9553.0060 DETERMINATION OF PROPERTY RELATED PAYMENT RATE.

Subpart 1. **Depreciation.** Allowable depreciation expense must be determined according to items A to E.

A. Subject to the limitations in item C, the basis for calculating depreciation is governed by subitems (1) to (7).

(1) The historical capital cost of the capital assets as limited by item C is the basis for calculating depreciation.

(2) For donations between a provider and a related organization, the net book value of the capital asset to the donor must be the basis for calculating depreciation for the donee. A donated capital asset is one acquired by the facility without making any payment in the form of cash, property, or services.

(3) Depreciation is not allowed on a capital asset or portion of a capital asset purchased through federal, state, or local appropriations or grants unless the appropriation or grant is required to be repaid through the revenues of the facility.

(4) The historical capital cost of the capital assets in item A must be increased for the cost of additions or replacements to assets capitalized according to part 9553.0035, subpart 8, items A to D, subject to the limitations in subitem (6) and item C, and must be depreciated according to this subpart. The increased depreciation expense must be recognized in the calculation of the payment rate for the rate year following the reporting year in which the cost was incurred without regard to when during that reporting year the capital asset was purchased. The facility may claim depreciation expense for the depreciable capital assets for only the portion of the reporting period after the construction was completed or the capital asset was purchased.

(5) When a facility first enters the medical assistance program, the accumulated depreciation of any used capital assets owned by the facility prior to entering the medical assistance program must be calculated by using the useful life schedule in item B starting from the later of the date of completion of construction, or the time of purchase by the current owner. However, the amount of accumulated depreciation must not exceed 50 percent of the historical capital cost of the capital asset.

(6) The historical capital cost of the capital assets and the accumulated depreciation of those capital assets must not be adjusted for either a full or partial change of ownership, reorganization of provider entities, or for any costs associated with replacing existing capital assets as a result of a casualty loss.

(7) In no instance shall the total accumulated depreciation allowance paid for a capital asset exceed the historical cost of that capital asset.

B. The straight line method of depreciation must be used to compute the facility's depreciation for each capital asset. The useful life of a capital asset must be determined in accordance with subitems (1) to (3), except as provided in part 9553.0030, subpart 4, item E.

(1) The useful life of a new capital asset must be calculated as follows:

(a) physical plant and other buildings must be depreciated over 35 years;

(b) physical plant improvements and additions must be depreciated over the greater of the remaining useful life in unit (a) or 15 years;

(c) land improvements must be depreciated over 20 years;

(d) depreciable equipment except vehicles must be depreciated over five years; and

(e) vehicles must be depreciated over four years.

(2) The useful life of a used capital asset must be assigned by the provider, based on the physical condition of the used capital asset. The useful life assigned to the used capital asset must be the greater of the remaining useful life of the capital asset shown in subitem (1) for this type of capital asset, or one-half of the useful life shown in subitem (1) for that type of capital asset.

(3) The useful life of a leasehold improvement must be determined in accordance with subitem (1) or (2) for that type of capital asset.

C. The facility's historical capital costs shall be limited by subitems (1) to (5).

(1) The facility's total historical capital costs of capital assets, as determined in item A must not exceed the maximum limits established annually per bed for licensed Class A beds and for licensed Class B beds, as follows:

Calendar Year Limits	Class A	Class B
Prior to 1974	$11,000	
1974	13,000	
1975	14,820	
1976	15,413	
1977	16,406	
1978	18,109	
1979	20,010	
1980	25,194	$29,452
1981	28,016	32,751

1982	29,165	34,094
1983	29,952	35,015
1984	30,012	35,085
1985	31,723	37,085

(2) The limitations in subitem (1) shall be adjusted on January 1 each year by the percentage increase in the construction index published by the Bureau of Economic Analysis of the United States Department of Commerce in the Survey of Current Business Statistics for the previous two Octobers. The construction index is incorporated by reference. It is available through the Minitex Interlibrary Loan System. Facilities entering the medical assistance program shall be subject to the limitation in effect at the time the facility entered the program.

(3) The depreciation on additions, replacements, or newly acquired depreciable equipment shall be allowed without regard to the limits in this item, if the acquisitions were required subsequent to the facility's certification in order to maintain compliance with the Life Safety Code, as referenced in Code of Federal Regulations, title 42, sections 442.507 to 442.509, as amended through December 31, 1982, or as subsequently amended, or with fire safety orders issued by an appropriate authority.

