

IN THE MATTER OF
ADVENTIST HEALTHCARE
SHADY GROVE MEDICAL CENTER

BEFORE THE
MARYLAND HEALTH
CARE COMMISSION
Docket No. 20-15-2443

REQUEST FOR PROJECT CHANGE AFTER CERTIFICATION

Adventist HealthCare Shady Grove Medical Center (SGMC), by its undersigned counsel, asks the Maryland Health Care Commission (the Commission) to approve two changes to the above-referenced project.

On April 15, 2021, the Commission issued a certificate of need (CON) authorizing SGMC to construct a new patient tower and renovate existing hospital space to improve and modernize facilities and services at 9901 Medical Center Drive in Rockville, Maryland (the Project). The Project was approved to be implemented in two phases under a single construction contract at a cost of \$180,011,359. The Project was to be funded with a \$154 million tax-exempt municipal bond issue, \$10 million in cash, and \$16 million in philanthropic donations.

Substantial progress has been made in planning for implementation. SGMC has completed the relocation of the temporary helipad and the temporary emergency department access road and entrance is underway. This will facilitate the start of utility and foundation work for the tower addition. SGMC is currently awaiting permits from Montgomery County Department of Permitting Services.

The design of the Project has not changed, but the overall project cost has increased substantially and, consequently, the Project must be pursued under multiple contracts. The cost increase is primarily due to inflationary pressures and volatile market conditions resulting from the COVID-19 pandemic and its impact on the labor market and global supply chain. This situation has been exacerbated by international conflicts further disrupting global supply chains. SGMC also needs to implement more extensive upgrades to the central utility plant (CUP) than had been initially planned. The current market conditions require this project to be pursued under multiple construction contracts – one for the core and shell of the new patient tower, a subsequent contract for the fit-out of the tower interior, and a third contract for the renovation of existing hospital space.

I. Increase in the Approved Total Project Cost

SGMC received Guaranteed Maximum Price (GMP) proposals for the construction of Phase 1 of the Project – construction of the new patient tower and CUP upgrades. The Project

cost has increased to \$247,657,497¹. This increase is the result of inflationary pressures, and the unusual market conditions created by the global COVID-19 pandemic which caused considerable spikes in the costs of construction materials and labor. This situation has been exacerbated by the war in the Ukraine which is further disrupting global supply chains and increasing global energy costs.

Cost increases since 2020 exceeded the inflation index used by the Commission. Per the Associated General Contractors of America April 2022 report, the construction industry is experiencing exceptionally steep and fast-rising costs for a variety of materials, compounded by major supply-chain disruptions and worker shortages. For example, steel, gypsum, lumber, electrical and plumbing supplies, and diesel fuel costs increased dramatically between 29% - 300%. Increased shipping costs also contributed to the budget increase. Labor costs also increased significantly across nearly all building trades including concrete contractors, steel erectors, electrical workers, and plumbing and HVAC servicers all seeing 5 - 9% increases since 2020. These volatile conditions have drastically increased the cost of the Project.

If the market begins to stabilize, the final cost of the new tower could be less than the GMP. This is why we are requesting authorization to build the new tower under two separate contracts – one for the core, to be issued immediately, and one for the interior fit out which can be issued when the core and shell is near completion. This is discussed in further detail in Section II below.

In addition to the volatile construction market, SGMC has discovered additional upgrades needed for the CUP beyond what was approved in the CON. These upgrades are necessary to bring the CUP up to current code and best practice standards that have evolved since the CUP was originally built. It will be more cost effective to pursue these upgrades now, as a part of the overall project, than to pursue them after the tower is completed in a separate project. These upgrades will add the latest technology, security, capability, and safety features and ensure that the CUP can serve the new tower and continue to serve SGMC into the future. The proposed upgrades include:

- Several upgrades to meet current code requirements and best practice standards:
 - o Installing a Life Safety Automatic Transfer Switch for the generators and emergency lighting.
 - o Installing a Critical Branch Automatic Transfer Switch.
 - o Replacing egress lights w/ LEDs fixtures.
 - o Installing an equipment branch dedicated to the heating equipment.
 - o Replacing generator power wiring.
- Installing 1300-ton chillers to ensure the CUP can serve the new tower and have additional capacity to support future needs.
- Replacing outdated boilers to serve the new tower as well as the rest of the hospital.

