

IN THE MATTER OF:

MAGNOLIA GARDENS, LLC

DOCKET NO. 11-16-2315

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BEFORE THE

MARYLAND HEALTH

CARE COMMISSION

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REQUEST TO MODIFY CERTIFICATE OF NEED

I. INTRODUCTION

On March 19, 2013, Magnolia Gardens, LLC (“Magnolia”) filed a request for modification of a Certificate of Need (“CON”) that was approved on April 19, 2012. The requested modification is for a change in the financing mechanism and a change in the ownership of the building. The CON issued to Magnolia (Docket No. 11-16-2315) was for the construction of a replacement comprehensive care facility (“CCF”) that would relocate the existing CCF currently operating as Magnolia Center. Originally constructed in the 1950s, Magnolia Center is a 104-bed CCF operating in the City of Lanham in Prince George’s County on the campus of Doctors Community Hospital. The new facility will also be located on the campus of Doctors Community Hospital on a site near the existing Magnolia Center.

Approved CON

The approved CON authorizes Magnolia Gardens to replace the existing 104-bed CCF, operated as Magnolia Center with a 130-bed, single-story CCF consisting of 72,660 gross square feet (“SF”). The 26 additional beds included in the replacement project were formerly operated at Gladys Spellman Hospital, were temporarily delicensed in June, 2011, and subsequently purchased by the applicant for \$58,000. Magnolia Gardens is a joint venture that is owned and operated by Magnolia JV, LLC, a subsidiary of Genesis HealthCare, LLC (49%), and Doctors Community Health Ventures, Inc., a subsidiary of Doctors Community Hospital (51%).

The approved facility is designed to operate with 108 patient rooms that include 86 private and 22 semi-private rooms. All of the rooms will have a private bathroom/toilet facility, and each unit will have centralized showers. The CCF will have two units that serve two patient populations with distinct programs of care. The Short Stay Unit will have 60 private rooms and will assist patients discharged from the hospital to recover, recuperate, and rehabilitate for discharge to the patient’s home. The 70-bed Long-Term Care Unit will have 22 semi-private and 26 private rooms for a resident population needing supportive maintenance of their health and daily living space.

The Commission approved this project at a total cost of \$20,743,511, consisting of \$18,575,930 in total current capital cost, \$320,801 in financing and other cash requirements, \$1,221,573 in capitalized interest, and an inflation allowance of \$625,207. Magnolia was planning to finance the project with \$20 million provided by the real estate investment trust, Health Care REIT, Inc., which would own the assets created by the project. The joint venture would provide the balance in cash to fund the \$743,511 for this project. Genesis HealthCare

entities would operate the replacement facility through lease arrangements with the owner of the real assets.

The approval was issued with the following condition:

At the time of first use review, Magnolia shall provide the Commission with a completed Memorandum of Understanding with the Maryland Medicaid Assistance Program agreeing to the minimum required level of Medicaid participation for Prince George's County.

Request for Modifications to an Approved CON

On behalf of Magnolia Gardens, on March 19, 2013 Genesis HealthCare submitted a request to modify the CON approved on April 19, 2012 to permit changes in the financing mechanism and the ownership of the building. The applicant states that instead of financing the project with \$20 million provided by the real estate investment trust, Health Care REIT, Inc., the joint venture will now finance the project through a conventional mortgage loan totaling \$14,175,000, with the remaining \$6,151,389 provided in cash from the joint venture members. The reason given for this change is the more favorable current interest rates possible with a conventional mortgage loan obtained by the joint venture when compared with the alternative cost of the Health Care REIT funding option. Magnolia provided a copy of a letter from M & T Bank, dated June 29, 2012, stating approval of the request for construction financing and permanent financing of Magnolia. The change to a mortgage loan will result in the applicant incurring costs for debt service, interest, and depreciation instead of lease payments and the applicant calculates that, on balance, the former cost will, in the aggregate, be lower than the lease payments required.

The other change to the CON is in the party who will own the building housing the facility. While Magnolia Gardens, LLC, will continue to be the operator of the CCF, the owner of the building will be Magnolia Gardens Real Estate, LLC instead of Health Care REIT. Magnolia Gardens Real Estate, LLC will have the same ownership structure as the operator.

Table 1 compares the total project costs issued with the original CON and the proposed costs resulting from the change in financing mechanism. Table 2 provides the changes in the source of funds for the Magnolia Center CCF.

**Table 1: Changes in Project Costs
Magnolia Gardens**

New Construction	Original CON April 2012	Modification March 2013	Change
Building	\$11,237,305	\$11,237,305	\$0
Land Purchase	565,000	565,000	0
Site Preparation	2,264,800	2,264,800	0
Architect/Engineering Fees	695,926	695,926	0
Permits	69,754	69,754	0
Subtotal	\$14,832,785	\$14,832,785	\$0
Other Capital Costs			
Equipment	\$1,500,000	\$1,500,000	\$0
Contingencies	896,497	896,497	0
Other Capital Costs	1,346,648	1,346,648	0
Capitalized Interest	1,221,573	500,000	(721,573)
Subtotal	\$3,743,145	\$3,743,145	(\$721,573)
Total Estimated Capital Costs	\$19,797,503	\$19,075,930	(\$721,573)
Inflation	\$625,207	\$929,658	\$304,451
Total Proposed Capital Costs	\$20,422,710	\$20,005,588	(\$417,122)
Financing Costs and Other Cash Requirements			
REIT Placement Fees	\$200,000	\$0	(\$200,000)
Loan Commitment Fee/Lender Costs	0	200,000	200,000
Legal Fees/CON Consulting Fees	120,801	120,801	0
Subtotal	\$320,801	\$320,801	\$0
TOTAL USE OF FUNDS	\$20,743,511	\$20,326,389	(\$417,122)

