

STATE OF MARYLAND



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**MARYLAND HEALTH CARE COMMISSION**

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**MEMORANDUM**

**TO:** Commissioners

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

**DATE:** March 18, 2021

**SUBJECT:** Staff Report and Recommendation:  
Request to Modify a Certificate of Need  
Encompass Health Rehabilitation Hospital of Southern Maryland, LLC  
Docket No. 18-16-2423

Attached is a Staff Report and Recommendation concerning a request for a Project Change after Certificate of Need Approval for a Certificate of Need (also referred to as a modification) issued to Encompass Health Rehabilitation Hospital of Southern Maryland, LLC (Encompass-Southern Maryland) on May 21, 2020 authorizing the construction of a 60-bed Inpatient Rehabilitation Hospital in Bowie, Maryland.

Encompass-Southern Maryland requests a modification to increase project costs by \$6,962,312 (17.8%), bringing the total to \$45,982,206. The applicant attributes the additional cost primarily to unforeseen delays in construction causing greater inflation in construction costs; design changes mandated by the city and/or county and an underestimation of the cost of patient care equipment. These changes are detailed in the staff report.

Staff recommends that the Commission **APPROVE** the proposed modification of the Certificate of Need issued to Encompass Health Rehabilitation Hospital of Southern Maryland, LLC to construct a 60-bed Inpatient Rehabilitation Hospital in Bowie, Maryland, including the conditions issued with the CON:

1. In its request for first use approval, provide information, acceptable to Commission staff, that details the activities it has undertaken for outreach to the community regarding the availability of charitable services;
2. Maintain compliance with the provisions of COMAR 10.24.09.04A(1) regarding the availability of charity care and a sliding scale of discounted charges for low income individuals who do not qualify for full charity care; and
3. Prior to first use, provide written transfer and referral agreements, acceptable to Commission staff, with facilities, agencies, and organizations that are capable of managing cases that exceed its own capabilities and/or provide alternative treatment programs appropriate to the needs of the persons it serves.

<b>IN THE MATTER OF</b>	*	
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<b>ENCOMPASS HEALTH</b>	*	<b>BEFORE THE</b>
	*	
<b>REHABILITATION</b>	*	<b>MARYLAND HEALTH</b>
	*	
<b>HOSPITAL OF SOUTHERN</b>	*	<b>CARE COMMISSION</b>
	*	
<b>MARYLAND, LLC</b>	*	
	*	
<b>Docket No. 18-16-2423</b>	*	

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**STAFF REPORT  
REQUEST FOR PROJECT CHANGE AFTER  
CERTIFICATE OF NEED APPROVAL**

**I. INTRODUCTION**

Background

On May 21, 2020, the Maryland Health Care Commission (Commission) awarded a Certificate of Need (CON) to Encompass Health Rehabilitation Hospital of Southern Maryland, LLC (Encompass-Southern Maryland) to establish a 60-bed special rehabilitation hospital in Bowie (Prince George’s County). The Commission authorized the construction of a 61,810 square foot hospital with an approved total cost of \$36,830,894. The project was to be funded with cash.

The applicant is a Delaware limited liability company and a subsidiary of Encompass Health Corporation (Encompass Health), a publicly traded proprietary corporation. Encompass Health, formerly known as HealthSouth Corporation, has a nationwide network of inpatient rehabilitation hospitals, home health agencies, and hospice agencies that offer facility-based and home-based rehabilitation services. The applicant reports that Encompass Health operates 127 acute inpatient rehabilitation hospitals and 272 home health and/or hospice agencies in 36 states and Puerto Rico. This includes a special rehabilitation hospital, Encompass Health Rehabilitation Hospital of Salisbury (Encompass-Salisbury, formerly known as HealthSouth Chesapeake Rehabilitation Hospital), a 74-bed special rehabilitation hospital located in Wicomico County.

Brief Summary of the Requested Project Change

The applicant requests a project change after Certificate of Need Approval pursuant to COMAR 10.24.01.17. Encompass-Southern Maryland now estimates that implementing the project will cost \$45,982,206, an increase of \$6,962,312 (17.8%) over the approved project cost.

