



MARYLAND HEALTH CARE COMMISSION

4160 PATTERSON AVENUE – BALTIMORE, MARYLAND 21215
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MEMORANDUM

To: Commissioners

From: Kevin R. McDonald, Chief
Certificate of Need

Date: November 17, 2016

Re: Staff Report and Recommendation:
Request to Modify a Certificate of Need
Kaiser Permanente Baltimore Surgical Center
Docket No. 16-03-2372

Attached is a Staff Report and Recommendation regarding the request for a modification of a Certificate of Need (“CON”) issued on June 17, 2016 to Kaiser Foundation Health Plan of The Mid-Atlantic States, Inc. (“Kaiser”)

Kaiser currently operates an ambulatory surgical facility (“ASF”) at the Kaiser Permanente South Baltimore County Medical Center at 1701 Twin Springs Road in Halethorpe, Baltimore County. The ASF, which opened in April 2013, utilizes two operating rooms (“OR”) that are used almost exclusively by members of Kaiser’s health plans. The Maryland Health Care Commission (“MHCC”) granted Kaiser a CON to finish 491 square feet of shell space for a third OR in June of this year (Docket No. 16-03-2372).

Kaiser requests authorization to increase the total project costs by approximately \$652,834, increasing the total project cost from \$1,600,405 to \$2,253,239. Kaiser’s request to change its approved CON arises from incorrect and incomplete project cost estimation, which is explained in detail in the Staff Report.

Staff recommends that the Commission **APPROVE** the proposed modification of the Certificate of Need issued to Kaiser Foundation Health Plan of The Mid-Atlantic States, Inc. to finish 491 square feet of shell space for a third OR (Docket No. 16-03-2372).

IN THE MATTER OF

KAISER PERMANENTE

BALTIMORE SURGICAL CENTER

DOCKET NO. 16-03-2372

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BEFORE THE

MARYLAND HEALTH

CARE COMMISSION

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REQUEST TO MODIFY CERTIFICATE OF NEED

I. INTRODUCTION

Kaiser Permanente¹ (or “KP”) is a health maintenance organization (“HMO”) with approximately 308,000 members in Maryland and owns and operates 17 outpatient medical office buildings in Maryland to provide care directly to Kaiser’s members. In addition, Kaiser contracts with community practitioners and facilities to provide care that Kaiser does not provide internally or to meet the geographic access needs of its members.

KP currently operates an ambulatory surgical facility at the Kaiser Permanente South Baltimore County Medical Center at 1701 Twin Springs Road in Halethorpe, Baltimore County. The applicant received certificate of Need (“CON”) approval in 2010 to establish an ambulatory surgical facility (“ASF”) with two operating rooms (“ORs”) and shell space for a future third OR (Docket No. 10-03-2306). The ASF, which opened in April 2013, is used almost exclusively by members of KP’s health plans.

In June of this year, the Maryland Health Care Commission (“MHCC”) granted KP a CON to finish 491 square feet of shell space for a third OR. The estimated cost of finishing the third OR at that time was \$1,600,405, which KP planned to fund with cash reserves.

KP is now seeking a change to the project issued a CON in June 2016 to reflect a large increase in the estimated cost of the project. Capital cost increases in CON-approved projects that exceed the inflation allowance calculated using the inflation index published on a quarterly basis by IHS Global Insights (“IHS”) in *Healthcare Cost Review* require Commission approval under COMAR 10.24.01.17B(2). KP now estimates that the total cost of the project will be \$2,253,239, an increase of \$652,834 or 40.8%.² An increase of this size exceeds the permissible inflation allowance. The applicant still plans to pay for the project using cash reserves.

¹ The applicant is Kaiser Foundation Health Plan of The Mid-Atlantic States, Inc. In its Mid-Atlantic States Region, “Kaiser Permanente” (a trade name) comprises Kaiser Foundation Health Plan of the Mid-Atlantic States, Inc. (“KFHP”) and the Mid-Atlantic Permanente Medical Group (“MAPMG”), a multi-specialty group practice of more than 1,200 physicians with which KFHP exclusively contracts to meet the medical care needs of approximately 600,000 Kaiser Permanente members in Maryland, Virginia, and the District of Columbia. KFHP is a non-profit corporation whose sole member is Kaiser Foundation Health Plan, Inc., and was formed on or about October 9, 1980.

² Exclusive of the \$16,238 inflation allowance included in the June 2016 cost estimate, the cost increase is \$638,010 or 40.3%.

II. APPLICABLE REGULATIONS

Under the Commission's regulations, at COMAR 10.24.01.17B, the following changes to a CON-approved project cannot be made without 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.

KP'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 CON (June 16, 2016) to the date it filed the request for approval of the project change (August 4, 2016).³ Accordingly, this request must be reviewed by the Commission.

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

- (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. IMPACT

The new cost estimate exceeds the inflation allowance used in CON regulation

As previously noted, 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).

