GALLAGHER
GALLAGHER EVELIUS & JONES
ATTORNEYS AT LAW

Thomas C. Dame
Direct Dial: 410.347.1331
tdame@gejlaw.com

June 10, 2021

Ms. Ruby Potter
ruby.potter@maryland.gov
Health Facilities Coordination Officer
Maryland Health Care Commission
4160 Patterson Avenue
Baltimore, Maryland 21215

VIA EMAIL &
FIRST-CLASS MAIL

Re: Sheppard Pratt at Ellicott City
Relocation and Replacement of Special Psychiatric Hospital
Matter No. 15-23-2367

Dear Ms. Potter:

On behalf of Sheppard Pratt Health System, Inc., we are submitting their Response to Additional Information Questions Dated June 10, 2021 regarding Sheppard Pratt's Second Request for Post-Approval Project in the above-referenced matter. A WORD version will be forwarded in a separate email.

I hereby certify that a copy of this submission has also been forwarded to the appropriate local health planning agencies as noted below.

Sincerely,

Thomas C. Dame

TCD:blr
Enclosure
cc: Paul Parker, Director, Center for Health Care Facilities Planning & Development, MHCC
Kevin McDonald, Chief, Certificate of Need
Suellen Wideman, Esq., Assistant Attorney General
Moira Lawson
Maura Rossman, MD, Health Officer, Howard County Health Dept.
Thomas D. Hess
Jennifer Wilkerson
Kelly Savoca

#745228
011000-0005

SHEPPARD PRATT HEALTH SYSTEM, INC.
SHEPPARD PRATT AT ELLICOTT CITY
RELOCATION AND REPLACEMENT OF SPECIAL PSYCHIATRIC HOSPITAL
Matter No. 15-23-2367

Response to Additional Information Questions Dated June 9, 2021

Introductory Statement Regarding changes to the Project Budget and Financial Projections:

As a result of recent evaluation and scrutiny of the budgeted numbers as part of Sheppard Pratt's FY 2022 budget process as well as recent review by the HSCRC staff in connection with a rate adjustment request, there have been some reclassifications of sources and uses and some modifications to the projected expenses since the Commission last reviewed and approved the budget and financial projections in March.

> *Uses:* Because of project delays, the interest incurred during the construction period (capitalized interest) increased. Sheppard Pratt overlooked this calculation when the initial request for project change was submitted several months ago, and the HSCRC staff noticed the issue in their recent review.
>
> *Sources:* There were some adjustments to the sources to reflect the current state of funding for the project.
>
> In 2017, Sheppard Pratt secured a $178 million bond issuance for the health system. At that time, Sheppard Pratt intended to use the bond proceeds as follows: (a) $70 million for the new hospital project; (b) $78 million to refinance existing health system debt; and (c) $30 million for routine capital projects.
>
> As reflected in the previously submitted project budgets, Sheppard Pratt projected to fund a portion of the hospital project with operating cash, which was properly classified as Cash (line B.1). However, a portion of the funding from the original bond issuance intended for capital projects was used to finance a portion of the hospital through construction due to operating cash constraints, primarily due to adverse financial performance caused by the COVID-19 pandemic. In the course of rate adjustment discussions, the funds previously reported as Cash and Philanthropy were reclassified to debt. After making the changes in the financials presented to the HSCRC, Sheppard Pratt made the same adjustments in the Table E included in the present request for project change.
>
> *Revenue and Expenses:* In addition, some changes to the expense budget reflect the most up to date budget figures for operating costs of the new facility, taking into account our most recent experience with the cost of labor, particularly since the COVID-19 pandemic began.

---

1. **The applicant alludes to the changes in the sources of funds resulted from "discussions with HSCRC." Please explain.**

Response

Sheppard Pratt is currently working with HSCRC staff to discuss a rate request to fund a portion of depreciation and interest for the new hospital as well as to address some recent cost pressures within the system. As part of these discussions, some of the numbers in the project budget and financial projections have been scrutinized. Ultimately, the HSCRC staff requested some reclassifications as described above. These conversations are still in process and will be ongoing.

2. **Explain why "gross interest during construction period" grew from $2.35 million in the initial approval and March 2021 project change to $9.8 million in this filing.**

Response

Following approval of the initial project change request in March 2021, Sheppard Pratt began engaging in discussions with the HSCRC regarding a request for rate adjustment, which relates in part to this hospital project. In reviewing the approved budget for the project, HSCRC staff noted that Sheppard Pratt did not reconcile the capitalized interest with the revised construction timeline for the project completion. The original project budget, as well as the budget submitted with the Initial Project Change Request, included capitalized interest for the initial estimated time period of construction. When the construction timeline was extended, Sheppard Pratt overlooked the need to update the interest expense to coincide with the longer period. As a result, the capitalized interest was understated by approximately $7.4 million, which has now been corrected.

