

FINAL REPORT OF
THE NEW JERSEY STATE COMMISSION OF INVESTIGATION
ON THE PROPERTY COST REIMBURSEMENT SYSTEM
FOR NURSING HOMES PARTICIPATING IN THE
NEW JERSEY MEDICAID PROGRAM

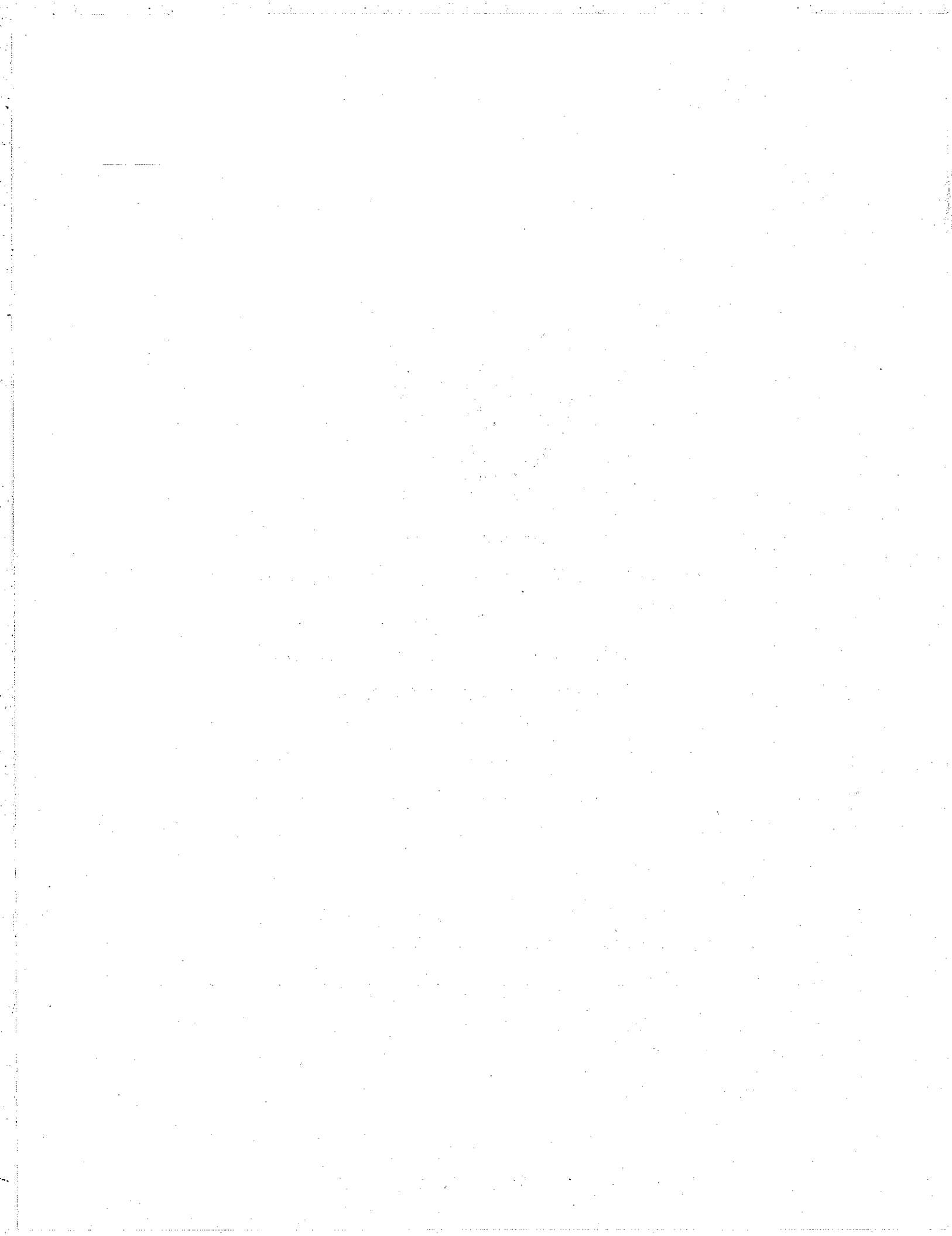


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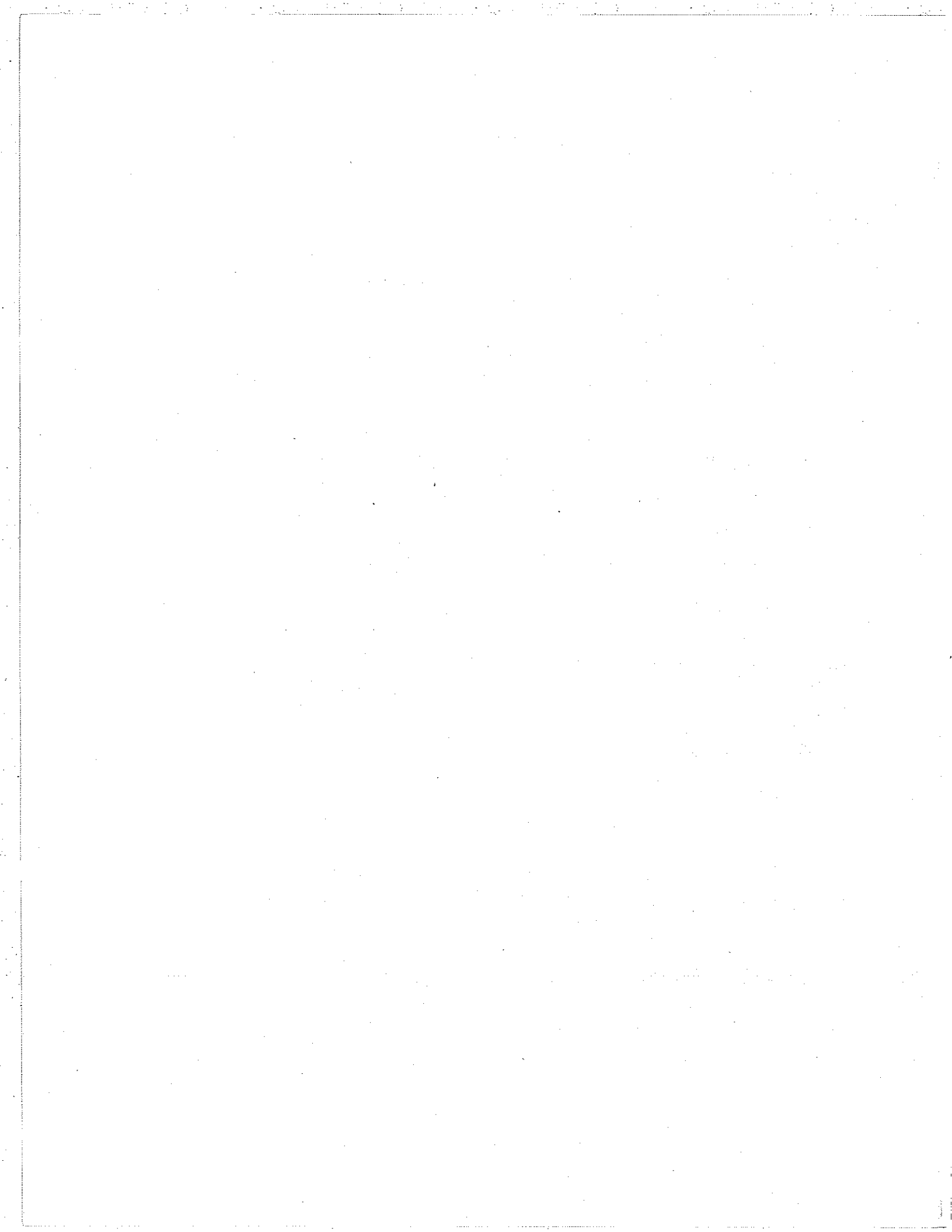
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INTRODUCTION

