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— Jeffrey Whitman, MD, president and chief surgeon, Key-Whitman Eye Center, Dallas, TX

Cents and Sensibility: To Update, Renovate or Build a New OASC?

HERE'S HOW ONE GROUP REACHED A DECISION.

If all goes according to schedule, by this time next year, Jeffrey Whitman, MD, and his team at Key-Whitman Eye Center in Dallas, Texas, will be operating out of a new and much larger ophthalmic ASC in North Dallas.

"The key to future success is to deliver high-volume, cost-effective care with technologically advanced services," says Dr. Whitman, president and chief surgeon at Key-Whitman. "We have extreme space constraints in our current location, so we knew we had to expand. A new center will give us opportunities to network with physicians who are interested in using our center."

Currently located in the Uptown area of Dallas, Key-Whitman is one of the oldest OASCs in Texas, having been founded in 1984 by Charles Key, MD. Employing nearly a dozen staff members, including two registered nurses, two licensed vocational nurses, three scrub technicians and three ophthalmic assistants, Key-Whitman performs about 5,000 cataract-related and general ophthalmic surgical procedures each year, with revenue totaling about $5.5 million annually, says Executive Director Dan Chambers, MBA, COE.

"We're known to offer high-technology procedures in a very efficient operation — often patients go from reception to discharge in about an hour," says Mr. Chambers, noting that the ASC offers such procedures as intraocular lens implants and femtosecond laser-assisted surgeries.

Overcoming Hurdles

But, as Dr. Whitman made clear, the practice has been toughing it out through some significant growing pains in recent years, thanks to steadily climbing patient volumes and local construction projects that have aggravated traffic congestion in the growing Uptown area.

Figure 1. A computer rendering of Key-Whitman's future waiting area.

"Parking has been a big issue — our patients would call us on the phone en route to the ASC telling us they were a block away and didn't know if they could get here in time. Some had to walk to our ASC because the traffic was so bad with all the local construction. Even after we hired a valet service, we still had problems," says Dr. Whitman.

"We also had to ask some surgeons to move cases to other ASCs because we couldn't accommodate the volume," Dr. Whitman adds.

The current center's layout has posed particular challenges to Key-Whitman's desires for expansion, agrees Associate Administrator Nikki Hurley, RN, MBA, COE.

"At the current location, the clinical and ASC space are located on the same floor, making it difficult to add outside

