Health Services Cost Review Commission
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MEMORANDUM

TO: Kevin McDonald, Chief - CON, MHCC

FROM: Katie Wunderlich, Executive Director, HSCRC
Jerry Schmith, Deputy Director, Hospital Rate Setting, HSCRC

DATE: March 17, 2020

RE: University of Maryland Upper Chesapeake Health Projects:
Modified Request for Merge/Consolidation UM UCMC and UM HMH, Matter No. 17-12-EX003
Modified Request to Convert UM HMH to an FMF in Aberdeen, Matter No. 17-12-EX004
Modified Certificate of Need for Special Psychiatric Hospital at Aberdeen Medical Center, Docket No. 18-12-2436

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On March 5, 2020, MHCC sent a memo requesting HSCRC staff to review and comment on the financial feasibility of University of Maryland Upper Chesapeake Health System's (UCHS) three intertwined proposals. Because of their interdependence, HSCRC staff reviewed them as concurrent projects and understand that MHCC will act on them simultaneously.

As per the description in the March 5 memo, two projects involve requests for exemption from Certificate of Need (CON), while one is a CON application. One exemption request is to convert University of Maryland Harford Memorial Hospital (HMH) to a freestanding medical facility (FMF) to be built in Aberdeen, while the other is to merge and consolidate certain inpatient services from HMH with University of Maryland Upper Chesapeake Medical Center (UCMC). The third element of this package is a CON application to establish a Special Psychiatric Hospital in Aberdeen, which would occupy the second floor of a building, constructed above the first floor FMF. This facility would be the centerpiece of what Upper Chesapeake Health System is calling the "Aberdeen Medical Campus" (AMC).

According to the memo, the primary objectives of the project package are to reconfigure and modernize the UCHS's delivery system to enable the continuation of quality of care and to consolidate services for cost savings and efficiency. A brief description of each project follows:

Upper Chesapeake Behavioral Health at Aberdeen:

- approximately 75,000 square feet ("SF") of new construction;
- 33 beds and shell space that could eventually accommodate 7 more beds;
- Total project budget is just below $63 million.

FMF:

- 25 ED treatment spaces
- 17 observation rooms
- approximately 69,000SF of new construction (on the first floor of the building that would include the psychiatric hospital)
- a diagnostic imaging suite with related staff and support spaces;
- non-treatment spaces, including triage/blood draw rooms, consultation rooms, staff support spaces, and offices; and
- a laboratory and pharmacy;
- Total project budget is $56,665,400.

Addition at UCMC to accommodate merging of HMH services:

- addition of three floors above the current cancer center (approximately 98,000SF);
- a shelled floor to accommodate actual and anticipated cancer center growth;
- one floor with 42 observation beds;
- one floor with 30 medical/surgical beds;;
- Total project budget of $84.4 million.

UM UCHS will fund the total project as well as the other capital projects for which UM UCHS and its constituent hospitals have sought approval from MHCC through a combination of $214.3 million in tax exempt debt and $4.0 million of interest earned on bond proceeds. The bonds are anticipated to be issued in fiscal year 2020 through the University of Maryland Medical System.

In commenting on the revenue and expense projections and financial feasibility of the proposed project, MHCC staff advised HSCRC staff to assume that UM UCH will achieve the projected volumes for the FMF and psychiatric hospital, but that there is not sufficient need shown for the 30 additional inpatient beds in the merger.

HSCRC Staff Comments:

We have reviewed the financial projections presented by UCHS and numerous schedules and narratives in support of such projections. These projections were reviewed in the context of the individual projects and the collective UCHS system, with a focus on the regulated service entities while maintaining awareness of the unregulated service components. The main purpose of our review was to determine what level of revenue should be retained by the regulated entities of UCHS and to determine the financial feasibility of the resulting UCHS as a whole.

The proposed construction is to be complete, and the related services are to commence by fiscal 2023. At that time, the projected GBR equivalent of HMH is to be approximately $119,400,000. Based upon the data provided by UCHS, the volume of business previously conducted at HMH would be redirected as follows: approximately $43.8M to UCMC; $17.0M to the Special Psychiatric Hospital; $36.0M to the FMF; and $22.6M to other third party regulated hospitals or to unregulated components.

Of the $22.6M volume directed to other third party/unregulated, UCHS would be allowed to retain $11.3M in revenue. Of the remaining $96.8M volume directed to regulated UCHS entities, UCHS would be allowed to retain $86.9M in revenue to be distributed among those entities, respectively. Therefore in total, UCHS would be allowed to retain $98.2M in GBR revenue.

The state-wide public health care system would save approximately $9.9M (gross reduction in retained GBR of $21.2M less $11.3M retained by UCHS). This would be coupled with approximately $4.7M of savings resulting from reduced Medicare reimbursement on billings from a standalone psychiatric hospital. Such reimbursement would not be based upon HSCRC rates as was approved at HMH, and which rates were paid by Medicare, but rather based upon the national Medicare fee schedule.

Financial Feasibility:

When the aforementioned $21.2M reduction in GBR revenue is applied to the 5-year projections (FY 2023 through FY 2027) the results imply the need to ramp up the reduction as follows: $15.2M in the first year of operations; $18.2M in the second year; and the full $21.2M in the third year of operations and forward. Focusing on the projected fifth year of operation (FY 2027) for the regulated entities (UCMC and AMC), gross patient revenues approximate $503M; net operating revenues approximate $425M; total operating expenses approximate $412M yielding an approximate $13M positive operating margin or 3%.

Although the HSCRC is focused upon regulated volumes, revenues and profitability, we noted the impact upon UCHS as a whole inclusive of UCHS owned physicians' practices and other UCHS owned but unregulated components. Again focusing on the fifth year of operation (FY 2027), the profit/loss was measured at a net loss of approximately $4M before non-operating income, which has averaged a positive $11M per year over the past three fiscal years, and averaged a positive $5M per year over the past five fiscal years. This implies that the UCHS system as a whole has the ability to absorb the planned reduction in GBR and remain profitable. We anticipate that UCHS will take full advantage of the current historically low interest rates on its financing needs, and that UCHS will continue to monitor and manage its operating costs. In addition, UCHS has the prerogative to amend its plans of financing this project should it wish to reduce the interest expense included in the projections. Further, UCHS has the prerogative to increase the shell space and defer certain of the fit-out should it wish to defer the depreciation expense included in the projections.

HSCRC staff believes that this project can be feasible. However, as is often the case, feasibility will depend on UCHS's ability to manage the project and the resulting operating expenses after the completion of the project. As pointed out, decisions on how to finance this project now will have an impact upon future operating margins. HSCRC staff believes that UCHS will make the decisions that they believe are appropriate in the future and that allow them to operate most efficiently.

cc: Ben Steffen, MHCC
Paul Parker, MHCC
Eric Baker, MHCC
Laura Hare, MHCC
Bob Gallion, HSCRC