ZA00O

Prince George's Hospital System

Miscellaneous Grant Programs

Capital Budget Summary

Grant and Loan *Capital Improvement Program*

($ in Millions)

Program	*2014 Approp.*	*2015 Approp.*	*2016 Request*	*2017 Estimate*	*2018 Estimate*	*2019 Estimate*	*2020 Estimate*
Prince George's Hospital System New Regional Medical Center	$20.000	$15.000	$30.000	$45.000	$90.000	$0.000	$0.000
Prince George's Hospital System Infrastructure Improvements	10.000	0.000	0.000	0.000	0.000	0.000	0.000
Total	**$30.000**	**$15.000**	**$30.000**	**$45.000**	**$90.000**	**$0.000**	**$0.000**

Fund Source	*2014 Approp.*	*2015 Approp.*	*2016 Request*	*2017 Estimate*	*2018 Estimate*	*2019 Estimate*	*2020 Estimate*
GO Bonds	$30.000	$15.000	$30.000	$45.000	$90.000	$0.000	$0.000
Total	**$30.000**	**$15.000**	**$30.000**	**$45.000**	**$90.000**	**$0.000**	**$0.000**

GO: general obligation

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Summary of Recommended Bond Actions

1. Prince George's Hospital System

   Approve the $30,000,000 general obligation bond authorization to continue design, construction, and equipping of the new regional medical center in Prince George's County.

Program Description

The Prince George's Hospital System (PGHS), currently operated by Dimensions Healthcare Corporation, consists of several parts: Prince George's Hospital Center, a 269-bed acute-care hospital and regional referral center; Laurel Regional Hospital, a 138-bed acute-care community hospital; and the Bowie Health Center. The system has experienced losses in market share, revenue losses, low liquidity, significant deferred capital needs, poor bond ratings, and a disadvantageous payor mix. Both the State and Prince George's County have provided significant financial support in recent years in order to keep the system functional and avoid significant operational deficits, potential bankruptcy, and even closure.

The State of Maryland, Prince George's County, and the Dimensions Healthcare Corporation entered into a memorandum of understanding (MOU) in calendar 2008 to provide financial support to the hospital that included a commitment of $150 million in operating funds over five years split equally between each party and $24 million in State capital funding over three years. The MOU was updated in calendar 2011 to include the University of Maryland Medical System (UMMS) and the University System of Maryland.

In accordance with the updated MOU, this project will construct a new regional medical center (PGRMC) and make improvements to existing health facilities in PGHS. The fiscal 2016 allowance includes $30 million in general obligation bond (GO) funding to continue design, construction, and equipping of the new regional medical center.

Budget Overview

The most recent effort to improve the system's financial situation was the establishment of the Prince George's Hospital Authority (Chapter 680 of 2008, subsequently amended by Chapters 116 and 117 of 2009). The authority was established as a State entity to implement a competitive bidding process for transferring PGHS to a new owner or owners. Following the creation of the authority and stemming from the desire to facilitate the transfer of the health care system by providing financial support to the new owners to assist their efforts to stabilize and improve the system, the State and the county entered into an MOU in 2008 that specified the terms and conditions of the financial support provided by each party. In January 2010, the authority announced that it did not believe that the system could be sold, and the authority expired without a transfer in place. However, the authority did make a series of broad recommendations, including continuing to search for a permanent owner and getting stakeholder and regulatory approval for a new inpatient facility to replace the Prince George's Hospital.

As set forth in the MOU, both the State and Prince George's County have provided significant financial support in recent years in order to keep the system functional and avoid significant operational deficits, potential bankruptcy, and even closure. The MOU articulated a total of $222 million in operating and capital support between fiscal 2009 and 2015, as shown in **Exhibit 1**.

Exhibit 1
Financial Support for Prince George's Hospital System
Fiscal 2012-2015
($ in Millions)

	Prior Authorizations	2012	2013	2014	2015	Total
State						
Operating Subsidy	$39.0	$15.0	$15.0	$15.0	$15.0	$99.0
General Obligation Bonds		4.0	10.0	10.0		24.0
Prince George's County						
Operating Subsidy	39.0	15.0	15.0	15.0	15.0	99.0
Total	**$78.0**	**$34.0**	**$40.0**	**$40.0**	**$30.0**	**$222.0**

Note: Does not capture the operating and capital support provided to the Prince George's Hospital System prior to the 2008 memorandum of understanding. Between fiscal 2002 and 2007, $15.8 million and $13.0 million were provided to the hospital system in operating and capital funding, respectively.

