



HAWAII STATE HEALTH PLANNING AND DEVELOPMENT AGENCY

STANDARD APPLICATION – CERTIFICATE OF NEED PROGRAM

Application Number 06-15

Applicant: Hawaii Medical Center, LLC
2228 Liliha St., #305
Honolulu, HI
Phone: 808-521-4344

Project Title: Acquisition of St. Francis Medical Centers Liliha/West; acquisition of St. Francis interest in joint ventures providing Computed Tomography (CT), Magnetic Resonance Imaging (MRI), outpatient cardiac catheterization and outpatient endoscopy services at St. Francis Medical Center Liliha

Project Address: 2226 Liliha Street, Honolulu, HI
91-2141 Ft. Weaver Rd., Ewa Beach, HI

1. **TYPE OR ORGANIZATION:** (Please check all applicable)

- Public _____
- Private X
- Non-profit _____
- For-profit X
- Individual _____
- Corporation _____
- Partnership _____
- Limited Liability Corporation (LLC) X
- Limited Liability Partnership (LLP) _____
- Other: _____

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2. **PROJECT LOCATION INFORMATION:**

A. Primary Service Area(s) of Project: (Please check all applicable)

- Statewide: _____
- O`ahu-wide: X
- Honolulu: _____
- Windward O`ahu: _____
- West O`ahu: X
- Maui County: _____
- Kaua`i County: _____
- Hawai`i County: _____

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3. **DOCUMENTATION** (Please attach the following to your application form):

- A. Site Control documentation (e.g. lease/purchase agreement, DROA agreement, letter of intent) **See attachment A, Asset Purchase Agreement**
- B. A listing of all other permits or approvals from other government bodies (federal, state, county) that will be required before this proposal can be implemented (such as building permit, land use permit, etc.) **See page 7**
- C. Your governing body: list by names, titles and address/phone numbers **See attachment B**
- D. If you have filed a Certification of Need Application this current calendar year, you may skip the four items listed below. All others, please provide the following:
 - Articles of Incorporation **See attachments C**
 - By-Laws **See attachments D**
 - Partnership Agreements
 - Tax Key Number (project's location)
 - Liliha – 18 018 025**
 - West – 91 017 006/056/059**

4. **TYPE OF PROJECT.** This section helps our reviewers understand what type of project you are proposing. Please place an "x" in the appropriate box.

	Used Medical Equipment (over \$400,000)	New/Upgraded Medical Equip. (over \$1 million)	Other Capital Project (over \$4 million)	Change in ownership	Change in service/ establish new service/facility	Change in Beds
Inpatient Facility				X		
Outpatient Facility						
Private Practice						

5. **TOTAL CAPITAL COST:** \$67,900,000 (Clinical component: \$34,721,855)

6. **BED CHANGES.** Please complete this chart only if your project deals with a change in your bed count and/or licensed types. Again, this chart is intended to help our reviewers understand at a glance what your project would like to accomplish. Under the heading "Type of Bed," please use only the categories listed in the certificate of need rules.

Note: There will be no changes in the numbers of beds at either campus. The tables below show the SHPDA-approved bed counts for each facility. Some of these counts are outdated and we will make corrections in future CON applications when we determine what the appropriate bed counts should be. We are proposing no changes now since this application is merely for a change in ownership with no other changes in the status quo.

St. Francis Medical Center ("Liliha")

Type of Bed	Current Bed Total	Proposed Beds for your Project	Total Combined Beds if your Project is Approved
Medical/surgical	230		230
Critical care	22		22
Skilled Nursing	52		52
TOTAL	304		304

St. Francis Medical Center - West

Type of Bed	Current Bed Total	Proposed Beds for your Project	Total Combined Beds if your Project is Approved
Medical/surgical	113		113
Critical care	14	RECEIVED	14
Obstetric	7	06 MAY -4 P3:39	7
TOTAL	134	ST. FRANCIS & DEV. AGENCY	134

7. CHANGE IN SERVICE. If you are proposing a change in service, then please briefly list what services will be added/modified. Be sure to include the establishment of a new service or the addition of a new location of an existing service. Please consult Certificate of Need Rules Section 11-186-5 for the categories of services. If you are unable to determine which category best describes your project, please consult with agency staff.

The tables below summarize the existing non-bed or special services provided at the Liliha or West campuses which have received CONs in the past. There will be no change (additions or modifications) in the existing services, only a change in ownership. Some of these services are provided solely by St. Francis, and some by joint ventures with St. Francis as one of the partners. In the case of joint ventures, HMC will acquire the ownership percentage of St. Francis of some of the joint ventures.

