

CAPITAL INVESTMENT BY DETROIT-AREA PROVIDERS

BY ALLAN BAUMGARTEN

Michigan regulates the supply of medical facilities and services through the Certificate of Need (CON) process. Among the activities subject to CON review are construction of new medical facilities, starting certain new services, acquisition of major pieces of equipment, and transfers of ownership. Michigan's original CON law was enacted in the 1970s and substantially rewritten in 1988. Staff of the Michigan Department of Health and Human Services (DHHS, formerly the Department of Community Health) administer the program. They receive and review applications for compliance with guidelines and evaluate need using data on existing capacity and utilization.

As part of our analysis of the financial impact of the Affordable Care Act (ACA) in the Detroit area, we looked at CON applications and decisions to see if providers were making changes in their capital investment strategies since implementation of the ACA began. In this briefing, we summarize and analyze three years of proposed CON applications for projects to be constructed or facilities whose ownership would change in the Detroit-area counties of Macomb, Oakland and Wayne.

CERTIFICATE OF NEED (CON) APPLICATIONS AND DECISIONS

Exhibit 1 summarizes CON applications that were reviewed and decided from 2013 to 2015. We grouped the proposed projects into 11 categories based on their sponsoring organization or purpose. The categories include the six largest hospital systems in the region, other hospitals, nursing homes, imaging outside of hospital systems, dental office imaging, and the development of other facilities or services.

Note that the data here are based on applications, not necessarily on projects that were approved. Some projects were rejected, the largest of which was McLaren Health's proposal in 2013 to spend \$303.7 million on a new hospital. It proposed the transfer of 200 licensed beds from its hospital in Pontiac to a new hospital that would be constructed on the McLaren Clarkston campus in northern Oakland County. That proposal was rejected by state regulators and a judicial appeal was denied. A proposal to the state Legislature in 2014 and 2015 to authorize construction and bypass the CON process also did not succeed. About eight years ago, the Legislature did bypass the CON process in two other cases. After years of debate and appeals, the Legislature approved construction of Henry Ford Hospital in West Bloomfield and Providence Park in Novi, both of which had been rejected by CON regulators.

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EXHIBIT 1
Capital Expenditures Requiring Certificate of Need Review for Detroit-Area Health Providers (2013–2015)

SYSTEM	2013		2014		2015		TOTAL		
	PROJECTS	DOLLAR VALUE	PROJECTS	DOLLAR VALUE	PROJECTS	DOLLAR VALUE	PROJECTS	DOLLAR VALUE	%
Beaumont Health	18	\$175,396,298	19	\$78,243,505	13	\$200,057,906	50	\$453,697,709	18.3%
Tenet Detroit Medical Center	27	27,331,058	11	19,640,943	14	163,006,852	52	209,978,853	8.5%
Henry Ford Health System	12	264,446,931	3	10,130,000	10	15,444,992	25	290,021,923	11.7%
Trinity Health	2	3,841,015	2	6,889,552	4	11,059,429	8	21,789,996	0.9%
St. John Providence	4	20,601,767	9	32,183,809	6	8,194,281	19	60,979,857	2.5%
McLaren Health	5	319,745,418	5	3,641,652	5	5,860,127	15	329,247,197	13.3%
Other Hospitals	8	16,876,175	5	90,122,640	8	28,934,879	21	135,933,694	5.5%
Nursing Homes	45	452,526,588	28	87,109,704	26	201,671,791	99	741,308,083	29.9%
Imaging	50	65,366,346	16	21,917,278	33	20,365,657	99	107,649,281	4.3%
Dental	8	946,228	18	6,053,795	13	1,960,886	39	8,960,909	0.4%
Other Facilities	8	15,268,693	10	68,439,048	11	39,990,917	29	123,698,658	5.0%
TOTAL	187	\$1,362,346,517	126	\$424,371,926	143	\$696,547,717	456	\$2,483,266,160	100.0%

Those hospitals opened in 2008 and 2009. Both systems had argued that the hospitals were needed in those developing suburbs and that the systems needed to offset their operating losses on hospitals in Detroit by serving patients with higher incomes and better insurance.

