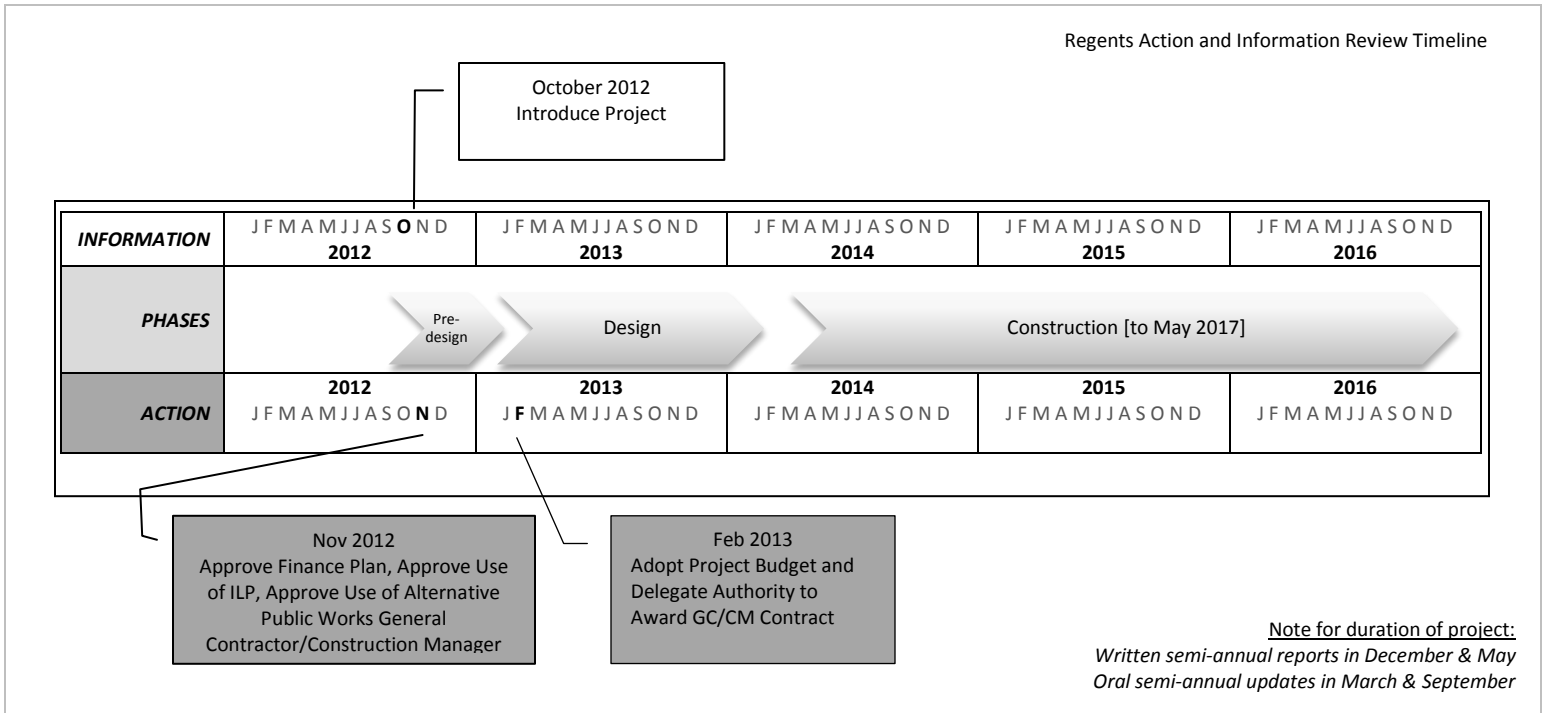


VII. STANDING COMMITTEES

B. Finance, Audit and Facilities Committee

UW Medical Center Expansion Phase II: Montlake Tower – Approve Financing Plan, Approve Use of Internal Lending Program and Approve Use of Alternative Public Works General Contractor/Construction Manager (GC/CM)



RECOMMENDED ACTION

It is the recommendation of the administration and the Finance, Audit and Facilities Committee that the Board of Regents:

- 1) Approve the UW Medical Center Expansion Phase II: Montlake Tower Financing Plan;
- 2) Approve use of the Internal Lending Program to fund up to \$136,100,000 for design, construction, and financing costs; and
- 3) Approve use of the General Contractor/Construction Manager (GC/CM) Alternative Public Works contracting method.

BACKGROUND

The University of Washington Medical Center Phase II Expansion: Montlake Tower is a two-phase project. The \$170 million five story Phase I was approved by

VII. STANDING COMMITTEES

B. Finance, Audit and Facilities Committee

UW Medical Center Expansion Phase II: Montlake Tower – Approve Financing Plan, Approve Use of Internal Lending Program and Approve Use of Alternative Public Works General Contractor/Construction Manager (GC/CM) (continued p. 2)

the Board of Regents in February 2008. To take advantage of a favorable construction cost climate by building out the entire eight story superstructure and leaving as shelled space three inpatient floors and future operating room areas, the budget was increased to \$204 million in January 2010. In June 2010, the Board of Regents was advised that in order to accommodate additional demand for oncology services identified in the strategic planning process, the eighth floor of the Montlake Tower would be built out as an inpatient oncology unit with special environmental protections for bone marrow transplant and other immunocompromised patients in lieu of completing the fifth floor as a regular medical/surgical inpatient unit, increasing the project cost to \$215 million.

