



## HAWAII STATE HEALTH PLANNING AND DEVELOPMENT AGENCY

### ADMINISTRATIVE APPLICATION – CERTIFICATE OF NEED PROGRAM

Application Number: #07-20A

Applicant: Kahuku Medical Center  
56-117 Pualalea  
Kahuku, Hawaii

Phone: 808 733-7913

Project Title: Acquisition of Kahuku Hospital  
Project Address: same

1. TYPE OF ORGANIZATION: (Please check all applicable)

- Public \_\_\_\_\_
- Private   X
- Non-profit   X
- For-profit \_\_\_\_\_
- Individual \_\_\_\_\_
- Corporation   X
- Partnership \_\_\_\_\_
- Limited Liability Corporation (LLC) \_\_\_\_\_
- 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: \_\_\_\_\_
- Honolulu: \_\_\_\_\_
- Windward O`ahu:   X
- West O`ahu: \_\_\_\_\_
- Maui County: \_\_\_\_\_
- Kaua`i County: \_\_\_\_\_
- Hawai`i County: \_\_\_\_\_

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

- A. Site Control documentation (e.g. lease/purchase agreement, DROA agreement, letter of intent) **An asset purchase agreement is being prepared and will be submitted when it is available. Further provision for the change in ownership is provided in Act 113, SLH 2007 (Attachment A). Site control will transfer through court action when Kahuku Hospital's bankruptcy closes. This is expected to be August 31, 2007.**
- 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
  - **Thomas Driskill, President, 3675 Kilauea Ave., Honolulu, HI 96816. Ph: 733-8020**
  - **Bill Wood, Vice President, Department. of Sociology, University of Hawaii, 2424 Maile Way, Honolulu, HI 96822. Ph: 956-7693**
  - **Vince Lee, Secretary and Treasurer, 3675 Kilauea Ave., Honolulu, HI 96816. Ph: 733-8000**
- D. If you have filed a Certificate of Need Application this current calendar year, you may skip the four items listed below. All others, please provide the following:
  - Articles of Incorporation **ATT. B**
  - By-Laws **ATT. C**
  - Partnership Agreements
  - Tax Key Number (project's location) **5-6-006:013**

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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 Beds/Service | Change in Ownership |
|---------------------|---|--|--|------------------------|---------------------|
| Inpatient Facility  |   |  |  |                        | X*                  |
| Outpatient Facility |   |  |  |                        |                     |
| Private Practice    |   |  |  |                        |                     |

\*The existing assets, services and beds now provided by Kahuku Hospital will be acquired and provided by the new Kahuku Medical Center

5. **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.

The table below shows the current "SHPDA-approved" bed count for Kahuku Hospital. There will be no change under the new Kahuku Medical Center.

| Type of Bed          | Current Bed Total | Proposed Beds for your Project | Total Combined Beds if your Project is Approved |
|----------------------|-------------------|--------------------------------|---|
| Medical/surgical     | 3                 |                                | 3   |
| Critical care        | 2                 |                                | 2   |
| Obstetric*           | 2                 |                                | 2   |
| Skilled Nursing (SN) | 12                |                                | 12  |
| Acute/SN "Swing"     | 6                 |                                | 6   |
| <b>TOTAL</b>         | <b>25</b>         |                                | <b>25</b>                                       |

\*Kahuku Hospital closed its OB unit in 2006, but the bed count remains on the books.

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6. PROJECT COSTS AND SOURCES OF FUNDS

|  |                              |                     |
|--|------------------------------|---------------------|
| <b>A. List All Project Costs:</b>                                      | '07 JUL 25 P4 :01            | <b>AMOUNT:</b>      |
| 1. Land Acquisition  | ST. HILARY PL. & DEV. AGENCY | _____               |
| 2. Construction Contract   |                              | _____               |
| 3. Fixed Equipment   |                              | _____               |
| 4. Movable Equipment   |                              | _____               |
| 5. Financing Costs   |                              | _____               |
| 6. Fair Market Value of assets acquired by lease, rent, donation, etc. |                              | <u>\$2,900,000*</u> |
| <b>TOTAL PROJECT COST:</b>   |                              | <u>\$2,900,000*</u> |

\*There is no capital cost per se to Kahuku Medical Center (KMC) since it will acquire the assets of Kahuku Hospital at no cost, pursuant to act 113, SLH, 2007. The Legislature appropriated \$3.9 million for the entire project, of which \$2.9 million will be used to acquire the assets, and the remaining \$1 million will cover various transition costs. KMC acknowledges that under the CON statute, the fair market value of all capital assets, no matter how they are acquired, count as a "capital expenditure" for CON purposes. The fair market value of the assets is based upon an IRS estimate taken into account by the Hawaii Legislature in determining the acquisition price. At this point it includes all assets, not just clinically-related assets. A detailed valuation is being prepared but will not be available until early September.

