Attachment B

## Preface: A Helpful Analogy

As the Health Department's Behavioral Health Bureau (BHB) continues adapting to the California Advancing and Innovating Medi-Cal (CalAIM) payment reform initiative, we have found a simple analogy useful in illustrating the magnitude of change underway.

Before payment reform, BHB operated like a highly successful baseball team—skilled, experienced, and fully aligned with the rules of that game. Then, the "league"—represented by the Centers for Medicare and Medicaid Services (CMS) and the California Department of Health Care Services (DHCS)—announced that on July 1, 2023, counties would now be playing cricket instead of baseball. Some fundamentals look similar, but the rules, field, and scoring system are entirely different.

Over the transition period, nearly 500 employees were required to shift from playing one sport to another with different expectations, coding structures, workflows, and compliance requirements. The work we do is not a game, but this analogy conveys the scale and complexity of the transition, as well as why revenue optimization under CalAIM is a gradual, continuous improvement process rather than an immediate outcome.

## The Behavioral Health Revenue Model

### Understanding the Revenue Model Under Cost Settlement

Prior to CalAIM, the County submitted monthly Medi-Cal claims to draw down federal funding for Specialty Mental Health Services (SMHS). At fiscal year-end, the State compared total allowable costs, to provide services, with total revenue received. If costs exceeded revenues, the State issued an additional payment; if revenues exceeded allowable costs, the County refunded the State the difference.

Under this model:

- Time spent on **direct service**, **documentation**, and **travel** was all reimbursable.
- Reimbursement was based on historical cost reports and applied uniformly across broad provider classifications.
- Annual and triennial audits could result in takebacks, contributing to the development of a strong compliance infrastructure within BHB.

This approach rewarded thorough documentation and cost justification, and it shaped the Bureau's systems, workflows, and staffing practices for decades.

Understanding the Revenue Model Under Fee-for-Service

Under CalAIM, County mental health plans must now use the American Medical Association's Current Procedural Terminology (CPT) coding structure. CPT rules allow reimbursement only for the **direct service** portion of an encounter; **documentation time and travel time are no longer reimbursable.**

Key changes include:

- Practitioner-specific hourly rates established by the State.
- Rates based on a statewide average of 37% direct service time per full-time equivalent (FTE), excluding travel and documentation.
- Counties must meet or exceed this direct service benchmark to maintain historical revenue levels.
- Revenue received in excess of cost may now be retained and reinvested in the behavioral health system, but unreimbursed costs cannot be settled or recouped at year-end.
- Recoupments will only be related to findings of fraud, waste, or abuse.

In the first year of implementation, the County of Monterey experienced an 8% reduction in SMHS revenue, reflecting the magnitude of system change.

Opportunities to Increase Revenues

Since implementation, the State has issued several clarifications regarding services that may be appropriately claimed under CalAIM. Early interpretations resulted in the exclusion of activities such as:

- clinically necessary time when the client is not present,
- work with significant support persons ("collateral services"), and
- clinical formulation or diagnostic conceptualization.

As DHCS provided additional guidance, BHB updated staff training, documentation standards, and billing workflows. These refinements have expanded the range of legitimate, billable activities without increasing staff workload.

This is reflected in revenue performance trends. SMHS Federal Financial Participation (FFP) and State General Fund (SGF) combined revenues for the past four fiscal years are shown in Table 1 below:

Table 1

| SMHS Revenues by Fiscal Year | | | | |
|---|---|---|---|---|
| FY | FFP | SGF | Total | % Increase/Decrease from Prior Year |
| 21-22 | $ 44,263,285.36 | $ 2,685,602.78 | $ 46,948,888.14 | |
| 22-23 | $ 51,864,001.37 | $ 3,498,439.18 | $ 55,362,440.55 | 18% |
| 23-24 | $ 46,627,722.25 | $ 4,111,243.62 | $ 50,738,965.87 | -8% |
| 24-25 | $ 51,574,556.53 | $ 5,501,718.79 | $ 57,076,275.32 | 12% |

The revenue increase in FY 24-25, demonstrates BHB's growing proficiency with CalAIM billing requirements and the impact of targeted training and process improvements.

As further evidence of BHB's continuous improvement processes having a beneficial impact on revenues, please note Graph 1 below which shows the Estimated 1st Quarter Service Value for the first three fiscal years of CalAIM payment reform. The service value – defined as the estimated billable total entered into BHB's electronic health record – for the first quarter increased from FY 24 to FY 25 by 11.5% and further increased in the current fiscal year by an additional 17%.

