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**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

A handwritten signature in black ink, appearing to read "Kevin R. McDonald".

**Date:** December 21, 2017

**Re:** Staff Report and Recommendation:  
Request to Modify a Certificate of Need  
314 Grove Neck Road OPCO, L.L.C.  
Recovery Centers of America at Bracebridge  
Docket No. 15-07-2363

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Attached is a Staff Report and Recommendation in the review of the request for a modification of a Certificate of Need (“CON”) issued in December 2016 to establish an alcoholism and drug abuse intermediate care facility (“ICF”) in Earleville (Cecil County), Maryland.

The RCA Earleville ICF will function as a medically monitored intensive inpatient detoxification (“detox”) facility, with 21 beds, operating in conjunction with an 87-bed residential treatment program. The ICF would be classified as a Level III.7D program under the level of care criteria of the American Society of Addiction Medicine (“ASAM”). The residential treatment program would be classified as an ASAM Level III.5 program, providing clinically managed high-intensity residential treatment. Facilities providing III.5 level of care are not subject to CON review.

RCA Earleville is requesting an increase in the approved cost of the project. There are two bases for that requested increase: (1) it underestimated the project cost; and (2) it erred in allocating the cost of the ICF component of the project as a proportion of the total project development costs.

MHCC action is required because the capital cost increase exceeds the inflation allowance. The total project cost climbed from \$32,581,216 to \$42,546,274. For the CON-regulated ICF, the total cost estimate rose from \$5,595,384 to \$7,388,582.

As originally approved, the project was to be financed with equity funding of \$4,561,387 and a mortgage of \$28,019,948. In its request for approval of a project change, the applicant states that the mortgage amount will increase to \$36,589,794 and equity funding will increase to \$5,956,480. RCA provided a letter from its primary funding source, Deerfield Private Design Fund III, L.P., assuring that it would provide the added funding.

MHCC staff recommends that the Commission **APPROVE** the proposed changes in Certificate of Need Docket No. 15-07-2363, to include both the increased cost attributable to the initial underestimation of project costs (\$1,421,788) and the increase attributable to a corrected allocation of cost between the CON-reviewable portion of the application and the non-reviewable residential treatment component (another \$371,410). The authorized change will increase the approved cost of the project from \$5,595,384 to \$7,388,582. The original conditions placed on this CON approval would remain unchanged.

IN THE MATTER OF  
314 GROVE NECK ROAD  
OPCO L.L.C.

\* BEFORE THE  
\* MARYLAND HEALTH  
\* CARE COMMISSION

Docket No. 15-07-2363

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**REQUEST TO MODIFY CERTIFICATE OF NEED**

**I. INTRODUCTION**

**Background**

In December 2016 the Maryland Health Care Commission (“Commission” or “MHCC”) granted 314 Grove Neck Road OPCO, L.L.C., an affiliate of Recovery Centers of America,<sup>1</sup> a Certificate of Need (“CON”) to establish an alcoholism and drug abuse intermediate care facility (“ICF”) in Earleville (Cecil County). The ICF will be a 21-bed detoxification (“detox”) unit providing medically monitored intensive inpatient detox services corresponding to Level III.7D on the American Society of Addiction Medicine’s (“ASAM”) defined continuum for addictions treatment. The ICF will operate in conjunction with an 87-bed clinically managed high-intensity residential treatment program (ASAM Level III.5), which is not an ICF subject to CON review and approval and was put into operation in October 2016. Together, the residential treatment and inpatient detox programs constitute a campus of services operated as RCA Earleville at Bracebridge. In February 2017, MHCC authorized RCA Earleville, subject to approval by the licensing authority, to provide detox services on a temporary basis in the residential treatment component of RCA Earleville at Bracebridge until completion of the approved detox ICF.

The CON issued to RCA Earleville for this project in December, 2016 is attached as Appendix 3.

The project involves renovation of an existing “manor house.” The approved cost of the detox ICF is \$5,595,335. The estimated cost of the entire project in December 2016 was \$32,581,335. The project was to be financed with equity funding of \$4,561,387 and a mortgage of \$28,019,948.

