



Kara M. Friedman
(312) 873-3639
kfriedman@polsinelli.com

161 N. Clark Street, Suite 4200
Chicago, IL 60601
(312) 819-1900
Fax: (312) 819-1910
www.polsinelli.com

November 16, 2011

Dale Galassie, Chair
Illinois Health Facilities and Services Review Board
525 West Jefferson Street
Springfield, Illinois 62761

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HEALTH FACILITIES &
SERVICES REVIEW BOARD

RE: Centegra Hospital Huntley, Project 10-090

Dear Chairman Galassie:

Polsinelli Shughart represents Sherman Hospital and I am writing this letter with reference to the Centegra-Huntley Hospital proposal. As you know, many of the area community hospitals have expressed concern about Centegra's strategy to build a hospital in Huntley. Many of the salient points surrounding those concerns have been described in previous testimony and submissions. However, after hearing the testimony of Centegra officials during the recent Mercy Crystal Lake public hearing on October 7th, it became evident that it was important to focus on a key issue.

Specifically, during the October 7th Mercy public hearing, Centegra officials in opposing Mercy's Crystal Lake proposal articulated their high level of concern that the Mercy proposal would "cannibalize" its McHenry County facilities with an expected catastrophic impact on its operations. Based on Centegra's own proposal however, a new hospital in Huntley would very similarly cannibalize Centegra's own facility in Woodstock as well as heavily draw from and adversely impact the Elgin hospitals.

This negative impact on area hospitals will occur if the Huntley hospital is approved because demographic trends in McHenry County including declining inpatient utilization rates do not support a new hospital.

The enclosed report, Assessment of Likely Impact on Centegra-Hospital-Woodstock which was completed by Krentz Consulting, focuses on the adverse impact the Centegra proposal would have on Centegra's own Woodstock hospital. Given the significant overlap in market share and downward utilization trends between the proposed Huntley hospital and Centegra's Woodstock hospital, it is clear that Centegra is not committed to the long term operation of the Woodstock hospital because the Huntley proposal will cannibalize the existing Woodstock facility.

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Centegra cannot credibly defend its own project while attacking the Mercy proposal. Further, its promises relating to its commitment to the ongoing viability and operation of Woodstock ring hollow.

As Centegra's Chief Executive said on October 7th at the Mercy public hearing, "Do not sacrifice the existing hospitals and safety net services we already provide for a new hospital."

Thank you for your consideration.

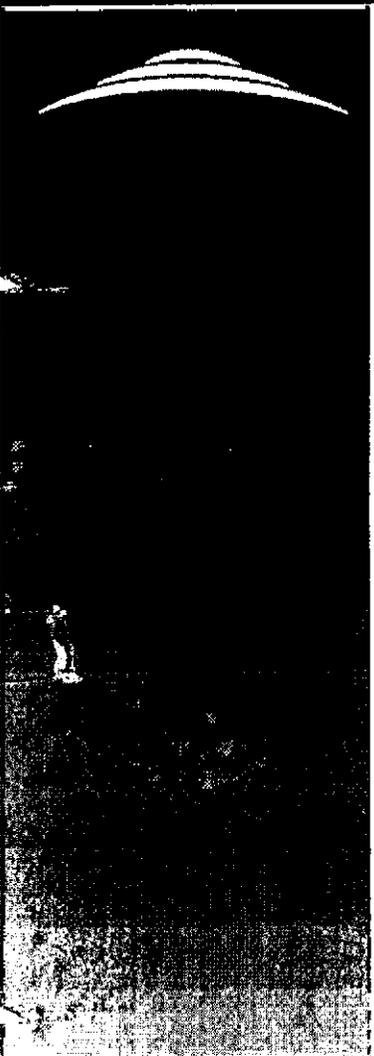
Sincerely,


Kara M. Friedman

KMF:

Enclosure

Cc: Rick Floyd



Assessment of Likely Impact on Centegra- Hospital-Woodstock

**In Response to Proposed Centegra Hospital-
Huntley (Project 10-090)**

November 16, 2011



Krentz Consulting LLC is pleased to provide this independent assessment of the *Impact on Centegra Hospital-Woodstock*. This study was commissioned by Sherman Health in response to Centegra Health System's initial request for Certificate of Need approval (Project 10-090) to build a new hospital in Huntley in Illinois Health Planning Area A-10 (McHenry County) and their supplemental information submitted on July 28, 2011 in response to questions by the Illinois Health Facilities and Services Review Board (HFSRB).


Krentz Consulting LLC

16 November 2011
Date



About Krentz Consulting LLC

Krentz Consulting LLC is a management consulting firm providing strategic planning services to the health care industry, including community hospitals, health systems, academic medical centers and medical schools, children's hospitals, and industry and professional associations. Krentz Consulting is nationally recognized for its strategic planning expertise, frequently serving as faculty at educational programs and writing articles for national publications.

Susanna E. Krentz, President of Krentz Consulting, has over twenty-nine years experience as a health care consultant and oversaw the process and reviewed all analyses for this project. As a recognized leader in strategy development for health care organizations, she has worked with numerous hospitals and health care systems across the country in the development of strategic plans, physician strategy, growth plans, resource allocation, and competitive strategy. She has a Master of Business Administration from the Booth School of Business, University of Chicago and a Bachelor of Arts from Yale University.

Tracey L. Camp, Senior Consultant, has 25 years of experience in health care planning and strategy and provided the analytical support for this project. Her areas of expertise include strategic planning, service line planning and demand modeling, medical staff development studies, and market research. She is expert at converting data into meaningful information to support decision making. She has a Bachelor of Arts from Northwestern University.

Executive Summary

- 1. Centegra-Woodstock depends on Centegra-Huntley's proposed service area.**
 - The proposed service area of the Centegra-Huntley hospital overlaps Centegra-Woodstock Hospital's existing service area.
 - 75% of Centegra-Woodstock's discharges (5,000 patients) live Centegra-Huntley's proposed service area.
- 2. The Applicant's volume forecasts understate the impact on Centegra Hospital-Woodstock.**
 - The applicant's impact assessment only considers lost patients from new population growth, not from population that already lives in the services area.
 - Krentz Consulting estimates that Centegra Woodstock's medical/surgical market share in the proposed service area could decrease from 16.6% to 10.5%, a 37 percent decline.
 - The total lost medical/surgical activity for Centegra-Woodstock is estimated to be 1,900 discharges, reflecting 1,500 medical/surgical discharges from current share and at least 400 additional patients (as identified by the Applicant) lost from the new population that enters the market between 2010 and 2018.
- 3. Centegra-Woodstock's daily census would fall below targeted occupancy levels for medical/surgical, ICU and obstetrics given estimated losses of current volumes.**

Occupancy Levels at Centegra-Woodstock After Estimated Loss of Current Volume

Medical Surgical	ICU	OB
62%	57%	42%

- 4. Reduced market share and lost volume would have an adverse impact on Centegra-Woodstock's financial health.**
 - The lost inpatient discharges are estimated to result in an annual inpatient and outpatient decrease of over \$27 million in net revenue and nearly \$9 million in lost contribution margin.

5. A new Centegra-Huntley Hospital may put resources at risk for less economically secure Woodstock residents.

- One in six households in Woodstock earn less than \$25,000 a year and 17 percent of the population is uninsured or covered by Medicaid, rates that are more than twice that for Huntley residents.
- A new Centegra-Huntley facility may attract the more economically advantaged patients in Huntley that Centegra Hospital-Woodstock relies on to help fund its services to the less economically-secure patient population in Woodstock.

