

<b>IN THE MATTER OF</b>  <b>ENCOMPASS HEALTH</b>  <b>REHABILITATION</b>  <b>HOSPITAL OF SOUTHERN</b>  <b>MARYLAND, LLC</b>  <b>Docket No. 18-16-2423</b>	* * * * * * * * * *	<b>BEFORE THE</b>  <b>MARYLAND HEALTH</b>  <b>CARE COMMISSION</b>
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**STAFF REPORT**  
**REQUEST FOR SECOND PROJECT CHANGE AFTER**  
**CERTIFICATE OF NEED APPROVAL**

**I. INTRODUCTION**

**Background**

The applicant, Encompass Health Rehabilitation Hospital of Southern Maryland, LLC (Encompass-Southern Maryland or Encompass) is a Delaware limited liability company and a subsidiary of Encompass Health Corporation (Encompass Health), a publicly traded proprietary corporation. Encompass Health is formerly known as HealthSouth Corporation. Encompass Health 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.

On May 21, 2020, the Maryland Health Care Commission (Commission) approved a Certificate of Need (CON) authorizing 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 \$39,819,094. The project was to be funded with cash. The Commission approved an increase in the project budget of \$6.96 million on March 18, 2021, yielding a total approved cost for the project of \$45,982,206. Encompass-Southern Maryland said the increase in the project’s estimated cost was due to construction cost inflation, government-mandated design changes, and its underestimate of equipment costs.

## **Summary of the Requested Project Change**

The applicant requests a second project change after Certificate of Need Approval pursuant to COMAR 10.24.01.17. It seeks approval to increase the project budget by \$6,701,380, bringing the total project cost to \$52,683,586. Encompass-Southern Maryland attributes this latest increase in the project budget to inflation, building design modifications, permitting delays, a need for additional site work based on findings of unsuitable soil conditions, and the unanticipated need to relocate a gas line found on the site. Relocating the line required additional paving, drainage, and changes in utilities requirements. The design modifications will decrease the overall square footage of the building from 61,810 to 59,575 square feet. The combined increases in project cost represent a 34% increase in the estimated cost of establishing this special hospital in the two years since it was initially authorized.

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 a permissible modification.<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 due to the scope of the requested change.

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

### **Current Request Compared with the 2021 Approved Budget**

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

**Table III-1: Approved Project Budget Estimate (March 2021) and Current Project Cost Estimate  
Encompass-Southern Maryland**

<b>Uses of Funds</b>				
	<b>March 2021 Change</b>	<b>Current Estimate</b>	<b>Variance</b>	<b>Change</b>
<b>New Construction</b>				
Building	\$21,566,286	\$25,213,652	\$3,647,366	16.9%
Site and Infrastructure	\$3,120,000	\$6,150,103	\$3,030,103	97.1%
Architect/Engineering Fees	\$1,788,398	\$1,829,560	\$41,162	2.3%

<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).

Permits	\$628,699	\$628,699	-	-
<b>Subtotal – New Construction</b>	\$27,103,383	\$33,822,014	\$6,718,631	24.8%
Movable Equipment	\$3,864,618	\$3,864,618	-	-
Contingency Allowance	\$1,851,471	\$400,000	(\$1,451,471)	-78.4%
Gross Interest During Construction	\$840,000	\$1,100,000	\$260,000	31.0%
Technology/Equipment	\$1,507,734	\$1,858,000	\$350,266	23.2%
Land Purchase	\$6,305,000	\$6,728,954	\$423,954	6.7%
Bed Purchase	\$2,321,000	\$2,321,000	-	-
<b>Total Capital Costs</b>	\$43,793,206	\$50,094,586	\$6,301,380	14.4%
CON Application Assistance	\$1,350,000	\$1,750,000	\$400,000	66.7%
Appraisal	\$150,000	\$150,000	-	-
ACE-IT Installation	\$289,000	\$289,000	-	-
Working Start Up Cost	\$400,000	\$400,000	-	-
<b>Total Uses of Funds</b>	\$45,982,206	\$52,683,586	\$6,701,380	14.6%
<b>Source of Funds</b>				
	<b>March 2021 Change</b>	<b>Current Estimate</b>	<b>Variance</b>	<b>% Change</b>
Cash	\$45,982,206	\$52,683,586	\$6,701,380	14.6%
<b>Total Sources of Funds</b>	\$45,982,206	\$52,683,586	\$6,701,380	14.6%

Source: Table E, Project Budget, from March 2021 approved CON change and the current Request for Project Change.

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

1. Design changes and inflation (45% of increase). Encompass states that this increase is a result of necessary structural support design changes because of unexpected soil quality issues, increased material prices and shortages resulting from COVID-19 related supply chain disruptions, and construction permitting delays. Encompass also cites increases in labor costs, which have steadily risen over the last two years.