Since December of 1974 when Medicaid and Medicare payments to nursing homes began to undergo public scrutiny, several agencies and committees of New Jersey government became involved with one more aspect of the inquiry. In December of 1974 the Governor requested the State Commission of Investigation (hereinafter referred to as "S.C.I." or "Commission") to conduct an evaluation of New Jersey's system of Medicaid reimbursement. Also, in December of 1974, the New Jersey Attorney General's office announced that it was probing the alleged interests of Dr. Bernard Bergman in New Jersey nursing homes. Later, that office set up a special portion of its Enforcement Bureau to specifically deal with possible criminal activities and fraud in the area of reimbursement to nursing homes and other providers. This unit has already produced several indictments. In January of 1975, Governor Byrne announced the formation of a cabinet-level committee to study the problems of Medicaid reimbursement for nursing home care. That committee issued its report on November 13, 1975, and the recommendations relating to property costs reimbursement reiterated several of the suggestions initially made by the S.C.I. on April 3, 1975, in its first interim report on nursing home reimbursement. The New Jersey Legislature also created its own committee to examine nursing homes in January of 1975. That committee, chaired by Senator John Faye of Middlesex County, is examining the quality of care in New Jersey nursing homes receiving Medicaid reimbursement and other aspects of the program.

Because of the attention being given to other facets of the Medicaid system as it relates to nursing homes, because reimbursement of land and building costs presents one of the largest cost factors of Medicaid reimbursement and because investigators involved in the area have realized that it is this component of reimbursement which is most often abused and most in need of reform,¹ the S.C.I. has continued to direct its attention to this area.

In the first report issued by the Commission in April of 1975, the genesis of a certain schedule of ceilings for rentals and imputed rentals was examined along with other components of the property cost reimbursement system created by the Division of Medical Assistance and Health Services (hereinafter referred to as "DMAHS") of the Department of Institutions and Agencies. One of the primary conclusions of that report was that the schedule of maximum rentals and imputed rentals was inflated so as to permit unnecessary hypothetical profits. The purpose of this report is to examine the realities of the former hypothesis and to further comment upon some other undesirable features of the property cost reimbursement system. This will be accomplished via an in-depth study of a number of nursing homes now participating in the Medicaid Program. Additionally, the report will address some of the deficiencies of

1. See, e.g., Reimbursement of Nursing Home Property Costs; Pruning the Money Tree, Report of the New York State Moreland Act Commission on Nursing Homes and Related Facilities, January, 1976; Report on Nursing and Related Facilities, Temporary State Commission on Living Costs and the Economy, April, 1975; Report of the Ad Hoc Committee on Capital Cost Reimbursement Rates, New York Public Health Council, October 25, 1975.

the Medicaid administration in DMAHS and the Department of Health as they relate to property cost reimbursement.

Some of the most noteworthy findings of the report are:

1. That there are profiteers and opportunists with investments in substantially Medicaid funded nursing homes in the state who recoup returns as high as 105% annually and have no connection with the operation of the facility.
2. That there has been and continues to be a large number of nursing homes participating in the Medicaid program which have never been audited.
3. That due to the lack of auditing, substantial overpayments have occurred to a number of homes examined by the Commission.
4. That there is no effective control by either the Department of Health or DMAHS on escalating property cost expenses.
5. That communication between the two agencies with the responsibility for administering the program is extremely poor.
6. That there exists a combine of loosely connected groups of New York-based entrepreneurs who control a substantial percentage of the Medicaid beds in New Jersey.

Finally, a summary of the recommendations appearing at the end of each section of this report is as follows:

1. That the entire present system of property cost reimbursement be completely overhauled along a pattern suggested initially by New York's Moreland Commission with modifications suggested by the S.C.I.
2. That while the foregoing system is being implemented certain controls on escalating property cost reimbursement should be adopted by the Department of Health.
3. That construction costs on new facilities and additions be strictly controlled since they will directly affect reimbursement.
4. That additional auditors be hired by DMAHS and that an educational program be provided for them to further increase their efficiency.
5. That Senate Bill 594, presently pending before the New Jersey Legislature, be substantially strengthened as to reporting requirements by individuals with interests in nursing homes and that that knowledge be utilized by the administering agencies.
6. That communication between DMAHS and the Department of Health be created by the institution of a standing committee on property cost reimbursement and ownership.

I. CASE STUDIES ON PROPERTY COSTS
REIMBURSEMENT UNDER THE MEDICAID SYSTEM

INTRODUCTION

As was stated at the outset, one of the purposes of this report is to examine certain nursing homes participating in the Medicaid program around the state and to comment upon the reimbursement of their property costs. The Commission is of the opinion that the property cost reimbursement system existing presently is unwieldy and wasteful. From figures supplied by the Division of Medical Assistance and Health Services of the Department of Institutions and Agencies, approximately \$22 million will be reported to that agency by nursing homes as property expense in fiscal 1976. Reimbursement of property costs represents a significant percentage of the total Medicaid payments to nursing homes of \$130 million in fiscal 1976. Efforts to restructure the system with an eye towards cost savings are, therefore, necessary and valuable.

As was the case in the first report issued by the Commission, however, a rudimentary understanding of reimbursement is a necessary prerequisite to a full comprehension of the analyses in this report. That first report contained a complete explanation of the reimbursement formula and the relevant pages are appended hereto as Exhibit 1, for the reader's edification. The only facet of the reimbursement system which plays a critical role in this report, however, is the system relating to property cost reimburse-

ment. Simply stated, DMAHS recognizes² property costs as debt service (mortgage interest) plus insurance on building plus depreciation plus a percentage return on equity. Where the home is rented via an "arms-length lease", the yearly rental is used for the amount of reimbursable property costs up to the maximum amounts supplied by the aforementioned rental schedule which is appended as Exhibit I to Exhibit I.

The foregoing are the traditional types of land and building treatment in a commercial situation. The maximum rental schedule and DMAHS regulations, however, create other classifications of arrangements which are important to understand for present purposes.

First, where an operator leases the nursing home from a party who is related by family ties or by business relationships, the lease is considered a "non-arms-length" one and the operator then has two options: he may use the amount computed from the maximum rental schedule, column "B", or he may use the actual carrying charges of the lessor (debt service, depreciation, insurance and return on equity) whichever figure is higher. This option is not available to lessees operating nursing homes under leases which are the product of arms-length agreements between

2. The term "recognizes" is a relative one. It is important to note that, although 100% of property related expenses are listed on the nursing home cost reports, the actual amount of reimbursement would be the listed figures times the percentage of Medicaid occupancy. Thus, for instance, if property costs are reported at \$100,000 and the Medicaid occupancy level is 50%, \$50,000 is the actual reimbursement.

unrelated parties.

Finally, DMAHS grants owner-operators "imputed rent"³ where their carrying charges do not meet the appropriate amount computed by the utilization of column "B" of the rental schedule. Thus the owner-operator has the option of using actual carrying charges or the imputed rental amount, again, whichever is greater.

In summary, then, there are four essential classifications of property cost reimbursement: 1) actual carrying charges granted to owner-operators whose property related expenses are greater than the imputed rental computation; 2) imputed rental granted to owner-operators whose actual carrying charges are less than the imputed rental computation; 3) the amount of the lease up to the maximums set by the schedule to lessees operating under an arms-length agreement; and 4) the amount of actual carrying charges of the lessor or the computation from the schedule, column "B", (again, whichever is greater) to the lessee operating under a "non-arms-length" lease between related parties.