It attributes the additional cost primarily to unforeseen delays in construction causing greater inflation in construction costs, design changes mandated by the city and/or county, and an underestimation in the original cost estimate of equipment costs.

The source identified for the additional project funding is cash.

## **II. APPLICABLE REGULATIONS**

COMAR 10.24.01.17B provides that certain “changes that would place the project at variance with its Certificate of Need ... shall receive approval from the Commission ...” Encompass-Southern Maryland seeks to make several permissible modifications.<sup>1</sup> This project requires Commission action because it would result in “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 provided in COMAR 10.24.01.17B(2).

Under COMAR 10.24.01.17D(3), the Commission may approve the requested change, approve it in part or with conditions, deny approval of the change for stated reasons, or require a complete CON review because of the scope of the requested change.

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

### Current Request Compared with the Original CON Approved Budget

The following table compares the approved costs of this project with the applicant’s current cost estimate, reflecting the capital cost increases.

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<sup>1</sup> The modification request does not involve an impermissible modification to the project (i.e., a change that would require submission and approval of a new CON application).

**Table III-1: Approved Project Budget Estimate (May 2020) and Current Project Cost Estimate  
Encompass-Southern Maryland**

<b>A. Uses of Funds</b>				
	<b>May 2020 CON</b>	<b>Current Estimate</b>	<b>Variance</b>	<b>% Change</b>
<b>New Construction</b>				
Building	\$17,840,840	\$21,566,286	\$3,725,446	20.9%
Site and Infrastructure	\$2,093,600	\$3,120,000	\$1,026,400	49.0%
Architect/Engineering Fees	\$1,665,227	\$1,788,398	\$123,171	7.4%
Permits	\$555,076	\$628,699	\$73,623	13.3%
<b>Subtotal – New Construction</b>	<b>\$22,154,743</b>	<b>\$27,103,383</b>	<b>\$4,948,640</b>	<b>22.3%</b>
Movable Equipment	\$2,500,000	\$3,864,618	\$1,364,618	54.6%
Contingency Allowance	\$1,110,151	\$1,851,471	\$741,320	66.8%
Gross Interest During Construction	\$840,000	\$840,000	\$0	\$0
Technology Equipment	\$1,600,000	\$1,507,734	-\$92,266	-5.8%
Land Purchase	\$6,305,000	\$6,305,000	\$0	\$0
Bed Purchase	\$2,321,000	\$2,321,000	\$0	\$0
<b>Total Capital Costs</b>	<b>\$36,830,894</b>	<b>\$43,793,206</b>	<b>\$6,962,312</b>	<b>18.9%</b>
CON Application Assistance	\$1,350,000	\$1,350,000	\$0	\$0
Appraisal	\$150,000	\$150,000	\$0	\$0
ACE-IT Installation	\$289,000	\$289,000	\$0	\$0
Working Start Up Cost	\$400,000	\$400,000	\$0	\$0
<b>Total Uses of Funds</b>	<b>\$39,019,894</b>	<b>\$45,982,206</b>	<b>\$6,962,312</b>	<b>17.8%</b>
<b>B. Sources of Funds</b>				
	<b>Original CON</b>	<b>Anticipated</b>	<b>Variance</b>	<b>% Change</b>
Cash	\$39,019,894	\$45,982,206	\$6,962,312	17.8%
<b>Total Sources of Funds</b>	<b>\$39,019,894</b>	<b>\$45,982,206</b>	<b>\$6,962,312</b>	<b>17.8%</b>

Source: Table E, Project Budget, from original CON Application and the Request for Project Change.

Encompass-Southern Maryland explained the increase in the estimated project cost as follows.

1. Design changes and inflation (54% of increase). Regulatory approval from local jurisdictions required certain design changes, most notably the addition of a second entrance. The original construction cost estimate was based on preliminary estimates that did not include the final changes to the design or inflation related to the delays resulting from the design changes. The current budget is based on bids received, while estimates were used in the original application.

