

HEALTHCARE PROVIDER POST-COVID-19 STRATEGIES

INITIATIVES PROVIDERS CAN IMPLEMENT
TO MITIGATE FINANCIAL LOSSES

INTRODUCTION

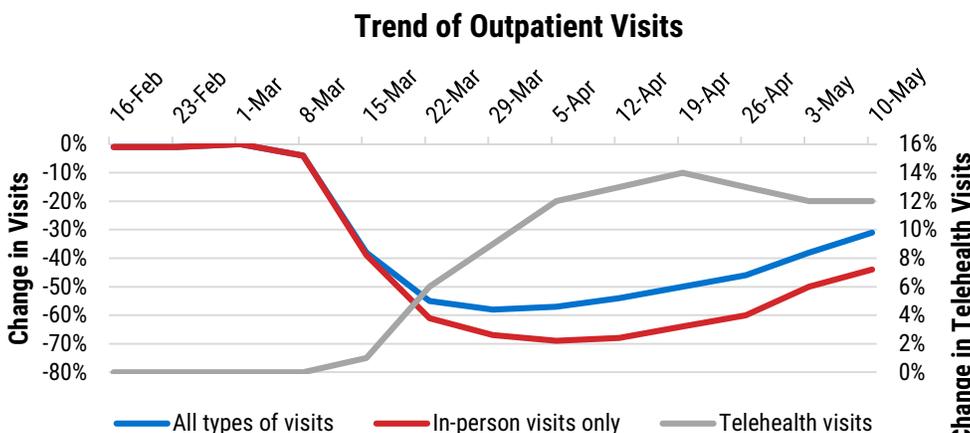
Over the past few months, health systems and independent practices alike have experienced financial losses due to the COVID-19 pandemic. As volumes increased for COVID-19 patients and elective surgeries were paused, revenues dropped dramatically, and expenses increased in some areas related to supporting COVID-19 healthcare.

The following report outlines specific data points that illustrate the impact of the COVID-19 pandemic on independent medical practices and health systems. It also highlights certain initiatives that providers can implement to mitigate the financial losses that are incurring as a result of the COVID-19 pandemic.

MEDICAL PRACTICES

The COVID-19 pandemic is drastically changing how outpatient care is delivered. Medical practices have seen a drastic decrease in volume of visits in the past two months due to patients deferring preventative visits and elective procedures, as well as the shift of in-person visits to telehealth. The Medical Group Management Association (MGMA) conducted a survey of physician practices in April. Of the findings from the survey, practices reported an average 60% decrease in patient volume and an average 55% decrease in revenue. As a result of the reduced revenue and volume, practices were furloughing and laying off staff. Now that several months have passed since the pandemic hit the U.S., more data has become available to measure the total impact to medical practices and the types of practices that are impacted the most. The Commonwealth Fund issued a study⁽¹⁾ in May conducted by researchers at Harvard University and Phreesia, a healthcare technology company, where visit volumes were analyzed for more than 50,000 providers that are Phreesia clients.

Outpatient visits were analyzed from February to May. All visits declined by almost 60% and in-person visits declined by nearly 70% by early April. As of mid-May, total visits were still one-third less than pre-COVID-19 levels. Telehealth visits increased by 14% in mid-April and has since plateaued.