Some discussion of the operation of the schedule is appropriate. Reference to Exhibit 2 discloses columns of monetary figures according to the year of construction and geographic location of the nursing home. For a nursing home in Essex County built in 1973, operating under an arms-length lease, for instance, the

3. This topic was commented upon in an in-depth fashion in the Interim Report issued by the S.C.I. on April 3, 1975. The recommendation which resulted from that examination was twofold: 1) that consideration be given to complete abrogation of the concept, and 2) that the option of taking the higher of the two computations be discontinued immediately.

figure is \$1,618. \$1,618 is then multiplied by the number of certified medicaid beds in the institution to arrive at the rental ceiling, thus, if the Essex County nursing home contained 100 beds, the ceiling would be \$161,800 (\$1,618 times 100). DMAHS would therefore reimburse any arms-length lease up to \$161,800.

The basis for the monetary amounts was unknown to the officials of DMAHS responsible for its implementation as of February 1975, when their testimony was taken. The Commission established that New Jersey adopted (with modifications) the New York schedule on the topic and further that that schedule was based on an average of inflated carrying costs supplied by the Metropolitan Nursing Home Association of New York City. The amounts are supposed to reflect construction costs for the buildings, but the manner in which they were extrapolated from an average of carrying costs was never fully explained.

There are several observations and comments which can be made upon New Jersey's system of property costs reimbursement, some of which are based upon facts from the prior report, some of which are evidenced by the instant report and others which are apparent from the face of the regulations. The Commission believes that the following are some particularly salient comments:

1. The reimbursement of carrying costs fails to take account of certain critical financing factors.

The DMAHS approach to reimbursement of the carrying costs — debt service, depreciation, insurance and a return on equity — fails

to take account of cash flow, tax advantages and real estate/building appreciation so that owners actually reap more profit from their financial posture than DMAHS presently recognizes.

2. The present system encourages trafficking in nursing homes.

Because the sale prices of nursing homes are not controlled by either the Department of Health through the certificate of need program or DMAHS through its auditing function, it is not uncommon for new homes to be quickly sold after construction at a price which far exceeds the construction costs. Nor is it uncommon, for these same reasons, for homes to be sold over and over again every two or three years with a constantly escalating sales price, the debt portion of which is, in effect, often substantially amortized by the State of New Jersey. This cost escalation, of course, bears no relationship whatsoever to the quality of care.

3. In addition to the "quick sale", refinancing is a common occurrence with a resultant monetary detriment to the State.

There is a natural inbred impetus for the owner of a nursing home to keep the interest portion of his mortgage payments at a high level. In the first place, mortgage interest is deductible for income tax purposes, and, in the second place, it is a reimbursable Medicaid cost. The portion of mortgage payments which is attributable to the principal, however, is neither deductible nor reimbursable. With traditional mortgage agreements, of course, the early amortization payments are heavily weighted in favor of

the interest portion which gradually declines over the period of amortization. Amortization merits the owner almost nothing, however (with the exception of the comparably minimal return on equity), and the owner, therefore, is impelled to resell and/or refinance on a rather regular basis. The State is the natural loser in this set of circumstances since it continues to reimburse for a continually elevated debt service.

4. The "double profit" syndrome.

There is no regulation upon the percentage of the value of the nursing home which may be financed and, where refinancing occurs, there is no regulation concerning the utilization of the proceeds of that refinancing. Furthermore, upon resale to a related party, the seller may take back a second mortgage beyond the institutional financing to make up the possibly inflated sales price. The risk on second and third mortgages, of course, is usually high, but in the case of a Medicaid nursing home with a high percentage occupancy, the payment of the mortgage interest is, in effect, guaranteed by the State.

5. With respect to leases, the fact of the existence of maximums set by the schedule causes no lease negotiations to be truly "arms-length".

Experienced nursing home owners are, of course, aware of the maximum rent for their home which can be costed for Medicaid

purposes and this factor substantially effects the negotiations between lessor and potential lessee. The lessee often finds himself in an extremely poor bargaining position because the State has, in effect, predetermined the rental for any given home. The Commission has found at least one occasion, for instance, where the actual lease documents call for rental equal to the maximum amount which Medicaid will reimburse.

6. The fact that the schedule is inflated, by being based upon existing inflated property costs, allows the amortization of inflated mortgages by lessors and a high profit margin to lessors and middlemen who assign or sublet at a profit.

The inflation of the maximum amounts listed in the schedule, of course, presents numerous possibilities for financial gain to astute lessors. Some of the possibilities which the Commission has established are listed above, and, again, where Medicaid occupancy is high, a substantial portion of the profits are derived from the State. It is also important to note that none of these profits bears any relationship whatsoever to the quality of care being provided in the particular nursing home and the lessor or sub-lessor is rewarded for nothing more than his business acumen.

7. The schedule amounts to be employed by each home are hinged to the year of construction of that home, and since misrepresentation of the year of construction would produce higher reimbursement, the utilization of the schedule becomes an invitation of fraud.

The above-described situation becomes particularly acute where the home operates from a refurbished building originally constructed for another purpose. Since the renovation is often costly and, in many cases, financed, and because DMAHS allows only the employment of the year of original construction, the temptation to misrepresent is great. To complicate matters, it appears that such misrepresentations have often gone unchallenged or at least unaudited by DMAHS, which situation is, again, costly to the State. The condition is probably fostered by the fact that DMAHS has no written guidelines for the treatment of renovated homes and the Commission will recommend that one be created.

8. The concept of "imputed rental", ostensibly created to attract older homes to the program, may be outmoded and, in certain cases, should definitely be abrogated.

Since operators who have relatively low carrying charges, and/or are almost fully depreciated, are given the option of employing imputed rental computed from column "B", there is a theoretical impetus for the home to become active in the program. Stripped to its essentials, however, the concept does nothing less than give owners something for nothing. New York officials testified sometime ago that imputed rental would probably be discontinued there and, again, the Commission suggested a similar action in New Jersey. The specifics of the S.C.I. recommendation are again contained in the appropriate sections.

As stated previously, the Commission has chosen several nursing homes for examination. The history of the financial transactions with respect to construction costs, financing, sales and leases makes up the bulk of the reported examination of these homes, but, because resale prices and leases are not indicative of value, the Commission has also undertaken herein to pinpoint other indicators of value. Additionally, various comments will be made upon profit realized through the property cost reimbursement and upon other faults of the property cost reimbursement system exhibited by that home.

Edison Nursing Home

The Edison Nursing Home is located at 465 Plainfield Avenue, Edison, New Jersey in Middlesex County. It contains 302 beds and is populated to a degree of 98% by Medicaid patients. The home is operated by a corporation called Edison Nursing Home, Inc., which is wholly owned by Mr. Herbert Kallen and his wife Lenore. Mr. Kallen and his wife sold the stock of the corporation which owns the land and building in October of 1970 and this transaction will be discussed hereinafter. Per its 1975 cost report, as desk audited by DMAHS, total adjusted property expenses are \$266,068 per year. This amount, since it is higher than the imputed rental schedule is the one used for Medicaid reimbursement purposes. Pursuant to the same cost report, the home was constructed in 1966.

