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MARYLAND HEALTH CARE COMMISSION

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MEMORANDUM

To: Commissioners

From: Kevin R. McDonald, Chief
Certificate of Need 

Date: November 15, 2018

Re: Staff Report and Recommendation:
Request to Modify a Certificate of Need
Coastal Hospice, Inc.
Docket No. 17-22-2404

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 December 21, 2017 to Coastal Hospice, Inc. (“Coastal”) authorizing Coastal to construct a 12-bed hospice house.

Coastal requests authorization to increase project costs by \$579,315 (7.2%), bringing the total to \$8,577,429. The applicant purchased a building from a bank, which had owned the vacant structure for ten years. During construction, multiple “found conditions” require correction and additional renovation or site preparation.

With these additional construction costs, the anticipated cost increase exceeds the permissible inflation allowance. Coastal will fund the additional cost with existing cash on hand, philanthropic pledges and – if necessary, an increase in the mortgage loan.

Staff recommends that the Commission **APPROVE** the proposed modification of the Certificate of Need issued to Coastal Hospice, Inc. to construct and renovate a building to house the 12-bed hospice house and associated programs.

IN THE MATTER OF
COASTAL HOSPICE, INC

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BEFORE THE
MARYLAND HEALTH
CARE COMMISSION

Docket No.: 17-22-2404

REQUEST FOR PROJECT CHANGE AFTER CERTIFICATE OF NEED APPROVAL

I. INTRODUCTION

A. Summary of the Requested Project Change

On December 21, 2017, the Maryland Health Care Commission (“Commission” or “MHCC”) awarded a Certificate of Need (“CON”) to Coastal Hospice, Inc. (“Coastal”), approving its application to renovate an existing building to construct a 12-bed hospice house¹ residential facility and outreach center in Ocean Pines, Maryland (Worcester County). The total approved project cost was \$7,998,114. As construction proceeded, Coastal encountered increased capital costs, primarily due to conditions found during the demolition phase of the construction. Coastal now estimates that the project cost has increased by \$579,315, resulting in a total estimated project cost of \$8,038,104.50. Commission regulations at COMAR 10.24.01.17B(2) requires that Coastal obtain approval from the Commission because the projected capital cost increase exceeds the project cost inflation allowance for the CON-approved project cost of \$7,998,114. Coastal will fund the increased cost with cash, remaining outstanding pledges and its mortgage loan. Coastal states that the approved project is approximately 50% complete, and that this request will not require any extension of time to meet applicable performance requirements.

B. Background

A hospice house is not a “health care facility” subject to CON regulation; however, general hospices are non-hospital health care facilities subject to CON regulation. Therefore, Coastal was required to obtain a CON for its hospice house project because the projected capital cost exceeded the \$6,000,000 threshold then in effect for all non-hospital health care facilities.

Coastal purchased the building and property for \$1,530,000. It was an unfinished shell comprising almost 20,000 square feet (“SF”) on three floors (including a basement level). As approved, the project would add just over 3,000 SF to the first floor. The property had been owned by a bank and had stood vacant for ten years.

¹ A "hospice house" is a residence operated by a Maryland general hospice that provides home-based hospice services to hospice patients in a home-like environment. The care provided to hospice house residents is not billed as general inpatient care. In its original application the applicant describes a hospice house as “designed to care for the custodial needs of the individual on routine home care level of care, for days, weeks or even months. As a contrast, general inpatient care is designed to meet the acute symptom management needs of the patient lasting only a few days.”

The first floor is dedicated to patient and family space, and will house 12 patient bedrooms, a family room, a children's play area, a sun room, a deck, a family kitchen, a meditation room, and a family-dining room. In addition to housing the 12-bed hospice house, the building will also provide space for:

- Hospice care staff and volunteers;
- Outreach programs including a palliative care clinic, community education programming, and grief support;
- The home hospice team caring for patients in Worcester and Somerset Counties, which will allow Coastal Hospice to discontinue leasing space for that team as it must now;
- Bereavement counseling and groups, volunteers, social work, nursing and admissions staff, as well as a community room for conferences and community education;
- A doctor's office, waiting room, and two exam rooms; and
- Community palliative care consultations.

