H-0269.5

HOUSE BILL 1484

State of Washington 56th Legislature 1999 Regular Session

By Representatives Parlette, Cody, Alexander, Conway and Edwards

Read first time 01/26/1999. Referred to Committee on Health Care.

AN ACT Relating to the medicaid related payment of property costs in licensed nursing facilities; amending RCW 74.46.330, 74.46.350, 74.46.360, and 74.46.370; adding new sections to chapter 74.46 RCW; providing an effective date; and declaring an emergency.

BE IT ENACTED BY THE LEGISLATURE OF THE STATE OF WASHINGTON:

Sec. 1. RCW 74.46.330 and 1980 c 177 s 33 are each amended to read as follows:

Tangible assets of the following types in which a contractor has an interest through ownership or leasing are subject to depreciation:

(1) Building - the basic structure or shell and additions thereto;

(2) Building fixed equipment - attachments to buildings, including, but not limited to, wiring, electrical fixtures, plumbing, elevators, heating system, and air conditioning system. The general characteristics of this equipment are:

(a) Affixed to the building and not subject to transfer; ((~~and~~))

(b) A fairly long life, but shorter than the life of the building to which <u>it is</u> affixed; <u>and</u>

<u>(c) For new or replacement building construction or for major renovations, receiving certificate of need approval or a certificate of</u>

<u>need exemption under chapter 70.38 RCW after July 1, 1999, the number of years used to depreciate fixed equipment shall be the same number of years as the life of the building to which it is affixed;</u>

(3) Major movable equipment including, but not limited to, beds, wheelchairs, desks, and x-ray machines. The general characteristics of this equipment are:

(a) A relatively fixed location in the building;

(b) Capable of being moved as distinguished from building equipment;

(c) A unit cost sufficient to justify ledger control;

(d) Sufficient size and identity to make control feasible by means of identification tags; and

(e) A minimum life greater than one year;

(4) Minor equipment including, but not limited to, waste baskets, bed pans, syringes, catheters, silverware, mops, and buckets which are properly capitalized. No depreciation shall be taken on items which are not properly capitalized as directed in RCW 74.46.310. The general characteristics of minor equipment are:

(a) In general, no fixed location and subject to use by various departments;

(b) Small in size and unit cost;

(c) Subject to inventory control;

(d) Large number in use; and

(e) Generally, a useful life of one to three years;

(5) Land improvements including, but not limited to, paving, tunnels, underpasses, on-site sewer and water lines, parking lots, shrubbery, fences, and walls where replacement is the responsibility of the contractor; and

(6) Leasehold improvements - betterments and additions made by the lessee to the leased property, which become the property of the lessor after the expiration of the lease.

Sec. 2. RCW 74.46.350 and 1980 c 177 s 35 are each amended to read as follows:

(1) Buildings, land improvements, and fixed equipment shall be depreciated using the straight-line method of depreciation. <u>For new or replacement building construction or for major renovations, receiving certificate of need approval or a certificate of need exemption under chapter 70.38 RCW after July 1, 1999, the number of years used to</u>

depreciate fixed equipment shall be the same number of years as the life of the building to which it is affixed. Major-minor equipment shall be depreciated using either the straight-line method, the sum-of-the-years' digits method, or declining balance method not to exceed one hundred fifty percent of the straight line rate. Contractors who have elected to take either the sum-of-the-years' digits method or the declining balance method of depreciation on major-minor equipment may change to the straight-line method without permission of the department.

(2) The annual provision for depreciation shall be reduced by the portion allocable to use of the asset for purposes which are neither necessary nor related to patient care.

(3) No further depreciation shall be claimed after an asset has been fully depreciated unless a new depreciation base is established pursuant to RCW 74.46.360.

