NKF GLOBAL HEALTHCARE SERVICES

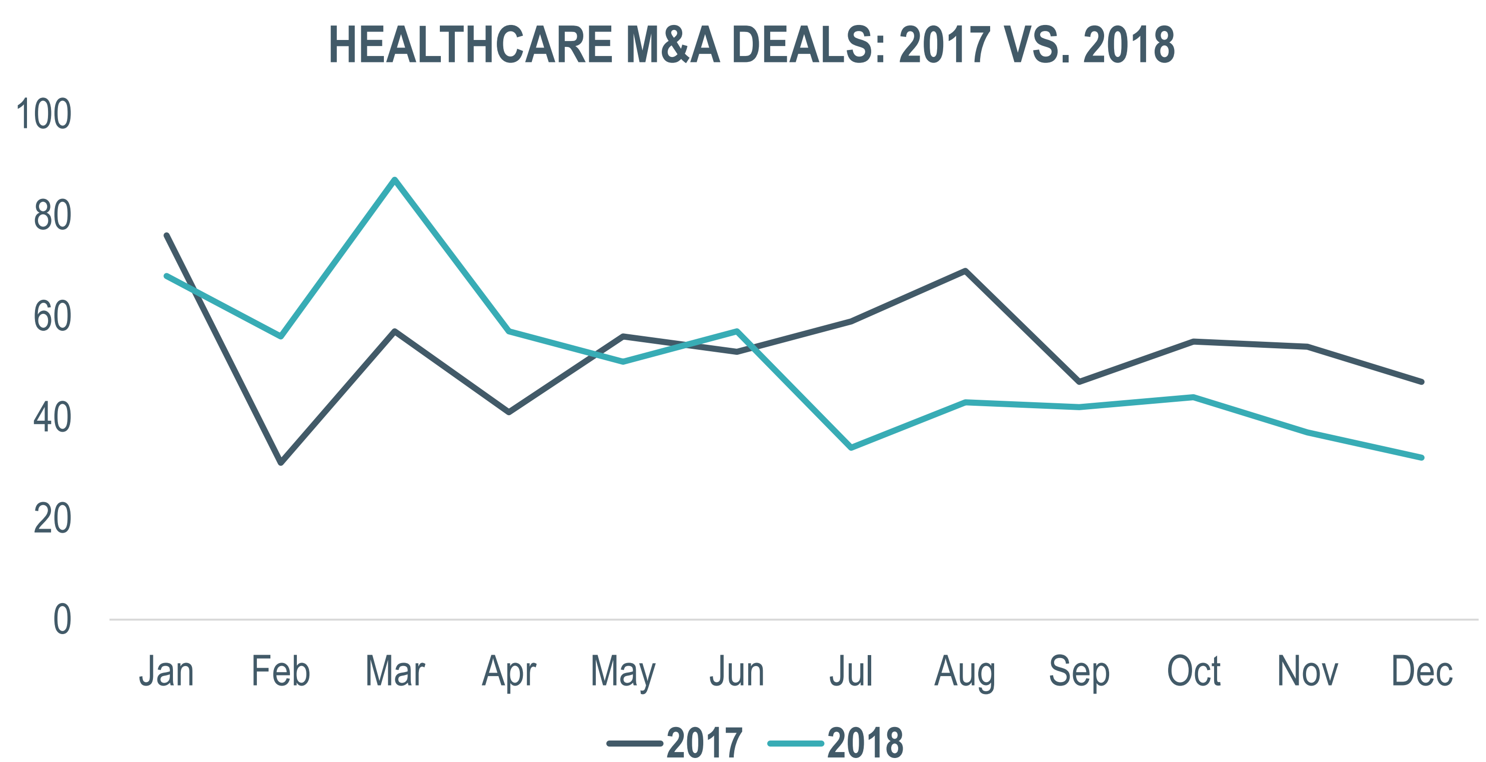
CLINICALS

HEALTHCARE M&A ACTIVITY AND THE IMPACT ON REAL ESTATE STRATEGY

Newmark Knight Frank

INTRODUCTION

In 2017, we saw the beginning stages of major consolidation and change on provider networks nationally. Health systems are merging together to enter new markets and/or increase market share in existing markets to grow scale and leverage operations for economic efficiency. Smaller health systems are joining larger health systems that have capital and resources to achieve economies of scale. Similar trends took place in 2018, as 30 health system and hospital deals were made in the first quarter of 2018, which is 11% higher than 2017 according to a report by Kaufman Hall & Associates. Overall total M&A activity for providers in 2018 had similar numbers as 2017 but trailed off a bit in the last quarter. The overall theme of these mergers are fueled by lower reimbursements, decreasing patient admissions and readmissions while providing a lower cost of care in the community. The impact of the mergers will see an effect in the real estate market in a variety of ways. More capital and scale could result in more development opportunities; on the other side, redundancy of space could see consolidation efforts to optimize the outpatient footprint in the market. Data around each health system's locations will be critical in understanding what real estate initiatives will be a catalyst for contributing to the success of the merger.