Coastal's original funding plan included a mortgage² up to \$4 million, ; \$2.9 million in cash; philanthropic donations of about \$750,000; a state grant of \$500,000; and a sale of property that was expected to net \$375,000.

C. Project Change Request

Coastal states that the existing building that was to become the hospice house was an abandoned shell that required significant demolition. Coastal submitted a Request for Project Change after Certificate of Need Approval due to the need to incur additional capital costs to correct a series of "found conditions" that emerged at various phases during the demolition and construction process. Specifically, Coastal states that the "found conditions" that require correction are:

- The roof trusses over the existing building were not built to specifications and were not fire treated, requiring the demolition of one side of the building to the ground level.
- Demolition revealed structural problems that required additional support beams and lintels to be installed, as well as termite damage requiring treatment and prevention measures.
- The sewer line is above the level of the sewer line exit from the building, requiring a pump and backup pump to be added.
- All air ducts and electrical systems in the building had to be replaced, and the geothermal units that were present in the building at purchase had mold and had to be scrapped.
- Communications systems for nursing and EMS were found inadequate as originally planned.
- Some necessary permits were not anticipated in the budget (storm water management and sediment control permit, technical review committee fees, environmental dwelling unit permit).

The architectural fees increased along with the required remedies to the "found conditions." However, since the architectural contract is based on a percentage of the construction costs, as

² Structured initially as a construction loan, to be converted to a mortgage upon project completion.

construction costs rose to address the issues, the architectural base fees increased along with the construction costs. In addition, Coastal states that a rebound in construction demand following the exodus of many subcontractors during the previous real estate downturn is leading to increased pricing. Coastal now estimates that the cost of the project at \$8,577,429, approximately \$580,000 above the cost approved in 2017 (an increase of 7.2%), and exceeding the permissible inflation allowance.³

II. APPLICABLE REGULATIONS

Commission regulations, at COMAR 10.24.01.17C, identify certain circumstances⁴ where a modification to an approved project is not permitted and a new CON application is required. Coastal's project change 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" Coastal 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

COMAR 10.24.01.17B(2). As previously noted, Coastal'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. FINANCIAL IMPACT OF THE REQUESTED PROJECT CHANGE

Projected Costs Exceed Inflation Allowance

³ The index used by MHCC would only allow an increase in project cost of just over \$110,000 for this hospice project during the applicable period.

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.

CON regulations provide for an inflation allowance, but require increases that exceed that allowance to seek Commission approval. The inflationary allowance is calculated using the building cost indices published on a quarterly basis by IHS Global Insight in *Healthcare Cost Review*.⁵ The amount of inflationary increase is determined from the CON application's submission date (August 4, 2017 or the 3rd quarter of CY 2017) to the date of the filing of a request for CON modification (August 6, 2018 – or the 3rd quarter of CY 2018). The allowable inflationary increase in capital cost is \$7,998,951,⁶ significantly less than the updated projected cost of \$8,577,429 and thus requires the Commission's review and approval.

CON-Approved Cost Compared to Project Change Request Costs

Table 1 below compares the projected costs and funding sources as originally approved by the Commission to those in the project change request submitted by Coastal. The areas with the biggest impact on the funding change are additional site preparation costs, increased architect and engineering fees, increased permit costs associated with design changes or county requirements, and increased building costs. These increased costs will be covered by existing cash on hand, philanthropic pledges and – if necessary, an increase in the mortgage loan.

⁵ As described at http://mhcc.maryland.gov/mhcc/pages/hcfs/hcfs_con/documents/con_capital_threshold_update_20170317.pdf.

⁶ Using the July 26, 2018 edition of the Building Cost Index published in *Healthcare Cost Review*, as required by COMAR 10.24.01.17B(2).