Phase I construction was substantially complete in July 2012 and the facility began operation in October 2012.

Inpatient bed and operating room capacity constraints are now impacting the execution of the strategic plan. Increased patient volumes have put significant demands on current capacity which has resulted in UW Medicine Executive Leadership concluding that Phase II of the UW Medical Center (UWMC) Expansion project needs to be accelerated in order to have additional ICU and operating room capacity in FY15 and 16. The Medical Center's inability to accommodate commercial volumes in strategically significant services will put its market strategy at risk.

UWMC management has completed an update of the UWMC facility plan for the medical center core campus. The plan integrates the Montlake Tower capacity and enhances the operational efficiency for the entire medical center. The cost of the core infrastructure improvements is estimated at \$104 million.

The total project cost for the revised Phase II is \$186.3 million and, subject to Regent approval, will be funded with \$50.2 million in UWMC cash reserves and \$136.1 million from the Internal Lending Program.

In order to add to the licensed bed capacity of UWMC with this project, the Washington State Department of Health must approve a *Certificate of Need* for the additional licensed bed capacity that Phase II will create. In order to receive *Certificate of Need* approval, the medical center must have Board of Regents approval of the financing for the project. If Regent approval of the financing plan is given at the November 8 meeting, UWMC will file its Certificate of Need application immediately.

VII. STANDING COMMITTEES

B. Finance, Audit and Facilities Committee

UW Medical Center Expansion Phase II: Montlake Tower – Approve Financing Plan, Approve Use of Internal Lending Program and Approve Use of Alternative Public Works General Contractor/Construction Manager (GC/CM) (continued p. 3)

PROJECT DESCRIPTION

The Phase II Expansion project includes completion of the three shelled-in inpatient floors of the Montlake Tower, including a mix of Intensive Care beds and medical/surgical beds. Completion of the shelled operating room areas will be done as well. Improvements to the core infrastructure of the Medical Center which were not included in the 2008 plan for Phase II have been incorporated into the current project plan. These improvements will enhance operating efficiencies of the entire medical center, as significant additional capacity would otherwise strain the existing infrastructure. Improvements include updates to pre-procedure patient preparation and recovery spaces and support areas for the operating rooms and second floor procedure areas. Updates to other clinical spaces such as infusion, neuro-diagnostic areas, oncology clinic, and chemotherapy pharmacy are also included.

CONTRACTING STRATEGY

The recommendation of the Capital Projects Office (CPO) is to use the GC/CM alternative public works contracting procedure, as authorized by RCW 39.10, for construction of this project. The use of a GC/CM has been absolutely critical to the success of the University's large and complex projects. During design, the GC/CM will be able to provide detailed construction scheduling, input into procedures and specifications, input into design constructability issues, and coordination of construction documents; determine construction logistics and needed lay-down areas; provide detailed cost estimates; and investigate existing conditions. This is especially important as the building will be partially occupied during construction.

To help meet the overall project schedule, the GC/CM is able to bid out and start construction on early work packages before all of the project construction documents are 100% complete, if there are compelling reasons to do so. All of these aspects of the GC/CM process will be especially important in the Montlake Tower phase II project.

CPO proposes to commence the GC/CM selection process in November 2012. Subject to the Board's delegated authority at its February 2013 meeting, it is anticipated that a preconstruction services agreement with the highest scoring firm will be awarded in March 2013. It is anticipated that the Board of Regents will be informed of the selected GC/CM at their May 2013 meeting in a report of actions taken under delegated authority.

VII. STANDING COMMITTEES

B. Finance, Audit and Facilities Committee

UW Medical Center Expansion Phase II: Montlake Tower – Approve Financing Plan, Approve Use of Internal Lending Program and Approve Use of Alternative Public Works General Contractor/Construction Manager (GC/CM) (continued p. 4)

SCHEDULE

Pre-design	September 2012 – January 2013
Design	February 2013 – February 2014
Construction	March 2014 – May 2017

CREDIT ANALYSIS

Overview

In conjunction with UW Medicine leadership, the Treasury Office undertook a rigorous due diligence on the Montlake Tower Phase II project. The process included reviewing the Medical Center's base case proforma, evaluating the key risks, performing stress tests and determining appropriate mitigation plans. In addition to working with UWMC management, the Treasury Office discussed the financial plan with an outside health care consultant to validate the underlying assumptions and business plan. The impact of the Montlake Tower project on the UW's overall debt capacity was also reviewed.