As noted, RCA Earleville initiated service in the non-regulated residential treatment component of the Earleville campus in 2016. It reports that from the time of its opening on October 5, 2016 through November 20, 2017, it has served a total of 533 patients and provided 8,083 patient-days. RCA Earleville reports providing 744 bed-days of charity care over that period.

RCA Earleville reports that construction and renovation work to complete the Earleville campus is underway and anticipates completion of the project by October 2018.

**Requested Project Change**

<sup>1</sup> Henceforth the applicant will be referred to as “RCA Earleville” or “RCA Earleville.”

RCA Earleville is requesting a modification to authorize a capital cost increase. There are two bases for that increase. First, RCA Earleville states that project costs were underestimated. Secondly, RCA Earleville states that it erred in the CON application development process, accurately allocating total project costs between the regulated ICF detox component of the project and the unregulated residential treatment component.

Estimated Cost Increase

RCA Earleville states that after receiving construction bids it “became apparent” that it had underestimated construction costs. For the project as a whole, total construction (both new construction and renovation) costs increased from \$15,793,174 to \$24,125,127, while total project cost climbed from \$32,581 to \$42,546,274. For the CON-regulated intermediate care facility (“ICF”) construction costs rose about 56% from \$1,905,726 to \$2,964,564, prior to adjusting for reallocation. (Note: in this section and Table 1 below “construction cost” includes associated costs such as permits, architectural fees, and site preparation. A detailed breakdown is included as Appendix 1.)

**Table 1: Comparison of Cost Estimates – December 2016 and December 2017**

	Total facility		Level III-7 component (CON-regulated)		
	As approved	As per change request	As approved	As per change request prior to reallocation	As per change request with reallocation
<b>New construction cost</b>	\$8,264,956	\$12,688,975	\$1,905,726	\$2,964,564	\$3,806,692
<b>Renovation cost</b>	\$7,528,216	\$11,436,152	N/A	N/A	N/A
<b>Total project cost</b>	\$32,581,216	\$42,546,274	\$5,595,384	\$7,017,172	\$7,388,582

Source: Applicant’s Response to Staff Information Request

Reallocation of cost to the ICF (CON-regulated) component of the project

Since the project consists of 21 Level III.7 ICF beds that are subject to CON regulation and 87 residential care beds that are not, the applicant allocated costs between the regulated ICF component and the unregulated residential treatment component. RCA Earleville made these allocations based on: the nature of each cost component, and; the extent to which it related to the facility as a whole, the ICF component, or the residential component.

The applicant modified its project several times, changing the ratio of detox beds to total beds.<sup>2</sup> In the course of those modifications, RCA Earleville failed to modify the allocation ratios as it modified the ratio of beds. RCA Earleville states:

<sup>2</sup> The original application (March 2015) included 17 level III.7/III.7D beds and 32 residential beds; that was modified to 21 and 28, respectively (May 2015); and finally to 21 level III.7/III.7D beds and 87 residential beds in Nov. 2015). See Appendix 2 for RCA Earleville’s explanation of the evolution of its cost allocations.

*RCA Earleville modified its application on several occasions, changing the number of beds, and the proportion of detox to total beds, with each modification. Unfortunately... RCA Earleville did not update the allocation percentage amount for all categories of costs with each modification. This resulted in an allocation which RCA Earleville believes is understated for the capital costs attributable to the CON-regulated ICF beds.*

Thus RCA Earleville also requests a reallocation of costs, and posits that an appropriate allocation methodology would allocate:

- Costs *attributable to the entire project* should be based on the number of ICF beds to the total number of beds (yielding a 19% allocation to the ICF component);
- Costs *attributable only to the new construction* based on the total number of ICF beds in the renovated space to the total number of ICF and residential beds in the renovated space (yielding a 30% allocation to the ICF component).

In this case applying this allocation methodology to the approved budget would increase the total capital costs attributable to ICF beds (due to the fact that a higher proportion of the ICF space is accounted for in the more expensive new construction rather than the renovation) while reducing the financing and other costs attributable to those beds. In the end, the proportion of total cost attributable to the regulated part of the facility would rise slightly, from 17.2% to 17.4%.

