



MARYLAND HEALTH CARE COMMISSION

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MEMORANDUM

TO: Commissioners

FROM: Kevin R. McDonald
Chief, Certificate of Need 

DATE: November 20, 2014

SUBJECT: NMS Healthcare of Hagerstown, LLC, Docket No. 10-21-2307

Enclosed is the staff report and recommendation on the request by NMS Healthcare of Hagerstown, LLC for a Project Change after CON Approval (“modification request”) for the above-referenced project initially approved by the Commission in July of 2010 for a total project cost of \$9,513,233. Subsequently, NMS sought and received (on December 20, 2012) MHCC approval for a change in its CON that authorized both an increase in total project cost-- bringing it to \$11,121,460 -- and a significant change in physical plant design.

NMS is before the Commission again with a request for a cost increase and an extension of its final performance requirement. NMS now estimates that the total project cost will be \$12,426,019, an increase of \$976,729. NMS cites “a number of developments beyond NMS’s control” that have created delays that will make it “essentially...impossible” to meet the third performance requirement deadline of January 11, 2015. The “developments” that are cited for the delays are in large part also explained as the cause for the cost increases. They are described in the enclosed report.

Staff has reviewed the request for the cost increase and believes that the requested modification does not change the Commission’s earlier findings regarding need, viability, cost effectiveness, or impact on other providers, and thus recommends **APPROVAL** of the modification request. Staff also recommends that the NMS request for a six-month extension of the third performance requirement be **GRANTED**, giving NMS until July 11, 2015 to document that the approved project has been completed, licensed, met all legal requirements and is providing the approved services.

IN THE MATTER OF:
NMS HEALTHCARE OF
HAGERSTOWN, LLC
DOCKET NO. 10-21-2307

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BEFORE THE
MARYLAND HEALTH
CARE COMMISSION

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REQUEST TO MODIFY CERTIFICATE OF NEED

I. INTRODUCTION

Background

The Maryland Health Care Commission (MHCC) granted NMS Healthcare of Hagerstown, LLC (NMS) a Certificate of Need (CON) to renovate and expand an existing 186-bed comprehensive care facility (CCF) located at 14014 Marsh Pike, in Hagerstown (Washington County) in July 2010.

The renovation and expansion was designed to accommodate an increase of 20 beds acquired from another nursing home in Washington County and to reconfigure the mix of private and multi-patient rooms in a way that would increase the number of private rooms and eliminate all patient rooms with more than two beds (the facility has 12 four-bed rooms, seven three-bed rooms, 55 semi-private rooms, and seven private rooms). The approved project included the construction of a two-story addition of 25,480 square feet (SF) and the renovation of 16,660 SF. The total approved cost was \$9,513,233.

Subsequently, NMS sought and received (on December 20, 2012) MHCC approval for a change in its CON that authorized both a cost increase and a significant change in physical plant design. The cost increase, excluding inflation allowances, was \$2,131,439 (23.7%) to \$11,121,460.¹ The changes in design involved a significant reduction in the scope of the renovations, from 16,660 square feet in the project as originally approved to 1,335 square feet in the modified project. This had the effect of limiting the number of private rooms to be created to 22 instead of the 42 in the originally-approved project. The modified project continued to eliminate all of the seven three-bed and twelve four-bed rooms and, despite the reduction in private room capacity, did triple the number of such rooms available upon completion of the project.

¹ With inflation allowances, the total cost increase for the project was \$1.936 million, an increase of 20.3%.

Request for Modified Certificate of Need

NMS is again before the Commission seeking a second change in its CON for a cost increase that exceeds the permissible inflationary increase. Capital cost increases that exceed the inflation allowance calculated using the inflation index published on a quarterly basis by IHS in *Healthcare Cost Review* require Commission approval under COMAR 10.24.01.17B(2). NMS now estimates that the total projected cost will be \$12,426,019, an increase of \$976,729 (8.5%).² The amount of increase exceeds the permissible inflation allowance.

At the same time, NMS is requesting a six-month extension of the third and final performance requirement attached to this CON. This performance requirement is: *“Documentation that the approved project has been completed, has been licensed, and has met all legal requirements and is providing the approved services no later than 24 months after the effective date of the binding construction contract.”* NMS previously met the first and second performance requirements respectively by executing a building construction contract on January 11, 2013, and initiating construction by November 11, 2013, following a Commission-approved extension of the second performance requirement deadline.

NMS cites “a number of developments beyond NMS’s control” that have created delays that will make it “essentially...impossible” to meet the third performance requirement deadline of January 11, 2015. The “developments” that are cited for the delays are in large part also explained as the cause for the cost increases. They are described later in this report.

