



Legislation Text

 File #: 14-319, Version: 1

CITY COUNCIL STAFF REPORT

MEETING DATE: OCTOBER 1, 2014

PREPARED BY: Kevin Riper, Administrative Services Director
 APPROVED BY: City Manager

HEALTHCARE INFRASTRUCTURE PLANNING - FINAL REPORT

RECOMMENDATION(S):

1. Receive and file report
2. Discuss next steps at the Council's October 3 Goal Review Workshop

COUNCIL PRIORITIES SUPPORTED:

Ongoing Priorities

Enhancing Public Safety

Annual Priorities

Enhancing Community Engagement & Diversity
 Participate in Regional Issues

NARRATIVE:

Throughout the summer the City Council has worked with health care planning consultants from Health System Advisors to consider planning and zoning issues in the community raised by the possible sale of St. Louise Regional Hospital in Gilroy by its current owner/operator, Daughters of Charity Health System, and by that System's request for rezoning almost 25 acres of property it owns east of Highway 101 on which its DePaul Urgent Care Center resides.

During three visits to Morgan Hill plus numerous telephone conferences, Health System Advisors reached out to the community generally, and to local healthcare providers specifically, to gather information and perspective-on top of extensive data collection and analysis.

In its final report (attached) Health System Advisors emphasizes that the combination of Morgan Hill demographics and the population's current pattern of using medical facilities mostly to the City's north, "a hospital in Morgan Hill is not likely viable."

Instead, the final report recommends the City focus on "Attracting a regional system willing to partner with local physicians to develop an ambulatory destination center in Morgan Hill offering services such as imaging, urgent care, specialists, procedure center, and supporting services."

In targeting such a system, the consultant suggests "Advocating for a Kaiser ambulatory center in Morgan Hill to better serve Kaiser members living in Morgan Hill."

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The recommendations conclude with an analysis of the most desirable land-use characteristics for attracting and providing such healthcare infrastructure: a minimum of five acres for two separate sites, and a third site of 10 to 12 acres with both access and good visibility from Highway 101, especially for ambulatory facilities.

PRIOR CITY COUNCIL AND COMMISSION ACTIONS:

On July 16, 2014 the City Council received a presentation from Health System Advisors detailing the major findings of the consultant's community outreach, data gathering and resulting analysis-findings that are presented in more detail in the attached final report

FISCAL AND RESOURCE IMPACT:

The cost of the consulting engagement (\$50,000 plus not-to-exceed \$10,000 for expenses, mostly travel and lodging for three trips to Morgan Hill, and for the purchase of selected healthcare data) was paid from Fund 207 Long Range Planning

CEQA (California Environmental Quality Act):

Not a Project

LINKS/ATTACHMENTS:

Healthcare Infrastructure Planning Report

City of Morgan Hill - Healthcare Infrastructure Planning
Report of Findings

September 24, 2014



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Executive Summary

The City of Morgan Hill engaged Health System Advisors (HSA) to conduct a study of the current and future healthcare infrastructure needs of Morgan Hill residents. The study was commissioned in response to two events that will impact future healthcare planning in Morgan Hill. First, the City is updating its General Plan through 2035 a process that will need to consider the City's current and future medical service needs so sufficient land can be zoned properly for future medical development. In addition, Daughters of Charity Health System (DCHS) is attempting to sell its healthcare delivery assets, including the De Paul Medical Center in Morgan Hill and the St. Louise Regional Hospital (SLRH) in Gilroy, which is currently the closest hospital to Morgan Hill. This sale could impact the future of healthcare delivery for Morgan Hill residents. In addition, DCHS has requested that the City re-zone the 24.55-acre De Paul Medical Center site to allow for future residential development.

As a result, HSA's study was designed to address several key questions to inform future land use considerations by the City of Morgan Hill:

1. How would a change of ownership of SLRH impact the residents of Morgan Hill?
2. What healthcare infrastructure do the residents of Morgan Hill (and the surrounding areas) need?
3. What healthcare providers and assets can likely be supported by the Morgan Hill residents locally?

To answer these questions, HSA conducted a thorough analysis of the market using the most current publicly available data. This includes population, demographic, healthcare utilization, payer mix, physician availability, and community need assessments. HSA paired this information with its experience with healthcare systems around the country and interviews and meetings of the key City and community leaders. This executive summary presents the key analyses, findings and recommendations resulting from the analysis. The attached report should be read in its entirety to fully understand the study's methods, findings and implications.

Findings and Recommendations

Based on the projected future demand for healthcare services from Morgan Hill residents, the estimated utilization levels that demand could support, the level of existing and competing services in the region, and the financial operating characteristics of various specific healthcare facilities and providers, recommendations were developed regarding prioritization of future healthcare infrastructure development in Morgan Hill. Figure 1 summarizes these priority recommendations.

Figure 1: Recommended Healthcare Infrastructure Priorities

Healthcare Component	Projected Need	Priority	Comment	2035 Est. MH Encounters ^a	
				Kaiser	Non-Kaiser
Hospital	Not viable	Very Low	Without closure of SLRH and an alternative funding source beyond healthcare services, a Morgan Hill hospital is not likely to be financially viable	1,350	2,000
Free-Standing ER	Not viable	Very Low	While financially viable, particularly for a competing San Jose system, California regulation makes free-standing ERs not viable today	n/a	7,200
Specialty Care	Selected viable	Varies by Specialty	Additional growth in selected specialties and outreach clinics from a San Jose system	65,000	130,000
Ambulatory Surgery	Viable	High	The market supports at least one 4+ suite procedure centers located in Morgan Hill without Kaiser volume	3,000	4,500
Imaging Center	Viable	Very High	The market readily supports cross-sectional imaging suggesting a full imaging center could be developed in Morgan Hill without Kaiser volume	22,000	35,000
Urgent Care	Viable	Very High	The market readily support 1 urgent care center today, with a 2 nd urgent care center supported as the market grows without including Kaiser volume	6,000	9,500
Primary Care	Viable	Very High	Shortage of primary care providers today, particularly Kaiser providers which are all in San Jose or Gilroy	80,000	120,000

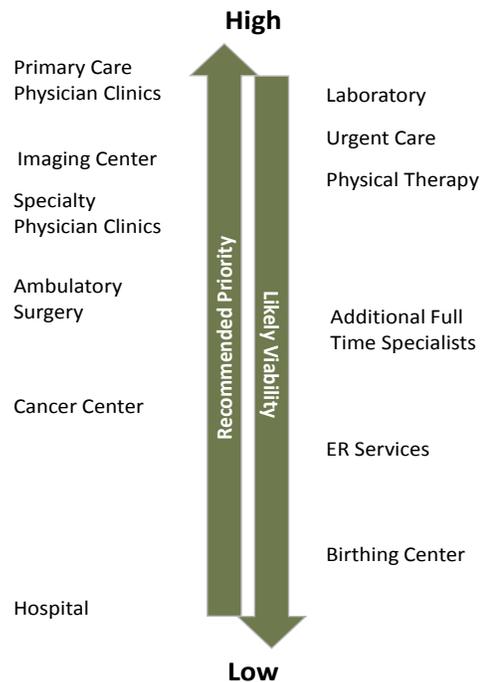
* Projected number of visits made by Morgan Hill residents to each health care component

A hospital in Morgan Hill is not likely viable, for several reasons:

- The future projected healthcare financial environment, which is likely to include continued downward pressures on payment for medical services.
- The large presence of Kaiser in the market splits the private payer market, leaving a non-Kaiser affiliated hospital to draw from a smaller pool of the more profitable private payer patients.
- A large portion of the Morgan Hill market is not using the local hospital (SLRH) today and will continue to use hospitals in San Jose regardless of whether a hospital exists in Morgan Hill.
- The current and projected future population does not warrant demand for enough hospital beds to create an efficient scale.

Instead, as summarized in Figure 2, Morgan Hill should focus its efforts on maintaining, attracting, and building a vibrant ambulatory healthcare community, including increasing the number of primary care providers (including Kaiser and non-Kaiser providers), as well as services such as laboratory, imaging

Figure 2: Recommended Priorities Summary



and physical therapy. Continued emphasis should also be placed on enhancing the existing urgent care and specialty physician services in Morgan Hill.

Due to California regulations, a free-standing emergency room is not considered to be a high priority. While providing Morgan Hill residents with convenient, fast access to emergency services is highly important, this need is currently being met adequately by SLRH and various San Jose hospitals. Further, the State statutes regulating free-standing ER's are out of the City's direct control and would need to be substantially changed to realistically contemplate an ER in Morgan Hill. In the event that SLRH ceases operations of an ER and/or the State enacts legislation to ease the restrictions on free-standing ER's, providing ER services in Morgan Hill would become a higher priority.

Space and Land Implications

Pulling together healthcare infrastructure that can likely be supported by the Morgan Hill market suggests an ambulatory destination center offering:

- Urgent care
- Imaging center
- Physician offices
- Rotating specialty clinics
- Potentially ambulatory surgery

A major ambulatory facility could range from 35,000 to 55,000+ square feet and would potentially require five to ten acres for a multi-story building. The site scale would depend on the density of the development and the provision of space for future expansion. Site selection is a critical factor. Any potential sites should have visibility from Highway 101 and immediate, easy access and the ability to expand to accommodate future increases in population and healthcare demand.

HSA Recommendations

The most immediate efforts regarding the retention and expansion of healthcare services in Morgan Hill should focus on:

- Attracting a regional system willing to partner with local physicians to develop an ambulatory destination center in Morgan Hill offering services such as imaging, urgent care, specialists, procedure center, and supporting services.
- Advocating for a Kaiser ambulatory center in Morgan Hill to better serve Kaiser members living in Morgan Hill.
- Define two or three locations with access and visibility from 101 for healthcare ambulatory facilities:
 - Minimum of five (5) acres for two (2) sites
 - One site 10 -12 acres

Project Overview

The City of Morgan Hill (population 41,197) is located on Highway 101 between San Jose and Gilroy, CA. Today, Morgan Hill residents use healthcare provided locally by Morgan Hill physicians and travel to San Jose and Gilroy for the majority of their hospitalizations, emergency room visits and hospital-based care. Due to turmoil in the healthcare provider market in the South Bay area, Daughters of Charity Health System (DCHS) is attempting to sell its healthcare delivery assets, including the De Paul Medical Center in Morgan Hill, St. Louise Regional Hospital (SLRH) in Gilroy and O'Connor Hospital in San Jose.

As DCHS prepares for a potential sale of the 24.55-acre De Paul Medical Center site, the organization has requested that the City of Morgan Hill rezone the land to allow future residential development. Such a rezoning would likely increase the value of the land, and could pave the way for an envisioned senior housing or other residential development on the site. The requested rezoning would also impact an adjacent 0.95-acre site that currently houses a privately-owned medical office building.

