

IN RE: THE PERMANENT RATE * BEFORE THE HEALTH SERVICES
APPLICATION OF HOLY CROSS * COST REVIEW COMMISSION
GERMANTOWN HOSPITAL, * DOCKET: 2014
GERMANTOWN, MARYLAND * FOLIO: 2070
* PROCEEDING: 2260R

* * * * *

STAFF RECOMMENDATION

(Revised based on discussions and action taken by the Commission at the 9/10/14 meeting)

September 10, 2014

I. INTRODUCTION

On August 1, 2014, Holy Cross Germantown Hospital (“HCGH,” or “the Hospital”) submitted a full rate application to the Health Services Cost Review Commission (“HSCRC,” or “the Commission”) to be effective October 1, 2014. HCGH is a new 93-bed acute care hospital located in Germantown, Maryland.

II. BACKGROUND

Holy Cross Health, the not-for-profit health system based in Montgomery County, Md., filed a Certificate of Need (“CON”) application in October 2008 and submitted modifications in February 2009 to establish a 93-bed acute care hospital in Germantown. In January 2011, the Maryland Health Care Commission issued a CON for this project. Following an appeal and a remand, a final CON (on Remand) was issued May 31, 2012.

The Hospital includes 60 general medical/surgical beds, 15 ICU beds, 12 obstetric beds, and six acute psychiatric beds. It also includes a procedure center, a labor and delivery unit, and a full service emergency department. The total project cost was approximately \$202 million.

The CON application projected a charge per case using inpatient Statewide average Reasonableness of Charges (ROC) calculation adjusted for payer mix, labor market, disproportionate share, medical education, and capital. The Academic Medical Centers are excluded from this calculation. The average outpatient charges were derived from Holy Cross Hospital’s (HCH’s) rates applied to forecasted volumes. HCH’s outpatient unit rates were considered comparable to Statewide averages which, therefore, were used as a proxy. Volume

growth during the ramp-up period (first three years of operation) reflected a 100% variable cost factor. The Hospital was projected to be profitable by the third year of operation.

III. THE HOSPITAL REQUEST AND JUSTIFICATION

Based on discussions between HSCRC staff and the Hospital, in order to maintain consistent pricing for patients and payers within the geographic area, the Hospital has requested that the initial unit rates for HCGH be the same as HCH FY 2015 Rate Order unit rates. The proposed rates produce a level of revenue that is in line with the CON application and consistent or lower than the revenues that would result from using the statewide median rates. Linking HCGH to HCH rates has the advantage of eliminating any barrier to moving patients from HCH to the new HCGH facility that could result if the rates for HCGH were higher.

The linkage to HCH Rate Order rates would be maintained for the duration of the start-up period (FY 2015-FY 2017), After FY 2017, it is expected that HCGH will transition to a population-based methodology. The Hospital has requested 100% variable reimbursement throughout the 3 year start-up period. The Hospital projects FY 2015 revenue as follows:

Summary of Rate Request

	<u>Current</u>	<u>Projected</u>	<u>% Change</u>
Inpatient Revenue	n/a	\$36,773,332	n/a
CPC	n/a	n/a	n/a
Outpatient Revenue	<u>n/a</u>	<u>27,002,000</u>	<u>n/a</u>
Total Approved Revenue	<u>n/a</u>	<u>\$63,775,332</u>	<u>n/a</u>

No one-time or retroactive adjustments are being requested.

IV. HOSPITAL RATE HISTORY

As stated above, HCGH is expected to commence operations on October 1, 2014 and, therefore, there is no rate history.

V. HOSPITAL FINANCIAL SITUATION

Since HCGH is requesting Holy Cross Hospital’s Rate Order rates, staff is reporting HCH’s financial performance under its current rate structure as one indication of the adequacy of those rates for the new HCGH. From a financial standpoint, it appears that HCH rates are quite adequate.

Holy Cross Hospital has reported the following audited FYE 2012 & FY 2013 and Unaudited FY 2014 operating results:

Holy Cross Hospital	Net Operating Revenue (Regulated)	Net Operating Profit/(Loss) (Regulated)	Operating Margin (Regulated)	Net Profits
FYE June 2014 (unaudited)	\$393,927,265	\$31,245,836	7.93%	\$45,225,895
FYE June 2013	379,486,100	42,986,600	11.3%	37,428,000
FYE June 2012	367,425,200	42,292,000	11.5%	26,077,900

VI. STAFF ANALYSIS

This staff recommendation is the culmination of significant analysis and consideration of the Holy Cross Germantown Hospital CON application, the process that resulted in CON approval of the HCGH, and analysis of the assumptions included in the CON compared to current market conditions. In addition, significant consideration was given to the implications of funding the HCGH relative to Holy Cross Hospital and the All-Payer waiver test. The staff recommendation herein is a result of this extensive process.