**B. Source of Funds**

|                               |  |                    |
|-------------------------------|--|--------------------|
| 1. Cash                       |  | _____              |
| 2. State Appropriations       |  | <u>\$2,900,000</u> |
| 3. Other Grants               |  | _____              |
| 4. Fund Drive                 |  | _____              |
| 5. Debt                       |  | _____              |
| 6. Other: _____               |  | _____              |
| <b>TOTAL SOURCE OF FUNDS:</b> |  | <u>\$2,900,000</u> |

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7. **CHANGE OF 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 reference the Certificate of Need Rules Section 110786-311-201-254 to the categories of services. If you are unable to determine which category best describes your project, please consult with agency staff.

There will be no change in service, the existing services will continue to be provided.

8. **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:

**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,
- g) Date of commencement of operation

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.

9. **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.

**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.

10. **Eligibility to file for Administrative Review.** This project is eligible to file for Administrative review because: (Check all applicable)

\_\_\_\_\_ It involves bed changes, which will have a capital expense of \$1,000,000 or less, and which will have an increased annual operating expense of less than \$500,000.

\_\_\_\_\_ It involves service changes which will have a capital expense of \$1,000,000 or less, and which will have an increased annual operating expense of less than \$500,000.

\_\_\_\_\_ It is an acquisition of a health care facility or service, which will result in lower annual operating expenses for that facility, or service.

\_\_\_\_\_ It is a change of ownership, where the change is from one entity to another substantially related entity.

\_\_\_\_\_ It is an additional location of an existing service or facility.

X\* The applicant believes it will not have a significant impact on the health care system.

**\*This application is only for the change of ownership/provider status of an existing, small, critical access hospital of just 25 beds, only 7 of which are acute. The ownership/provider status will be from one not-for-profit corporation to another not-for-profit corporation.**

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**3.B. Listing of other permits or approvals (continued from page 2).**

Operating License – Department of Health '07. JUL 26 P 2:54  
 Medicare/Medicaid Certification – Department of Health survey, agreement with the Centers for Medicare and Medicaid (CMS).  
 Critical Access Hospital Designation – Centers for Medicare and Medicaid (CMS)  
 Radiation Facility License – Department of Health & DEV. AGENCY  
 Certificate of Registration for Controlled Substances – Department of Public Safety, State of Hawaii.  
 Pharmacy License – Department of Commerce and Consumer Affairs.  
 Controlled Substance Registration Certificate – U.S. Department of Justice, Drug Enforcement Agency.  
 Materials License – U.S. Nuclear Regulatory Commission  
 Blood Bank/Apheresis Registration – U.S. Department of Health and Human Services, Food and Drug Administration.

**8. Implementation Schedule (continued from page 5).**

Date financing is assured – May 31, 2007  
 Date of Site Control – September 1, 2007  
 Date other governmental approvals will be applied for: Aug. 15-Sep. 1 '07  
 Date other approvals recvd: Sep. 1 to Oct. 31 '07 (some will be retroactive)  
 Date of Commencement of Operation – September 1, 2007

**9. Executive Summary**

Kahuku Medical Center, Inc. (KMC) is a newly established not-for-profit corporation, the sole member of which is the Hawaii Health Systems Corporation (HHSC). KMC will acquire the assets of the existing Kahuku Hospital and continue to provide the services now provided by the Hospital. There will be no change other than the change in ownership and provider status. This acquisition is provided for under Act 113, SLH 2007, which was signed into law by the Governor on May 31, 2007.

Section 1 of Act 113 provides an excellent background:

The legislature finds that Kahuku Hospital has been serving the residents of the north shore of Oahu from Kualoa to Waimea Bay, with a population of about twenty-seven thousand, since 1929. Kahuku Hospital is a twenty-five-bed facility that has provided an array of health care services, including emergency care, general acute care, surgery, skilled nursing, ancillary care and health education. It is one of nine hospitals in Hawaii with a federal medicare designation as a critical access hospital, which allows it to annually receive higher reimbursements amounting to about \$1,000,000 in additional revenue.