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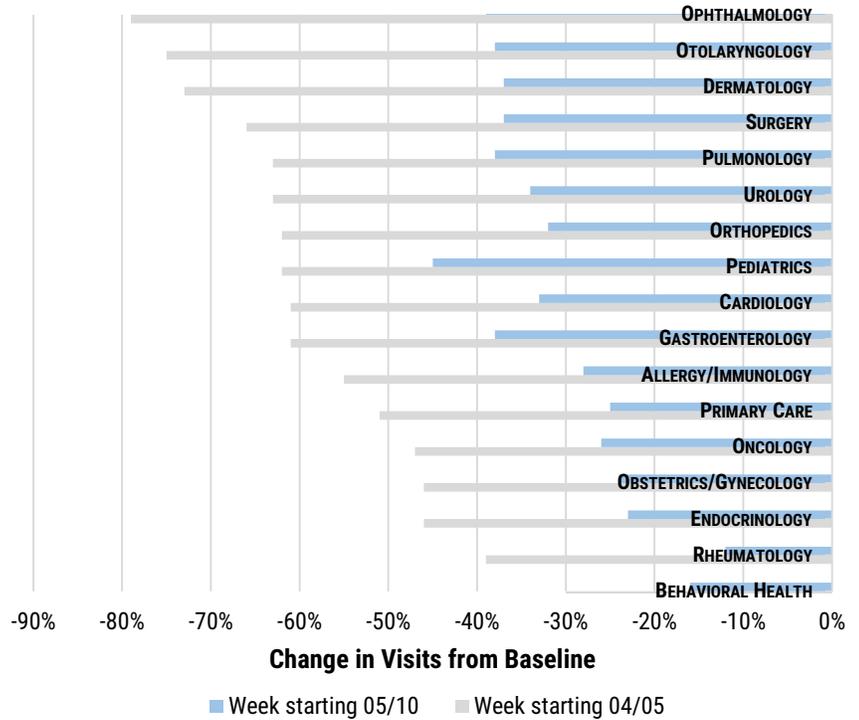
(1) Commonwealth Fund, The Impact of the COVID-19 Pandemic on Outpatient Visits: A Rebound Emerges.

MEDICAL PRACTICES, CON'T.

Provider types hit hardest during the pandemic include Ophthalmology, Otolaryngology, Dermatology and Surgery, which all experienced a decline of in-person visits by more than 65% in April. By mid-May, all provider types saw a decrease of in-person visits to about one-third of pre-COVID-19 levels, except for Pediatrics which saw a 17% decrease. The significant and comprehensive decrease indicates a continued reluctance for in-person visits.

As of mid-May, all provider types have seen a decrease in the number of in-person visits.

Change in Visits for Provider Type

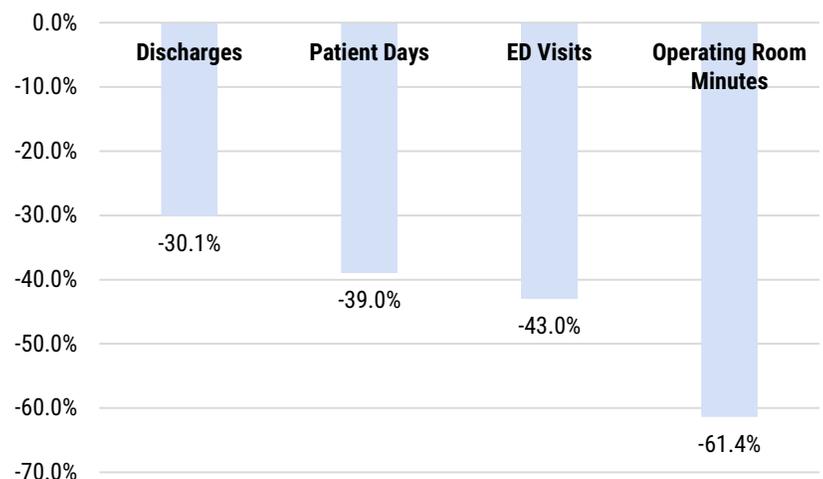


(1) Commonwealth Fund, The Impact of the COVID-19 Pandemic on Outpatient Visits: A Rebound Emerges.

HEALTH SYSTEMS

As for the health systems and hospitals, the financial strain will be significant. The American Hospital Association (AHA) issued a report on May 5th estimating \$202.6 billion in losses resulting from COVID-19 expenses and lost revenue between the months of March through June. The estimates include loss of revenue from foregone or cancelled services and the additional costs for equipment and labor support.

National Hospital Volume Year Over Year April Changes



(2) Kaufman Hall May 2020 National Hospital Flash Report, National Volume Figures

The month of April was the first full month hospitals experienced financial and operational impacts from the COVID-19 pandemic. According to Kaufman Hall's May National Hospital Flash Report⁽²⁾, hospital operating EBITDA margins fell 174% compared to last year and 118% compared to last March. Also, year-over-year volumes were down significantly for discharges, Emergency Department visits and Operating Room Minutes.

