicant considered before submitting their application, the determination is either made that this criterion is met (regular or expedited reviews), or in the case of projects under concurrent review, move on to step three.

Step three of this assessment is to apply any service or facility specific criteria (tie-breaker) contained in WAC 246-310. The tiebreaker criteria are objective measures used to compare competing projects and make the determination between two or more approvable projects which is the best alternative. If WAC 246-310 does not contain any service or facility criteria as directed by WAC 246-310-200(2)(a)(i), then the department would look to WAC 246-310-240(2)(a)(ii) and (b) for criteria to make the assessment of the competing proposals. If there are no known recognized standards as identified in WAC 246-310-200(2)(a)(ii) and (b), then using its experience and expertise, the department would assess the competing projects and determine which project should be approved.

SHS's Remand Evaluation Summary

In its May 31, 2007, remand evaluation supporting the issuance of CN #1379, the department concluded that this sub-criterion was met based on the following factors:

1) a review of the options considered by SHS before submitting the initial application;
2) the department's numeric need methodology concluded need for additional bed capacity in the East King County planning area was demonstrated; and
3) SHS's application proposed to add acute care bed capacity to the planning area in three phases, thereby filling the need in the planning area without significantly over-bedding the planning area at any one time.

As a result, the department concluded SHS's project was the best alternative for the East King County planning area, and SHS's three-phase project was approved. [source: Department's remand evaluation, pp16, 17, & 25 and Appendices 10A, 10B, & 10C]

SHS Amendment Application Review

To evaluate SHS's amendment project, the department begins with the three steps identified above.

Step One

For this project, SHS has met the applicable review criteria under WAC 246-310-220. Therefore, the department moves to step two below.

Step Two

SHS is in the early stages of beginning construction of the new hospital at the new site approved on June 14, 2010. In its initial application, SHS stated it would fund the project with 100% cash reserves, and provided financial information demonstrating compliance with review criteria based on this funding source. The department's initial financial review was based on this funding source. Since a change in the funding from cash reserves to tax exempt bonds could negatively affect SHS's financial projections or its overall financial viability, SHS's submission of an amended application is necessary.

Additionally, in the previous sub-criteria, the department concluded that SHS continues to be in strong financial health even with the recent downturn in the economy. Moving forward with this project, even with the change in funding sources, continues to be the best option for the residents of the community.

Step Three

This step is used to determine between two or more approvable projects which is the best alternative. While SHS's initial application did undergo a comparative review with Overlake Hospital Medical Center, this amendment application is not undergoing concurrent review.

Based on the information above, the department concludes this project continues to be the best available alternative for the residents of Issaquah and surrounding communities. 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

This sub-criterion is evaluated within the financial feasibility criterion under WAC 246-310-220(2). Based on that evaluation, the department concludes that this sub-criterion is 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 met.