The sources and uses of funds are below:

Sources of Funds

Equity (both phases)	105,200	From UWMC reserves
ILP Debt Phase I	160,000	Approved February 2008
ILP Debt Phase II (See NOTE)	136,100	Regent's action in November 2012
Total Sources of Funds	401,300	

Uses of Funds

Phase I	215,000	
Phase II (original scope)	81,800	Includes savings of \$8.2m from original estimate
Additional Projects Phase II	104,500	
Total Uses of Funds	401,300	

Annual Debt Service for Phase II is \$9.3 million (30 years, 5.5%)

NOTE: Includes 1% cost of issuance on the ILP draws

VII. STANDING COMMITTEES

B. Finance, Audit and Facilities Committee

UW Medical Center Expansion Phase II: Montlake Tower – Approve Financing Plan, Approve Use of Internal Lending Program and Approve Use of Alternative Public Works General Contractor/Construction Manager (GC/CM) (continued p. 5)

Base Case Assumptions and Proforma

Net patient revenues are projected to grow at 4% annually over the planning period, reflecting a combination of moderate inflationary growth and additional revenue from the Montlake Tower expansion. Operating expenses also are projected to grow at 4% and include new hiring as well as wage and benefit increases. The operating margin averages 4.3%, which is well above the Moody's median for A-rated hospitals. Average debt service coverage is 4.7 times, which is also in line with A-rated hospitals. Days-cash, while growing over the planning period, remains below the Moody's A-rated median.

The base case proforma is shown in Attachment 1.

Risks, Stress Tests and Mitigation

Three stand-alone stress tests were applied to the base case proforma as well as one simultaneous stress test. The impact of these stresses was benchmarked against Moody's A medians and Treasury Office requirements.

For the first stress test, ICU volume growth was reduced from a range of 8% to 6% annually to 4% annually in the first five years. Under this scenario, the operating margin percentage remains above Moody's A median, but debt service coverage and days-cash are at or below the Moody's A medians. All results are above the minimum levels established by the Treasury Office.

For the second stress test, commercial payer reimbursement rates were assumed to grow at 1% annually, which is half the growth assumed in the base case. Under this scenario, operating margin, debt service coverage and days-cash decline to well below the Moody's A medians, which would drive mitigation planning.

For the third stress test, the assumed repayment rate from a future health care exchange program was assumed to be closer to the Medicaid reimbursement rate. Under this scenario, the average operating margin and debt service coverage remain above Moody's A medians and the days-cash is above Treasury Office minimums but below A medians.

Under the simultaneous stress scenario, the medical center's debt service coverage and reserves remain below Moody's medians but above treasury office minimums during the planning period. Mitigation actions would need to be taken in this case.

VII. STANDING COMMITTEES

B. Finance, Audit and Facilities Committee

UW Medical Center Expansion Phase II: Montlake Tower – Approve Financing Plan, Approve Use of Internal Lending Program and Approve Use of Alternative Public Works General Contractor/Construction Manager (GC/CM) (continued p. 6)

A summary of the results of the stress tests is shown in Attachment 2.

The Medical Center's management team has ongoing plans in place to mitigate negative financial impacts, including completely reviewing programs and services, adjusting scope and staffing levels to optimize efficiency while maintaining quality and safety, continued performance initiatives, and deferring capital expenses.

Health Care Reform and Sequestration

Health care reform and sequestration have both been discussed as variables impacting the long range financial plan for UWMC and for all of UW Medicine. At this point, there remain significant uncertainties around the impact of health care reform subsequent to FY14. Management has analyzed a number of the anticipated impacts at each site through the long range financial planning process. Those impacts have been included in each plan. Sequestration is estimated to impact a very small portion of the Medicare program and will likely be offset by other changes such as wage or market basket adjustments.

Future Capital Needs

UW Medicine does extensive long range capital planning in concert with strategic and long range financial planning. Forecast capital expenditures for FY14 – FY18 for the four medical centers have been included as capital investments within each individual plan. Significant construction projects, IT investments and replacement capital needs are currently all assumed to be purchased using cash reserves of each medical center, with the exception of the Montlake Tower Phase II, which assumes additional borrowings of \$136 million. Total capital spending for FY14 for the four medical centers is approximately \$170 million, including the MLT.

Institutional Debt Capacity

This project has been included on the One Capital Plan since Phase I was approved in 2008. The increases in the project scope since that time have been reviewed and approved by the Provost and the Regents. The size of the ILP loan at \$136 million reflects the Medical Center's need to balance cash reserves with debt levels. With the addition of the borrowing from the Phase II project and current authorized projects, UW's total debt reaches a maximum level of \$2.5 billion in 2015. The addition of this debt maintains key ratios within the Moody's Aa range.

Attachment 3 projects the impact of this debt on UW's credit rating.

VII. STANDING COMMITTEES

B. Finance, Audit and Facilities Committee

UW Medical Center Expansion Phase II: Montlake Tower – Approve Financing Plan, Approve Use of Internal Lending Program and Approve Use of Alternative Public Works General Contractor/Construction Manager (GC/CM) (continued p. 7)

REVIEW AND APPROVALS

The project and the financing plan have been reviewed and approved by the UWMC Finance Committee of the UW Medicine Board, the UW Medicine Board, the Vice Provost, the Senior Vice President and the Treasury Office.

