Re: Luminis Health Doctors Community Medical Center (LHDCMC)
Obstetric Service & Facility Expansion & Renovation
Docket No. 23-16-2466

Applicant's Response to Health Services Cost Review Commission Memorandum Dated November 1, 2023

November 16, 2023

The Applicant, Luminis Health Doctors Community Medical Center ("Luminis Health"), responds to the November 7, 2023 Memo from the Health Services Cost Review Commission ("HSCRC") to the Maryland Health Care Commission ("MHCC") in response to the MHCC's May 19, 2023 request for the HSCRC's opinion as to whether the project is financially feasible. In its Memo, the HSCRC raised certain issues that it opined could, if they were to all resolve in unsatisfactory manner, call into question the viability of the project, but also concluded that the project could be viable if these issues were resolved favorably. The HSCRC also acknowledged Luminis Health's eligibility for an incremental capital adjustment for the project, which was not factored into the application as submitted, and would further improve the feasibility of the project.

Luminis Health previously addressed many of the issues raised in the HSCRC memo[1] and submits that these issues do not call into question the viability of the project that has been demonstrated in this review. As requested by MHCC Staff, we have further elaborated on the questions that were raised, below.

1) **HSCRC Staff Comment (Useful Life)**: Noting that Luminis Health used a 36-year useful life for depreciation calculations, Staff concludes from "review of recent CON applications, the average useful life of acquired assets in construction projects was 25 years" and notes that Luminis Health's own audit report indicates the average useful life of existing assets is 25.5 years.

   Applicant Response:

   In Completeness Questions dated June 23, 2023, Luminis Health explained that the useful life for this project was based on the American Hospital Association (AHA) depreciation guide. Unlike the "average" asset mix of all Luminis Health's facilities or complete acute

[1]Several issues raised in the HSCRC memo were issues it asked about and Luminis Health responded to during the review process. For example, Luminis Health explained its useful life calculations in its June 23, 2023 completeness responses in response to the same question from the HSCRC, but the HSCRC's memo does not acknowledge or account for Luminis Health's response to this question. Likewise, we responded to the concern about the future grant funding for the project. HSCRC Staff also raised the same concern about the calculation of the debt service coverage ratio (DSCR) late in the review process, and a conference call was held on October 23 in which Luminis Health reviewed the methodology of the calculation that had been approved by the Maryland Health and Higher Educational Facilities Authority (MHHEFFA), our Bond Trustee, and our banking partners. We believed HSCRC's concern about Luminis Health's DSCR had been addressed through this call, but the HSCRC continues to raise it, even while admitting that Luminis Health's DSCR complies with its bond covenants.

care hospitals, this project is largely dedicated to Maternity care, which means a greater proportion of the capital spend as compared to a general acute-care hospital project falls under the category of building cost (with a 40-year useful life) and a smaller proportion falls under fixed asset, which has a 15-year useful life. These line-by-line explanations that correspond to Table E in the CON Application Tables Packet were provided to support our calculations and, as indicated, the resulting calculation shows that 90% of the costs are in the building category, resulting in an average 36 year useful-life for the project.

2) **HSCRC Staff Comment (Capitalized Interest and Expensed Interest)**: Staff computed approximately $16.7 million of capitalized interest over 24 months, while Luminis Health computed approximately $12.4 million in capitalized interest during construction. Additionally, Staff computed approximately $50.6 million in expensed interest over the periods projected, while Luminis Health computed approximately $49.1 million in expensed interest.

   Applicant Response:

   Luminis Health is unable to replicate the calculations performed by the HSCRC, but neither of these elements is material or has a substantial implication on the feasibility of the project. The difference in capitalized interest calculations will have a negligible impact on depreciation expense and no impact on cash. The difference in interest expense calculations is likely related to the timing of assumptions but is nonetheless immaterial to the financial scope of the project.

3) **HSCRC Staff Comment (Government grants and philanthropy)**: Staff expresses a concern that if the projected grants and philanthropy are not received, the additional financing would put stress on the financial feasibility of the project by reducing days cash on hand and debt service coverage ratio.

   Applicant Response:

   Luminis Health has a long track record of successful philanthropic endeavors, and is confident there is widespread support for the establishment of a maternity program at our LHDCMC campus that will attract meaningful financial support. Additionally, the Prince George's County Executive has indicated that advocating for funding for this project is a high priority for the County, being closely aligned with the findings of the recently published report by Huron, "Assessing Prince George's County Healthcare and Social Needs and 10+ Year Investment Strategy". While there is no guarantee of future government funding, the extent to which our project is a priority of Prince George's County and closely aligned with independent findings in terms of need, scope, and priorities is indicative of a strong likelihood for continued support, beyond the already approved and pre-authorized funding.