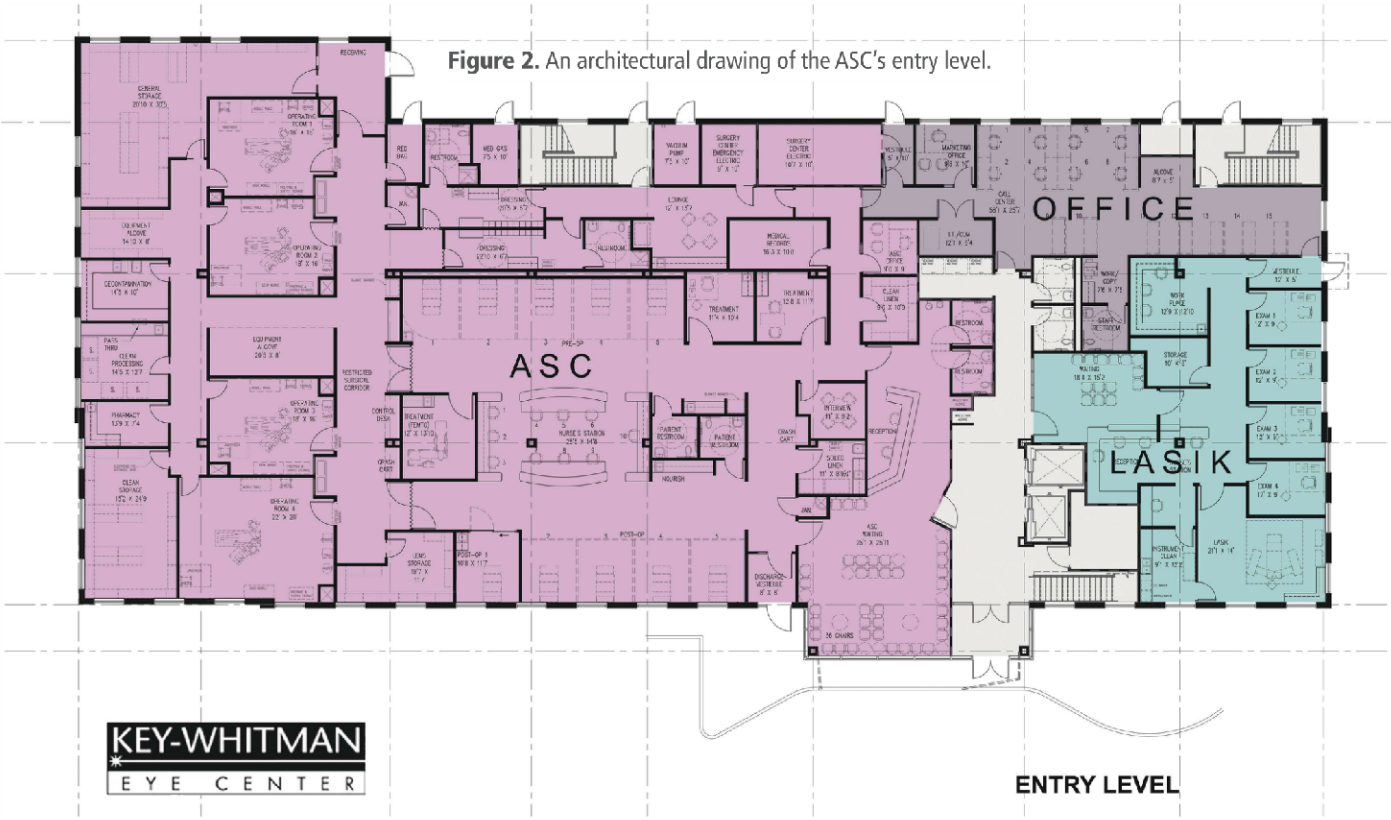

Figure 2. An architectural drawing of the ASC's entry level.

physicians to the ASC," Ms. Hurley says. "Their patients would have to enter the shared floor space." In addition, "we wanted better and increased space to add more equipment, create a more pleasing environment and preserve flexibility for future opportunities," she says.

The Commitment to Grow

The burgeoning patient base, combined with the looming 2016 expiration of their current lease, led the Key-Whitman team to begin exploring their options. By mid-2014, they had signed an agreement with a local developer to design and build their new ophthalmic office and OASC in North Dallas, and retained Eckert Wordell, a Michigan-based architectural firm, to assist in the ophthalmic planning, design and regulatory compliance review.

At two stories tall and 35,000 square feet, the medical building will host a new OASC as well as an optical center, a LASIK center and a specialty eye clinic and research center. The 12,500-square-foot OASC will include four operating rooms, a separate femtosecond laser OR, an exam room and a YAG laser treatment room and will be more than twice the size of Key-Whitman's current surgery center.

Decisions, Decisions

At a total estimated cost of $3 million to $3.5 million, the project is not small by any measure. Why not just update, remodel or expand the current center? For Key-Whitman, the answer came down to two major issues: money and government regulation.

"The expense of renovation, downtime, clinic impact and risk factors of regulatory compliance could result in enormous out-of-pocket opportunity costs — in the millions of dollars," says Dr. Whitman, noting that the estimated price tag of renovations could have exceeded $1.5 million. Not only that, but the practice likely would have been forced to reduce the size of the clinic to meet state and federal building codes. Even then, Dr. Whitman says, "we feared we might not meet all compliance regulations due to the building limitations, even with a renovation."

It was a realistic fear, says Jeffery S. Eckert, AIA, senior principal of Eckert Wordell. In considering updating, remodeling or expanding an existing facility, Mr. Eckert says the first order of business is to determine the feasibility of meeting current codes and standards.

"Whether you're updating, remodeling or expanding your facility, complying with the Life Safety CMS rules is required for continued licensure compliance," Mr. Eckert says. While minor cosmetic updates (e.g., new finishes) won't trigger the need for regulatory review and approval, major changes such as increasing the number of ORs and/or enlarging an ASC will.