¹ It should be noted that SGMC is planning to allocate only the amount approved in the CON toward the Phase 2 renovations of the existing hospital space. Therefore, SGMC does not project any additional cost increases to the project beyond the patient tower portion addressed in this request.

To finance the project, SGMC remains committed to raising \$16 million in philanthropic donations. To date, SGMC has raised just under \$8 million in charitable contributions and fully expects to reach its target. The bond issue for the Project was completed in October 2021. The tax-exempt bonds were issued through the Maryland Health and Higher Educational Facilities Authority, consistent with the plan as stated in the CON application. The remainder of the cost will be funded by cash from operations. Due to the increase in the Project budget, SGMC plans to file a rate application request with the Health Services Cost Review Commission (HSCRC) to help offset the cost of these increases. The HSCRC has been notified that this request is pending.

The attached Table 3 from the latest Quarterly Progress Report, being filed simultaneously with this request, details the cost increases. The budget increased from \$180,011,359 to \$247,657,497. Therefore, we request an increase of \$67,646,138.

II. Multiphase Construction Contracts Required

In addition to the budget increase, SGMC requests approval to sign multiple construction contracts to complete the Project. The Project, as approved, is to be completed in two phases under one construction contract. The two phases together comprise 60 months of construction with an April 2023 deadline for obligating at least 51% of the total capital expenditure. Phase 1, the new patient tower and CUP upgrade portion of the project, is required to be completed within 36 months of executing a binding construction contract. The renovation of existing hospital space under Phase 2 is required to be completed within 24 months of Phase 1 completion.

As noted above, construction costs are volatile for the reasons explained. Consequently, SGMC requests permission to complete this project under three separate construction contracts. Phase 1 of the Project must be divided into two contracts – one for the core and shell of the new patient tower and CUP upgrades and a separate, subsequent contract to fit out the interior. A third contract will be used to complete Phase 2 renovations to the existing hospital. In fact, under the current market conditions, general contractors are unwilling to issue a GMP contract so far in advance of the work included in Phase 2.

Fortunately, these changes will not have an impact on SGMC's ability to meet the project conditions and requirements per the attached CON Approval document and may well result in the overall cost of the project being less than currently projected. The contract for the core and shell of the new tower and the CUP upgrade portion of the Project will represent at least 51% of the overall project budget. SGMC will execute that contract well in advance of the April 2023 deadline. Proceeding with the core and shell will keep the Project moving and avoid locking in the extraordinarily high cost of the fit out based on current market conditions. It will take approximately 22 months to complete the core and shell of the tower. In that time, SGMC will continue to monitor market conditions and can request proposals for the interior fit out in 12 to 18 months. There is reason to believe that by pushing out the contract for fit out, SGMC will be able to obtain more favorable prices than what is available on the market currently. The cost of lumber and gas (general market indicators) have decreased significantly in recent months, and there have been smaller incremental decreases to other construction materials as well.

Using multiple contracts will allow the Project to move forward within the timeline required by the CON. Therefore, with approval of this petition, it is not anticipated that the overall duration of the construction period will need to be extended beyond the current schedule.

III. Standard of Review

The Commission's regulations at COMAR 10.24.01.17A require notification of any proposed project changes. Certain types of proposed project changes are impermissible, including the following (§.17C):

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 or medical service categories from those approved;
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.

The proposed changes identified in this filing do not alter the fundamental nature of the project, will not result in an increase in the total licensed bed capacity as previously approved, and as explained above will not require any extension of time beyond what is permitted under Regulation .12E or as otherwise would be applicable pursuant to the Commission's July 30, 2021 Guidance to meet applicable performance requirements. Thus, the shift from one construction contract to three contracts (two for Phase 1 and one for Phase 2) is not a material change to the project.

Though all project changes require notification to the Commission, the following types of changes to a project require formal Commission approval (§.17B):

1. Before making a significant change in physical plant design;
2. Before 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;
3. When total projected operating expenses or revenue increases exceed the projected expenses or revenues in the approved Certificate of Need Application, inflated by 10 percent per year;
4. Before changing the financial mechanisms of the project;
5. Before changing the location or address of the project.