(4) After the facility's first three full reporting years and every three full reporting years thereafter, the facility's investment per bed limitation established according to subitems (1) to (3) shall be increased by the average of the annual percentage increases in the investment per bed limitation for the current reporting year and the previous three full reporting years. For purposes of this subitem, a full reporting year must contain at least 12 months. The adjustment to the facility's investment per bed limitation shall not apply to any original construction and investment costs. Depreciation on the original construction and investment in historical capital costs of capital assets shall continue to be limited by the per bed limitation in effect when the facility entered the medical assistance program.

(5) For purposes of this item, the facility's total historical capital cost of capital assets must not include the facility's allowable portion of capital assets of the central, affiliated, or corporate office whose costs are allocated to the facility's administrative cost category in accordance with part 9553.0030, subpart 4, item D.

D. Gains and losses on the disposal of capital assets must be included in the computation of allowable costs. A gain on the sale or abandonment of a facility's capital assets must be offset against the property related cost category to the extent that the gain resulted from depreciation expense claimed for reimbursement under parts 9553.0010 to 9553.0080, 12 MCAR SS 2.05301-2.05315 [Temporary], or parts 9510.0500 to 9510.0890. Gains or losses on trade-ins shall be reflected in the historical capital cost of the acquired capital asset. Claims for losses are limited to a total of ten cents per resident day per reporting year. Any excess loss not claimed during the reporting year may be carried forward to future years.

E. Except as provided in subpart 7, facilities must fund depreciation according to subitems (1) to (8).

(1) The annual deposit to the funded depreciation account must be determined according to the following formula: (allowable depreciation - required annual principal payment on the capital debt) multiplied by (1 - the percentage of equity determined in subpart 5). The required annual deposit to the funded depreciation account and any amount determined in subpart 5, item F, which is not used to reduce capital debts or working capital loans must be deposited to the account no later than the end of the reporting year.

(2) Funded depreciation must be invested in liquid marketable investments such as savings or money market accounts, certificates of deposit, and United States Treasury bills.

(3) Funded depreciation and interest income earned on funded depreciation must be used for capital debt reduction or for the purchase or replacement of capital assets or payment of capitalized repairs for the facility.

(4) An amount not to exceed 50 percent of the cumulative total amount of allowable depreciation required to be deposited in the funded depreciation account and the interest income earned on funded depreciation may be withdrawn for the purchase or replacement of capital assets or payment of capitalized repairs for the facility. If the amount in the funded depreciation account after a withdrawal is equal to or greater than the balance of capital debt remaining at the end of the prior reporting year, that excess amount may also be withdrawn for the purchase or replacement of capital assets or payment of capitalized repairs for the facility.

(5) A separate funded depreciation account must be maintained for each facility.

(6) Income earned on funds withdrawn for purposes other than those allowed in subitem (3) or in excess of the percent allowed in subitem (4) must be offset against the facility's property related costs. These withdrawals must be assumed to be on a first in, first out basis.

(7) Providers who do not deposit the required amount of depreciation in the funded depreciation account by the end of the reporting year will have their allowable capital debt interest expense for the facility reduced. The reduction must be calculated by assuming that the portion of funded depreciation not deposited in the funded depreciation

account during the reporting year was applied to reduce capital debts in accordance with subpart 5, item C.

(8) Funds deposited to meet the required Depreciation Reserve of the Minnesota Housing Finance Agency fulfill the requirements of this item. Amounts deposited in a Development Cost Escrow Account required by the Minnesota Housing Finance Agency or other similar accounts are not considered funded depreciation. Facilities financed by the Minnesota Housing Finance Agency must submit a copy of a statement breaking out the interest income according to the type of deposit.

Subp. 2. **Limitations on interest rates.** The commissioner shall limit interest rates according to items A to C.

A. Except as provided in item B, the effective interest rate of each allowable capital debt, including points, financing charges, and amortization of bond premiums or discounts, entered into after December 31, 1985, is limited to the lesser of subitems (1), (2), and (4) for all capital debt except motor vehicles. The limitations on motor vehicle capital debt is the lesser of subitems (1), (3), and (4). The limits are:

(1) the effective interest rate on the capital debt;

(2) a rate 1.5 percentage points above the posted yield for standard conventional fixed rate mortgages of the Federal Home Loan Mortgage Corporation as published in the Wall Street Journal and in effect on the first day of the month in which the capital debt is incurred;

(3) a rate three percentage points above the prime rate as published in the Minneapolis Star and Tribune and in effect on the first day of the month in which the capital debt is incurred; or

(4) 16 percent.