Compliance Issues

"In the case of the Key-Whitman

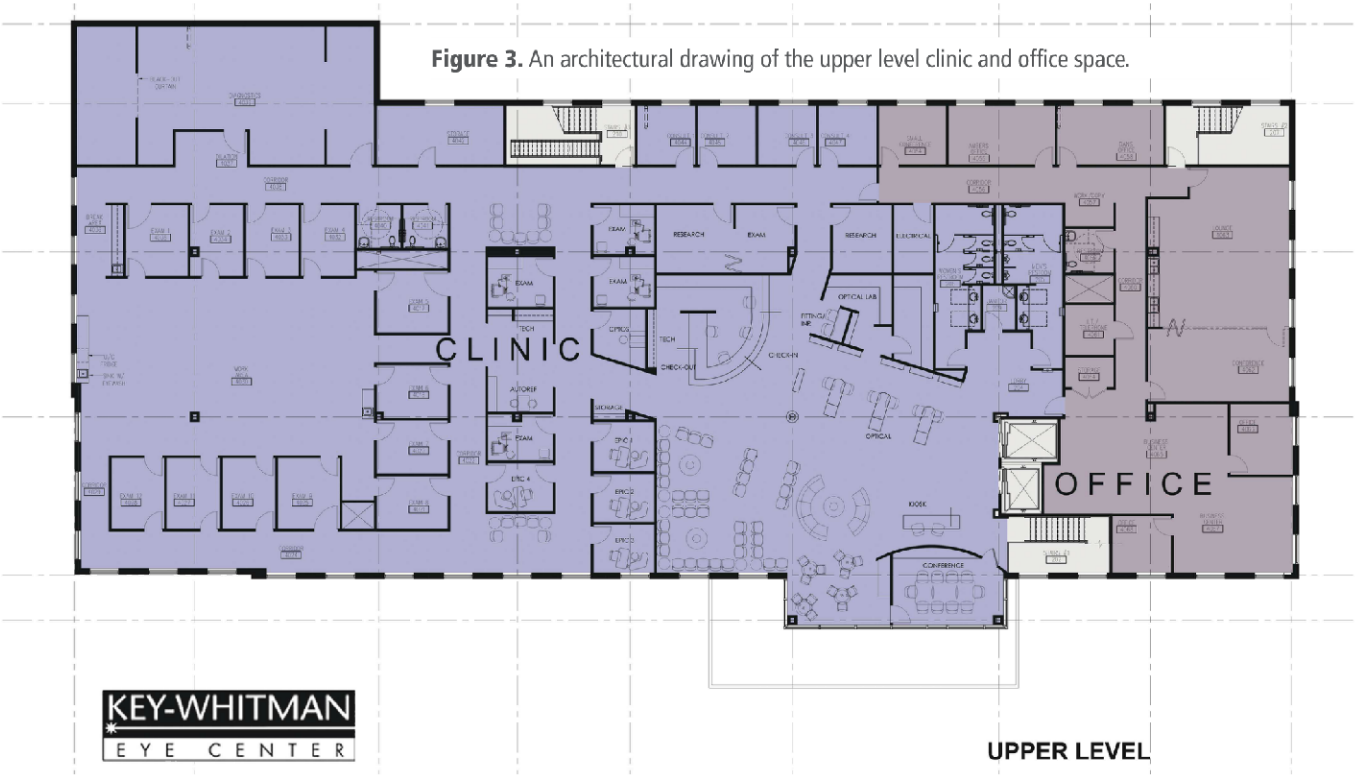

Figure 3. An architectural drawing of the upper level clinic and office space.

project, the regulatory requirements for a four-OR facility wouldn't have been possible given the footprint of the existing facility, even if they vacated the clinic space for the ASC expansion," Eckert says.

Stephen C. Sheppard, managing principal for real estate and operations at Medical Consulting Group, LLC, in Springfield, Mo., agrees and notes that regulatory mandates have grown in recent years, leading to more complicated and expensive growing pains for OASCs. "Over the last 15 years, the regulatory requirements for ASC physical plants have changed enormously," says Mr. Sheppard, who is working as a consultant on the project. "In 1999-2000, I worked on small, one-OR ophthalmic ASCs and we could meet all of the requirements in 1,800 to 2,000 square feet. For that same center today, we initially budget 3,500 square feet."

"It's very expensive to build a new regulatory-compliant ASC," Mr. Chambers says. "The expense has escalated in the past 5 years with all the new regulatory demands, infection control requirements, backup systems, and so on."

Benefits

In addition to these practical financial and regulatory reasons, Key-Whitman cited expected benefits, such as increased patient capacity, operating profits, flexibility and return on investment, as reasons for choosing new construction over staying put and attempting to renovate.

"Changes in technology continue at a rapid rate and it makes sense to create as much flexibility in the physical plant as you can," Mr. Sheppard says. "Even 3 years ago there were questions about the market penetration of femtosecond laser-assisted cataract surgery. That's no longer the case. New ASCs need to incorporate space for a femto laser. It's usually sub-optimal to place the laser in an OR, since it impedes the flow."