Source: Department of Legislative Services, 2008 Memorandum of Understanding

The MOU did not articulate operating support beyond fiscal 2015, and the fiscal 2016 allowance includes neither an operating subsidy for the system nor additional capital funds to support existing PGHS infrastructure improvements.

Financing of New Regional Medical Center

Costs for the design, construction, and capital equipping for PGRMC are estimated to total $622 million. However, it should be noted that this estimate is preliminary and, as yet, uninformed by the design process, which has only recently gotten underway. In addition, the preliminary estimate does not include any enhancements to the existing primary care network in the county or the discharge of the Dimension Healthcare Corporation's current liabilities.

State support for the project is currently programmed at $200 million over five years. Through fiscal 2016, the State has authorized $65 million in GO bond funds, which UMMS is currently using to support the early design stages of the project. Prince George's County will provide an additional $208 million toward the cost of the new facility, which is structured to be available in one lump sum upon approval of the Certificate of Need (CON) application by the State. The remaining UMMS contribution is expected to come from the issuance of debt – specifically, with annual debt service funded through the inclusion of debt service within hospital rates. However, the Health Services Cost Review Commission (HSCRC), which sets standard rates that hospitals may charge for the purchase of care, must grant approval for debt service to be included in the hospital's rates.

Although the State's total funding commitment for the project has remained at $200 million, the timing of State funding has been modified to more closely align the State's funding with anticipated project expenditures. **Exhibit 2** shows recent changes in the State's programmed funding commitment.

Exhibit 2
Recent Changes in State Funding Plan
($ in Millions)

Fiscal Year	2013 Session CIP	2014 Session CIP	2014 Session MCCBL	2015 Session MCCBL
2014	$20.0	$20.0	$20.0	$20.0
2015	20.0	30.0	15.0	15.0
2016	20.0	30.0	40.0	30.0
2017	20.0	30.0	35.0	45.0
2018	120.0	90.0	90.0	90.0
Total	**$200.0**	**$200.0**	**$200.0**	**$200.0**

CIP: *Capital Improvement Program*
MCCBL: Maryland Consolidated Capital Bond Loan

Source: Department of Budget and Management, Department of Legislative Services

As demonstrated in the exhibit, the Maryland Consolidated Capital Bond Loan (MCCBL) of 2014 had scheduled $40 million in capital funding for the project in fiscal 2016. However, due to reduced debt capacity, the MCCBL of 2015 reduces this amount by $10 million while increasing scheduled fiscal 2017 funding in an equal amount (therefore, leaving total funding for the project intact).

It should be noted that, of the $20 million provided in fiscal 2014, $5 million remains restricted pending an MOU regarding joint education and research programs among PGHS; the University of Maryland, Baltimore; and the University of Maryland, College Park. **The agency should comment on the status of the MOU.**

Current Status of the Project

It had been envisioned that the new regional medical center would be located in a central area of Prince George's County with convenient access to tertiary care for residents of Prince George's and other Southern Maryland counties. Several sites were considered, and the Largo Town Center was ultimately selected. Construction of site work and infrastructure is expected to begin in September 2015 with the beginning of the construction phase overlapping with the completion of design.

Site selection is one component for the CON application that is currently under review by the Maryland Health Care Commission (MHCC). UMMS advises that among other factors being considered by MHCC is the formation of a companion rate agreement by HSCRC. UMMS further advises that it submitted an amendment to its CON application in February 2015 and that it expects its application to be docketed imminently – at which point legal challenges to the project, if any, could be raised. Any opposition to the application (or related circuit court action) could delay the CON process.

Although the actual size and scope of the new facility is predicated on the completion of the CON process, UMMS received approval from the State to allow State funds to be used for design so that the project will remain on schedule and on budget. Prince George's County, however, has indicated that it will not contribute funding for the project until the CON process has been completed.