INITIATIVES PROVIDERS ARE APPLYING TO OFFSET FINANCIAL LOSSES

As a result of the financial implications of COVID-19, health systems and independent providers are having to create strategies that will allow them to be more efficient and adapt to new methods of care. These changes will have a lasting impact on how healthcare is delivered in the future.

01

INCREASED USE OF TELEHEALTH

One of the clear changes of care has been the accelerated adoption of telehealth among healthcare consumers. According to a McKinsey & Company report in May⁽³⁾, in 2019, 11% of U.S. consumers were using telehealth. Today, 46% of consumers are using telehealth to replace their cancelled visits. The report estimates that the telehealth revenue market could potentially grow to be \$250 billion, compared to its current market of \$3 billion. Providers that take steps to enhance their telehealth capability and security to imbed it into the continuum of care will be well-positioned for the future.

02

WORKING FROM HOME

Another result of the pandemic has been the shift to administrative and non-essential staff working from home. Many providers are finding that some job functions can continue to operate remotely and that a portion of that staff will not need to return to a facility full-time.

03

INCREASE IN M&A ACTIVITY

Some of the hardest hit healthcare providers are the independent practice groups. If a provider has a strategic goal to grow market share, add new service capabilities or grow in a new market, acquisition of independent practices would help achieve those goals if financially and operationally beneficial. Independent practice groups could also benefit from the financial support of a health system as they recover post-COVID-19.

04

AMBULATORY CARE STRATEGIES

The post-COVID-19 world will come with new ambulatory care strategies. Providers could see a pent-up demand for elective procedures that have been put on hold and those procedure schedules will need to be managed effectively at outpatient sites. Some ambulatory centers could have new vacancy given telehealth initiatives and those sites could be used to alleviate the increased demand for elective surgeries. In addition to the managing the type of services at ambulatory locations, assessment of space and how it is configured for safety, access and the type of patients visiting will be beneficial to mitigating risks.

05

RAISING CAPITAL BY BOND ISSUANCES

Health Systems issue municipal bonds to access capital for operational benefits and to fund capital projects. For not-for-profit health systems, those bonds are tax-exempt. These bond markets can be used to increase their capital availability for projects. Geisinger Health, Ascension Health, OhioHealth and University of Missouri Healthcare have issued sizable bonds recently. For-profit systems are also looking to raise capital through debt offerings. In April, Tenet Healthcare completed a \$700M debt offering. Depending on their credit ratings and how well they are positioned, there could be a risk for defaults and if so, M&A activity could increase.

06

OPTIMIZING REAL ESTATE PORTFOLIO

As health systems implement these new strategies, their facilities and real estate obligations will be directly impacted. To note, during the months of March and April where elective procedures were halted and some facilities were not being utilized, the majority of health systems continued to pay their rent on their lease obligations. There are several real estate strategies that health systems can take that will help reduce the financial impact and also position the health system portfolio of locations to accommodate these new strategies. The next section outlines the real estate strategies in detail and benefits to the provider.

IDENTIFYING REAL ESTATE STRATEGIES

Now is an important time for health systems and practice groups to look to their real estate portfolio to create value by reducing operating costs and unlocking capital. There will be various advances in how we deliver care that will result from the COVID-19 pandemic, and these advances will have a direct impact on real estate. Telemedicine, streamlined operations, work-from home initiatives and repurposed assets for safety and access measures will all play a role in how healthcare providers occupy real estate. Several strategies that can be evaluated and implemented to reduce operating costs and increase capital availability are below. These strategies can help position the provider for future success and lessen the impact of financial losses due to the pandemic.

Portfolio Management

It is key to organize critical data points associated with real estate obligations. Understanding important lease dates, rent and operating expenses of leased and owned assets and the services being provided at each location will help deliver the baseline portfolio data and highlight where the healthcare provider can look for opportunities.

Upcoming Lease Expirations

Of the leases with upcoming expirations, the utilization of space and services provided should be evaluated to understand if the right services are being provided based on the demographics of the market and whether the space is utilized in an efficient manner. Additionally, providers should evaluate whether those assets should be repurposed depending on new safety and access measures being implemented post-COVID-19. There could be opportunities to reduce or reconfigure space to optimal requirements, potentially reducing both cost and risk.

