
Medicenter v. Dept. of Human Services
Cite as 4 *N.J.A.R.* 26

MEDICENTER OF LAKEWOOD,
Petitioner,
v.
DEPARTMENT OF HUMAN SERVICES,
Respondent.

Decided March 18, 1983

Initial Decision

SYNOPSIS

Medicenter of Lakewood, a long-term nursing care facility challenged the determination of the Division of Medical Assistance and Health Services concerning the setting of reimbursement rates for the care of Medicaid patients. At issue in the case was the propriety of the method used of the Division in establishing a portion of the reimbursement rate.

The administrative law judge noted that, pursuant to *N.J.A.C.* 10:63-3, *et seq.*, the reimbursement rate may be determined either: (a) on the basis of actual additional cost with a factor for a return on the net equity added; or (b) on the basis of a screening formula, also containing a provision for return on the net equity. Whichever of the two calculations is lower is the figure used in determining the reimbursement rate.

In this case the parties disputed only the procedure used by the Department of Human Services in calculating the screened costs, specifically, the appropriate method of determining the capital facilities allowance portion of the rate under the screened cost approach. The administrative law judge concluded that the agency's action in setting the amortization rate in accordance with the lower actual interest rate paid by petitioner was correct. The judge determined that the adjustment in the amortization rate was appropriate because of the financing of the addition to the facility (*N.J.A.C.* 10:63-3.10(a) and (k)), in this case the Economic Development Authority.

Accordingly, the judge concluded that where a facility is able to obtain low cost financing for its addition, that in establishing the rate of reimbursement for the Medicaid patients in the addition, the agency is required to use the actual interest rate paid in establishing the amortization rate.

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MASIN, ALJ:

Medicenter of Lakewood, a long-term nursing care facility, challenges the determination of the respondent concerning the setting of rates for reimbursement of the petitioner for its Medicaid patients. The rates in question were established by the respondent for the period beginning July 1, 1981. The petitioner requested a hearing on the controversy and the matter was transferred to the Office of Administrative Law as a contested case, pursuant to *N.J.S.A.* 52:14F-1 *et seq.*

As noted, Medicenter of Lakewood is a long-term care facility (LTCF) which provides skilled nursing assistance for its patients. It accepts Medicaid recipients and is reimbursed by the State, through the Department of Human Services, for the care of these individuals. The rate of reimbursement is computed by the Department of Human Services and the Department of Health, acting in cooperation. By statute, the Division of Medical Assistance and Health Services (DMAHS) of the Department of Human Services is the administrator of the Medicaid program. *N.J.S.A.* 30:4D-5. As a portion of its responsibility, the Division is required, pursuant to Title XIX of the Social Security Act, 42 *U.S.C.* 13:96 *et seq.*, to make payment to long-term care facilities at rates "reasonable and adequate to meet the costs which must be incurred by efficiently and economically operated facilities." 42 *U.S.C.* 13:96a(a)(13). The rate of reimbursement is controlled by the "Cost Accounting and Rate Evaluation" (CARE) guidelines. These are contained in *N.J.A.C.* 10:63-3 *et seq.*

At issue in this particular case is the propriety of the method used by the Division of Medical Assistance and Health Services in establishing a portion of the reimbursement rate. The specific portion at issue deals with the proprietary component.

Testimony received at the hearing from a representative of the State Department of Health, Health Economic Services, and a review of the regulations, indicate that the reimbursement rate is calculated based on a dual approach. The reimbursement may be determined either: (a) on the basis of actual historical cost with a factor for a return on net equity added; or (b) on the basis of a screening formula,

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also containing a provision for return on net equity. Whichever of the two calculations is lower is the figure used in determining the reimbursement rate.

In this case the contention between the parties concerns only the procedure used by the Department of Human Services in calculating the screened costs. Specifically, the issue is over the appropriate method of determining the capital facilities allowance (CFA) portion of the rate under the screened cost approach. The difficulty relates to the appropriate role, if any, of the actual interest rate paid by Medicenter of Lakewood in connection with the financing of its 60-bed long-term care addition which was opened on November 1, 1980. As stipulated by the parties, financing for this construction was obtained through the Economic Development Authority (EDA), a government agency. The EDA loan was obtained at an annual interest rate of 9.896 percent.

