Rule No. 560-X-42-.11 Property Costs

This rule does not apply to State owned and operated facilities who are paid a use allowance in lieu of depreciation for buildings and improvements. The annual use allowance for buildings and improvements shall be two percent of acquisition cost. Major movable equipment for State owned and operated facilities will be depreciated as in paragraph (10) of this rule.

(1) Medicaid Approval. The construction, sale or lease of any ICF/~~MR~~IID facility must be approved by Medicaid for purposes of Medicaid reimbursement. Medicaid may, at its option, elect not to approve any new construction, sale or lease of a facility entered into without its prior approval; in which case, Medicaid will not reimburse any property costs. Capital expenditures must be approved under applicable Certificate of Need regulations by appropriate state and/or federal agencies. When construction is accomplished without such approval, Medicaid will be able to pay only operating costs; capital expenditures will not be an allowable cost in these cases, as further explained in Rule No. 560-X-42-.04(3).

(2) New Construction. Construction costs as defined in Rule No. 560-X-42-.11-(9) will be reimbursed on actual cost up to a maximum of $16,600.00 per bed. This limitation is intended to discourage construction of lavish facilities.

(3) Land. The maximum allowable cost assigned to land upon which a newly constructed facility is built, or upon which a purchased facility is located, shall use as a guideline an amount not to exceed 5% of the construction costs (with respect to a newly constructed facility) or of the allowable basis determined pursuant to Rule No. 560-X-42-.11(4) with respect to a purchased facility) absent a showing by the provider that the 5% is not a reasonable amount. Each such construction or purchase situation shall be subject to the "prudent buyer" concept with each case to be considered on its own merits.

(4) Sale of Existing Facilities. Effective for sales closed on or after October 1, 1988, the allowable basis to the purchaser of a facility participating in the Medicaid program of those assets which would be includable as construction costs pursuant to Rule No. 560-X-42-.11(9) if the facility were being constructed rather than purchased, shall be the lower of:

(a) The actual sales price negotiated for the purchase of the facility. For purposes of this Rule, including but not limited to this section (a) and Section (7) (a) of this Rule, sales price shall mean the total price agreed upon by the seller and purchaser as evidenced by a signed copy of a final sales agreement. The stated sales price agreed to by the seller and the buyer shall not be reduced by any discount involved with issuance, by the purchaser of notes, mortgages, bonds, or securities, and the acceptance of such debt instruments as part of the agreed upon purchase price by the seller; or

(b) The current replacement cost of the facility [based upon the current Alabama Medicaid ceiling on Construction Costs of new facilities under Rule No. 560-X-42-.11(2) reduced as follows:

Age of Facility	Write Down
1 - 10 yrs.	2.5% per year for each year of age up to 10 years
11 - 15 yrs.	25% plus 2.0% per year over 10 years

16 - 25 yrs.	35% plus 1.5% per year over 15 years
26 or older	50% plus 1.0% per year over 25 years

For purposes of this subsection (b), fractional years shall not be counted. Also, the maximum allowable basis of a facility, portions of which have been constructed at different times, will be calculated by considering separately each area of the building constructed at different times.

Example: Valuation of a 100 bed facility held 15 years

100 beds x $16,600 = $ 1,660,000
Less: Depreciation

[($1,660,000 x 35% (25%)+(2%x5)=35%] (581,000)
Maximum allowable depreciable basis $ 1,079,000
Land (limited to 5% of depreciable basis) 83,000
(prior to write down, if applicable)
Total Allowable Basis $ 1,162,000

or;

(c) A purchase price which would represent an increase over the sales price paid by the seller of one-half of the percentage increase, from the date of acquisition by the seller to the date of sale by seller, in the Dodge Construction Systems Costs for Nursing Homes; or

(d) A purchase price which would represent an increase over the sales price paid by the seller of one-half of the percentage increase, from the date of acquisition by the seller to the date of sale by seller, in the Consumer Price Index for all Urban Consumers (United States city average).