Consolidation Opportunities

As a subset of looking at upcoming lease expirations, it is critical to evaluate other leased and owned assets in the market. This evaluation will determine if there are redundant services, if potential vacant space could be used for relocation efforts, or if services are positioned in the market appropriately to serve the community needs. As a result, there could be opportunities to consolidate clinical space or non-clinical space into a more aligned real estate footprint for the market.

Lease vs. Own Strategies

Typically, healthcare providers are looking to own their real estate more than lease, as it gives them more control. However, not all locations should be owned. Striking the right balance of leased and owned assets is valuable to maintain flexibility, as well as to reduce operating costs and unlock capital. Each location in the portfolio should be evaluated to determine whether leasing or owning the space is advantageous for the healthcare provider. Assessing qualitative and quantitative measures to identify which locations would be candidates for leasing or owning is beneficial to maintain the right mix of ownership. Initial criteria to evaluate include the amount of occupancy the provider has in the building versus third-party space, what acuity level of services are being provided at the location, and what the long-term strategy for services is at the location. These factors will help guide the decision on whether to consider owning or leasing the space.

IDENTIFYING REAL ESTATE STRATEGIES, CON'T.

Creative Financial Structures

In conjunction with the lease vs. own strategy, entering into the right financial structure long-term, whether it be for current locations or new projects, will be important to reducing balance sheet liability and P&L impact. There are several advantageous financing structures that should be considered for ongoing or new needs in the pipeline. These structures include the following:

CREDIT LINES

Many providers are utilizing existing or new lines of credit to help with immediate liquidity needs. While these are likely the easiest and fastest structures to access liquidity, the amount of accessible capital has limitations. Further, financial covenants that govern the accessibility and repayment terms may not factor into the unique challenges of the current environment. Additionally, rates are often higher to reflect the product's flexibility and thus may not translate to the cheapest form of the borrower's capital.

ALTERNATIVE CAPITAL SOURCES

Equipment Leases and Synthetic or Hybrid Leases are potentially attractive lease financing structures for providers needing to finance real property and/or equipment in a short time period. These structures vary in tenor (term) and offer attractive short- and long-term financing solutions. These are typically credit-based products that can offer competitive financing rates in line with the provider's taxable or tax-exempt bond rates. Additionally, longer-term (15+ year) interest-only structures can be accessible for stronger investment-grade credits.

OWNED REAL ESTATE

Hospitals or health systems seeking to raise cash to position for the next year and beyond may see opportunities in monetizing real estate to generate liquidity. These transactions are still in strong demand in the healthcare real estate capital markets, with discretionary institutional and private capital offering competitive pricing and terms. The strategic rationale for this structure varies depending on hospital leasing commitment, underlying property value and mission critical value to the provider, among other factors. For owned assets with high system-level occupancies, hybrid lease financings can be utilized in a sale/leaseback structure to generate maximum proceeds at highly competitive financing rates on an interest-only basis for longer-term (15+ years).

CONTINUING LEASING

If leasing space is still advantageous for the provider, flexibility in lease terms will be important to allow the provider to be agile as business strategies evolve and change during the recovery phase and as the provider adjusts to a new normal course of business.

Depending on the initiatives that providers are focusing on to help offset the financial impact, there will be several real estate strategies that can achieve short- and long-term financial benefits. A roadmap of the various initiatives should be outlined to make sure critical dates are met and that the estimated benefit to the healthcare provider can be quantified appropriately. As health systems are expected to see \$50B in revenue over the next few months, it will be important to harness available real estate data and analyze the various opportunities available to healthcare providers, as its overall strategy evolves throughout the COVID-19 recovery phase.

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SOURCES: (1) Commonwealth Fund, The Impact of the COVID-19 Pandemic on Outpatient Visits: A Rebound Emerges. (2) Kaufman Hall National Hospital Report May 2020. (3) McKinsey & Company, Telehealth: A Quarter-Trillion-Dollar Post-COVID-19 Reality?

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