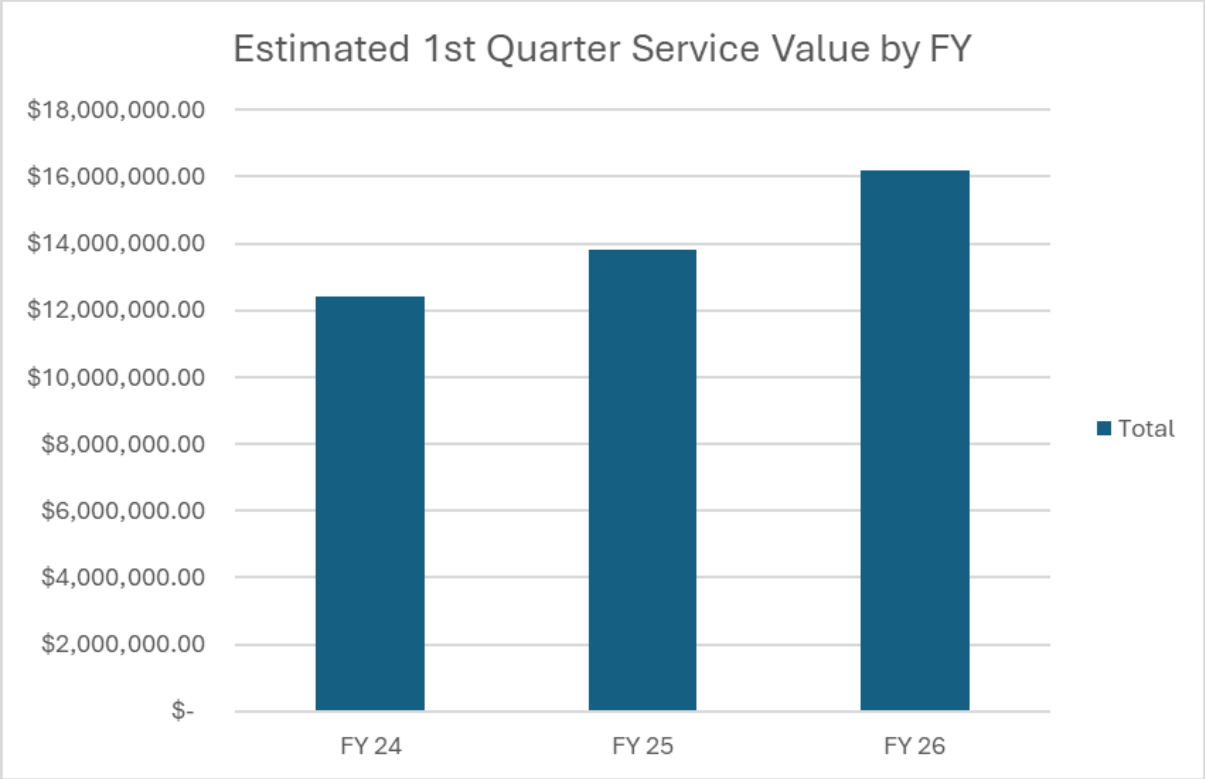
The Bureau's Service Code Work Group — a collaboration among clinical staff, supervisors, billing specialists, and CalAIM subject matter experts—has played a significant role in increasing billable service capture. The group has:

- identified common misconceptions about billable vs. non-billable activities,
- issued practical "tips and tricks" guidance to staff, and
- streamlined documentation expectations in alignment with statewide standards.

Notably, the transition to simpler progress notes, made possible by documentation reform, has reduced unreimbursed time, while new State guidance on claiming clinical formulation time has expanded billable opportunities for diagnostically focused work.

As a result, first-quarter service value, as previously defined, reflected an increase of 11.5% in FY 24–25 and an additional 17% in the current fiscal year, reflecting meaningful improvement in staff alignment with CalAIM requirements, as shown in Graph 1.

Graph 1:




Revenue Forecasting Model

The Bureau's revenue forecasting model estimates potential Medi-Cal revenue growth under CalAIM using conservative assumptions. Key inputs include:

- Filled FTEs in billable classifications,
- Practitioner-specific hourly rates,
- A systemwide average direct service as a percent of total FTE hours,
- BHB's current claim denial rate, and
- The proportion of direct services that are non-claimable (e.g., services to incarcerated clients or IMD residents).