On November 6, 2006, the board of directors of Kahuku Hospital voted to file for chapter 7 bankruptcy and close down the Hospital on December 31, 2006, because of continuing operating losses of about \$1,500,000, a sum that has now reached \$3,500,000. If such a closure was to occur, the Hospital would lose its hospital license, its certificate of need, and its critical access hospital designation, all of which would require time and expense for another hospital to obtain, effectively shutting down hospital-based health care services in the area for an indefinite period. Closing down Kahuku Hospital would pose a grave threat to the health and safety of all residents on the north shore and windward areas of Oahu, who would have to drive either twenty-two miles to Wahiawa General Hospital or thirty-two miles to Castle Medical Center in Kailua for hospital-based care, with both trips requiring driving over an hour along a single-access road that is periodically closed by inclement weather or traffic mishaps.

Accordingly, the legislature finds that it is in the public interest to keep Kahuku Hospital operating to serve the residents of the north shore of Oahu by enabling it to file for chapter 11 rather than chapter 7 bankruptcy, which would allow the Hospital to:

1. Continue operations;
2. Preserve its hospital license;
3. Retain its certificate of need and critical access hospital designation;
4. Reorganize; and,
5. Settle its debts.

The purpose of this Act is to authorize the Hawaii Health Systems Corporation to bring Kahuku Hospital under its governance through formal affiliation with the corporation and to provide for transitional facilitation by the director of health.

Other provisions of the act include:

- The physical assets and the ground lease of the existing Kahuku Hospital shall become the property of the corporation.
- None of the liabilities of the Hospital shall become liabilities of the corporation.
- The corporation may retain any or all employees.
- Employees shall not become State employees.
- The Director of Health Shall act as an "honest broker" to facilitate the acquisition.

Finally, the Act appropriates \$3,900,000 (to be expended by the Department of Health) to carry out the purposes of the Act.

HHSC has already begun work with Kahuku Hospital with the expectation that the Hospital can complete its bankruptcy proceedings by August 31, 2007 with the transition to KMC becoming effective on September 1, 2007.

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- HHSC has formed a management team to manage the transition process.
- This team is now working with representatives of the Hospital and others such as the State Office of Rural Health to accomplish a smooth transition.
- The Oahu Region of HHSC has established a management services agreement with the Hospital, in effect from July 1 to August 31, 2007. HHSC is now managing the Hospital during the transition period.
- KMC Inc., the new not-for-profit corporation, with HHSC as the sole member, has been established. KMC Inc. will own and operate the Hospital when the transition is complete (expected to be September 1, 2007).

As noted above, the Legislature has appropriated \$3.9 million for this project. Of this, \$2.9 million is for acquisition of the assets of Kahuku Hospital. It is anticipated that such funds will be used during the bankruptcy proceedings to resolve claims for Kahuku Hospital's unpaid debts and other expenses, such that Kahuku Medical Center will acquire the facility free of liens and encumbrances. For example, because of its financial problems, the Hospital is in arrears on its land lease and has significant unpaid amounts due to the IRS for employee withholding.

When KMC begins to operate the Hospital, there will be a service agreement between KMC and the Oahu Region of HHSC. HHSC anticipates that under this agreement it will provide to the Hospital an Administrator, who will be an employee of HHSC. All existing Hospital employees will be retained by KMC, and will be employees of KMC, not State employees.

There will be certain advantages to Kahuku under this affiliation with HHSC. For example, the Hospital can benefit from existing purchase and service contracts. Also, the Hospital will have access to the quality assurance and risk management programs of HHSC.

**a. Relationship to the Hawaii Health Performance Plan (H2P2), also known as the State of Hawaii Health Services and Facilities Plan.**

As stated earlier, Kahuku Hospital provides a basic range of primary services that is responsive to the community's needs. This proposal will allow the continuation of these inpatient and outpatient services at Kahuku Hospital through a change in ownership. This is consistent with major provisions of the H2P2.

Goals and objectives. The H2P2 establishes several goals and objectives for realizing the Hawai'i health care vision which are pertinent to this application. For example:

- Reduce health disparities among Hawai'i's residents.

- Achieve equitable and effective access at reasonable cost for all Hawai'i's residents to health service that are responsive to the holistic needs of community's members.
- Early detecting and diagnosing of treatable diseases.
- Reducing the effects of chronic disease and prolonging health related quality life.
- Reducing morbidity and pain through timely and appropriate treatment.
- Establishing regionalized health care delivery systems that include community input, are cost-effective, and that foster improved access to quality health care services.
- Reducing the risk of injury and violence by promoting a safe environment and a safe community.

Desired characteristics of a health care delivery system. The first of these is "Emphasis on basic primary care as a means of increasing access to quality care in a cost-effective manner in various community settings."