In considering this matter it is necessary to pay close attention to the wording of several sections of the CARE guidelines. Specifically, *N.J.A.C.* 10:63-3.10(e) reads:

- (e) Two rates will be developed for calculating the CFA for LTCF's.
 1. Interest rate: Equal to the Medicare return on equity rate for the 12 month period ending with December of 1976 (10.719 per cent).
 2. Amortization rate: Equal to the ratio of annual debt service (principal and interest) to original principal required to amortize a loan in 25 equal annual installments, with an interest rate equal to the above defined "interest rate" (11.631 per cent).
- (f) For the first 25 years of the life of a LTCF beginning with the year of construction, the amortization rate will be applied to the 1977 reasonable appraised value of the building and fixed equipment.
- (k) For the existing LTCF's, the State will not increase the CFA rate in future years should the Medicare return on equity rate increase. Should this rate decrease by more than the reasonable cost of refinancing, both the interest rate and the amortization rate will be reduced. The same adjustments will be made should financing through a State authority be made available at lower interest rates.
- (l) For new LTCF's, or for additions to existing LTCF's, the amortization rate will be established based upon the latest Medicare return on equity rate published at the inception of operations. The provisions of subsection (k) of this section will apply in subsequent years.

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The parties agree that the Medicare rate of return, calculated for purposes of establishing an amortization rate, is 18.29 percent as of November 1, 1980. This figure is 150 percent of the Medicare rate of return, plus an additional figure for establishing the interest rate as an amortization rate. The 18.29 percent is the rate which the petitioner seeks to use in the calculation of its rate of reimbursement. The agency seeks to use 150 percent of the actual interest rate as calculated into an amortization factor, equaling 15.33 percent.

The parties agree that subsequent to prior administrative hearings, the Medicare rate of return was utilized in the rate-setting calculations for the period November 1, 1980 through June 30, 1981. The actual rate of interest, 9.896 percent, calculated into the amortization factor of 15.33 percent, is being used by the agency as of July 1, 1981, pursuant to its interpretation of the regulations.

The testimony received, and a review of the documents placed in evidence, indicate that this hearing results from a clash of viewpoint as to the proper interpretation of sections (k) and (l) of *N.J.A.C.* 10:63-3.10. This dispute, while being contested in this proceeding between the facility and the Department of Human Services, Division of Medical Assistance and Health Services, previously was a subject of controversy between representatives of the Division and of the Health Economics Services section of the Department of Health. A series of memoranda passing between those agencies and various personnel therein seem to lay out the positions of the above agencies and present in some detail the positions of the parties in this proceeding.

Essentially, the question to be addressed here is whether the language of subsection (l) requires that the subsection (k) adjustment in the amortization rate be made because of the financing of the addition to the facility "through a State authority at lower interest rates." If the adjustment is required then the Department of Human Services' position must be upheld and the rate set at 15.33 percent. If the subsection (l) language does not require such a downward adjustment, then the higher amortization rate sought by the petitioner is appropriate.

It would appear that the agency's action in setting the amortization rate in accordance with the lower actual interest rate paid by Medicenter is appropriate. Although admittedly the language of the regulation could be clearer, a review of the regulation, as well as the overall set of regulations contained in subchapter 3, indicates that it was the intention of the agency, in accordance with its statutory mandate, to attempt to assure that, where a facility might receive unduly high rates,

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adjustments were to be made to assure against such occurrences. Thus, I **CONCLUDE**, that, where a facility such as Medicenter is able to obtain low cost financing for its addition, that in establishing the rate of reimbursement for the Medicaid patients in the addition, the agency is required to use the actual interest rate paid in establishing the amortization rate.

N.J.A.C. 10:63-3.10(l) requires the agency, when dealing with an addition to an existing LTCF, to set the amortization rate "based upon the latest Medicare return on equity rate published at the inception of operations." The agency, following some contest over the issue, has done so. The regulation then provides, "The provisions of subsection (k) of this section will apply in subsequent years." Under subsections (k), "For existing LTCF's" where refinancing occurs at a lower interest rate the interest rate and the amortization rate will be reduced. The section then provides, "The same adjustments will be made should financing through a State authority be made available at lower interest rates."

In the agency's viewpoint, where a facility, previously existing, builds an addition and obtains interest rates for the construction monies through a governmental agency at a lower rate of interest it makes no sense to allow that facility to obtain a rate of amortization which ignores the actual interest paid and which deals instead with the Medicare rate of return. Since the regulation clearly provides that in the case of existing LTCF's where the Medicare rate of return on equity decreases "by more than the reasonable cost of refinancing" the interest rate and amortization rate will be reduced, and since it is the clear intention of that regulation to limit the level of reimbursement and reduce it in accordance with the reduction in the cost of money, it makes sense, in the agency's view, to also reduce the rate of reimbursement being paid to an existing facility for its addition which was built with monies, financed through a State authority, at a lower interest rate. The agency sees no difference in the situations, in that in both, the reduction in the cost of money to the facility reduces its expenses and allows it to obtain a greater profit if the rate of reimbursement is allowed to remain at the same level because of a lack of any adjustment in the calculation as concerns the interest rate.