Sec. 3. RCW 74.46.360 and 1997 c 277 s 1 are each amended to read as follows:

(1) For all partial or whole rate periods after December 31, 1984, the cost basis of land and depreciation base of depreciable assets shall be the historical cost of the contractor or lessor, when the assets are leased by the contractor, in acquiring the asset in an arm's-length transaction and preparing it for use, less goodwill, and less accumulated depreciation, if applicable, which has been incurred during periods that the assets have been used in or as a facility by any contractor, such accumulated depreciation to be measured or adjusted in accordance with subsections (4), (5), ((~~and~~)) (6), and (7) of this section and RCW 74.46.350 and 74.46.370. If the department challenges the historical cost of an asset, or if the contractor cannot or will not provide the historical costs, the department will have the department of general administration, through an appraisal procedure, determine the fair market value of the assets at the time of purchase. The cost basis of land and depreciation base of depreciable assets will not exceed such fair market value.

(2) For new or replacement building construction or for substantial building additions requiring the acquisition of land and which commenced to operate on or after July 1, 1997, the department shall determine allowable land costs of the additional land acquired for the replacement construction or building additions to be the lesser of:

(a) The contractor's or lessor's actual cost per square foot; or

(b) The square foot land value as established by an appraisal that meets the latest publication of the Uniform Standards of Professional Appraisal Practice (USPAP) and the financial institutions reform, recovery, and enhancement act (FIRREA).

(3) Subject to the provisions of subsection (2) of this section, if, in the course of financing a project, an arm's-length lender has ordered a Uniform Standards of Professional Appraisal Practice appraisal on the land that meets financial institutions reform, recovery, and enhancement act standards and the arm's-length lender has accepted the ordered appraisal, the department shall accept the appraisal value as allowable land costs for calculation of payment.

If the contractor or lessor is unable or unwilling to provide or cause to be provided to the department, or the department is unable to obtain from the arm's-length lender, a lender-approved appraisal that meets the standards of the Uniform Standards of Professional Appraisal Practice and financial institutions reform, recovery, and enhancement act, the department shall order such an appraisal and accept the appraisal as the allowable land costs. If the department orders the Uniform Standards of Professional Appraisal Practice and financial institutions reform, recovery, and enhancement act appraisal, the contractor shall immediately reimburse the department for the costs incurred.

(4) The historical cost of depreciable and nondepreciable donated assets, or of depreciable and nondepreciable assets received through testate or intestate distribution, shall be the lesser of:

(a) Fair market value at the date of donation or death; or

(b) The historical cost base of the owner last contracting with the department, if any.

(5) Estimated salvage value of acquired, donated, or inherited assets shall be deducted from historical cost where the straight-line or sum-of-the-years' digits method of depreciation is used.

(6)(a) For facilities, other than those described under subsection (2) of this section, operating prior to July 1, 1997, where land or depreciable assets are acquired that were used in the medical care program subsequent to January 1, 1980, the cost basis or depreciation base of the assets will not exceed the net book value which did exist or would have existed had the assets continued in use under the previous contract with the department; except that depreciation shall not be assumed to accumulate during periods when the assets were not in use in or as a facility.

(b) The provisions of (a) of this subsection shall not apply to the most recent arm's-length acquisition if it occurs at least ten years after the ownership of the assets has been previously transferred in an arm's-length transaction nor to the first arm's-length acquisition that occurs after January 1, 1980, for facilities participating in the medical care program prior to January 1, 1980. The new cost basis or depreciation base for such acquisitions shall not exceed the fair market value of the assets as determined by the department of general administration through an appraisal procedure. A determination by the department of general administration of fair market value shall be final unless the procedure used to make such determination is shown to be arbitrary and capricious. For all partial or whole rate periods after July 17, 1984, this subsection is inoperative for any transfer of ownership of any asset, depreciable or nondepreciable, occurring on or after July 18, 1984, leaving (a) of this subsection to apply alone to such transfers: PROVIDED, HOWEVER, That this subsection shall apply to transfers of ownership of assets occurring prior to January 1, 1985, if the costs of such assets have never been reimbursed under medicaid cost reimbursement on an owner-operated basis or as a related-party lease: PROVIDED FURTHER, That for any contractor that can document in writing an enforceable agreement for the purchase of a nursing home dated prior to July 18, 1984, and submitted to the department prior to January 1, 1988, the cost basis of allowable land and the depreciation base of the nursing home, for rates established after July 18, 1984, shall not exceed the fair market value of the assets at the date of purchase as determined by the department of general administration through an appraisal procedure. For medicaid cost reimbursement purposes, an agreement to purchase a nursing home dated prior to July 18, 1984, is enforceable, even though such agreement contains no legal description of the real property involved, notwithstanding the statute of frauds or any other provision of law.

