LOMPOC VALLEY MEDICAL CENTER'S CHAMPION CENTER

SUMMARY

In July 2017, the Lompoc Valley Medical Center, a healthcare district, shut down the operations of its $21 million Champion Center, a freestanding chemical dependency recovery hospital, after operating for only two-and-a-half years. In the course of operating the Champion Center for such a brief period, it lost $10 million, requiring financial support from the Medical Center's other operations. The 2017-18 Santa Barbara County Grand Jury investigated the reasons why this financial failure took place.

BACKGROUND

The Lompoc Valley Medical Center (District), originally established as the Lompoc Healthcare District, was the first operating healthcare district in California. This District was created by the Santa Barbara County Board of Supervisors in 1946 and is governed by a locally elected five-member board of directors (Board). It opened its hospital in 1956.

In 1994, the devastating Northridge earthquake shook the Los Angeles area. Because many critical facilities were severely damaged due to the lack of state-of-the-art structural reinforcements, the State Legislature in 1994 enacted SB1953, which required all general acute-care hospitals to meet more stringent construction standards to withstand seismic forces. These regulations were to be met by all proposed new construction of acute care hospitals immediately upon the passage of the law. Existing, non-seismically compliant buildings were required to meet the new seismic standards within a date-certain grace period. This afforded owners of acute care hospitals who wished to continue to operate a period of time to either design, fund and complete the new seismic upgrades, or relocate, close or demolish the structure before 2020.

Rather than seismically retrofit the 40-year-old non-compliant hospital, the District Board decided to replace it by building a new 60-bed facility. The District secured the financing for the new hospital with a general obligation bond issue of $74.5 million through Cal-Mortgage, a division of California's Office of Statewide Health Planning and Development, which the District's voters approved in 2005. The new hospital opened in 2010.

Leaving the old facility unoccupied for any amount of time was not considered an option as potential vandalism or defacement was a threat. In 2009, a real estate agent was engaged and it was put on the market for sale, but there were no interested buyers.

That year District senior staff were introduced to the owner of Addiction Medicine Services (AMS), who operated a drug and alcohol rehabilitation program connected to a hospital in Hemet, California. Several interviewees stated that after visiting the old hospital in Lompoc, the AMS

owner did not think the facility would be a good fit for his program. Within a short time, however, the District and the AMS owner agreed that the building could be remodeled to accommodate the unique three-step program that combined detox, rehabilitation, and outpatient counseling that was being used in Hemet. The District's CEO at the time convinced the Board of the concept's viability in Lompoc.

With the Board's approval, in 2009 the District hired a consultant firm to evaluate the AMS operation in Hemet and its potential replication in Lompoc. The AMS chemical dependency recovery hospital (CDRH) in Hemet operated under the license of an acute care hospital. This 2009 report concluded that the recovery model in Hemet could be successfully replicated in Lompoc, and that a similar facility in the old hospital could be a potential financial contributor to expand the District's revenue streams. However, the report also warned the District that the old hospital's non-conforming seismic condition had to be considered when deciding how to license a chemical detoxification program. If the Champion Center (Center) operated under the District's general acute care license, it would need to meet seismic safety requirements. However, the report also noted that a freestanding CDRH would be exempt from the seismic safety requirements. A second visit by the consulting firm confirmed that the AMS operation was a well-run facility and a viable model for the old hospital.

The District then initiated the processes of designing the remodeling of the hospital, determining its construction costs and exploring what kind of financing was available. According to senior District staff, the District did not pursue a cost assessment of seismically upgrading the building.

With its construction cost estimate in hand, the District decided to approach Cal-Mortgage again for a revenue bond issue in the estimated amount of $18.75 million. Cal-Mortgage's processes required an applicant to provide a report that examined whether the District would be able to meet bond obligations. The District hired a consultant group to develop the study. The report concluded that with all of its assets, the District could repay its debt obligations.

Cal-Mortgage eventually agreed to authorize the revenue bond issue, which did not require the approval of the District's voters as the repayment would come from District's income and not from the District's voters. Funds were awarded in January 2013, construction began the following month, and the old building was remodeled and structurally upgraded. With AMS in charge of managing the recovery program, the Center had its ribbon-cutting ceremony in August 2014 and received its license as a CDRH in September. The first patients entered on November 11, 2014, allowing the District to apply for accreditation by the independent Center for Improvement in Healthcare Quality (CIHQ). With its approval, the Center could contract with insurance payers.