Analysis of Rates for Start-up Period

A. CON Requested Rates

The inpatient revenue projected in the CON was based on statewide case-mix adjusted charge per case for FY 2010. The charge per case was established based on a Statewide ROC (excluding JHH & UMMS). The CPC was adjusted for payer mix, labor market, case-mix, DME, IME and Capital. Outpatient revenue was based on HCH rates applied to outpatient volumes.

There have been a number of methodology, payment, and external changes to the rate setting system since the filing of the CON in October of 2009. The most relevant is the movement to a per capita based All-Payer model in January 2014. Under this new system, all hospitals in the State, including Holy Cross Hospital, have adopted global budgets. In addition to the new All-Payer model, changes in methodology since the submission of the CON were considered by staff in evaluating the proposed initial rates for HCGH relative to the approach outlined in the CON.

B. CON projected Service Area and source of patients for HCGH

The Expected Service Area (“ESA”) of the new hospital includes the 18 contiguous zip codes surrounding the Germantown campus in the Northern region of the county. The HCHG CON was approved to provide improved access to the growing population in this region of Montgomery County. The projected source of patients for the new hospital included 70% of HCH discharges originating from the ESA and projected discharges originating from population\utilization growth in the ESA.

C. Adjustments for Shifts in Volumes of Services from Area Hospitals to the New Facility

Although not the subject of this rate application, the following information is provided as information to the Commission regarding the adjustments that will be made for shifts in volumes to the new facility. The Commission has already taken this approach into consideration when it approved the balanced update effective July 1, 2014, which included a provision for the revenue increase to HCGH above the reduction taken from the budgets of competing hospitals. Specifically, since competing hospitals including Holy Cross Hospital have all adopted global budgets, adjustments will need to be made to those budgets to reflect the movement of patients to the new HCGH. HSCRC staff has included provisions in the GBR contracts of each hospital with a substantial market share in the ESA of the new hospital, which provides for an adjustment to their budget for movement of volumes to the new facility, using a 50% variable cost factor consistent with HSCRC transitional policies adopted January 1, 2014. With the exception of HCH, the staff intends to make the reductions in the applicable hospital budgets upon examining actual changes in volumes from the ESA after the opening of the new facility. For HCH, the staff and HCH will estimate the volume reduction prospectively, and the global budget for HCH will be adjusted in advance, with a true up at the end of each quarter until volumes stabilize.

D. Reasonableness of Charges

As indicated above, the CON application based projections for the new HCGH facility on statewide median charge per case rates adjusted for ROC adjustments for inpatient cases and used HCH's unit rates for outpatient services. It has been the Commission's practice to hold hospitals accountable for the projections made in their CON applications. Consistent with the general approach outlined in the application, staff calculated rates and estimated revenues for the HCGH facility using Statewide median rates. Staff also computed estimated revenues using average Montgomery County hospital rates, rates of a comparable group of similarly sized hospitals, and HCH rates. As shown below in Table 1, HCH weighted unit rates are comparable or below the weighted rates from all of the comparisons.

In the comparative analysis, HCGH's projected volumes were multiplied by HCH FY 2015 rates to calculate HCGH projected FY 2015 revenue. Statewide Median Revenue was calculated by applying HCGH projected volumes to FY 2014 Statewide Median Rates price leveled to FY 2015 (excluding rates of specialty hospitals and Academic Medical Centers). The same methodology was applied to Montgomery County Hospitals¹ and the smaller group of similarly sized hospitals.²

In reviewing the CON application, the Hospital projected that more than one-third of the patient base for the new hospital would come from patients that are now being served at Holy Cross Hospital. Staff believes it is important to facilitate this movement to the extent possible. Linking the rates of the new facility to the rates of HCH will help accomplish this objective by eliminating any rate differential between the facilities while

¹ Holy Cross Hospital, Shady Grove, Montgomery General, Washington Adventist & Suburban

² Charles Regional, Harford, Montgomery General & Med Star St. Mary's Hospital.

providing a revenue base that is comparable or lower than the approach outlined in the CON application. Therefore, staff is recommending that the rates of HCGH be linked to the HCH Rate Order throughout the start up period.