"The cost of the new facility will be more [than renovating], but the return on the investment at the end of a 5-year term would favor a new facility at higher volumes, which is what we expect with the baby boomer growth for eye care," Dr. Whitman says. "We can increase our capacity, double our size, add revenue and operating profits in a new, highly compliant, state-of-the-art facility with the latest ophthalmic surgical equipment.

"And more importantly," he adds, "[building new] offers an opportunity to add new physician equity partners to our organization."

Indeed, Key-Whitman's new facility will be paid for through a combination of equity contributions from new partners, tenant allowances and debt financing, Mr. Chambers says. The new facility is slated to open its doors in February 2016.

"We already have some potential partners who want to move into our location and there is no way we could have accommodated them in our existing ASC space," he says. "We expect to have strong utilization for three ORs by the middle of our first year, and good utilization by the end of year 2." ■

REMODEL? EXPAND? BUILD? HOW TO CHOOSE WHEN YOU'RE AT A CROSSROADS

Key-Whitman effectively had no other option than to build a new facility to balance regulatory mandates with its desire to grow. This isn't always the case for OASCs, so careful analysis is important to determine the best course of action. Here are some guidelines to follow when you're at the crossroads.

Update when you're looking to make mostly cosmetic or slight modifications. "But be very careful with the size of your update, as it can trigger a major intervention by state and federal regulatory bodies," says Jeffrey Whitman, MD.

Also consider the size of your market, adds Stephen Sheppard. "Can you attract additional surgeons to increase utilization of the facility? Key-Whitman can in Dallas, and the community itself is growing rapidly. But in a town of 100,000, those opportunities may not be available, so renovations to update cosmetics and technology are often a better option than expansion."

Utilization is also important to consider, Mr. Sheppard says, by centers that primarily focus on anterior segment procedures, heavily weighted by cataract procedures. "I work with a group of cataract surgeons who are performing more than 3,500 procedures annually out of one OR and it is dark on Friday. They have a significant share of their market. Thus, there's no need to substantially expand their physical plant," he says.

Remodel when you have 5-plus years remaining on your lease and a run-down facility with no added volume projected, says Dr. Whitman. "Many state and federal guidelines require complete and major updates, which can be more difficult to undertake than moving to a newer facility," he says.

"Control of the space is critical," agrees Mr. Sheppard. "If you lose control of the space via expiration of your lease, you're essentially starting over with the licensure and Medicare certification process, and you'll have to construct the space to 2015 standards. I wouldn't undertake a major remodel with less than 10 years worth of control of the space – and I'd like a renewal option or two to extend that."

Also consider your physicians' exit strategy, Mr. Sheppard says. "If the surgeons are retiring and want to realize the 'fair value' of their investment in the ASC, but the lease only has 2 years left, they'll be faced with a material discount in the expected sales price. Successor surgeons are buying a future income stream, which isn't worth much if it's going away in 2 years."

Expand when you're confident you can obtain increased patient volumes and are able to add physician partners to mitigate financial risks and increase valuation.

"The critical element is increasing surgical volume," says Mr. Sheppard. "There are only two ways to fail in the development of an ASC: 1. Overbuild it so that it can't carry the debt service or 2. Overestimate future surgical volume. If you haven't 'locked in' the future volume growth via selling interests to additional doctors, a costly expansion is risky. In my experience, typically 85 percent-plus of the surgical volume originates from owner-surgeons or their employees. It's unrealistic to anticipate that a non-owner surgeon will deliver substantial volume over an extended period of time. An ownership opportunity will open up in a competing facility, and that volume will move."

Build when your facility and practice are 25-plus years old and the infrastructure of your ASC can no longer handle the physical demands of future regulatory compliance.

"When the facility is no longer efficient and/or competitive in your marketplace, is out of compliance, and/or you're about to lose control of the space, it's time to move," says Mr. Sheppard.

In addition, "there are many more "dynamic" considerations relating to changing technology, demographic shifts in your market, and other factors.

"OASCs have to balance three resource groups: surgeon OR hours demanded, staff labor hours and the throughput capacity of the physical plant," states Mr. Sheppard. "Surgeon OR hours demanded and physical plant throughput are typically hard to change rapidly. Additionally, one of those two items frequently drives staff labor hours."