Attachments

- 1) Base Case Proforma
- 2) Stress Test Summary
- 3) Current and Projected UW Credit Rating
- 4) Montlake Tower Expansion Phase II

UW MEDICAL CENTER MONTLAKE TOWER PHASE II
TEN YEAR PRO FORMA 2011 - 2020
BASE CASE

(\$ in millions)	Actual, Audited	Actual, Pre-Audit	Budget	UWMC Projected						
	<u>2011</u>	<u>2012</u>	<u>2013</u>	<u>2014</u>	<u>2015</u>	<u>2016</u>	<u>2017</u>	<u>2018</u>	<u>2019</u>	<u>2020</u>
Operating revenue	847.9	876.0	936.3	996.9	1,041.1	1,086.4	1,131.7	1,173.5	1,209.6	1,255.6
Operating expense	790.7	815.9	891.0	938.5	985.7	1,021.9	1,068.0	1,103.6	1,143.8	1,186.9
Interest expense	3.9	2.6	11.8	11.4	11.0	10.6	17.4	16.8	16.2	15.6
Operating Margin	53.2	57.5	33.5	47.0	44.4	53.9	46.3	53.1	49.5	53.1
Operating Margin %	6.3%	6.6%	3.6%	4.7%	4.3%	5.0%	4.1%	4.5%	4.1%	4.2%
Nonoperating income	6.7	(22.3)	(14.8)	(13.1)	(11.3)	(11.1)	(10.8)	(10.3)	(9.8)	(9.1)
Net Income	59.9	35.2	18.8	33.9	33.1	42.8	35.5	42.7	39.7	44.0
<u>Debt Service Coverage</u>										
Net income	59.9	35.2	18.8	33.9	33.1	42.8	35.5	42.7	39.7	44.0
Depreciation & amortization	40.1	41.1	51.3	54.4	56.8	58.9	69.2	70.6	71.9	73.4
Interest expense	3.9	2.6	11.8	11.4	11.0	10.6	17.4	16.8	16.2	15.6
Revenue Available for DS	103.9	78.8	81.8	99.8	101.0	112.3	122.1	130.2	127.9	133.0
Total Debt Service	9.8	8.5	20.2	20.6	20.9	20.2	27.9	27.9	27.8	27.8
Debt Service Coverage	10.6	9.3	4.1	4.8	4.8	5.6	4.4	4.7	4.6	4.8
Cash Reserves	307.1	254.3	277.4	286.9	296.4	298.4	323.9	350.7	381.2	420.5
Days Cash on Hand	148.6	119.4	118.9	116.9	115.1	111.9	116.4	121.9	127.9	136.0

UW MEDICAL CENTER MONTLAKE TOWER PHASE II
 TEN YEAR PRO FORMA 2011 - 2020
 STRESS TEST SUMMARIES

1. ICU VOLUME STRESS (VOLUME GROWTH AT 4% PER YEAR)

	Actual, Audited	Actual, Pre-Audit	Budget	UWMC Projected						
	2011	2012	2013	2014	2015	2016	2017	2018	2019	2020
Operating Margin	53.2	57.5	33.5	47.0	37.5	40.8	28.9	35.3	31.8	33.9
Operating Margin %	6.3%	6.6%	3.6%	4.7%	3.6%	3.8%	2.6%	3.1%	2.7%	2.7%
Net Income	59.9	35.2	18.8	33.9	26.2	29.4	17.5	24.1	20.8	23.1
Debt Service Coverage	10.6	9.3	4.1	4.8	4.5	4.9	3.7	4.0	3.9	4.0
Days Cash on Hand	148.6	119.4	118.9	116.9	112.7	104.9	103.4	102.9	103.2	105.5

2. NET REVENUE STRESS (COMMERCIAL PAYOR RATE INCREASE BY 1% ANNUALLY)

	Actual, Audited	Actual, Pre-Audit	Budget	UWMC Projected						
	2011	2012	2013	2014	2015	2016	2017	2018	2019	2020
Operating Margin	53.2	57.5	33.5	41.0	32.6	36.2	22.8	22.5	11.3	6.7
Operating Margin %	6.3%	6.6%	3.6%	4.1%	3.2%	3.4%	2.1%	2.0%	1.0%	0.6%
Net Income	59.9	35.2	18.8	27.9	21.1	24.6	11.1	10.7	(0.5)	(5.3)
Debt Service Coverage	10.6	9.3	4.1	4.5	4.3	4.7	3.5	3.5	3.2	3.0
Days Cash on Hand	148.6	119.4	118.9	114.8	108.7	99.2	95.7	91.2	85.0	79.1