Financial and Funding Considerations

The MCCBL of 2014, while reaffirming the State's commitment to PGRMC, also included budget language added by the Maryland General Assembly that requires UMMS, Prince George's County, the Department of Budget and Management, the State Treasurer's Office, and the Department of Legislative Services to study alternative financing mechanisms to provide predictable funding for the project (besides the State's currently programmed use of general obligation bonds). Representatives from each agency and other interested stakeholders met on three separate occasions and conducted teleconferences during the 2014 interim to weigh the relative merits and fiscal implications of a variety of alternative funding options. In addition to considering potential ways to expedite the provision of the State's financial contributions (as compared with how they are currently structured in the *Capital Improvement Program* (CIP), the workgroup considered fiscal issues impacting both UMMS and the State, as discussed below.

Improving the UMMS' Long-term Financial Operation of PGRMC

As previously outlined, past and current operators have required significant and unprecedented annual operating and capital support from the State and Prince George's County to remain operational. Funding and financing options that serve to reduce total project costs and annual debt service costs would improve the annual financial performance of the facility.

Although the timing of the State's multi-year funding commitment is structured to coincide with projected project cash flow, UMMS has expressed concern that the current multi-year funding plan will likely increase its financing costs and negatively impact annual financial performance of the facility. Preliminary information provided by UMMS indicates that a funding plan from the State that provides the remaining State funding as early as fiscal 2016 could reduce the size of the issuance by as much as \$5.2 million, reflecting reduced capitalized interest costs. An upfront funding structure would also assist UMMS with the underwriting for its debt financing and likely reduce annual interest costs. For example, a 50-basis-point reduction on UMMS' \$208.0 million debt issuance could reduce debt service costs by as much as \$700,000 annually based on a comparison of 30 years financing at 4.0% and 3.5%, respectively, which would directly improve the ability of UMMS to profitably operate PGRMC.

With the goals of improving the projected financial performance of PGRMC and keeping certain liabilities off of UMMS' audited financial statement and balance sheet, UMMS has independently pursued financing options that involve third-party conduit financing and lease-leaseback of land and facilities, as discussed later in this document.

State Fiscal Considerations

While options for accelerating the State's funding commitment to PGRMC may reduce total project financing costs and improve UMMS' operating margins for the facility, such options also raise important State fiscal considerations regarding debt affordability, operating budget impact, and potential impact to other capital projects already scheduled in the CIP.

With respect to debt affordability, the current fiscal climate has negatively impacted ratios. Any further negative adjustments could result in a breach that potentially could force a reduction in debt issuances. It is important, therefore, that any alternative financing options – including the use of third-party conduit financing, if it includes a pledge of State general funds specifically attached to debt service – be structured so as not to impact State debt affordability. To achieve this, either a non-State revenue source must be identified or the general funds must not be directly pledged to support debt service. However, not providing a source of funds pledged to debt service can affect the debt issuance underwriting, which in turn directly impacts the bond rating and, ultimately, the issuance rate and annual financing costs.

Another factor is the potential impact on the State operating budget. The State currently faces a significant general fund shortfall. Clearly, the use of general funds is limited, whether as an up-front option or as part of a long-term commitment in conjunction with third-party conduit financing.

Alternative Financing Options

Alternative funding mechanisms examined by the workgroup are summarized below.

Provide General Fund Pay-as-you-go Appropriation: The State could have provided a capital general fund appropriation of \$165 million in the fiscal 2016 operating budget, which would have resulted in an up-front completion of the State's remaining commitment. This would have facilitated capitalized interest saving for UMMS and improved the underwriting of UMMS' debt financing, resulting in potentially lower interest rates on its bonds. However, as previously outlined, general funds are in short supply, making this option untenable.

Restructure the State CIP to Accelerate GO Bond Funding: As previously illustrated in Exhibit 2, the State has programmed its capital GO bond funding commitment to PGRMC through fiscal 2018. The State could further restructure the CIP to accelerate the remaining funding. However, while this would expedite funding as sought by UMMS, it would have negative consequences for other projects and capital priorities already scheduled for funding in the CIP. The State could also consider adding new GO bond authorizations beyond what is already programmed to accommodate PGRMC, but this would cause the State to breach its debt affordability limits.