The data do not show a clear pattern of investment activity. The combined dollar value of applications went from \$1.362 billion in 2013 down to \$424.4 million in 2014 and up to \$696.6 million in 2015. Much of the difference can be explained by a few large projects. For example, in 2013, McLaren Health's proposal for the new hospital, later rejected, accounted for more than \$300 million.

The second largest project that year was a proposal by the Henry Ford Health System to spend \$250 million on implementation of a new electronic medical record (EMR) system. It was determined that CON approval was not required for the EMR system. The third largest project, which was approved, was Beaumont Health's proposal to spend \$140 million to construct a new west pavilion at its Royal Oak campus. In 2015, the biggest project was a proposal to replace 104 beds and add operating rooms at Beaumont Health in Farmington Hills, the former Botsford campus.

Also notable in 2013 was more than \$450 million in spending for nursing homes. The largest individual pieces were for acquiring nursing homes in the area. There was also several new construction projects and proposals to add beds to existing nursing homes. We did not study the nursing home industry as part of this project but note a general trend in nursing homes devoting more of their capacity and services to patients admitted for short-term rehabilitation after surgeries or other hospitalizations. Payments from Medicare and insurers for those admissions are generally more lucrative than long-term stays covered by Medicaid. There was only \$87 million of nursing home activity in 2014 but that number increased to \$201.7 million in 2015. That included \$89 million for acquisition of one nursing home plus new and expansion projects. Again, not based on any extended analysis, it appears from this level of investment in both acquisitions and construction that nursing homes are seen as a strong business opportunity.

Over the three-year period, proposals totaling \$2.483 billion were submitted for review. Nursing home acquisitions and construction was 29.9% of the total and Beaumont Health (including the Oakwood and Botsford hospitals) accounted for 18.7%. McLaren Health was 13.3% of proposed projects, but once the Clarkston project is excluded, it had less than \$30 million in CON activity in its three Detroit-area hospitals. Note that a medical office building, on its own, would not require CON review. However, a proposal to build out an ambulatory surgery center or to add certain kinds of imaging or lithotripsy in offices within that building would be subject to review.

Tenet Detroit Medical Center had \$210 million of CON activity from 2013–2015, with the largest project, a \$145 million patient care tower at Children's Hospital, applied for in 2015. When Vanguard acquired the Detroit Medical Center (DMC) hospitals in 2011, it promised to make \$850 million in capital improvements in the DMC system. Tenet Health acquired Vanguard, including the DMC hospitals, in 2013. (An appointed board, called Legacy DMC, has been monitoring Vanguard and Tenet's compliance with the covenants it entered into when acquiring the DMC, including the capital investment commitment. While Tenet has reported on its capital investments, it has also classified much of that information as proprietary, and therefore, not available to the public.)

The St. John Providence hospitals had 19 CON applications during those three years, totaling \$61 million of proposed spending. This was less than 3% of the total. The two Trinity Health hospitals in the area proposed eight projects for a total of \$21.8 million.

Another large area of CON activity was imaging, including introducing or adding CT and MRI equipment. Almost \$108 million was to be spent on those projects outside of hospital systems and about \$9 million was proposed to be spent on imaging equipment in dental offices.

SUMMARY

Detroit-area hospital systems and other providers submitted CON applications covering almost \$2.5 billion in capital investment in facilities and equipment and acquisition of nursing homes. Of the hospital systems, Beaumont Health proposed the largest amount of facilities investment. State regulators blocked a proposal by the McLaren system to build a new hospital, and took the position that new hospitals are not needed because capacity is more than adequate.

The level of capital investment is not high in the Detroit area and we don't see any pattern of investment in response to the key elements of the Affordable Care Act—especially the expansions of coverage through Medicaid and subsidized insurance. Indeed, it may be concluded that capital investment has been relatively restrained, in part because hospital systems expect that inpatient utilization will continue to decline.