B. Variable or adjustable interest rates for allowable capital debts are allowed subject to the limits in item A. For each allowable capital debt with a variable or adjustable interest rate, the effective interest rate must be computed by dividing the interest expense including points, financing charges, and amortization of bond premiums or discounts for the reporting year by the average allowable capital debt. The average allowable capital debt shall be computed as in subpart 3, item G, subitem (4).

C. The effective interest rate for capital debts incurred before January 1, 1984, is allowed in accordance with the laws and rules in effect at the time the capital debt was entered into provided the effective interest rate is not in excess of what the borrower would have had to pay in an arms-length transaction in the market in which the capital debt was incurred. For rate years beginning after September 30, 1987, the effective interest rate for debts incurred before January 1, 1984, is subject to the limit in item A, subitem (4), unless the refinancing of the capital debt is prohibited by the original terms of the agreement with the lender.

Subp. 3. **Allowable interest expense.** Allowable capital debt interest expense shall be determined in accordance with items A to J.

A. Except as in subpart 1, item E, subitem (7), interest income earned on the required funded depreciation shall not be deducted from capital debt interest expense and working capital interest expense. Interest income earned on amounts deposited in a Development Cost Escrow Account required by the Minnesota Housing Finance Agency or other similar accounts and which is available during the reporting year to the provider or provider group shall be deducted from capital debt interest expense. Any other interest income shall not be deducted from capital debt interest expense. Except for interest income earned on the required funded depreciation, interest income available during the reporting year to the provider or provider group shall be deducted from the working capital interest expense.

B. All interest expense for capital debts entered into prior to January 1, 1984, shall be allowed in accordance with the laws and rules in effect at the time the capital debt was entered into provided the effective interest expense is not in excess of what the borrower would have had to pay in an arms-length transaction, except that for rate years beginning after September 30, 1987, the effective interest rate for debts incurred before January 1, 1984, is allowed subject to subpart 2, item A, subitem (4).

C. A facility which has a restricted fund must use its restricted funds to purchase or replace capital assets to the extent of the cost of those capital assets before it borrows funds for the purchase or replacement of those capital assets. For purposes of this subpart, a restricted fund is a fund whose use is restricted by the donor, the nonprofit facility's board, or any other nonrelated organization, to the purchase or replacement of capital assets.

D. Construction period interest expense must be capitalized as a part of the cost of the physical plant. The period of construction extends to the earlier of either the first day a medical assistance recipient resides in the facility, or the date the facility is certified to receive medical assistance recipients, except that the period of construction cannot extend beyond the date on which the project is complete. A project is complete when a certificate of occupancy is issued or, if a certificate of occupancy is not required, when the project is available for use.

E. Interest expense for capital debts entered into after December 31, 1983, shall be allowed for the portion of the capital debt which together with all other outstanding capital debts does not exceed 100 percent of the historical capital cost of the facility's capital assets subject to the limitations in item H and subpart 1, item C.

F. Interest expense for capital debts on capital assets acquired, leased, constructed, or established after December 31, 1983, shall be allowable only for the portion of the capital debt which does not exceed 80 percent of the historical capital cost of the capital asset including points, financing charges, and bond premiums or discounts subject to the limitations in item H and subpart 1, item C.

G. Changes in interest expense, except increases in interest expense due to refinancing of existing capital debts, or changes in ownership, shall be allowed in the calculation of the total payment rate for the rate year following the reporting year in which the cost was incurred. Changes in interest expense due to refinancing of existing capital debts, changes in ownership, or reorganization of provider entities, shall be subject to subitems (1) to (4).

(1) Increases in interest expense due to changes in ownership, reorganization of provider entity, or the refinancing of a capital debt, except for refinancing of a capital debt allowed under subitems (2) to (4), are not allowable costs.

(2) Increases in interest expense due to refinancing of a construction capital debt for a newly constructed facility are an allowable cost for the amount of the refinanced construction capital debt which does not exceed the limitation in item F. The interest rate on the refinanced construction capital debt shall be limited under subpart 2.

(3) Increases in interest expense which result from refinancing of a capital debt with a balloon payment shall be allowed according to units (a) to (c).

(a) The interest rate on the refinanced debt shall be limited under subpart 2, item A.

(b) The refinanced capital debt shall not exceed the balloon payment, except to the extent of refinancing costs such as points, origination fees, or title search.

(c) The term of the refinanced capital debt shall not exceed the term of the original debt computed as though the balloon payment did not exist. If the term of the original debt does not extend beyond the date of the final balloon payment, the term of refinanced capital debt shall not exceed 30 years including the term of the original capital debt.