Use Bond Anticipation Notes: Prince George's County will use Bond Anticipation Notes (BAN) to facilitate up-front funding for its capital contribution for PGRMC. Specifically, the county has advised that it will issue county-backed debt in conjunction with UMMS debt issuance. For the State, however, the use of BANs would count as State tax-supported debt in much the same manner as would the addition of new GO bond authorizations and, therefore, offers no advantages to simply increasing the amount of State GO authorizations. Since the State is currently near its debt service to revenue affordability limit this option looks to be foreclosed. Using BANs without a commensurate reduction in planned levels of GO bond authorizations could cause the State to breach its debt affordability limits.

Third-party Conduit Financing: The State could participate with UMMS in a third-party conduit financing scenario that would facilitate UMMS' receipt of the State's contribution in full when the financing occurs. UMMS has independently explored the use of third-party conduit financing as an alternative to the currently structured GO bond funding. Such a financing mechanism could result in savings to UMMS by reducing the bond issuance amount associated with capitalized interest costs as well as improve the underwriting for UMMS' financing, which should result in a more favorable interest rate and corresponding annual debt service savings. In addition, UMMS estimates that a third-party conduit financing scenario that includes a lease-leaseback provision will prevent the UMMS subsidiary facility operator from having to book depreciation on its audited financial statement estimated at $24.8 million. Both the direct financing savings and indirect benefits from avoiding certain balance sheet liabilities will positively impact the facility operator's net operating margins, improving the long-term financial viability and sustainability of PGRMC.

UMMS has met with the Maryland Stadium Authority (MSA) and the Maryland Economic Development Corporation (MEDCO) to outline options for third-party conduit financing participation. Both options entailed the third-party entity owning the underlying land and the building and then leasing the facility to UMMS. For instance, MSA could seek State approval through legislation to issue lease-revenue debt comprised of the remaining State (and other) funding. (Prince George's County has already agreed to provide $208 million no later than the date upon which the project debt financing is completed.) In order to keep the bonds investment-grade, UMMS would have to guarantee rent payments equal to the debt service on the MSA-issued debt. The debt service payments would flow through an independent trustee to the bond holders.

For its part, the State would have to provide annual funding sufficient to cover the debt service costs associated with the bonds to fund the State's remaining financial contribution to the project. To the extent that State general funds were used as the funding source, the payments could not be specifically pledged to debt service (that is, if they are to be severed from the State's debt affordability calculation). One option would be for the State to return to offering annual operating support to UMMS in an amount and duration sufficient to cover the State's share of debt service. (In this scenario, State payments would not be pledged specifically to debt service.) This method would produce financial savings to UMMS but would likely increase the amount of funding needed annually from the State.

UMMS has also explored the option of engaging MEDCO to become the owner of PGRMC and enter into a lease arrangement with UMMS/Anuco, which would facilitate the removal of depreciation expenses from UMMS' audited financial statements and provide overall savings to UMMS. However, because MEDCO is statutorily prohibited from issuing tax-exempt revenue bonds for hospital facilities, those bonds would most likely need to be issued instead by the Maryland Health and Higher Education Facilities Authority (MHHEFA). The debt service on the bonds would have to be backed by a pledge of the revenues from the project and a lease with UMMS/Anuco. Furthermore, specific authorization from the State would be required for MHHEFA to issue hospital debt that is not backed by hospital revenues. MHHEFA would also likely require direct linkage of the State funding to debt service in order to underwrite the issuance; otherwise, the bonds would not receive an investment-grade rating and consequently would be more costly.

Workgroup Findings

Ultimately, the workgroup has not issued formal findings or recommendations. However, as outlined above, the workgroup examined several alternative funding options for meeting the State's remaining funding contribution to PGRMC, including the advantages and limitations of each. It is clear that any alternative financing mechanisms must be weighed against the State's current fiscal condition, with regard to both the operating and capital budgets. A challenging fiscal climate makes it difficult to structure an alternative funding plan that entails the use of general funds whether as a direct capital appropriation to the project or in support of an operating or capital lease in the form of debt service or lease payments. In addition, with respect to any option that entails the use of a lease structure, a non-State revenue source must be identified, or such a lease will ultimately be counted as a State tax-supported lease within the debt affordability calculation, for which there is no capacity.

GO Bond Recommended Actions

1. Approve the $30,000,000 general obligation bond authorization to continue design, construction, and equipping of the new regional medical center in Prince George's County.