## II. REGULATIONS RE CHANGES TO APPROVED PROJECTS

Commission regulations, at COMAR 10.24.01.17C, identify certain circumstances<sup>3</sup> where a modification is not permitted and a new CON application is required. RCA's modification request does not involve an impermissible modification. However, COMAR 10.24.01.17B provides that certain listed "changes that would place the project at variance with its Certificate of Need ... shall receive approval from the Commission ...". Significant to the RCA Earleville project is the requirement in subsection .17B(2)<sup>4</sup> that an applicant must receive MHCC approval

[b]efore incurring 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 ....

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<sup>3</sup> Impermissible modifications include:

- (1) Changes in the fundamental nature of a facility or the services to be provided in the facility from those that were approved by the Commission;
- (2) Increases in the total licensed bed capacity of medical service categories from those approved; and
- (3) Any change that requires an extension of time to meet the applicable performance requirements specified under Regulation .12 of this chapter, except as permitted under Regulation .12E of this chapter.

<sup>4</sup> Other changes that require Commission approval, found at COMAR 10.24.01.17B, are: a significant change in physical plant design; certain increases in revenue or operating expenses; change in financing mechanisms; and a change in the location of the project.

As previously noted, RCA Earleville's request involves a capital cost increase that is in excess of the inflation allowance, and thus requires Commission action. Under COMAR 10.24.01.17D(3), the Commission may: approve the requested change; approve it in part or with conditions; decide not to approve the change for stated reasons; or require a complete CON review because of the scope of the requested change.

### **III. COST INCREASES AND FINANCIAL IMPACT OF THE PROPOSED MODIFICATION**

#### **Projected Cost Increase Exceeds the Inflation Allowance**

Although the above-quoted CON regulation provides for an inflation allowance, an increase that exceeds that allowance must seek Commission approval. The allowance is calculated using the building cost indices published on a quarterly basis by IHS Global Insight in *Healthcare Cost Review*. RCA Earleville's CON was approved in January 2017 with a Total Current Capital Cost of \$2,386,896; the estimated Total Current Capital Cost in the project change request is \$3,808,684 before adjusting for the requested cost reallocation (which would further increase the Total Current Capital Cost to \$4,756,238), far exceeding the cost increase threshold that requires Commission review.

#### **Projected Financial Impact of Proposed Modification**

As originally approved, the project was to be financed with equity funding of \$4,561,387 and a mortgage of \$28,019,948. In its request for approval of a project change, the applicant states that the mortgage amount will increase to \$36,589,794 and equity funding will increase to \$5,956,480.

On an operating basis, RCA Earleville states that it does not expect to increase its revenue or operating expenses as a result of the requested change because: "{f}unding for the project is obtained through {RCA} a parent company of the RCA Earleville OPCO entity, which in turn charges RCA Earleville an administrative fee. The parent entity does not expect to charge the OPCO entity a higher administrative fee as a result of the requested changes."

When asked to provide assurances from its primary funding source, Deerfield Private Design Fund III, L.P. ("Deerfield"), RCA provided a letter from Deerfield on December 14 2017 that contained the requested assurances.

### **IV. ANALYSIS AND STAFF RECOMMENDATION**

Staff has reviewed RCA Earleville's request for project change, in light of the conclusions in the Reviewer's Recommended Decision that was adopted by the Commission. Staff concludes that the proposed modification would not have a material effect on the findings made by the Commission in that 2016 decision. Since there are no changes to the location, capacity, or nature of the project, staff believes that the conclusions of the Commission concerning Need and Impact on existing providers or on costs and charges would not change. With regard to Viability and Financial Feasibility, because the applicant has assurance of additional funding from Deerfield, the project will still be viable despite the additional capital cost. The increase in project costs will not hurt operating results because the added interest and depreciation expense will be borne by RCA, the applicant's parent company.