Edison Tower, Inc., was incorporated on June 4, 1963. On October 25, 1963, 13.49 acres of land for the site were sold to Edison Tower, Inc. The grantor of said parcel was the Second Construction Corp., Inc. (Leon Weiss and Rudolph Weiss) and the sale price listed on the deed was \$1.00. On the same date, October 25, 1963, there was executed an F.H.A. Building Loan Agreement listing a construction mortgage amount of \$2,225,300 (89.99% of assessed valuation by F.H.A.). The listed general contractor was the Weiss-Bern Corporation. The mortgagee on the mortgage of \$2,225,300 was the Garden State National Bank. The listed total project cost for construction on the F.H.A. application was \$1,744,338, listed non-construction costs

amounted to \$176,849 for a total of \$1,921,187.

On April 1, 1965, a certificate of occupancy was issued. On July 1, 1965, the original construction mortgage of \$2,225,300 was modified and transformed into permanent financing with the same mortgagor and the same mortgagee (the bank had, in the interim, changed its trade name).

On October 13, 1970, Edison Tower, Inc., sold its outstanding stock to Mr. Kallen. The terms of the sale were as follows: 1) a \$150,000 cash downpayment, 2) the assumption of the existing mortgage (amount outstanding at the time of sale - \$1,943,665), and 3) a personal note whereby a corporation known as 465 Plainfield Inc. (another corporation wholly owned by Mr. Kallen) promised to pay W.B.W. Associates, a co-partnership having its principle place of business in Brooklyn, New York, and made up of Messrs. Weiss, Bernstein and Weiss (who were also the stockholders of Edison Tower, Inc.), the sum of \$916,720.56. The terms of the note called for the payment of interest only from November 1970 through the first day of October 1973 and thereafter, with minor adjustments, a payment of principal and interest at the rate of 7½% per annum, amounting to payments of \$7,916.67 per month, beginning the first day of November, 1973, through October 1980 at which time the unpaid balance is due and payable.

The June 30, 1971 cost report submitted to DMAHS lists the following items for property cost reimbursement purposes:

land - \$159,000, improvements - \$3,120,929, for a total of \$3,279,929. In July of 1971, the nursing home was appraised for tax purposes at \$2,293,788. In the interim the real estate tax assessment was increased to \$2,950,350. On July 2, 1973, the nursing home requested that that real estate tax assessment be lowered to \$2,500,000 on the theory that the assessment was, "in excess of fair market value." In support of this petition, another appraisal was submitted using three different methods of appraisal, reproduction (\$2,462,500), comparable sales (\$2,501,600) and income capitalization (\$2,462,500). The assessment on improvements was reduced by \$60,000, as a result of this petition, on November 8, 1973. On June 27, 1974, another petition was filed seeking a reduction to \$2,500,000 for the same reasons as the 1973 petition. That petition was dismissed on August 27, 1974 and an appeal was filed with the State Division of Tax Appeals on October 31, 1974.

Comments and Observations

On October 13, 1970, the amount of financing on the nursing home was the amount of the outstanding mortgage (\$1,943,665) plus the amount of the aforementioned note from 465 Plainfield Corp. to W.B.W. Associates (\$916,720) for a total of \$2,860,385. After the first year, the nursing home became a more than 90% Medicaid facility and remains so to this date. The result, of course, is that the State of New Jersey has paid the over-

whelming majority of the interest on this indebtedness since it was incurred.

The aforementioned figure, \$2,860,385 is more than \$360,000 in excess of any appraisal that has ever been done on the nursing home, including appraisals that were done some two years before this transaction. The figure is also over \$1,000,000 in excess of the total construction cost listed on the initial F.H.A. application when the home was being built. Finally, the figure is also more than \$360,000 in excess of the value placed on the home by the owners themselves in their various tax appeals. It is true that the sale included an amount of \$300,000 for furnishings in the nursing home and another \$150,000 for good will, but the cost reports filed by the institution indicate nowhere that the financing on the institution pertains to anything but the building.

In the view of the Commission, the October 13, 1970 sale would probably not have taken place but for the advent of the Medicaid system. This example points out that, since there is no limitation upon the amount of debt financing which the Medicaid program will allow, informed entrepreneurs will sell nursing homes at highly inflated values as long as the state continues to underwrite unlimited debt.

White House Nursing Home

The White House Nursing Home is located at 560 Berkeley Avenue, Orange, New Jersey, and contains 176 beds. White House Nursing Home, Inc., which, according to the license application, is wholly owned by Mr. Eliezer M. Grossman and his wife, operates the nursing home under a lease from the I & S Realty Corporation, 1354 46th Street, Brooklyn, New York. The yearly rental is \$1,700 per bed (\$299,200).

The land and building of the White House Nursing Home was purchased on October 11, 1972. The institution was formerly the Beard School. The purchasers were Messrs. Stephen Atkins, Jack Atkins and Harold Kent, trading as the Beard Nursing Home Association. The purchase price, according to the deed, was \$450,000. The Beard School was constructed in 1909.

On October 13, 1972, a letter of construction mortgage commitment was granted by the Franklin Capital Corporation to Atkins Associates, Inc. (the same group which made up the Beard Nursing Home Association) in the amount of \$1,725,000. The first disbursement on that construction mortgage was \$450,000, and that amount, according to the mortgagee, was utilized for the purchase of the land and building. The mortgage was granted at 4-3/4% over the prime rate with a minimum of 9% and a maximum of 12%.

On February 23, 1973, I & S Realty Corp. (who ostensibly did not as yet own the facility) executed a lease with the

aforementioned White House Nursing Home, Inc. The lease is of the "net-net" variety and calls for a yearly rental of \$1,700 per bed (\$299,200 per annum) during the first 121 months of the term and \$1,800 per bed (\$316,000 per annum) for the remaining term of 21 years.

Thereafter, on May 24, 1973, the Beard Nursing Home Association, a partnership made up of the aforementioned Messrs. Atkins, Atkins and Kent, sold the facility to I & S Realty Corp., a New Jersey corporation which lists its sole officers and directors as Icek and Sara Cywiak. The purchase price, according to the deed, was \$2,057,000. In addition to the assumption of the outstanding mortgage, the buyers executed on May 5, 1973, a second mortgage in the amount of \$182,500 back to the Beard Nursing Home Association. This mortgage was granted at an annual interest rate of 7½% for a term of five years.

The institution, according to information obtained by the Commission, had some difficulty in obtaining permanent financing. The previously mentioned second mortgage was modified and extended on November 28, 1975 whereby the principal sum was reduced and the term was extended. Thereafter, on January 19, 1976, a new first mortgage was negotiated in the amount of the original construction mortgage (\$1,725,000) in order to allow additional time to obtain permanent financing. The rate of interest on that mortgage is 10½%; payments are \$20,125 per month for a term of three years with a required balloon

payment of approximately \$1,500,000, at the end of the term. The promissory note filed by I & S Realty with the aforesaid mortgage bears the signatures of Messrs. Atkins, Atkins, Kent and their wives as individual and collective guarantors. This same group ostensibly sold the property some two and one half years prior to the date of this promissory note.

The real estate tax assessment on the land upon which the nursing home is situate is listed at \$179,300; the assessment on the building is \$616,000. The assessment rate in the City of Orange is 76.51% of true.

Comments and Observations

1. It is the stated policy of DMAHS that the original year of construction is employed when determining the maximum rental ceiling for renovated facilities. That policy was not followed with respect to the White House Nursing Home cost report.

An examination of the 1975 cost report for the facility discloses that DMAHS allowed a 1973 construction date which has the effect of allowing a rate of \$1,618 per bed (\$284,768) as ceiling in the case of an unrelated lease. Thus, DMAHS disallowed only \$14,432 (\$299,200 - \$284,768) with respect to the amount claimed for rent. If the stated policy was followed, the year of construction would be 1909 and the maximum rental figure would be \$256 per bed (\$45,056). Thus the disallowance should have been \$254,144.

