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*Obtaining a Certificate of Need (“CON”) is costly in terms of both time and resources, and gaining approval is not guaranteed. Providers may wait months or years for approvals that may never come, spending tens or hundreds of thousands of dollars in the process. As a result, existing CON assets can have significant value as both standalone and contributory assets.*

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## GENERAL OVERVIEW

### CERTIFICATES OF NEED

A CON is an authorization required by numerous states for the addition or adjustment of certain medical services and/or facilities in a given region. Requirements for approval varies across the nation, and apply to over 100 types of expansion, construction, purchase, or transfer of services, medical equipment, or healthcare facilities. The purpose of CON legislation asserts that overbuilding and redundancy in healthcare leads to higher costs. CON operating rights have an economic value similar to a radio station broadcast license or a license to serve alcohol. Multiple factors influence the value of the CON. These include:

- Local demographics and competition
- Specific service(s) included
- Market share
- Reimbursement and payer mix
- Likelihood of future new entrants
- Previous approvals

### CON REGULATORY LANDSCAPE

The first CON law was enacted in New York in 1964 with the intent to reduce overall healthcare expenditures. Hospitals benefitted from ensuing limited competition and by 1978 a campaign led by the American Hospital Association (“AHA”) had successfully lobbied for CON laws in 42 states and the District of Columbia. Since that time Congress has disavowed these laws on multiple occasions and a number of

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the original 42 states have repealed their CON programs. Currently, under varying degrees of restrictions, 39 CON jurisdictions remain.

