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MARYLAND HEALTH CARE COMMISSION

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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', is written over the 'From:' line.

Date: December 21, 2017

Re: Staff Report and Recommendation:
Request to Modify a Certificate of Need
11100 Billingsley Road OPCO LLC
Recovery Centers of America - Waldorf
Docket No. 15-08-2362

Attached is a Staff Report and Recommendation in the review of the request for a modification of a Certificate of Need (“CON”) issued in January 2017 to establish an alcoholism and drug abuse intermediate care facility (“ICF”) in Waldorf, Charles County, Maryland.

The RCA Waldorf ICF will function as a medically monitored intensive inpatient detoxification (“detox”) facility, with 64 beds, operating in conjunction with a 76-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 Waldorf 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 \$28,669,470 to \$36,485,425. For the CON-regulated ICF, the total cost estimate rose from \$10,712,744 to \$16,783,294.

As originally approved, the project was to be financed with equity funding of \$4,013,726 and a mortgage of \$24,655,744. In its request for approval of a project change, the applicant states that the mortgage amount will increase to \$31,377,466 and equity funding will increase to \$5,107,959. RCA provided a letter from its primary funding source, Deerfield Private Design Fund III, L.P., assuring that it would provide the added funding.

IN THE MATTER OF

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BEFORE THE

1100 BILLINGSLEY ROAD
OPCO, L.L.C.

MARYLAND HEALTH

CARE COMMISSION

Docket No. 15-08-2362

REQUEST TO MODIFY CERTIFICATE OF NEED

I. INTRODUCTION

Background

On January 26, 2017, the Maryland Health Care Commission (“Commission” or “MHCC”) granted 11100 Billingsley Road OPCO LLC (“RCA Waldorf” or “RCA Billingsley”), an affiliate of Recovery Centers of America (“RCA”), a Certificate of Need (“CON”) to establish an alcoholism and drug abuse intermediate care facility (“ICF”) in Waldorf, Charles County, Maryland, with specified conditions.¹ The RCA Waldorf ICF was proposed to function as a medically monitored intensive inpatient detoxification (“detox”) facility, with 64 beds, operating in conjunction with a 76-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.

The 20-acre project site includes a main building and three ancillary buildings that were constructed in 1988 and are in various stages of disrepair. The renovation plan includes the removal of all interior finishes, including mechanical, electrical, life safety, and plumbing systems in all of the buildings. RCA also plans to add a second floor to two of the buildings. The total size of the facility will be approximately 72,335 square feet.

The original estimated total project cost was \$28,669,470, with \$10,712,744 of that approved for the CON-regulated detox ICF. The project was to be funded with an equity contribution of \$4,013,726 and a mortgage loan of \$24,655,744.

RCA reports that it has made substantial progress in implementing the project, having acquired the real estate, secured the requisite site plan and permit approvals, and entered into a construction contract for the renovations and new construction.

Requested Project Change

RCA Waldorf 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.

¹ See Appendix 2 for the conditions attached to the Certificate of Need.

Estimated Cost Increase

RCA states that after receiving construction bids it “became apparent” that it had underestimated construction costs. The total construction cost² estimate for the project as a whole increased from \$13,944,902 to \$21,059,979. The total project cost climbed from \$28,669,470 to \$36,485,425. For the CON-regulated ICF, the construction cost estimate rose from \$5,035,814 to \$7,653,015, prior to adjustment for a more accurate reallocation.

Table 1: Comparison of Cost Estimates in CON with Requested Change

	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
Total Construction Cost – New Construction	\$3,306,126	\$5,074,197	\$1,400,832	\$2,135,254	\$2,334,130
Total Construction Cost – Renovation	\$10,638,776	\$15,985,782	\$3,634,982	\$5,517,761	\$7,353,459
Total Project Cost	\$28,669,470	\$36,485,425	\$10,712,744	\$13,600,164	\$16,783,294

Source: Applicant’s November 30, 2017 response to staff questions, Exh. 2.

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

Since the project consists of 64 Level III.7D ICF beds that are subject to CON regulation and 76 residential care beds that are not, RCA Waldorf’s application allocated costs between the two components. The applicant now requests a reallocation of costs that would increase the proportion of total costs allocated to the ICF component. It explains that it based its cost allocations on either the proportion of detox beds to total residential beds, or on the proportion of detox beds in the new addition to total beds in the new addition, depending on the nature of each line item.

RCA Waldorf explains that, in its several modifications of the project, it changed the ratio of detox beds to total beds in each iteration. In the course of those modifications, the applicant states that it failed to modify the cost allocation ratios as it modified the ratio of beds. See Table 2 below.

Table 2: Changes to Bed Allocation During CON Review Process

Filing Event	Level III.7 / III-7D Beds	Residential Beds	Total Beds	Level III.7 / III-7D Beds as % of Total Beds
Original application	21	145	166	13%
First Modification	64	102	166	39%
Second Modification	64	76	140	46%

Source: RCA’s November 30, 2017 response to staff questions.

²In this section and Table 1, “construction cost” includes associated costs such as permits, architectural fees, and site preparation. A detailed breakdown is included as Appendix 1.