(5) Seven Year Rule. No increase in property costs resulting from a change in ownership will be allowed for reimbursement purposes for a period of seven (7) years after the last change in ownership that resulted in a revaluation of depreciable basis or after the original construction of the facility. If a change occurs, reimbursement to the new owner will be under the same terms as under Rule No. 560-X-42-.11(11) related to non bona fide sales. Medicaid will consider granting exceptions to this seven (7) year rule, but only in cases of extreme hardship, such as death of the owner. Requests for such exceptions should be submitted in writing to the Commissioner of the Alabama Medicaid Agency and should be fully documented.

(6) Leases. The maximum lease payment which will be considered an allowable property cost will be the lower of (a) or (b), as follows:

(a) The actual lease payments which lessee is obligated to pay to the owner; or

(b) For net leases, 12% of the replacement cost of the facility [based on the current Medicaid ceiling on construction costs of new facilities under Rule No. 560-X-42-.11(2) adjusted as provided under Rule No. 560-X-42-.11(4)]. In those cases in which the depreciable assets have been stepped-up within the immediately preceding seven years, the 12% shall be applied to the net depreciated allowed book value at the date of the lease agreement.

(c) Leases submitted to the Agency for approval must be specific as to the responsibility for payment of fire and casualty insurance and property taxes. The maximum allowable lease payment calculated in (b) above includes an allowance for taxes and insurance.

(d) Sale/Leaseback Transactions. Reimbursement of rental or lease payments for these type transactions will be limited to the lower of: 1. the costs (depreciation, interest) of ownership which the facility would have been reimbursed had it retained legal title to the assets, or 2. The allowable Medicaid lease payment.

(7) Depreciation Recapture.

(a) Prior to Agency approval of the sale of a facility which has previously participated in the Medicaid program, all depreciation previously allowed and reimbursed through the per diem rate attributable to periods subsequent to the later of October 1, 1980, or the last recapture date will be recaptured. If the facility was sold at a price in excess of the sellers' cost of the property as reduced by accumulated depreciation, as computed under Medicaid depreciation guidelines, the recapture amount will be the lesser of the sellers' actual gain on the sale or the amount of the depreciation previously reimbursed through the per diem rate. Any gain based on the stated sales price agreed to by the seller and the buyer shall not be reduced by any discount involved with issuance by the purchaser of notes, mortgages, bonds, or securities, and the acceptance of such debt instruments as part of the agreed upon purchase price by the seller.

(b) Recapture of depreciation is not applicable in those instances where a stepped-up basis is not allowed, whether refused or is unallowable by the seven (7) year rule, or any other provisions of the regulations. Any subsequent sale, which results in a purchaser assuming a stepped-up basis, shall be subject to depreciation recapture from the later of October 1, 1980, or the last recapture date. The amount of recapture otherwise due to Medicaid from the seller of a facility which has been used in the Medicaid program will be ratably reduced commencing after that seller (regardless of that seller's method of acquisition) has owned the facility for 7 full years, at the rate of 1.04167% per month (being an annual rate of 12.5%). This reduction will result in no recapture being due once an owner has owned a facility for 15 full years. Each subsequent sale or other transfer of ownership is subject to a fifteen year holding period before the amount subject to recapture is reduced by 100%.

(c) If the seller's allowable costs during the seller's participation in the Medicaid program have in any year(s) exceeded the overall ceiling, the amount of depreciation subject to recapture will be determined as follows:

1. For any such fiscal year between October 1, 1980, and the date of sale, the amount of depreciation subject to recapture for each such year will be determined as follows:

(i) Reimbursement ceiling divided by average otherwise allowable cost per day (as shown on the rate computation schedule) = Reimbursement percentage.

(ii) Reimbursement percentage x depreciation x Medicaid occupancy = Amount of Recapture.

(iii) For partial fiscal years, the computation will be prorated based upon the number of full calendar months included in the partial year.

(d) Recapture will take the form of a lump sum repayment by the seller to Medicaid of the amount of depreciation computed under the depreciation recapture provisions as set out herein above. However, when Medicaid is requested to approve the sale of a facility wherein no arrangements are made for such a depreciation recapture payment by the seller, Medicaid may, notwithstanding any other provision of this section, withhold all reimbursement otherwise due to

the purchaser until such recapture repayment is fully recaptured from reimbursement otherwise payable to the purchaser.