In the petitioner's view, only where an existing facility refinances at a lower interest rate should the reduction in the amortization rate occur. The petitioner argues that the purpose of the regulations generally are to encourage investment in LTCF's in order to obtain more

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beds for Medicaid patients. Only by allowing the rate of reimbursement to remain at its existing level, despite the introduction of monies obtained at a lesser interest rate, will the agency be able to allow the statute and its regulations to have their desired affect and permit said construction. Thus, in the petitioner's view, a reduction in the amortization rate due to the lower interest rate obtained for money used for the construction of an addition will frustrate the overall goal of the CARE guidelines and will be counter-productive.

I have reviewed in detail the memorandum which have passed between the various personnel of the Division of Health Economics Services and the Division of Medical Assistance and Health Services. I have reviewed the determination of Director Russo of the Division of Medical Assistance, who has previously decided the inter-agency dispute in favor of the Division of Medical Assistance's position that the lower rate of interest, that is the actual rate, should be used for an addition to an existing facility in calculating the amortization rate. While I believe that both sides have arguments in their favor and that the issue is one which could conceivably be decided either way, I am convinced that Director Russo's determination is a reasonable one and is permissible under both the language of subsections (k) and (l) and the overall goals of the CARE guidelines.

The forward to *N.J.S.A.* 10:63-3 provides that the revised guidelines in the long-term care facility reimbursement formula have been developed to meet the following overall goals:

1. To comply with Federal requirements for a reasonable cost related formula;
2. To provide sufficient reimbursement to assure adequate levels of patient care;
3. To provide sufficient incentive to attract the long-term care facility investment, thereby reducing the reported Medicaid bed shortage; and
4. To end opportunities for excessive property cost reimbursement.

A review of the testimony indicates that the Department's decision as to the proper interest rate to be used in the reimbursement formula is reasonable in light of the goals of the CARE regulations. Certainly, reducing the reimbursement level controls the costs to the government, and ultimately to the taxpayers, of reimbursement for Medicaid care. There is no evidence that the lowered rate will be unreasonable or that it is not properly cost related. In addition, there is no evidence offered to indicate that if the facility receives the lowered reimburse-

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ment rate because of the use of the actual interest rate as compared to the Medicare rate of return in the computation of the facility component that the rate of return will be insufficient to assure adequate levels of patient care. Further, although the evidence indicates that there is still a need for additional Medicaid bed space in New Jersey, the testimony of Mr. Speranza indicates that there have been a number of projects either approved or seeking approval which will provide additional Medicaid space. While perhaps the higher reimbursement rate would further stimulate investment in long-term care facilities, the use of the lower rate cannot be said to be so counter-productive to the attraction of this investment as to be unreasonable and unsupported. Finally, it is clear that the use of a higher rate does increase the percentage of profit for a facility which has managed to obtain low cost financing and while the profit which may be achieved as a result of reimbursement at the higher rate may not be excessive, the use of the lower rate does tend to assure that there will be little if any likelihood for such high reimbursement rates as to perhaps achieve a level which might be considered out of line. Overall, although again the issue is one which is perhaps subject to reasonable debate, I **CONCLUDE** that the use of the actual rate of interest does not work so as to create an unreasonably low rate of reimbursement for the petitioner facility. Thus, I must **CONCLUDE** that the Division has properly determined that in calculating the CFA component of the reimbursement rate the appropriate figure to be used for interest is the actual rate of interest paid by a facility such as Medicenter of Lakewood for an addition to its facilities. Although this technically is not refinancing, since it constitutes financing of a new section of the building, the application of the subsection (k) procedure seems in line with the theory of the CARE regulations. Where a facility is able to obtain financing for either additional construction or to refinance its debt, and where the financing is at a lower rate than the norm (the Medicare rates) the regulations aim at achieving an adjustment in the rate of reimbursement to control the amount of reimbursement for the property cost factor rather than to permit the facility to achieve a greater percentage of reimbursement by leaving the reimbursement rate at a level reflecting the Medicare rate of return.

I see no reason for concluding that in connection with subsection (l) the provisions of subsection (k) should not be applied to an addition to an existing LTCF.

It is, therefore, **ORDERED** that in connection with the rate of reimbursement for Medicaid patients for the period beginning July

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1, 1981, the Division of Medical Assistance and Health Services shall use the actual interest rate paid by the petitioner in connection with its addition in calculating the capital facilities allowance factor in the reimbursement rate.

**After reviewing this Initial Decision,
the Division of Medical Assistance and Health Services, on
May 3, 1983, issued the following Final Decision:**

The Director, Division of Medical Assistance and Health Services has reviewed and considered the entire record in this matter.

Based upon his full review of the record, the Director affirms the recommended decision of the administrative law judge and hereby adopts the findings and conclusions of the administrative law judge in their entirety and incorporates the same herein by reference.

Furthermore, the Director notes that the judge properly interpreted and applied the CARE Guidelines in issue.

THEREFORE, it is on this 3rd day of May, 1983, ordered:

That Petitioner's request to use the Medicare rate of return to calculate the Capital Facilities Allowance is hereby denied.