For these reasons, MHCC staff recommends that the Commission **APPROVE** the proposed changes in Certificate of Need Docket No. 15-07-2363, to include both the increased cost attributable to the initial underestimation of project costs (\$1,421,788) and the increase attributable to a corrected allocation of cost between the CON-reviewable portion of the application and the non-reviewable residential treatment component (another \$371,410). The authorized change will increase the approved cost of the project from \$5,595,384 to \$7,388,582. The original conditions placed on this CON approval would remain unchanged.

**Appendix 1: Detailed Comparison of Cost Estimates in CON with Requested Change**  
**Source: Exhibit 2 in Applicant's Response to Staff Information Request**

	Total project		ICF Only		
	In CON	Modification	In CON	Modification w/o reallocation	Modification w/ reallocation
<b>A. USE OF FUNDS</b>					
<b>1. CAPITAL COSTS</b>					
<b>New Construction</b>					
Building	\$5,151,300	\$8,693,691	\$1,287,825	\$2,173,423	\$2,608,107
Site and Infrastructure	\$2,993,032	\$3,874,660	\$588,131	\$761,371	\$1,162,398
Architect/Engineering Fees	\$70,767	\$70,767	\$17,465	\$17,465	\$21,230
Permits (Building, Utilities, Etc.)	\$49,857	\$49,857	\$12,305	\$12,305	\$14,957
<b>SUBTOTAL</b>	<b>\$8,264,956</b>	<b>\$12,688,975</b>	<b>\$1,905,726</b>	<b>\$2,964,564</b>	<b>\$3,806,692</b>
<b>Renovations</b>					
Building	\$7,403,144	\$10,015,691	N/A	N/A	N/A
Site and Infrastructure		\$1,295,387			
Architect/Engineering Fees	\$73,378	\$73,378			
Permits (Building, Utilities, Etc.)	\$51,696	\$51,696			
<b>SUBTOTAL</b>	<b>\$7,528,218</b>	<b>\$11,436,152</b>			
<b>Other Capital Costs</b>					
Movable Equipment	\$2,195,438	\$2,195,438	\$184,800	\$184,800	\$426,891
Contingency Allowance	\$754,957	\$2,387,943	\$167,798	\$530,748	\$464,322
Legal fees	\$250,000	\$250,000	\$107,143	\$107,143	\$48,611
Property Due Diligence	\$50,000	\$50,000	\$21,429	\$21,429	\$9,722
<b>SUBTOTAL</b>	<b>\$3,250,395</b>	<b>\$4,883,381</b>	<b>\$481,170</b>	<b>\$844,120</b>	<b>\$949,546</b>
<b>TOTAL CURRENT CAPITAL COSTS</b>	<b>\$19,043,569</b>	<b>\$29,008,508</b>	<b>\$2,386,896</b>	<b>\$3,808,684</b>	<b>\$4,756,238</b>
<b>LAND PURCHASE</b>	<b>\$7,600,000</b>	<b>\$7,600,000</b>	<b>\$1,477,778</b>	<b>\$1,477,778</b>	<b>\$1,477,778</b>
<b>TOTAL CAPITAL COSTS</b>	<b>\$26,643,569</b>	<b>\$36,608,508</b>	<b>\$3,864,674</b>	<b>\$5,286,462</b>	<b>\$6,234,016</b>
<b>2. Financing Cost and Other Cash Requirements</b>					
Transaction Costs	\$2,964,628	\$2,964,628	\$754,424	\$754,424	\$576,455
Acquisition Costs	\$380,000	\$380,000	\$162,857	\$162,857	\$73,889
Due Diligence Costs	\$150,000	\$150,000	\$64,286	\$64,286	\$29,167
<b>SUBTOTAL</b>	<b>\$3,494,628</b>	<b>\$3,494,628</b>	<b>\$981,567</b>	<b>\$981,567</b>	<b>\$679,511</b>
<b>3. Working Capital Start-Up Costs</b>	<b>\$2,443,138</b>	<b>\$2,443,138</b>	<b>\$749,143</b>	<b>\$749,143</b>	<b>\$475,055</b>
<b>TOTAL USES OF FUNDS</b>	<b>\$32,581,335</b>	<b>\$ 42,546,274</b>	<b>\$5,595,384</b>	<b>\$7,017,172</b>	<b>\$7,388,582</b>
<b>B. SOURCES OF FUNDS</b>					
Mortgage	\$28,019,948	\$36,589,794	\$4,812,030		\$6,354,180
Private Equity funding	\$4,561,387	\$5,956,480	\$783,354		\$1,034,402
<b>TOTAL SOURCES OF FUNDS</b>	<b>\$32,581,335</b>	<b>\$42,546,274</b>	<b>\$5,595,384</b>		<b>\$7,388,582</b>