Critical elements of a health care delivery system. The plan lists five critical elements:

- Access
- Quality management
- Cost-effectiveness
- Continuity of care
- Constituent participation

It is apparent that this proposal relates well to these elements, with the possible exception of cost-effectiveness. We acknowledge that the operating revenues do not cover expenses, and that State subsidies are needed. However, Kahuku is a critical access hospital, as are other small hospitals in rural areas of the state, and subsidies are justified to maintain the services the community needs.

This proposal is also consistent with the provisions of the Windward O`ahu Subarea (SAC) Values and Priorities of the H2P2 (see pps. III-8 to III-9).

Some highlights:

- The SAC values include "responsibility and accountability"; "effectiveness"; "responsive"; and "community."
- The second priority of the SAC is "injuries," and the continuation of the emergency room at Kahuku is important in addressing this priority.

## **b. Need and Accessibility**

Description of the service area. Kahuku Hospital is in the area of the Windward Subarea Health Planning Council. Its primary service area is the Koolauloa District of O`ahu (Exhibit A), which constitutes Census tracts 101

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and 102 (Exhibit B). However, it frequently serves people from outside the service area, going as far west as Waialua.

The Hospital is the only inpatient primary care provider in this area, providing emergency room service, medical/surgical beds, skilled nursing beds, diagnostic radiology and laboratory service. The next nearest hospitals, (Wahiawa and Castle) are approximately 50 minutes away, mostly by two lane roads, which are sometimes closed by weather or accidents. As such, the Hospital functions as a safety net facility, and is designated as a critical access hospital by Medicare.

According to the 2000 census (Exhibit C), census tracts 101 and 102 totaled 18,899 residents in 2000. The Legislature, in Act 113 (Attachment A), estimates the population of the service area to be 27,000.

The service population is at increased socio-economic risk compared to the state as a whole. Examples include: 31.5% of the population is below 200% of the federal poverty line (22% is the state average); unemployment rate is 7.2% (5.9% is the state average); and 20% of households receive food stamps. (Source: State of Hawaii, Primary Care Needs Assessment Databook," December 1999, published by the Hawaii Department of Health).

Need. The need which will be met by Kahuku Hospital under KMC operation is essentially the same need which is being met now by Kahuku Hospital.

The most important needs:

- Emergency room
- Basic inpatient medical/surgical care
- Skilled nursing (SNF)
- Intermediate care facility (ICF) (to ICF patients waitlisted in SNF beds).
- Diagnostic Radiology (inpatient and outpatient)
- Laboratory (inpatient and outpatient)
- Pharmacy (inpatient only).

Attached as Exhibit D are detailed utilization statistics, by month, for FY 2006; and the first 11 months of FY 2007 (ending May, 2007). The table below summarizes selected utilization information.

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TABLE B-1  
 UTILIZATION STATISTICS FOR SELECTED SERVICES AT  
 KAHUKU HOSPITAL, FISCAL YEARS 2006 AND 2007

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| Service          | Total FY '06 | Total FY '07* | ADC '06 | ADC '07 |
|------------------|--------------|---------------|---------|---------|
| ER Visits        | 4,146        | 4,183         |         |         |
| Acute bed days** | 2,059        | 2,051         | 5.6     | 5.6     |
| SNF bed days**   | 3,064        | 3,187         | 8.4     | 8.7     |
| Radiology        | 6,780        | 5,777         |         |         |
| Laboratory       | 22,201       | 18,752        |         |         |

\*Annualized from first 11 months

\*\*Includes OB days in 2006 and acute days in Acute/SNF swing bed

\*\*Includes SNF patients waitlisted in acute bed and ICF patients waitlisted in SNF bed

The data above show the usage of a small, community safety-net hospital. We believe that, in this case, we can assume that the usage reflects the community's need, and that this need will continue at approximately the same level.

Again, this is a small safety-net hospital showing what appears to be a low average daily census for acute and long term patients. However, given the alternative of traveling long distances for inpatient service, the facility is of vital importance for those individuals and communities it does serve. Further, given the overcrowding in other island long term care facilities, the long term beds here are an important benefit.

The ER visits show a daily utilization of more than 11 patients. Some of these patients are in critical or life-threatening conditioning. Kahuku does maintain an emergency physician on site 24/7, and is able to provide adequate care for most patients. For those patients needing a higher level of service, Kahuku can stabilize and transport them by ground or helicopter ambulance. Again, the next-nearest ERs, at Wahiawa or Castle Hospitals would be about 50 minutes away.

