

OFFICE OF THE ATTORNEY GENERAL
STATE OF GEORGIA

IN THE MATTER OF THE LEASE *
OF BURKE MEDICAL CENTER * NO. AG 2021-02
TO BURKE HOSPITAL COMPANY, LLC *
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REPORT OF FINDINGS

I.

BACKGROUND

BURKE MEDICAL CENTER

Burke Medical Center (the “Hospital”) is a general acute care hospital licensed for 40 beds. The Hospital is located at 351 South Liberty Street, Waynesboro, Georgia 30830. It is operated and owned by the Hospital Authority of Burke County (the “Authority”). The Hospital’s primary service area is Burke County, but also serves patients from Richmond, Jefferson, Jenkins, and Screven counties. The Hospital provides emergency services, general surgery, swing bed, cardiology, gastroenterology, orthopedics, family and internal medicine, physical and occupational therapies, cardiopulmonary rehabilitation, respiratory care, wound care, and laboratory and radiology services.

As proposed, Burke Hospital Company, LLC, a newly formed Georgia for-profit company (“BHC”) will lease certain assets from the Authority. These assets include the Hospital, equipment, land, and two clinics in exchange for a monthly rent payment.¹ BHC is currently equally owned by Michael Kleinpeter and John George, MD.

THE DISPOSITION PROCESS

The record indicates that the Hospital has encountered many difficulties in recent years due to a variety of factors. Most significantly, the Hospital has experienced significant loss of in-patient volume. From 2017 to 2020, the Hospital’s occupancy rate averaged around eight (8%), which is unusually low for an acute care hospital. The deterioration of patient volume can be attributed to a lack of referrals to the Hospital and a lack specialists practicing medicine in

¹ The Authority owns and operates two clinician spaces located in two different physician office buildings adjacent to the Hospital. They are located at 300 Jones Avenue and 304 Jones Avenue, Waynesboro, Georgia.

Burke County. Local physicians often refer patients to facilities in nearby Augusta, Georgia where specialists are available. Additionally, the amount of uncompensated care and fixed expenses have significantly impacted the Hospital's financial performance. These difficulties have led to continued operating losses for the Hospital and a limitation on the types of services that can be offered. To cover the operating losses, Burke County has been subsidizing the Hospital's operating losses between 2017 and 2020 at approximately \$5.6 million per year.

Historically, the Authority has relied on management companies to operate and manage the Hospital to deliver health care to the residents of Burke County. In 2012, the Authority issued a Request for Proposals ("RFP") for either a lease or management agreement. The Authority received three formal proposals from: (1) Partners First Management, LLC; (2) Quorum Health Resources, LLC; and (3) Optim Health System.² As a result, the Authority entered into a management agreement with Partners First Management, LLC in June 2012. However, the management agreement was unsuccessful and was terminated in 2013. As a result, the Authority sought proposals from other management companies, including ERH Healthcare and Community Hospital Corporation ("CHC"). CHC was engaged in 2013 by the Authority to manage the Hospital. However, in 2016, the Authority did not renew CHC's contract for management services.

Under both management agreements, the Authority continued to suffer significant operating losses requiring it to rely on Burke County to support the Hospital's operations. Since 2016, the Authority has been managing the Hospital through its own management team. Through the years, other hospital systems such as University Hospital, Augusta University, and HCA have all explored limited engagements with the Authority through physician clinics. While such engagements provided access to physician based services in Burke County, most hospital related services were then rendered in Augusta, Georgia. Ultimately, due to the decline in patient volumes, the Hospital's fixed costs, and rising uncompensated care, the Hospital continued to sustain operational losses forcing it to rely on the County to sustain its operations. In fiscal years 2017 to 2020, Burke County has subsidized the Hospital's operating losses with \$4.60 million, \$5.3 million, \$6.95 million, and \$5.59 million, respectively.

² University Hospital, Georgia Health Sciences University n/k/a Augusta University, and Hospital Corporation of America ("HCA") did not submit proposals.