(e) As to periods subsequent to October 1, 1980, during which a facility is leased to a Medicaid provider, and therefore, no depreciation is claimed as such for purposes of Medicaid reimbursement, the depreciation allowance which would have been reimbursable to the owner of the facility during the term of the lease if the owner had also been the provider will be computed. The amount so computed will be treated as "imputed depreciation" and will be subject to recapture from the seller as though such depreciation had been actually claimed and allowed for Medicaid reimbursement during the lease period. Medicaid will not approve the sale of a facility which has been leased until it is provided with adequate records (such as, but not limited to, federal income tax returns) from which it can compute the amount of "imputed depreciation."

(8) Facilities Financed by Bond Issues. Medicaid will treat the lease of a facility which has been financed by a Medical Clinical Board bond issue, pursuant to which the "lessee" has an option to purchase at less than market value, as a lease purchase agreement for reimbursement purposes. In these instances, the lessee's allowable property costs will be limited to the amount which would be allowable if the lessee had legal title to the facility's assets (the owner's allowable property costs) such as straight line depreciation, insurance, property taxes, interest, and an equity return on the investment in property, plant and equipment related to patient care, net of depreciation, and loans. The return on equity capital is subject to the provisions in Rule No. 560-X-42-.13.

(9) Definition of Construction Costs. "Construction Costs" include the cost of:

(a) Buildings. Buildings include, in a restrictive sense, the basic structure or shell and additions thereto. The remainder is identified as building equipment.

(b) Building Equipment. Building equipment includes attachments to buildings, such as wiring, electrical fixtures, plumbing, elevators, heating systems, air conditioning systems, etc. The general characteristics of this equipment are that it normally: (1) is affixed to the building and not subject to transfer; and (2) has a relatively long useful life, but the useful life is shorter than the useful life of the building to which affixed.

(c) Major Movable Equipment. Major movable equipment includes such items as beds, wheelchairs, desks, etc. The general characteristics of this equipment are that it: (1) has a relatively fixed location in the building; (2) is capable of being moved, as distinguished from building equipment; (3) has a unit cost sufficient to justify ledger control; and (4) has sufficient size and identity to make control feasible by means of identification tags.

(d) Land (Non-depreciable). Land (non-depreciable) is excluded from Construction Costs for purposes of the limitations on Construction Costs contained in Rule No. 560-X-42-.11(2). However, allowable land costs are subject to the limitation contained in Rule No. 560-X-42-.11(3).

(e) Land Improvements (Depreciable). Depreciable land improvements include paving, on-site sewer and water lines, parking lots, shrubbery, fences, walls, etc., if replacement is the responsibility of the provider.

(f) Capitalized Costs. Construction period interest and other expenses which are normally capitalized as part of the cost of the acquired property under generally accepted accounting principles.

(g) Acquisition costs such as feasibility studies, accounting fees, legal fees, etc., are not reimbursable costs for sales occurring on or after October 1, 1988.

(10) General Principles Relating to Property Costs. Property Costs include, but are not limited to, depreciation, interest, lease and rental payments, insurance on buildings and contents, and property taxes. In addition to the limitations contained in this Rule No. 560-X-42-.11, all property costs will be subject to the "prudent buyer" concept with each case to be considered on its own merits. Also, depreciation, interest, rent, insurance, and taxes associated with space and equipment used for non-covered services or activities must be eliminated from allowable property costs. Treatment of costs associated with the operation of a laundry is dealt with in detail in Rule No. 560-X-42-.09.

(a) Depreciation

1. In order to be allowable as a property cost, depreciation must be: (a) identifiable and recorded in the provider's accounting records; (b) based on the allowable historical cost of the asset; and (c) prorated over the estimated useful life of the asset using the straight line method. The useful life guidelines published by the American Hospital Association must be followed in establishing the useful life of a new asset. (See Schedule 11A at the end of this chapter.) The Agency may allow lives different from these guidelines, if the provider requests consideration in writing. Medicaid may allow used assets to be depreciated over shorter estimated useful lives if prior approval of such shorter useful lives is requested in writing by the provider. If such prior approval is not obtained, used assets will be depreciated over the same useful lives as established for new assets. For those assets not appearing on Schedule 11A at the end of this chapter, Medicaid will establish the appropriate useful life on a case-by-case basis.