Likewise, Kahuku provides the only radiology and laboratory services in the service area. Kaiser has a small clinic in Kahuku, and sends its radiology patients and most of its lab work to its Moanalua facility. However, it does use the Kahuku Hospital lab for stat work. Other physicians in the service area do send outpatients to the Hospital for lab and radiology service.

Accessibility. This proposal guarantees the continued accessibility of Kahuku Hospital's services to the residents of and the visitors to the service area. These services include emergency, acute inpatient, skilled nursing, radiology and laboratory. In the absence of the Hospital, these services are only available at facilities approximately fifty minutes away.

The services at Kahuku Hospital, under the ownership and operation of KMC, will be available to all patients, regardless of income, race or ethnicity, gender, age, or disability.

**c. Quality of Service/Care**

The current Kahuku Hospital is certified by Medicare and Medicaid, and has a history of providing quality primary care. Quality may be strengthened under this proposal, since the quality assurance and risk management programs of HHSC will be available to KMC.

The quality of care for those served by Kahuku Hospital will be maintained simply by continuing the existing facility and its services. The alternative of declaring bankruptcy and closing the facility would suddenly make basic services much less accessible and available. Accordingly, the quality of care available in the Kahuku service area would decline.

**d. Cost and Finances**

The capital cost of the proposal will be \$2,900,000, which is the amount determined to be a fair acquisition cost by the Hawaii Legislature based on an IRS appraisal. Act 113 appropriates these funds so that the capital funds are available.

Exhibit E (attached) provides revenue and expense projections for the first three years of operation under KMC (the first year being the 10 months from September, 2007 through June, 2008). These projections are based on the recent experience of Kahuku Hospital and assume a 5% annual increase in both revenues and expenses.

The projections show that, as with the existing Hospital, operating revenue will not cover operating expenses. In FY 2008, we project operating revenue of \$4,600,000 and operating expenses of \$6,000,000, leaving us with an operating deficit of \$1,400,000. The Legislature has already appropriated \$1,500,000 for each of the fiscal years 2008 and 2009 to make up the deficit. We anticipate that, as with other small rural hospitals, the Legislature will continue to provide such assistance in the future.

**e. Relationship to the Existing Health Care System**

This proposal will provide for the continuation of a key component of the health care system in Koolauloa and the island of O`ahu.

Kahuku Hospital has been in existence since 1929. It is a safety net facility. Its emergency room, with adjoining helipad, is the only ER in the approximately 54 mile stretch between Castle and Wahiawa hospitals. The

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ER serves approximately 4,100 patients annually. It is the only provider of acute hospital beds in the same area. It is the only provider of skilled nursing beds in the area. It is the only provider of laboratory and radiology services in the area.

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Its loss would definitely have a negative impact on the health care system. Its continuation would be a definite plus for the health care system.

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**f. Availability of Resources**

Both the financial and personnel resources needed to implement the proposal are available.

Capital cost. The applicant is KMC, which will incur no capital cost itself, although it will be acquiring the assets of the existing Kahuku Hospital. We estimate the assets to be worth approximately \$2.9 million, and the legislature has appropriated \$3.9 million "or so much thereof as may be necessary for fiscal year 2007-2008 to carry out the purposes of this Act." It is anticipated that the the acquisition amount of \$2.9 million will be approved by the bankruptcy court and expended to resolve claims against Kahuku Hospital in bankruptcy proceedings such that KMC will acquire the facility free and clear of such claims and any related liens.

Operating costs. As shown in Exhibit D, the operating revenues will not be sufficient to cover operating expenses, even though Kahuku, as a critical access hospital, receives additional Medicare reimbursement. As with other small rural hospitals, Kahuku has received operating subsidies from the State, and we anticipate that this will continue. For each of the fiscal years 2008 and 2009, the Legislature has already appropriated \$1,500,000.

Staff resources. KMC will continue to employ the staff now employed by Kahuku Hospital. In addition, the Oahu Region of HHSC will provide an administrator under a service agreement. The table below shows the FTE by type.

| <u>Staff</u>          | <u>FTE</u>   |
|-----------------------|--------------|
| Nursing               | 30.23        |
| Ancillary             | 10.69        |
| Support services      | 17.74        |
| Fiscal/Business       | 12.05        |
| <u>Administrative</u> | <u>4.00</u>  |
| <b>Total</b>          | <b>74.71</b> |

These staff are available since, with the exception of one administrator, they are currently employed at Kahuku Hospital and will be offered continued employment under KMC, the new owner/operator.