## **Appendix 2: RCA Earleville's Explanation of its Allocations of Project Cost between the Level III.7/III.7D and Residential Components**

RCA Earleville revised its project plans and accompanying budget on several occasions...In...its initial application, RCA Earleville calculated each line item of expense based on the percent of detox beds to total beds, or 35%.

In...its May 18, 2015 Modified Application, RCA Earleville calculated each line item of expense based on the percent of detox beds to total beds, or 43%.

In...November 30, 2015 Modified Application, RCA Earleville revised its budget, but erroneously did not update many of its allocations. As a result, RCA Earleville calculated the following line item expenses based on the May 18, 2015 percent of detox beds to total beds (43%): the land purchase cost, architect/engineering fees, permits, legal fees and due diligence. RCA Earleville did update some of its allocations, allocating 25% of new construction building costs, 20% of site and infrastructure, 8% of moveable equipment costs, and 22% of the contingency allowance to the detox portion of the project. RCA Earleville is unable to recreate its methodology for each of those line items at this time.

In...its October 7, 2016 Modification, RCA Earleville updated some of the allocations. For example, RCA Earleville updated its allocation of the land purchase cost from 43% to 19% attributable to the detox portion of the project, consistent with the percent of detox to total beds. RCA Earleville also separated permits, which had previously been included only under renovation costs, into both renovation and new construction costs, and allocated 25% of the new construction permit cost to the detox portion of the project. RCA Earleville also updated the transaction costs attributable to detox to 25%. RCA Earleville is not able to identify why this 25% allocation was used.

In...its request for a post-approval project change, RCA Earleville discovered that the allocations were not uniform and that some of the historical allocation figures were used, and addressed this in its request for project change.

*Excerpted from Applicant's 11/30/17 response to staff's information request.*

### **Appendix 3: Conditions Attached to RCA Earleville CON Approval**

1. Prior to first use approval, RCA -Earleville must receive preliminary accreditation by the Joint Commission and must timely receive final accreditation by the Joint Commission.
2. Prior to first use approval, RCA-Earleville must provide executed transfer and referral agreements with the remaining categories of providers in standard .05J, for which it has not provided the agreements clearly identifying the category each provider or agency occupies.
3. Prior to first use approval, RCAEarleville must document additional referral agreements with sources likely to refer indigent or gray area populations for treatment at RCA Earleville, consistent with COMAR 10.24.14.05K.
4. RCA Earleville shall provide a charity care commitment to indigent and gray area patients that is equivalent to 15% of the net revenue associated with total detox patient days (i.e., patient days in Level 3.7-D beds). RCA Earleville shall document its provision of care to indigent and gray area patients on an annual basis by submitting an annual report completed by an independent firm of Certified Public Accountants using Agreed-Upon Procedures documents: its total net revenue; its net revenue from total detox patient days; the value of the charity care provided to indigent and gray area patients; and details the procedures used in the analysis. Each audited annual report shall be submitted to the Commission within 90 days of the end of RCA Earleville's fiscal year, from the project's inception and continuing for five years thereafter.
5. At the end of the fifth year of full operation following completion of the approved project, RCA Earleville will provide a report to the Commission on its program effectiveness using measures, drawn from recognized organizations that develop and promote the use of quality measures from other sources, that are approved by Commission staff within 120 days from the grant of first use approval. The evaluation of program effectiveness shall include, at a minimum, evaluation of treatment success through follow-up of discharged patients and collaborative efforts with similar treatment programs in Maryland and other states to initiate standardized peer review for study and improvement of program effectiveness.