(c) In the case of land or depreciable assets leased by the same contractor since January 1, 1980, in an arm's-length lease, and purchased by the lessee/contractor, the lessee/contractor shall have the option:

(i) To have the provisions of subsection (b) of this section apply to the purchase; or

(ii) To have the reimbursement for property and return on investment continue to be calculated pursuant to the provisions contained in ((~~RCW 74.46.530~~)) section 6(1) (e) and (f) of this act based upon the provisions of the lease in existence on the date of the purchase, but only if the purchase date meets one of the following criteria:

(A) The purchase date is after the lessor has declared bankruptcy or has defaulted in any loan or mortgage held against the leased property;

(B) The purchase date is within one year of the lease expiration or renewal date contained in the lease;

(C) The purchase date is after a rate setting for the facility in which the reimbursement rate set pursuant to this chapter no longer is equal to or greater than the actual cost of the lease; or

(D) The purchase date is within one year of any purchase option in existence on January 1, 1988.

(d) For all rate periods past or future where land or depreciable assets are acquired from a related organization, the contractor's cost basis and depreciation base shall not exceed the base the related organization had or would have had under a contract with the department.

(e) Where the land or depreciable asset is a donation or distribution between related organizations, the cost basis or depreciation base shall be the lesser of (i) fair market value, less salvage value, or (ii) the cost basis or depreciation base the related organization had or would have had for the asset under a contract with the department.

(7) Beginning July 1, 1999, for buildings, building improvements, leasehold improvements, land improvements, and fixed equipment, the allowable net book value shall be the actual allowable net book value, or fifty percent of the undepreciated allowable asset value, or the allowable asset value as depreciated in accordance with subsection (6) of this section, whichever amount is greater.

Sec. 4. RCW 74.46.370 and 1997 c 277 s 2 are each amended to read as follows:

(1) Except for new buildings, major remodels, and major repair projects, as defined in subsection (2) of this section, the contractor shall use lives which reflect the estimated actual useful life of the

asset and which shall be no shorter than guideline lives as established by the department. Lives shall be measured from the date on which the assets were first used in the medical care program or from the date of the most recent arm's-length acquisition of the asset, whichever is more recent. In cases where RCW 74.46.360(6)(a) does apply, the shortest life that may be used for buildings is the remaining useful life under the prior contract. In all cases, lives shall be extended to reflect periods, if any, when assets were not used in or as a facility.

(2) Effective July 1, 1997, for asset acquisitions and new facilities, major remodels, and major repair projects that begin operations on or after July 1, 1997, the department shall use the most current edition of Estimated Useful Lives of Depreciable Hospital Assets, or as it may be renamed, published by the American Hospital Publishing, Inc., an American hospital association company, for determining the useful life of new buildings, major remodels, and major repair projects, however, the shortest life that may be used for new buildings is thirty years. New buildings, major remodels, and major repair projects include those projects that meet or exceed the expenditure minimum established by the department of health pursuant to chapter 70.38 RCW.

(3) Building improvements, other than major remodels and major repairs, shall be depreciated over the remaining useful life of the building, as modified by the improvement <u>and in accordance with RCW 74.46.360(7)</u>.

(4) Improvements to leased property which are the responsibility of the contractor under the terms of the lease shall be depreciated over the useful life of the improvement <u>and in accordance with RCW 74.46.360(7)</u>.

(5) A contractor may change the estimate of an asset's useful life to a longer life for purposes of depreciation <u>and in accordance with RCW 74.46.360(7)</u>.

