

**MISSISSIPPI STATE DEPARTMENT OF HEALTH  
DIVISION OF HEALTH PLANNING AND RESOURCE DEVELOPMENT  
MAY 2015**

**CON REVIEW HG-MOB-0215-003  
MADISON HMA, LLC D/B/A MERIT HEALTH MADISON  
CONSTRUCTION OF MEDICAL OFFICE BUILDING  
CAPITAL EXPENDITURE: \$9,000,000  
LOCATION: CANTON, MADISON COUNTY, MISSISSIPPI**

**STAFF ANALYSIS**

**I. PROJECT SUMMARY**

**A. Applicant Information**

Madison HMA, LLC d/b/a Merit Health Madison is a limited liability company and a wholly-owned subsidiary of CHS/Community Health Systems, Inc. Merit Health Madison, previously known as Madison River Oaks Medical Center (Madison), is a 67-bed medical surgical hospital located in Madison County. Madison HMA, LLC d/b/a Merit Health has three directors and six officers, and is governed by a six-member Board of Trustees.

On February 19, 2015, the Secretary of State issued the entity a Certificate of Good Standing.

Merit Health Madison is accredited by the Joint Commission and the hospital's pathology lab is accredited by the College of American Pathologists.

The occupancy rates, average lengths of stay (ALOS), and the Medicaid utilization rates for Merit Health Madison are as follows:

**Merit Health Madison  
Utilization Data**

<b>Fiscal Year</b>	<b>Occupancy Rate (%)</b>	<b>ALOS (Days)</b>	<b>Medicaid Utilization Rate (%)</b>
2011	18.52	2.91	35.31
2012	27.86	3.04	NA
2013	25.31	3.21	51.97

**Source:** Division of Health Facilities Licensure and Certification, MSDH.

**B. Project Description**

Madison HMA, LLC d/b/a Merit Health Madison ("Madison"), requests Certificate of Need (CON) authority to construct, on its hospital campus, a two-story medical office building (the "MOB") to be financed and owned by a non-affiliated third party, CG Medvest Canton, LLC ("CG Medvest"), a Delaware limited liability company created

for the sole purpose of owning the MOB. The hospital owns the real property on which the MOB will be constructed and will execute a ground lease for the real property (with rental revenue accruing to the Hospital) and building leases for the MOB with CG Medvest.

The MOB will comprise approximately 35,704 square feet of space and will be located approximately 100 yards from the hospital's main building. Hospital-affiliated and non-Hospital-affiliated physician practices will execute either leases or subleases for office space in the MOB. The applicant expects tenants to include a physical therapy provider and orthopedic with x-ray capability, primary care and obstetrics/gynecology practices. The majority of the physician practices leasing space in the MOB will be those employed by a hospital affiliate and will occupy approximately 70% of the MOB's rentable square footage.

The applicant's final objective for the project is to offer high quality healthcare services in the most efficient and economical setting for physicians and patients in north Madison County.

The total proposed capital expenditure is \$9,000,000, at an estimated cost of \$236 per square foot (See Expenditure Summary for complete percentage breakdown of project). The applicant projects that the capital expenditure will be obligated by July 1, 2015 and the project is expected to be complete by July 1, 2016.

The applicant indicates the proposed capital expenditure will be funded with a commercial construction loan obtained by CG Medvest Canton, LLC.

The MSDH Division of Health Facilities Licensure and Certification has approved the site for the MOB project, as proposed.

## **II. TYPE OF REVIEW REQUIRED**

This project is reviewed in accordance with Section 41-7-173, 41-7-191 (1)(j), and 41-7-193 of the Mississippi Code of 1972, Annotated, as amended, 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 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 8, 2015.

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

**A. State Health Plan (SHP)**

The *FY2015 State Health Plan* contains criteria and standards which the applicant is required to meet before receiving CON authority for construction, renovation, and expansion. This application is in substantial compliance with the applicable criteria stated in the *Plan as follows*:

**SHP Criterion 1 - Need**

**Projects which do not involve the addition of any acute care beds.**

Madison HMA, LLC proposes the construction of a MOB on the Merit Health Madison hospital campus, to be financed and owned by a non-affiliated third party, CV Medvest. Madison HMA, LLC owns the real property on which the MOB will be constructed and the hospital and CG Medvest will execute a ground lease for the property and a building lease for the MOB. The new MOB will provide for consolidation of physician offices and outpatient therapy services and, according to the applicant, assist in attracting new physicians.