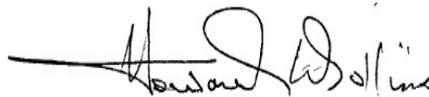
In this circumstance, only §.17B(2) and (4) are applicable because the contracted capital costs of the project increased as itemized in the QPR Table 3 and SGMC plans to apply for rates to cover to fund the project. These project changes did not affect the design of the project, therefore §.17B(1) is not applicable. Since operating revenues and expenses will not increase above those

projected in the approved CON inflated by 10 percent per year, §.17B(3) is not applicable. The location or address of the project is not change, hence §.17B(5) is not applicable.

CONCLUSION

For these reasons, SGMC respectfully requests that the Commission approve the changes described above.

Respectfully submitted,



Howard L. Sollins
John J. Eller
Baker, Donelson, Bearman, Caldwell & Berkowitz
100 Light Street
Baltimore, MD 21202
410-685-1120
hsollins@bakerdonelson.com
jeller@bakerdonelson.com

CERTIFICATE OF SERVICE

I hereby certify on this 15th day of September 2022, a copy of the Request for Project Change After Certification were mailed via first class mail and via email to:

Ben Steffen, Executive Director
Maryland Health Care Commission
4160 Patterson Avenue
Baltimore, MD 21215

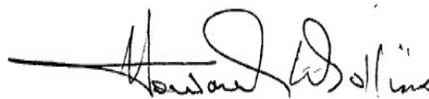
Mr. Paul Parker
Director, Health Care Facilities Plan. & Dev.
Maryland Health Care Commission
4160 Patterson Avenue
Baltimore, Maryland 21215-2299

Ms. Ruby Potter
Maryland Health Care Commission
Health Facilities Coordination Office
4160 Patterson Avenue
Baltimore, MD 21215

Renee Webster
Office of Health Care Quality
7120 Samuel Morse Drive
Second Floor
Columbia, Maryland 21046-3422

James Bridgers, Ph.D.
Acting Health Officer - Montgomery County
401 Hungerford Drive, 5th Floor
Rockville, MD 20850

Andrew R. Nicklas, JD
Deputy General Counsel & Director of Government Relations
Adventist HealthCare
820 W. Diamond Avenue, Suite 600
Gaithersburg, MD 20878