3. **From a big-picture perspective, the Project Budget (Table E) seems to show that borrowing (lines B.3 and 6) replaces cash and philanthropy (lines B.1 and 2) as sources of funds. Thoroughly explain why the sources of funding changed from:**

   a) $14.4 million in cash to $0

Response

As explained above, $14.4 million in Cash (line B.1) was reclassified to debt (included as a portion of the Working Capital Loan source (line B.6)). As part of the original $178 million bond issuance in 2017, some of the debt was intended for routine capital for the organization unrelated to the new hospital facility. At the time, several other projects were being considered, which were not pursued for a variety of reasons. Because of cash constraints over the previous several years, and most recently as a result of the pandemic, a portion of these funds were used for the hospital construction. The classification of these funds was subject to some deliberation in the course of discussions with the HSCRC staff. The options discussed were: Cash (line B.1), Authorized Bonds (line B.3), or Working Capital Loans (line B.6). As a result of the HSCRC discussions, it seemed most appropriate to classify the funds in the category of Working Capital Loans to distinguish the source from operating cash and the hospital bond proceeds fund.

b) $66.7 million in bonds to $70 million

Response

The construction fund and interest fund from the 2017 debt issuance was $70 million. The interest expense during the construction period (i.e., capitalized interest) was reconciled to account for the construction delay. In addition we updated the sources to include the entire financing, including the amount that funds interest during construction so that the sources match the uses.

c) Philanthropy of $7.5 million in the original application to $16.5 million in the March modification to $5 million in the recent change request

Response

At the time of the grant of the CON until very recently (within the last 60 days), Sheppard Pratt expected there would be additional philanthropic funding related to the new hospital. While we have received more than $5 million in grants and philanthropic funds, to date, only $5 million has been expressly dedicated by funders for the new hospital, while other donated funds went to other system operating costs and capital items. However, discussions with some donors are still ongoing. Although the Philanthropy line in Table E (line B.2) expressly may include gifts expected in the future, Sheppard Pratt determined to be conservative, and included only funds clearly earmarked for the hospital capital at this time as philanthropy dollars.

d) No funds from working capital loans to $25 million in working capital loans

Response

As explained above, based on the cash constraints as well as the limited philanthropic funds expressly dedicated to the project, part of the original bond issue that was intended to fund routine capital for the organization was used to fund part of the new hospital construction. As noted, in discussions with the HSCRC staff, it was confirmed that these funds should be classified as working capital loan funds, not cash, as a portion of the funds were previously classified.

4. Table G shows an incremental increase in "interest on project debt" that increases by about $150,000 on incremental debt of more than $28 million. This implies an interest rate of less than 0.6%. Is that realistic?

Response

The updated interest did not increase much because the original assumed interest rate (on a lesser amount of debt) is now determined to be too high. As shown in Exhibit 16 of the original CON application, Sheppard Pratt assumed an interest rate of 4% for 30 years on the $70 million in hospital bond funds. The updated interest expense, reflected in the revised Tables G and H includes more debt at a lower rate of interest, equivalent to an approximate effective interest rate of 2.8%. This updated interest expense was reviewed by HSCRC for reasonableness during the rate request process. The increase of approximately $150,000 accounts for a reconciliation and true-up of the interest expense to reflect the current cost of the larger debt amount.

5. Explain the 6.25% increase in projected operating cost reflected on Table H, R& E inflated.

Response

The increase in expense of $2.5m (6.25%) is primarily in the categories of Corporate Overhead (line 2.l) and Other (line 2.k).

6. On Table H, Line items 2. j, k, and l – *rentals, other, and corporate overhead* – all increase significantly (collectively, by 55% from approximately $4.5 million to $6.9 million). Please explain these increases.

Response

Corporate Overhead (line 2.l) increased by $1.3 million, principally due to an allocation for increased malpractice costs. Recent costs related to malpractice coverage have increased dramatically, including an increase in reserves, insurance coverage and claim payouts. The recent insurance renewal resulted in an increase in costs of over 100% for malpractice insurance due to market hardening.

In addition, the Other line (line 2.k) increased by approximately $800,000 to reflect higher costs for operating the larger facility, which became more clear during the recent operating budget process. This includes increased costs related to utilities, routine repairs, additional maintenance, grounds keeping and security related expenses.

Rentals (line 2.j) increased to reflect the current cost for the existing lease for the facility being replaced in Ellicott City. That lease continues through 12/31/21; following that, there will be no rental expense in the budget.

I hereby declare and affirm under the penalties of perjury that the facts stated in this response to written questions from the Commission staff regarding the Second Request for Post-Approval Project Change and its attachments are true and correct to the best of my knowledge, information, and belief.

June 10, 2021	DocuSigned by: Kelly Savoca 0956C57E5870471...
Date	Kelly Savoca Vice President and Chief Financial Officer Sheppard Pratt Health System, Inc.