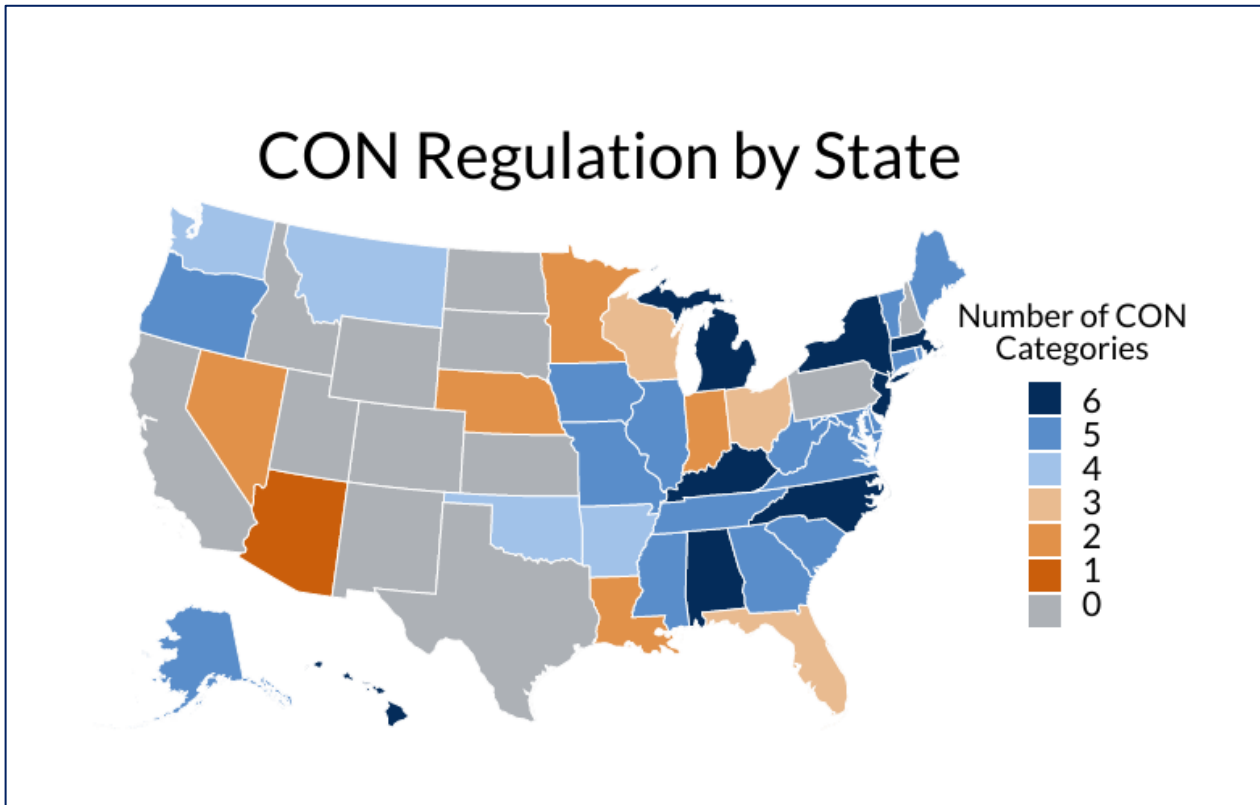
## IMPACT OF COVID

The unprecedented demand for healthcare services during the COVID-19 pandemic impacted CON laws as states managed their resources by differing tactics. At least 25 jurisdictions loosened or suspended CON requirements during states of emergency in order to allow healthcare providers greater flexibility to respond to the crisis.

## CON CATEGORIES

CON categories vary across jurisdictions but fall into six broad groups, as follows:

- Hospital beds - may include swing, hospice, psychiatric, or neonatal beds.
- Beds outside hospitals - may include nursing homes, intermediate care facilities, or ambulatory surgery centers.
- Equipment - may be based on minimum expenditures and include imaging devices or radiation therapy machines.
- Facilities/buildings - may be based on minimum expenditures and/or include new construction or renovations to existing buildings such as dialysis centers or mental health facilities.
- Services - may vary widely from specialties such as organ transplants to primary care and may require established providers to secure CONs to offer new services.



<sup>1</sup> <https://ij.org/wp-content/uploads/2020/08/Conning-the-Competition-WEB-08.11.2020>.

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### CERTIFICATE OF NEED VALUATION

CONs may need to be valued in a variety of circumstances, including change of ownership, disputes, purchase price allocations, and contract buyout provisions. There is no single formula or rule of thumb that ensures that the dollar value placed on a CON is FMV. Instead, as with any intangible asset, the CON should be reviewed from several perspectives, each of which is based on economic concepts drawn from the three traditional approaches to valuation: cost, income, and market.

- **Cost Approach:** What is the cost of the application and legal fees to obtain new CON approval, including the associated opportunity cost of lag time during the approval process?
- **Income Approach:** How does the value of the business with a CON differ from the value of the business without a CON?
- **Market Approach:** Does the value placed on the CON make sense compared to the limited publicly-available market data related to the value of other CONs?

### ILLUSTRATIVE EXAMPLE

To illustrate, the value of a representative CON for a diagnostic imaging facility in North Carolina is discussed in the following sections. For the purposes of this example, we assume there are no need determinations within the State Medical Facilities Plan that would provide a foreseeable opportunity for a new CON application for such a facility within the region.

#### COST APPROACH

The cost of obtaining a new CON consists of 1) estimated application fees, 2) legal and consulting fees associated with obtaining CON approval, and 3) the opportunity cost of review time.

CON Valuation - Cost Approach		
	Low	High
Application Fees <sup>1</sup>	\$ 6,500	\$ 9,500
Consulting and Legal Expenses <sup>2</sup>	50,000	200,000
Opportunity Cost - 4 to 6 Months of EBITDA <sup>3</sup>	377,443	566,164
<b>Indication of Value of CON, Rounded</b>	<b>\$ 430,000</b>	<b>\$ 780,000</b>

<sup>1</sup> Base fee in NC is \$5,000 plus \$.003 per \$1 over \$1 million (assumes cost of \$1.5 to \$2.5 million).

<sup>2</sup> Low end simply includes the cost to prepare and submit an application, while the high end assumes CON is contested.

<sup>3</sup> Typical timeline for approval is 3 to 4 months plus 1 to 3 months to prepare the application.

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**Opportunity Cost of Obtaining a New CON:** This component of the analysis assumes that if the business were transferred without the CON, the buyer would have to obtain a CON through the regular approval process. In our example, we estimate that this process could take four to six months, including one to three months to develop the CON application and three to four months to obtain approval once issued, based on an analysis of historical diagnostic imaging CON approvals in North Carolina. This time frame was then applied to the imaging center’s historical financial results.