Howard L. Sollins, Shareholder

Table 3. Project Cost

Project Budget/Expenditures	CON Application	Current Estimated Total Cost (Sep 22)	Binding Contract Obligations (Oct 22)	Cumulative Expenditures (Sep 22)
1. Capital Costs				
New Construction				
Building	\$80,210,892	\$180,297,895	\$129,825,641	\$5,191,087
Fixed equipment	\$3,827,297	Included above	Included above	Included above
Land Purchase	\$ -	\$ -	\$ -	\$ -
Site and Infrastructure	\$10,558,146	Included above	Included above	\$0
Architect/engineering fees	\$6,357,828	\$8,327,983	\$7,661,521	\$5,349,748
Permits (building, utilities, etc)	\$2,343,851	\$2,343,951	\$325,473	\$324,423
Subtotal- New Construction	\$103,298,014	\$190,969,829	\$137,812,635	\$10,865,259
Renovation				
Building	\$8,840,236	\$8,840,236	\$206,900	\$0
Fixed equipment				
Architect/engineering fees	\$656,620	\$665,551	\$465,149	\$113,715
Permits (building, utilities, etc)	\$242,067	\$242,067	\$0	\$0
Subtotal- Renovations	\$9,738,923	\$9,747,854	\$672,049	\$113,715
Other Capital Costs				
Movable equipment	\$3,829,400	\$3,629,400	\$1,233,238	\$151,976
Contingency Allowance	\$12,847,170	\$7,347,943	\$0	\$0
Gross Interest during Construction Period	\$14,611,596	\$15,206,426	\$15,206,426	\$1,401,600
Furniture	\$2,392,000	\$2,367,000	\$199,320	\$0
Interior and Exterior Signage	\$738,400	\$738,400	\$89,000	\$7,575
IS/Comm	\$6,665,000	\$6,880,784	\$46,310	\$0
Security System	\$1,265,000	\$1,100,392	\$36,627	\$0
Relocation Expense	\$330,600	\$450,866	\$120,020	\$92,508
Certifications, inspections, etc.	\$214,360	\$313,357	\$239,062	\$14,137
Subtotal- Other Capital Costs	\$42,893,526	\$38,034,569	\$17,170,003	\$1,667,796
APPROVED TOTAL CURRENT CAPITAL COST	\$155,930,463	\$238,752,252	\$155,654,687	\$12,646,770
Inflation allowance	\$14,682,334	\$7,654,377 ¹	\$0	\$0
Subtotal Other Capital Costs	\$14,682,334	\$7,654,377	\$0	\$0
TOTAL CAPITAL COSTS	\$170,612,797	\$246,406,628	\$155,654,687	\$12,646,770
2. Financing Costs and Other Cash Requirements				
Loan placement fees	\$1,925,187	\$1,171,726	\$1,171,726	\$1,171,726
Bond discount		\$0	\$0	\$0
Legal fees (CON Related)		\$0	\$3,317	\$3,317
CON application assistance		\$0	\$0	\$0
Legal fees - Other		\$49,139	\$0	\$0
Liquidation of existing debt		\$0	\$0	\$0
Special Exception Costs		\$0	\$0	\$0
Imputed interest		\$0	\$0	\$0
Operationalization				
Debt service reserve fund	\$7,473,375	\$0	\$0	\$0
Subtotal Financing	\$9,398,562	\$1,220,865	\$1,175,043	\$1,175,043
3. Working Capital Startup Costs				
Total Uses of Funds (1+2+3)	\$180,011,359	\$247,627,494	\$156,829,730	\$13,821,813
Project Square Footage				
New Construction	150,352			
Renovation	25,969			

¹ We have used current cost estimates for projecting capital expenses, hence the estimated inflation costs represent future inflation.

MARYLAND HEALTH CARE COMMISSION

Certificate of Need

TO: Andrew Nicklas
Director, Government Relations,
and Deputy General Counsel
Adventist HealthCare
820 West Diamond Avenue
Gaithersburg, MD 20878

April 15, 2021
Date

RE: Adventist HealthCare Shady Grove Medical Center
Construct a Patient Tower and Renovate Existing Facilities

20-15-2443
Docket No.

PROJECT DESCRIPTION

This Certificate of Need authorizes Adventist HealthCare Shady Grove Medical Center (SGMC) to complete major expansion and renovation of its facility at 9901 Medical Center Drive, in Rockville. The project will add a six-floor patient care tower with 150,352 square-feet (SF) of inpatient service space, and renovation of 25,696 SF of existing hospital building space. The project is not intended to either add to the number of beds the hospital routinely places into operation or introduce new facilities or services. It is planned and designed to modernize the existing facilities and services. SGMC expects to complete the project in two phases scheduled over 66 months (projected completion in August 2026), including six months of final design and planning. Phase 1 – construction of the patient tower, is expected to take 36 months. Phase 2 – renovation of the existing facility, is expected to be completed in 24 months.

The total project cost is estimated at just over \$180 million, consisting of approximately \$103.3 million for new construction, \$9.7 million for renovation, a contingency allowance of \$12.8 million, and an inflation allowance of \$14.7 million. The project will be funded with a \$154 million tax-exempt municipal bond issue, approximately \$10 million in cash, and \$16.0 million in philanthropic donations.

ORDER

The Maryland Health Care Commission reviewed the Staff Report and Recommendation and, based on that analysis and the record of the review, ordered on April 15, 2021, that a Certificate of Need be issued for the project with the following conditions:

1. Prior to its request for first use approval, Adventist HealthCare Shady Grove Medical Center shall identify bed capacity it will retain in operational status, the physical bed capacity it will repurpose but retain as physical bed capacity, and the physical bed capacity it will eliminate. This plan shall specifically address the hospital's assessment

of the need for surge bed capacity and its plan to maintain and deploy adequate surge capacity when needed.