The impending DCHS asset sale could impact the Morgan Hill populations who utilize healthcare services in San Jose or Gilroy. Further, a sale and potential rezoning of the De Paul Medical Center site would require the relocation of the largest critical mass of health care providers in Morgan Hill.

In addition to planning for these potential DCHS asset sale impacts, the City of Morgan Hill is also in the process of updating its General Plan through 2035. The updated General Plan will serve as the foundation for the next 20 years of development in Morgan Hill. As part of the General Plan update process, it is important that the City consider its current and future medical service needs so sufficient land can be zoned properly for future medical development.

The City of Morgan Hill engaged Health System Advisors (HSA) to conduct a study both to understand the impacts of various DCHS asset sale scenarios and to project the changing healthcare infrastructure needs of Morgan Hill residents for its General Plan. HSA's study was designed to address several key questions to inform future land use considerations by the City of Morgan Hill:

1. How would a change of ownership of SLRH impact the residents of Morgan Hill?
2. What healthcare infrastructure do the residents of Morgan Hill (and the surrounding areas) need?
3. What healthcare providers and assets can likely be supported by the Morgan Hill residents locally?

To answer these questions, HSA conducted a thorough analysis of the market using the most current publicly available data. This includes population, demographic, healthcare utilization, payer mix, physician availability, and community need assessments. HSA paired this information with its experience with health systems around the country and interviews and meetings of the key City and community leaders. This report outlines the current and future needs for healthcare infrastructure in Morgan Hill. The information contained herein is also intended to help the City address the issue of how Morgan Hill's future healthcare needs and impending changes to the landscape of local and regional healthcare services will impact the City's future land use needs.

Market Assessment

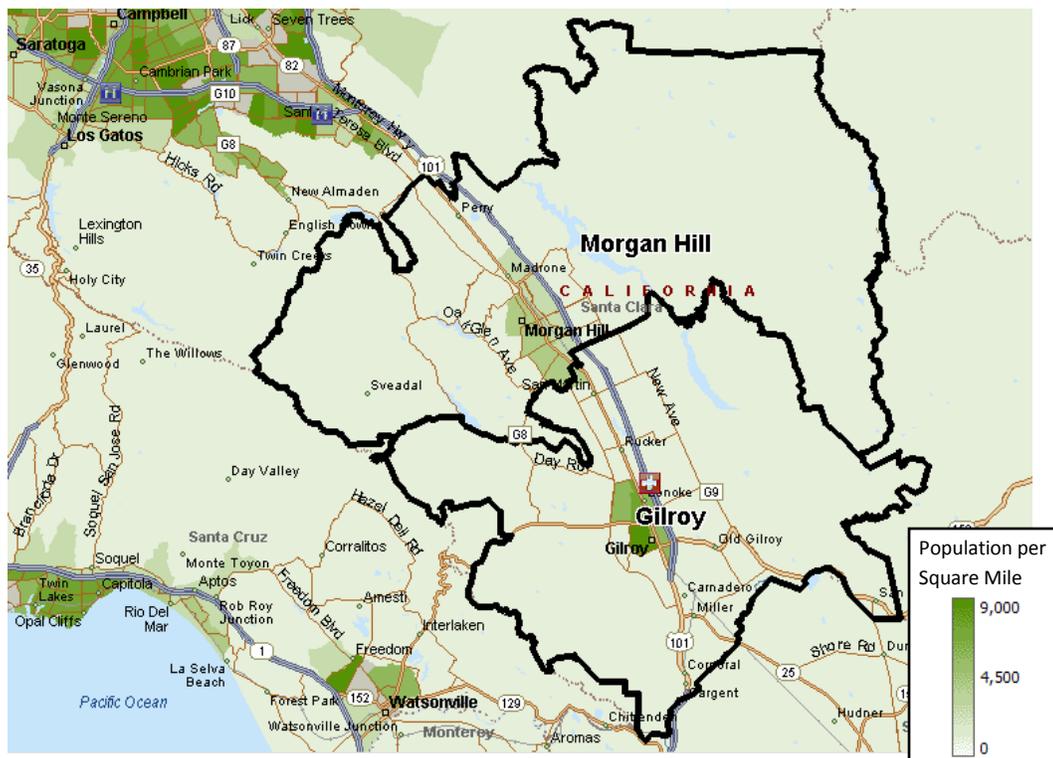
As an initial step in assessing the healthcare needs of the Morgan Hill market, it is important to properly define the market area for varying types of healthcare services. For purposes of this analysis, HSA has defined Morgan Hill as the 95037 and 95038 zip codes. While we recognize that these zip codes include certain portions of unincorporated Santa Clara County, the use of zip code geographies allows for consistency with available healthcare data, which is provided on a zip code level. This Morgan Hill market definition serves as the assumed

market area for healthcare services that are typically provided locally, including primary care physicians and certain specialty providers.

In evaluating the potential need for a hospital in Morgan Hill, particularly in the event that SLRH ceases operations after its sale, HSA has utilized a larger market area, as hospitals typically draw from a larger geographic area than locally based providers. HSA has defined the Morgan Hill Hospital Service Area (MHSA) to include Morgan Hill (zip codes 95037 and 95038), Gilroy (zip codes 95020 and 95021) and San Martin (zip code 95046). Though a hospital situated in Morgan Hill would draw from outside the MHSA, HSA designed this area to encompass at least 90 percent of a potential Morgan Hill hospital's patient origin.

Figure 3 illustrates the Morgan Hill and MHSA geographies and includes population density data presented on the basis of population per square mile. As shown in the map, the majority of the population in Morgan Hill and Gilroy is clustered along the 101 Freeway. The MHSA lies to the southeast of the large population base in the South Bay Area.

Figure 3: Morgan Hill / MHSA Area Map



The Morgan Hill/MHSA population is growing at a faster rate than the national average

The City of Morgan Hill had a population of 39,876 in 2013 and 41,197 in 2014, while the 95037 and 95038 zip codes, which include the City of Morgan Hill and certain portions of unincorporated Santa Clara County, had a population of 47,545 in 2013 (2014 population data by zip code was not available). Throughout this document, references to Morgan Hill demographics define Morgan Hill as the 95037 and 95038 zip codes. The population within Morgan Hill is projected to grow to 50,414 by 2018, an annual growth rate of 1.2 percent. Nearly half of this population growth is projected to occur in the 65 and older age range. Given the utilization of healthcare services tends to increase with age, Morgan Hill’s population will likely experience a growing need for medical services or access to services in the coming years.

Figure 4: Population Growth Projections by Age Group

Population by Age								
Age Range	Morgan Hill				MHSA			
	2013 Estimate	2018 Projection	Δ	CAGR	2013 Estimate	2018 Projection	Δ	CAGR
0-17	12,757	12,969	212	0.3%	31,860	32,851	991	0.6%
18-64	29,381	30,646	1,265	0.8%	69,951	73,600	3,649	1.0%
65+	5,407	6,799	1,392	4.7%	12,124	15,103	2,979	4.5%
Total	47,545	50,414	2,869	1.2%	113,935	121,554	7,619	1.3%

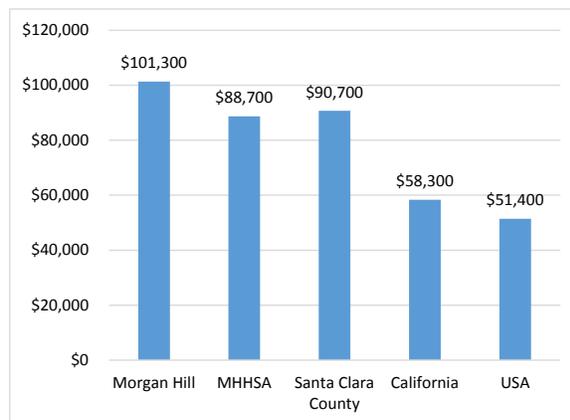
The MHSA had a total population of 113,935 in 2013. This population is projected to grow at an annual rate of 1.3 percent over the next five years a slightly higher rate of growth than is projected for Morgan Hill. A slightly higher percentage of growth in the MHSA is projected to occur in the 0 to 65 age ranges as compared to Morgan Hill; however, nearly 40 percent of the population growth in the MHSA is still projected to occur within the over 65 age range.

Morgan Hill features a relatively affluent populace

Household income levels can significantly impact a market’s need for and ability to support healthcare infrastructure. Less affluent populations often have poorer health levels than more affluent populations, typically leading to higher per capita healthcare utilization levels. As part of this, less affluent populations also tend to have higher levels of uninsured residents and residents covered by public programs such as Medi-Cal, which make lower negotiated payments to providers for healthcare services as compared to payments made by private insurance providers.

The median household income within Morgan Hill exceeds \$100,000 per year and is nearly double the national median of \$51,400. The median household income in the MHSA is approximately \$88,700. While this is still well above the national median, it is nearly \$13,000 below the median for Morgan Hill, indicating that the Gilroy area generally exhibits lower household income levels than Morgan Hill. The impact of household income levels and associated healthcare payer mix will be discussed further within this report.

Figure 5: Median Household Income Comparison



Current Healthcare Utilization and Services

In order to project the future healthcare needs of the Morgan Hill area populace, it is important to understand the existing healthcare environment, including utilization rates, competitive environment, existing local providers and the prevalence of healthcare payer groups such as private insurance, Medicare and Medic-Cal. This section presents characteristics of the existing healthcare market in four key categories as defined below:

- *Inpatient* – Patients whose care requires a stay in a hospital
- *Major Outpatient* – Patients who receive medical treatment without being admitted to a hospital (also referred to as ambulatory care)
- *Emergency Department* – Patients arriving at the hospital in need of immediate care
- *Physicians* – Inventory of primary care physicians and specialists serving the market

Inpatient

Figure 6 summarizes inpatient utilization rates for Morgan Hill and MHSA residents in 2012.¹ Utilization rates are defined as the number of hospital inpatient discharges per 1,000 residents in a one-year period.