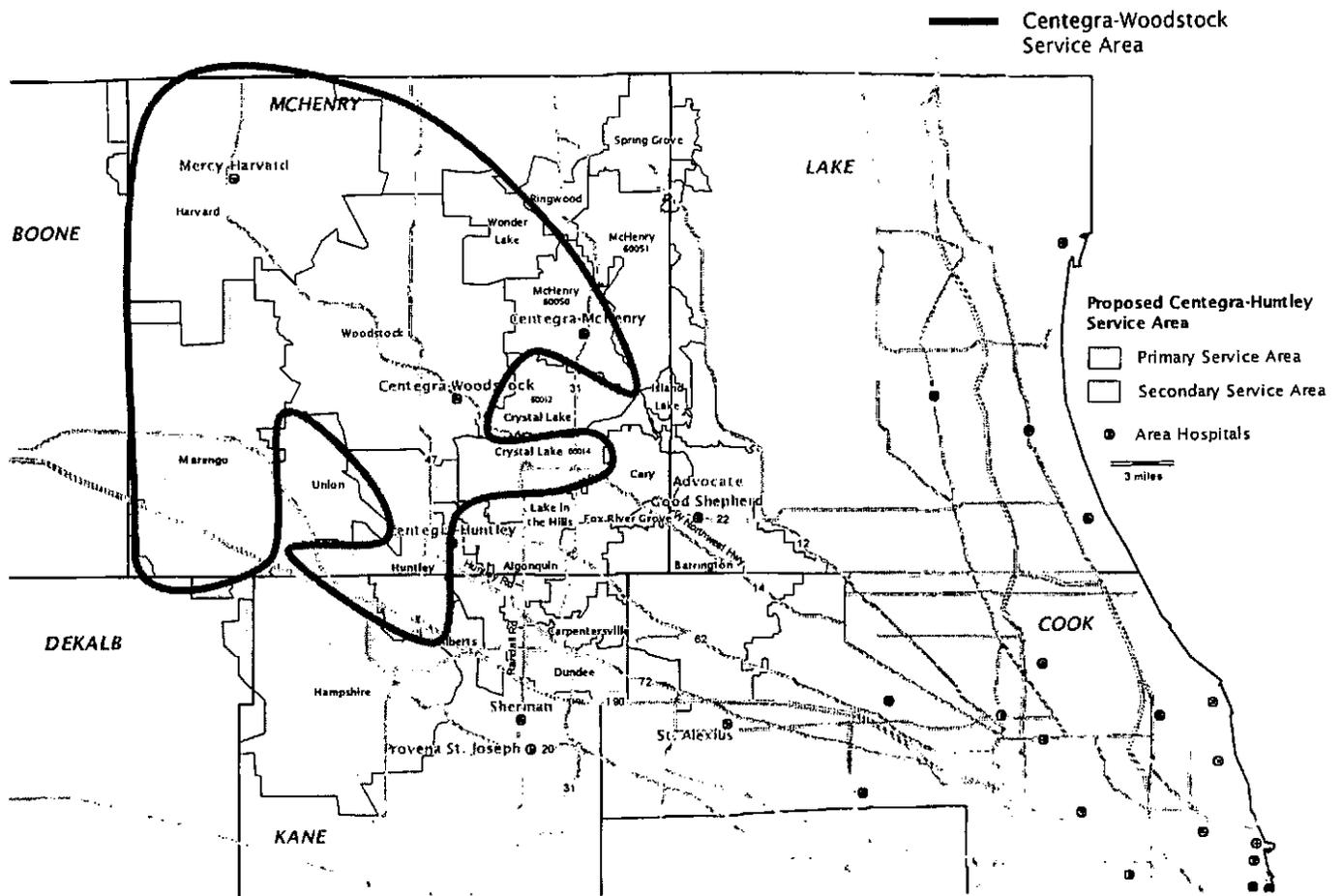
**Supporting Information
Assessment of Likely Impact on
Centegra Hospital-Woodstock
Proposed Centegra-Huntley Hospital (Project 10-090)**

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Centegra-Woodstock Depends on Centegra-Huntley's Proposed Service Area

As shown in the map in *Exhibit 1*, the proposed service area of the Centegra-Huntley hospital geographically covers a substantial portion of Centegra-Woodstock Hospital's existing service area. Centegra-Woodstock currently treats approximately 5,000 med/surg and obstetric inpatients from Centegra-Huntley's proposed service area, representing 75 percent of its total facility discharges¹.