2. Any future change to the financing of this project involving adjustments in rates set by the Health Services Cost Review Commission must exclude \$21,226,090, which includes the estimated new construction costs that exceed the Marshall Valuation Service guideline cost and portions of the contingency allowance and inflation allowance that are based on the excess construction cost.

PERFORMANCE REQUIREMENTS

In accordance with COMAR 10.24.01.12C(3)(b), the project is subject to the following performance requirements:

The applicant states the project will be implemented in two phases, with all phases included in a single construction contract. Taking these two phases into account, the applicant will adhere to the following timeframes for completion of the proposed project:

Binding construction contract obligating not less than 51% of the Commission-approved capital expenditure, as documented by a binding construction contract,	Within 24 months of the date of the Certificate of Need (no later than April 2023)
Initiation of Phase 1 Construction	Within 4 months of binding construction contract
Completion of Phase 1 Construction	Within 36 months of binding construction contract
Completion of Phase 2 Construction	Within 24 months of completion of Phase 1 construction

Failure to meet these performance requirements will render this Certificate of Need void, subject to the requirements of COMAR 10.24.01.12 F through I.

PROPOSED CHANGES TO THE APPROVED PROJECT

Before making any changes to the facts in the Certificate of Need application and other information provided to the Commission, SGMC must notify the Commission in writing and receive Commission approval of each proposed change, including the obligation of any funds above those approved by the Commission in this Certificate of Need, in accordance with COMAR 10.24.01.17. Pursuant to COMAR 10.24.01.17B(2), the project cannot incur capital cost increases that exceed the approved capital cost inflated by an amount determined by applying the Building Cost Index published on a quarterly basis by IHS Economics in the Healthcare Cost Review unless CSI obtains a modification of this Certificate of Need from the Commission. Instructions for determining the threshold that necessitates Commission review and approval of changes to the capital cost approved in this Certificate of Need are located on the Commission's website at:

http://mhcc.maryland.gov/mhcc/pages/hcfs/hcfs_con/hcfs_con.aspx

DESIGN APPROVAL AND FACILITIES LICENSURE BY DHMH

This Certificate of Need does not constitute a license or replace any approvals required by the Office of Health Care Quality or others within the Maryland Department of Health (MDH) to construct and operate new space within an existing facility. SGMC must provide MDH with all information it requires for plan approval, facility licensure, and putting into operation renovated space within its existing facility, including information pertaining to project design and specifications.

QUARTERLY STATUS REPORTS

SGMC must submit quarterly status reports on the approved project to the Commission, beginning July 15, 2021, three months from the date of this Certificate of Need, and continuing, at three-month intervals, until the completion of the project.

REQUEST FOR FIRST USE REVIEW

SGMC must request in writing, not less than 60 days but not more than 120 days before the first use of the approved operating room, a first use review from the Commission, specifying the anticipated date of first use and documenting that the project has been substantially completed and will be completed, within 120 days or less, in a manner and at a cost consistent with this Certificate of Need. Commission staff will review the request in consultation, as necessary, with OHCQ, and in accordance with COMAR 10.24.01.18 to determine whether the project conforms with the Certificate of Need. First use approval does not constitute a license or replace any approvals required by OHCQ or others within MDH to operate new space within an existing health care facility. Therefore, SGMC should assure that OHCQ is notified of the imminent completion of the project and should arrange for completion of any inspections and or approvals required by OHCQ in a timely manner. First use approval remains in effect for 90 days. If first use of the new operating room does not occur within 90 days of approval, SGMC shall reapply for first use approval.

ACKNOWLEDGEMENT OF RECEIPT OF CERTIFICATE OF NEED

Acknowledgement of your receipt of this Certificate of Need, stating acceptance of its terms and conditions, is required within thirty (30) days.

MARYLAND HEALTH CARE COMMISSION

Docket No. 20-15-2443

April 15, 2021

Page 2

A handwritten signature in black ink that reads "Ben Steffen". The signature is written in a cursive, slightly slanted style.

Ben Steffen
Executive Director

cc: Patricia T. Nay, M.D., Executive Director, Office of Health Care Quality
Travis Gayles, M.D., Ph.D., Health Commissioner, Montgomery County Health
Department