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

A. USE OF FUNDS	Originally Approved	New Cost Estimate	Change in Estimate	% Change
Capital Costs				
<u>New Construction/Renovation</u>				
Building	\$5,163,025	\$5,446,605	\$283,580	5.5%
Architect/Engineering fees	\$479,000	\$524,913	\$45,913	9.6%
Permits	\$7,500	\$19,795	\$12,295	163.9%
Site preparation	\$54,900	\$266,225	\$211,325	384.9%
Subtotal	\$5,704,425	\$6,257,538	\$553,113	9.7%
<u>Other Capital Costs</u>				
Movable Equipment	\$340,000	\$340,000	\$0	0.0%
Contingency	\$184,130	\$184,130	\$0	0.0%
Gross Interest	\$29,040	\$51,242	\$22,202	76.5%
Oxygen	\$100,000	\$100,000	\$0	0.0%
Subtotal	\$653,170	\$675,372	\$22,202	3.4%
Total Current Capital Costs	\$6,357,595	\$6,932,910	\$575,315	9.0%
Land	\$1,530,917	\$1,530,917	\$0	0.0%
<u>Financing Costs & Other Cash Requirements</u>				
Legal	\$21,152	\$21,152	\$0	0.0%
Working Capital Start-Up Costs	\$88,450	\$92,450	\$4,000	4.5%
Total Uses of Funds	\$7,998,114	\$8,577,429	\$579,315	7.2%
B. SOURCE OF FUNDS				
Cash	\$1,326,444	\$1,881,759	\$555,315	41.9%
Mortgage*	\$3,519,473	\$3,519,473	\$0	0.0%
Philanthropy	\$746,280	\$746,280	\$0	0.0%
State Grant	\$500,000	\$500,000	\$0	0.0%
Sale of Land	\$375,000	\$399,000	\$24,000	6.4%
Cash Paid for Building	\$1,530,917	\$1,530,917	\$0	0.0%
Total Sources of Funds	\$7,998,114	\$8,577,429	\$579,315	7.2%

* Initially a construction loan, and convertible to a mortgage at project conclusion.

Projected Financial Impact of Proposed Modification

Coastal states that it expects to fund the increased capital costs with a combination of increased cash and philanthropic contributions that now seem likely to exceed what the applicant budgeted. Coastal also has the option of increasing the amount of the mortgage above the amount

estimated in the application.

Coastal’s operating budget will be affected by an increase in depreciation expense of \$17,000; whether interest expense is affected depends on whether the final mortgage amount borrowed exceeds the original estimate. Given the healthy net income historically shown and projected (Table 2 below), operations can sustain this increased cost.

Table 2: Actual and Projected Financial Performance of Coastal Hospice

	Actual		2017 (unaudited)	Projected	
	2015	2016		2018	2019
Net Operating Revenue	\$8,346,446	\$9,864,389	\$11,591,671	\$12,405,900	\$13,754,425
Total Operating Expenses	\$8,503,316	\$9,436,307	\$11,009,436	\$11,630,193	\$13,291,266
Income From Operations	(\$156,870)	\$428,082	\$ 582,235	\$775,707	\$463,159
Non-operating Income	\$1,210,871	\$971,034	\$1,867,826	\$1,551,941	\$1,057,003
Net Income	\$1,054,001	\$1,399,116	\$2,450,0	\$2,327,648	\$1,520,162

Source: CON application, DI#3.

IV. RECOMMENDATION

Staff has reviewed this request for project change after certificate of need approval, compared, it to the Commission’s conclusions in its December 2017 decision, and concludes that the proposed modification would not have a material effect on the findings made by the Commission at that time. There are no changes to the location, capacity, or nature of the project, thus of the Commission’s conclusions concerning need and impact on existing providers or on costs and charges would not change.

Despite the 7.2% increase in project cost, staff concludes that the Commission’s earlier findings regarding cost and effectiveness of alternatives or project viability would not be likely to change and Coastal has the resources to cover that increase. Operating results should not be negatively affected in any significant way.

For the reasons stated, staff recommends that the Commission **APPROVE** the requested project change and issue a Modified Certificate of Need.

IN THE MATTER OF
COASTAL HOSPICE, INC

* BEFORE THE
*
* MARYLAND HEALTH
*
* CARE COMMISSION

Docket No.: 17-22- 2404

FINAL ORDER

Based on the analysis and recommendations in the Staff Report and the record in this review, it is, this 15th day of November, 2018, **ORDERED:**

That the request of Coastal Hospice for a project change to increase the approved cost of the renovation and construction project of its 12-bed hospice house at Ocean Pines, Maryland in Worcester County from the cost of \$7,998,114 in its December 21, 2017 Certificate of Need to an estimated cost of \$8,577,429 is hereby **APPROVED.**

MARYLAND HEALTH CARE COMMISSION