



Economic Impact Analysis Virginia Department of Planning and Budget

12 VAC 30-90 – Department of Medical Assistance Services Methods and Standards for Establishing Payment Rates-Long Term Care Services: Transition to New Capital Payment Method February 6, 2004

The Department of Planning and Budget (DPB) has analyzed the economic impact of this proposed regulation in accordance with Section 2.2-4007.G of the Administrative Process Act and Executive Order Number 21 (02). Section 2.2-4007.G requires that such economic impact analyses include, but need not be limited to, the projected number of businesses or other entities to whom the regulation would apply, the identity of any localities and types of businesses or other entities particularly affected, the projected number of persons and employment positions to be affected, the projected costs to affected businesses or entities to implement or comply with the regulation, and the impact on the use and value of private property. The analysis presented below represents DPB's best estimate of these economic impacts.

Summary of the Proposed Regulation

The proposed changes will establish an eight-year holding period as non-chain affiliated facility in order for a nursing home to qualify for immediate transition to the full fair rental value capital reimbursement methodology following the sale of the facility. The proposed change is designed to eliminate a loophole in the current regulation that is believed to be abused by chain nursing homes that would not qualify for the exemption under the original intent of the regulations.

Estimated Economic Impact

The reimbursement methodology for nursing home capital costs was modified in July 2002 to gradually phase in the fair rental value methodology and phase out the old methodology over a ten-year period. Current reimbursement rate is determined by blending 20 percent of the new methodology and 80 percent of the old methodology. The transition will continue in

increments of ten percent per annum. Thus, at the end of the next eight years, fair rental value methodology will be completely phased in.

Current regulations provide an exemption from the transition period and provide immediate phase in to capital reimbursement rates fully determined by the fair rental value methodology if a nursing home is purchased from a non-chain individual owner.¹ Since the reimbursement rates could be substantially greater under the new methodology², this exemption provides owners significant incentives for abuse. For example, two chain owners that would not normally qualify for the exemption could arrange a questionable sale of facilities to a non-chain owner first and then resale of the facility to each other in order to get reimbursed at a higher capital rate.

The Department of Medical Assistance Services (DMAS) estimates that approximately 25 nursing homes out of 220 Medicaid enrolled providers could potentially qualify for the exemption if the ownership is transferred. Since this exemption was provided in 2002, five or six transfers of ownership took place, which allowed the new owners to get fully reimbursed under the fair rental value methodology. Among these transactions, two were questionable and believed to have been executed to take advantage of the exemption available only to non-chain owners. The total reimbursement to these facilities in fiscal year 2004 is estimated to be approximately \$202,000 more than it would be under the transition methodology.

Given that the potential abuse of this exemption exists under the current regulations, DMAS proposes to add an eight-year holding period to make this exemption available only to those that were originally intended. Under the proposed language, a new owner will not be able to immediately convert to fair rental value methodology unless the previous non-chain owner has been the owner in the past eight years. Thus, the main benefit of the proposed change is preventing inappropriate reimbursement of Medicaid funds to those who do not qualify under the original intent of the regulations. These funds then could be considered as an addition to the Medicaid operating budget to purchase additional health care services for the recipients. The

¹ For the purpose of this report, a chain organization means an organization consisting of more than two health care facilities.

² The reimbursement rate per Medicaid day could be up to \$10 higher under the new methodology. Thus, the annual capital reimbursement amount for a 120-bed facility under the new methodology may be \$300,000 more than what it would be under the old methodology.

magnitude of the fiscal benefit to the state of Virginia, however, cannot be estimated because such estimation requires availability of private information only facility owners have.

Although the proposed change will prevent potential abuse and restore the reimbursement mechanism to achieve the original intent, it is not clear whether the original intent has a valid economic foundation supported by the mission and the role of DMAS. According to DMAS, the purpose of the exemption is “to enable small or non-chain nursing home providers to more easily sell their facilities and leave the nursing home business by allowing the purchaser of these facilities to benefit from the fair rental value methodology.” From an economic point of view, the scope of the regulations should be limited to the areas where the private markets fail. Providing preferential capital reimbursement rates to facilities previously owned by small or non-chain owners does not seem to address any known market failures. This exemption provides incentives to small or non-chain owners to sell their facilities by providing higher reimbursements to new owners at the expense of the state of Virginia. We recommend that DMAS eliminate this exemption and apply the same methodology to all facility owners regardless of the number of facilities they own or their affiliation with a nursing chain.

Businesses and Entities Affected

These regulations apply to approximately 220 nursing homes. The proposed change will prevent chain nursing homes from taking advantage of the exemption originally designed for non-chain owners. Since whether a chain owner is planning to take advantage of the exemption or not is private information, the number of nursing homes that may be specifically affected is not known.

Localities Particularly Affected

The proposed regulations apply throughout the Commonwealth.

Projected Impact on Employment

The proposed regulations are expected to save some Medicaid funds that may have been otherwise used to pay to non-qualifying chain owners. With the proposed changes, these funds now will be retained in the Medicaid operating budget and will be used to purchase additional health care services for indigent recipients. Thus, preventing the transfer of funds from Medicaid

operating budget to non-qualifying chain owners will likely have a positive effect on employment as additional services are purchased with these funds.

Effects on the Use and Value of Private Property

The loophole in the current regulations may allow a non-qualifying nursing home to take advantage of higher reimbursements in the amount of \$300,000 for a typical facility based on FY 2004 rates. This amount would decrease as the new methodology is phased in by increments of ten percent per annum and eventually disappear when the fair rental value methodology is fully phased in eight years later. The potential abuse of the current exemption would mean higher revenues for a non-qualifying nursing home for the same services offered and therefore would increase expected stream of profits. Since any increase in expected stream of profits would be reflected in the present value of the facility, it is conceivable that the value of nursing homes whose owners are planning to take advantage of the exemption through a questionable transaction may be inflated. Thus, the proposed changes will prevent the abuse of this exemption and make sure that the value of a nursing facility is reflective of correct stream of future profits and hence its true market value.