SERVICES/PERCENT OWNERSHIP CHANGE INCLUDED IN THIS CON APPLICATION

Service	Provider	S.F.%	Liliha	West
Computed Tomography (at West)	SFMC West	100		X
Computed Tomography (at Liliha)	Island Imaging Centers	50	X	
Magnetic Resonance Imaging (at West)	SFMC West	100		X
Magnetic Resonance Imaging (at Liliha)	Island Imaging Centers	50	X	
Cardiac Catheterization -- inpatient	SFMC (Liliha)	100	X	
Cardiac Catheterization -- outpatient	Island Cardiology Center	33	X	
Endoscopy Center	Hawaii Endoscopy Center	29	X	

JOINT-VENTURED SERVICES WHICH ARE NOT INCLUDED IN THIS CON APPLICATION

(St. Francis or its subsidiaries will retain ownership interest)

Service	Provider	S.F.%	Liliha	West
Radiation Therapy (at West)	Leeward Radiation Oncology	50		X
Radiation Therapy (at Liliha)	Cancer Center of Hawaii	33	X	
Positron Emission Tomography ("PET")	Hawaii PET Imaging	20	mobile	

8. PROJECT COSTS AND SOURCES OF FUNDS (For Capital Items Only)

A. List All Project Costs:		CLINICAL PORTION	TOTAL AMOUNT
1.	Land Acquisition (value of land leased)	<u>\$7,080,000</u>	<u>\$17,700,000</u>
2.	Construction Contract		_____
3.	Fixed Equipment		_____
4.	Movable Equipment		_____
5.	Financing Costs	<u>\$0</u>	<u>\$3,700,000</u>
6.	Fair Market Value of assets acquired by lease, rent, donation, etc.		_____
7.	Other: <u>Acquisition of existing assets*</u> *See Attachment A for details	<u>\$27,641,855</u>	<u>\$46,500,000</u>
TOTAL		<u>\$34,721,855</u>	<u>\$67,900,000</u>

B. Source and Method of Estimation

Describe how the cost estimates in Item "A" were made, including information and methods used: Cost figures are taken from the asset purchase agreement.

C. Source of Funds	AMOUNT:
1. Cash	<u>\$10,000,000</u>
2. State Appropriations	_____
3. Other Grants	_____
4. Fund Drive	_____
5. Debt	<u>\$40,200,000</u>
6. Other: <u>Land lease payments (present value of cash flow)</u>	<u>\$17,700,000</u>
TOTAL SOURCE OF FUNDS:	
	<u>\$67,900,000</u>

9. **IMPLEMENTATION SCHEDULE:** Please present a projected time schedule for the completion of this project from start to finish. Include all of the following items that are applicable to your project:

Please see page 7

- a) Date of site control for the proposed project,
- b) Dates by which other government approvals/permits will be applied for and received,
- c) Dates by which financing is assured for the project,
- d) Date construction will commence,
- e) Length of construction period,
- f) Date of completion of the project, and
- g) Date of commencement of operation.

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Please remember that the Agency does monitor the implementation of Certificates approved. Non-implementation of a project as described in your application may result in a fine and/or withdrawal of the Certificate of Need.

10. **EXECUTIVE SUMMARY:** Please present a brief summary of your project. In addition, provide a description of how your project meets each of the Certificate of Need criteria listed below. If a new location is proposed, please attach an easy to read map that shows your project site.

Please see page 7

- a) Relationship to the Hawai'i Health Performance Plan (H2P2), also known as the State of Hawai'i Health Services and Facilities Plan
- b) Need and Accessibility
- c) Quality of Service/Care
- d) Cost and Finances (include revenue/cost projections for the first and third year of operation)
- e) Relationship to the Existing Health Care System
- f) Availability of Resources

3.B Continuation of item 3.b, listing of other permits or approvals (from page 2 of 5).

- Approval by Attorney General as provided under Hawaii Revised Statutes (HRS) 323D-72
- State licensure – Office of Health Care Assurance, State Health Department
- Medicare/Medicaid Certification – State Health Department

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8.A Continuation of item 8.A, listing of project costs.

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There are no additional capital costs that are specifically related to this change in ownership. HMC has a ten year capital plan to make significant improvements to the facilities being acquired. If any of these require a CON, we will submit the application at the appropriate time. If SHPDA requests it, we would be pleased to share this capital plan with SHPDA for information purposes. However, we reiterate that the current application is only to change ownership in the existing facilities and that it should be reviewed as such. Any items in the capital plan that might require a CON would be submitted for SHPDA approval at the appropriate time.