<u>(6) For new or replacement building construction or for major renovations, receiving certificate of need approval or a certificate of need exemption under chapter 70.38 RCW after July 1, 1999, the number of years used to depreciate fixed equipment shall be the same number of years as the life of the building to which it is affixed.</u>

NEW SECTION. **Sec. 5.** A new section is added to chapter 74.46 RCW to read as follows:

(1) The property component rate allocation for each facility shall be determined by dividing the sum of the reported allowable prior period actual depreciation, subject to RCW 74.46.310 through 74.46.380, adjusted for any capitalized additions or replacements approved by the department, and the retained savings from such cost center, by the greater of a facility's total resident days for the facility in the prior period or resident days as calculated on eighty-five percent facility occupancy. If a capitalized addition or retirement of an asset will result in a different licensed bed capacity during the ensuing period, the prior period total resident days used in computing the property component rate shall be adjusted to anticipated resident day level.

(2) A nursing facility's property component rate allocation shall be rebased annually, effective July 1st, using cost report data from the immediately preceding calendar year, and in accordance with this section and this chapter.

(3) When a facility is constructed, remodeled, or expanded after obtaining a certificate of need or exemption from the requirements for certificate of need for the replacement of existing nursing home beds under RCW 70.38.115(13)(a), the department shall determine actual and allocated allowable land cost and building cost. Payment for such allowable costs, determined pursuant to the provisions of this chapter, shall not exceed the maximums set forth in this section. The department shall determine construction class and types either through examination of building plans submitted to the department, or on-site inspections, or both. The department shall use definitions and criteria contained in the Marshall and Swift valuation service published by the Marshall and Swift publication company. Buildings of excellent quality shall be considered to be of good quality, without adjustment, for the purpose of applying these maximums.

(4) Construction costs shall be final labor, material, and service costs to the owner or owners and shall include:

(a) Architect's fees;

(b) Engineer's fees, including plans, plan check and building permit, and survey to establish building lines and grades;

(c) Interest on building funds during the period of construction and processing fee or service charge;

(d) Sales tax on labor and materials;

(e) Site preparation, including excavation for foundation and backfill;

(f) Utilities from structure to lot line;

(g) Contractor's overhead and profit, including but not limited to job supervision, workmen's compensation, fire and liability insurance, and unemployment insurance;

(h) Allocations of costs that increase the net book value of the project for purposes of medicaid payment; and

(i) Other items included by Marshall and Swift valuation service when deriving the calculator method costs.

(5) The department shall allow construction costs at the lower of actual costs or the maximums derived from Marshall and Swift valuation service tables establishing base construction cost limits and common-use area cost limits by facility licensed bed capacity and building type and class. The limit will be the sum of the basic construction cost limit plus the common use area limit corresponding to the type and class of the new construction, remodel, or expansion. The maximum units shall be calculated using the most current cost criteria contained in the Marshall and Swift valuation service and shall be adjusted forward to the midpoint date between award of the construction contract and completion of construction.

(6) When some or all of a nursing facility's common-use areas are situated in a basement, the department shall exclude some or all of the per-bed allowance for common-use areas to derive the construction lid for the facility. The amount excluded will be equal to the ratio of basement common-use areas to all common-use areas in the facility multiplied by the common-use area limits determined in accordance with subsection (5) of this section. In lieu of the excluded amount, the department shall add an amount calculated using the calculator method guidelines for basements in nursing homes, published in the Marshall and Swift valuation service.

(7) Subject to the provisions regarding allowable land contained in this chapter, allowable costs for land shall be the lesser of:

(a) Actual cost per square foot, including allocations;

(b) The average per square foot land value of the ten nearest urban or rural nursing facilities at the time of purchase of the land in question. The average land value sample shall reflect either all urban or all rural facilities depending on the classification of urban or rural for the facility in question. The values used to derive the average shall be the assessed land values that have been calculated for the purpose of county tax assessments; or

(c) Land value for new or replacement building construction or for substantial building additions requiring the acquisition of land that commenced to operate on or after July 1, 1997, the department shall determine allowable costs of the additional land acquired to be the lesser of:

(i) The contractor's or lessor's actual cost per square foot; or

(ii) The square foot land value as established by an appraisal that meets the latest publication of the uniform standards of professional appraisal practice (USPAP) and the financial institutions reform, recovery, and enforcement act of 1989 (FIRREA). The department shall obtain a USPAP appraisal that meets FIRREA first from an arm's-length lender that has accepted the ordered appraisal or if the department is unable to obtain from the arm's-length lender a lender-approved appraisal meeting USPAP and FIRREA standards or if the contractor or lessor is unable or unwilling to provide or cause to be provided a lender-approved appraisal meeting USPAP and FIRREA standards, then

(A) The department shall order such an appraisal; and

(B) The contractor shall immediately reimburse the department for the costs incurred in obtaining the USPAP and FIRREA appraisal.