Gross charges are calculated as:

| [System Direct Service %] X [Total Classification FTE Hours] X [Classification Hourly Rate] |
|---|

Charges are then reduced by:

1. BHB's current 9% claim denial rate;
2. The percentage of direct service time not eligible for Medi-Cal reimbursement; and
3. A conservative 50% Federal Medical Assistance Percentage (FMAP), despite the County's actual effective FMAP of 58.9% due to enhanced match for certain eligibility groups.

This conservative modeling supports the projection that increased alignment with CalAIM will continue to expand billable services and augment federal revenue available to support Mental Health Rehabilitation Center (MHRC) operations.

**MHRC Cost Discussion**

County of San Mateo's Review of Costs and Revenue Model

On November 19, 2025, BHB staff met with representatives of the County of San Mateo Behavioral Health and Recovery Services (BHRS) to review the County of Monterey's MHRC financial model. The County of San Mateo provided initial budget and operational cost information from its Cordilleras project, offering a useful benchmark for evaluating our assumptions.

The County of San Mateo BHRS confirmed that the County of Monterey's cost build-up and revenue methodology are reasonable. They noted their own MHRC operating costs ultimately exceeded early estimates, partly due to vendor contract negotiations in a higher-cost geographic market.

To ensure conservative modeling, Monterey County increased projected provider operating costs to align with the County of San Mateo's FY 2021 budget (inflated to FY 2026 dollars), despite likely lower costs due to the County of Monterey's cost-of-living differences. This conservative approach is reflected in the fiscal analyses that follow.

It is important to note the variables in our cost model. Depending on small changes to debt costs, Medi-Cal reimbursement rates, and others listed below, there can be large swings to the total annual cost of the project.

Key Variables Affecting Total Cost

Certain variables significantly affect overall project costs and should be considered when evaluating options:

- **Debt Costs:** Each basis-point change in interest rates alters annual debt service by $5,400–$8,600.
- **Construction Costs:** Scaling down the project may reduce soft costs depending on design and scope modifications.
- **Provider Operating Costs:** Every 1% change in projected provider operating costs results in a $35,500–$78,000 annual impact. If the County of Monterey's cost of living is ~25% lower than the County of San Mateo's, operating costs could be $887,000–$1.95M lower annually.
- **Medi-Cal Bed-Day Rate:** Rates are based on historical cost reports and may not reflect current costs. If Medi-Cal rates can be adjusted to better represent actual costs, this project will move closer to self-sustainability without need of additional revenue inputs from the wider behavioral health system.
- **Grant Funding:** Reducing project scope jeopardizes $51M in existing BHCIP grant awards. A single-facility build would potentially forfeit all grant funding and require full reliance on debt financing.

**MHRC Options – Summary of Fiscal Modeling**

The following sections present detailed cost and revenue estimates for four project scenarios. These figures incorporate conservative revenue assumptions, County of San Mateo-based operating cost benchmarks, and updated construction cost estimates. Each option summarizes:

- Annual debt service,
- Provider payments,
- Building depreciation,
- Medi-Cal and other revenues,
- Net County cost, and
- Fiscal comparison to current IMD expenditures.

**Option 1**
**"Single MHRC"**

Construct a single 16-bed MHRC, along with the support building and full site improvements for the parcel. The total construction cost is estimated at $74,322,171.12 and would be fully debt-funded due to the loss of BHCIP grants. Total project costs with interest would be $139,958,175.05.

Annual operating costs are estimated at $9.7 million, partially offset by $1.3 million in projected revenue and $1.7 million in savings from reduced IMD payments for clients transitioned to the MHRC. This results in a remaining annual funding gap of approximately $6.8 million that BHB would need to cover.

| **Mental Health Rehabilitation Center "Single MHRC" Cost Analysis Summary (Year 1)** | |
|---|---|
| **Costs** | |
| Annual Debt Service | $4,665,272.50 |
| Payments to Providers | $3,556,194.96 |
| Annual Building Depreciation (Cost Plan) | $1,486,443.42 |
| **Total Costs** | **$9,707,910.88** |
| | |
| **Revenue** | |
| Property Lease Revenue | $216,000.00 |
| Medi-Cal Revenue | $1,079,319.60 |
| Other County Revenue | $0.00 |
| **Total Revenue** | **$1,295,319.60** |
| | |
| New Model Annual Cost to County | $8,412,591.28 |
| | |
| Annual Average Savings from Payments to IMDs (no FFP) | $1,672,998.42 |
| | |
| Difference Between Current Model and New Model (To be funded by BH revenues) | ($6,739,592.86) |