The applicant submits that currently the medical offices of physicians on the hospital's medical staff are located either in a modular building adjacent to the hospital, a small medical office building across the street from the hospital, or many miles distant in the cities of Madison and Jackson. According to the applicant, there is no suitable space near the hospital that could be used as medical office space by additional physicians that provide care for patients at the hospital. Patients in north Madison County are often forced to travel to Jackson in order to visit their physician in his or her office space. Likewise, physicians on the hospital's medical staff often travel more than 20 miles from their offices to see patients at the hospital.

According to the applicant, Merit Health Madison is an essential provider for residents of north Madison County and also the counties of Leake, Attala, Holmes, and Yazoo. The applicant asserts that this area suffers from high poverty rates: 27.7% in Attala and Leake counties, 33.5% in Yazoo County and 43.5% in Holmes County. The median household income for 2009-2013 in Holmes County was \$22,325. Consequently, the applicant states that many residents of the area do not have the means to travel far to obtain much needed health care services.

The applicant states that construction of an MOB on the campus of the hospital will allow for consolidation of the hospital's medical staff members at one location in space specifically designed for physician offices and other healthcare providers in a location that will facilitate quality care for the hospital's patients.

### **SHP Criterion 5 – Charity/Indigent Care**

Madison affirms that it will provide a reasonable amount of indigent/charity care; however, the hospital does not classify a patient or payor group as “medically indigent.” According to the applicant, these patients are included in the charity care and self pay categories of patients. Madison projects \$8,730,007 in gross patient revenue from self pay patients in Projected Year 1 and \$16,212,871 in gross patient revenue from charity care patients in Projected Year 1.

### **SHP Criterion 6 – Reasonableness of Cost**

The cost of the MOB project is \$236.09 per square foot. The applicant asserts that the costs included in RSMeans Building Construction Cost Data calculation are only (1) hard costs for the building shell, which in this project include extensive structural and deep foundations that are not typical, (ii) core costs and (iii) interior build-out costs.

In addition, the applicant states that the extra cost of the building shell with concrete structure and drilled pier foundations adds a premium of approximately \$500,000 to the building cost and site prep. These extra costs, according to the applicant, are beyond the hospital’s, the developer’s and the contractor’s control due to the soil on which the MOB will be constructed.

The developer, CG Medvest Canton, LLC, the contractor and the architect believe that the cost per square foot is appropriate and reasonable for the proposed project.

### **SHP Criterion 7 – Floor Area and Space Requirements**

The gross square footage of the proposed project is 35,704 square feet. The applicant states that given the services offered and the physician office space requirements for the multiple clinics practicing in the MOB, the square footage compares favorably to similar projects in Mississippi and across the United States.

## **B. General Review (GR) Criteria**

Chapter 8 of the *Mississippi Certificate of Need Review Manual, Revised September 1, 2011*; 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 criteria, standards, and policies of the *FY 2015 Mississippi State Health Plan* applicable to the construction, renovation, and expansion projects.

### **GR Criterion 2 – Long Range Plan**

The applicant states that its long range plan is to continue to provide high quality health care services in the most efficient and cost-effective manner. The proposed project is consistent with these long range plans, according to the applicant.

### **GR Criterion 3 – Availability of Alternatives**

The applicant states that because no suitable medical office space exists in the Canton, Mississippi area that could accommodate the number of physician offices that will be offered in the proposed MOB, the only alternative to the project is to take no action and to maintain the status quo. The applicant believes that keeping the physician practices in their current location could result in those physicians being less available to the hospital and the hospital's patients. Also, lack of suitable physician office space nearby would hinder the hospital from recruiting physicians to the area and likely result in patients traveling outside the service area.

### **GR Criterion 4 - Economic Viability**

The applicant asserts that charge structure will not change with this new project nor do they expect the burden of additional healthcare costs on the healthcare delivery system. Projected levels of utilization are not expected to change because the project is for construction of a MOB.

Madison states that the project is financially feasible and will likely meet or exceed their expectations for improving the delivery of health care services and improving efficiencies. The applicant expects that the rental revenues associated with the space that the hospital will sublease to physician practices will cover the majority of the expenses incurred by the hospital. However, in the event that the project fails to meet expectations, the applicant states that the hospital will cover the expenses associated with the MOB with revenues from its other operations.

The application contained a letter from the hospital's chief financial officer attesting to the financial feasibility of the project.