2. Site preparation (37% of increase). After construction started, engineers discovered a variety of issues: existing soil could not be used in structural areas and additional fill had to be brought in from off-site; a gas line had to be relocated; changes to meet local permitting requirements including adding additional water line service to the building, construction of additional stormwater lines and tie-ins, and a perimeter drainage system.

3. Increased costs of technology equipment (4% of increase). Technology equipment expense increased by \$350,266 based on market price adjustments and on Encompass's recent actual expenditures for a comparable hospital that opened this year.

4. Other miscellaneous costs (13% of increase). Encompass states that the land cost increased prior to closing on the purchase, and the current sum includes title services, transfer taxes, and recordation fees. Legal fees have increased and delays in the project have led to an increase in gross interest during construction.

The increase has been partially offset, as would be expected, by a \$1,451,471 (78.4%) reduction in the project's contingency allowance.

### **Change in Project Cost Exceeds the Inflation Allowance**

The applicant projects that completion of the project will require an additional expenditure of \$6,701,380 above the amount approved on March 18, 2021. CON regulations allow for inflation in approved project costs, without the need to obtain Commission approval, if the increases reflect published inflation benchmarks for health care facility construction costs. COMAR 10.24.01.17B. 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*.<sup>2</sup>

Using the building cost inflation index noted above, the inflation allowance for this project is approximately \$786,695, or 1.8 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 financial projections made by Encompass-Southern Maryland in the 2021 project change and the current request.

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

	2021 Project Change				Current Project Change Request		
	Year 1	Year 2	Year 3		Year 1	Year 2	Year 3
<b>Revenue</b>							
Gross Revenue	\$23,762,937	\$37,290,369	\$41,760,180		\$24,397,406	\$38,915,504	\$44,303,033
Allowance for Bad Debt	239,105	376,508	422,394		245,489	392,916	448,114
Contractual Allowance	7,494,800	11,748,227	13,140,399		7,694,911	12,260,221	13,940,542
Charity Care	327,815	441,625	460,181		336,567	460,871	488,202
<b>Net Operating Revenue</b>	<b>\$15,701,217</b>	<b>\$24,724,010</b>	<b>\$27,737,206</b>		<b>\$16,120,439</b>	<b>\$25,801,496</b>	<b>\$29,426,174</b>
<b>Expenses</b>							
Salaries & Wages	\$11,171,543	\$16,048,267	\$16,511,925		\$11,719,754	\$17,172,505	\$18,022,017
Project Depreciation	1,839,971	1,849,613	1,864,078		2,033,393	2,043,036	2,057,500
Supplies	562,649	852,923	956,872		590,260	912,673	1,044,382
Other Expenses	3,251,971	4,023,750	4,289,233		3,393,989	4,272,902	4,639,116
<b>Total Operating Expenses</b>	<b>\$16,826,134</b>	<b>\$22,774,553</b>	<b>\$23,622,107</b>		<b>\$17,737,396</b>	<b>\$24,401,117</b>	<b>\$25,763,016</b>
<b>Income Taxes</b>	<b>(30,958)</b>	<b>53,649</b>	<b>113,248</b>		<b>(44,499)</b>	<b>38,538</b>	<b>100,810</b>
<b>Net Income</b>	<b>(\$1,093,960)</b>	<b>\$1,895,807</b>	<b>\$4,001,851</b>		<b>(\$1,572,459)</b>	<b>\$1,361,841</b>	<b>\$3,562,349</b>

Source: Tables I and J, Utilization Statistics and Revenue & Expenses, from 2021 Approved Project Change and the Current Request for Project Change.

As in the 2021 approved project change, Encompass-Southern Maryland projects that it will generate positive net income in the second year of operation. Projections extending into years four and five of operations, not shown above, project somewhat higher net revenue and net income than projected in the original application.

<sup>2</sup> The building cost indices are published by IHS Global Insight in *Healthcare Cost Review* here: [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)

#### IV. ANALYSIS AND RECOMMENDATION

There are no material changes in the location, capacity, or nature of the project; therefore, 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 significant, Encompass-Southern Maryland states that it will still fund the project with cash. Commission staff does not believe that the increased cost of the project will affect the overall viability of the project in the long term.

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>3</sup>

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.

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<sup>3</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)

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<b>ENCOMPASS HEALTH</b>	*	<b>BEFORE THE</b>
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<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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**FINAL ORDER**

Based on Commission staff’s analysis of the request by Encompass Health Rehabilitation Hospital of Southern Maryland, LLC for a project change after Certificate of Need approval, it is, this 19<sup>th</sup> day of May, 2022, **ORDERED** that:

The request by Encompass Health Rehabilitation Hospital of Southern Maryland, LLC to increase the total approved cost for the establishment of a 60-bed special rehabilitation hospital in Bowie to \$52,683,586 is hereby **APPROVED**, with the following 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**