In 2020, the Authority was approached by BHC with a proposal to lease the Hospital, expand surgical services, and enhance the types and level of services available at the Hospital. Although the Authority did not pursue a formal disposition process, which is the preferred course of action, the Authority took into consideration a number of factors as it evaluated BHC's proposal. These factors included: (1) access of healthcare services in the community; (2) maintaining a hospital for the economic development of Burke County; and (3) ensuring the disadvantaged and vulnerable populations have access to acute care services in Burke County. Chris Collins, Chairman of the Hospital Authority of Burke County, testified that these factors were the main considerations for the Authority. Additionally, Mr. Collins testified that the Authority decided to forgo a formal disposition process because interest from outside management companies or other facilities was unlikely given that the last RFP did not yield much interest even at a time when the Hospital was financially strong. The Authority also engaged Doug Cates, Partner at Cherry Bekaert, who assisted the Authority in conducting its due diligence of BHC, as well as, negotiating the proposed lease agreement.

Mr. Collins further testified that the proposed lease with BHC meets the Authority's goals of maintaining ownership of the Hospital, maintaining an acute care hospital for the community, expanding new levels of services, and mitigating the financial losses of the Hospital and the continued reliance on the County for subsidies.

THE PROPOSED TRANSACTION

Under the terms of the Lease Agreement ("Lease"), the Authority will lease the Hospital and its assets, including the premise, equipment, and land to BHC on June 1, 2021 for an overall 40 year term. The initial term of the Lease is for 7 years with 6 automatic 5 year renewals and 1 renewal for 3 years. As part of the consideration for the transaction, BHC will make monthly rent payments to the Authority. The Authority will receive rent in the amount of \$20,000 per month for the first 2 years of the Lease (\$240,000 per year). Afterwards, the rent will increase to \$30,000 per month for the remaining 5 years of the initial term (\$360,000 per year). If the Lease is renewed, the monthly rent will increase by 3% per renewal term provided that such amount falls within a fair market value range, which shall be determined by a third-party appraiser within 6 months of the start of the renewal term. Additionally, once operations at the Hospital become profitable, BHC will contribute 10% of any distributions made by BHC to its owners into a trust

fund to be utilized by the Authority to maintain the facility and fund capital repairs and replacements.

Pursuant to the Lease, BHC has committed to: (1) provide medically necessary healthcare services to the residents of Burke County; (2) maintain and operate the Hospital to ensure it retains its licenses as an acute care general hospital and maintain the current licensed bed capacity; (3) continue to provide the same services offered by the Hospital currently; (4) provide access to a dedicated emergency department 24 hours 7 days a week to the community, with no fewer than 8 emergency bed rooms; (5) maintain no fewer than 6 beds for general acute care patients at any one time; (6) assume certain contractual obligations of the Authority related to the operations of the Hospital; (7) offer employment to all Hospital employees as of the effective date of the Lease; and (8) maintain and implement a charity care policy. Additionally, BHC is responsible for the day-to-day maintenance and repair of the building systems which include mechanical, electrical, plumbing, sanitary, sprinkler, heating and ventilation and air conditioning, security, life safety, elevator and other service systems of the Hospital. However, the Authority shall be responsible for any capital repairs or replacements.

Furthermore, during the first 3 years of the Lease, the Authority will provide BHC with financial subsidies to support BHC in the provision of charity care provided to sick and indigent patients and for the operations of the Hospital, including for capital equipment, repair and replacement for purposes of operating the Hospital in accordance with industry standards. The financial subsidies provided by the Authority are as follows: (a) on the commencement date of the Lease, \$1 million for capital assets and \$1 million for working capital; (b) On October 1, 2021, \$1 million for capital assets; (c) On October 1, 2022, \$2 million for capital assets; (d) first 2 years of the Lease, \$500,000 per month (\$6.0 million per year); and (d) third year of the Lease, \$416,667 per month (\$5.0 million for the year). The financial subsidies shall cease either upon BHC achieving cumulative profitability or the expiration of the third year of the Lease.