2. Since, as in most cases with nursing homes, the lease in this case is of the "net-net" variety, the only actual expense to the owner is mortgage amortization. Thus, the yield on the original investment can be computed by subtracting the yearly mortgage expense from the amount received under the lease and then expressing that figure as a percentage of that original investment.

In the instant case, I & S Realty purchased the nursing home for \$2,057,000. Toward that purchase price, however, two mortgages were undertaken. The principal sum on the first is \$1,725,000 and the total amount on the second was originally \$182,500. If it is presumed that the balance of the payment was in cash, the maximum initial investment of I & S Realty was \$149,500.

The nursing home has not as yet obtained permanent financing, but assuming that it does in the near future and assuming that the terms are conventional ones (a principal amount of \$1,725,000 (the construction cost) at 10½% interest for 21 years) the monthly first mortgage payments will be \$16,985 (\$203,820/yr). The proposed payment on the second mortgage is \$2500 per month (\$30,000/yr) for five years. When these amounts are subtracted from the income on the lease (\$299,200) the return on the initial investment of \$149,500 is 44% in the first five years and 64% for the balance of the term.

Emerson Convalescent Center

The Emerson Convalescent Center is located at 100 Kinderkamack Road, Emerson, New Jersey. The institution contains 148 beds and began operation in 1975. It is projected that this nursing home will be populated by 90% Medicaid patients. The institution is presently owner-operated by a corporation known as the Emerson Convalescent Center, Inc. That corporation was incorporated on April 1, 1975 and its stockholders, all of whom own less than 15% of the corporation are Messrs. Frank Chaimovits, Morris Schnitzer, Nathan Friedman, Ernest Hollander, Leo Rosenson, Mark Kamin, Jacob Bergstein, Herman Menche, Joseph Schwartz, and Zev Ajlman.

The first corporation involved with this institution was an entity known as Emerson Nursing Homes, Inc., which was incorporated on August 9, 1965. At that time, however, the corporation owned only the tract of land upon which the nursing home is now situate and no building was built until some time later. On September 13, 1968, the Manor of Emerson was incorporated and that entity purchased the aforementioned tract of land from Emerson Nursing Homes, Inc. on March 26, 1970 for an amount of \$306,931. Thereafter, on February 11, 1971, the Manor of Emerson obtained a construction mortgage in the amount of \$1,784,900 from the Carteret Savings & Loan Association, Newark, New Jersey. The term of this mortgage was 20 years

and the interest rate was 8½%. Only interest payments were required from March 1971 through November 1972, thereafter the principal and interest payments equaled \$15,489 per month.

Before the structure was completed, however, bankruptcy proceedings were filed on February 17, 1973 by the Manor of Emerson. As a result of that filing, the receiver was authorized to execute a construction contract with the Glenwal Construction Company, Inc., who would be authorized to complete the work in the building which was at that time approximately one half completed. Also as a result of the bankruptcy proceedings, a new mortgage commitment was obtained from the Advance Mortgage Co., in the amount of \$2,900,000. That mortgage was executed on March 28, 1973 and was to run at a rate of 7% per annum for a term of 30 years. Only interest payments were required from May 1973 through August 1974, but thereafter installments of interest and principal in the amount of \$18,021 per month were required. Subsequently on October 16, 1975, a supplemental mortgage was granted by the Advance Mortgage Co. to the Manor of Emerson in the amount of \$192,100 which required payments of \$1,200 per month at an interest rate of 7% per annum for a term of 30 years. This supplemental mortgage was later consolidated with the original mortgage of \$2,900,000 into one instrument with a required principal of \$3,092,100 to be amortized in payments of \$19,431 per month for 30 years. On the same day, October 16, 1975, the institution was sold by the Manor of Emerson to the Emerson Convalescent Center, Inc., a New Jersey corporation made up of the stock-

holders previously mentioned in this section of the report. The sales price was \$3,342,100. The present tax assessment on the institution is \$112,400 for land and \$1,200,000 for improvements. The tax ratio in Emerson is 54% of true value. The original assessment on the land and improvements was \$112,400 for land and \$1,655,000 for improvements. On August 15, 1975, however, the Manor of Emerson, through its attorney, filed a petition for reduction in that assessment for the following reason: "The assessment is far in excess of either the market value or cost of construction and building certificate of occupancy has not been issued by local authorities so building cannot be occupied." The aforesaid petition requested a reduction in the assessment on the building to \$800,000 for the foregoing reasons. As a result of that application, the tax assessor's office of Emerson Borough sought and received assistance from the Division of Taxation, Local Property and Public Utility Branch, concerning the actual value of the building. As a result of that request, an appraisal study was made by the Division of Taxation in order to assist the Tax Assessor's Office of the Borough of Emerson. The result of that evaluation was that the total value of the land and building as of October 1, 1974, was \$2,169,244 (\$2,056,844 - building; \$112,400 - land). As a result of this appraisal, the tax assessment was reduced to its present figure.

Comments and Observations

The Commission is of the opinion that the Emerson Convalescent Center represents a classic example of over-mortgaging and a resultant unnecessary expense to the Medicaid program. A competent appraisal has set the value of the land and building at \$2,169,244, as of October, 1974. As of October 1975, however, mortgages on the institution amounted to \$3,092,100. Adjusting for an increase in value between October 1974 and October 1975, the Medicaid program, therefore, would be allowing the reporting for reimbursement purposes of mortgage expenses applicable to approximately \$800,000 over the appraised value of the building.

It is interesting to note that the owning and operating corporation disclosed its awareness of the fact that the building and land was not worth in excess of \$3,000,000 when it filed its appeal of the assessment on August 15, 1975. As was previously illustrated, that operating corporation stated that the assessment was "far in excess of either the market value or the cost of construction". It is the Commission's view, therefore, that the market value of \$3,342,000 as denoted in the recent sale of the institution is a completely artificial one and that that sale could never have been consummated as financed, but for the existence of the favorable reimbursement formulas of the Medicaid program. As in other cases found by the Commission, mortgagees are granting loans based not upon the actual value

of the building but upon income producing potential. The excessive financing is based upon the income producing potential which, in turn, is predicated on state reimbursement. That reimbursement, however, is based on the initial excessive financing — the classic situation of a dog chasing its tail.

Heritage Hall Nursing Home

Heritage Hall Nursing Home is located at 524 Wardell Road, Neptune, New Jersey in Monmouth County and is operated by a corporation known as H.G.H. Nursing Home, Inc. The facility contains 115 beds and 99% of its occupancy is made up of Medicaid patients. Mr. Harry Ostreicher is the president of H.G.H. Nursing Homes, Inc. and owns 91% of the corporation. H.G.H. Nursing Homes, Inc. rents the facility from Mr. Herman Greenbaum of Flushing, New York. The present rental is in the amount of \$150,000 per year. Mr. Greenbaum purchased the home in 1974.

The nursing home was originally built as a motel in 1962. Thereafter, on June 14, 1966, the National Theater Supply Company sold the home to Hamilton Hall Nursing Home, Inc., for a purchase price of \$262,000. On September 22, 1966, Hamilton Hall Nursing Home, Inc., became Heritage Hall Nursing Home, Inc. The nursing home was opened on May 22, 1967. On September 7, 1967, Heritage Hall Nursing Home, Inc., obtained a mortgage in the amount of \$525,000 at 6-3/4% for a term of 10 years from the Hudson City Savings Bank. On November 29, 1968, a second mortgage in the amount of \$50,000 at 18% interest for a term of 5 years was granted with four individual investors as the mortgagees. On November 13, 1973, Heritage Hall Nursing Home, Inc. obtained a mortgage in the amount of \$760,000 for a term of 10 years at 9% interest from the Knick Service Corporation. The initial mortgage of \$525,000 was canceled and, previously, on October 11, 1973 the aforementioned \$50,000 mortgage had been canceled.