(8) If allowable costs for construction or land are determined to be less than actual costs under subsections (3) and (9) of this section, the department may increase the amount if the owner or contractor is able to show unusual or unique circumstances having substantially impacted the costs of construction or land. Actual costs shall be allowed to the extent they resulted from such circumstances up to a maximum of ten percent above levels determined in subsections (5), (6), and (7) of this section for construction or land. An adjustment under this subsection shall be granted only if requested by the contractor. The contractor shall submit documentation of the unusual circumstances and an analysis of its financial impact with the request.

(9) For the purpose of calculating a nursing facility's property component rate, if a contractor elects to bank licensed beds or to convert banked beds to active service, under chapter 70.38 RCW, the department shall use a resident occupancy level of eighty-five percent subsequent to the decrease or increase in licensed bed capacity.

(10) The property component rate allocations calculated in accordance with this section shall be adjusted to the extent necessary to comply with RCW 74.46.421. If the department determines that the weighted average rate allocations for all rate components for all facilities is likely to exceed the weighted average total rate specified in the state biennial appropriations act, the department shall adjust the rate allocations calculated in this section proportional to the amount by which the total weighted average rate allocations would otherwise exceed the budgeted level. Such adjustments shall only be made prospectively, not retrospectively.

NEW SECTION. **Sec. 6.** A new section is added to chapter 74.46 RCW to read as follows:

(1) The department shall establish for each medicaid nursing facility a return on investment component rate allocation composed of two parts: A financing allowance and a variable return allowance. The financing allowance part of a facility's return on investment component rate shall be rebased annually, effective July 1st, in accordance with the provisions of this section and this chapter.

(a)(i) For facilities existing and for new construction or major renovations approved prior to July 1, 1999, the financing allowance shall be determined by multiplying the net invested funds of each facility by .10, and dividing by the greater of a nursing facility's total resident days from the most recent cost report period or in accordance with (a)(iii) of this subsection, as applicable.

(ii) For new construction or major renovations receiving certificate of need approval or an exemption from the certificate of need requirements under chapter 70.38 RCW, or department of health construction review approval of plans, on or after July 1, 1999, the first five million dollars of increase in allowable net book value over the immediately preceding calendar year allowable net book value shall be multiplied by a factor of .10, and divided by the number of resident days described in (a)(i) or (iii) of this subsection. However, the amount of increase in allowable net book value over the immediately preceding calendar year allowable net book value exceeding five million dollars, if any, will be multiplied by a factor of .09, and divided by the number of resident days described in (a)(i) or (iii) of this subsection.

(iii) If a capitalized addition or retirement of an asset will result in a different licensed bed capacity during the ensuing period, the prior period total resident days used in computing the financing and variable return allowances shall be adjusted to a resident occupancy level of eighty-five percent subsequent to the decrease or increase in licensed bed capacity.

(b) In computing the portion of net invested funds representing the net book value of tangible fixed assets, the same assets, depreciation bases, lives, and methods referred to in RCW 74.46.330, 74.46.350, 74.46.360, 74.46.370, and 74.46.380, including owned and leased assets, shall be utilized, except that the capitalized cost of land upon which the facility is located and such other contiguous land which is reasonable and necessary for use in the regular course of providing resident care shall also be included. Subject to provisions and limitations contained in this chapter, for land purchased by owners or lessors before July 18, 1984, capitalized cost of land shall be the buyer's capitalized cost. For all partial or whole rate periods after July 17, 1984, if the land is purchased after July 17, 1984, capitalized cost shall be that of the owner of record on July 17, 1984, or buyer's capitalized cost, whichever is lower. In the case of leased facilities where the net invested funds are unknown or the contractor is unable to provide necessary information to determine net invested funds, the secretary shall have the authority to determine an amount for net invested funds based on an appraisal conducted according to RCW 74.46.360(1).