**Assumptions**

- Debt Issuance of $74,322,171.12
- 4.69% Interest Rate on Debt
- $0 in Grant Funding
- 100% County Utilization
- Construction includes full parcel site improvements, support building, and 1 MHRC

- MHRC Operating Costs aligned with San Mateo's FY 21 budgeted operating cost in FY 26 dollars

**Option 2**
**"Phase I, Part 1 Only"**

Construct three 16-bed MHRCs, along with the support building and full site improvements for the parcel. The total construction cost is estimated at $114,851,102.93 and would be partially funded by $20.1 million grant. Total debt issuance would be $94,684,324.93 with total project costs including interest of $198,469,497.87.

Annual operating costs are estimated at $18.9 million, partially offset by $5.9 million in projected revenue and $3.7 million in savings from reduced IMD payments for clients transitioned to the MHRC. This results in a remaining annual funding gap of approximately $9.3 million that BHB would need to cover.

| **Mental Health Rehabilitation Center "Phase I, Part 1 Only" Cost Analysis Summary (Year 1)** | |
|---|---|
| **Costs** | |
| Annual Debt Service | $5,943,423.96 |
| Payments to Providers | $10,668,584.87 |
| Annual Building Depreciation (Cost Plan) | $2,297,022.06 |
| **Total Costs** | **$18,909,030.89** |
| | |
| **Revenue** | |
| Property Lease Revenue | $648,000.00 |
| Medi-Cal Revenue | $2,361,011.63 |
| Other County Revenue | $2,889,408.40 |
| **Total Revenue** | **$5,898,420.03** |
| | |
| New Model Annual Cost to County | $13,010,610.86 |
| | |
| Annual Average Savings from Payments to IMDs (no FFP) | $3,659,684.05 |
| | |
| Difference Between Current Model and New Model | ($9,350,926.81) |

**Assumptions**

- Debt Issuance of $94,684,323.93
- 4.69% Interest Rate on Debt
- $20,166,799 in Grant Funding
- 73% Monterey County Utilization

- Construction includes full parcel site improvements, support building, and 3 MHRCs
- MHRC Operating Costs aligned with San Mateo's FY 21 budgeted operating cost in FY 26 dollars

**Option 3**–
**"Phase I, Part 1 and Phase I, Part 2"**

Construct six 16-bed MHRCs, along with the support building and full site improvements for the parcel. The total construction cost is estimated at $172,454,829.00 and would be partially funded by $54.267 million grants and local match. Total debt issuance would be $118,188,050.00 with total project costs including interest of $276,830,026.84.

Annual operating costs are estimated at $32.2 million, partially offset by $17.2 million in projected revenue and $3.7 million in savings from reduced IMD payments for clients transitioned to the MHRC. This results in a remaining annual funding gap of approximately $11.3 million that BHB would need to cover.

| **Mental Health Rehabilitation Center "Phase I, Part 1 & Phase I, Part 2" Cost Analysis Summary (Year 1)** | |
|---|---|
| **Costs** | |
| Annual Debt Service | $7,418,774.93 |
| Payments to Providers | $21,337,169.73 |
| Annual Building Depreciation (Cost Plan) | $3,449,096.58 |
| **Total Costs** | **$32,205,041.24** |
| | |
| **Revenue** | |
| Property Lease Revenue | $1,296,000.00 |
| Medi-Cal Revenue | $2,361,011.63 |
| Other County Revenue | $13,557,993.27 |
| **Total Revenue** | **$17,215,004.90** |
| | |
| New Model Annual Cost to County | $14,990,036.35 |
| | |
| Annual Average Savings from Payments to IMDs (no FFP) | $3,659,684.05 |
| | |
| Difference Between Current Model and New Model | ($11,330,352.30) |

**Assumptions**

- Debt Issuance of $118,188,050.00
- 4.69% Interest Rate on Debt

- $51,166,779.00 in Grant Funding
- $3,100,000 in local match funding (MHSA)
- 36% Monterey County utilization
- Construction includes full parcel site improvements, support building, and 6 MHRCs
- MHRC Operating Costs aligned with San Mateo's FY 21 budgeted operating cost in FY 26 dollars

**Option 4**–
**"Cease Future Work of Project"**

Further work on the project will cease and sunk costs estimated at approximately $3,690,354 through November 2025 will need to be funded by the BHB.