2. Site preparation (15% of increase). Site preparation costs increased due to the additional entrance, that required construction of a retaining wall. Other changes that increased costs related to site preparation including the use of permeable paving aiding in stormwater management, reduction of runoff, and decreased flood risk.

3. Higher patient care equipment cost (20% of increase). Encompass states that it strives to improve the quality of care it provides to patients, which requires a periodic review and upgrade

of the equipment used to provide this care. Encompass states that it has committed considerable resources to this effort, which is reflected in additional expenses for items related to therapy, nursing, and the physical plant.

4. An increased contingency allowance (10% of increase). Encompass states that it expects no further cost increases, but “believes this projected increase ... [to be] prudent” and that it should account for any unforeseen expenses due to events beyond its control.

The Change in Project Cost Exceeds the Inflation Allowance

The applicant projects that completion of the project will require an additional expenditure of \$6,962,312 above that authorized in May 2020. CON regulations provide for inflation in approved project costs that reflect published estimates of inflation in health care facility construction costs. Increases that exceed this index require Commission approval. The inflation allowance is calculated using the building cost indices published on a quarterly basis by IHS Global Insight in *Healthcare Cost Review*.  
[https://mhcc.maryland.gov/mhcc/pages/hcfs/hcfs\\_con/documents/con\\_cap\\_cost\\_index\\_20200127.pdf](https://mhcc.maryland.gov/mhcc/pages/hcfs/hcfs_con/documents/con_cap_cost_index_20200127.pdf).

Using the building cost inflation index noted above, the allowable inflation allowance for this project is approximately \$1.4 million, or 3.9 percent, well below the cost increase projected by Encompass-Southern Maryland. Thus, Commission approval of the proposed cost increase is required.

Impact on Financial Performance

The following table presents and compares key statistical and financial projections made by Encompass-Southern Maryland in both its initial application and its proposed modification.

**Table III-2: Summary Projected Utilization and Financial Statistics  
Original Application and Project Change Request**

	Original Application			Project Change Request		
	Year 1	Year 2	Year 3	Year 1	Year 2	Year 3
<b>Utilization Statistics</b>						
Discharges	904	1,218	1,500	866	1,313	1,473
Patient Days	12,207	16,422	20,212	10,396	15,759	17,680
Average Length of Stay	13.5	13.5	13.5	12	12	12
<b>Revenue</b>						
Gross Revenue	\$24,125,590	\$33,661,771	\$41,515,424	\$23,762,937	\$37,290,369	\$41,760,180
Allowance for Bad Debt	162,986	228,194	281,940	239,105	376,508	422,394
Contractual Allowance	7,634,595	10,640,589	13,107,244	7,494,800	11,748,227	13,140,399
Charity Care	333,929	399,988	459,020	327,815	441,625	460,181
<b>Net Operating Revenue</b>	<b>\$15,994,080</b>	<b>\$22,393,000</b>	<b>\$27,667,220</b>	<b>\$15,701,217</b>	<b>\$24,724,010</b>	<b>\$27,737,206</b>
<b>Expenses</b>						
Salaries & Wages	\$10,961,859	\$13,432,913	\$15,654,744	\$11,171,543	\$16,048,267	\$16,511,925
Project Depreciation	685,488	922,193	1,135,024	1,839,971	1,849,613	1,864,078
Supplies	685,488	922,193	1,135,024	562,649	852,923	956,872
Other Expenses	3,670,893	4,256,425	4,758,936	3,251,971	4,023,750	4,289,233
<b>Total Operating Expenses</b>	<b>\$16,696,450</b>	<b>\$19,999,384</b>	<b>\$22,951,022</b>	<b>\$16,826,134</b>	<b>\$22,774,553</b>	<b>\$23,622,107</b>
Income Taxes	(19,329)	65,872	129,790	(30,958)	53,649	113,248

Net Income	(\$683,041)	\$2,327,744	\$4,586,408	█	(\$1,093,960)	\$1,895,807	\$4,001,851
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Source: Tables I and J, Utilization Statistics and Revenue & Expenses, from original CON Application and the Request for Project Change.