### **GR Criterion 5 - Need for the Project**

The applicant states that currently the offices of most physicians providing services in the hospital are located at a great distance from the hospital and from patients that reside in northern Madison County. Residents of this area, including the low income population, are therefore forced to travel upwards of 20 miles to receive physician services. Constructing an MOB in the area will allow hospital-affiliated and non hospital-affiliated physicians to maintain office space in a location that is more convenient to patients in the area, thereby increasing the patients' access to physician services.

The application contains 18 letters of support from community leaders, businesses, and health care providers.

### **GR Criterion 6 - Access to the Facility or Service**

The hospital affirms that all residents of the health planning service area, hospital service area, patient 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 existing facility.

Madison projects \$8,730,007 in gross patient revenue from self pay patients in Projected Year 1 and \$16,212,871 in gross patient revenue from charity care patients in Projected Year 1.

### **GR Criterion 7 - Information Requirement**

The applicant 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**

The applicant asserts that although there are various medical office buildings and physician offices located within GHSA V, the existing MOBs and physician offices are primarily located in the city of Jackson in Hinds County or in the city of Madison in southern Madison County. The hospital primarily services patients that reside in northern Madison County and in the surrounding counties of Yazoo, Holmes, Attala and Leake. Currently, these patients are forced to travel long distances to physician offices for follow up appointments and to receive other specialty physician services.

Because no new services will be offered as a result of this project, staff concludes that this project would have no adverse affect on other providers in the referenced service area.

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

#### **GR Criterion 9 - Availability of Resources**

No new personnel are required by the project. CG Medvest will own the MOB; however, the facility is constructed in part on behalf of Merit Health Madison which will lease the facility from CG Medvest. The clinically related contractual services provided to the hospital will not change.

#### **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 35,704 square feet of new construction.
- e. **Cost per Square Foot:** The applicant estimates the cost of new construction to be \$236.09 per square foot (see Attachment 2). The *RSMeans Building Construction Cost Data, 2014, Edition*, lists new construction costs for medical offices ranging from \$121 (where 20% of projects cost less) to \$15 (where 25% of projects cost more) per square foot.

#### **GR Criterion 16 - Quality of Care**

Merit Health Madison is in compliance with the *Minimum Standards for the Operation of Mississippi Hospitals*, according to the Division of Health Facilities Licensure and Certification, MSDH. The facility is accredited by the Joint Commission and certified for participation in the Medicare and Medicaid programs. In addition, the hospital's pathology lab is accredited by the College of American Pathologists.

**IV. FINANCIAL FEASIBILITY**

**Capital Expenditure Summary**

The total estimated capital expenditure is allocated as follows:

	<b>Item</b>	<b>Cost (\$)</b>	<b>Percent (%) of Total</b>
a.	Construction Cost -- New	\$6,513,920	72.37
b.	Construction Cost -- Renovation	0	0
c.	Capital Improvements	0	0
d.	Total Fixed Equipment Cost	100,000	1.11
e.	Total Non-Fixed Equipment Cost	400,000	4.44
f.	Land Cost	0	0
g.	Site Preparation Cost	446,755	4.96
h.	Fees (Architectural, Consultant, etc.)	356,500	3.96
i.	Contingency Reserve	812,119	9.02
j.	Capitalized Interest	170,000	1.88
j.	Legal and accounting fees	32,000	..35
k.	Other	138,706	1.54
	<b>Total Proposed Capital Expenditure</b>	<b>\$9,000,000</b>	<b>*100.00</b>

**\*Total percentage does not compute due to rounding.**

The above capital expenditure is proposed for construction of a new medical office building. The proposed project involves approximately 35,704 square feet of new space at an estimated cost of \$236.09 per square foot (see Attachment 2). The costs for projects listed in *The RSMeans Building Construction Cost Data, 2014 Edition*, ranged from \$121 to \$185 per square foot, with a median cost of \$151 per square foot.

The application contains a letter signed by the Chief Financial Officer, attesting to the financial feasibility of the project.

**B. Method of Financing**

The applicant proposes to finance the proposed capital expenditure with equity contribution of \$1,500,000; cash reserves of \$500,000; and a commercial construction loan of \$7,000,000 obtained by CG Medvest Canton, LLC. Madison will lease the building from CG Medvest, LLC.

