



MARYLAND HEALTH CARE COMMISSION

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MEMORANDUM

To: Commissioners

From: Kevin R. McDonald, Chief
Certificate of Need *Kevin R. McDonald*

Date: November 15, 2018

Re: Staff Report and Recommendation:
Request to Modify a Certificate of Need
Stella Maris, Inc.
Docket No. 16-03-2376

Attached is a Staff Report and Recommendation in the review of a request for a Project Change after Certificate of Need Approval for a Certificate of Need (“CON”) issued on May 18, 2017 to Stella Maris, Inc. (“Stella Maris”). The CON authorized a project to construct a building addition and renovate the existing facility. The approved project did not change the number of licensed beds at the facility, but increased the number of private patient rooms from 114 to 158, and reduced the number of rooms where more than two residents share a toilet.

Stella Maris requests authorization to increase total project costs by \$4,024,479, bringing the total to \$33,716,305. The applicant identified the following reasons for the project cost increase: failure to account for additional inflation costs due to later project start as a result of applicant’s modification of the application; inflation of construction costs and changes in market conditions; design changes that added an elevator to the new addition and improvements to mechanical and electrical systems; discovery during preconstruction investigation of additional infrastructure replacements, relocations and upgrades that would be needed; and a need to replace the telecommunication system and add a nurse call reporting and staff tracking system. With these increases, the total anticipated cost increase is \$4,024,479 (about 13.55%), which exceeds the permissible inflation allowance. Stella Maris will fund the additional cost by increasing its cash contribution by \$1,024,479 and seeking an additional \$3 million in mortgage loans.

Staff recommends that the Commission **APPROVE** the proposed modification of the Certificate of Need issued to Stella Maris, Inc. to construct a four-story addition including a two-

floor, 60-bed transitional care unit and a minor renovation of an existing structure (Docket No. 16-03-2376), with the same standard conditions issued with the 2017 CON, which are:

1. At the time of first use review, Stella Maris, Inc. shall provide the Commission with a Memorandum of Understanding with the Maryland Medical Assistance Program agreeing to maintain at least the minimum proportion of Medicaid patient days required by Nursing Home Standard COMAR 10.24.08.05A(2)(b).
2. At Stella Maris, Inc. shall meet and maintain the minimum proportion of Medicaid patient days required by its Memorandum of Understanding with the Maryland Medical Assistance Program and by Nursing Home Standard COMAR 10.24.08.05A(2).

IN THE MATTER OF
STELLA MARIS, INC.
Docket No. 16-03-2376

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BEFORE THE
MARYLAND HEALTH
CARE COMMISSION

STAFF REPORT
Request for Project Change After Certificate of Need Approval

I. INTRODUCTION

Background

On May 18, 2017, the Maryland Health Care Commission awarded a Certificate of Need (“CON”) to Stella Maris, Inc. (“Stella Maris”), approving its application to renovate its existing comprehensive care facility, or nursing home, and construct a building addition in order to modernize its outdated facility. The approved project will bring portions of the facility into compliance with current design standards, including requirements of the Americans with Disabilities Act and Maryland licensing regulations regarding floor space per bed, at COMAR 10.07.02.28C(2)(b).

Stella Maris is a 412-bed comprehensive care facility located in Timonium (Baltimore County), Maryland. The approved project did not change the number of licensed beds at the facility, but increased the number of private patient rooms from 114 to 158, and reduced the number of rooms where more than two residents share a toilet.

During completeness review of its original application, filed in 2016, Stella Maris requested and was granted an extension of time so that it could submit a modified application that would change the funding sources for the project. Its modified CON application proposed to finance \$18 million of the project through a mortgage on the property, with \$4,680,000 of the mortgage to be used to pay off Stella Maris’s remaining payments on bonds issued in 1997 by the Maryland Health and Higher Education Facilities Authority.

The CON-approved project included the addition of a four-story, 75,375 square foot (“SF”) addition and renovation of 5,106 SF. The new construction will include a two-floor, 60-bed rehabilitation (“rehab”) or transitional care unit with thirty private rooms on each floor. The total approved cost of \$29,691,826 included an estimated \$18,737,505 for new construction, \$1,744,165 for renovations, \$3,182,559 for other capital costs, an inflation allowance of \$847,597, and financing and other cash requirements of \$5,180,000. The project was to be financed with the previously noted \$18 million mortgage, \$1,691,826 in cash, and \$10 million in philanthropy.

