IN RE: APPLICATION FOR	* BEFORE THE MARYLAND HSCRC	
TEMPORARY CHANGES IN RATES		
TIDALHEALTH PENINSULA	* DOCKET:	2023
REGIONAL	* FOLIO:	2431
SALISBURY, MARYLAND	* PROCEEDING:	2621T

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FINAL STAFF RECOMMENDATION

APRIL 26, 2023

Overview

TidalHealth Peninsula Regional ("Peninsula," or "the Hospital") applied to the Health Services Cost Review Commission ("HSCRC," or "the Commission") for a temporary emergency change in rates pursuant to Section 10.37.10.05 of the Code of Maryland Regulations ("COMAR") to be effective April 11, 2023, the date of the temporary rate request filing.

The Hospital requests funding of $20 million as of April 11, 2023, and that this amount be allowed to be fully charged to patients by June 30, 2023. The adjustment would be reconciled in a full rate application to be filed when the full rate review moratorium expires.

Temporary Rate Change Procedures and Guidelines

The procedures for a temporary rate application are outlined in COMAR 10.37.10.05 and specify that a hospital may apply at any time for a temporary change in rates provided that one of the following conditions is satisfied:

(1) A decline in the hospital's experienced or projected net revenues, due to factors beyond the hospital's control, requiring funds beyond those normally available;

(2) An increase in the hospital's experienced or projected expenses, due to factors beyond the hospital's control, requiring funds beyond those normally available; or

(3) A hospital's expenses from regulated services exceed its revenues from regulated services, or the hospital's financial integrity is otherwise jeopardized (for example, for breaching its bond covenants).

Within 12 working days from the filing of the application, the Commission must issue its order either denying the temporary change in rates and stating the grounds therefore or granting a temporary change in rates, stating the amount, the necessity of the change, and that a regular rate review will be conducted as soon as practicable. A temporary change in rates is subject to the Commission's final rate order in the regular rate review proceeding, which may be effective as of the date of the temporary rate order. Under 10.37.10.05F, the Commission shall consider both the hospital's financial condition, as well as its relative efficiency and effectiveness in its performance under the Total Cost of Care Model. Furthermore, the regulation states that a temporary rate approved by the Commission may not result in regulated revenue exceeding regulated expenses in the most recently completed fiscal year.

Background

Peninsula is a 266 bed private, not-for-profit hospital providing Level III Trauma Care as well as other comprehensive acute care services to the people of the Lower Eastern Shore and the surrounding Delmarva area. The Hospital claims that it had experienced significant volume growth over the past fiscal year. The Hospital further claims that by the end of FY2023, it will have unfunded volume growth of $29.6 million based on approved unit rates times actual annualized volumes less the approved GBR. They believe this underfunding of volume is accentuated by the underfunding of general inflation in recent update factors and specific spikes in labor costs associated with the COVID-19 pandemic.

Peninsula states that it is facing a breach of its Debt Service Coverage Ratio (DSCR) of 1.1 to 1 contained in its long-term debt bond documents with the Maryland Health and Higher Education Facilities Authority (MHHEFA). DSCR is measured by net income available for debt service divided by the maximum annual debt service on all outstanding debt. The Hospital is only one of several entities included in the "Obligated Group" of "TidalHealth," the issuer of the bonds. The other entities included in the Obligated Group are Tidal Health Nanticoke, Tidal Health McCready, Tidal Health Medical Partners, and Tidal Health Endowment Fund.

Staff Analysis

Since temporary rate applications require a Commission order within 12 working days, HSCRC Staff evaluated the Hospital's request as it relates to meeting the threshold outlined in COMAR 10.37.10.05. That is, the Staff will evaluate the Hospital's contention that it has met one of the conditions enumerated in this regulation for filing a temporary rate application:

(1) a decline in the hospital's experienced or projected net revenues, due to factors beyond the hospital's control, requiring funds beyond those normally available.

<u>Staff Comments:</u>

The Hospital is under a global budget revenue (GBR) agreement that does not provide additional revenue simply because volumes grow, and certainly not at 100% of the change. Under a global budget a hospital is allowed additional revenue for:

1) volume growth related to estimated changes in the population provided by the Maryland Department of Planning, which is further adjusted by geography and age,

2) volume growth related to changes in market share, and
3) volume growth related to an increase of out of state business beyond a certain point.