On June 26, 1974, Heritage Hall Nursing Home, Inc. sold the nursing home for \$1,175,000 to Mr. Herman Greenbaum. It should be noted that only 12 acres of a total of 54.7 acres in the plot were transferred pursuant to this sale. The terms of that sale, according to the attorney who handled the transaction, were as follows: Greenbaum assumed the outstanding amount of \$760,000 existing mortgage which, at the time of the sale was \$755,000, executed a mortgage back to Heritage Hall Nursing Home, Inc. in the amount of \$125,000, and provided a cash investment of approximately \$290,000. The \$125,000 mortgage was given at an interest rate of 8½% per annum for ten years (monthly payments of \$1550).

Prior to this sale, however, on March 30, 1974, Mr. Greenbaum leased the home, effective July 1, 1974, to a corporation known as H.G.H. Nursing Home, Inc., the present operator of the facility. The terms of the lease were as follows: 1) the annual rent for the first year was \$140,000, to be paid in equal monthly installments of \$11,666.66, commencing June 1, 1974; 2) for the second year and for 25 years thereafter the rental would be \$150,000 per year payable in monthly installments of \$12,500, commencing June 1, 1975; 3) the aforementioned amounts can be escalated based upon increases in the Consumer Price Index. The lease is a "net-net" one with the lessee undertaking all obligations for the property, other than the payment of the aforesaid mortgages.

This lease transaction and purchase by the aforementioned Mr. Greenbaum, according to a Department of Health Certificate of Need Financial Feasibility Analysis Group study, increase the per patient per day cost to the Medicaid system by \$2.04.

Records existing in the tax assessor's office for New Shrewsbury disclose a \$751,000 assessment on the building and \$35,800 on the land. Replacement value according to the tax records lists an amount of \$810,843.

Comments and Observations

1. During the first ten years of the lease, Mr. Greenbaum's rate of return will be minimal. From the second year of the lease forward, he will be receiving income of \$150,000 per year in rental and paying out \$115,524 on the first mortgage and \$18,600 on the second mortgage. After the initial ten year period, however, both mortgages will be satisfied and the lease will run for an additional 15 years at at least \$150,000 per year. Thus, it is more realistic to speak of income versus expenses over the terms of the lease and mortgages. Mr. Greenbaum's total income under the lease will be \$3,740,000 ($25 \times \$150,000 - \$10,000$), his total payout on the first mortgage will be \$1,155,240 and his total payout on the second mortgage will be \$186,000 for total expenses of \$1,341,240. When expenses are subtracted from income, Mr. Greenbaum's net yield is \$2,398,760 on an investment of \$290,000. Although much of the yield is deferred, the net average rate of return

over the 25-year period as 33%. Furthermore, this yield is actually higher when one considers that principal portion of the mortgage payments, in effect, is returned to Mr. Greenbaum when the mortgages are satisfied at the end of the ten year terms and he owns the nursing home unencumbered.

2. Prior to the July 1, 1974 lease, the rental on the nursing home was \$80,000 per year, but as a result of the July 1, 1974 lease, that rental increased to a total of \$163,000 per year with no relation to increased patient care. The Department of Health analyzed this increased rental and calculated the result as an increase in the per patient per day costs to the State of \$2.04. That report, however, addresses itself only to the issue of financial feasibility and not to the issue of whether so substantial an increase in the Medicaid rate should be justified albeit allowed in the first place. The increase in the rate takes place, furthermore, even though the rental is in excess of DMAHS maximum rental schedule.

Bay View Nursing and Convalescent Center

Bay View Nursing and Convalescent Center is located in Bayville, New Jersey, and contains 323 beds. This facility is presently operated by Bay View Convalescent Center Inc. under a sublease from Bay View Nursing & Convalescent Center Inc. According to information obtained by the Commission, the nursing home was originally constructed in 1927 and was renovated in 1970 and transformed into a nursing home.

On April 3, 1970, Seabrook Center Inc., a corporation composed of Mr. Charles Bick, of New York, New York, and Dr. Mattis Yellin, of Lakewood, New Jersey, purchased the nursing home from the original owners, Mrs. and Mrs. Abraham Kraig, who owned it via various corporations. The purchase price was \$1 million, which included approximately \$430,000 in cash, the assumption of a \$100,000 first mortgage, and the supplying of an additional amount of approximately \$430,000 in secondary and tertiary mortgages.

Thereafter, on October 15, 1973, Seabrook Center Associates (now listed as a partnership with its principal place of business as Bayville, New Jersey) entered into an agreement of lease with the Bay View Nursing and Convalescent Center, Inc. for a term of 25 years at an annual rental of \$175,000 per year. The lease is of the "net-net" variety whereby the lessee is responsible for the payment of all operating costs of the facility. On January 24, 1974, the same Bay View Nursing and Convalescent Center, Inc., entered into an agreement with one Samuel Paneth,

whereby Mr. Paneth purchased the right to sublease from the Bay View Nursing and Convalescent Center, Inc. for an amount of \$314,000. \$250,000, according to the agreement was to be paid in cash, and an additional \$64,000 was supplied via four personal notes of Mr. Paneth at an annual interest rate of 7%. That agreement came to fruition on July 1, 1974, whereby the Bay View Nursing and Convalescent Center, Inc. subleased the premises to the Bay View Convalescent Center, Inc. There is no mention of Mr. Paneth in that sublease, but it is assumed that the July 1 lease is a product of his negotiations with various other parties. The lease between Bay View Nursing and Convalescent Center, Inc. and Bay View Convalescent Center Inc. calls for an annual rental of \$220,000 per year for a five-year term renewable for three successive five-year terms over the further period to end September 30, 1998.

The Bay View Convalescent Center, Inc., according to documents filed with the Department of Health, is made up of the following individuals - Anna Heller, 1459 56th Street, Brooklyn, New York (51.6%), Eva Blau, 1621 53rd Street, Brooklyn, New York (13.4%), and the following individuals with 10% or less, all residing in Brooklyn, New York, Elizabeth Friedman, Fred Herzka, Oscar Heller, Margaret Friedman and Herman Klein. The Bay View Convalescent Center, Inc. is the entity which presently operates the facility. According to records of DMAHS, the lease is considered an arms-length transaction.

Comments and Observations

1. There is a discrepancy between the date of construction supplied to the Commission by Mr. Oscar Heller, the present administrator (1927), and the date of construction filed on the cost report of the institution (1940). Due to the listed construction date of 1940, the institution is allowed as a ceiling on the rental \$317 per bed or \$102,391 per year. If the actual construction date of the institution is 1927, the facility would be allowed the minimum figure of \$230 per bed or \$74,290 per year. This discrepancy amounts to an overreporting of expenses of approximately \$28,000 per year.

2. Perhaps the most interesting observation with respect to the Bay View Nursing and Convalescent Center, Inc., however, is the disparity between the amount being reimbursed by the Medicaid program for rental of buildings and the amount actually being charged. As has been stated, even with the aforementioned discrepancy, the nursing home has been receiving reimbursement for only \$102,391 per year. The actual rental being paid by the operating corporation pursuant to the lease of July 1, 1974, is \$220,000 per year. Thus, the nursing home is spending in excess of \$117,000 per year on the rental of the building, which figure is not being reimbursed by the Medicaid program. Since the nursing home averages an approximate Medicaid population of 94%, it would be unwarranted to conclude that this excess rental figure is being provided by the private patients housed in the

institution. Two alternative conclusions, therefore, arise: either the patients at the Bay View Nursing and Convalescent Center are receiving substandard care because a large portion of the reimbursement of the nursing home is being diverted into the rental of the building, which factor does not relate to patient care, or there is enough surplusage in a large nursing home populated mainly by Medicaid patients to pay a rental which is in excess of double the amount being reimbursed for that purpose.