**C. Effect on Operating Cost**

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

**D. Cost to Medicaid/Medicare**

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

<b>Payor Mix</b>	<b>Utilization Percentage (%)</b>	<b>First Year Revenue (\$)</b>
<b>Medicare</b>	23	\$ 43,528,668
<b>Medicaid</b>	31	58,735,034
<b>Commercial</b>	31	58,921,635
<b>Self Pay</b>	5	8,730,007
<b>Charity Care</b>	9	16,212,871
<b>Other</b>	1	1,404,740
<b>Total</b>	<b>100</b>	<b>\$ 187,532,955</b>

**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. 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 criteria and standards for construction, renovation, expansion, or capital improvements involving a capital expenditure in excess of \$2,000,000 contained in 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 Madison HMA, LLC, d/b/a Merit Health Madison for the construction of a Medical Office Building.

**Attachment 1**

<b>Madison, HMA, LLC d/b/a Merit Health Madison Three-Year Operating Statement (with Project)</b>			
	<b>Year 1</b>	<b>Year 2</b>	<b>Year 3</b>
<b>Revenue</b>			
Patient Revenue:			
Inpatient	\$ 54,941,513	\$ 58,842,360	\$ 63,020,168
Outpatient	132,591,442	142,005,434	152,087,820
<b>Gross Patient Revenue</b>	<b>\$ 187,532,955</b>	<b>\$ 200,847,794</b>	<b>\$ 215,107,988</b>
Charity Care	\$ 16,212,871	17,363,984	18,596,827
Deductions from Revenue	138,282,803	149,261,157	160,994,687
<b>Net Patient Revenue</b>	<b>\$ 33,037,281</b>	<b>\$ 34,222,653</b>	<b>\$ 35,516,474</b>
Other Operating Revenue	\$ 553,246	\$ 648,599	\$ 678,327
<b>Total Operating Revenue</b>	<b>\$ 33,590,526</b>	<b>\$ 34,871,252</b>	<b>\$ 36,194,801</b>
<b>Expenses</b>			
Operating Expenses:			
Salaries	\$ 12,777,476	\$ 12,969,138	\$ 13,163,675
Benefits	2,730,903	2,771,867	2,813,445
Supplies	3,952,446	4,071,019	4,193,150
Services	3,337,700	3,404,454	3,472,543
Lease	1,080,842	1,175,384	1,196,611
Depreciation	2,690,462	2,742,995	2,796,578
Interest	24,633	22,170	19,953
Other	7,816,817	8,051,322	8,292,861
<b>Total Expenses</b>	<b>\$ 34,411,278</b>	<b>\$ 35,208,348</b>	<b>\$ 35,948,816</b>
<b>Net Income (Loss)</b>	<b>\$ (820,752)</b>	<b>\$ (337,097)</b>	<b>\$ 245,985</b>
<b>Assumptions</b>			
Inpatient days*	5,038	5,141	5,244
Outpatient days*	37,681	38,434	39,203
Procedures	0	0	0
Charge/outpatient day	\$ 3,519	\$ 3,695	\$ 3,879
Charge per inpatient day	10,905	11,446	12,018
Charge per procedure	0	0	0
Cost per inpatient day	6,830	6,849	6,855
Cost per outpatient day	913	916	917

**Attachment 2**  
**Madison HMA, LLC d/b/a Merit Health Madison**  
**Computation of Construction and Renovation Cost**

<b>Cost Component</b>	<b>Total</b>	<b>New Construction</b>	<b>Renovation</b>
New Construction Cost	\$6,543,920	\$6,543,920	
Renovation Cost	\$0		\$0
Total Fixed Equipment Cost	\$100,000	\$100,000	\$0
Total Non-Fixed Equipment Cost	\$400,000		
Land Cost	\$0	\$0	
Site Preparation Cost	\$446,755	\$446,755	
Fees (Architectural, Consultant, etc.)	\$356,500	\$356,500	\$0
Contingency Reserve	\$812,119	\$812,119	\$0
Capitalized Interest	\$170,000	\$170,000	\$0
Other	\$170,706	\$0	
<b>Total Proposed Capital Expenditure</b>	<b>\$9,000,000</b>	<b>\$8,429,294</b>	<b>\$0</b>
Square Footage	<b>35,704</b>	35,704	0
Allocation Percent		100.00%	0.00%
<b>Costs Less Land, Non-Fixed Eqt., Other</b>	<b>\$8,600,000</b>	<b>\$8,429,294</b>	<b>\$0</b>
<b>Cost Per Square Foot</b>	<b>\$240.87</b>	<b>\$236.09</b>	<b>0</b>

Source: FY 2015 Mississippi State Health Plan