Figure 6: Summary of Inpatient Utilization

Age Group	Morgan Hill			MHSA		
	2012 Population	2012 Discharges	Utilization Rate	2012 Population	2012 Discharges	Utilization Rate
<18	12,716	398	31.3	31,666	1,087	34.3
18-64	29,138	1,899	65.2	69,254	4,890	70.6
65+	5,166	1,153	223.2	11,604	2,696	232.3
Total	47,020	3,450	73.4	112,524	8,673	77.1

Note: Excludes the “normal newborns” diagnosis-related group

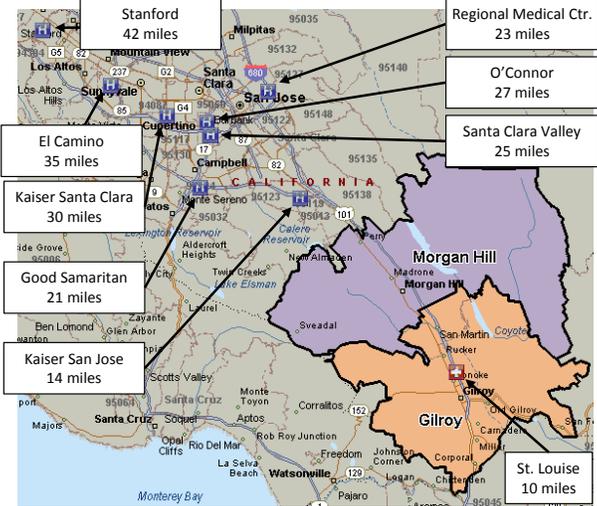
Rates

In 2012, Morgan Hill residents generated 3,450 inpatient discharges (excluding normal newborns), resulting in a utilization rate of 73.4 discharges per 1,000 residents. Utilization rates were significantly higher within the 65 and over age range (223.2 discharges per 1,000 residents), mirroring national trends. Inpatient utilization rates in the MHSA were higher than Morgan Hill utilization rates in each of the specified age ranges. Overall, the MHSA exhibited inpatient utilization rates approximately five percent higher than Morgan Hill.

Several hospitals in the region currently serve Morgan Hill residents. The MHSA is home to SLRH in Gilroy. However, 78 percent of inpatient discharges from Morgan Hill leave the MHSA.

The eight other hospitals illustrated in Figure 7 had at least 100 inpatient discharges originating from Morgan Hill in 2012. As shown, all are located to the northwest of Morgan Hill.

Figure 7: Hospitals Drawing 100+ Inpatient Discharges from



¹ 2012 is the most recent year for which full year data is available from the California Office of Statewide Health Planning and Development (OSHPD)

78 Percent of Morgan Hill Residents Leave the MHSA for Inpatient Service

Figure 8 summarizes inpatient discharges of Morgan Hill residents in 2012 by hospital. As shown, Kaiser Foundation Hospitals (Kaiser) is the market leader for Morgan Hill, capturing 32 percent of inpatient discharges in 2012. Kaiser Permanente functions as both an insurance carrier and healthcare provider. In the South Bay area, Kaiser Foundation Hospitals serve almost exclusively individuals who have insurance coverage through Kaiser Permanente.

Despite its location within the MHSA, SLRH captured just 22 percent of the Morgan Hill market. SLRH lost market share in 2012 after capturing approximately 25% each year from 2009 through 2011.

Good Samaritan Hospital in San Jose ranks third in terms of market share from Morgan Hill, followed by Santa Clara Valley Medical Center (SCVMC). SCVMC is a County-owned facility that serves a disproportionally large share of Medi-Cal and indigent care patients.

Figure 9 presents additional detail related to specific service lines for which Morgan Hill residents are being served within the MHSA at SLRH versus those who are migrating outside of the market for these specific services. As shown, SLRH retained 36 percent of general medicine inpatients originating from Morgan Hill in 2012, the highest of any service line. SLRH also captured at least 20 percent of Morgan Hill inpatients in the areas of cardiac services, neurology, obstetrics, general surgery and ear, nose and throat (ENT) in 2012.

The results of this analysis indicate that a very large majority of Morgan Hill residents are not supporting the local hospital in Gilroy.

Figure 8: Inpatient Discharges by Hospital Morgan Hill Residents - 2012

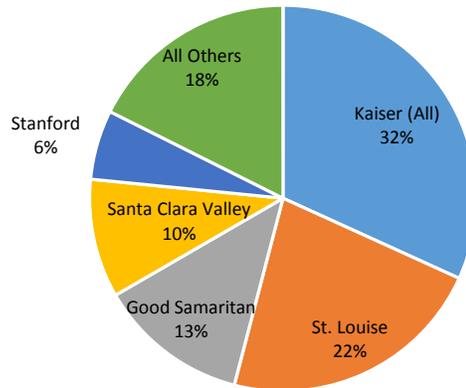


Figure 9: SLRH Market Share by Service Line Morgan Hill Residents - 2012

	2009	2010	2011	2012	Total	Change
General Medicine	42%	38%	38%	36%	38%	-6%
Cardiac Services	29%	29%	26%	26%	27%	-4%
Neurology	23%	16%	28%	23%	23%	0%
Obstetrics	22%	24%	25%	23%	24%	1%
General Surgery	26%	26%	24%	22%	25%	-4%
ENT	10%	7%	13%	21%	12%	10%
Oncology	17%	25%	20%	19%	20%	2%
Vascular Surgery	12%	22%	27%	19%	19%	7%
Gynecology	17%	20%	20%	17%	19%	0%
Spine	14%	13%	16%	14%	14%	0%
Other Trauma	22%	18%	14%	14%	17%	-8%
Orthopedics	24%	25%	26%	13%	22%	-11%
Neonatology	8%	15%	14%	12%	12%	4%
Urology	9%	22%	27%	8%	17%	-1%
Thoracic Surgery	0%	0%	0%	7%	2%	7%
Psychiatry	9%	4%	4%	3%	5%	-5%
Neurosurgery	0%	9%	10%	0%	5%	0%
Ophthalmology	0%	0%	0%	0%	0%	0%
Rehabilitation	0%	0%	0%	0%	0%	0%

Kaiser and Medicare Payer Groups Growing in Flat Market

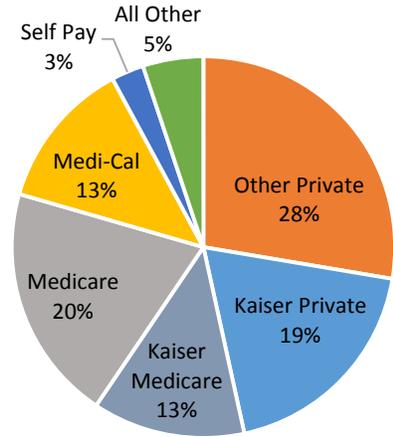
The healthcare payer mix in a market significantly impacts the financial operations of hospitals and other medical services in that market. As noted previously, public programs such as Medi-Cal make lower payments to providers for healthcare services as compared to payments made by private insurance providers. Therefore, a region with a higher proportion of privately insured residents may be better able to financially support hospitals and other medical services. Conversely, hospitals and other healthcare providers located in regions with a higher proportion of public payers may be less financially viable, even with similar utilization levels, unless, like Valley Medical Center, they have other sources of revenue to offset the lower medical payments.

As summarized in figure 10, Kaiser was the payer for 32 percent of inpatient discharges originating from Morgan Hill in 2012, including 19 percent privately covered by Kaiser and 13 percent enrolled in Medicare Advantage through Kaiser. It should be noted that, because the California Office of Statewide Health Planning and Development (OSHPD) does not specify patients for whom Kaiser is the payer, HSA has utilized the number of patient discharges at Kaiser hospitals as a proxy for estimating the number of patients for whom Kaiser serves as payer.

Other private insurers represented 28 percent of the market, resulting a total of 47 percent private payers. Of the remaining patients, the largest payer group was Medicare, which primarily covers patients age 65 and over, followed by Medi-Cal.

Since 2009, the number of patients for whom Kaiser served as payer increased approximately five percent per year, despite overall inpatient growth increasing by just one percent per year over the same period. Medicare also showed growth higher than the market as a whole, growing at a rate of three percent per year.

**Figure 10: Inpatient Discharges by Payer
Morgan Hill Residents - 2012**

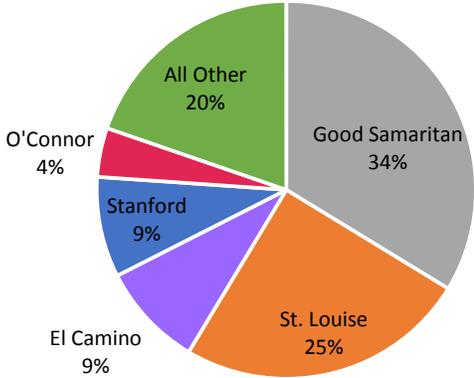


Good Samaritan Captures the Largest Share of Non-Kaiser Private Payer Inpatients

As noted previously, a hospital servicing a higher proportion of patients with private health coverage typically generates higher revenue levels due to the higher payments received from private insurers. Therefore, in assessing the competitive hospital environment in the Morgan Hill region, it is important to understand which hospitals are most successful in capturing market share from the private payers.

Figure 11 summarizes the share of Morgan Hill inpatient discharges captured by area hospitals when only including non-Kaiser, private payer patients. As shown, Good Samaritan is the market share leader among other private payers, capturing 34 percent of the market. SLRH drew a 25 percent market share in 2012 among the important other private payer group.

**Figure 11: Other Private Payer Inpatient Discharges
Morgan Hill Residents - 2012**



Outpatient

Figure 12 summarizes ambulatory surgery (outpatient) utilization rates per 1,000 residents for Morgan Hill and MHHSA residents in 2012. It should be noted that the figures in the table include only ambulatory surgery procedures reported to OSHPD. These figures exclude procedures done at physician-owned ambulatory surgery centers such as the South Bay Surgery Center in Morgan Hill.

Figure 12: Summary of Outpatient Utilization Rates

Age Group	Morgan Hill			MHHSA		
	2012 Population	2012 Patients	Utilization Rate	2012 Population	2012 Patients	Utilization Rate
<18	12,716	206	16.2	31,666	690	21.8
18-64	29,138	1,534	52.6	69,254	3,785	54.7
65+	5,166	771	149.3	11,604	1,758	151.5
Total	47,020	2,511	53.4	112,524	6,233	55.4

In 2012, Morgan Hill residents had 2,511 ambulatory surgery procedures, resulting in a utilization rate of 53.4 discharges per 1,000 residents. Utilization rates were highest among the 65 and over age range (149.3 discharges per 1,000 residents). Inpatient utilization rates in the MHHSA were approximately four percent higher than in Morgan Hill.

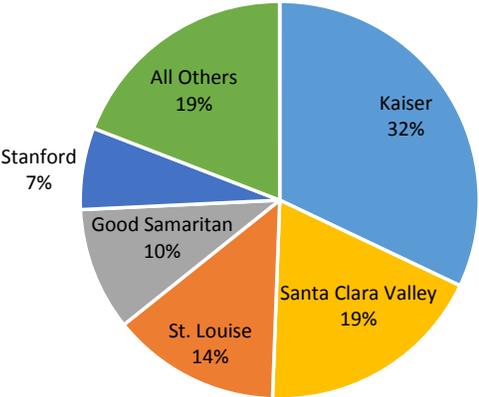
86 Percent of Morgan Hill Residents Leave the MHHSA for Ambulatory Surgeries

Figure 13 summarizes ambulatory surgery procedures for Morgan Hill residents in 2012 by organization. As shown, Kaiser is the market leader for Morgan Hill, capturing 32 percent of ambulatory surgeries in 2012. This is equal to the share of Morgan Hill inpatient discharges captured by Kaiser in 2012.