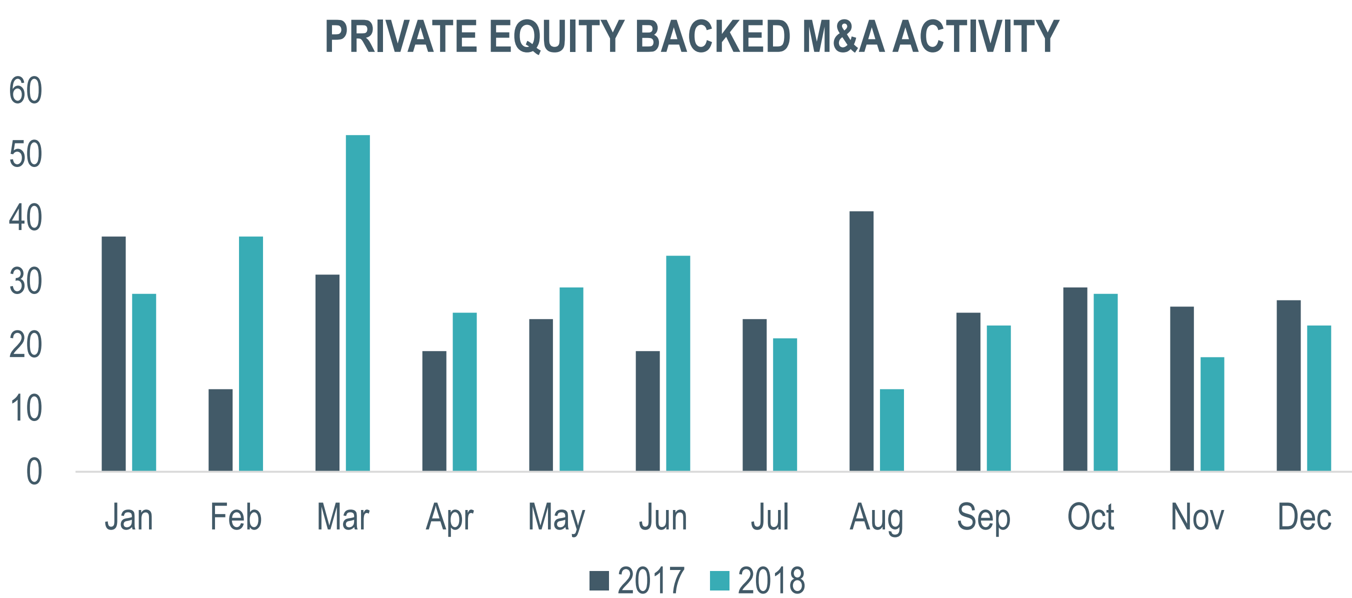


INTRODUCTION

Certain mega-deals like CVS-Aetna and Cigna-Express Scripts and increased private equity investments will continue to shape and transform how healthcare is delivered to the market. For example, the CVS-Aetna merger will provide a new model for the healthcare industry with CVS offering primary-care services and medical follow-ups directly from the drugstore. The merger is also a strategic move for CVS to stay competitive with Amazon, which is increasing its presence in the healthcare industry. Also, many health systems are partnering with CVS and Walgreens in their markets to provide primary care and urgent care clinics close to patient's homes. Other noted mergers for health systems in 2018 include Beth Israel Deaconness Medical Center & Lahey Health and the recently completed Dignity Health & CHI merger to form CommonSpirit Health.

INCREASE IN PRIVATE EQUITY ACTIVITY WITHIN PHYSICIAN GROUPS

Private equity backed transaction volume was up 5% in 2018 compared to 2017. Having access to capital for operational and technology needs allows practices to position themselves for future growth. Some physicians find it more appealing to sell their practice to a private equity firm versus selling to a hospital. A part of the appeal is that physicians don't lose complete ownership/control and there are attractive economic benefits. Attractive economic benefits include ownership of the management services organization as well as potential disposition of real estate assets to REITs or other institutional investors if owned by the practice group.