(4) Increases in interest expense for a variable or adjustable rate capital debt are allowable if the effective interest rate does not exceed the limits in subpart 2, item A, subitem (4). For each variable or adjustable rate capital debt, the effective interest rate shall be computed by dividing the interest expense including points, finance charges, and amortization of bond premiums and discounts, for the reporting year by the average allowable debt. The average allowable debt for each variable or adjustable rate capital debt shall be computed by dividing the sum of the allowable debt at the beginning and end of the reporting year by two. Any variable or adjustable rate capital debt which has a zero balance

at the beginning or end of the reporting year shall use a monthly average over the reporting year.

H. For purposes of parts 9553.0010 to 9553.0080, the cost of land purchased prior to January 1, 1984, shall be limited according to laws and rules effective on December 31, 1983. The cost of land purchased on or after January 1, 1984, shall be limited to $3,000 per licensed bed.

I. Interest expense incurred as a result of a capital debt or working capital loan between related organizations shall not be an allowable cost, except as in item B.

J. Except as provided in item D, capital debt related financing charges including points, origination fees, and legal fees shall be amortized over the term of the capital debt.

Subp. 4. **Computation of property related payment rate.** The commissioner shall determine the property related payment rate according to items A to C.

A. The number of capacity days is determined by multiplying the number of licensed beds in the facility by the number of days in the facility's reporting year. For rate years beginning on or after October 1, 1988, a facility that has reduced its licensed bed capacity after January 1, 1988, may, for the purpose of computing the property related payment rate under this subpart, establish its capacity days for each rate year following the licensure reduction based on the number of beds licensed on the previous August 1, provided that the commissioner is notified of the change by August 4. The notification must include a copy of the delicensure request that has been submitted to the commissioner of health.

B. The commissioner shall compute the allowable property related costs by reviewing and adjusting the facility's property related costs incurred during the reporting year by applying parts 9553.0010 to 9553.0080. The facility's property related per diem shall be determined by dividing its allowable property related costs by 96 percent of the capacity days. For facilities with 15 or fewer licensed beds, the commissioner shall use the lesser of 96 percent of licensed capacity days or resident days, except that in no case shall resident days be less than 85 percent of licensed capacity days.

C. The facility's property related payment rate shall be determined by adding the amount in item B, and the capital debt reduction allowance in subpart 5, or the allowance in subpart 7, item F.

Subp. 5. **Capital debt reduction allowance.** A provider whose facility is not leased or a facility which is leased from a related organization shall receive a capital debt reduction allowance. The amount of the capital debt reduction allowance and the reduction of capital debt required must be determined according to items A to G.

A. The total amount of the capital debt reduction allowance and the portion of that amount which must be applied to reduce the provider's capital debt shall be determined according to the following table:

Percentage Of Equity In Capital Assets Used By The Facility	Total Capital Debt Reduction Allowance Per Resident Day (In Dollars)	Amount Which Must Be Applied To Reduce Capital Debt (In Dollars)
Less than 20.01	.50	.40
20.01 to 40.00	.50	0
40.01 to 60.00	.70	0
60.01 to 80.00	.90	0
80.01 to 100.00	1.10	0

B. Except as provided in subpart 7, item F, the provider's percentage of equity in the facility shall be determined by dividing equity by total allowable historical capital cost of capital assets.

C. Each reporting year, the provider shall reduce the capital debt at the end of the reporting year by an amount equal to the portion of the capital debt reduction allowances paid during the reporting year which must be applied to reduce capital debt multiplied by the prorated resident days corresponding to each capital debt reduction allowance paid during the reporting year.

D. The amount of reduction of capital debt computed in item A, must be in addition to the normal required principal payments on the capital debt to be reduced.

E. The amount of reduction of capital debt computed in item C must be applied first to reduce the principal on the allowable portion of any capital debt on which the provider is only required to pay interest expense. The remaining portion of the amount shall be applied to reduce other allowable capital debt starting with the capital debt which had the highest amount of interest expense during the reporting year.

F. If prepayment of a capital debt is prohibited by the funding source and the provider does not have any other capital debts, the portion of the capital debt reduction allowance which must be applied to reduce capital debt shall be applied first to the reduction of any working capital loans; the balance shall be deposited in the funded depreciation account. If prepayment of the capital debt results in the imposition of a prepayment penalty by the funding source, a portion of the capital debt reduction allowance which must be applied to reduce capital debt may be used to pay that penalty and the remainder may be used to reduce capital debt or the entire portion of the capital debt reduction allowance to be used to reduce capital debt may be deposited in the funded depreciation account.