SCVMC captures nearly 20 percent of the Morgan Hill ambulatory surgery market, representing the second largest market share. The vast majority of these patients (97 percent) are in the Medicare, Medi-Cal self-pay or other/indigent payer groups, with just three percent having private coverage.

SLRH ranks third in ambulatory surgery market share, capturing 14 percent of the Morgan Hill market. In other words, 86 percent of Morgan Hill residents sought ambulatory surgery treatment outside of the MHHSA (excluding those treated at physician-owned surgery centers). This fact, along with the 78 percent of Morgan Hill inpatients who left the MHHSA for service, underscores the extent to which healthcare is currently migrating out of the MHHSA, with the vast majority being captured by organizations in San Jose.

Figure 13: Ambulatory Surgeries by Organization Morgan Hill Residents - 2012



Outpatient Payer Mix is Similar to Inpatient Payer Mix

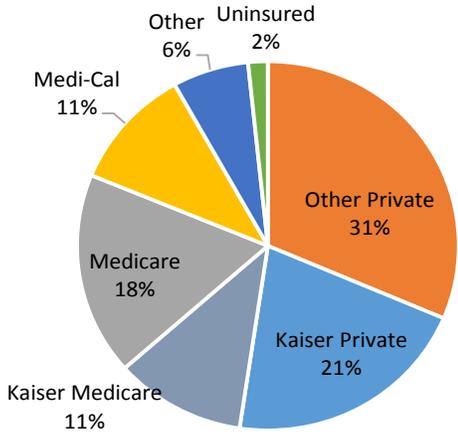
Figure 14 summarizes the payer mix for outpatient procedures among Morgan Hill patients.

Kaiser was the payer for 32 percent of ambulatory surgeries originating from Morgan Hill in 2012, which equals Kaiser’s market share for Morgan Hill inpatients. Kaiser’s share included 21 percent privately covered by Kaiser and 11 percent enrolled in Medicare Advantage through Kaiser, similar to Kaiser’s outpatient payer mix (19 and 13 percent, respectively).

Other private insurers represented 31 percent of the ambulatory market, resulting a total of 52 percent private payers. Non-Kaiser Medicare covered approximately 18 percent of ambulatory procedures, while Medi-Cal was the payer for 11 percent.

Since 2009, Kaiser’s ambulatory surgery payer share has increased by six percent per year despite overall ambulatory procedures decreasing by three percent over the same period.

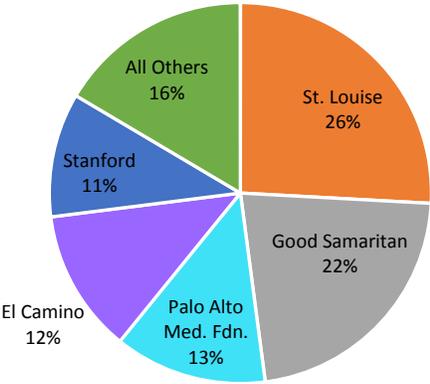
Figure 14: Ambulatory Surgeries by Payer Morgan Hill Residents - 2012



St. Louise Holds a Slight Market Lead for Non-Kaiser Private Payer Ambulatory Patients

Figure 15 summarizes the share of Morgan Hill ambulatory surgeries captured by area organizations when only including non-Kaiser, private payer patients. As shown, SLRH holds a narrow market lead over Good Samaritan (26 percent to 22 percent). Other organizations drawing at least 10 percent of the Morgan Hill ambulatory market include the Palo Alto Medical Foundation, El Camino and Stanford.

Figure 15: Other Private Payer Ambulatory Surgery Market Share - Morgan Hill Residents - 2012



Emergency Department

Due to the nature of emergency department visits, geographic location is typically the primary factor influencing patients’ hospital selection. Inpatient and ambulatory patients are also influenced by geographic proximity, but also place importance on considerations such as perceived quality of care and whether a provider is included in one’s coverage network, whereas most emergency medical responders, paramedics and ambulance crews are required to transport patients to the closest location with available care.

Figure 16: Emergency Department Market Share Morgan Hill Residents - 2012

Hospital	Distance from MH (Miles)	2012 ED Visits	Market Share
St. Louise	10	5,021	50%
Kaiser	14	2,697	27%
Santa Clara Valley	25	910	9%
Good Samaritan	21	672	7%
O'Connor	27	186	2%
All Others	n/a	639	6%
Total		10,125	100%

As summarized Figure 16, SLRH captured approximately half of emergency department visits originating from Morgan Hill in 2012. Given the importance of proximity when choosing an emergency department, it is interesting to note that half of Morgan Hill emergency department patients seek treatment outside of the MHHSA, despite SLRH being the closest emergency room based on driving distance. In general, HSA would expect upwards of two-thirds of the patients using an emergency room to stay in the local market. Removing Kaiser patients, who will be incented to travel to a Kaiser facility for all but the truly emergent cases, SLRH captures slightly more than two-thirds of the remaining market.

Kaiser has gained emergency department market share in recent years. Specifically, the number of emergency department visits originating from Morgan Hill that utilize Kaiser hospital grew by nine percent per year from 2010 through 2012.

Medi-Cal is Payer for a Disproportionate Number of Emergency Department Visits

Figure 17 summarizes the payer mix for emergency department visits originating from Morgan Hill. As shown, approximately 49 percent of emergency department visits are paid privately, including Kaiser at 20 percent and other private payers at 29 percent.

Medi-Cal was the payer for 25 percent of emergency department visits, compared to 13 percent of inpatient discharges and 11 percent of ambulatory procedures. This is indicative of a nationwide trend in which Medicaid patients are more likely to seek treatment at emergency departments rather than with primary care physicians, whose panels are often closed to Medi-Cal patients.

Because hospitals receive higher payments from private payers, it is useful to understand which area hospitals are currently capturing emergency department demand from patients covered by private payers. Figure 18 summarizes the market share among non-Kaiser private payer emergency department visits originating from Morgan Hill in 2012.

As shown, St. Louise captures approximately 64 percent of other private payer emergency department market share. However, it is notable that more than one-third of private payer demand migrates outside of the MHHSA, even when excluding Kaiser patients.

Figure 17: Emergency Dept. Visits by Payer Morgan Hill Residents - 2012

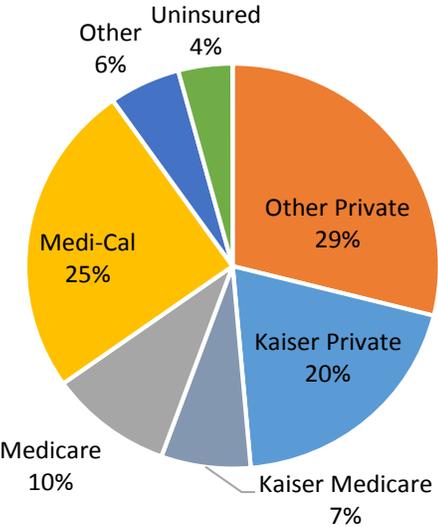
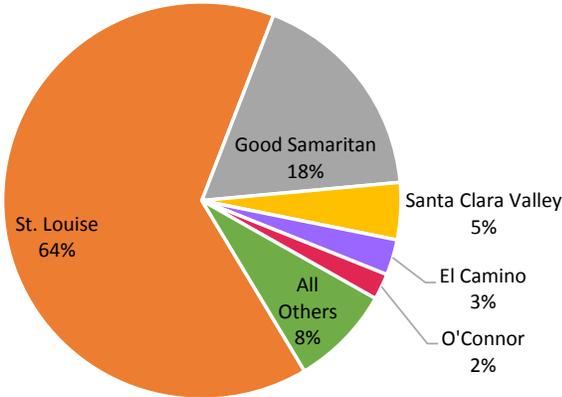


Figure 18: Other Private Payer Emergency Dept. Market Share - Morgan Hill Residents - 2012

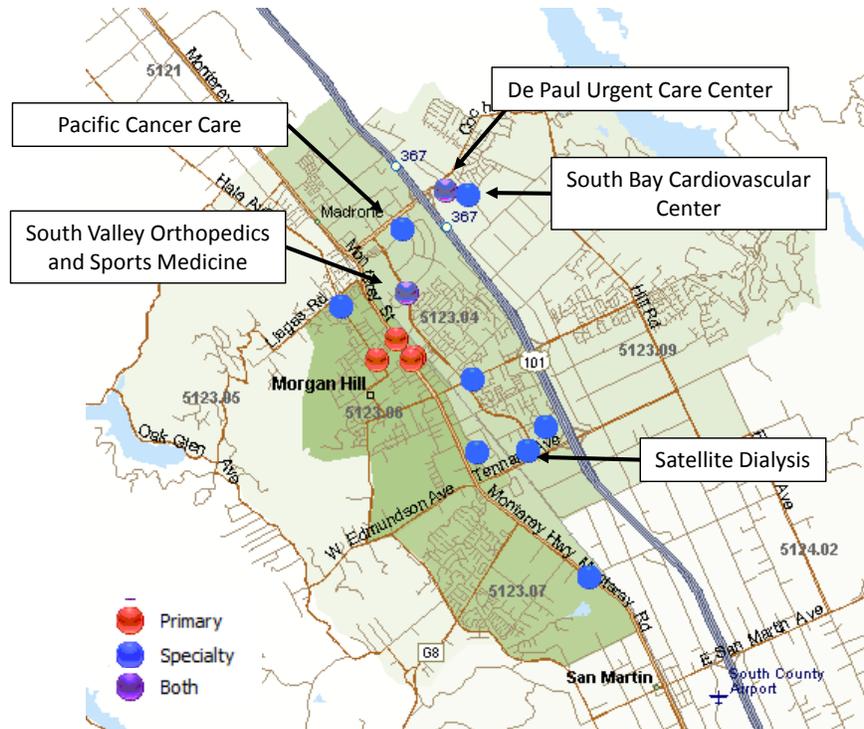


Physicians

The discussion of utilization, market share and payer mix presented to this point has focused on services provided by regional hospitals. However, a complete analysis of healthcare services and needs in Morgan Hill must also consider non-hospital based physicians, including primary care providers, pediatricians and various specialists.

Approximately 43 physicians practice at 14 locations in Morgan Hill. Figure 19 shows the locations of primary care and specialty providers in Morgan Hill. Locations with four or more physicians have been identified by name in the map.

Figure 19: Map of Existing Morgan Hill Healthcare Providers



It should be noted that some of the providers practicing at the locations identified in the previous map are based in Morgan Hill full-time, while others divide their time between Morgan Hill and office locations in other cities. When specialists have multiple offices, HSA has adjusted our analysis to include only the portion of their time spent seeing patients in Morgan Hill.

