

Benesch Health Care Market Intelligence

Table of Contents

1. Key Findings
2. Subsector Activity
3. Regulatory/Legal
4. Reimbursement

1. Key Findings

- The post-acute care (PAC) sector has seen an increase in mergers and acquisitions activity in response to healthcare reforms as providers search for ways to reduce costs through economies of scale.
- The volume of [healthcare M&A deals increased](#) to 260 in 2013 from 199 in 2007. The PAC, surgical and emergency center segments are expected continue to drive M&A activity within the healthcare sector.
- The senior housing and assisted living subsectors are [highly active](#) as a result of the looming retirement of Baby Boomers. New construction, private equity and REIT activity have all been strong.
- After a record year in 2013, healthcare REITs have lagged in 2014 as new builds and investor demand has put the market near saturation.
- Hospice facilities are facing [increasing regulatory attention](#) after the industry has grown exponentially in recent years.

2. Subsector Activity

Senior/Assisted Living Facilities

- The **\$330-billion assisted living sector** [continues to grow](#) in the U.S., with 75% of new construction located in 10 metropolitan markets. Despite concerns about the high rate of new projects in recent years, new builds “have leveled off” to a more sustainable level. Another report suggested that, while senior living construction is showing signs of a relative cooling, [assisted living new builds remain strong](#).
- The most high-profile transaction in the sector has been **Brookdale Senior Living’s \$1.4-billion acquisition** of **Emeritus**, an all-stock deal in which Brookdale will also assume \$1.4 billion of Emeritus’ debt. It created the largest owner-operator of senior housing in the U.S., increasing Brookdale’s capacity by more than two-thirds to about 112,700 units in 1,161 communities.
- Senior housing and assisted living facilities are attracting significant interest from developers and investors alike. Significant deals in this space in recent months have included: **Sabra Health Care REIT’s \$59.1-million buy** in Texas and Florida; **Health Care REIT’s \$2.3-billion deal** with HealthLease Properties REIT and Mainstreet Property Group; and HealthLease Properties’ [\\$67.8-million](#) portfolio acquisition from Mainstreet Property Group.
- In addition, former **Brookdale Senior Living** co-president and COO John Rijos is planning to make up to [\\$250 million](#) worth of acquisitions during the next three to four years and Chicago-based **Birchwood Health Care Properties** is targeting [\\$50 million](#) in middle-market PAC acquisitions. Several other investors and providers have also signalled their intentions to expand PAC holdings.
- **Ascension Health** formed a [senior-care division](#) to integrate its existing senior-care services—including independent living, assisted-living and SNFs—under the name **Ascension Health Senior Care**. The reorganization is designed to strengthen the St. Louis-based company’s footprint in the PAC sector.
- The robust senior housing market is also [creating spinoff activity](#) in related sectors. For example, **AOD Software**, which offers tech services to senior care providers, recently acquired **Stratis**, a maker of home health and home care cloud-based software. By combining, these two technology providers will become one of the largest healthcare IT companies focused on seniors, serving more than 3,000 senior care and home care sites.
- However, the rapid rate of acquisitions has also [raised concerns](#), with **Fitch Ratings** suggesting REITs will have to change their strategies. Fitch warns that the flurry of activity creates the risk that REITs may end up paying premium prices for assets, pursuing higher-yielding and higher-risk assets, or employing more leverage to maintain growth.
- Similarly, after historically low interest rates helped healthcare REITs reach record levels in 2013, they were the worst-performing type of property trust for the 12-month period ending May 2014. The Bloomberg healthcare REIT index fell 18% during that time, compared to a 4.7% decline in overall REIT performance. Should interest rates increase, it would likely have a further negative impact on the sector.
- Healthcare REITs such as Sabra Healthcare, Senior Housing Properties and HCP have been among the lowest-performing specialty trusts during the past [six-month](#) and [one-year](#) periods.