**NC Diagnostic Imaging CON Approval Times - 2019 Issuances**

Facility	Application Review Date	Certificate Issue Date	Months	Type	Amount
Triad Breast Imaging Center	9/1/2019	12/28/2019	4.00	Multi-Modality Imaging	\$ 1,659,212
Raleigh Radiology Cameron Village	9/1/2019	12/28/2019	4.00	Multi-Modality Imaging	NA
Duke Imaging Services at Cary Parkway	7/1/2019	10/1/2019	3.00	Mammography	\$ 590,000
Raleigh Radiology Knightdale	7/1/2019	10/15/2019	3.50	Multi-Modality Imaging	\$ 2,054,336
Duke Health Arrington Radiology	7/1/2019	10/17/2019	3.50	Multi-Modality Imaging	\$ 9,310,000
Duke Radiology Holly Springs	5/1/2016	9/11/2019	39.00	MRI	\$ 6,155,880
Iredell Mooresville	5/1/2019	8/20/2019	3.75	Multi-Modality Imaging	\$ 4,998,069
Atrium Health Kenilworth Diagnostic Center	5/1/2019	8/20/2019	3.75	Multi-Modality Imaging	\$ 8,760,394
Duke Health Holly Springs	5/1/2019	8/17/2019	3.75	Multi-Modality Imaging	\$ 289,679
Atrium Health Mountain Island Emergency Department	3/1/2019	6/18/2019	3.50	Multi-Modality Imaging	\$ 18,038,406
Rex Hospital	3/1/2019	6/1/2019	3.00	PET	\$ 4,206,352
FirstHealth Moore Regional Hospital - Richmond	12/1/2018	3/5/2019	3.00	MRI Relocation	\$ 2,823,597
Duke Health Holly Springs	11/1/2018	2/14/2019	3.50	Multi-Modality Imaging	\$ 1,902,746
Duke Health Center Apex	11/1/2018	2/14/2019	3.50	Multi-Modality Imaging	\$ 760,237

<b>25th % tile</b>	<b>3.38</b>
<b>Median</b>	<b>3.50</b>
<b>75th % tile</b>	<b>3.81</b>

## MARKET APPROACH

Publicly-available market data related to arm's length transactions involving CONs is typically limited since these transactions are private and there are limited disclosure requirements. Even in the absence of state and industry subsegment -specific comparable CON transactions, publicly-available data from purchase price allocations ("PPAs") can be used to help value a CON. CONs are often valued under the "fair value" standard by independent, third-party valuation firms for merger and acquisition financial reporting purposes, which are occasionally publicly reported. These datapoints from reported PPAs can then be compared to the subject CON as a percentage of business enterprise value.

- The median CON from our study represents 14.7% of the overall business enterprise, while the range from the 25th to 75th percentile is 11.5% to 28.0%.
- Only one of the comparable entities is specific to imaging centers (highlighted) as publicly-traded (at the time) Alliance Healthcare Services, Inc. reported sufficient detail related to a 2010 imaging center acquisition in Alaska (12.7% of the enterprise value).