Morgan Hill has a Shortage of Primary Care Providers

A population-based need assessment was completed to identify areas in which the healthcare needs of Morgan Hill residents are adequately met by existing local providers versus areas in which additional physicians may be needed to provide services to local residents. The analysis is based on planning metrics developed by HSA that estimate the number of primary care providers, pediatricians and specialists needed to serve a population of a given size. These planning ratios are proprietary and are based on HSA's experience in markets nationwide. Figure 20 presents a summary of the population based physician need assessment for Morgan Hill.

The results of the population based need assessment indicate that Morgan Hill is home to several specialty providers that largely meet the estimated need for specialty care among Morgan Hill residents.

However, Morgan Hill is home to relatively few primary care physicians. Specifically, Morgan Hill currently has a shortage of approximately 22 adult primary care providers and two pediatrics providers.

Additional demand resulting from this significant shortage of adult primary care physicians is likely being filled by a combination of non-local physicians and increased emergency department and urgent care volumes.

Figure 20: Summary of Population-Based Physician Need Assessment for Morgan Hill

 HEALTH SYSTEM ADVISORS	Provider Need Ratios		2015 Population Need and Supply			
	HSA Planning Metric	FTEs per 100,000	2015 Population	2015 Need	2015 Supply	2015 (Shortage) /Surplus
Physician Type						
Primary Care						
Adult Primary Care Providers *	1,634	61.2	48,642	29.8	7.8	(22.0)
Pediatrics Providers *	8,250	12.1	48,642	5.9	4.0	(1.9)
Primary Care Total	1,364	73.3	48,642	35.7	11.8	(23.9)
Medical Specialties						
Allergy & Immunology	70,000	1.4	48,642	0.7	-	(0.7)
Cardiology	25,000	4.0	48,642	1.9	2.0	0.1
Dermatology	35,000	2.9	48,642	1.4	1.5	0.1
Endocrinology	100,000	1.0	48,642	0.5	1.0	0.5
Gastroenterology	30,000	3.3	48,642	1.6	-	(1.6)
Hematology/Oncology	45,000	2.2	48,642	1.1	3.5	2.4
Infectious Disease	125,000	0.8	48,642	0.4	0.5	0.1
Maternal Fetal Medicine	100,000	1.0	48,642	0.5	-	(0.5)
Neonatology	100,000	1.0	48,642	0.5	-	(0.5)
Nephrology	65,000	1.5	48,642	0.7	1.5	0.8
Neurology	50,000	2.0	48,642	1.0	0.5	(0.5)
OB/GYN	9,000	11.1	48,642	5.4	2.5	(2.9)
Physical Med & Rehab	35,000	2.9	48,642	1.4	-	(1.4)
Psychiatry	25,000	4.0	48,642	1.9	2.5	0.6
Pulmonology	65,000	1.5	48,642	0.7	1.0	0.3
Radiation Oncology	125,000	0.8	48,642	0.4	1.5	1.1
Rheumatology	100,000	1.0	48,642	0.5	-	(0.5)
Medical Specialties Subtotal	2,354	42.5	48,642	20.7	18.0	(2.7)
Surgical Specialties						
Cardiovascular Surgery	100,000	1.0	48,642	0.5	-	(0.5)
ColoRectal Surgery	250,000	0.4	48,642	0.2	-	(0.2)
General Surgery	27,500	3.6	48,642	1.8	1.3	(0.4)
Neurosurgery	75,000	1.3	48,642	0.6	0.5	(0.1)
Ophthalmology	25,000	4.0	48,642	1.9	-	(1.9)
Orthopedic Surgery	18,000	5.6	48,642	2.7	3.0	0.3
Otolaryngology	40,000	2.5	48,642	1.2	0.1	(1.1)
Plastic/Reconst. Surgery	100,000	1.0	48,642	0.5	-	(0.5)
Urology	35,000	2.9	48,642	1.4	1.0	(0.4)
Vascular Surgery	80,000	1.3	48,642	0.6	0.5	(0.1)
Surgical Specialties Subtotal	4,249	23.5	48,642	11.4	6.4	(5.0)
Total Provider Need	718	139.3	48,642	67.8	36.2	(31.6)

* Includes patient-facing non-physician providers

Hospital Scenarios

In addition to existing healthcare utilization and services in Morgan Hill, an evaluation of the future healthcare needs of area residents must consider the potential impact the impending sale of the 93-bed SLRH in Gilroy could have on the populations in and around Morgan Hill. HSA evaluated four major scenarios related to a potential SLRH sale on the basis of their impact on the healthcare service for the residents of Morgan Hill. The four scenarios considered include:

- Scenario 1: SLRH is purchased by Kaiser
- Scenario 2: SLRH is purchased by Santa Clara Valley Medical Center
- Scenario 3: SLRH is purchased by a for-profit operator
- Scenario 4: SLRH is purchased by another non-profit operator

It is also important to understand that “California law requires Attorney General’s review and consent for any sale or transfer of a healthcare facility owned or operated by a non-profit corporation. The Attorney General’s decision often requires the continuation of existing service levels of charity care, continued operation of emergency rooms and other essential services, and other actions necessary to avoid adverse effects on healthcare in the local community.”²

Scenario 1: SLRH is purchased by Kaiser

Under Scenario 1, in which SLRH is purchased by Kaiser, the SLRH campus would presumably be used to provide services to Kaiser Foundation Health Plan members located in areas south of the existing Kaiser hospital in San Jose. However, based on our understanding of Kaiser’s operating model, there are several data pieces that suggest they would be unwilling to continue inpatient services at the SLRH campus, two of which are significant:

1. In the MHSA, Kaiser would need to operate very few beds for their plan members and well below Kaiser’s typical minimum scale and even below the minimum future prototype hospital scale of 100 beds that was investigated in a national competition several years back.
2. Kaiser already has the closest access for members of Morgan Hill with their hospital in south San Jose, located 14 miles from Morgan Hill (compared to SLRH being 10 miles from Morgan Hill).

Additionally, a Kaiser-operated SLRH could potentially limit healthcare options for non-Kaiser populations in the area as it would be anticipated that Kaiser would continue to run a mostly closed system. With that being said, operating SLRH as a Kaiser facility could provide opportunities in Morgan Hill for providers who are not affiliated with Kaiser.

Scenario 2: SLRH is purchased by Santa Clara Valley Medical Center

SCVMC currently serves a relatively large share of Medi-Cal, uninsured and indigent patient populations, operating as a “safety net” hospital for patients who may be turned away from many other healthcare facilities. A purchase of SLRH by SCVMC would potentially allow SCVMC to extend this mission to residents located in southern Santa Clara County, including some who may lack transportation access to the primary SCVMC location in San Jose. Additionally, SCVMC, as the safety net hospital, has alternative funding options that may make healthcare operations more viable with the Medi-Cal and self-pay populations.

Currently SCVMC focuses their access on underserved patients and those on Medi-Cal. As a result, the organization does not focus on serving privately insured patients as much as other health systems. If this stance continues with

² Source: Official website of the California Office of the Attorney General (oag.ca.gov)

an acquisition of SLRH, the portion of Morgan Hill residents that are privately insured may find access to the SCVMC systems of care no better and potentially worse than today. With the focus on underserved populations, it is unlikely a SCVMC owned SLRH facility would support the number of beds to be efficient compared to the regional center in San Jose.

Scenario 3: SLRH is purchased by a for-profit operator

SLRH has struggled financially in recent years, which is one of the drivers behind DCHS’s intention to sell the facility. In order for a new owner to operate SLRH for profit, significant changes would likely need to be made to the facility’s operations and a large increase in market capture would be required. To achieve these changes, major disruption to the staffing, programmatic, and payer contracts would likely result. Moreover, even with a 50 percent increase in market share, the macro economic trends in healthcare do not bode well for long-term inpatient services at SLRH. So, while a new for-profit operator may offer new services not currently being provided in the market, there is also the possibility that potential operating cost cutting measures could negatively impact healthcare services in the Morgan Hill area.

Scenario 4: SLRH is purchased by another non-profit operator

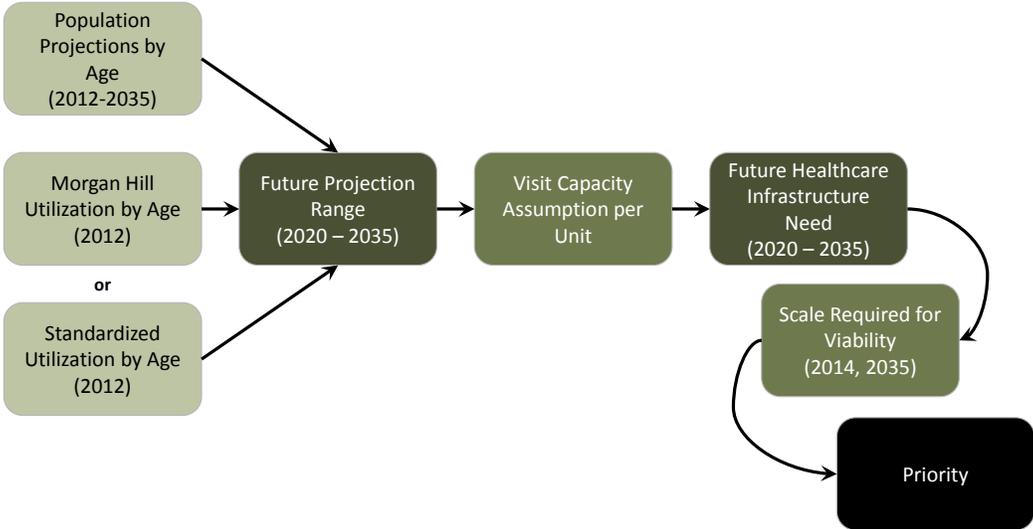
In the event that another non-profit entity purchases SLRH, it is unlikely that the facility would continue to be operated in a similar manner to the status quo. Currently operating at a huge loss, another non-profit operator would need to make similar changes as a for-profit operator. We do not initially believe those changes can happen fast enough to maintain an inpatient capability at SLRH without significant subsidy from a parent company.

Similar to a scenario in which SLRH is purchased by a for-profit company, the non-profit scenario could result in the offering of new services, potential operating cost cutting measures could have a negative impact on regional healthcare services.

Future Healthcare Need Projections

Future projections regarding healthcare utilization in Morgan Hill were developed for each of several key service categories. When possible, current and historical Morgan Hill resident utilization data were used as the baseline from which future projections were developed. Where Morgan Hill metrics are not available, standardized utilization rates for California, the West Coast region or the U.S. as a whole were applied to the Morgan Hill future

Figure 21: Future Need Projection Process



population.

The projected utilization rates were applied to projected population figures for the years 2020 through 2035. The population projections were based on current population by age group in Morgan Hill, future population projections provided by the City, and projected future population by age data provided by Santa Clara County.

