maryland
health services
cost review commission

MEMORANDUM

TO: Wynee Hawk, Chief, CON, MHCC
Eric Baker, Program Manager, CON, MHCC

FROM: Katie Wunderlich, Executive Director, HSCRC
Jerry Schmith, Director, Revenue & Regulation Compliance, HSCRC
Bob Gallion, Associate Director III, Revenue & Regulation Compliance, HSCRC

DATE: August 9, 2021

RE: Hope Health Systems, Inc. (HHS)
Special Psychiatric Hospital – 16-bed Child & Adolescent Facility
Docket No. 20-03-2444

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This memo is in response to your request dated February 3, 2021. Hope Health Systems, Inc. (HHS) has submitted a Certificate of Need (CON) application dated October 21, 2020, proposing a capital expenditure of approximately $4.5 million to construct a 16-bed special inpatient psychiatric hospital for children and adolescents in a building owned by Hope Health Properties, LLC (HHP). The proposed facility is to house 16 single patient rooms (4 for children and 12 for adolescents). The inpatient facility would be established by renovating part of a building in which HHS currently operates an outpatient psychiatric clinic, located in the Woodlawn community of Baltimore County, Maryland. Programming at HHS currently includes partial hospitalization, outpatient mental health, expanded school mental health, Department of Justice (DOJ) service, rehabilitation programs, substance abuse, and mobile treatment. HHS states that it believes its range of outpatient services positions it well to provide its discharged inpatients with continued follow up care.

You have requested that the staff of HSCRC review the financial projections provided in the CON application and subsequent filings, (and separately you have requested that HSCRC staff advise MHCC as to any questions we would like answered before offering our opinion), and then also to advise MHCC of our opinion on the general financial feasibility of the proposed project. Additionally, you have requested that HSCRC staff comment on any other aspects of this CON application that may be pertinent. MHCC staff has not commented on the utilization projections presented in the CON application as to reasonableness and has not asked HSCRC staff to assume that HHS will achieve the projected utilization volumes.

BACKGROUND

As you have described it, the project will consist of approximately 10,134 SF of renovation, which, upon completion, will be separate and distinct from the existing outpatient services offered within the building, with a separate entrance for patients and visitors.

THE PROJECT

As you have described it, the total cost of the project is approximately $4.5 million, and the applicant plans to fund the project with a loan from Taylor Capital Consultants, who has pre-qualified the full amount for the loan. (Exhibit 9 of application). The project cost consists of approximately $2.4 million in demolition, building renovation, and infrastructure improvements; $1 million in fixed and movable equipment; $640,000 for IT systems; $140,000 in architect fees and permits and $320,000 for contingency.

HSCRC REVIEW, DISCUSSION, and OPINION

HSCRC staff has reviewed the following: 1) the CON application dated October 22, 2020, and the CON Modification dated March 15, 2021; 2) the subsequent Completeness Responses dated January 7, 2021, January 29, 2021, and April 26, 2021; and 3) the Interested Party Comments Responses dated March 15, 2021. Consistent with your request, we compiled and shared with you our review questions, which were forwarded to the applicant on March 24, 2021, and for which partial responses were included in the Completeness Responses received April 26, 2021. We understand that the April 26, 2021 Completeness Responses constitute a response to our questions dated March 24, 2021 as well as questions from MHCC and interested parties, and we, therefore, do not anticipate further responses from HHS to those questions not addressed, or not addressed fully in the April 26, 2021 communication.

Upon review of the materials submitted by HHS, it became evident that the applicant may have confused the presentation of the affiliated parties, as well as their respective roles in the proposed project. The applicant was uncertain as to which of the related parties was being represented by the statistical and financial Tables in the CON and subsequent submissions. To further compound the confusion, the descriptions of the relationships between the parties as documented in the submissions changed as time passed and more questions followed.