METHODOLOGY

The 2017-18 Santa Barbara County Grand Jury (Jury) interviewed Board members of the Lompoc Valley Medical Center. The Jury also met with District senior officials and senior management of Addiction Medicine Services. The Jury also studied the consultant reports on the Hemet facility and the financial feasibility study done in conjunction with the Cal-Mortgage application. In addition, the Jury read the District Board minutes from 2009 through 2017. The minutes

included staffing reports, marketing efforts, monthly profit and loss statements and interactions with the Centers for Medicare and Medicaid Services (CMS) and the California Department of Public Health (Public Health).

OBSERVATIONS

Due Diligence

Based on minutes of the District's Board meetings, as of August 2010 the District decided to pursue the CDRH project with AMS some eight months after the AMS CEO first visited the old hospital facility. This decision appears to have been based to a substantial degree on the November 2009 consultant report that examined the AMS program in Hemet. Senior staff and Board members of the District acknowledged that the Hemet CDRH was the only such facility they looked at. The Jury also found no evidence that a comprehensive risk assessment was conducted or contracted by the District to examine the market for a CDRH in Lompoc or the potential risks of pursuing such a project before the decision was made to proceed.

The District contracted a separate consulting firm in August 2010 to produce a financial feasibility study that was required by Cal-Mortgage. The completed study is dated November 2, 2012. The stated objective of the study was, "…perform a feasibility study to assess the District's ability to support the financing for the Project. This study includes the projected operating performance of the District's acute and long-term care business, as well as the operating performance of the Program." The District estimated the cost of the renovation to be $18 million and agreed to finance the project with a combination of tax-exempt bonds insured through the Cal-Mortgage Loan Insurance Program and District cash reserves.

The feasibility study's market analysis of chemical dependency inpatient rates indicated a decrease for the years 2008-2010 in the projected Champion Center service area, which was defined by AMS as Santa Barbara and San Luis Obispo Counties. Projections and assumptions regarding Champion Center performance were based on demographics of the service area and input provided by AMS and the District. For example:

- For projections on insurance coverage regarding estimated Champion Center patients, the study "relied upon AMS' experience and the scope of benefits covered by each payer type."
- "The potential volume that could be captured by the CDRH was estimated in the Market Analysis section of this report and was based on service area trends, projected use rates, and interviews with members of the [District] Management team, the Board, and representatives of AMS."
- "The net patient revenue for the CDRH was developed using a combination of AMS' experience with the two centers it currently manages and anticipated Medicare rates."

Thus, key judgments regarding the performance of the Champion Center were based on input from the District and AMS, the two key stakeholders in the proposed project. District officials confirmed to the Jury that no other independent risk assessments were conducted either before or after the District decided to pursue the project.

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Management Contracts

The CEO, with the Board's approval, began discussions with AMS about a business relationship with the District. The District and AMS agreed that AMS would manage the program. In the original contract, in accordance with Cal-Mortgage's stipulations, AMS would provide and pay for specialized chemical dependency counselors, a resident manager, administrative duties for patient registration and intake as well as marketing the Center's services to organizations that might be a source of patient referrals. The District in turn would provide and pay for the medical staff, accounting, IT support, facility maintenance and housekeeping services including utilities.

As compensation, AMS would receive 44% of the adjusted gross revenue for the first year, and 32% in the second year. The original contract was signed in November 2014. This contract underwent three subsequent amendments. The final amendment in 2017 adjusted AMS compensation to a fixed, flat management fee of $96,506 monthly, and the entire AMS staff was paid from this fee.

Licensure

The AMS license in Hemet to conduct chemical rehabilitation services was based on operating as a service under the Hemet Valley Medical Center's general acute care license. AMS physical facilities were not required to implement seismic retrofitting because of its relationship as a service provider under the hospital's license. This led senior District staff to proceed with the plan to operate the AMS program in the same way at the Champion Center. A lengthy dialogue with officials at the Public Health Licensing and Certification Division ensued. Ultimately, Public Health refused to license the Lompoc facility under the general acute care license of the new hospital, because it contended that the Center had to be seismically retrofitted. Finally, in August 2011, after an unsuccessful meeting to persuade them otherwise, a decision by the District's CEO, its attorney, the architect, and the Chief Information Officer was made to abandon the idea of having the facility licensed under the District's general acute care license and to pursue a license for the facility as a freestanding CDRH. The Center received its license as a CDRH in August 2014.

In the end, the decision to not seismically retrofit but to seek licensure as a freestanding CDRH was ironically the cause for CMS to deny the Center certification as a Medicare provider in July 2016 because detoxification treatment in a freestanding CDRH was not a covered service by CMS.