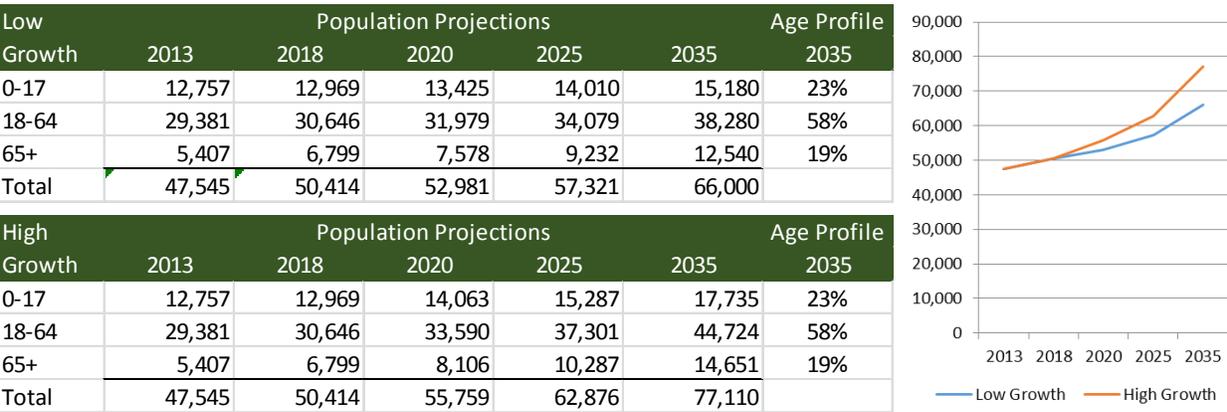
Applying the projected utilization rates to the projected population levels resulted in estimates of total annual utilization of healthcare services by Morgan Hill residents. By making assumptions regarding the typical utilization capacity of specific types of healthcare infrastructure (i.e.: hospitals, ambulatory surgery centers, emergency rooms, urgent care centers, etc.), estimates were developed regarding the square footage and/or acreage required to service the projected future utilization needs. The highest priority needs were then identified based on the scale required for viability among the various healthcare services and facilities considered.

Population Projections

The population figures used as a baseline to estimate future population levels 2014 population estimates provided for area zip codes by AC Nielsen. Future projections were based on the Morgan Hill population projections developed by the City for the 2035 General Plan update, which estimate the City’s population ranging from 60,000 to 70,100 by 2035. An adjustment was made to the 2035 projections to account for areas within the subject zip codes that are outside of the City limits and therefore were not included in the City’s projections. This resulted in total population projections of 66,000 to 77,110 in 2035.

Because healthcare utilization varies with age, changes to the age characteristics of the local populace were also projected. Based on 2014 population by age data for Morgan Hill provided by AC Nielsen and estimated 2035 population by age data for Santa Clara County provided by the County, the population projections were stratified into three primary age categories: 0 to 17, 18 to 64 and 65+. Figure 22 summarizes the population projections utilized for this analysis.

Figure 22: Population Projections



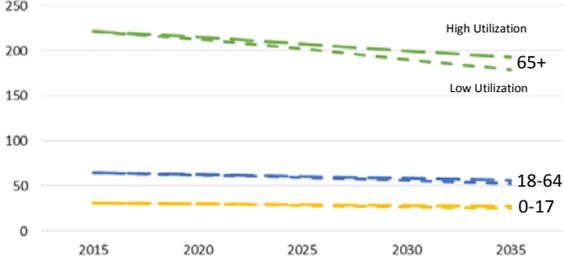
Hospital Bed Need

In order to estimate the number of hospital beds needed to service the Morgan Hill population, three primary factors were considered.

1. Use of inpatient services by the population

Inpatient utilization levels vary by age, with older populations exhibiting higher utilization rates. Overall, inpatient utilization rates have been decreasing for decades as technology, finances, and medical advances have moved services from the inpatient to the outpatient setting. Figure 23 summarizes the projected inpatient utilization rates per 1,000 for Morgan Hill residents through 2035, and illustrates the anticipated continued decline in utilization rates.

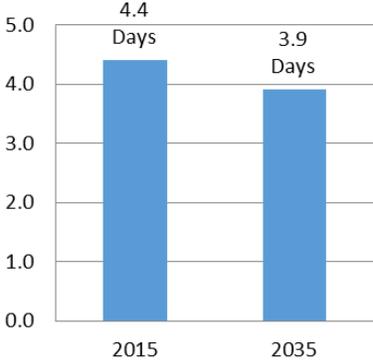
Figure 23: Projected Inpatient Utilization per 1,000 Population



2. Average length of hospital stay

The average length of stay for hospital patients has also been declining as finances and medical advances allow faster recovery times. This trend reduces hospital demand over time, as fewer beds are needed to service the same number of inpatients. As summarized in Figure 24, HSA projects inpatient length of stay for inpatients from Morgan Hill to decline from 4.4 days today to 3.9 days by 2035.

Figure 24: Projected Average Length of Hospital Stay

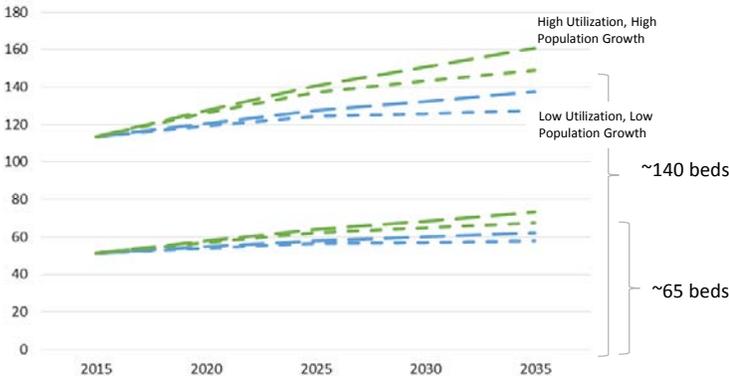


3. Average occupancy at which a hospital can typically function

Typically a hospital is at operational capacity if the average daily census reaches 85 percent occupancy. Therefore, an 85 percent occupancy rate has been assumed when estimating the future need for hospital beds.

Combining the population projections with the other factors to project hospital bed needs for the market suggests that approximately 65 hospital beds will be required to meet the needs of Morgan Hill residents in 2035, while approximately 140 beds will be needed to serve the extended Morgan Hill Hospital Service Area (MHSA) will need by 2035. These projections are summarized in Figure 25.

Figure 25: Projected Hospital Beds Needed



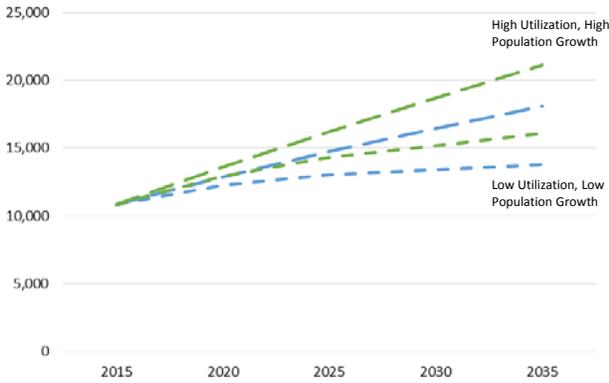
It is important to note that this does not imply that a 65-bed or 140-bed hospital in Morgan Hill will be supportable in 2035. A local hospital would capture only a percentage of the total need as it would not reasonably capture the tertiary and pediatric cases, patients whose healthcare coverage is through Kaiser, and some percentage of competitors' cases.

Without the presence of Kaiser, a successful community hospital might be expected to capture 65 percent of the market, which would equate to approximately 91 beds for the MHSA. With Kaiser capturing 32 percent of the market, a hospital in Morgan Hill is likely to be unable to capture more than 35 to 40 percent of the market, resulting in 45 to 64 inpatient beds being needed for the residents of the MHSA. Additional volume may come from outside the MHSA however, we anticipate that this volume would comprise less than 15 percent of the total volume of a Morgan Hill hospital and thus not change the outcome of the analysis significantly.

Emergency Room Need

Projections of emergency room need were developed to assess the potential viability of a stand-alone emergency room in Morgan Hill under scenarios in which SLRH does or does not continue to operate an emergency room in the future. While free-standing emergency rooms are effectively prohibited in California today, the growth of this access model for populations without a local hospital in other parts of the country is such that over a 20-year horizon, California regulations might change to make a free-standing ER more available.

Figure 26: Projected Annual Emergency Room Visits



Based on current and projected future population and ER utilization rates, projections of annual emergency room visits originating from Morgan Hill were projected, as summarized in Figure 26. As shown, Morgan Hill residents are estimated to generate 14,000 to 21,000 ER visits in 2035.

A free-standing ER in Morgan Hill would not capture all of this demand due to factors such as competition and the limitations associated with free-standing ER's. Free-standing ER's have a different capability than full service ER's and typically treat only level 3, 4, and 5 ER patients (levels 1 and 2 represent higher degrees of trauma requiring a level of care typically only provided at ER's attached to hospitals). As summarized in Figure 27, levels 3, 4 and 5 typically represent approximately 85 percent of ER cases.

Figure 27: Typical ER Case Mix

Typical Mix	Hospital ER	Free-Standing
Level 1	5%	0%
Level 2	10%	0%
Level 3	43%	34%
Level 4	33%	52%
Level 5	9%	14%

It is estimated that a free-standing ER in Morgan Hill could garner as much as 33 percent of the level 3 cases and upwards of 67 percent of the level 4 and 5 cases originating from Morgan Hill. It is estimated that a free standing ER in Morgan Hill could generate approximately 7,200 annual visits. Additional volumes would be expected if St. Louise Regional Hospital or DePaul Urgent Care close.

Ambulatory Surgery Center Need

Future ambulatory surgery needs for the residents of Morgan Hill were estimated based on projected future utilization rates. The utilization rate projections used historical data from OSHPD as a baseline, with adjustments made to include physician-owned surgery centers not reporting to OSHPD. Figure 28 summarizes the projected annual ambulatory surgery demand originating from Morgan Hill.

In order to assess the viability of an ambulatory surgery facility in Morgan Hill, it was assumed that such a facility could potentially draw 25 percent of its patients from outside of Morgan Hill, resulting in an upward adjustment to the projections presented in Figure 28. However, it was further estimated that the maximum market share for an ambulatory surgery center in Morgan Hill would approximate 50 percent given the presence of Kaiser and other competitors outside of the market.

It was further estimated that the annual capacity per procedure room would range from 1,200 to 1,400 procedures per room per year, with a 67 percent utilization rate needed for financial viability. Based on these assumptions, by 2035 there is projected support for an ambulatory surgery center with six to seven procedure rooms, which exceeds the typical scale needed for financial viability (4+ rooms depending on the mix of specialties).

Imaging Center Need

Medical imaging is typically distributed to physician offices for basic imaging (x-ray, ultrasound, bone densitometry, etc.) and often consolidated for types of imaging that require larger investments in equipment (MRI, CT, nuclear medicine, etc.). De Paul Urgent Care Center offers radiology services (x-ray), but Morgan Hill lacks more sophisticated imaging capabilities such as MRI, CT and nuclear medicine.