3. EXCHANGE PLAN PAYMENT RATE STRESS (REIMBURSEMENT AT MIDPOINT BETWEEN MEDICARE AND COMMERCIAL)

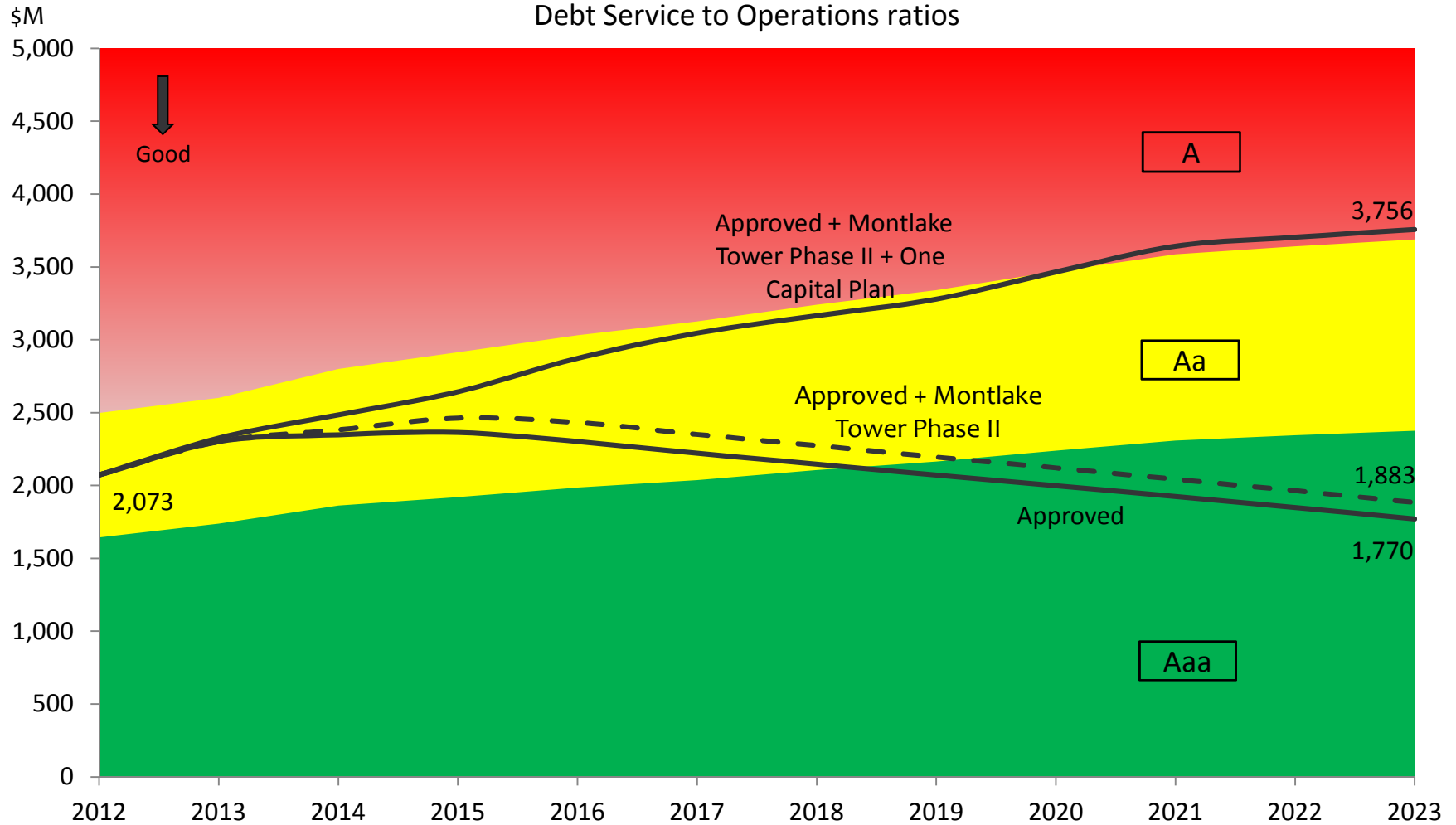
	Actual, Audited	Actual, Pre-Audit	Budget	UWMC Projected						
	2011	2012	2013	2014	2015	2016	2017	2018	2019	2020
Operating Margin	53.2	57.5	33.5	47.0	39.2	43.5	30.6	37.1	33.2	36.4
Operating Margin %	6.3%	6.6%	3.6%	4.7%	3.8%	4.0%	2.7%	3.2%	2.8%	2.9%
Net Income	59.9	35.2	18.8	33.9	27.9	32.2	19.4	26.0	22.3	25.9
Debt Service Coverage	10.6	9.3	4.1	4.8	4.6	5.0	3.8	4.1	4.0	4.1
Days Cash on Hand	148.6	119.4	118.9	116.9	113.3	106.4	105.6	105.8	106.4	109.5

4. COMBINED ICU & EXCHANGE RATE STRESS

	Actual, Audited	Actual, Pre-Audit	Budget	UWMC Projected						
	2011	2012	2013	2014	2015	2016	2017	2018	2019	2020
Operating Margin	53.2	57.5	33.5	47.0	32.3	30.3	13.1	19.0	15.0	16.6
Operating Margin %	6.3%	6.6%	3.6%	4.7%	3.1%	2.8%	1.2%	1.7%	1.3%	1.4%
Net Income	59.9	35.2	18.8	33.9	20.9	18.7	1.2	7.0	2.8	4.4
Debt Service Coverage	10.6	9.3	4.1	4.8	4.3	4.4	3.2	3.4	3.3	3.4
Days Cash on Hand	148.6	119.4	118.9	116.9	111.0	99.4	92.6	86.6	81.4	78.4