3. Finally, the Commission is of the opinion that it is valid to comment upon the return of Bayview Nursing and Convalescent Center Inc. as a participant in another lease-sublease arrangement. Bay View Convalescent Center Inc. purchased the right to sublease from Bay View Nursing and Convalescent Center, Inc. for a purchase price of \$314,000. Bayview Nursing and Convalescent Center, Inc. will receive the difference between \$175,000 and \$220,000 over a period of 25 years, assuming renewal of the sublease. In total, it will receive a sum of \$1,125,000, on an investment of \$314,000, or a net return of \$811,000. There is no evidence that this return in any way effects patient care.

Beachview Nursing Home

The Beachview Nursing Home is located at 401 Boardwalk, Atlantic City, New Jersey, and contains 100 beds. The facility is operated by the Beachview Nursing Home, Inc., under a lease from a firm known as Romar Realty.

The land upon which the nursing home is situated was sold in 1963 by an entity known as the Metrode Company, Inc. to the Metro Operating Company for an amount of \$55,000. On November 15, 1963, a building contract between the Metro Operating Company and Joseph Montoro was executed. The final cost of construction of the nursing home was \$491,052. On March 28, 1966 the Metro Operating Company leased the nursing home to a corporation known as B. J. Nursing Homes, Inc., for an amount of \$120,000 per year. This lease was essentially of the "net-net" variety, except that the owners of the institution, Metro Operating Company, were required to pay the first \$19,000 in taxes. The net amount of the lease is therefore \$101,000 per year for a term of 21 years.

On July 28, 1967 the Metro Operating Company obtained its permanent financing in the form of a mortgage in the amount of \$650,000 at an interest rate of 7½% per annum for a term of 18 years from the First Federal Savings and Loan Association of Philadelphia, Pennsylvania. On May 14, 1968, the Metro Operating Company sold the premises to a corporation known as Brimsco Inc., for a sum of \$942,500. On the following day, May 15, 1968, Brimsco conveyed the property to an entity

known as Romar Realty Co. of New York, New York. Again, the purchase price was \$942,500. The terms of this sale are a \$5,000 initial downpayment plus the assumption of the first mortgage which possessed an outstanding amount of \$638,000 at the time in addition to the assumption of various credit notes totaling \$63,000 and various other credits. The sale was also made subject to the existing lease with B. J. Nursing Homes, Inc.

Thereafter, On June 10, 1973, B. J. Nursing Homes, Inc. assigned their position in the lease from the new owner, Romar Realty, to a corporation known as Beachview Nursing Home, Inc. The term of that assignment was a purchase price of \$275,000, amortized at a rate of \$1,667 per month for the remaining life of the lease which was at that time 13-2/3 years. The amortization of this lease purchase cost was, according to information received from the facility accountant, included in the cost report for Medicaid purposes, and amounts to \$20,000 per year.

Comments and Observations

1. If the \$20,000 per year amortization of the lease purchase cost, which was executed in 1973, becomes a reimbursable expense, there has been created, in the Commission's opinion, another method to circumvent the regulations of the maximum rental schedule. The nursing home under examination

presently receives the maximum rental allowable of \$105,000 per year. If B.J. Nursing Homes, Inc., had subleased the premises, at an increased rental, the reimbursable rental expense would not change due to that maximum. Due to the fact of the assignment, however, and possible reimbursement of the leasehold purchase expense, there is an additional amount which will be reimbursed regardless of the strictures of either the maximum rental schedule or any other regulation of DMAHS. According to information received by the Commission, the Audit Section of DMAHS is presently considering whether or not to reimburse this expense.

Lincoln Park Intermediate Care Center

Lincoln Park Intermediate Care Center is located at 499 Pine Brook Road, Lincoln Park, New Jersey. The institution contains 526 beds and 294 are certified for Medicaid purposes. The home became certified for Medicaid in January of 1973.

Lincoln Park Intermediate Care Center is the registered trade name for a joint venture between two corporations which, cumulatively own and operate the nursing home. The trade name was filed on December 20, 1974, and the participating corporations are Lincoln Park Nursing and Convalescent Home, Inc., and Mimi Holding Co., Inc.

Lincoln Park Nursing and Convalescent Home, Inc., is the operating corporation and was incorporated on July 2, 1965. 100% of the corporation is owned by Mr. Jerry Turco. Mimi Holding Co., Inc. was incorporated on March 31, 1966, owns the land upon which the nursing home is situated, and in turn, owned by Mr. Jerry Turco (60%) and Mrs. Dolores Turco, his wife, (40%).

On April 15, 1966, Mimi Holding Co., Inc. purchased a 22.94 acre tract and the sale price was \$28,340 (from sources other than the deed). On January 2, 1972, Mimi Holding Co., Inc. entered into a contract with J. Turco Paving Contractor, Inc., another corporation owned by Mr. Turco, for the construction of a nursing home. The consideration for the performance of that contract was \$3,500,000. A building permit was issued

on May 18, 1972. On July 6, 1972, a construction mortgage was granted to Mimi Holding Co., Inc., by Sackman Gilliland Corporation as the mortgagee in the amount of \$4,000,000. On November 27, 1973, the construction mortgage was transformed into permanent financing via an assignment of the original mortgage to the Rochester Savings Bank of Rochester, New York. The face amount of the mortgage is \$4,000,000, the interest rate is 9½% and the term is 25 years.

On April 12, 1974, the building contract amount was amended from \$3,500,000 to \$3,750,000. Additionally, on June 19, 1974, another mortgage was obtained by the Mimi Holding Co., from a corporation known as Financial Resources Group as the mortgagee. The face amount of that instrument was \$300,000 and the rate of interest is "5% above prime but in no case less than 15%." The term was one year.

A more noteworthy factor, however, for the purposes of this report is a more recent situation concerning the financial dealings surrounding a proposed sale and lease of the subject nursing home. The New Jersey State Department of Health has recently granted a certificate of need for a change of operator and there are plans to expand the nursing home for Medicaid purposes, via certifying an additional 226 beds for Medicaid. The Commission has explored the surrounding circumstances via the testimony of the proposed purchaser, David Schwartz, exhibits which refer to the sale, and interviews with several of the involved parties. In March of 1974 the facility was appraised by the office of Carl Krell, M.A.I., real estate appraisers of

East Orange, New Jersey. The amount of the appraisal at that time was \$6 million. On May 28, 1974, there was completed an "updated appraisal" of the same facility and the amount of that appraisal was \$9 million, computed according to a capitalization of income method. The May 28th appraisal also contains an evaluation of the property pursuant to cost analysis and the total figure under that method is \$6,835,600.

Shortly thereafter, Mr. Turco, the owner of the facility, entered into negotiation with one David Schwartz, of 1262 45th Street, Brooklyn, New York, with respect to the sale of the facility. Mr. Schwartz testified before the Commission that the bulk of the negotiations centered around the appropriate sale price of the facility and that the final agreement was that Schwartz would buy the facility for an amount of \$8 million. The agreement was formalized on November 21, 1974. The terms of that agreement are as follows:

1. The purchase price is the sum of \$4 million in excess of the balance due on an existing first mortgage.
2. The terms of payment are as follows:
 - a. The sum of \$300,000 simultaneously with the execution of the contracted sale.
 - b. The sum of \$1,200,000 at the time of closing.
 - c. A second mortgage in the amount of \$2,500,000. with Mr. Schwartz as mortgagee and Mimi Holding as mortgagor.