In FY 2022, the Hospital generated a regulated operating profit of $38.3 million or 8.5% of GBR regulated net revenue. The Hospital also generated an operating loss of $14.7 million or -55% for services provided at the Hospital but not regulated by the Commission. The average regulated profit margin over the prior three years was 14.5%, materially higher than the statewide average regulated margin.

Additionally, in FY2022 TidalHealth generated a $77.8 million loss on other businesses outside of Peninsula Regional Medical Center. That loss includes a hospital outside of the State of Maryland and a very significant loss from its Medical Group. These all resulted in a Total Consolidated Operating Loss of $54.3 million for FY 2022 for TidalHealth.

(2) An increase in the hospital experienced or projected expenses, due to factors beyond the hospital's control, requiring funds beyond those normally available.

<u>Staff Comments:</u>

When the annual Update Factor was being calculated last year, overall inflation was estimated to be 3.66% for FY2023. Staff added an additional 0.4% for a prior shortfall, bringing the overall inflation provided for FY2023 to 4.06%. The Hospital is correct that the actual inflation estimated for FY2023 is currently higher. While the cost of various inputs cannot be controlled, other factors that are well within the Hospital's control could and should be used to manage overall cost changes. As pointed out in the prior section, the change in the regulated expenses has not resulted in a regulated margin shortfall. A review of the operating expenses of Peninsula indicates that expenses were not beyond its control as the Hospital generated an 8.5% regulated profit and a 4.5% overall profit.

(3) A hospital's expenses from regulated services exceed its revenues from regulated services, or the hospital's financial integrity is otherwise jeopardized (for example, for breaching its bond covenants).

<u>Staff Comments:</u>

In determining whether the Hospital meets this criterion, Staff reviewed the financial condition of the Hospital, including the Hospital's overall regulated and unregulated revenues and expenses, as well as other factors that might explain or otherwise shed light on the operating margins and financial condition of the Hospital. Importantly, it should be remembered that the Hospital is only one of several entities that comprise TidalHealth. As such, Peninsula has only so much influence on the overall financial condition of the TidalHealth organization. A review of only Peninsula's audited operating margins (both regulated and unregulated) and TidalHealth's other non-regulated entities from FY2019 to FY2022, and its estimated margins for FY2023 based on year-to-date Schedule FS data supplied to the Commission by the Hospital, is presented in Figure 1.

Net Operating Revenue - Operating Expenses = Operating Margin

Figure 1
Tidal Peninsula Regional Medical Center Operating Margin
($ in thousands)
RY 2018-2022

	RY 2019 Audited	**RY 2020 Audited**	**RY 2021 Audited**	**RY 2022 Audited**	**Estimated FY 2023[1]**
Regulated	$53,821.0 13.8%	$43,322.0 10.7%	$84,039.0 18.4%	$38,334.0 8.5%	**$38,276.0 8.2%**
Unregulated[2]	-$49,078.0 -74.1%	-$52,699.0 -65.6%	-$24,852.0 -70.3%	-$14,739.0 -55.9%	**$5,019.0 17.7%**
Total	**$4,743.0 1.0%**	**-$9,377.0 -1.9%**	**$59,188.0 12.0%**	**$23,575.0 4.5%**	**$40,152.0 8.5%**
Other NON Regulated	**-$1,235**	**-$8,459.0**	**-$76,240.0**	**-$77,846.0**	**-$94,261.0**

As noted from the audited reports of the Hospital and the estimated RY 2023 data provided by the Hospital, it is clear that regulated expenses have not exceeded regulated revenues during any point in time over the last 5 years.