Current and Projected UW Credit Rating 2012-2023

Financial ratio approach with Expendable Resources to Direct Debt, Debt Service Coverage and Debt Service to Operations ratios



Based on FY2011 Moody's Public Higher Education medians; includes Valley Medical Center & Northwest Hospital debt

MONTLAKE TOWER (MLT) EXPANSION PHASE II

BOARD OF REGENTS

NOVEMBER 8, 2012

F-15.4/211-12
11/8/12

PRESENTATION OVERVIEW

- **Project Background and Proposed Recommendations**
- **UW Medicine Strategic Plan**
- **Proposed Montlake Tower Facility Configuration and Core Hospital Infrastructure Enhancements**
- **Proposed Sources and Uses of Funds and Long Range Financial Plan**
- **Stress Tests, Sensitivities and Mitigation Strategies**
- **Approval Timeline**

BACKGROUND & PROPOSED RECOMMENDATIONS

2005 -2007 The Project. The Expansion project was conceived in FY05 and received Board of Regents (BOR) approval in FY08. The scope of work envisioned an 8-story 226,000 square foot patient care services tower to be built in two phases. The BOR approved funding for Phase I and conceptually agreed to Phase II. **Original project cost - \$310 million**

2010 – Approved Change in Scope to Phase I. In January 2010, the Board of Regents approved a change in scope to Phase I which included construction of three Phase II shelled floors. Build out of a special air-handling-needs 30 bed Oncology unit was added to the Phase I scope in June 2010. Subsequent Phase II planning was anticipated to begin in FY15 with occupancy occurring in FY17. **Revised project cost - \$305 million**

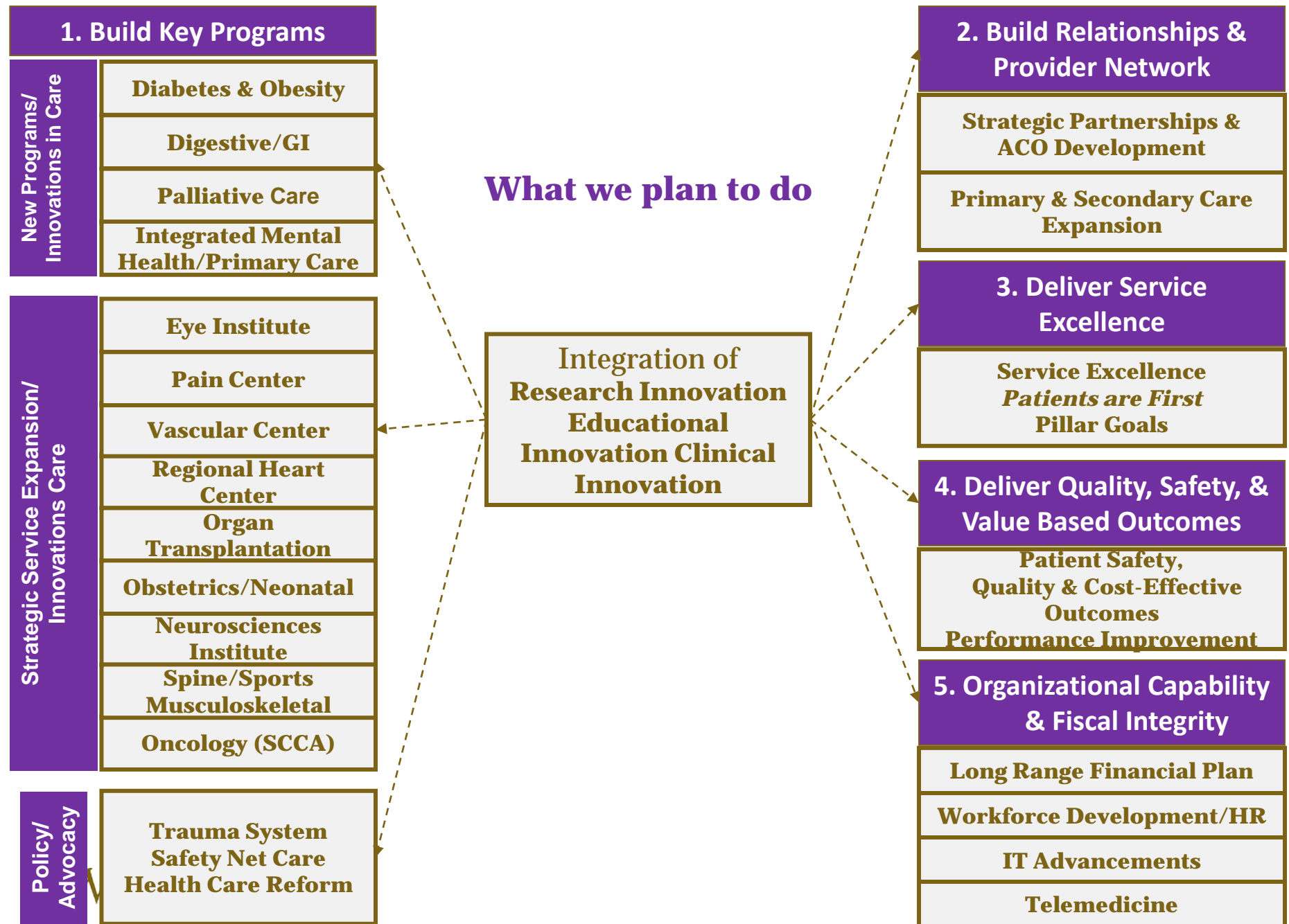
2012 Proposed Accelerated Phase II recommendation. Inpatient capacity has become very constrained and is impacting the ability to execute the strategic plan. Management recommends accelerating the build out of the shelled inpatient floors to increase ICU, Medical/Surgical and Operating Room capacity beginning mid-FY13. **Revised project cost - \$297 million**