Modification Request

Stella Maris submitted a Request for Project Change After CON Approval to increase the total project cost to \$33,716,305, a \$4,024,479 increase over the budget approved in the 2017

CON. Stella Maris states that the increased cost is needed to allow it to address several issues and make needed changes to the project, including:

- Failure to account for additional inflation costs due to later project start as a result of applicant's modification of the application;
- Inflation of construction costs and changes in market conditions;
- Design changes that added an elevator to the new addition and improvements to mechanical and electrical systems;
- Discovery during preconstruction investigation of additional infrastructure replacements, relocations and upgrades that would be needed; and
- A need to replace the telecommunication system and add a nurse call reporting and staff tracking system.

Stella Maris will fund the additional cost by increasing its cash contribution by \$1,024,479 (to a total of \$2,716,305) and seeking an additional \$3 million in mortgage loans (to a total of \$21 million).

II. APPLICABLE REGULATIONS

Commission regulations, at COMAR 10.24.01.17C, identify certain circumstances¹ where a modification is not permitted and a new CON application is required. Stella Maris's modification request does not involve an impermissible modification. However, COMAR 10.24.01.17B² provides that certain "changes that would place the project at variance with its Certificate of Need ... shall receive approval from the Commission" Stella Maris is required to obtain 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, Stella Maris'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

¹ 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.

²In addition to the cost increase for which Stella Maris seeks approval, other changes that require Commission approval are: a significant change in physical plant design; certain increases in revenue or operating expenses; change in financing mechanisms; or a change in the location of the project.

not to approve the change for stated reasons; or require a complete CON review because of the scope of the requested change.

III. INFLATION ALLOWANCE, COST INCREASES, AND FINANCIAL IMPACT OF THE PROPOSED MODIFICATION

Inflation Allowance

Capital cost increases that exceed the inflation allowance calculated using the building cost indices published on a quarterly basis by IHS Global Insight in *Healthcare Cost Review* require Commission approval under COMAR 10.24.01.17B(2). The Commission approved Stella Maris modified application for CON on May 15, 2017, at an approved total current capital cost of \$23,664,229. Application³ of the inflation index in accordance with COMAR 10.24.01.17B(2) results in a permitted 2.26% inflationary increase, or approximately \$535,812, an amount that is well exceeded by Stella Maris’s requested capital cost increase of \$4,024,479.

CON-Approved Cost Compared to Modification Request

Stella Maris estimates that the proposed modifications will increase the project budget by about 13.5%. Table 1 compares the projected costs and funding sources approved by the Commission in May 2017 to those in the modification request submitted by Stella Maris.

Table 1: Cost and Funding Comparison – CON-Approved Cost and New Cost Estimate

Project Elements	CON-Approved Amount	Estimate in Requested Modification	Difference	% change
Capital Costs				
New Construction				
Building	\$15,018,872	\$20,371,323	\$5,352,451	35.64%
Site and Infrastructure	1,983,633	2,399,319	415,686	20.96%
Architect/Engineering Fees	1,683,000	1,683,000	0	N/A
Permits	52,000	62,000	10,000	19.23%
<i>Subtotal</i>	\$18,737,505	\$24,515,642	\$5,778,137	30.84%
Renovations				
Building	\$781,562	\$145,863	(\$635,699)	(81.34%)
Fixed Equipment	952,603	0	(952,603)	(100.00%)
Permits	10,000	0	(10,000)	(100.00%)
<i>Subtotal</i>	\$1,744,165	\$145,863	(\$1,598,302)	(91.64%)
Other Capital Costs				
Movable Equipment	\$762,083	\$1,179,039	\$416,956	54.71%
Contingencies	2,152,524	1,000,000	(1,152,524)	(53.54%)

³ This computation was based on the process outlined in the document “Determining the Threshold for Required Approval of Changes in Certificate of Need Approved Capital Cost” on the Commission’s website at http://mhcc.maryland.gov/mhcc/pages/hcfs/hcfs_con/documents/con_cap_cost_index_20180727.pdf