Exhibit 1
Proposed Centegra-Huntley Service Area
Overlaid with Centegra-Woodstock Service Areas



¹Source: Illinois COMPdata. Data represent a simple annualization of 9 months CY 2010 data. Discharges exclude normal newborns in MS-DRG 795, psychiatry, substance abuse, and rehabilitation (psychiatry, substance abuse, and rehabilitation are not included in Applicant's proposed bed complement).

Note: Service area definition for Centegra-Woodstock was imputed from COMPdata by Krentz Consulting to comprise 75% of their inpatient origin (ex. normal newborns) during the first 9 mos of 2010.

Estimated Volume Impact on Centegra Hospital-Woodstock

After applying reasonable estimates of market share losses by sub-geography, *Exhibit 2* shows the estimated volume impact of a new Centegra-Huntley hospital on Centegra Hospital-Woodstock's current discharges from Centegra-Huntley's defined service area.

- Centegra-Woodstock is estimated to lose over 1,800 discharges or 37 percent of its volume originating from Centegra-Huntley's defined service area.

Exhibit 2 Impact of New Centegra-Huntley Hospital on Centegra-Woodstock Discharges

	Centegra-Woodstock Current Discharges (2010 Annualized) in Centegra-Huntley Proposed Service Area	
	Centegra- Woodstock Current Discharges from Service Area ¹	Potential Loss of Centegra- Woodstock Current Discharges
<i>Centegra Huntley Total Service Area</i>		
Medical/Surgical	4,200	1,558
OB	685	259
Neonatal	<u>155</u>	<u>59</u>
TOTAL	5,039	1,876

Notes: Medical/surgical volume would include care delivered in the ICU. Volume excludes normal newborns in MS-DRG 795.

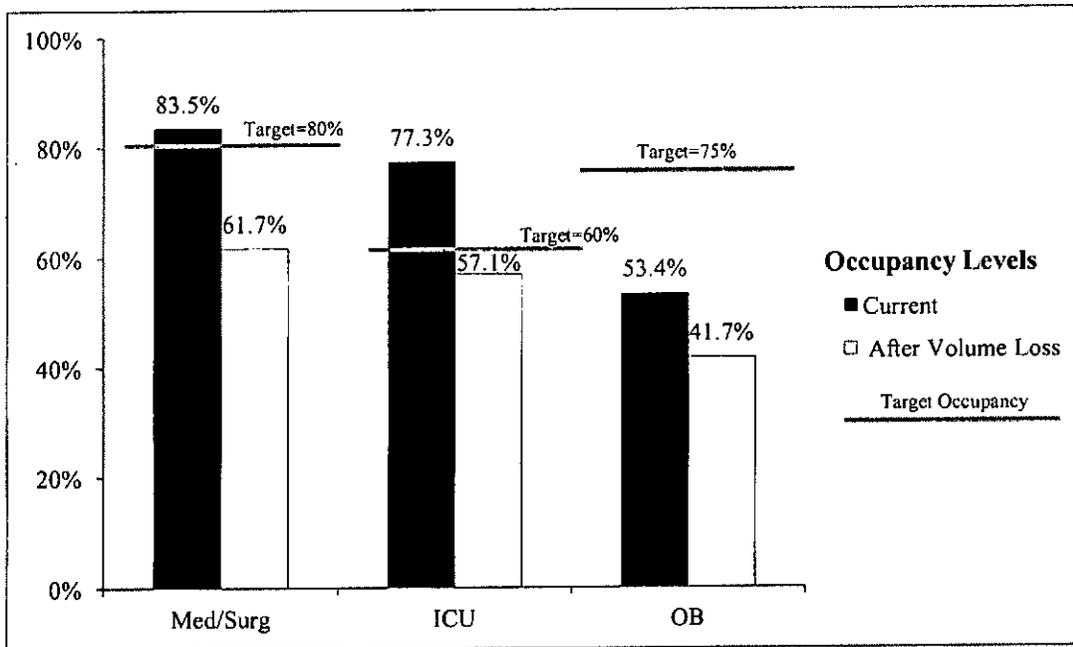
The methodology for estimating volume loss and additional detail by sub-geography is presented in *Attachment 2*.