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

KP submitted its CON application for the project in the first quarter of 2016, while the modification request came in the third quarter of 2016. The allowable inflated capital cost is \$1,616,508,⁴ with an allowable inflation level of \$16,103 over the originally-approved capital costs. As noted in the preceding table, the actual capital cost increase (\$652,834) is well above that allowable inflation, requiring KP to seek Commission approval.

CON-approved cost compared to modification request

Table 1 shows estimated costs (and sources of funds) approved by the Commission in June 2016, and the currently-requested modification. KP states that the total cost for the project now exceeds that of the original approval by \$652,834 (40.8%).

Table 1: Comparison of Approved Project Cost and New Cost Estimate

Project Elements	Original Approved Amount	Current Cost Estimate	Nominal Change	Percentage change
Capital costs				
Building	\$366,006	\$620,000	\$253,994	69.4%
Architect/engineering fees	27,450	67,099	39,649	144.4%
Permits	10,000	10,000	0	0.0%
Equipment	\$822,070	\$829,666	\$7,596	0.9%
Contingencies	136,000	183,960	47,960	35.3%
Project mgmt./owner's miscellaneous	113,091	401,902	288,811	255.4%
Total current capital costs	\$1,474,617	\$2,112,627	\$638,010	43.3%
Non-current capital costs				
Inflation allowance	16,238	31,062	14,824	91.3%
TOTAL CAPITAL COSTS	\$1,490,855	\$2,143,689	\$652,834	43.8%
Non-Legal Consultant Fees	109,550	109,550	0	0%
TOTAL PROJECT COST	\$1,600,405	\$2,253,239	\$652,834	40.8%

Source: September 28th response from Kim Horn, Kaiser Permanente, to request for additional information from MHCC sent on August 15th.

The reasons put forward by KP for the cost estimate increases are summarized below.

- **The estimated building costs** increased because the original cost estimate was flawed in several respects: (1) it failed to take into account that the applicant would be paying premium costs for after-hours work; (2) it failed to include the costs related to Infection Control & Risk Assessment plans; (3) it did not properly account for labor market conditions or the cost of a premium general contractor; (4) KP had not completed estimates for the cost of the mechanical systems required to support the new OR and did not include them in the estimate; and (5) a number of cost line item estimates increase because they are a function of the overall higher project cost for renovating and equipping the space or are related to the other errors in the estimate (these include the contingency allowance, bonding expenses, insurance expenses, and general

⁴ Using the Building Cost Indexes reported in the MHCC's August 12, 2016 edition of the "Determining the Threshold for Required Approval of Changes in CON Approved Capital Costs."

contractor fees).

- **Architect and engineering fees** increased because the original budget erroneously accounted only for the fee expenditure through schematic design and did not include the additional expenses for preparation of construction documents, construction administration, and project close-out.
- **Project management** charges from KP's Capital Projects group to administer the project from inception to close-out were greatly underestimated in the original budget, as was "**terminal cleaning**," i.e., the daily post-construction-work cleaning of sterile areas with disinfectant products to prepare for the next day's OR schedule in the existing 2 rooms.

Impact on operating cost and revenue

In the KP business model, the expenses at the facility are entirely subsidized by Kaiser Foundation Health Plan of the Mid-Atlantic States. Similarly, the center does not charge patients for the services they obtain at the facility, because payments for subscriber services are covered by subscriber premiums, not fees paid for specific services. In its original application, KP submitted a projected profit and loss statement for Kaiser Permanente Mid-Atlantic that projected profits from operations for the next ten years. The forecast model assumed increasing revenue through membership growth and moderating expenditure growth during this time. The cost for this project of approximately \$650,000 would not have a consequential impact on KP's \$2.7 billion Mid-Atlantic operation.

IV. ANALYSIS AND RECOMMENDATION

Kaiser Permanente's request to change its approved CON arises from incorrect and incomplete project cost estimation. However, staff concludes that the initial Commission findings regarding the project remain valid. The proposed capital project: complies with the applicable State Health Plan standards; is needed; is a cost-effective approach to meeting KP's objectives; is viable; is proposed by an applicant that has complied with the terms and conditions of previously issued CONs; and will have a positive impact on Kaiser's ability to provide outpatient surgery to its members without adversely affecting costs and charges or other providers of surgical services. Surgical patients will not see increased charges. KP's health maintenance organization ("HMO") subscribers are not charged for services and almost all of KP's surgical patients are HMO subscribers. The impact on subscriber premiums that could be related to such a small expenditure is not material.

Staff recommends that Kaiser Permanente's request to increase the capital cost of the project from \$1,600,405 to \$2,253,239 be **APPROVED**.

IN THE MATTER OF

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FINAL ORDER

Based on the analysis and findings in this Staff Report and Recommendation, it is this day, the 17th of November, 2016, **ORDERED:**

That the request of Kaiser Foundation Health Plan of The Mid-Atlantic States, Inc. to increase the cost of its capital project to finish space in its Baltimore Surgical Center to add a third operating room, originally issued Certificate of Need approval on June 16, 2016, is **APPROVED.**

The approved cost of the project, with this increase, is \$2,253,239.

MARYLAND HEALTH CARE COMMISSION