Sources: March 15, 2012 Modifications to CON application and 2013 Request for Modification of the CON, Ex.2

**Table 2: Changes in Source of Funds
Magnolia Gardens**

Source of Funds	Original CON	2013 Requested Modification	Change
Cash	\$743,511	\$6,151,389	\$5,407,878
Health Care REIT	20,000,000	0	(\$20,000,000)
Mortgage	0	\$14,175,000	\$14,175,000
TOTAL SOURCE OF FUNDS	\$ 20,743,511	\$ 20,326,389	(\$417,122)

Sources: March 15, 2012 Modifications to CON application and 2013 Request for Modification of the CON, Ex.2

II. STAFF REVIEW AND ANALYSIS

COMAR 10.24.01.17 sets forth changes in approved projects that require Commission action which include changes in the financing mechanism of the project, and three impermissible changes that would require a new CON. The three impermissible changes are: (1) changes in the fundamental nature of the facility or the services to be provided in the facility from those that were approved; (2) increases in the total bed capacity or capacity of medical service categories from those approved; and (3) changes requiring extensions of time to meet applicable performance requirements, except as permitted by regulation. This modification request does not include any impermissible modifications. The modification does not change the fundamental nature of the approved facility or services approved by the Commission. The proposed changes will not increase the total bed capacity or services offered. Although the project implementation target dates have changed, the changes do not require an extension of the applicable performance requirements.

The five changes that require Commission action are (1) any significant changes to the physical plant design; (2) capital cost increases that exceed the approved capital cost, inflated by an amount determined by applying the Building Cost Index published in Health Care Cost Review from the application submission date to the date of the filing of a request for approval of a project change; (3) when total projected operating expenses or revenue increases exceed the projected expenses or revenues in the approved Certificate of Need Application, inflated by 10 percent per year; (4) a change in the project financing mechanism; and (5) a change in location or address of the project. The requested modification does not include: any significant changes to the physical plant design, number of beds, or square footage; any increases to the capital costs for this project; or any changes to the location or address of the proposed CCF.

Regarding the question of whether the change in projected operating expenses and revenue will exceed the projections in the approved CON by more than 10% a year, Commission staff compared the projected revenue expenses for the project as approved with revised projected revenues and expenses submitted with the modification request. The comparison showed that the change in financing will reduce expenses and revenue for the first full year of operation as a 130-bed CCF. This reduction in revenue is attributable to slightly lower Medicaid rates and the reduction in expenses is attributable to the change in financing that is expected to result in expenses for interest, depreciation, and amortization that will be approximately \$154,000 less in the first full year than the rent that would be paid to Health Care REIT.

The requested change in ownership of the building does not require Commission action and does not constitute a prohibited transfer of a CON, which, in this case, was issued to Magnolia Gardens, LLC. The only requested change that requires Commission action is the proposed change in the financing mechanism and the proposed change will reduce both capital costs and operating expenses. Staff considered the availability of funds to provide the cash contribution, which significantly increases in this case from \$743,511 to over \$6 million dollars under the proposed change. Staff notes that as of June 30, 2012 Doctors Community Hospital and subsidiaries were reported to have almost \$25 million dollars in cash and cash equivalents and over \$13 million in marketable securities, and on December 31, 2011, FC-GEN Operations Investments, LLC, the parent of Genesis HealthCare, LLC, were reported to have \$50,916,000 in cash and cash equivalents.

III. SUMMARY AND STAFF RECOMMENDATION

This project was approved due to the need to modernize the existing facility and the finding that replacement with a larger facility was the most cost effective approach to accomplishing this modernization in a viable way when compared to the alternative of expanding and renovating the existing physical plant. The requested modification to the financing mechanism will reduce the project costs and projected operating expenses and Medicaid rates. The requested change in the ownership of the building will not have any impact on the control of operations and does not require Commission action.

Staff recommends the approval of the changes to the financing mechanism, as outlined above.

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MAGNOLIA GARDENS, LLC

DOCKET NO. 11-16-2315

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CARE COMMISSION

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FINAL ORDER

Based on the information and findings in this Staff Report and Recommendation, and the record in this review, it is this 16th day of May, 2013, **ORDERED:**

That the request by Magnolia Gardens, LLC, to modify its Certificate of Need, Docket No. 11-16-2315, is **APPROVED** subject to the following condition:

At the time of first use review, Magnolia shall provide the Commission with a completed Memorandum of Understanding with the Maryland Medicaid Assistance Program agreeing to the minimum required level of Medicaid participation for Prince George's County.

MARYLAND HEALTH CARE COMMISSION

May 16, 2013