Other (IT)	267,952	1,270,320	1,002,368	374.08%
<i>Subtotal</i>	\$3,182,559	\$3,449,359	\$266,800	8.38%
TOTAL CURRENT CAPITAL COSTS	\$23,664,229	\$28,110,864	\$4,446,635	18.79%
Inflation Allowance	\$847,597	\$365,441	(\$482,156)	(56.89%)
TOTAL CAPITAL COSTS	\$24,511,826	\$28,476,305	\$3,964,479	16.17%
Financing Cost and Other Cash Requirements				
Loan Placement Fees	\$350,000	\$410,000	\$60,000	17.14%
Legal Fees	100,000	100,000	0	N/A
Non-Legal Consultant Fees	50,000	50,000	0	N/A
Liquidation of Existing Debt	4,680,000	4,680,000	0	N/A
<i>Subtotal</i>	\$5,180,000	\$5,240,000	\$60,000	1.16%
Working Capital Start-up Costs	0	0	0	N/A
TOTAL USES OF FUNDS	\$29,691,826	\$33,716,305	\$4,024,479	13.55%
SOURCES OF FUNDS FOR PROJECT				
Cash	\$1,691,826	\$2,716,305	\$1,024,479	60.55%
Philanthropy	10,000,000	10,000,000	0	N/A
Mortgage	18,000,000	21,000,000	3,000,000	16.67%
TOTAL SOURCES OF FUNDS	\$29,691,826	\$33,716,305	\$4,024,479	13.55%

Stella Maris's further explanation of the drivers of the cost increase follow.

- Later-than-anticipated start date: In its original planning, Stella Maris estimated that the project would be completed by May 15, 2020, and projected inflation costs for the project to be 2.7% per year. Stella Maris's modified application, submitted on November 15, 2016, did not adjust its inflation estimate to reflect a six-month delay in the project's start date, thus underestimating inflation by about \$305,000.
- Increasing construction demand and market uncertainties: Stella Maris cites rapidly changing market conditions in the construction industry as a reason for increased capital costs. It states that an uptick in construction activity has increased demand for labor and materials, driving construction costs higher than in 2016. In addition, recent foreign trade disputes have created uncertainty in certain sectors of the construction industry, driving up costs for construction materials such as steel, pipe, and rebar. Based on actual bids received to date, Stella Maris estimates that changes in market conditions add approximately \$2,300,000 to the cost of the project.
- Design changes to improve the facility's efficiency and the patient experience: Stella Maris states that, in the final design phase, it realized that adding 755 SF to the new ground-floor addition would accommodate the rehabilitation gym, which had originally been planned to go into space on the first floor, which necessitated relocating administrative services. It states that this change will result in easier patient access and reduced renovation costs.

Stella Maris also identified additional improvements to the mechanical and electrical systems that will reduce operating costs and increase patient safety and comfort. These design changes add approximately \$2,750,000 to new construction costs while reducing renovation costs by approximately \$636,000.

- Additional infrastructure investment: Stella Maris found that new gas, electric, sanitary, and water lines need to be added and existing lines relocated to allow the new construction to occur, with the sanitary line requiring complex excavation and installation. Extensive electrical work will be required. It states that, collectively, these issues have added approximately \$415,000 to the project budget.
- Replace telecommunication system and add call reporting and staff tracking system: Stella Maris determined that its existing telecommunications system cannot be expanded to support the new addition and, therefore, it must replace the telecommunications system for the entire facility. Costs for the new telecommunications system total \$628,500. Additionally, a nurse call reporting and staff tracking system will add another \$140,000.

Projected Financial Impact

Table 2, below, shows a macro-level comparison of Stella Maris’s overall financial projections, comparing the projections made in its November 2016 application with those in its modification request.

Table 2: Financial Projections, As Approved and Modified⁴

LINE ITEM	As Approved May 2017				As Modified			
	FY2018	FY2021	FY2022	FY2023	FY2018	FY2021	FY2022	FY2023
Net Operating Revenue	\$55,400,520	\$57,664,398	\$57,664,398	\$57,664,398	\$58,736,000	\$61,897,800	\$61,897,800	\$61,897,800
Total Operating Expenses	\$54,175,281	\$57,559,184	\$57,595,518	\$57,554,060	\$57,870,000	\$61,159,450	\$61,300,450	\$61,364,450
Net Income from Operations	\$1,225,239	\$105,214	\$68,880	\$110,338	\$866,000	\$738,350	\$597,350	\$533,350
Payor Mix (% of Revenue)								
Medicare	25%	25.0%	29.0%	29.0%	29%	33.0%	33.0%	33.0%
Medicaid	47%	47.0%	40.0%	40.0%	39%	32.0%	32.0%	32.0%
Self-Pay/ Commercial	28%	28.0%	31.0%	31.0%	32%	35.0%	35.0%	35.0%
Payor Mix (% of Patient Days)								
Medicare	10.5%	10.5%	13.5%	13.5%	8.6%	12.0%	12.0%	12.0%
Medicaid	69.4%	69.4%	66.7%	66.7%	71.1%	68.5%	68.5%	68.5%
Commercial Insurance	2.1%	2.1%	2.3%	2.3%	3.0%	3.0%	3.0%	3.0%
Self-Pay	18.0%	18.0%	17.5%	17.5%	16.5%	16.5%	16.5%	16.5%