The contract of sale contains many additional terms and conditions, but the most important variable was that the actual closing of title would not take place unless the Department of Health of the State of New Jersey issued a certificate of need previously mentioned, which would have the effect of certifying all the beds in the facility for Medicaid purposes. At the time of the contract, of course, only approximately half of the beds were certified for Medicaid purposes.

Thereafter, on January 29, 1975, several events took place effecting the proposed sale. First, the original agreement between Mimi Holding Co., Inc., and David Schwartz as purchaser was modified to take into account the second mortgage on the property held by Financial Resources Group. Schwartz agreed to assume the second mortgage and Mimi Holding Co., Inc. (Turco) agreed to reduce the downpayment of \$1.5 million to \$1.2 million, due to the assumption of the \$300,000 mortgage. Secondly, Schwartz created a co-partnership with its principal office in Brooklyn, New York, called Lincoln Park Associates. His partner in this venture was an individual by the name of Allen Black and Mr. Schwartz testified that the consideration from Mr. Black was approximately \$50,000. Schwartz then assigned all of his interests in the contract of sale to the partnership.

Finally, also on January 29, 1975, Schwartz (Lincoln Park Associates) entered into a memorandum of understanding with an entity known as Lincoln Park Intermediate Care Center, Inc., a corporation of the State of New Jersey made up of Mr. Abraham

Greenbaum and Mr. David Mandell. By the terms of that agreement, Lincoln Park Intermediate Care Center, Inc., agrees to provide Lincoln Park Associates with \$500,000 toward the purchase price of the facility as reflected in Schwartz's initial agreement of November, 1974, as modified on January 25, 1975. Additionally, the agreement between Lincoln Park Associates and Lincoln Park Intermediate Care Center, Inc., proposes that a lease be entered into at the time of closing between Lincoln Park Associates and Lincoln Park Intermediate Care Center, Inc. That lease will run from Lincoln Park Associates as landlord to Lincoln Park Intermediate Care Center, Inc., as the tenant. The memorandum of understanding further provides that the terms of the lease with respect to payment will be as follows: The annual rent will be \$585,000 per year for 294 intermediate care beds and for 20 shelter care beds. In the event that the other beds are transformed into Medicaid certified beds via the approval of the certificate of need application, the rental will be \$1,910 per bed per year. The Commission was also provided with the actual lease which was a product of the aforementioned memorandum of understanding and was dated May 1975. In conformance with that memorandum of understanding, the lease calls for a rental of \$1,004,660 per year for a term of 21 years (total rental of \$21,097,860). It is also of note that one of the clauses in the memorandum of understanding provides that, although the maximum rental is \$1,004,600, the lessor must accept whatever the Medicaid program provides to the lessee as

reimbursement of rent down to \$861,000.

It is important to note that all of the aforementioned documents, including the sale of the Mimi Holding Co. to Lincoln Park Associates, the modification agreements, the memorandum of understanding, and the subsequent lease are dependent upon the granting of a certificate of need to transform the Lincoln Park Convalescent and Nursing Home from approximately a 50% Medicaid certified facility into a 100% Medicaid certified facility. The most recent available information with respect to the granting of that certificate of need is as follows: 1) Two certificates of need are actually necessary, one approving the transfer, the other certifying the additional beds for Medicaid purposes; 2) the certificate of need for the transfer has been approved but the second certificate of need application has not yet been filed.

Comments and Observations

It is the opinion of the Commission that the proposed sale and lease of the Lincoln Park Facility is illustrative of the many and varied problems of the present system of property cost reimbursement as it exists in the Medicaid system in New Jersey today. The schedule of maximum rental allowable is allegedly reflective of construction costs. The Lincoln Park facility was constructed for approximately \$3.75 million and the "imputed rent" figure which would be employed

on Lincoln Park's cost report, assuming 100% Medicaid certification, is \$811,618, yet the actual carrying charges for the facility (mortgage interest, insurance, depreciation and a return on equity) amounts to only \$504,637. This is true, even though there is no equity on the part of the owner in the present facility as listed on the cost report. According to Mr. Schwartz's testimony, the beds which are not presently certified for Medicaid purposes are lying vacant. If the certification is approved, however, the owner, due to the deficiency of the present system, will be allowed to report a figure over \$300,000 higher than his actual carrying charges. Moreover, the possibility of certifying the additional beds has surfaced an opportunity which is presently being taken advantage of by the proposed purchaser and lessee.

The final result is that a home that was built and finished in November of 1974 for \$4 million, is sold one year later for \$8 million. It is the belief of the Commission, as supported by the conditional nature of the documents involved, that such a transaction could not and would not take place if it were not for the existence of the presently property cost reimbursement system of Medicaid. The Commission is of the belief that the following observations are relevant:

1. Mr. Schwartz's return may be computed, of course, by comparing his initial investment with his income. After the aforementioned series of agreements and modifications, the bottom line investment for Mr. Schwartz as Lincoln Park

Associates is approximately \$700,000. His annual costs may be computed by adding the amortization of the original mortgage of \$4 million (\$419,604 per year), the amortization of the \$300,000 second mortgage for a term of three years (\$124,795 per year), and the amortization of the \$2.5 million third mortgage given back to Mimi Holding Company for a period of 15 years (\$250,000 per year) for a total of \$794,399 per year. Mr. Schwartz's income, of course, is the yearly amount to be paid under the lease which is \$1,004,660 for a term of 21 years. Expressing the return (income less expenditures) as a percentage of the original investment over a 21-year period illustrates that Mr. Schwartz is receiving a return of approximately 30% per year. Mimi Holding Co., Mr. Turco and his wife, will be receiving \$250,000 per year and a balloon payment of \$550,470 under the terms of the \$2.5 million mortgage. Since Mr. Turco obtained 100% financing for the facility, his initial investment is zero and his return is infinite.

2. The fact that the actual rental is actually dependent upon the reimbursement provided by the Medicaid program illustrates that astute investors do not actually negotiate at arms length but instead hinge their leases upon the maximum which the program will provide. It is alleged that those maximums are reflective of construction costs, but in the case of Lincoln Park, they will theoretically allow reimbursement of in excess of \$1,000,000 per year for a home which cost approximately \$4,000,000 to build.

3. The Commission was also interested in the affect upon the Medicaid rate. To understand the actual impact of this transaction on the Medicaid rate and the expense to the State of New Jersey, it would be relevant to reconstruct what the Medicaid rate would be but for this sale. Using the true year of construction of 1973, the per patient day cost of the lease is the maximum rent allowable of \$851,068 , plus the equipment rental of \$105,200, divided by the number of patient days. Assuming a 90% occupancy rate, the per patient day cost generated by the lease would be \$5.53. If Mr. Turco retained ownership and converted the 232 sheltered care beds, his property cost would be \$765,856 (the correct imputed rental amount) divided by the number of patient days. Again, assuming 90% occupancy, the per patient day real estate cost, exclusive of taxes, would be \$4.43. This difference of \$1.10 per patient day times a 90% occupancy rate of 172,800 patient days per year gives an additional cost to the state of \$190,080 per year. If Mr. Turco were to retain the nursing home and apply for certification himself, this expense could be completely avoided.

The most disconcerting factor, however, is that no portion of this increased cost is being applied to patient care. Mimi Holding Co., Inc., in the person of Mr. Turco and his wife, will have nothing to do with the operation of the nursing home, but will be collecting \$250,000 per year after having received \$1.2 million in cash on an initial investment which was 100%