LOOKING TO 2019

Just as it did throughout 2017, healthcare M&A activity continued to increase in 2018. Large scale acquisitions impacting regional and national healthcare delivery were announced and some were finalized. Private equity investment has increased from 2017 to 2018 with a focus on physician owned practices. As for 2019, we should see more large mergers and acquisition of regional or national health systems to follow along with the previous years. All indicators are pointing to more private equity investments into physician practices as an attractive alternative to merging with a health system. The major impact to the healthcare market in 2019 will be technology advancements and venture capital injecting into businesses that will bring technology improvements and efficiency into providing care to patients. As Apple has launched its health records initiative, it will also be closely watched to see how their strategy will impact the delivery of care.

PHYSICIAN M&A SPOTLIGHT

DUPAGE MEDICAL GROUP

INDEPENDENT, MULTI-SPECIALTY PHYSICIAN GROUP
SUBURBAN MARKETS OF ILLINOIS

DuPage Medical Group is an example of a physician-owned group not consolidating or merging with a larger health system; instead, the group looked to private equity investment to expand its presence in the market. In 2017, Ares Management, a Los Angeles based asset management firm, invested $1.45 billion into DuPage Medical Group. The investment will allow DuPage to expand service offerings and reduce operating costs. In August 2018, DuPage expanded their footprint by opening seven new therapy clinics. The expansion appears to be a strategy to increase market share and referral business with their other specialty services in their existing markets. In June 2018, DuPage looked to monetize eight medical office buildings they owned. Harrison Street paid $240 million for the buildings throughout the Chicago suburbs. The investment in the medical office buildings is attractive given the large population base and increasing need for medical services. Expansion in new markets and monetization of assets are examples of real estate initiatives DuPage is making a priority for future success of the practice.

HEALTH SYSTEM M&A SPOTLIGHT

BETH ISRAEL DEACONESS MEDICAL CENTER & LAHEY HEALTH

MASSACHUSETTS

The merger was announced in 2017 and is currently close to being final. The new proposed health system would include 13 hospitals, over 800 primary care physicians and more than 3,500 specialists across the state. The system would represent a competitor to Partners HealthCare, the biggest health system in the state with 10 hospitals and $12 billion in annual revenue. The intention of the merger is to improve patient care in the community while also containing rising healthcare costs consumers are experiencing. Real estate activity could play a role in the effort to reduce cost by shifting care to lower cost settings, as well as evaluating overlapping or redundant point of care and making the health system footprint more optimal.

REAL ESTATE INITIATIVES IMPACTING M&A ACTIVITY

The real estate footprint can be a catalyst to successful mergers and acquisitions for physician practices and health systems. Creating a real estate strategy that aligns with the overall goals of the merger can sometimes determine whether a merger is successful or if it creates more redundancy. The following initiatives are examples providers need to evaluate pre- and post-merger:

- Overlapping or Redundant Services in a Market
- Consolidation of Administrative Footprint
- Monetization to Unlock Capital
- Consolidation or Downsizing of Inefficient Space
- Realignment of Services in a Market to Patient Demand

Effectively evaluating these real estate initiatives and their financial and operational benefits will allow providers to better align with their merger and acquisition goals and objectives.

ABOUT NEWMARK KNIGHT FRANK

Newmark Knight Frank is one of the world's leading commercial real estate advisory firms. Together with London-based partner Knight Frank and independently-owned offices, NKF's 16,000 professionals operate from more than 430 offices in established and emerging property markets on six continents. With roots dating back to 1929, NKF's strong foundation makes it one of the most trusted names in commercial real estate. NKF's full-service platform comprises BGC Partners, Inc., a real estate services segment, Cantor Fitzgerald, one of the oldest and most established franchises in the financial intermediary industry, CCRE, a commercial real estate finance company, and Berkeley Point Capital, one of the nation's leading multifamily capital solutions providers. For further information, please visit www.ngkf.com.

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Newmark Knight Frank's Global Healthcare Services team is one of the largest and most experienced healthcare real estate teams in the country, advising healthcare clients seeking to maximize value on assets and implement long-term business strategies. The Global Healthcare Services team provides clients with a single-source solution for every phase of acquiring, financing, developing, and disposing healthcare real estate. The team comprises real estate transaction and consulting professionals with more than 25 years of experience serving hospitals, health systems, and medical office building owners throughout the U.S. and across the globe. For further information, please visit www.ngkfglobalhealthcare.com.

Interested in GHS evaluating your real estate portfolio pre- or post-merger? Let's talk.

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