4) **HSCRC Staff Comment (Operating margin):** Staff highlighted that the final version of Table K produced a net operating margin of $5.8 m or 12.2%, and created a different Pro Forma for the project in which they computed operating income of $3M (6.2% of operating revenue) and a cash flow operating margin of $14.5million.

   Applicant Response:

   While the HSCRC's calculations differ from Luminis Health's, the more conservative projection by the HSCRC still results in a viable obstetrics program at LHDCMC.

5) **HSCRC Staff Comment (Request for projected balance sheets)**: Staff states that it requested but did not receive projected balance sheets from Luminis Health.

   Applicant Response:

   Luminis Health explained to the HSCRC in September that balance sheet projections are not part of our standard financial reporting package. The uncertainty of the healthcare market in fiscal years 2021, 2022, and 2023 coupled with fluctuating capital markets and an environment of uncertain and rapidly changing interest rates lead to the conclusion that projected balance sheets beyond the current audited fiscal year 2023 are likely unreliable and could potentially lead to materially inaccurate conclusions. Luminis Health provided as much alternate detail as possible.

6) **HSCRC Staff Comment (Debt service coverage ratio)**: Staff opines that the measured debt service coverage ratios (DSCR) for June 30, 2022, and June 30, 2023 are indicative of operating performance measures for the obligated group that are insufficient to service the burden of its present debt and planned additional project debt. In addition, they express concerns that the degree of reliance upon non-operating "below the line" income items to service its debt is reflective of additional risk that such income may or may not be both consistently present and of material positive value in future fiscal periods.

   Applicant Response:

   The calculation of Luminis Health's DSCR is in accordance with the master loan agreement and has been reviewed and approved by MHHEFA, the bond trustee, and with banking partners. Investment income, including realized gains/losses and dividends and interest, are available to service the debt and thus are included in the calculations, consistent with our peers in the Maryland market. The HSCRC acknowledges in the memo that Luminis Health's calculation is in accordance with MHHEFA's methodology and consistent with the bond covenants.

   Luminis Health has maintained compliance with the covenants even in its two most recent (and highly financially challenging) years. In addition, we expect operating performance to improve in the current and future periods, which will continue to relieve any pressure on the DSCR.

7) **HSCRC Staff Comment (Bond rating):** HSCRC Staff notes that in a report dated October 25, 2023, S&P Global Ratings lowered its long-term rating on the MHHEFA hospital revenue bonds issued for Luminis Health to 'A-' from 'A', with a stable outlook. Additionally, they state that "this downgrade from an 'A' to 'A-' rating may well result in an additional twenty-five basis point increase in its cost of capital."

Applicant Response:

It is important to understand the context of the financial reports that the HSCRC is referencing. The Covid-19 pandemic negatively impacted the vast majority of Maryland hospitals in fiscal years 2021 and 2022 due to the historically unprecedented increase in clinical staffing costs related to skyrocketing demand for clinical workforce throughout the country. Medicare forward funding utilized to support hospital balance sheets in fiscal year 2021 was completely unwound in the first half of fiscal year 2023, therefore while the Medicare funding made FY2021 reporting more balanced, these funds are no longer available.

Federal and state grants and one-time support payments declined dramatically in FY2022 and were immaterial in fiscal year 2023. Compounding the issue in FY2023 were revenue cycle issues that significantly reduced our booked net revenue. For FY2023 Luminis Health's total expenses were 2.5% less than FY2022 actual, displaying that the organization promptly moved to address financial pressures associated with excess expenses that impacted FY22 and implemented operational measures to manage expenses. Net revenue however was 1.4% less than fiscal year 2022 actual due to the compounded revenue cycle issue. Luminis Health has allocated resources to understand the root cause of the revenue cycle decline and implemented corrections that are beginning to return Luminis Health's revenue cycle performance to historic, higher collection levels. We do not anticipate ongoing challenges with collections.

Luminis Health is currently rated "A-"with a stable outlook by S&P and "A3" with a negative outlook by Moody's. As Luminis Health embarks on the renovation and expansion projects at LHDCMC we anticipate issuing approximately $150 million of additional debt and assumed a borrowing cost of 5.5%. At the current rating levels, the addition of $150 million of debt may put downward pressure on Luminis Health's Moody's and S&P ratings due to increased leverage, but the ratings should remain in the BBB category if a downgrade were to occur. A reduction in the external credit ratings would not have a material impact on Luminis Health's expected borrowing costs for the additional debt, as each notch for a rating downgrade would increase Luminis Health's borrowing costs in the current market by approximately 10-15 basis points. In addition, the additional debt is anticipated to be structured with the principal amortization wrapped around the existing debt to minimize the impact on annual cashflow requirements.

In summary, projecting Luminis Health's operating performance based on fiscal years 2022 and 2023 grossly understates the system's financial results pre-Covid-19 and our own internal fiscal year 2024 and forward expectations.