Insurance Contracts

Medicare

When the Center opened its doors in November 2014, neither Medicare nor other insurance contracts were in place. The first contact with CMS that the Jury was made aware of was a 2012 letter to CMS in which the District sought confirmation that the Center did meet the specific "conditions of participation" for certification of the Center, operating as an acute inpatient (non-surgical) hospital.

The Jury learned that a District official had a telephone conversation in 2012 with the CMS San Francisco office to determine if CMS could certify the proposed Center as a Medicare provider.

The CMS representative indicated that it was conceptually possible that the proposed project could be certified, but that it was only an opinion and was no guarantee of approval.

The next contact with CMS that the Jury is aware of is a letter from the District's attorneys, dated August 17, 2015, two-and-a-half years after its inquiry about "conditions of participation." The Jury was not provided any other communications between CMS and the District from 2012 to 2015. The letter argues that Public Health was under the impression that a CDRH can qualify for Medicare certification because a CDRH provides acute medical detoxification services.

In a January 28, 2016 letter, CMS replied to the District's attorneys August 2015 letter but noted that neither CMS, Public Health, nor Noridian (a Medicare administration contractor) had any record of an application for Medicare certification. CMS gave the District thirty days to produce the application submission or risk rejection and/or denial.

Three months later, in a letter dated May 6, 2016, the District's attorneys thanked CMS for considering a "clean" application for Medicare certification as an acute hospital and argued that the Center was a provider of acute hospital services.

In a letter dated July 14, 2016, CMS notified the District that it denied certification for the Center as an acute care hospital because Public Health had designated it as a CDRH, which CMS does not recognize as a category for Medicare coverage. The District's attorneys inquired about the appeals processes, but the District decided not to pursue it.

Other Insurance Carriers

The Center had to be accredited in order to obtain private insurance contracts. For that to happen, the Center had to hire a full staff and accept patients to show that it had a viable and responsible program. Some of the first patients went through the program without paying, as there were no insurance contracts in place. Once accredited by CIHQ (in March 2015), Center staff could turn its attention to contracting with insurers.

Although it was projected to take six months to obtain insurance coverage, the time lost was much greater than expected. As a new, separately licensed freestanding facility, the Center could not obtain insurance contracts under the District's general acute care license. The Center's staff had to apply for all new contracts. However, the Center was in the midst of attempting to obtain Medicare certification and, according to a District official, insurers prefer that Medicare already be in place before issuing contracts. This made working with the insurance providers difficult. Between March 2015 and December 2016, the Center worked through many delays securing insurance contracts. For example, the first insurance contract was signed in June 2015, but the Center was not loaded onto its system until eight months later. Other insurers had a three-month waiting period before coverage could become effective in addition to another six-month delay to load the Center into their systems.

After opening in November 2014 without insurance contracts, operating more than sixteen months without a full complement of insurance payers created continued operational losses. By 2016, the Center had an average of 20-25 patients in the facility at all times, yet this represented only a 40 percent occupancy rate. Tricare, a government insurance program for military families,

did not become available until September 2016. Medi-Cal did not become available until 2017, just as the District closed the Center.

Marketing

The owner of AMS drew on his experience in treating personnel from the Los Angeles Police Department and Vandenberg Air Force Base for post-traumatic stress disorder (PTSD) in addition to its standard detox treatment for chemical dependency. He convinced the District that the Center program could serve military personnel, police officers and first responders suffering from PTSD. The new facility was named the Champion Center to honor these men and women. Unfortunately, very few referrals came from the Los Angeles Police Department or Vandenberg Air Force Base.

The marketing of the Center was the AMS owner's responsibility. His efforts consisted of meeting with potential referral sources but none resulted. The District hired a marketing person in February 2015 and created a marketing budget of $240,000 to bolster their efforts, to include television, radio and print ads. To intensify its marketing efforts, an outreach person was hired in October 2016, eight months before the Center closed.

Operating Losses

The Center missed every occupancy target. It had neither enough patients nor the insurance reimbursements to cover the costs of operating a complete drug rehabilitation program. The monthly $300,000 losses were beyond what had been projected. The losses totaled over $10 million in the two-and-a-half years the Center was open.

Staffing was the biggest expense. In all, AMS and the District employed a staff of 54 for the Center. In order to accept patients, they had to have a licensed and certified staff available at the minimum ratio of one nurse to five patients and two licensed nurses present at all times, regardless of the number of patients. The Center always had to be ready for any potential patients, especially for those needing detoxification. Furthermore, to attract new patients to the full complement of services, the Center needed a number of specialized counselors for the rehabilitation part of the AMS program.

Another complication in staffing was that a CDRH facility had to have a physician medical director with specialized training in addiction medicine. There were five medical directors in two years of operation. When the last medical director resigned in May 2017, this vacancy, combined with operating losses, resulted in the closure of the Center.