¹ Source of volume from Illinois COMPdata for discharges occurring in the first nine months of calendar year 2010 and annualized using a simple annualization method. Discharges exclude normal newborns in MS-DRG 795, psychiatry, substance abuse, and rehabilitation (psychiatry, substance abuse, and rehabilitation are not included in Applicant's proposed bed complement).

Centegra-Woodstock's Daily Census would Fall Below Targeted Occupancy Levels

As shown in *Exhibit 3*, losing more than 1,800 discharges would substantially reduce occupancy levels at Centegra-Woodstock for all service types. Centegra-Woodstock's OB occupancy levels were already well below targeted levels and would drop to less than 42 percent, compromising its ability to offer a viable program.

Exhibit 3
Impact on Centegra-Woodstock Occupancy Levels



Note: Applied Centegra Woodstock's 2010 inpatient ALOS by service type to potential lost discharge inpatient volume to determine expected impact on average daily census. Applied Centegra-Woodstock's 2010 ratio of ICU ADC (as a proportion of total med/surg/ICU ADC) to estimate potential lost ICU ADC. Potential volume loss is understated as it does not include any potential loss of observation volume.

Source of current Centegra-Woodstock occupancy levels is 2010 Annual Hospital Questionnaires, HFSRB.

Reduced Market Share and Lost Volume Would Have an Adverse Impact on Centegra-Woodstock's Financial Health

Using the methodology described in *Attachment 1*, we estimate that a new Centegra Hospital-Huntley would result in a reduction of over 1,800 inpatient discharges at Centegra Hospital-Woodstock and an annual inpatient and outpatient loss of over \$27 million in net revenue and nearly \$9 million in lost contribution margin.

Exhibit 4 Financial Impact on Centegra Hospital-Woodstock

Annual Inpatient Loss:	
Lost Inpatient Discharges	1,876
Lost Net Revenue	\$14.9M
Lost Contribution Margin	\$4.8M
Annual Inpatient + Outpatient Loss (adjusted by outpatient factor):	
Lost Net Revenue	\$27.1M
Lost Contribution Margin	\$8.9M

A New Centegra-Huntley Hospital May Put Resources at Risk for Less Economically Secure Woodstock Residents

As shown in *Exhibit 5*, Huntley residents are less racially diverse, more economically secure, and more likely to be insured than Woodstock residents. One in six households in Woodstock earn less than \$25,000 a year and 17 percent of the population is uninsured or covered by Medicaid, rates that are more than twice that for Huntley residents. A new Centegra-Huntley facility would draw away the more economically-secure patients in Huntley that Centegra Hospital-Woodstock relies on to help fund its services to the less economically-secure patient population in Woodstock. Siphoning of economically-secure patients, combined with shelving of plans to reinvest at the Woodstock facility, reduce vital resources for Woodstock residents.

Exhibit 5
Socioeconomic Characteristics of Huntley vs. Woodstock

	Woodstock ZIP Code 60098	Huntley ZIP Code 60142
Median Household Income 2011 ¹	\$59,576	\$73,719
Percentage of Households with 2011 Income < \$25,000 ¹	17.4% (1 in 6 households)	7.9% (1 in 12 households)
Percentage of Population Covered by Medicaid or Uninsured ²	17.3%	7.2%
Percentage of Population that is Hispanic or Non-White 2011 ¹	28.9%	12.6%

¹Source: Nielsen Claritas, 2011.