In recent years, there has been a trend toward higher utilization of MRI and slower growth in utilization of CT, due in part to potentially harmful levels of radiation associated with CT scans, particularly in pediatric patients. Nuclear medicine utilization rates have experienced recent declines. In projecting imaging utilization for Morgan Hill residents in future years, it was assumed that the utilization rates per 1,000 residents for MRI will continue to increase over time, while CT utilization rates will decline among pediatric patients and experience slowing growth among adult patients.

Figure 28: Ambulatory Surgery Projections

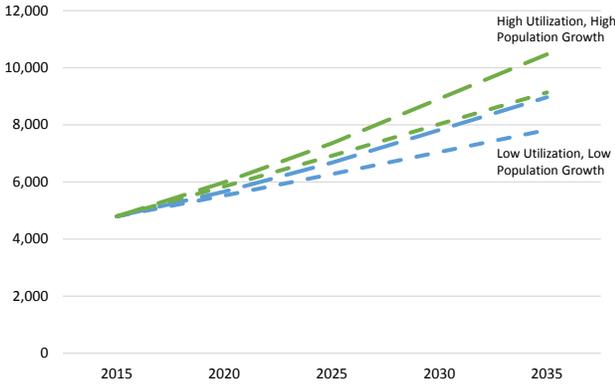
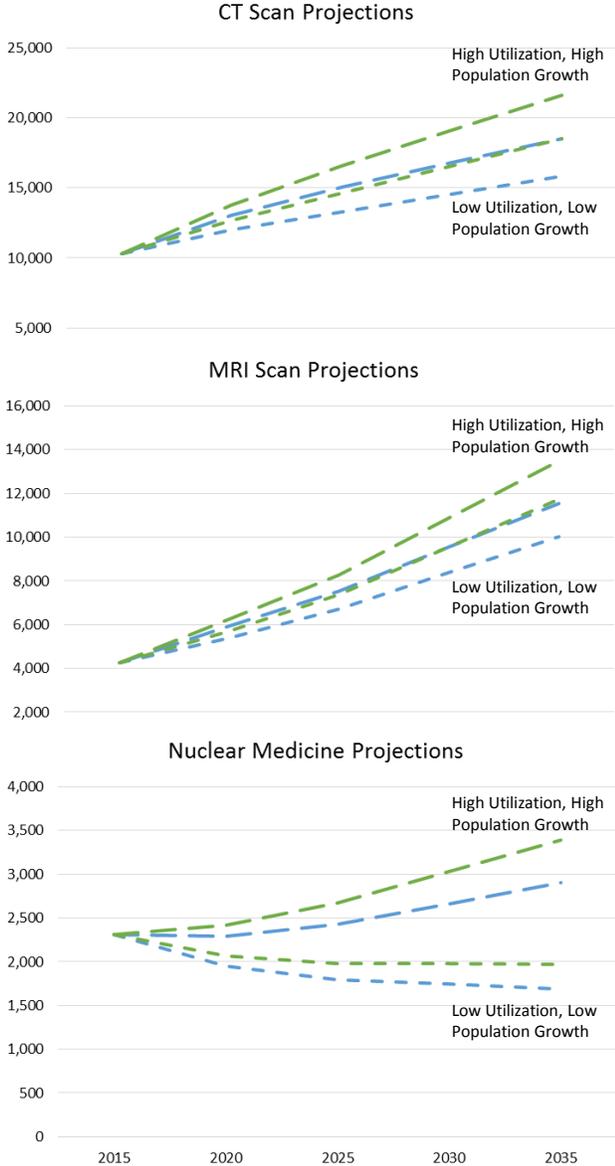


Figure 29: Imaging Projections



Nuclear medicine utilization rates per 1,000 are anticipated to continue to decline.

Based on the anticipated changes in utilization rates and overall population levels, Figure 29 summarizes projected future imaging needs for Morgan Hill residents.

In assessing the viability of an imaging center in Morgan Hill, it has been assumed that 40 percent of this volume will remain in the market. Further, the following assumptions have been used regarding annual capacity of each type of imaging facility:

- CT: 6,000 cases/year outpatient
- MRI: 3,200 cases/year outpatient
- Nuclear Med: 2,500 cases/year outpatient

Typically, financial viability for an imaging center can be reached at less than half capacity. Based on these estimates and assumption, there is projected to be support for one to two CT, one to two MRI and slightly less than 1 nuclear medicine camera in Morgan Hill by 2035.

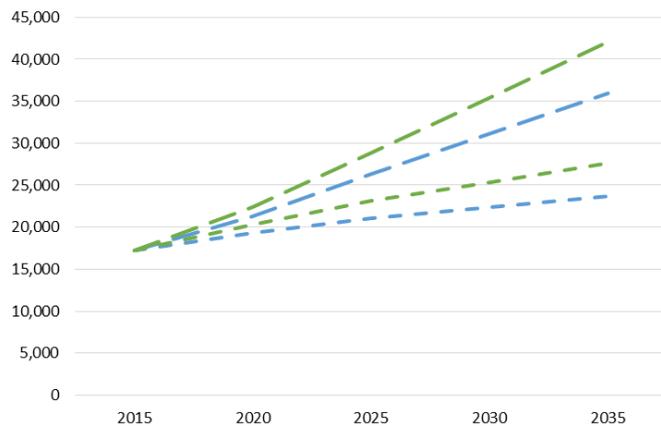
Urgent Care Need

Urgent care centers have been growing nationally six to eight percent annually for over two decades. The DePaul Urgent Care Center is reportedly busy and actively growing, suggesting support for urgent care in the Morgan Hill market.

Urgent care often substitutes for low acuity emergency room and primary care visits. The limited emergency room and primary care access in Morgan Hill will tend to inflate the use of urgent care

Urgent care utilization rates per 1,000 residents are anticipated to continue to grow over the next 20 years, although the rate of growth is projected to moderate over time. Based on projected increases in population and utilization per 1,000, Figure 30 summarizes the projected annual urgent care visits originating from Morgan Hill.

Figure 30: Urgent Care Visit Projections



It is assumed that substantially all of the urgent care demand originating from Morgan Hill will stay in the market, with the exception of patients covered by Kaiser (40 percent of visits), who are likely to seek care at a Kaiser facility. It is further assumed that 50 percent of the urgent care demand will be cared for through primary care offices or emergency rooms. Given that the minimum volume needed for financial viability for an urgent care is 5,000 cases annually, there is projected to be support for slightly less than two non-Kaiser urgent care centers in Morgan Hill by 2035.

Physician Need

As summarized in Figure 20 presented previously in this report, population-based physician need modeling shows a clear need for additional primary care providers in Morgan Hill.

While the need for specialists in Morgan Hill is less pronounced due to the relatively strong inventory of existing specialists in the market, certain specialties that are not offered locally could potentially be supported, particularly those that are less dependent on hospital resources. Additional specialties with a heavy ambulatory focus that can be supported in Morgan Hill today include gastrointestinal (GI), physical therapy and ophthalmology.

Most specialists are not in solo practices; as a result, having one physician at a stand-alone facility is unlikely. Instead, larger groups might develop a clinic in the community and rotate providers from San Jose.

It is conceivable that by 2035 substantially all the current physicians will be retired. Given this physician turnover and the anticipated growth in population over the next 20 years, the data suggests additional primary care providers and multiple ambulatory specialties could be supported in Morgan Hill with and without Kaiser patients, as summarized in Figure 31.

Additionally, for some specialties, having a location to see clinic visits with supporting diagnostics and procedural spaces could make Morgan Hill more attractive than Gilroy even though Gilroy has a hospital today.

By 2035, there is projected to be support for nearly 100 full-time physicians in Morgan Hill (including Kaiser physicians) including 46 primary care providers, as well as specialists in the areas of cardiology, dermatology, GI, oncology, physical therapy, psychiatry, general surgery, ophthalmology, orthopedic surgery, ENT, and urology.

In addition, there is projected to be partial support suggesting the potential to rotate specialists to the community in multiple other specialties.

Figure 31: Summary of Population-Based Physician Need Assessment for Morgan Hill – Projected 2035

HEALTH SYSTEM ADVISORS	Provider Need Ratios		2035 Population Need		
	HSA Planning Metric	FTEs per 100,000	2035 Population	2035 Need	2035 Need w/o Kaiser
Physician Type					
Primary Care					
Adult Primary Care Providers *	1,634	61.2	77,100	36.7	22.0
Pediatrics Providers *	8,250	12.1	77,100	9.3	5.6
Primary Care Total	1,364	73.3	77,100	46.1	27.6
Medical Specialties					
Allergy & Immunology	70,000	1.4	77,100	1.1	0.7
Cardiology	25,000	4.0	77,100	3.1	1.9
Dermatology	35,000	2.9	77,100	2.2	1.3
Endocrinology	100,000	1.0	77,100	0.8	0.5
Gastroenterology	30,000	3.3	77,100	2.6	1.5
Hematology/Oncology	45,000	2.2	77,100	1.7	1.0
Infectious Disease	125,000	0.8	77,100	0.6	0.4
Maternal Fetal Medicine	100,000	1.0	77,100	0.8	0.5
Neonatology	100,000	1.0	77,100	0.8	0.5
Nephrology	65,000	1.5	77,100	1.2	0.7
Neurology	50,000	2.0	77,100	1.5	0.9
OB/GYN	9,000	11.1	77,100	8.6	5.1
Physical Med & Rehab	35,000	2.9	77,100	2.2	1.3
Psychiatry	25,000	4.0	77,100	3.1	1.9
Pulmonology	65,000	1.5	77,100	1.2	0.7
Radiation Oncology	125,000	0.8	77,100	0.6	0.4
Rheumatology	100,000	1.0	77,100	0.8	0.5
Medical Specialties Subtotal	2,354	42.5	77,100	32.8	19.7
Surgical Specialties					
Cardiovascular Surgery	100,000	1.0	77,100	0.8	0.5
ColoRectal Surgery	250,000	0.4	77,100	0.3	0.2
General Surgery	27,500	3.6	77,100	2.8	1.7
Neurosurgery	75,000	1.3	77,100	1.0	0.6
Ophthalmology	25,000	4.0	77,100	3.1	1.9
Orthopedic Surgery	18,000	5.6	77,100	4.3	2.6
Otolaryngology	40,000	2.5	77,100	1.9	1.2
Plastic/Reconst. Surgery	100,000	1.0	77,100	0.8	0.5
Urology	35,000	2.9	77,100	2.2	1.3
Vascular Surgery	80,000	1.3	77,100	1.0	0.6
Surgical Specialties Subtotal	4,249	23.5	77,100	18.1	10.9
Total Provider Need	718	139.3	77,100	97.0	58.2

Healthcare Infrastructure Needs

The previous section of this report detailed the projected need for healthcare services for Morgan Hill residents through 2035. As the City moves forward with the development of the 2035 General Plan, it will be important to reserve sufficient land and use appropriate zoning to ensure that the infrastructure required to provide healthcare services can be accommodated as the City continues to grow. This section presents recommended priorities for healthcare infrastructure development in Morgan Hill and provides guidelines as to the space and land that may be required to accommodate that development.