The financing plan for the project will also change. The applicant projects to borrowing an additional \$1.5 million (16.1%), increasing debt as a funding source from \$9.3 to \$10.8 million, while also planning to reduce the cash equity contribution by \$500,000 (23.8%), from \$2.1 to \$1.6 million.

II. APPLICABLE REGULATIONS

Under the Commission’s regulations, at COMAR 10.24.01.17B, the following changes to an approved CON require the Commission’s approval:

1. A significant change in 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. If 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. Changing the financing mechanisms of the project; or
5. Changing the location or address of the project.

² Exclusive of the \$327,830 inflation allowance included in the 2012 cost estimate, the cost increase is \$1.304 million or 11.7%.

NMS's request to modify its CON for this project involves a capital cost increase that exceeds the approved capital cost inflated by an amount determined by applying the Building Cost Index published in *Health Care Cost Review* from the date of the approval of the Modified CON (December 20, 2012) to the date it filed the request for approval of the project change (October 1, 2014).³ A change in the financing mechanism of the project is also proposed, with debt increasing as a source of funding from 81% to 87%.⁴ Accordingly, this request must be reviewed and approved by the Commission.

The actions available to the Commission are found in **COMAR 10.24.01.17D(3)**:

(3) The Commission shall provide written notification to the applicant within 45 days of the Commission's receipt of the change request that:

- (a) The proposed change is approved and is incorporated into a modified Certificate of Need for the project;
- (b) The proposed change is approved in part or approved with conditions;
- (c) The proposed change is not approved, with explanation; or
- (d) The proposed change is of sufficient scope to warrant complete review in accordance with the Certificate of Need review process described in Regulations .08—.10 of this chapter, and may only be considered upon completion of this review

III. COST INCREASES AND FINANCIAL IMPACT OF THE PROPOSED MODIFICATION

CON-approved cost compared to modification request

Table 1 shows projected costs (and sources of funds) as originally approved, as modified in December 2012, and the currently-requested modification. Total capital cost now projected exceeds that of the original approval by \$2.8 million (30.3%), and exceeds the first allowed modification by \$1.3 million.

³ NMS's request to modify the CON does not involve any significant change in physical plant design, operating expense or revenue, or location of the project.

⁴ It should be noted that this is still less than the proportion of debt financing projected in the original 2010 plan of 90%.

Table 1: Cost and Funding Comparison -- Project as Approved, at First Modification, and at New Cost Estimate

USES OF FUNDS	As Approved July 15, 2010	Modification as Approved December 20, 2012	Requested Modification October 1, 2014
<i>New construction</i>			
Construction	\$3,719,282	\$6,307,012	\$6,418,063
Site preparation	870,718	1,792,820	2,521,684
Architect/engineering fees	529,826	790,768	852,820
Permits (buildings/utilities)	81,512	82,044	82,044
Subtotal-New Construction	\$5,201,338	\$8,972,644	\$9,874,611
<i>Renovation</i>			
Subtotal-Renovation	\$1,327,054	\$239,835	\$544,875
<i>Other capital costs</i>			
Equipment	605,850	605,850	605,850
Contingencies	580,000	580,000	350,000
Bed Purchase	150,000	208,051	150,000
Interior design fees			25,000
Owner's rep			355,603
Subtotal-Other Capital Costs	\$1,335,850	\$1,393,901	\$1,486,453
Total Current Capital Costs	\$7,864,242	\$10,606,380	\$11,905,939
Inflation Allowance	\$523,212	\$327,830	\$0
Capitalized Construction Interest	933,779	240,310	240,310
Total Capital Costs	\$9,321,233	\$11,174,520	\$12,146,249
Loan Placement Fees	100,000	182,770	182,770
Legal and Consulting Fees	90,000	90,000	95,000
Other - Printing	2,000	2,000	2,000
Subtotal-Financing/Other	\$192,000	\$274,770	\$279,770
Total Uses of Funds	\$9,513,233	\$11,449,290	\$12,426,019
SOURCES OF FUNDS			
	As Approved July 15, 2010	Modification as Approved December 20, 2012	Requested Modification October 1, 2014
Cash	\$951,323	\$2,128,090	\$1,609,719
Mortgage	\$8,561,910	\$9,321,200	\$10,816,300
Total Sources of Funds	\$9,513,233	\$11,449,290	\$12,426,019

NMS explained the most recent proposed cost increases as follows:

- **Weather:** site work was interrupted last winter due to the severity of the winter. Although certain measures were taken that allowed the majority of the work to keep moving forward, site work was part of a critical path for major project elements which were thus delayed (\$38,510).