²Source: Thomson Reuters based on claims data, 2010.

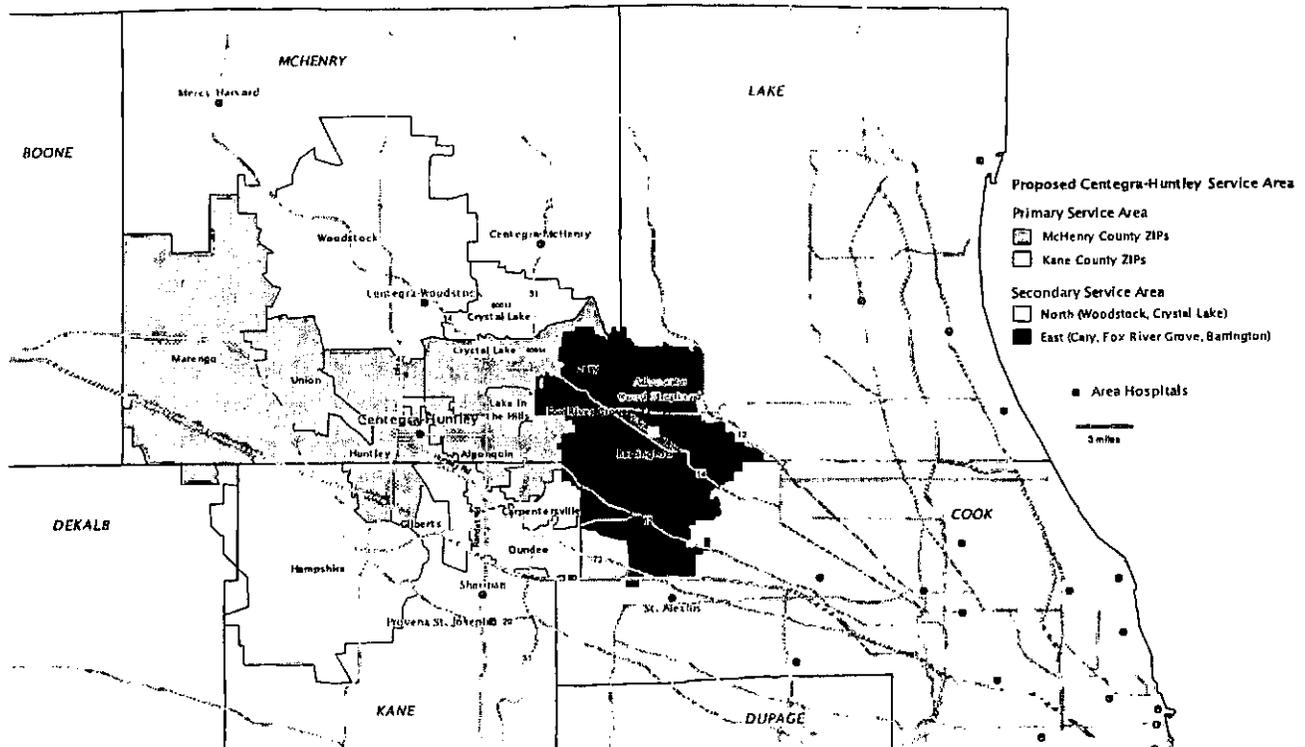
Attachment 1

Volume Impact Methodology for Centegra Hospital-Woodstock

Krentz Consulting modeled the impact that the proposed Centegra-Huntley hospital would have on the utilization of Centegra-Woodstock. The methodology and assumptions used in the impact analysis are described below.

