maryland health services cost review commission

MEMORANDUM

TO: Kevin McDonald, Chief, CON, MHCC
Moira Lawson, Analyst, CON, MHCC

FROM: Katie Wunderlich, Executive Director, HSCRC
Jerry Schmith, Director, Revenue & Regulation Compliance, HSCRC

DATE: May 20, 2021

RE: Luminis Health Doctors Community Medical Center (LHDCMC)
Establishment of 16-bed Adult Inpatient Psychiatric Unit
Docket No. 21-16-2448

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This memo is in response to your request dated April 29, 2021. LHDCMC has submitted a Certificate of Need (CON) application dated April 9, 2021 proposing a capital expenditure of approximately $7.8 million to construct a 16-bed adult inpatient psychiatric unit in a building within its hospital campus. The proposed 12,008 square foot unit would be established by renovating the second floor of a building which formerly housed the Magnolia Gardens licensed comprehensive nursing care facility. The LHDCMC campus is located in Lanham, within Prince George's County, Maryland. Programming at the proposed unit is to include evaluation, treatment, and care management for adult patients with a psychiatric disorder as the primary diagnosis; however, the unit will admit patients with limited medical comorbidities and/or substance use as a co-occurring disorder. Both voluntary and involuntary adult admissions will be accepted. The new unit will be part of a continuum of behavioral health services located in the same building.

You have requested that the staff of HSCRC review the financial projections provided in the CON application and subsequent filings, 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 commented that the utilization projections presented in the CON application are reasonable, and has asked HSCRC staff to assume that the utilization volumes projected by LHDCMC will be achieved.

BACKGROUND

As you have described it, LHDCMC states that the new unit will help to meet the existing need for adult inpatient psychiatric services in Prince George's County. According to the applicant, there were 1,900 discharges of Prince George's residents from adult psychiatric inpatient facilities outside of the county. The applicant states that the addition of adult psychiatric beds in Prince George's County will lead to increased access to a continuum of behavioral health services, better integration with community outpatient services, and a reduction in relapse rates, readmissions, and return visits to the Emergency Department.

THE PROJECT

As you have described it, the total cost of the project is estimated at $7,787,303 and will be funded through a $5,037,303 grant from Prince George's County and $2,750,000 in cash.

HSCRC REVIEW, DISCUSSION, and OPINION

HSCRC staff has reviewed the CON application dated April 9, 2021 and the related Exhibits 1 through 27, and the amended Tables G, H, J, K, and L as submitted May 18, 2021. Upon review of these materials, observations were noted and conclusions were reached as follows.

The Table E - Project Budget reflects that financing for the project requires $2.75 million from cash balances, and $5.04 million from a local government grant. The audited financial statements for fiscal 2020 reflect cash balances of $91.8 million for LHDCMC, $99.2 million for LHDCMC and subsidiaries consolidated, and $178.8 million for Luminis Health, Inc. and subsidiaries consolidated, respectively. Therefore, it is apparent that the applicant and its affiliates have more than sufficient cash available to afford the cash financing requirement of this project.

As per page 19 of the CON, the project timeline calls for a 10-month renovation project, likely to be completed within 18 months of approval of the CON. The Table I - Statistical Projections New Facility or Service reflects first year operations (fiscal 2023) at 67% occupancy, and achieving 85% occupancy in the fifth year of operations (fiscal 2027), effectively achieving "full occupancy." The Table J - P&L Uninflated New Facility or Service reflects projected operating results for each year from initiation (fiscal 2023) through two years following full occupancy, or the seventh year of operations (fiscal 2029). Staff tested the average charge rate assumed in the projections of $1,635 per patient day. Staff researched the July 1, 2020 rate orders for Brook Lane, McNew, and Sheppard Pratt and found the average charge to be approximately $1,582 per patient day, a variance of 3% from the LHDCMC assumption. Staff judged the variance to be immaterial, and given that MHCC permitted HSCRC staff to assume projected volumes were to be achieved, the revenue build-up was effectively substantiated. Staff noted that the P&L projections initially reflected contra revenues at 7.5% of gross patient charges. Upon re-evaluation, the applicant amended the projections to reflect contra revenues at 10% of gross charges. Contra revenues account for payers' contractual disallowances, charity care, and bad debt write-offs. The rate of contra revenue is reflective of Luminis' experience at McNew. The applicant documented that its operating expense projections were based upon recent performance at its McNew facility. Testing of these assumptions was on a limited scope basis. Depreciation was tied to a high level predictive test with a variance judged to be immaterial. Salaries, wages, and benefits were tied to the Table L as amended upon discussion with the applicant. The Table J bottom line net income reflects a 13.3% positive margin (or $971,000) in the seventh year of operations (fiscal 2029), two years after achieving full occupancy. Further Table J reflects a positive margin each year during the seven years projected.

The Table K – P&L Inflated New Facility or Service incorporates Table J and adds a component for inflation. The assumptions used by the applicant have the effect of inflating net revenues at a slightly faster pace than operating expenses in total. However, the staff reviewed the rates of inflation for operating expenses, which ranged from 1.5% on other, to 2% on payroll, to 3% on supplies, and judged such assumed rates to be reasonable on their face. Staff acknowledges that the rate of inflation in the near future will be difficult to predict given that the nation is just now coming out of the economics associated with the global pandemic. The projected net income in the seventh year of operations (fiscal 2029), two years after achieving full occupancy, is measured at a 17.1% positive margin (or $1.5 million). Again Table K reflects a positive margin each year during the seven years projected. Based upon review of Table J and K, it appears that the operation of the project on a stand-alone basis is contributing to the financial strength of the applicant, and not detracting from it. Upon inquiry by staff, Luminis' management made the assertion that they will not be seeking a GBR adjustment at this time for this project.

The Table G – P&L, Uninflated Entire Facility includes the operations of the project and runs through fiscal 2029. The gross revenues are projected using no inflation and modest volume changes. Contra revenues are projected at 17.1% of gross patient revenues, and approximate actual experience in fiscal 2020. Rates of growth in net revenues are nearly equal to the rates of growth in operating expenses. The Table G bottom line net income reflects a 5.6% positive margin (or $14.3 million) in the seventh year of operations for the project (fiscal 2029), and each year projected reflects a positive margin. The Table H – P&L Inflated Entire Facility incorporates Table G and adds a component for inflation. Again, assumptions drive the rate of inflation on revenues slightly faster than that of operating expenses. The projected net income in the seventh year of project operations (fiscal 2029), is measured at 9% positive margin (or $27.3 million). And again, Table H reflects a positive margin each year of the seven years projected. Based upon review of Tables G and H, it appears that LHDCMC will be profitable as measured on the whole throughout the years projected, up to and including the second year of operations of the project following full occupancy.

You have requested that staff opine on the financial feasibility of the 16-bed adult psychiatric unit project proposed by LHDCMC. Based upon review of the history of audited financial statements, staff is comfortable 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; that such use of its working capital does not put at risk the financial position of the applicant ; and staff is comfortable that the project can achieve a positive operating margin at least two years after project completion and full occupancy. We base the opinion on sufficient competent evidence as submitted by the applicant in the initial CON application. At this time, based upon review of all the submitted materials, staff is of the opinion that this project is financially feasible.