VALUATION ANALYSIS

Under O.C.G.A. § 31-7-406(6), a transaction involving the acquisition or disposition of the assets of a nonprofit hospital to an acquiring entity requires the Attorney General to make a determination as to whether the seller “will receive an enforceable commitment for fair and reasonable community benefits for its assets.”

Pinnacle Healthcare Consulting (“Pinnacle”) was engaged by Morris, Manning & Martin, LLP (Morris Manning) on behalf of the Hospital Authority to prepare an appraisal of the fair market value rent (FMVR) for the real estate, furniture, fixtures, and equipment at the Hospital as of February 1, 2021 (“Valuation Date”). In its report, Pinnacle compared the resulting FMVR of the proposed base lease payments over the initial 7-year term of the lease, and ultimately concluded that the proposed lease payments fall within an appropriate range of FMVR. Christopher Louis and Robert Thorn of Pinnacle testified at the public hearing held on April 26, 2021.

There are typically three traditional approaches considered to determine value. The three approaches are: (1) the Income Approach; (2) the Market Approach; and (3) the Cost Approach (Net Asset Value). The Income Approach is based on the concept that the value of a business is the present worth of the expected future economic benefits to be derived by the owners of the business. Under the Market Approach, value is derived through a comparison of the transaction prices of similar assets trading in the marketplace. In the Cost (Net Asset Value) Approach, value is estimated based on the value of all of the subject business’s underlying assets, both tangible and intangible, net of liabilities.

Pinnacle initially considered all three of the traditional approaches to valuation in its FMVR assessment, namely the Cost Approach, the Market Approach, and the Income Approach, but ultimately relied on the Cost and Income Approaches to derive the FMVR for the Hospital assets because Pinnacle determined these approaches to most accurately reflect market participant behavior.

Under the Cost Approach, Pinnacle sought to estimate what the Hospital’s assets would be worth if they were to be purchased, rather than leased. Initially, Pinnacle utilized a technique under the Market Approach to set the value of the Hospital’s land, as though it were vacant and available for its best possible use, and then benchmarking this value against comparable parcels in the region. Pinnacle’s benchmarking analysis yielded an adjusted price per acre range of \$190,803 to \$217,318, which is equal to \$4.38 to \$4.99 per square foot. Pinnacle then selected a benchmark price of \$4.60 and applied this price to the Hospital’s total square footage, which yielded a land value of \$1,320,000 under this approach.

With this land value in mind, Pinnacle estimated the value of the Hospital’s site improvements and buildings using the replacement cost new (RCN) method, adjusted for the

existing condition and depreciation of assets. Pinnacle then adjusted the estimated RCN for the existing condition and depreciation of the Hospital's assets, yielding values of \$107,232 and \$3,835,241 for site improvements and buildings, respectively. Combining the estimated values for land, site improvements and buildings, Pinnacle calculated the total value of the Hospital's assets at \$5,260,000.

Under the Income Approach, Pinnacle multiplied the dollar value of the Hospital's assets by an annual percentage capitalization rate to yield an annual rental amount by converting the value of the subject assets into what would be considered a fair market value rent for leasing the facility as opposed to purchasing it. This capitalization rate was derived by Pinnacle utilizing the following three techniques: (1) Band of Investment Capitalization Method; (2) Loan Underwriter's Method; and (3) the Survey Method. After applying each method listed above, Pinnacle selected and applied the capitalization rate of 6.4% to the estimated \$5,260,000 value of the assets, concluding a FMVR range of \$306,000 to \$374,000 for the Hospital's assets. Pinnacle determined that the average annual rent amount of \$326,000 for the initial 7-year lease term of the proposed transaction falls within FMV range.

Finally, Pinnacle conducted a Community Benefit analysis utilizing the definitions and methodology used for reporting a non-profit's community benefit on Schedule H of the Internal Revenue Service Form 990. Along with the available costs contained in the Hospital's accounting system, Pinnacle used the "cost-to-charge ratio" (CCR) method to approximate the Hospital's 2020 costs in its calculations. The CCR is calculated as a hospital's total gross charges divided by its total Medicare-allowable cost. Pinnacle quantified and analyzed the Hospital's charity and indigent care, unreimbursed Medicaid, unreimbursed Medicare, bad debt, and other IRS areas of community benefit, concluding that the Hospital's total estimate of community benefit for 2020 was \$786,650. Comparing this value with BHC's strategic plan for the Hospital, Pinnacle concluded that the strategic plan has the potential to increase access to care and that new services have the potential for the Hospital to increase financial performance.