(c) In determining the variable return allowance:

(i) For each July 1st rebased rate setting period, the department, without utilizing peer groups, shall first rank all facilities in numerical order from highest to lowest according to their per resident day adjusted or audited, or both, allowable costs for direct care, therapy care, support services, and operations rate components combined for the rebase year cost report period.

(ii) The department shall then compute the variable return allowance by multiplying the appropriate percentage amounts, which shall not be less than one percent and not greater than four percent, by the sum of the facility's direct care, therapy care, support services, and operations rate components. The percentage amounts will be based on groupings of facilities according to the rankings prescribed in (c)(i) of this subsection. Those groups of facilities with lower per diem costs shall receive higher percentage amounts than those with higher per diem costs.

(d) The sum of the financing allowance and the variable return allowance shall be the return on investment rate for each facility, and shall be added to the prospective rates of each contractor as determined in RCW 74.46.506, 74.46.515, 74.46.521, and section 5 of this act.

(e) In the case of a facility that was leased by the contractor as of January 1, 1980, in an arm's-length agreement, which continues to be leased under the same lease agreement, and for which the annualized lease payment, plus any interest and depreciation expenses associated with contractor-owned assets, for the period covered by the prospective rates, divided by the contractor's total resident days, minus the property component rate allocation determined according to section 5 of this act, is more than the return on investment rate determined according to (d) of this subsection, the following shall apply:

(i) The financing allowance shall be recomputed substituting the fair market value of the assets as of January 1, 1982, as determined by the department of general administration through an appraisal procedure, less accumulated depreciation on the lessor's assets since January 1, 1982, for the net book value of the assets in determining net invested funds for the facility. A determination by the department of general administration of fair market value shall be final unless the procedure used to make such a determination is shown to be arbitrary and capricious.

(ii) The sum of the financing allowance computed under (e)(i) of this subsection and the variable allowance shall be compared to the annualized lease payment, plus any interest and depreciation associated with contractor-owned assets, for the period covered by the prospective rates, divided by the contractor's total resident days, minus the property component rate determined according to section 5 of this act. The lesser of the two amounts shall be called the alternate return on investment rate.

(iii) The return on investment rate determined according to (d) of this subsection or the alternate return on investment rate, whichever is greater, shall be the return on investment rate for the facility and shall be added to the prospective rates of the contractor as determined in RCW 74.46.506, 74.46.515, 74.46.521, and section 5 of this act.

(f) In the case of a facility that was leased by the contractor as of January 1, 1980, in an arm's-length agreement, if the lease is renewed or extended under a provision of the lease, the treatment provided in (e) of this subsection shall be applied, except that in the case of renewals or extensions made subsequent to April 1, 1985, reimbursement for the annualized lease payment shall be no greater than the reimbursement for the annualized lease payment for the last year prior to the renewal or extension of the lease.

(2) For the purpose of calculating a nursing facility's return on investment component rate, if a contractor elects to bank beds or to convert banked beds to active service, under chapter 70.38 RCW, the department shall use a resident occupancy level of eighty-five percent subsequent to the decrease or increase in licensed bed capacity.

(3) The return or investment component rate allocations calculated in accordance with this section shall be adjusted to the extent necessary to comply with RCW 74.46.421. If the department determines that the weighted average rate allocations for all rate components for all facilities is likely to exceed the weighted average total rate specified in the state biennial appropriations act, the department shall adjust the rate allocations calculated in this section proportional to the amount by which the total weighted average rate allocations would otherwise exceed the budgeted level. Such adjustments shall only be made prospectively, not retrospectively.

NEW SECTION. **Sec. 7.** This act is necessary for the immediate preservation of the public peace, health, or safety, or support of the state government and its existing public institutions, and takes effect July 1, 1999.

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