9. Continuation of item 9, implementation schedule (from page 5 of 5)

- a) Asset Purchase Agreement signed – March 22, 2006
- b) Certificate of Need Approval Received – June 30, 2006
- c) Attorney General Approval Received – July 31, 2006
- d) Hawaii Medical Center Assumes Operations – August 1, 2006

9. EXECUTIVE SUMMARY

Hawaii Medical Center LLC ("HMC") is proposing to acquire various assets of St. Francis Healthcare System of Hawaii ("SFHCS" or "St. Francis"). HMC will acquire the acute hospital assets of St. Francis Medical Center ("SFMC" or "Liliha"), on Liliha Street, and St. Francis Medical Center – West ("SFMCW" or "West"), on the Ewa plain. HMC will also acquire certain St. Francis interests in joint venture entities which provide the following services at Liliha: CT, MRI, outpatient cardiac catheterization and outpatient endoscopy. Please see page 4 of 6 of the pages at the beginning of this application for further information about the

entities which provide these services and the ownership interest currently held by St. Francis which will be acquired by HMC.

HMC will then become the provider of the various in-patient and out-patient services listed on pages 3 and 4 of this application.

Regarding the bed services and counts, this application presents the "SHPDA-approved" bed counts as the number being acquired by the new owner. We emphasize that this application is relatively straightforward. It proposes no changes from those services and counts now on the record. This application is merely a change of ownership and a change of provider of the existing services. We acknowledge that future bed changes are anticipated, but these changes will be made through future CON applications.

We welcome the opportunity that this application presents to demonstrate that the new provider (HMC), and the acquisition of the hospitals by HMC, will meet the CON criteria.

As noted above, HMC anticipates future changes which will require other CON approvals. These changes will be applied for at the appropriate time, with appropriate justification. We do not wish to use this current application to make changes in the status quo, other than ownership. It would only complicate what should be a fairly uncomplicated issue.

The applicant. Hawaii Medical Center is a Hawaii Limited Liability Company. CHA Hawaii, LLC ("CHA Hawaii") will own 51% of the company. CHA Hawaii is a subsidiary of Cardiovascular Hospitals of America, LLC ("CHA"). Hawaii Physician Group, LLC ("HPG") will own up to 48%, and SFHCS will own 1% without vote

CHA is led by Dr. Badr Idbeis, who is CEO and Chairman of the Board. Dr. Idbeis, founded the Kansas Heart Hospital (KHH) and developed the Kansas Spine Hospital. Under his leadership, the quality measures at KHH were those of 5 stars of HealthGrades (an independent quality-rating organization) STS data and patient satisfaction data. It is these outcomes that prompted the founder to start CHA and implement the same methods that achieved such superb results.

The CHA model of hospital operation is to partner with local physicians through ownership investment. Physicians thus have an increased incentive to perform at a higher level of quality, productivity and efficiency.

Because of its experience, CHA brings the latest technologies, IT integration, comprehensive and efficient operating methods and

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procedures that contribute to improved productivity and the reduction of cost.

Need for the sale. St. Francis, which has been operating hospital services in Hawaii since opening the Liliha facility in 1927, has encountered serious problems in recent years. The most serious problem has been years of financial hardships due to several factors including: reduced government Medicare/Medicaid payments, staffing shortages, low admissions, costly new technology requirements, a 2002 nurses' strike, and other circumstances.

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Although St. Francis was current on its debt payments (\$30 million in debts in late 2005), it was not meeting the "debt-ratio requirement," (the level of income), required by its bond insurers. This, coupled with a future that promised increasingly higher financial hurdles, brought the St. Francis Board to the conclusion that it must divest itself of its hospitals and its outpatient dialysis program. (The sale of the outpatient dialysis program received a CON in December, 2005, and is not part of this application).

St. Francis first negotiated a sale of the hospitals locally with Queen's, Kaiser and Hawaii Pacific Health, but all three eventually pulled out of the bidding. It was then that some of the local physicians conceived the idea of physician ownership, and contacted CHA. After studying the financials, CHA and the local physicians have decided to partner as HMC and make the acquisitions proposed in this application.

A. Relationship to the Hawai'i Health Performance Plan (H2P2).

This proposal complies with the provisions of the H2P2. The vision of the H2P2 is "Supported by their community, individuals achieve optimum health." Two of the goals of the H2P2 are: "reduce health disparities among Hawai'i's residents; and, achieve equitable and effective access at reasonable cost for all Hawai'i's residents to health services that are responsive to the holistic needs of community's [sic] members."

This CON application is for a change of ownership in existing facilities and services. Although we are mainly proposing to maintain the status quo, we believe the new ownership and management of these existing services will improve them. Maintaining the services, and perhaps improving them will reduce disparities, achieve access at reasonable cost, and be responsive to community needs. The apparent alternative to this change of ownership is the closing of the facilities and services, which would have a serious negative impact on the vision and goals.