Ernst & Young, LLP ("EY"), in accordance with O.C.G.A. § 31-7-405(b), was retained as an independent financial advisory consultant by the Attorney General to assist in the review of the proposed lease transaction between the Hospital Authority and BHC. The Attorney General engaged EY to provide valuation advisory services, but not to provide a separate valuation or a

fairness opinion. Ms. Natasha A. Hunerlach, a partner at Ernst & Young specializing in health care provider valuations, testified at the hearing.

PUBLIC COMMENT

The public hearing was held on April 26th, at 12:00 p.m. in Burke County, Georgia, at the auditorium located at 715 West 6th Street, Waynesboro, Georgia 30830. Additionally, due to the COVID-19 pandemic, the public was invited to attend virtually through a WebEx virtual meeting. Pursuant to O.C.G.A. § 31-7-404, notice of the public hearing was published in *The True Citizen* on March 17, 2021 and March 24, 2021. At the public hearing, two persons made comments with one in favor of the transaction and the other inquiring about specific details of the transaction.

Following the public hearing, the record was held open until the close of business on April 28, 2021, for any further public comment. This Office received one written comment after the hearing that raised concerns about the amount of subsidies and the exercise of due diligence conducted by the Authority. Counsel for the Authority and BHC were requested to inform the undersigned in writing before the record closes as to whether their respective clients intended to proceed with the proposed transaction as structured or modify the proposed transaction in some respect. On April 28, 2021, counsel for both parties submitted a joint letter stating that their clients wish to proceed with the transaction as proposed.

II.

FINDINGS

The Hospital Acquisition Act (the “Act”) involves a public interest determination in the Attorney General’s review of a proposed disposition and acquisition of hospital assets. See O.C.G.A. §§ 31-7-400 through 31-7-412; *Sparks v. Hospital Authority of City of Bremen and County of Haralson*, 241 Ga. App. 485 (1999) (physical precedent only). The Act requires a written notice filing and a public hearing “regarding the proposed transaction in the county in which the main campus of the hospital is located.” O.C.G.A. §§ 31-7-401, 31-7-405(a). The purpose of the public hearing is “to ensure that the public’s interest is protected when the assets of a nonprofit hospital are acquired by an acquiring entity by requiring full disclosure of the purpose and terms of the transaction and providing an opportunity for local public input.” O.C.G.A. § 31-7-406.

Under the Act, disclosure is linked to whether “appropriate steps have been taken to ensure that the transaction is authorized, to safeguard the value of charitable assets, and to ensure that any proceeds of the transaction are used for appropriate charitable health care purposes.” O.C.G.A. § 31-7-406. The Act identifies thirteen factors that are key considerations in determining whether the appropriate steps have been taken by the parties. *Id.* The thirteen factors are listed in Appendix A to this report.

The thirteen factors set forth in O.C.G.A. § 31-7-406 can be grouped into four categories relating to (a) the exercise of due diligence by the seller (factors number 1, 2, 3, 4 and 8), (b) conflicts of interest (factors number 5 and 13), (c) valuation of the hospital assets (factors number 6, 7 and 10), and (d) the charitable purpose of the proposed transaction (factors number 9, 11 and 12).

The Exercise of Due Diligence by the Seller

Factor number 1 is satisfied, as the disposition of the Hospital is authorized by applicable law. With regard to factor number 2, one individual has made two donations to the Hospital that exceed \$100,000. The donations appear to be made without restrictions, and therefore, it does not appear that the proposed disposition is inconsistent with the directives of any major donors who have contributed over \$100,000.00.