G. For purposes of determining the provider's property related payment rate for the facility, only capital debt interest expense resulting from allowable capital debt reduced in accordance with items C to F shall be allowed.

Subp. 6. **Energy conservation incentive.** The commissioner shall approve requests for exceptions to subpart 3, item F, and part 9553.0035, subpart 8, for initiatives designed to reduce the energy usage of the facility. The requests must be accompanied by an energy audit prepared by a professional engineer or architect registered in Minnesota, or by an auditor certified under part 7635.0130 to do energy audits. The cost of the energy audit is an allowable operating cost and must be classified in the plant operations and maintenance cost category. Energy conservation measures identified in the energy audit that:

A. have a payback period equal to or less than 36 months and a total cost not exceeding $1 per resident day shall be exempt from subpart 3, item F and part 9553.0035, subpart 8; or

B. have a payback period greater than 36 months or have a total cost in excess of $1 per resident day shall be exempt from subpart 3, item F.

Subp. 7. **Reimbursement of lease or rental expense.** The provider or provider group's lease or rental costs shall be determined according to items A to H.

A. Lease or rental costs of depreciable equipment shall be allowed if:

(1) the lease or rental agreement is arms-length; and

(2) the lease or rental cost is equal to or less than the cost of purchasing that piece of depreciable equipment. For purposes of this subitem, the cost of purchasing the piece of depreciable equipment must be determined according to subparts 1 to 4 and item E; or

(3) the arms-length lease or rental agreement for the piece of depreciable equipment covers a period of 60 days or less annually.

B. Leases or rental agreements shall be considered arms-length transactions unless the lease or rental agreement:

(1) results from sale and lease-back arrangements;

(2) results from a lease with option to buy at less than anticipated value;

(3) is paid to a related organization; or

(4) for other reasons is required to be capitalized in accordance with generally accepted accounting principles.

C. The costs of a lease or rental agreement for a facility's physical plant shall be subject to the following limitations:

(1) Lease or rental costs which are not arms-length leases as defined in item B shall be disallowed.

(2) Arms-length leases or rental costs shall be allowed subject to the limitations in item E.

(3) Leases or rental costs incurred under agreements entered into on or before December 31, 1983, are allowable under rules and regulations in effect on December 31, 1983, subject to the conditions in item B and the limitations in item E.

(4) Increases in lease or rental costs resulting from the renewal, renegotiation, or extension of a lease or rental agreement in subitem (3) are allowable to the extent that the facility's property related payment rate does not exceed the average property related payment rate of all facilities in the state.

D. For nonarms-length lease or rental costs disallowed under item C, subitem (1) or (3), the provider shall receive in lieu of the lease or rental costs for the facility's physical plant the applicable depreciation, interest, and other reasonable property related costs incurred by the lessor, such as real estate taxes. Depreciation and interest shall be established in accordance with subparts 1 to 5, and shall be based on the lessor's historical capital cost of the capital assets and historical capital debt.

E. The present value of the lease or rental payments allowed in item A, subitem (2) and item C, subitems (2), (3), and (4) together with the historical capital cost of all other capital assets used by the facility shall not exceed the limitations in subpart 1, item C, and subpart 3, item H. The present value of the lease or rental payments must be calculated exclusive of real estate taxes and other costs assumed by the lessor. The interest rate used in calculating the present value of the lease or rental payments shall be the lessor's interest rate subject to the limits in subpart 2. If the lessor's interest rate is not provided by the lessor, the commissioner shall use the interest rate limit established by the rule in effect on the date the lease or rental agreement became effective.

F. Providers with physical plant lease or rental costs disallowed under item C, subitem (1) if such a disallowance was the result of a less than arms-length agreement under item B, subitem (3) may receive the capital debt reduction allowance as in subpart 5 except that for purposes of computing the percentage of equity in subpart 5, the lessor and the lessee's historical capital costs of capital assets in the facility and the related historical capital debt must be used.

G. Facilities which lease capital assets from related organizations must fund depreciation in accordance with subpart 1, item E.

H. Parts 9553.0010 to 9553.0080 shall be used to determine the allowable property related cost for facilities which have lease or rental agreements and subsequently purchase the same capital asset. In no case shall the allowed property related costs on the purchased capital asset exceed the annual cost allowed for the lease or rental agreement prior to the sale under parts 9553.0010 to 9553.0080.

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