Table 1

	Comparison of FY15 HCGH Revenue Based on:			
	HCH Rates	Statewide Median Rates	Montgomery County Average Rates	Comparable Size Hospitals ¹
	(in thousands)			
Inpatient	\$36,773	\$38,906	\$37,158	\$38,853
Outpatient	27,002	28,040	27,970	29,207
Total Gross Revenue	<u>\$63,775</u>	<u>\$66,946</u>	<u>\$65,128</u>	<u>\$68,060</u>
Variance		-4.7%	-2.1%	-6.3%

Notes: [1] Comparable sized hospitals include Medstar St. Mary's, Harford Memorial, Montgomery General, and Charles Regional.

Because this is a new facility, it will need to maintain a 100% variable cost factor as volume grows for a reasonable period of time or until it reaches the volume levels projected in the CON application, if those volume levels are achieved earlier. This will allow it to accumulate the fixed cost base to operate a hospital of its size. This exception for the new HCGH to the transitional variable cost policy of 50% approved effective January 1, 2014 was contained in the policies approved at that time.

Similar to other systems with GBR/non-GBR agreements, the revenue updates for the new HCGH will be governed based on an agreement with the System for both of the hospitals. An updated GBR/non-GBR agreement has been drafted and reviewed with the System and is ready for adoption effective with the approval of the rate order. This agreement will govern the mechanics of the rate updates and the linkage of rates between the hospitals. The agreement provides that HCGH will be included in the HSCRC quality

based initiatives as soon as possible, possibly in combination with Holy Cross Hospital, and no later than the beginning of FY2018. Based on staff's review of uncompensated care levels at Holy Cross and in the service area, the GBR/Non-GBR Agreement also provides that HCGH will be afforded the average uncompensated care level of the State in rates, neither contributing to nor receiving a distribution from the Statewide pool until FY 2017 when there is sufficient experience in its levels of uncompensated care.

VII. FINAL RATES SUMMARIZED

Based on the analysis outlined in Section VI and the fact that HCGH is a new facility, the staff recommends the following:

1. HCGH initial units rate be set at HCH FY 2015 Rate Order Rates.
2. That rates be effective October 1, 2014 or the initial opening date of the new facility, whichever is later.
3. That HCGH rates will remain linked to the HCH unit rates as shown on its Rate Order NISI and updated annually using a revenue neutral approach relative to HCGH and its CON-projected volumes and the budgeted revenue in this recommendation, until such time as volumes stabilize. It is anticipated that stabilization will be achieved in FY 2017.
4. As a new facility, that HCGH maintain a 100% variable until stable volumes are achieved in FY 2017 or volumes projected in the CON are reached, whichever comes earlier.
5. That the specific mechanics of updates and aligning unit rates to HCH Rate Order be managed through the GBR/Non-GBR agreement with Holy Cross Health, similar to other GBR/Non-GBR system agreements in the State.
6. That no later than FY2018, HCGH will work with the HSCRC staff to convert to one of the prevailing HSCRC Population Health Based reimbursement models based on FY 2017 actual volumes and unit rates.

Chet Burrell
President and Chief Executive Officer

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September 5, 2014

John Colmers
Chairman
Health Services Cost Review Commission
4160 Patterson Avenue
Baltimore, MD 21215

Donna Kinzer
Executive Director
Health Services Cost Review Commission
4160 Patterson Avenue
Baltimore, MD 21215

Re: HSCRC DRAFT Recommendation: Update Factors for FY2015

Dear Mr. ^{John} Colmers and Ms. ^{Donna} Kinzer,

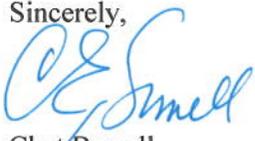
CareFirst appreciates the opportunity to comment on the rate recommendation for the Holy Cross Germantown Hospital (HCGH).

Overall, CareFirst believes that Staff conducted a thorough and comprehensive review of HCGH's rate application. While the HSCRC traditionally holds hospitals to the representations made in a CON application, the current proposal represents a slight restructuring of HCGH's rates that results in aggregate revenues that are at or below those proposed in the CON application. The linkage to Holy Cross Hospital (HCH) rates also eliminates barriers to entry while at the same time maintains the integrity of HSCRC's rate process. Given these considerations, CareFirst believes that the modifications and other provisions proposed in the staff recommendation are reasonable and appropriate.

We also understand that as a new facility, HCGH has no record on which to base their uncompensated care (UCC) allowance. Given that a significant portion of HCGH's patient population will draw from the HCH patient service area and HCH's UCC allowance closely approximates the state average, CareFirst believes it is reasonable to use the state average until actual costs are established.

Again, CareFirst supports the Staff's recommendation and we thank you for this opportunity to provide our comments.

Sincerely,


Chet Burrell
President & CEO