- **Subsurface Rock:** NMS has run into an extreme amount of unforeseeable rock below the surface. Due to the sensitive nature of the nursing home, blasting was not permitted, so the removal of the rock is a deliberate process that has further slowed the anticipated schedule (\$468,447).
- **Other concealed conditions:** As the project is an addition to an existing building, there are numerous conditions that NMS has encountered that have had a negative impact on the schedule. These include: buried site structures such as manholes; old footings no longer needed; existing footings at higher elevations than anticipated, requiring NMS to underpin the existing footings; missing or inadequate footings for new columns (\$136,885).
- **Change orders and fees:** The project incurred change orders (\$212,741) and increased A/E, interior design and owner's representative fees (\$492,369).

Inflation allowance

Capital cost increases that exceed the inflation allowance calculated using the inflation index published on a quarterly basis by IHS in *Healthcare Cost Review* require Commission approval under COMAR 10.24.01.17B(2).

The initial approval of a modification request was in the fourth quarter of 2012, while the current request came in the fourth quarter of 2014. Using the cost index, allowable inflation is 1.030224% of the total capital cost of \$10,846,691, or \$327,830. As noted in the preceding table, the actual capital cost increase (\$971,729) is well above that, requiring Commission approval.

Impact on operating cost and revenue

Given the delayed implementation and time that has passed between the initial application and the current modification request, as well as the differing time horizons reflected in the application and modification request, comparisons are difficult. However, changes in costs and revenues do not appear to exceed the projected expenses or revenues in the approved Certificate of Need Application, inflated by 10 percent per year.

IV. ANALYSIS AND RECOMMENDATION

Although the increase in project cost is not insignificant, the proposed modification would not have a material effect on the findings made by the Commission with respect to the cost and effectiveness of alternatives or project viability.

Cost effectiveness remains sound, with the new construction component of the project now projecting at 3% above the Marshall Valuation Service (MVS) benchmark while the renovation component projects to be less than half the MVS benchmark. This is actually slightly better than the projections appeared in the first modification.

As for **viability**, the project now actually projects greater profitability than it did at the time of approval, due primarily to a projected census mix with higher acuity and more Medicare patients (Medicare patients represented 30% of the facility's census in FY14, but only 22% in FY09, when this project was planned).

The modification also has **little impact on the rates** that will be paid for nursing home care by the primary payors, Medicare and Medicaid. Medicare reimburses prospectively with predetermined rates based on patient acuity. Its rates are established by geographic region and are not facility-specific. Therefore, construction costs by the NMS Hagerstown facility have no impact on those rates and are not part of the calculation of the Medicare rate. While Medicaid currently reimburses retrospectively, it has a ceiling that the NMS Hagerstown facility has already exceeded. Therefore, any increase in construction costs will not add to the level of reimbursement available from Medicaid. Passing along increased costs to patients paying out of pocket or private third-party payors, who accounted for 2.4% of the facility's patient days in FY2014, would be limited by conventional market forces.

Finally, because no material changes are occurring in the location, capacity, or nature of the project, the requested modification does not change the need for the project or its impact on existing providers.

Staff recommends that this project be APPROVED, and that this approval maintain the condition placed on the original approval of the project:

At the time of first use review, NMS Healthcare of Hagerstown, LLC shall provide the Commission with a completed Memorandum of Understanding with the Maryland Medical Assistance Program agreeing to maintain the proportion of Medicaid patient days required by Nursing Home Standard COMAR 10.24.08.05A.(2).

Staff also recommends that the NMS request for a six-month extension of the third performance requirement be granted. That would give NMS until July 11, 2015 to *document that the approved project has been completed, licensed, met all legal requirements and is providing the approved services.*

IN THE MATTER OF:
NMS HEALTHCARE OF
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DOCKET NO. 10-21-2307

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BEFORE THE
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FINAL ORDER

Based on the analysis and findings in this Staff Report and Recommendations, it is this day, the 20th of November, 2014, **ORDERED**

That the request of NMS Healthcare Hagerstown, LLC to modify the cost of the capital project originally approved through Certificate of Need, Docket No. 10-21-2307, on July 15, 2010, is **APPROVED** with the same condition placed on the original approval and first modification, which was granted on December 20, 2012.

The total approved cost of the modified project is \$12,426,019.

This Certificate of Need remains subject to the following condition:

At the time of first use review, NMS Healthcare Hagerstown, L.L.C. shall provide the Commission with a completed Memorandum of Understanding with the Maryland Medical Assistance Program agreeing to maintain the proportion of Medicaid patient days required by Nursing Home Standard COMAR 10.24.08.05A.(2).

MARYLAND HEALTH CARE COMMISSION
November 20, 2014