It is currently believed that HHP may be affiliated with HHS by mutual ownership, but that HHP may not be directly owned by HHS. Additionally, it is believed that HHS currently operates four (4) outpatient psychiatric clinics at the following locations: Woodlawn, Greenspring, Eldersburg, and Middletown, and that these service locations operate as a division(s) of HHS. It is believed that the proposed inpatient psychiatric hospital "Hope Health Hospital" (HHH) is also to operate as a division of HHS. Therefore, the identity of the smallest and most immediate corporate entity responsible for the proposed new service offering is HHS. This understanding is confirmed on page 2 of the Completeness Responses dated April 26, 2021. Additionally, it is important to note that on this same page of this same document it states: "The HHP Properties are held as collateral on HHP mortgage debt incurred for acquisition and renovation of the HHP Properties. HHS, as the primary tenant in the HHP Properties, is a guarantor of the HHP mortgage debt. HHP intends to refinance the balance owed on its existing mortgage and consolidate that balance with additional funds borrowed to pay for the improvements to the Whitehead Road property that are required to facilitate the development and operation of the HHS psychiatric hospital (HHH). HHP anticipates more favorable interest rate and other terms than applicable to its existing mortgage debt. HHP and HHS have negotiated amendments to the HHS lease that reflect the above refinancing."

The Table E - Project Budget has changed from the initial presentation of a $4.5M project to the current presentation of a $1.5M project. The initial presentation may have been a blended one, part HHP and part HHS. The current presentation is believed to describe the cost to HHS for its division HHH as a proposed new tenant operation. The uses are limited to moveable equipment, professional fees, and a working capital allowance. Sources are limited to "cash," but they may well be proceeds from the proposed HHP financing to be advanced to HHS via mutual ownership.

The Table I – Statistics, New Facility or Service has remained constant and unchanged since the initial October submission. It is of interest to note, however, that the applicant has submitted 4 different P&Ls since October, with 2 different top line revenue measures, and with 3 different total operating expense measures. Total discharges are projected to grow at an average annual rate of 2%, while average length of patient stay is projected to decline at an average annual rate of 2%. Total patient days is projected to remain unchanged at 4,964 patient days per year from 2023 through 2028. As per page 71 and 72 of the CON, the existing state resources will be the source of shifting volumes to HHH, and the greatest of such resources are Sheppard Pratt, Johns Hopkins, & University. Staff requested information from the applicant regarding its proposed systems and resources designed to achieve 80% occupancy in the very first year of operations (2022) given the well-established networking systems by incumbent service providers. Such assumed volume assumptions appear optimistic on their face, especially given that all future periods are projected at 85% occupancy. The applicant did not provide a response to this request. Staff is currently not in a position to judge the reasonableness of this projected volume assumption.

The Table J – P&L Uninflated, New Facility or Service has changed from its initial presentation of a $8.2M top line revenues with a $813K (12.5%) positive operating margin projected for 2028 (two years after completion and occupancy) to the current presentation of $7.9M top line revenues with a $1K (0.0%) breakeven operating margin for that same projected year. However, upon further review of the current presentation, it appears that the depreciation on the moveable equipment included on Table E --approx. $87,500/ year-- and the real property tax pass through to tenant rent as per the lease (approx. $9,975/year) have been omitted from the presentation. If such were to be added back to operating expenses, then the resulting profit margin may be a negative $96K (-1.5%) in 2028. Also of note is

that some of the line-item components of operating expenses are changing from submission to submission without narrative explanation, leading staff to question the applicant's research in preparing the expense values presented. And the recent changes in the salaries, wages and benefits buildup beg the question - has the applicant departed from its original vision of a consistent, competent, quality patient service offering? Additionally, it was noted that the value of Project Amortization approximates that of the debt service requirement of a $1.5M loan over 30 years at a 6.5% interest rate. There is inconsistency with the refinancing described in the Completeness Responses dated April 26, 2021, which noted the rate at 4%. The P&L should properly reflect the interest component of the amortization, and the depreciation of the acquired assets, but should not present the repayment of principal loan proceeds; such repayment is an element of a cash flow statement, not a P&L.