Recommended Priorities

Based on the projected future demand for healthcare services from Morgan Hill residents, the estimated utilization levels that demand could support, the level of existing and competing services in the region, and the financial operating characteristics of various specific healthcare facilities and providers, recommendations were developed regarding prioritization of future healthcare infrastructure development in Morgan Hill. Since a significant percentage of Morgan Hill residents are served by Kaiser, HSA has subdivided its recommended priorities into “Kaiser” and “non-Kaiser”. Even with this distinction, the priorities remain the same for both provider categories as detailed in Figure 31 on the previous page. Figure 32 summarizes these priority recommendations.

Figure 32: Recommended Healthcare Infrastructure Priorities

Healthcare Component	Projected Need	Priority	Comment	2035 Est. MH Encounters*	
				Kaiser	Non-Kaiser
Hospital	Not viable	Very Low	Without closure of SLRH and an alternative funding source beyond healthcare services, a Morgan Hill hospital is not likely to be financially viable	1,350	2,000
Free-Standing ER	Not viable	Very Low	While financially viable, particularly for a competing San Jose system, California regulation makes free-standing ERs not viable today	n/a	7,200
Specialty Care	Selected viable	Varies by Specialty	Additional growth in selected specialties and outreach clinics from a San Jose system	65,000	130,000
Ambulatory Surgery	Viable	High	The market supports at least one 4+ suite procedure centers located in Morgan Hill without Kaiser volume	3,000	4,500
Imaging Center	Viable	Very High	The market readily supports cross-sectional imaging suggesting a full imaging center could be developed in Morgan Hill without Kaiser volume	22,000	35,000
Urgent Care	Viable	Very High	The market readily support 1 urgent care center today, with a 2 nd urgent care center supported as the market grows without including Kaiser volume	6,000	9,500
Primary Care	Viable	Very High	Shortage of primary care providers today, particularly Kaiser providers which are all in San Jose or Gilroy	80,000	120,000

* Projected number of visits made by Morgan Hill residents to each health care component

A hospital in Morgan Hill is not likely viable, for several reasons:

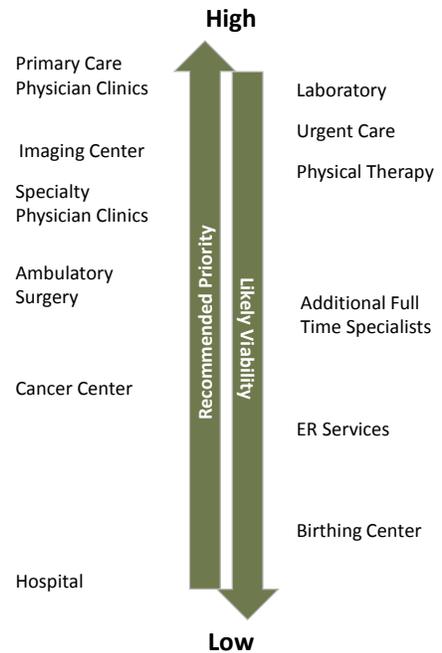
- The future projected healthcare financial environment, which is likely to include continued downward pressures on payment for medical services, particularly as the aging population results in an increasing percentage of patients covered by Medicare.
- The large presence of Kaiser in the market splits the private payer market, leaving a non-Kaiser affiliated hospital to draw from a smaller pool of the more profitable private payer patients.

- A large portion of the Morgan Hill market is not using the local hospital (SLRH) today. Many of these residents will continue to use hospitals in San Jose regardless of whether a hospital exists in Morgan Hill due to factors such as existing relationships with providers in those locations and a potential perception of higher quality care at San Jose hospitals.
- The current and projected future population does not warrant demand for enough hospital beds to create an efficient scale. A hospital of the appropriate size to serve the Morgan Hill market would be too small to compete financially with the larger hospitals in San Jose.

Instead, as summarized in Figure 33, Morgan Hill should focus its efforts on maintaining, attracting, and building a vibrant ambulatory healthcare community, including increasing the number of primary care providers (including Kaiser and non-Kaiser providers), as well as services such as laboratory, imaging and physical therapy. Continued emphasis should also be placed on enhancing the existing urgent care and specialty physician services in Morgan Hill.

In the short term, a free-standing emergency room is not considered to be a high priority. While providing Morgan Hill residents with convenient, fast access to emergency services is highly important, this need is currently being met adequately by SLRH and various San Jose hospitals. Further, the State statutes restricting free-standing ER's are out of the City's direct control. In the event that SLRH ceases operations of an ER and/or the State enacts legislation to ease the restrictions on free-standing ER's, providing ER services in Morgan Hill would become a higher priority.

Figure 32: Recommended Priorities Summary



Space and Land Implications

As the City considers the size and types of spaces and sites that will be needed to accommodate healthcare infrastructure needs in the future, it is important to consider trends in healthcare infrastructure development. Healthcare is continuing to consolidate in order to realize scale economies. Small private practice physician groups are rapidly disappearing and small hospitals are consolidating. Ambulatory sites are requiring greater scale to be financially viable and support multi-disciplinary care models. Overall, the trend is fewer larger sites.

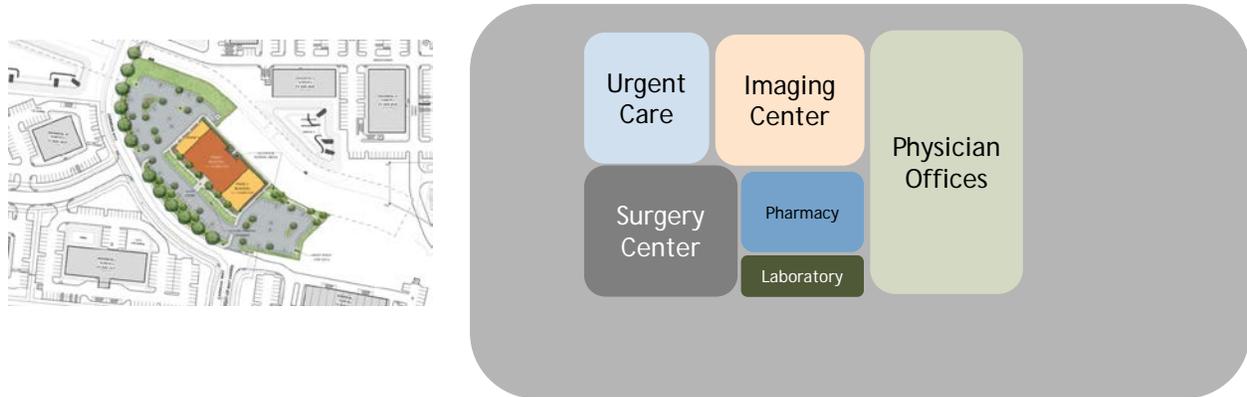
Pulling together healthcare infrastructure that can likely be supported by the Morgan Hill market suggests an ambulatory destination center offering:

- Urgent care
- Imaging center
- Physician offices
- Rotating specialty clinics
- Potentially ambulatory surgery

While it is beneficial to co-locate several of these services in one or two locations, not all healthcare infrastructure will likely be consolidated. Private physician offices will benefit from consolidation but only to a point, while Kaiser and community physicians will not likely co-locate on the same site.

Figure 34 presents a conceptual plan illustrating how several of these services may be provided in a consolidated location. The layout is not necessarily presented to scale, but is intended to illustrate the multi-service healthcare center concept.

Figure 33: Multi-Service Healthcare Center Conceptual Layout



A major ambulatory facility could range from 35,000 to 55,000+ square feet and would potentially require five to ten acres for a multi-story building. The site scale would depend on the density of the development and the provision of space for future expansion.

Site Selection Criteria

As consumer expectations for service and convenience rise, site selection is taking on increasing importance for the success of healthcare facilities. Moreover, the importance of site selection increases for ambulatory services as is being recommended for the City of Morgan Hill. Typically, site selection includes three primary criteria: market desirability, site desirability and ease of implementation.

Market Desirability

Market desirability focuses on the underlying market support (population, utilization, competitors, physician structure) for healthcare expansion and is paired with the organization's strategic intent. In this case, the City of Morgan Hill cannot significantly impact the market desirability. Nevertheless, in virtually all cases, the City of Morgan Hill will be judged as highly desirable. As discussed previously, the payer mix, population growth, and lack of significant established competition makes the City of Morgan Hill a desirable market for healthcare systems to target.

Site Desirability

Site desirability is focused typically on three primary elements:

1. Visibility – Ability to easily see the facility and associated signage from major regional travel corridors
2. Accessibility – Fast, convenient access for local residents and patients traveling from both inside and outside of the local area with limited congestion and hassle
3. Space – Availability of land to accommodate current and future facility needs

Ease of Implementation

Ease of implementation is largely dependent on two elements, constructability and timing, as described below:

1. Constructability: the city/zoning requirements that help/hinder rapid, flexible construction. This often includes options for vertical or horizontal adjacencies; parking, setbacks, façade, and signage limitations/requirements; and expansion zones to accommodate future changes.
2. Timing: how quickly the process can be moved through various regulatory reviews.

The City of Morgan Hill can heavily influence the ease of implementation criteria by streamlining the zoning and construction approval processes. Moreover, it can support the site desirability criteria by ensuring several highly accessible, visible sites of appropriate size are available for healthcare development. And, while the City cannot directly affect the market desirability criteria, it can use this document to demonstrate the Morgan Hill market's current desirability to health systems.

HSA Recommendations

The most immediate efforts regarding the retention and expansion of healthcare services in Morgan Hill should focus on:

- Attracting a regional system willing to partner with local physicians to develop an ambulatory destination center in Morgan Hill offering services such as imaging, urgent care, specialists, procedure center, and supporting services.
- Advocating for a Kaiser ambulatory center in Morgan Hill to better serve Kaiser members living in Morgan Hill.
- Define two or three locations with access and visibility from Highway 101 for healthcare ambulatory facilities:
 - Minimum of five acres for two sites
 - One site 10 to 12 acres

Next Steps

Upon approval or modifications of the HSA Recommendations, HSA believes logical next steps will be twofold:

1. Incorporate the recommendations on space and site availability into the City's General Plan including making the necessary changes and/or additions to the zoning to accommodate two five (5) acre sites and one 10-12 acre site.
2. Present this analysis to the major health system providers in the region (both Kaiser and non-Kaiser) to demonstrate the Morgan Hill market's current desirability with the goal of attracting investment into the City of Morgan Hill.