2012 Core Hospital Infrastructure recommendation. Management has completed an update of the Medical Center's 10-year facility plan for its core hospital campus. The plan integrates the MLT capacity and enhances operational efficiencies for the entire campus. Enhanced infrastructure cost \$104.5 million. **Total revised/expanded project cost - \$401 million**

Project Financial Plan. The proposed project financial plan includes \$136 million of long term debt and incorporates the \$401 million capital costs. The plan has been reviewed/stress tested by the UW Treasury.

Certificate of Need Approval. Increasing UWMC licensed beds from 450 to 529 will require Certificate of Need approval.

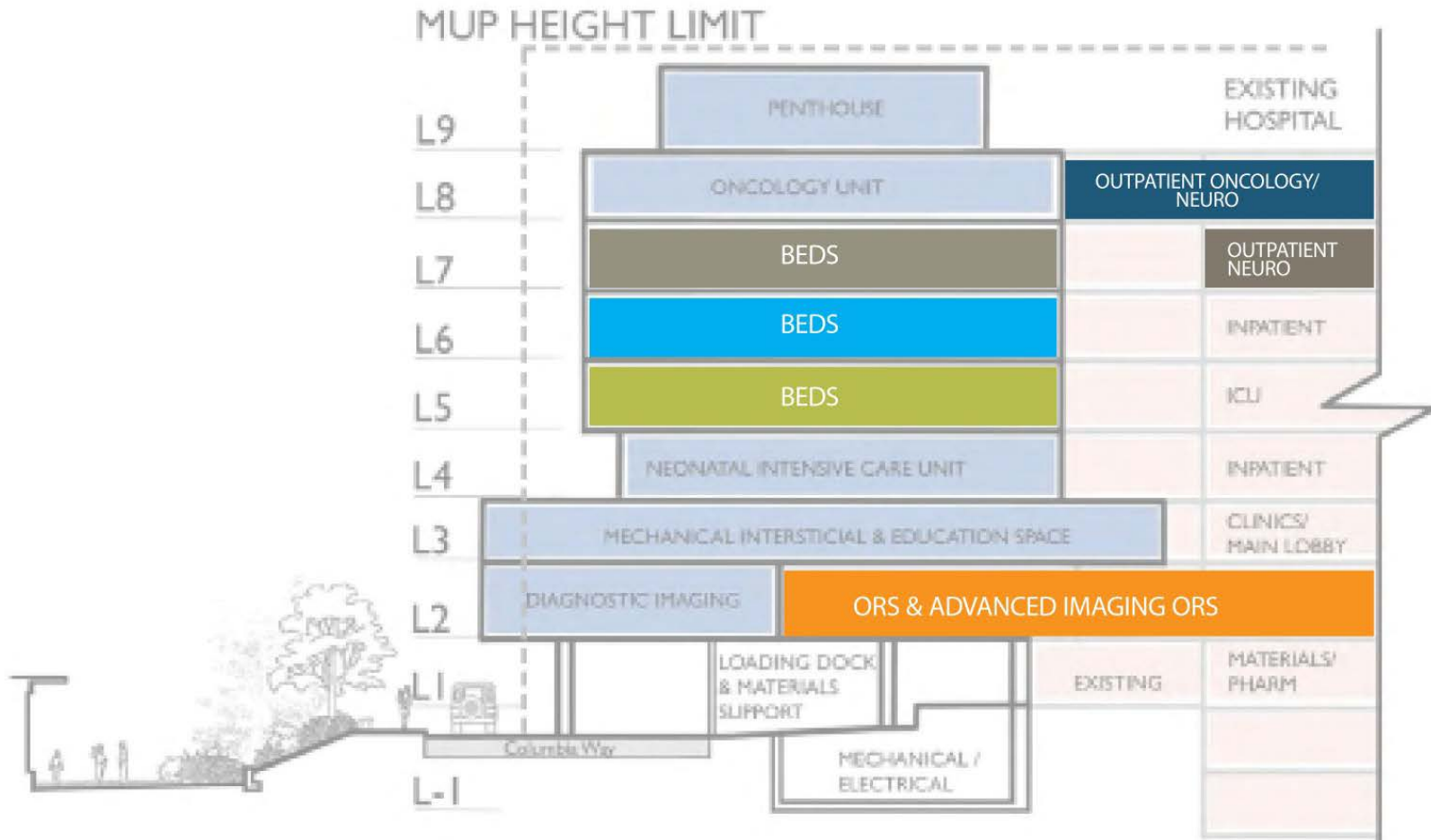
UW MEDICINE STRATEGIC PLAN 2012 SUMMARY



UW MEDICAL CENTER



MONTLAKE TOWER PHASE II



PROPOSED CORE HOSPITAL INFRASTRUCTURE ENHANCEMENTS

The recently updated ten year facility plan includes substantial remodeling of the core hospital to maximize the MLT expansion, address future strategic growth and position the UWMC facility for the next decade. Projects include:

- Preparation and recovery space for the operating rooms and second floor procedure areas
- 7EE Clinic space (to accommodate displaced clinics)
- 8SS Neuro-diagnostic Center (including EEG and EMG)
- 8SE Infusion, Satellite Pharmacy & Oncology Clinic

These additional projects are estimated to cost \$104.5 million.

Costs associated with updating and significantly expanding and enhancing the medical center lobby and front entrance are not included in the above cost estimate but have been included in the long range capital plan. Front entrance costs are estimated to be \$18 million and will be brought forward as an equity financed project for BOR approval in the next three to six months.

PROPOSED SOURCES AND USES

(\$ IN MILLIONS)

Sources of Funds

Equity	\$	105.2	From UWMC reserves
ILP Debt Phase I		160.0	Approved 2008
ILP Debt Phase II		136.1	Regents action in November 2012
Total Sources of Funds	\$	401.3	

Uses of Funds

Phase I	\$	215.0	
Phase II (original scope)		81.8	Includes savings of \$8.2m from original estimate
Additional Projects Phase II		104.5	
Total Uses of Funds	\$	401.3	

NOTE: Total project cost and debt includes 1% cost of issuance on the ILP draws

Key Indicator	FY13	FY14	FY15	FY16	FY17	FY18	FY19	FY20	FY21	FY22
Days Cash on Hand	118.9	116.9	115.1	111.9	116.4	121.9	127.9	136.0	144.8	154.1
Debt Service Coverage	4.1	4.8	4.8	5.6	4.4	4.7	4.6	4.8	5.0	5.2

OVERVIEW OF LONG RANGE PLAN