The District leaders claim that the Center was never overstaffed, and that all those who worked there were always busy. The program itself was staff intensive, with patients in the latter two stages of the program going to multiple counseling sessions daily. Even at its highest occupancy, including self-paying and insured patients, the income was not covering the expenses. For example, in March 2016, the total insurance income was $317,970, but the expenses totaled $609,192.

Ultimately, it took over a year and a half for the District to acknowledge that the operation was not and would not meet its projected expectations. Consequently, the Center had to close.

Although the forecast was for a first year loss of $1,900,000 and a second year of $411,000, the actual operating loss for the first fiscal year (2014-15) was $2,400,000 and $3,900,000 each for the second and the third fiscal years. In the end, the District had invested roughly $21 million ($18.75 million bond and $2 million cash reserves) in the facility, and incurred an additional $10 million in operating losses. Even though the Center continued to receive hopeful feedback from the healthcare community and some of its former patients, the District could not continue to sustain the financial losses. In July 2017, the District Board closed the Center after its last patient completed the program.

The Aftermath

The proposal to close the Center was a quiet one. No public announcements to explain the closure were ever made and the closure only appeared on the District's agenda of a specially called meeting, which was posted as required. The Board members and senior District staff who were interviewed did not explain their actions to the public. All senior staff and Board members interviewed who were involved in the startup of the Champion Center stated that no mistakes were made in the development or operation of the Center. As an independent special district, principal oversight of the District rests with its Board.

In addition to startup costs of $2 million and underwriting the more than $10 million operating losses of the Center, the District remains responsible for the repayment of the $18.75 million loan. Since July 2017, the Champion Center facility has stood vacant except for a small portion currently used by the District for laundry services. The District leadership told the Jury that they are confident that the District can repay the remainder of the loan even as it struggling with diminishing reimbursements. The District has offered the Center for sale at an appraised value lower than the remaining bond debt and has also has considered leasing the Center. It is uncertain how the Center will be used or generate income. Its debt service on the bonds, which is a little more than $1 million per year, will continue until 2042.

CONCLUSION

The 2017-18 Santa Barbara County Grand Jury concluded that although the Champion Center began with a vision of community service and the prospect of generating additional income for the District, a combination of factors contributed to the Champion Center's failure:

- the reliance on only one chemical dependency recovery hospital to validate their decision to proceed;
- the failure to engage in appropriate market research to determine the potential number of patients;
- the lack of a comprehensive risk assessment to examine what could go wrong, instead relying on a feasibility study to determine the District's ability to repay the bond debt that based financial projections on the same sole chemical dependency recovery hospital; and
- the decision not to retrofit seismically, which caused delays for licensing and insurance coverage.

Furthermore, the Jury found it disturbing that the Lompoc Valley Medical District leadership interviewed who were involved with the startup process stated that no mistakes were made and they had no need to explain the failure of the Champion Center to its voters.

FINDINGS AND RECOMMENDATIONS

Finding 1
At this point only the income from Lompoc Valley Medical Center operations is available to service the debt obligations of the Cal-Mortgage revenue bond, which will require at least a $1 million per year repayment until 2042.

Recommendation 1a
That the Board of Directors of the Lompoc Valley Medical Center report to its constituents how they propose to repay the Cal-Mortgage revenue bond.

Recommendation 1b
That the Board of Directors of the Lompoc Valley Medical Center explain to its constituents how the repayment to Cal-Mortgage will affect its existing operations.

Finding 2
The Lompoc Valley Medical Center leadership did not provide a full explanation to its constituents for the failure of the Champion Center.

Recommendation 2
That the Board of Directors of the Lompoc Valley Medical Center provide a clear and detailed explanation of the failure of the Champion Center to its constituents, consistent with its stated core principle of transparency.

REQUEST FOR RESPONSE

Pursuant to *California Penal Code §933 and §933.05*, the Grand Jury requests each entity or individual named below to respond to the enumerated Findings and Recommendations within the specified statutory time limit:

Responses to Findings shall be either:
- Agree
- Disagree Wholly with an explanation
- Disagree Partially with an explanation

Responses to Recommendations shall be one of the following:
- Has been implemented, with a brief summary of the implemented actions
- Will be implemented, with an implementation schedule

- Requires Further Analysis, with an explanation of the scope and parameters of an analysis or study and a completion date of less than 6 months after the issuance of this report
- Will not be implemented because it is not warranted or reasonable, with an explanation of why.

Lompoc Valley Medical Center Board of Directors– 90 days

Findings: 1 and 2
Recommendations: 1a, 1b, 2