As in its initial application, Encompass-Southern Maryland projects that it will generate positive net income in its second year of operation using aggressive utilization projections (average annual occupancy of 72% by Year 2 and 81% by Year 3). Projections extending into years four and five of operations, not shown above, project about 10 percent more discharges and somewhat higher net revenue and net income than projected in the original application.

#### IV. ANALYSIS AND RECOMMENDATION

Because there are no material changes occurring in the location, capacity, or nature of the project, staff concludes that this requested modification does not change the Commission's 2020 findings concerning the need for and the positive impact of the project. While the increase in the total project cost is not insignificant, Encompass-Southern Maryland states that it will still be able to fund the project with cash, so Commission staff does not view the increased cost of the project as an issue of concern.

The project's increased cost will not result in higher costs for the Medicare program, which is expected to provide about 86 percent of the facility's revenue. Medicare's reimbursement rates for acute care rehabilitation are based on a prospective payment system rate that is adjusted only for geographic factors, patient characteristics, and length of stay. Thus, any increase in construction costs will not change the hospital level of reimbursement from Medicare or increase costs for the Medicare program.<sup>2</sup> Of note, Encompass-Southern Maryland has projected a decreased average length of stay based on its recent experience at other facilities, suggesting improved efficiency and perhaps lower costs.

For these reasons, staff recommends that the Commission approve Encompass Health Rehabilitation Hospital of Southern Maryland, LLC's request for project change after Certificate of Need, including the conditions issued with the CON:

1. In its request for first use approval, provide information, acceptable to Commission staff, that details the activities it has undertaken for outreach to the community regarding the availability of charitable services;
2. Maintain compliance with the provisions of COMAR 10.24.09.04A(1) regarding the availability of charity care and a sliding scale of discounted charges for low-income individuals who do not qualify for full charity care; and
3. Prior to first use, provide written transfer and referral agreements, acceptable to Commission staff, with facilities, agencies, and organizations that are capable of managing cases that exceed its own capabilities and/or provide alternative treatment programs appropriate to the needs of the persons it serves.

<sup>2</sup> [http://www.medpac.gov/docs/default-source/payment-basics/medpac\\_payment\\_basics\\_20\\_hospital\\_final\\_sec.pdf?sfvrsn=0](http://www.medpac.gov/docs/default-source/payment-basics/medpac_payment_basics_20_hospital_final_sec.pdf?sfvrsn=0)

**IN THE MATTER OF**

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**ENCOMPASS HEALTH**

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**BEFORE THE**

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**REHABILITATION**

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**MARYLAND HEALTH**

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**HOSPITAL OF SOUTHERN**

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**CARE COMMISSION**

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**MARYLAND, LLC**

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**Docket No. 18-16-2423**

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**FINAL ORDER**

Based on Commission staff's analysis of the request by Encompass Health Rehabilitation Hospital of Southern Maryland, LLC for project change after Certificate of Need approval, it is, this 18<sup>th</sup> day of March, 2021, **ORDERED** that:

The request by Encompass Health Rehabilitation Hospital of Southern Maryland, LLC to increase to \$45,982,206 the total approved costs for the establishment of a 60-bed special rehabilitation hospital in Bowie, Maryland is hereby **APPROVED**, with the same conditions specified in the original Certificate of Need:

1. In its request for first use approval, provide information, acceptable to Commission staff, that details the activities it has undertaken for outreach to the community regarding the availability of charitable services;
2. Maintain compliance with the provisions of COMAR 10.24.09.04A(1) regarding the availability of charity care and a sliding scale of discounted charges for low-income individuals who do not qualify for full charity care; and
3. Prior to first use, provide written transfer and referral agreements, acceptable to Commission staff, with facilities, agencies, and organizations that are capable of managing cases that exceed its own capabilities and/or provide alternative treatment programs appropriate to the needs of the persons it serves.

**MARYLAND HEALTH CARE COMMISSION**