2. The costs of improvements, including major leasehold improvements such as building additions, will be depreciated over the useful life of the improvements, regardless of the remaining term of any lease agreement.

3. Any gain attributable to periods during which a provider has participated in the Medicaid program, resulting from the disposal of equipment will be used to offset depreciation expenses for the year in which the gain is realized. Any loss attributable to periods during which a provider has participated in the Medicaid program and resulting from such a disposal will be added to allowable costs for the year during which the loss is realized. In determining the gain or loss, such gains or losses will be treated as having accrued ratably over the entire period during which the provider has owned the asset. The allowable aggregate amount of such gains and losses will be limited to 10% of the provider's total allowable depreciation for the year during which such gain or losses are realized. Any amounts in excess of this 10% will be carried forward to subsequent years, with the same 10% limitation applying until the total gain or loss is absorbed into an allowable cost year. No gain or loss will be recognized for purposes of this section from a trade-in of a depreciable asset. Refer to Rule No. 560-X-42-.11(10) (a) 4, for an explanation of the basis to be utilized whenever an asset is traded in.

4. Trade-Ins. When an asset is acquired by trading in an asset that was depreciated under the program, the basis for purposes of depreciation of the new asset will be the sum of the undepreciated balance of the old asset and the cash paid or to be paid.

(b) Interest. Subject to the provisions of Section 10 of this Rule, necessary and reasonable interest incurred to finance the purchase or construction of a facility, to purchase equipment, and to finance the cost of major repairs and renovations, is an allowable property cost. Interest on the portion of a loan which exceeds the construction or purchase price approved by Medicaid for

the financed asset will not be included in property costs, but will be subject to the other interest provisions of Rule No. 560-X-42-.08. If an asset is refinanced by a current owner at a higher rate of interest, allowable interest on the refinanced portion of the original loan will, unless the entire interest expense meets the necessary and reasonableness tests of Rule No. 560-X-42-.08, be limited to the interest which would have been allowed under the original financing arrangement. The excess interest on the refinanced portion will be an unallowable cost.

(c) Leases and Rental Payments. All major lease and rental agreements must be in writing and must be approved by Medicaid for Medicaid reimbursement purposes prior to the signing by the provider. Medicaid will, in all cases, exclude from the provider's allowable costs all lease payments made or accrued prior to Medicaid approval of the lease agreement. Medicaid may, however, at its option, elect not to reimburse any lease payments under, or any other property costs incurred in connection with, any lease entered without its prior approval.

1. Facility Leases. Leases will be subject to the "prudent buyer" concept with each case to be considered on its own merits. Factors considered by Medicaid in its review will include, but not be limited to, the age of the facility, current costs versus proposed costs, length of lease, existing debt service, and fair return to lessor. No lease will be approved which contains a "percentage of the gross" or "escalator" clause. The fact that a lease is being renegotiated will not be grounds for increasing the amount of the lease payment. Medicaid reserves the right to require an independent appraisal of the leased facility at the expense of the provider by an appraiser selected by Medicaid. For Medicaid reimbursement purposes, allowable rental payments between related parties cannot exceed the lessor's allowable property costs. Subleases which include payment in excess of that being made by sub lessors will not be honored as to the additional payments. No increase in a lease payment will be recognized if an increase in lease payment or an increase in property costs due to the sale of the facility has occurred during the immediately preceding seven (7) year period. Medicaid will consider granting exceptions to the seven (7) year rule, but only in cases of extreme hardship, such as the death of the owner. Requests for exceptions should be submitted in writing to the Commissioner of Medicaid and should be fully documented.

2. Equipment Rental. Reasonable costs of such rental equipment as is normally and traditionally rented by health care institutions and which is rented from a non-related organization, are allowable provided the arrangement does not constitute a lease-purchase agreement. All items leased under a lease-purchase agreement must be capitalized and depreciated over the useful life of the asset.

(d) Insurance on Building and Contents. The reasonable costs of insurance on buildings and their contents used in the rendition of covered services purchased from a commercial carrier and not from a limited purpose insurer [Ref. HIM-15, Section 2162(2)] will be considered as allowable costs.