Chapter II of the H2P2 provides several occupancy and utilization rates as thresholds justifying new services or "targets" for efficient services. On page A-7 of this application we present data which show that the existing utilization rates of the services in this application compare well with the thresholds, with the exception of acute bed occupancy at Liliha. Acute bed utilization at Liliha has declined because of the difficulties listed above, but we expect to increase these utilization numbers under HMC. Further, the alternative of closing Liliha would have a negative impact on the community and other facilities as they struggled to accommodate all the inpatients and outpatients now served at Liliha.

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B. Need and Accessibility

There is a community need for the continuation of the services provided by the two facilities.

In general, the two facilities serve the entire island of O`ahu, although West, being the only hospital in the area, primarily serves the Wai`anae and Ewa districts. Liliha, which is the only transplant facility in the State, serves that population statewide.

Together the facilities provide 442 beds to the community, including 52 skilled nursing beds at Liliha. The community needs these beds to continue in operation. Without them, O`ahu's health care system would have great difficulty meeting the needs of the community.

The HMC services will be accessible to all those in need, without regard to ability to pay. HMC will also continue the full range of services now provided by St. Francis.

C. Quality of Service/Care

The St. Francis hospitals are currently JCAHO accredited, and JCAHO accreditation will be continued under the new ownership. The facilities will be State-licensed and certified for Medicare and Medicaid.

As noted above, CHA has a track record of providing a high quality of service at its mainland facilities, and has extensive quality assurance policies and procedures which will be implemented at the HMC facilities.

With the physician ownership, the physicians will have even more incentive and personal interest in providing the utmost quality of care.

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D. Cost and Finances

The capital cost of the ownership change will be \$67,900,000, as follows: \$46,500,000 for the non-land assets; \$3,700,000 financing costs; and \$17,700,000 as the value of the land acquired on a twenty year lease, with a \$1 buyout at the end of that time.

The capital financing will be:

- \$10,000,000 in cash. \$5,100,000 will come from CHA-Hawaii and \$4,900,000 from HPG. \$1,162,500 was already paid at the signing of the asset purchase agreement on March 22nd, and the remainder will be paid upon closing.
- \$40,200,000 in debt. St. Francis will finance this amount through the taking back of a note, thus there is no immediate exchange of cash.
- \$17,700,000 through monthly payments on the twenty year land lease (with a \$1 buyout at the end of that period). The capital value of \$17,700,000 as calculated as the present value of the cash flow.

HMC believes that utilization of the facilities will increase slightly under new management and with physician ownership. In our utilization and financial projections we estimate, and that a financially stable level will be achieved by the end of the first year. (See Exhibits D-2). By the end of the first year of operation the facilities will be financially feasible, i.e., revenues will cover expenses

E. Relationship to the Existing Health Care System

This proposal relates well to the existing health care system.

According to the 2004 SHPDA approved bed count, SFMC, with 252 acute beds, is the second largest acute care hospital in the State (although we acknowledge that the actual number of beds in operation is lower). SFMC also has 52 SNF beds.

SFMCW, with 134 acute beds, is the only acute hospital in the Ewa or Wai'anae districts.

Both hospitals are an important component of the existing health care system, and the system will be seriously harmed if the facilities do not continue operation. HMC is committed to maintaining the same range and level of services now provided at the facilities. St. Francis, because of its financial problems, is unable to continue operating the hospitals, and the alternative of closing down the hospitals would put a difficult strain on the other facilities (including long-term care) in the

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system. More importantly, some people who need service would have difficulty accessing it, or even find it impossible.

We acknowledge that the first years' slightly increased utilization at the HMC facilities will be accompanied by a slight decrease in utilization at other facilities. However, this decrease will be spread over several facilities, and the impact on any particular facility should be slight. Further, any decrease should be temporary, as utilization at all facilities should increase as Hawai'i's population ages and increases.

Finally, with the new ownership, the two facilities will have the financial resources to modernize their services and make them more responsive to the community's needs.

F. Availability of Resources

The financial resources are available to acquire and operate the hospitals. The capital funds are available through cash and through St. Francis taking back a note for the balance. Operating funds are also available, as shown in our financial projections in Section D. By the end of the first year of operation, the operating revenue of the facilities will be enough to cover expenses.

Section C and D of this application present a staffing pattern. As part of the asset acquisition agreement, HMC will retain the current employees of SFMC and SFMCW, and honor their collective bargaining agreements. As our utilization increases, we will need additional staff, and we know that there are shortages in several categories, such as nursing. However, we believe that with the improved circumstances of the facilities we will be able to attract new staff. CHA has mainland experience in recruiting staff, and we believe that experience will help too.

Although we expect to staff from local sources, we would use travel nurses as a last resort.

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