The Table K – P&L, Inflated, New Facility or Service has, as may be expected, also changed with each resubmission of Table J. In addition to all the comments already noted in reviewing Table J, all of which also apply to Table K, there are additional observations. Revenues are projected to grow at an annual average rate (2.2%) slightly higher than that projected for Total Operating Expenses (1.9%), which slightly pushes improvement in the projected operating margin year over year. Given the assumption that patient mix and patient days are nearly 86% attributable to Medicaid, staff questions the likelihood that this governmental payer will agree to reimburse at ever higher rates of service year after year. The projected 2028 operating margin of $92K may be closer to breakeven after accounting for the omitted depreciation and real property tax expenses.

The Table L – Workforce Information has changed in a material respect as resubmitted. The original Table L reflected 59.7 FTEs, all of which were regular employees, and $3.8M in compensation without disclosing the value of benefits if any. The current Table L reflects 65.1 FTEs, 49 of which are regular employees, 16.1 are contracted employees, and $4.7M in compensation with $545K of that in benefits that are restricted to just the regular employees. Staff took particular interest in the job categories selected for reclassification of FTEs from regular with benefits to contracted employees without benefits. The positions of Clinical Director, Psychologist, and Psychiatrist were included among those job categories reclassified as contracted without benefits. Staff is concerned that this reclassification may introduce new challenges to the project that may impact the timing of readiness to begin service, and the quality of service. Staff understands that the marketplace for medical and clinical professionals is very competitive and is concerned with the turnover of professional personnel.

Financial Statements for HHS have been included with the submitted materials. Review of these statements has raised questions and concerns. Building is included in the assets of the 2018 audited statements, which may contradict the representations that the building is owned by HHP, not HHS. The cash balances, current ratios, and equity ratios reflected in the 2017 and 2018 audited statements are less than what one may expect for a financially healthy business operation. The disclosures in such audited statements were less than adequately helpful in explaining the relatively material transactions regarding acquisition of building and debt. As of the date of this memo, staff has yet to receive audited statements for 2019 and 2020.

In the March 24, 2021 communication to the applicant, staff requested that the applicant provide several materials to aid in reaching an opinion regarding the feasibility of the project. Such requested materials included CON Tables F, G & H, which pertain to Statistics, P&L Uninflated and P&L Inflated, respectively, for the "Entire Facility or Service," implying application to HHS (inclusive of the HHH division). Please recall that HHS is represented to be guarantor of the debt of HHP. Such requested materials also include projected balance sheets for HHS (inclusive of HHH division). The applicant did not provide a response to this request. Staff is currently not in a position to judge the projected financial health of HHS through 2028 (two years after planned completion and occupancy). It should be noted that as per the Completeness Responses dated April 26, 2021, HHP is proposing to borrow $5.7M to refinance its current debt and to afford financing for the larger $4.5M project. HHS is obliged to guarantee the entire $5.7M loan, not just the $1.5M for HHH.

You have requested that staff opine on the financial feasibility of the special psychiatric hospital project proposed by HHS. Generally speaking, staff needs to gain comfort that the applicant has sufficient working capital to maintain the operation from its inception throughout at least two years after the completion and full occupancy of the project. Staff needs to be satisfied that such use of its working capital does not put at risk the financial position of the applicant (as measured by its debt covenants, its balance sheet liquidity, its leverage and equity ratios). In addition, staff needs to be comfortable that the applicant can assemble the financial resources necessary to get the project off the ground and can then subsequently service any such financing sources without putting its financial position at a level of unhealthy risk. These required levels of comfort go beyond the question of whether the project can achieve a positive operating

margin at least two years (or longer as required) after project completion and full occupancy. The HSCRC staff typically bases its opinion on sufficient competent evidence as submitted by the applicant, recognizing that there are times when the evidence needed to review is beyond that which was included in the initial CON application. At this time, based upon review of all the submitted materials, and with no expectation of further response from the applicant, staff is not in a position to reach an opinion of the financial feasibility of this project.