The due diligence factors number 3 and 4 necessitate review of the process and procedures employed by the Seller “in deciding to dispose of hospital assets, selecting the acquiring entity, and negotiating the terms and conditions of the disposition.” O.C.G.A. § 31-7-406(3). The Authority did not conduct a formal process for the solicitation and selection of proposals, which is the preferred approach. However, the Authority provided detailed testimony regarding all of the Authority’s efforts, its current financial distress, its previous attempts to engage larger health systems and management companies, and the steps it has taken to protect the interests of the Authority in the transaction, including engaging Doug Cates, Partner at Cherry Bekaert, to assist in its due diligence and negotiation of the Lease. Factors 3 and 4 are satisfied.

Since there is no separate management or services contract negotiated in conjunction with the proposed transaction, factor number 8 is not applicable to the determination of Seller’s exercise of due diligence.

Conflicts of Interest

The disclosure of any conflict of interest involving the Sellers, the Chief Executive Officer of the Hospital and its expert consultants is to be considered under factor number 5. Conflict of interest certifications, as required by the Act and the notice filing requirements of the Attorney General, have been filed by members of the governing board of the Authority, by the chief executive officer of the Hospital, and by Robert Thorn and G. Christopher Louis, Directors at Pinnacle Healthcare Consulting. Such certifications do not disclose any impermissible conflicting financial interest in the proposed transaction.

With regard to factor number 13, the instant transaction involves the lease of a nonprofit hospital to a for-profit corporation owned by individuals and health care providers.³ To ensure a patients' choice is protected, health care providers will be required to provide written disclosures to their patients of their financial interest in the Hospital operations. Furthermore, BHC will be required to disclose its' members ownership on its website to ensure there is public disclosure as required by federal laws. These safeguards and procedures are consistent with factor number 13.

Valuation of the Hospital Assets

The value of the Hospital and the amount of consideration to be paid in the proposed transaction must be weighed under factors number 6, 7 and 10. In a sale of hospital assets from a nonprofit corporation to a for-profit corporation, the nonprofit seller should receive "fair value" for its assets. *See* O.C.G.A. § 31-7-406(6).

While the term "fair value" is not defined in the Act, it is reasonable to conclude that fair value means "fair *market* value," since the Act is concerned with the sale or lease of real, personal and intangible property. Likewise, under factor number 13, board members and the chief executive officer of the nonprofit seller corporation must provide a certification "stating that the nonprofit corporation has received fair *market* value for its assets or, in the case of a proposed disposition to a not-for-profit entity or hospital authority, stating that the nonprofit corporation has received an enforceable commitment of fair and reasonable community benefits for its assets." O.C.G.A. § 31-7-403(b)(3). (emphasis added.) The reference to "fair market

³ BHC intends to add additional investors, including other physicians that are in positions to influence referrals to the Hospital. The undersigned did not conduct a separate analysis under the Physician Self-Referral Act ("Stark Law") and offers no opinion, but the record includes the parties' analysis concluding that the proposed transaction falls within the "whole hospital" exception.

value” in this separate, but related, provision of the Act suggests that the term “fair value” in factor number 6 should be read as “fair market value,” in order to apply the Act’s provisions consistently, especially since “fair market value” is the more descriptive and specific term. Thus, when the provisions of the Act are read in *pari materia* and in context, the term “fair value” should be construed to mean “fair market value.”

Collectively, the analysis and conclusions developed by Pinnacle in its Fair Market Value Analyses and Community Benefit Report, as reviewed by EY, indicates that the annual base lease payments over the initial 7-year term is within the range of fair market value rent. Additionally, EY observed that Pinnacle used reasonable valuation methods and techniques in its analysis of the proposed transaction to support its conclusion. Based on the record, it appears the Authority will receive fair market value for its assets as required by the Act. Since the Seller is not financing any portion of the proposed transaction, factor number 7 is not applicable.

The proposed transaction complies with factor number 10 because the Lease provides the Authority with a right of first refusal to obtain the leased assets in the event BHC attempts to transfer or assign its leasehold interest. Furthermore, BHC may not assign the Lease without the Authority’s consent.

