Appendix E

Financial Review Summary

The Capital Asset Realignment for Enhanced Services (CARES) Commission staff requested assistance from the Department in reviewing the cost effectiveness analyses submitted by VISNs[1] in support of realignment initiatives. The Department assigned a team consisting of staff from the following organizations: Office of Asset Enterprise Management, Office of Management; Office of Policy, Planning, and Preparedness; and the Veterans Health Administration (VHA) Office of Facilities Management. Each team member was selected for his or her professional expertise and experience.

A Limitations on the Reviews

The team was asked to review the proposals as submitted by VHA. The team was not briefed by the CARES Program Office or consultants with regard to the cost-effectiveness methodology utilized in the realignment studies. The team also did not have the opportunity to ask CARES staff or the VISNs any clarifying questions that might have led to greater understanding of the proposals and could have obviated many of the comments made by the team. Because of the review timeframe limitations, a thorough analysis of the recurring and non-recurring costs along with proposed capital expenditures was not possible for all proposals.

It was not possible for reviewers to validate any of the cost data provided in the Excel templates that accompanied the proposals since almost all cells were "pasted" with data and did not reveal the underlying formulas. The team had to accept data at face value, with no opportunity to verify or validate, the underlying assumptions and cost estimates. Examples of the obstacles encountered in the review included:

- The average salary costs for in-house staffing, which comprised approximately two-thirds of operating costs, was not known and could not be assessed.

[1] Terms amenable to the use of acronyms are so designated throughout this report. To assist the reader who may be unfamiliar with the acronyms used, a glossary of terms is provided in Appendix A.

- The methodology for estimating construction, renovation, and demolition costs could not be verified.
- The methodology for estimating the cost of providing service in the 100 Percent Contracting Alternatives is also not known and could not be verified.
- Some proposals included only summary construction costs while others provided more detailed information on specific portions of projects; thus, it was not possible to verify these costs except at the broadest level.
- There is no source documentation or traceable methodology by which to audit the costs and savings reported in each proposal.
- It appears that some errors were also made when the data was "cut and pasted" into the templates.
- Data provided in the narrative was not always consistent with the data provided in the excel templates.

Reviewing projected workload was not one of the charges of the workgroup. However, many of the realignment proposals showed significant workload increases with little or no justification provided on how these projections were developed. As with the financial information, the reviewers had to take workload data at face value. Since the workload is most likely the primary driver behind much of the cost data, it will be important for key decision makers to have a full understanding of how workload projections were developed and applied to the CARES realignment proposals.

The proposals varied greatly in length, level of detail, quality, and completeness. This fact, in addition to the extreme limitations on time available, forced the team to conduct only a preliminary analysis of the cost effectiveness of the proposals using essentially the members' professional judgment and experience.

B General Observations

Twenty-one realignment proposals were reviewed by the team. The review team did not have the opportunity to review proposals that were not submitted by VHA, e.g., Big Spring, Brooklyn/Manhattan, Hot Springs, etc. There was wide variability in the quality of the realignment studies. At best, the proposals provide a broad overview of the possible alternatives available at the 21 locations. However, numerous inconsistencies and errors in data were found in the proposals. The life cycle costs presented contain many apparent weaknesses and could mislead decision makers. The relative cost effectiveness of alternatives in each proposal may change dramatically after more detailed analyses are completed.

During the next stage of the CARES Capital Investment Process, approved proposals will proceed with the completion of comprehensive Capital Investment Applications (Exhibit 300), which are required by the Office of Management and Budget. The applications will include a more thorough review of a minimum of three alternatives using a full 30-year life cycle. The applications will also include specific project space requirements, design and construction costs, and project schedules. In addition, the applications will have to address how projects align with VA's overall strategic and performance goals. The comments of this review team should be addressed at the time of the development of the comprehensive applications.

1 *Life-Cycle Costing*

The methodology used to develop these realignment proposals and the life cycle costing of alternatives does not always follow generally accepted principles and the proposals provide only a very general indication of the relative cost effectiveness of the alternatives. The following are a number of key observations:

- The life cycle costs for the Status Quo and for each alternative are calculated for the entire 19-year period (FY 2004 through FY 2022) and are discounted to present value. Such an approach ignores the realities of implementation. For example, the 100 Percent Contracting Alternatives could be implemented at an earlier date than alternatives with a construction requirement

A life cycle cost analysis should reflect anticipated implementation dates for each alternative and should not use a uniform period of operations for all alternatives. In addition, if the constant 19-year life cycle is used for all proposals, the initial recurring or operating costs of all alternatives should be identical to those of the Status Quo until each alternative can be expected to become operational. This is because the Status Quo will be in operation until the implementation dates of the other alternatives. An alternative approach would be to synchronize the life cycle to begin at the earliest implementation date of any alternative. In no case should savings be calculated before realistic implementation dates.

Generally, life cycle costing would include a description of assumptions regarding budgeting and construction activities but in many of these proposals, no descriptions of the assumptions are provided at all. Many proposals make explicit or implicit assumptions without presenting supporting evidence.

Other aberrations were observed that are not explained. For example, at Las Vegas the recurring costs for the recommended alternative of a new hospital includes costs for FYs 2004–2007 that are significantly higher than those shown for the Status Quo for those same years. It is not clear how or why the recurring costs would differ since presumably the Status Quo continues until construction is completed.

2 *Capital Costs*

Construction costs as shown in the Capital Cost Summary are generally "building-only" costs that are current as of the date of the database, which are already 1 year old. These costs do not include sitework and all of the necessary additional markups needed for Congressional funding requests to ensure that sufficient funding is available for implementation. Thus, capital costs are frequently understated in proposals.