Financial Integrity

The Hospital contends that the financial integrity of TidalHealth is in jeopardy. Staff does not believe that the financial instability originates from Peninsula Regional as Figure 1 shows that the regulated services at the Hospital have generated very large profits, and that all of the services provided at the Hospital (including those unregulated by the HSCRC) have generated reasonable profits. In fact, Moody's Investors Services stated in a December 16, 2022, Credit

[1] Estimated values are directly provided by the hospital and only includes anticipated margins related to TidalHealth PRMC, TidalHealth Nanticoke Hospital, and the TidalHealth Medical Partners

[2] The unregulated losses for TidalHealth Peninsula Regional decreased because the Hospital elected to combine its physician losses for Peninsula Regional and Nanticoke Hospital into a non-regulated entity, TidalHealth Medical Partners during Fiscal Year 2021.

Opinion on TidalHealth, Inc. MD that "Favorably, TidalHealth will continue to benefit from revenue predictability of Maryland's Global Budget Revenue (GBR)." The report goes on to say, "Multi-year trends of operating performance variability will continue with lower than historical performances due to integration of newly affiliated hospitals and elevated labor cost."

Unregulated and Non-regulated Physician Losses

In FY 2021, Nanticoke Hospital in Delaware, and McCready Hospital in Crisfield, merged with Peninsula Regional Medical Center to become TidalHealth, Inc. At that time, the various medical groups of the Hospital were moved to become TidalHealth Medical Partners, Inc. It is evident in Figure 1 that the Hospital's unregulated business and other non-regulated losses are driving both current and past losses. It is unclear from Figure 1 what share of non-regulated losses is attributable to physician services provided at Tidal Health Peninsula Regional, as Tidal Health elected to report hospital associated physician losses in its Medical Partners entity in RY 2021. It is also unclear how reasonable the physician losses are, as the current year estimated losses of $86.5 million are larger than the unregulated losses reported by any hospital in the State. Excluding the academic medical centers which operate differently, the average Maryland hospital had unregulated losses of ~$24 M in FY22.[3] Further restricting the comparison to trauma facilities, PRMC fares unfavorably as well, as trauma facilities had an average unregulated loss of ~$31 million. There are two issues that Staff considers important to understand more fully: first, to determine how much of the TidalHealth Medical Partners business is attributable to the operation of Peninsula Regional and second, to evaluate the reasonableness of the subsidy provided to physicians in TidalHealth Medical Partners. The Staff intends to follow up with the Hospital to better understand both elements of the physician loss.

Hospital Efficiency

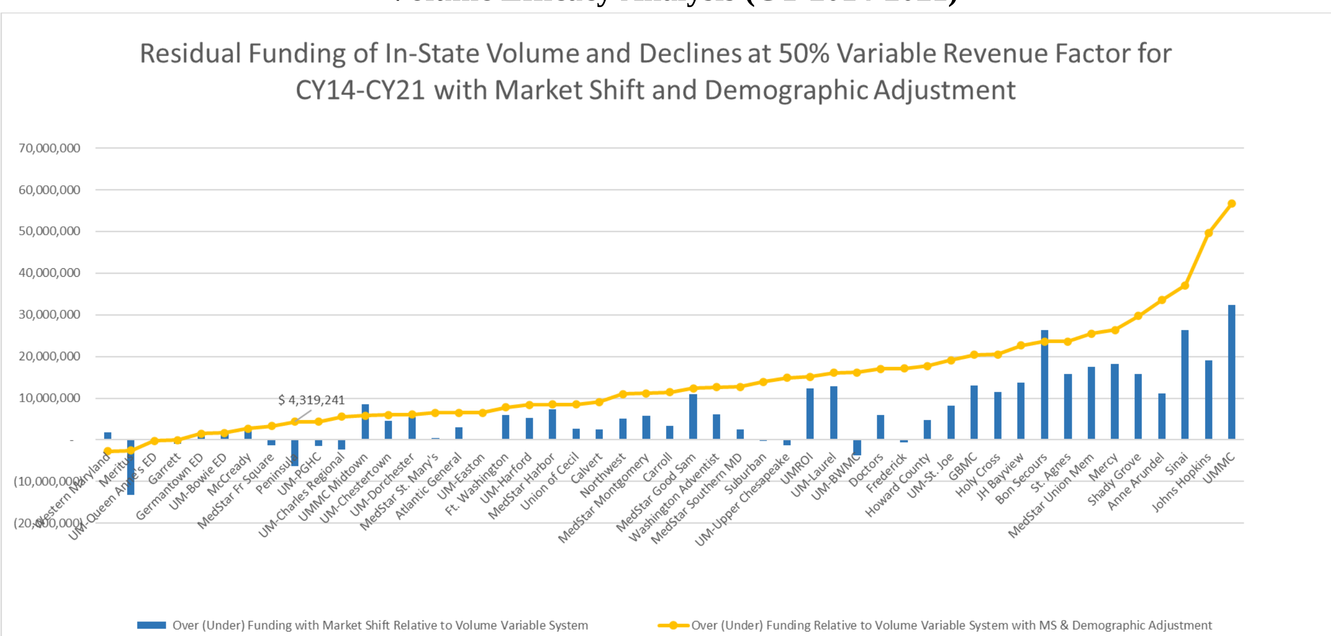
The Hospital has demonstrated relative efficiency prior to the pandemic, and it *may* meet the standard for rate relief in the full rate application once the moratorium on full rate applications is lifted. Due to the confounding effects of the COVID-19 pandemic, the Commission has not been able to model hospital efficiency in the Interhospital Cost Comparison (ICC) tool that is the basis for the Commission's efficiency policies (i.e., Full Rate Applications, Integrated Efficiency policy). For this reason, the Commission voted to place a temporary moratorium on Full Rate Applications and suspended the Integrated Efficiency policy for RY 2023.