Skilled Nursing Facilities

- **CMS** outlined a [2% increase](#) to Medicare reimbursement rates for skilled nursing facilities (SNFs) in 2015, increasing total payouts by \$750 million for the year.
- **CMS** also [revitalized the Special Focus Facility](#) program after they decreased the number of facilities in 2013 due to budget sequestration. The move allows states to select increased numbers of facilities for more scrutiny through at least every six month on-site inspections and increasing sanctions of violations are identified.
- An increase in [malpractice suits](#) filed against for-profit nursing homes has prompted some providers to shift away from tort-friendly states, including Pennsylvania, home to the fourth-largest concentration of residents aged 85 or older. For example, Extendicare announced in August it would lease 22 SNF in three states, including Pennsylvania, to a third-party operator.
- Significant activity in the SNF subsector includes: **Aviv REIT's \$84-million deal**; **Ensign Group's acquisition of two facilities** in Wisconsin; and **Aviv's \$71-million deal** for eight facilities in Texas and California.

Home Care/Hospices

- The home care and hospice space is also experiencing **significant M&A activity**, as best demonstrated by Kindred Healthcare's [\\$1.8-billion acquisition](#) of Gentiva Health Services.
- There has been an **increased emphasis** on the potential for home healthcare to act as a [lower-cost alternative](#) to assisted living or skilled nursing facilities.
- Home healthcare providers—such as [Genworth](#)—have also promoted the **lower cost of home care** in order to highlight the potential for savings as providers and government look to lower cost of care across the PAC spectrum.
- In response to a **nurse shortage**, CMS granted hospices permission to continue to rely on [contract nurses](#) to meet their staffing needs. CMS pointed to Bureau of Labor Statistics identifying a nurse shortage as an “extraordinary circumstance” and extended the period allowing hospices to use contracted staff for core services until at least Sept. 30, 2016.

3. Regulatory/Legal

- **The IMPACT Act**, [passed by Congress](#) in September, requires PAC providers to report quality and data metrics. The act creates a system for collecting “standardized post-acute care assessment data for quality, payment and discharge planning,” also directs MEDPAC to move towards the creation of a unified PAC payment system. Portions of the law are expected to come into effect in 2016.
- The law also includes [additional changes](#) to the government’s **five-star nursing home rating program**. Facilities will be required to report staffing levels quarterly using an electronic system that can be verified with payroll data. In addition, a nationwide auditing program will be created to ensure the accuracy of the quality measures rating, based on information collected about every resident.
- Finally, under the law, Medicare will be allowed to **review hospice programs** where a large proportion of clients receive care for six months or more, which is considered a long hospice stay. It also seeks to increase the [frequency of inspections](#) in order to ensure quality of care.
- In August, a **Government Accountability Office report** found the CMS lacks reliable data and sufficient oversight to avoid duplication of post-payment claims reviews. The study finds the lack of oversight may also create false findings of improper payments and cause unnecessary administrative burdens for Medicare providers and the Medicare program itself.
- The National Partnership to Improve Dementia Care, a [public-private coalition](#) that includes CMS, the American Health Care Association/National Center for Assisted Living and LeadingAge, is asking post-acute care providers to continue to **reduce the use of antipsychotic medications** among residents by 25% by the end of 2015 and 30% by the end of 2016. This continues the ongoing focus on reduction of antipsychotic medication in nursing facilities.
- The **DoJ Criminal Division’s Fraud Section** is now required to [more actively investigate](#) qui tam, or whistleblower, complaints filed under the False Claims Act. This increased focus could make it more difficult for defendants to reach settlements, as agreements will now need both Civil and Criminal Division approval.
- **CMS** advised in April it would increase its focus on nursing homes with [significant and persistent quality issues](#).

4. Reimbursement

- Congress has increased its focus on the PAC sector due to the [perception](#) of “comfortable” margins for providers.
- As the economy continues to rebound, **program restorations and provider rate increases** have followed. A higher number of states [raised Medicaid provider rates](#) for most major providers—including nursing homes and managed care facilities—in FY2014 and FY2015.
- There has been some momentum in Congress towards eliminating Medicare’s **sustainable growth-rate** (SGR) formula, in favor of an alternative payment model. This may slow in response to the passage of the IMPACT Act as well as the high cost of replacing the SGR.
- Suggested PAC reforms have included lowering the SNF payment update by 1.1% to save about \$12 billion, as well as adjusting some payments for SNFs and IRFs to save \$1 billion. Such considerations could again be considered in any future Medicare reforms.