Demolition costs are not estimated in many of the proposals. In proposals that contain demolition cost estimates, the methodologies used to estimate these costs are inconsistent.

Capital costs are included in many proposals for alternatives such as 100 Percent Contracting in which no capital costs should be included at all. In other cases such as Kerrville/San Antonio, capital costs are included for construction that has nothing to do with the decision at hand. In these instances, the life cycle costs are inflated or misleading.

3 *Alternatives*

The description of alternatives in many of the proposals is poorly written and difficult to understand. In many cases, the preferred alternative is intuitively sound but is not adequately supported by evidence.

The characteristics of 100 Percent Contracting Alternatives are not consistently applied among proposals. Proposals frequently contain significant funding for new construction and renovation, which is contrary to the concept of contracting all workload to the community. In some cases, the contracting alternatives are described as transferring workload to other Veteran Administration (VA) facilities. In addition, some proposals did not even consider the 100 Percent Contracting Alternative.

The 100 Percent Contracting Alternative is often unrealistic in that it does not consider reasonable options. For example:

- An obvious alternative at Las Vegas would include constructing a new outpatient facility while contracting inpatient care to replace the inpatient services that will no longer be provided by the U.S. Air Force (USAF). Contracting inpatient care at Las Vegas would save approximately $10 million each year or $170 million from FY 2006 through FY 2022 according to the life cycle costs. Instead, the contract option only considers contracting all services.
- In the case of Kerrville, no consideration is given to the possibility of contracting for inpatient services while waiting for construction to be completed at San Antonio in FY 2010. Since the inpatient services are proposed to be transferred to San Antonio anyway, contracting for those services at San Antonio could be accomplished by FY 2005 or FY 2006.

4 *Nursing Homes and Domiciliaries*

Many of the proposals address nursing home or domiciliary needs. Making decisions on these proposals may not be wise at this time since future workload is straight-lined pending approval of a new projection methodology. At least one realignment proposal, White City, uses workload projections that appear to be inconsistent with recent workload and seriously inflated.

Some proposals stress that veterans have significant psychiatric nursing home needs that cannot be met through community nursing homes while other proposals would contract for all nursing home services with no mention of special veteran needs or problems with community nursing home services. There is no apparent explanation for this inconsistency across the country.

5 *Enhanced Use Leasing*

The replacement value of property is generally cited in some of the proposals, presumably as an indication of the market value of property intended to be sold or subject to enhanced use lease (EUL). Some proposals contain no estimate of the value of the property. The replacement value of property should not be used since it bears no relationship to the actual property value. The market value should be accurately determined by a Fair Market Value appraisal or, if an appraisal is not available or feasible, by a Broker's Opinion.

It appears that the full potential of EUL ventures is not widely understood. Many proposals identify only unneeded or underutilized space/land that could be out-leased. The robust nature of VA's enhanced-use lease authority to leverage our assets to acquire all, or a portion of the needed commodity (services, facilities, etc.) is not capitalized upon. For example:

- The Pittsburgh health care system proposes closing the Highland Drive campus and transferring services to the other two remaining divisions. The proposal indicates that this would require approximately $100 million in capital investment in new space and parking (500,000 square feet/900 parking spaces) at the remaining care sites and that they could EUL the Highland Drive Campus.
- The proposal does not identify the interrelationships and interconnectivity of using VA's enhanced-use lease authority to acquire most, if not all, of the required new capital. For example, VA could leverage the Highland Drive site by requiring the lessee to provide the needed buildings and parking as consideration "in-kind" for the lease. This would negate some or all of the need for appropriated funds.
- It also appears that some of the proposals explored converting VA buildings to assisted living facilities as the only means of utilizing VA's EUL authority.

Generally, savings expected to be received from divestiture or EUL are not identified in the proposals and it is not clear if they have been included in the life cycle costing.

6 *Historic Buildings*

The proposals often identify historic buildings but do not present a reasonable course of action that could be used when EUL or divestiture is considered. For example, Walla Walla acknowledges that 15 of 28 buildings are historic but do not provide a recommendation or solution for handling this situation.

7 *Special Emphasis Programs*

Special emphasis programs are addressed in some of the proposals but are not specifically identified in others. The White City proposal makes a very strong case for continuing its rehabilitation center and clinics. On the other hand, the Lexington/Leestown proposal acknowledges that neither division provides Spinal Cord Injury (SCI), TBI, or Blind Rehabilitation programs and does not propose to improve that situation. Special emphasis programs should be a high priority and be specifically address in all capital investment proposals that are developed.

8 *Staffing*

Many of the proposals do not identify the impact of alternatives on staffing except on a very general level. Some proposals identify full-time employee impact but most do not. In addition, several proposals included costs of full moving/relocation of all effected employees, which is not mandated.

9 *VBA Collocations*

The Pittsburgh and Cleveland proposals identify collocations with Veterans Benefits Administration (VBA) as justification for selection of alternatives yet in both instances, VBA has concluded that the collocations will not take place. It is not clear how the collocation were considered in the life cycle costing of these proposals.

10 *State Home and Homeless Grant Programs*

Neither of these cost-effective programs were utilized to their full capability. Many economic advantages exist with these programs that would go a long way in offsetting out-year fixed cost expenditures. The State Home programs only requires VA to subsidize the procurement of the facility by committing only 65 percent of the total construction costs and utilizes a per diem process for veterans assigned to theses facilities. IF VA doesn't have any veterans in a State Nursing Home on a given day; VA has does not have monetary commitment for that period; VA only pays when using a bed; and the state is liable for the total operating cost of the facility. Likewise, the Homeless Grant program is almost a mirror copy of the State Home Grant program, with the only difference being that VA reimburses the total cost of procurement of these low-cost facilities. All the advantages of only paying for utilized services still exists.