RCA Waldorf stated that the CON-approved budget used allocations between 34% and 44% for each line item.³ It now suggests that “it would be appropriate to change the allocation of costs for each category of expenses based on the total number of ICF beds to the total number of beds (ICF and residential), a 46% allocation.” Such a modified allocation of expenses shifts more of the project’s total cost to the ICF beds.

Staff believes that the cost reallocation requested in this Request for Project Change is justified; allocation of total cost based on the percentage of beds that fall into the regulated category makes sense.

II. REGULATIONS RE CHANGES TO APPROVED PROJECTS

Commission regulations, at COMAR 10.24.01.17C, identify certain circumstances⁴ 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 Waldorf project is the requirement in subsection .17B(2)⁵ 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

As previously noted, RCA Waldorf’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.

³ In its November 30, 2017 filing, the applicant stated that, in its original application, “calculated each line item of expense based on the percent of detox beds to total beds, or 13%.” In its May 2015 filing, it “calculated each line item of expense based on the percent of detox beds to total beds, or 39%.” RCA Waldorf states that, in its October 2016 Modification (filed after the Reviewer held a project status conference), it “erroneously did not update many of its allocations, and instead continued to use the 39% allocation even though the Detox portion of the project represented 46% of the beds.” The applicant notes that it cannot explain different allocations that were used in its Modified Application. RCA Waldorf states that it addressed the inconsistent and incorrect allocations in its request for project change

⁴ 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.

⁵ 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.

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 of the project change. The allowance is calculated using the building cost indices published on a quarterly basis by IHS Global Insight in *Healthcare Cost Review*. RCA Waldorf's CON application was approved on January 26, 2017, with a total capital cost of \$6,174,174; the estimated current total capital cost in the project change request is \$9,055,811 before adjustment for the requested cost reallocation (which would further increase the total current capital cost to \$11,361,298), 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 \$4,013,726 and a mortgage of \$24,655,744. In its request for approval of a project change, the applicant states that the mortgage amount will increase to \$31,377,466 and equity funding will increase to \$5,107,959.

On an operating basis, RCA Waldorf 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 Billingsley OPCO entity, which in turn charges RCA Billingsley 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 Waldorf'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 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. 15-07-2362, to include both the increased cost attributable to the initial underestimation of project costs (\$2,887,420) 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 (an additional \$3,183,130). The requested project change, if approved by the Commission, will increase the approved cost of ICF portion of the project from \$10,712,744 to \$16,783,294. Staff recommends that the original conditions placed on this CON approval remain unchanged.

Appendix 1: Detailed Comparison of Cost Estimates in CON with Requested Change

USE OF FUNDS					
	Total Project		ICF Only		
CAPITAL COSTS	In CON	Modification	In CON	Modification without reallocation	Modification with reallocation
New Construction	\$3,306,126	\$5,074,197	\$1,400,832	\$ 2,135,254	\$2,334,130
Renovations	\$10,638,776	\$15,985,782	\$3,634,982	\$5,517,762	\$7,353,459
Other Capital Costs	\$2,952,620	\$3,638,498	\$1,138,360	\$1,402,795	\$1,673,709
TOTAL CURRENT CAPITAL COSTS	\$16,897,522	\$24,698,477	\$6,174,174	\$9,055,811	\$11,361,298
LAND PURCHASE	\$4,750,000	\$4,765,000	\$1,831,325	\$1,837,108	\$2,191,900
TOTAL CAPITAL COSTS	\$16,897,522	\$29,463,477	\$8,005,499	\$10,892,919	\$13,553,198
2. Financing Cost and Other Cash Requirements	\$1,677,702	\$1,677,702	\$646,824	\$646,824	\$771,743
3. Working Capital Start-Up Costs	\$ 2,060,421	\$5,344,246	\$2,060,421	\$ 2,060,421	\$2,458,353
TOTAL USES OF FUNDS	\$28,669,470	\$36,485,425	\$10,712,744	\$ 13,600,164	\$16,783,294
B. SOURCES OF FUNDS					
Mortgage	\$24,655,744	\$31,377,466	\$9,212,960	\$11,696,141	\$14,433,633
Private Equity funding	\$4,013,726	\$5,107,959	\$1,499,784	\$ 1,904,023	\$2,349,661
TOTAL SOURCES OF FUNDS	\$28,669,470	\$36,485,425	\$10,712,744	\$ 13,600,164	\$16,783,294

Appendix 2: Conditions in RCA-Waldorf January 26, 2017 Certificate of Need

1. RCA-Waldorf 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-Waldorf 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 120 days of the end of RCA-Waldorf's fiscal year, from the project's inception and continuing for five years thereafter;
2. RCA-Waldorf must receive accreditation by the Commission on Accreditation of Rehabilitation Facilities prior to receipt of First Use Approval.
3. Prior to first use approval, RCA-Waldorf 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;
4. Prior to first use approval, the applicant must document additional referral agreements with sources likely to refer indigent or gray area populations for treatment at RCA-Waldorf, consistent with COMAR 10.24.14.05K; and
5. At the end of the fifth year of full operation following completion of the approved project, RCA-Waldorf 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.