(e) Property Taxes. Ad Valorem and personal property taxes on property used in the rendition of covered services are allowable under this section. Fines, penalties or interest related to those taxes are not allowable.

(f) Life and Rental Insurance. Premium payments for life insurance required by a lender or otherwise required pursuant to a financing arrangement will not be an allowable cost. Loss of rental insurance will also be considered an unallowable cost.

(g) Minor Equipment is not subject to the provisions of this Section. Minor equipment must be expensed as of the date of purchase. Minor equipment includes such items as waste baskets, bed pans, catheters, silverware, mops, buckets, sheets, towels, etc. The general

characteristics of this equipment are (1) no fixed location and subject to use by various departments of the provider's facility; (2) comparatively small in size and unit cost; (3) subject to inventory control; (4) fairly large quantity in use; and (5) a useful life of approximately three years or less.

(h) Capitalization Level. Any asset with a per unit cost of $500 or more with an expected useful life of three years or more must be capitalized. Any group purchase of assets (i.e., 10 mattresses, 4 beds, etc.) with an aggregate cost of $1,000 or more with an aggregate expected useful life of three years or more must be capitalized.

(11) Non Bona Fide and Related Party Sales.

(a) Non Bona Fide Sales. If a facility changes ownership and a purchaser cannot justify that the sale was bona fide, the seller's book value shall be used by the purchaser as the basis for the depreciation of the purchased assets. In such cases, the purchaser shall record the historical cost and accumulated depreciation of the seller recognizable under the program, and these shall be considered as incurred by the purchaser for program reimbursement purposes. No additional interest expense or return on equity resulting from such a non bona fide sale will be reimbursable.

(b) Related Party Sales. Any sale between a provider and a "related party" will not be deemed a bona fide sale. The purchaser's cost basis in depreciable assets and the remaining depreciable life of assets purchased will be the same as that of the seller. The portion of the purchase price reasonably allocated to assets which is in excess of the seller's book value shall be entered as a separate item on the books of the purchaser and eliminated from the computation of allowable interest expense, allowable depreciation and return on equity capital for the purposes of Medicaid reimbursement. The provisions of HIM-15 shall be applicable in determining whether a sale is between related parties.

(12) Rate Computation. The allowable property costs (as defined in this section) will be added to the allowable other costs and return on equity capital for determination of the 90th percentile.

(13) Transactions Involving Corporate Stock. The purchase of the stock of a corporate provider will generally not be considered as a purchase of the provider's assets; therefore, such a stock purchase will not result in a revaluation of the assets of the provider. However, such a revaluation will be permitted upon the statutory merger or consolidation of the corporation provider with another corporation under the same circumstances wherein such a revaluation would be permitted by 42 CFR Section 413.134(k). Additionally, a revaluation of assets will be permitted where the purchase of stock of a corporate provider is followed within three (3) months by the liquidation of the provider. Any revaluation of the assets of a provider as the result of such a statutory merger, consolidation, or liquidation shall be subject to the same prior approval and basis limitations as though an outright sale of the assets has been made.

(14) Changes in Ownership. In a transfer which constitutes a change of ownership, the old and new providers shall reach an agreement between themselves concerning trade accounts payable, accounts receivable and bank deposits. Medicaid will pay the new provider for unpaid claims for services rendered both prior to and after the change of ownership. The new provider shall be liable to Medicaid for unpaid amounts due or which become due Medicaid from the old provider.

(15) Bed Additions or Replacement Beds. It is anticipated that bed additions to existing facilities will cost less than new facilities since these additions generally do not require additional administrative, dietary, and plant operation areas. Bed Additions or replacement bed construction costs built at the same location as the core facility will be reimbursed on an actual cost basis using $12,000 per bed as a reasonable guideline. This limitation is intended to discourage construction of lavish facilities. Appropriate adjustments to this $12,000 per bed cost limitation may be made based on the availability of service areas in the existing facility.

(16) Renovations. Renovations to the existing facility will be reported as a separate cost breakdown.

(17) In those instances wherein a facility that is being leased is sold, the purchaser of the facility must furnish the Agency with documentation of the seller's actual facility acquisition cost prior to Medicaid computation of an allowable depreciable basis.

Author: Robin Arrington, Associate Director, LTC Provider/Recipient Services Unit
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