Charitable Purpose of the Proposed Transaction

With respect to the charitable purpose of the proposed transaction, factor number 9 requires that the disposition proceeds be used for charitable health care purposes consistent with the nonprofit’s original purpose or for the support and promotion of health care in the affected community. The consideration, or monthly rent, received by the Authority through the Lease Agreement will be used to maintain the Hospital and premises. Pursuant to the Lease, the Authority is obligated to maintain the Hospital through capital repairs and replacements. By maintaining the assets, the Authority protects the value of the Hospital following the termination or expiration of the lease. Thus, the rental payments are being used to maintain the Hospital for the community that will be used to support the Authority’s obligation to ensure access to healthcare services in Burke County.

The other 2 charitable purpose factors, numbers 11 and 12, concern the purchaser’s commitment to provide (a) continued access to affordable care, (b) the range of services historically provided by the seller, (c) health care to the disadvantaged, the uninsured and the underinsured and (d) benefits to the community to promote improved health care. BHC has

made express contractual commitments in the Lease to maintain the general acute care hospital license of the Hospital and provide emergency services 24 hours a day, 7 days a week. BHC will also maintain its status as a participating provider in Medicare and Medicaid. BHC has also agreed to continue to provide indigent and charity care to the disadvantage, uninsured and underinsured and to maintain a charity care policy. Thus, factor 10 is satisfied.


The evidence, taken as a whole, demonstrates an enforceable commitment to improve health care in the community and to assure continued access to affordable care. The record as a whole demonstrates that the Authority has obtained from BHC an enforceable commitment to provide health care to the disadvantaged, the uninsured and the underinsured and to provide benefits to the community to promote improved health care.

III.

CONCLUSION

Upon review of the public record and in accordance with the Hospital Acquisition Act, the Hearing Officer finds that the public record in this matter discloses that the parties have taken appropriate steps to ensure that the transaction is authorized and that the value of the charitable assets is safeguarded.

This 26~~th~~ day of May, 2021.



ALKESH B. PATEL
Senior Assistant Attorney General
Hearing Officer

APPENDIX A

- (1) Whether the disposition is permitted under Chapter 3 of Title 14, the Georgia Nonprofit Corporation Code,' and other laws of Georgia governing nonprofit entities, trusts, or charities;
- (2) Whether the disposition is consistent with the directives of major donors who have contributed over \$100,000.00;
- (3) Whether the governing body of the nonprofit corporation exercised due diligence in deciding to dispose of hospital assets, selecting the acquiring entity, and negotiating the terms and conditions of the disposition;
- (4) The procedures used by the nonprofit corporation in making its decision to dispose of its assets, including whether appropriate expert assistance was used;
- (5) Whether any conflict of interest was disclosed, including, but not limited to, conflicts of interest related to directors or officers of the nonprofit corporation and experts retained by the parties to the transaction;
- (6) Whether the seller or lessor will receive fair value for its assets, including an appropriate control premium for any relinquishment of control or, in the case of a proposed disposition to a not-for-profit entity, will receive an enforceable commitment for fair and reasonable community benefits for its assets;
- (7) Whether charitable assets are placed at unreasonable risk if the transaction is financed in part by the seller or lessor;
- (8) Whether the terms of any management or services contract negotiated in conjunction with the transaction are reasonable;
- (9) Whether any disposition proceeds will be used for appropriate charitable health care purposes consistent with the nonprofit corporation's original purpose or for the support and promotion of health care in the affected community;
- (10) Whether a meaningful right of first refusal to repurchase the assets by a successor nonprofit corporation or foundation has been retained if the acquiring entity subsequently proposes to sell, lease, or transfer the hospital to yet another entity;
- (11) Whether sufficient safeguards are included to assure the affected community continued access to affordable care and to the range of services historically provided by the nonprofit corporation;

- (12) Whether the acquiring entity has made an enforceable commitment to provide health care to the disadvantaged, the uninsured, and the underinsured and to provide benefits to the affected community to promote improved health care; and
- (13) Whether health care providers will be offered the opportunity to invest or own an interest in the acquiring entity or a related party, and whether procedures or safeguards are in place to avoid conflicts of interest in patient referrals.