1. Centegra-Huntley's proposed primary and secondary service area was segmented into sub-geographies with which to judge current and expected patient migration patterns (see map below of sub-geographies).
2. Discharges for inpatients residing in the sub-geographies were grouped into medical, surgical, OB, and neonatal service categories defined by Krentz Consulting. The source of the discharge information was obtained by COMPdata for discharges occurring in the first nine months of calendar year 2010 and annualized using a simple annualization method.
3. For each sub-geography, assumptions of volume loss were made for each of the service categories.

Centegra-Huntley Proposed Service Area Submarkets Defined for Impact Analysis



McHenry PSA=60014,60102,60142,60152,60156,60180
Kane PSA=60110,60118,60136,60140

North SSA=60012,60098
East SSA=60010,60013,60021

Financial Impact Methodology for Centegra Hospital-Woodstock

Since proprietary financial information for Centegra Hospital-Woodstock is not available, we estimated the financial impact of lost volume by applying the average lost net revenue and contribution margin¹ per case estimated for a group of Concerned Hospitals (Advocate Good Shepherd, Sherman Health, and St. Alexius Medical Center) to Centegra-Woodstock's estimated lost volume. Because the financial ratios of the Concerned Hospitals reflected only their lower acuity volume that would be lost to Centegra-Huntley, it is a reasonable proxy to apply to Centegra Hospital-Woodstock. Contribution margin is an appropriate measure to judge the financial impact of lost volume because it quantifies the amount of money available to cover the fixed costs of an enterprise that can't be eliminated (like buildings and fixed staffing) when volume declines. Any loss of volume-driven contribution margin means that the fixed costs of an enterprise will have to be spread across a smaller patient base which may compromise a hospital's financial health or require an increase in prices.

A new Centegra-Huntley hospital will shift both inpatient and outpatient volume. To estimate the impact of potential lost outpatient volume at Centegra-Woodstock, we increased the potential lost inpatient net revenue and contribution margin by the average outpatient factor assumed for the Concerned Hospitals [an outpatient factor reflects a hospital's proportion of outpatient activity and is determined by dividing a hospital's total gross revenue by its inpatient gross revenue].

¹ Contribution margin represents the amount of revenue gained after covering the variable operating expenses of care delivery. A positive contribution margin in a service helps offset the fixed infrastructure costs of an enterprise (such as buildings) as well as under- or uncompensated care.

Attachment 2

Impact of Centegra-Huntley Hospital on Centegra-Woodstock Volume

Centegra-Woodstock Current Discharges in Centegra-Huntley Proposed Service Area (2010 Annualized)		
	Centegra-Woodstock Current Discharges from Service Area	Potential Loss of Centegra-Woodstock Discharges
<i>Centegra Huntley PSA-McHenry ZIPs</i>		
Medical/Surgical	2,241	1,120
OB	336	168
Neonatal	<u>75</u>	<u>37</u>
TOTAL	2,651	1,326
Overall % Loss		50%
 <i>Centegra Huntley PSA-Kane ZIPs</i>		
Medical/Surgical	29	29
OB	12	12
Neonatal	<u>3</u>	<u>3</u>
TOTAL	44	44
Overall % Loss		100%
 <i>Centegra Huntley SSA-East</i>		
Medical/Surgical	74	37
OB	40	20
Neonatal	<u>12</u>	<u>6</u>
TOTAL	126	63
Overall % Loss		50%
 <i>Centegra Huntley SSA-North</i>		
Medical/Surgical	1,856	371
OB	297	59
Neonatal	<u>66</u>	<u>13</u>
TOTAL	2,218	444
Overall % Loss		20%
 <i>Centegra Huntley Total Service Area</i>		
Medical/Surgical	4,200	1,558
OB	685	259
Neonatal	<u>155</u>	<u>59</u>
TOTAL	5,039	1,876
Overall % Loss		37%

Notes: Medical/surgical volume would include care delivered in the ICU. Volume excludes normal newborns in MS-DRG 795.