Comparable CON Values As a % of Enterprise Value

Type	Target	Acquirer	Date	Enterprise		
				Value	CON Values	CON %
Home Health	Alacare Home Health & Hospice	Encompass Health Corp	7/1/2019	\$ 217,500,000	\$ 34,300,000	15.8%
Home Health	Various 2018 Home Health Acquisitions	Encompass Health Corp	12/31/2018	\$ 13,100,000	\$ 2,500,000	19.1%
Hospital: Rehabilitation	Various 2018 IRF Joint Ventures (SC, NC, CO)	Encompass Health Corp	12/31/2018	\$ 39,300,000	\$ 12,500,000	31.8%
Home Health	Camellia Healthcare	Encompass Health Corp	5/1/2018	\$ 131,000,000	\$ 16,600,000	12.7%
Home Health	Christian Care at Home	Amedisys, Inc.	3/1/2018	\$ 2,300,000	\$ 200,000	8.7%
Hospital: Rehabilitation	Various 2017 IRF Joint Ventures (MS, OH)	Encompass Health Corp	12/31/2017	\$ 35,000,000	\$ 9,800,000	28.0%
Cancer: Radiation Therapy	North Alabama Cancer Care Organization	Alliance HealthCare Services, Inc.	1/1/2016	\$ 67,580,000	\$ 9,900,000	14.6%
Cancer: Radiation Therapy	Pacific Cancer Institute, Inc.	Alliance HealthCare Services, Inc.	12/31/2015	\$ 12,893,000	\$ 6,200,000	48.1%
Home Health	Various 2015 Home Health Acquisitions	HealthSouth Corp.	12/31/2015	\$ 30,500,000	\$ 4,900,000	16.1%
Home Health	CareSouth Health System, Inc.	HealthSouth Corp.	11/1/2015	\$ 174,000,000	\$ 15,600,000	9.0%
Hospital: Rehabilitation	Cardinal Hill Rehabilitation Hospital	HealthSouth Corp.	5/1/2015	\$ 60,000,000	\$ 8,800,000	14.7%
Cancer: Radiation Therapy	Charleston Area Radiation Therapy Centers	Alliance HealthCare Services, Inc.	11/1/2014	\$ 28,800,000	\$ 11,500,000	39.9%
Hospital: Rehabilitation	Fairlawn Rehabilitation Hospital	HealthSouth Corp.	6/1/2014	\$ 84,100,000	\$ 9,700,000	11.5%
Hospital: Rehabilitation	Walton Rehabilitation Hospital	HealthSouth Corp.	4/1/2013	\$ 28,900,000	\$ 3,300,000	11.4%
<b>Imaging</b>	<b>Diagnostic Health Center of Anchorage, LLC</b>	<b>Alliance HealthCare Services, Inc.</b>	<b>5/1/2010</b>	<b>\$ 13,737,000</b>	<b>\$ 1,750,000</b>	<b>12.7%</b>

10th Percentile	8.9%
25th Percentile	11.5%
Median	14.7%
75th Percentile	28.0%
90th Percentile	43.2%

Source: Scope Research Intangible Asset Database

## ABOUT BUCKHEADFMV

*BuckheadFMV specializes in the valuation of healthcare businesses, services, and assets of all kinds. Our focus is on providing well-supported FMV opinions for even the most complex arrangements and organizations, deep proprietary research on healthcare valuation issues, and a nimble approach to client service.*

### FMV OPINIONS

Our valuation experts provide fair market value (FMV) and commercial reasonableness opinions for a wide range of financial arrangements entered into by physicians, hospitals, and other healthcare entities.

### BUSINESS VALUATION

We have extensive experience in the valuation of healthcare organizations. Our singular focus on the healthcare industry enables our deep understanding and knowledge of healthcare valuation issues and

### PHYSICIAN COMPENSATION CONSULTING

In addition to valuation services, we provide a variety of compensation-related consulting services, including physician compensation design and modeling.

### ASSET APPRAISALS

Our valuation experts also provide appraisals of furniture, medical and office equipment, medical records, and other selected assets in healthcare facilities. Our reports are specifically tailored to healthcare acquisitions and include documentation of compliance with the Stark Law and other healthcare regulations.



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- Lithotripsy Services
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- Marketing Services
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- Meeting Attendance
- Midlevel Supervision
- Non-Monetary Compensation
- Part A Pathology
- Patient Centered Medical Homes
- Perfusion
- Physician Recruitment Incentives
- Professional Interpretations/Reads
- Quality Incentives
- Shared Savings Distribution
- Space, Equipment, & Staff Leasing

### Business Valuation and Asset Appraisals

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- Behavioral Health
- Cancer Centers
- Clinical Laboratories
- Diagnostic Imaging
- Dialysis
- Endoscopy Centers
- Home Health
- Hospices
- Hospitals
- Infusion Centers
- Physical Therapy
- Physician Practices
- Rehabilitation Hospitals
- Surgical Hospitals
- Urgent Care