[3] This is not a direct comparison as Tidal Health reports all physician losses as non-regulated (i.e., losses reported in their Consolidated Statements but not in their annual HSCRC filings), while the statewide statistics include only unregulated losses (i.e., losses reported on a hospital's annual HSCRC filing) but not any non-regulated physician costs. However, Staff believe most hospitals report most physician losses as unregulated. The Peninsula Regional values would remain an outlier if non-regulated physician losses at other hospitals were included.

Prior iterations of the Integrated Efficiency policy that assessed RY 2020 hospital cost per case efficiency and CY 2018 Medicare and Commercial TCOC performance, relative to national benchmarks, indicated that Peninsula was a relatively efficient institution in the State.

Due to this past efficiency, the Hospital was provided an additional $9.3 million for FY2023. This revenue was intended to fund enhancements to labor market rates and some of the cost of the new graduate medical education program (some savings would be incurred as residents began caring for patients). Additionally, in the settlement agreement between the Hospital and the Commission, it was agreed that Peninsula would receive funding for increases in volume for its new inpatient adolescent psychiatric service. This additional volume funding for all use rate growth, regardless of whether it constitutes a marketshift, will improve Peninsula's overall volume funding, which through CY 2021 was $4.3 million more than the Hospital would have received under a fee-for-service system where incremental volume is funded at a 50% variable cost factor (see figure 2 below). Staff does not have this analysis updated for volume growth through CY 2022, as the full calendar year marketshift has not yet been completed. But based on the preliminary six month marketshift for January-June 2022, Staff notes that this finding will likely not change, because the Hospital received a marketshift adjustment of $317 thousand across all service lines; under a fee-for-service system, it would have received a $51 thousand reduction.

Figure 2
Volume Efficacy Analysis (CY 2014-2021)



Summary of Staff Analysis

Based on the analysis contained within this report, Staff finds that the Hospital has not met the threshold outlined in COMAR 10.37.10.05 for filing a temporary rate application. Staff further finds that if the financial integrity of the TidalHealth System is truly jeopardized, it is not due to the operations of TidalHealth Peninsula, but rather stems from the other non-regulated groups including Tidal Health Medical Partners, and TidalHealth Nanticoke.

Staff Recommendation

In response to the Temporary Rate Change request filed by the Hospital on April 11, 2023, Staff makes the following recommendations:

Based on the thresholds outlined in COMAR 10.37.10.05, Staff finds that the Hospital has not met the requirements for filing a temporary rate application.

Staff further recommends that Commission initiate a full rate review of the Hospital, which would include a detailed analysis of TidalHealth Medical Partners and TidalHealth Nanticoke Hospital to determine the impact of these entities on the financial integrity of TidalHealth Inc. and the Obligated Group responsible for the financial viability of the System.