⁴ Revenue and expense figures in this table include revenues and expenses arising from the entire Stella Maris operation, including: nursing home operations; inpatient hospice; home health agency services; community-based hospice; adult day care; personal care; outpatient therapy; and other miscellaneous services. Stella Maris states that its nursing home operations comprise approximately 68-70% of total revenues. Stella Maris also states that “it is difficult to project expenses associated with each of the separate service lines due to shared overhead and other factors, [but]...it is reasonable to assume that expenses associated with nursing home operations approximate the same ratio (68-70%) of Stella Maris’s overall expenses.”

Stella Maris's approved CON application projected very modest profitability for its entire operation for the first three years after project implementation, averaging about \$95,000 annually. In the requested project change, those projected operating results improve significantly, with the bottom line averaging over \$600,000. This improved financial performance is mostly attributable to a restructuring of organizational debt (that is unrelated to the project) as well as a change in how project debt will be drawn down. Interest costs will be reduced despite an increase in total debt because rather than incurring debt immediately Stella Maris will employ a scheduled principal draw, i.e., debt will be incurred as construction progresses and cash is needed. In its original application Stella Maris's assumed debt would be incurred immediately rather than pursuant to a draw schedule.

IV. RECOMMENDATION

Stella Maris's request for project change entails no changes in the location, capacity, or nature of the project. Thus, the modification request would not change the Commission's findings of May 2017 regarding either need for the project or its impact on existing providers. Nor will approval of this modification endanger the facility's operating performance or the applicant's financial viability. Staff concludes that the requested changes should not result in a change to the Commission's prior findings regarding cost effectiveness.

The requested modification is not expected to have an impact on the rates paid by consumers. The applicant states that it will absorb the additional costs of this project and will not pass them along to its residents. The rate paid for nursing home care by the primary payors, Medicare and Medicaid, will not be affected by the higher capital cost of the facility. 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 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 for capital that the proposed facility would reach even without this increase. Stella Maris maintains that the market will dictate its private pay rates for the small percentage of private pay patients.

For reason stated, staff recommends that the Commission **APPROVE** the requested modification of the 2017 Certificate of Need issued to Stella Maris, Inc. and that the Modified CON contain the same conditions placed on the original CON:

1. At the time of first use review, Stella Maris, Inc. shall provide the Commission with a Memorandum of Understanding with the Maryland Medical Assistance Program agreeing to maintain at least the minimum proportion of Medicaid patient days required by Nursing Home Standard COMAR 10.24.08.05A(2)(b).
2. Stella Maris, Inc. shall meet and maintain the minimum proportion of Medicaid patient days required by its Memorandum of Understanding with the Maryland Medical Assistance Program and by Nursing Home Standard COMAR 10.24.08.05A(2).

IN THE MATTER OF
STELLA MARIS, INC.
Docket No. 16-03-2376

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BEFORE THE
MARYLAND HEALTH
CARE COMMISSION

FINAL ORDER

Based on Commission Staff's analysis and recommendation, it is this 15th day of November, 2018, **ORDERED**:

That the request of Stella Maris, Inc. for a project change to increase the approved cost of the renovation and construction project at its comprehensive care facility in Baltimore County from the cost of \$29,691,826 in its May 18, 2017 Certificate of Need to an estimated cost of \$33,716,305, is **APPROVED**, subject to the following conditions:

1. At the time of first use review, Stella Maris, Inc. shall provide the Commission with a Memorandum of Understanding with the Maryland Medical Assistance Program agreeing to maintain at least the minimum proportion of Medicaid patient days required by Nursing Home Standard COMAR 10.24.08.05A(2)(b).
2. At Stella Maris, Inc. shall meet and maintain the minimum proportion of Medicaid patient days required by its Memorandum of Understanding with the Maryland Medical Assistance Program and by Nursing Home Standard COMAR 10.24.08.05A(2).

MARYLAND HEALTH CARE COMMISSION