The UWMC Long Range Financial Plan (LRFP) was last updated as a five year projection in the fall of 2011. The current update reflects a ten year projection in order to fully incorporate the long term impacts of the Montlake Tower.

1. Significant components of the LRFP have been updated to reflect FY12 experience and updated assumptions:
 - Volume and net revenue assumptions
 - Expense assumptions
 - Capital expenditures
 - Financial indicators

2. Phase II impacts are included:
 - Accelerated timing of the build out
 - Volumes for Phase II additional capacity
 - Cost estimates for infrastructure work to update existing facility in order to support new volumes in addition to original Phase II work planned in Montlake Tower
 - Proposed debt/equity assumption of funding

STRESS TESTS, SENSITIVITIES AND MITIGATION STRATEGIES

As part of the due diligence process, a number of stress tests were analyzed in order to evaluate potential risks. Those stress tests focused on the following key variables:

- Volumes (ICU, Radiology and NICU)
- Net revenue assumptions

Additionally, sensitivities were reviewed. The chart below illustrates the impact of a 1% shift in key revenues and/or expenses and no improvement in productivity.

	Annual Change from Base Case	One Year Resulting Change (\$ in millions)
<u>Revenue</u>		
All Volumes	1% decrease	<u>FY14</u> \$(6)
Reimbursement (Commercial only)	1% decrease	\$(6)
Case Mix (Inpatient)	1% decrease	\$(6)
<u>Expense</u>		
Labor (Base Wages)	1% increase	\$(5)
FTE/Adjusted Occupied Bed	No improvement	\$(16)

Mitigation strategies were developed and would be employed should any of the above scenarios occur.

APPROVAL TIMELINE

COMPLETED

- Concurrence of UW Treasury on debt capacity analysis and proforma – August through October 2012.
- Board of Regents informational briefing at the October 11th Facilities and Finance Committee.
- UWMC Committee of the UW Medicine Board – approval at the October 25th meeting.

PENDING APPROVALS

- UW Medicine Board - approval at the November 5th meeting.
- Board of Regents – approval at the November 8th meeting of the following:
 1. approval of financing
 2. approval of alternative public works utilizing the General Contractor/Construction Manager (GC/CM) method of contracting
- If Regents approval is obtained, the Certificate of Need application will be filed November 9th.
- Board of Regents - approval of project budget and delegation of authority to award GC/CM Contract at the February 2013 meeting.

Construction anticipated to begin - Winter, 2014