Survival of the Fittest: In a complex landscape, only the strong survive.

Over the last few years, there has been growing pressure for consolidation in the healthcare industry. But are hospitals fully thinking through the move to acquire or be acquired? Do they know the full occupancy cost and real estate picture that comes with consolidation?

A lot more goes into a successful acquisition than just a one-time financial transaction and not understanding the full impact of consolidation can put hospitals at risk of endangerment.

By: Jason J. Clark,
MSc., Managing Director, Healthcare Solutions
Eat or be eaten

More than ever, healthcare providers are motivated to seek mergers and acquisitions. In fact, the pace of healthcare M&A activity was greater in 2012 than it has been for more than a decade, according to Fitch Ratings.

It’s understandable in this environment. The business of running a hospital has never been more difficult or complex. Implementation of the Patient Protection and Affordable Care Act (PPACA), cuts in reimbursement rates, an aging population and an increasing number of obese or otherwise unhealthy Americans are all factors contributing to the rough terrain.

As a result, almost a quarter of all US hospitals are losing money on operations. Many are now at risk of bankruptcy, or worse yet, of having to close their doors for good.

So, to survive in this landscape, hospitals are turning to consolidation.

Bigger is better … or is it?

Consolidation – whether through merging, acquiring or being acquired – offers a host of benefits. These includes higher negotiating power with reimbursement rates, improved economies of scale, greater market share, integrated services and the ability to share best practices.

But is bigger always better? It’s a question worth asking, as a recent McKinsey report stipulates, 70 percent of mergers fail to produce better results than the individual companies. While this statistic is applied to all industries, not just healthcare, it serves as a startling reminder that consolidation is not a one-size-fits-all strategy. And, from an occupancy cost perspective, it also supports a budding reality that a bigger footprint does not always equate to a more cost-effective one, but rather the opposite – a more complex, risky and costly footprint.

Real estate is a good example of this, as it often gets buried in balance sheets. After all, healthcare organizations may be involved in thousands of leases in medical office buildings and clinics across multiple regions. And they probably don’t have FTC Scrutiny

All of this is further complicated by the Federal Trade Commission (FTC), which has increased its scrutiny over the healthcare arena – confronting the growing number of hospital “monopolies.” One of the most recent Supreme Court cases, FTC v. Phoebe Putney, is a warning to all healthcare systems to avoid anticompetitive activities.
the terms of every lease at their fingertips. But these costs add up. A whopping 40 percent of their balance sheets are often tied up with real estate and occupancy costs.

To rein in these costs, it’s time for hospitals to gain more visibility into their real estate portfolios before they make the decision to consolidate.

Bringing more diligence to real estate and occupancy costs

Acquiring a hospital is more than just analysis and a one-time purchase. It involves much more. Below are important factors for hospital executives to consider as they look into consolidation:

• **Staffing models**
  Like other industries, healthcare staffing models need to be evaluated to have the right people in the right places, share resources, utilize best technologies and adapt to the ebbs and flows of hospital facilities management.

• **Facility conditions**
  The majority of expense in the life cycle of a healthcare facility is not in the initial development but in day-to-day costs such as maintenance, repairs, cosmetic renovations and small capital projects. It’s critical for merging hospitals to have facility capital planning in place to maintain profitability and healthy credit ratings.

What you don’t know could cost you

Looking at an acquisition as a one-time transaction and not as a life cycle of occupancy costs is a big mistake some hospitals make.

For example, take the California Office of Statewide Health and Planning Development (OSHPD), whose mandatory schedule requires that hospitals must renovate or replace facilities in order to meet seismic compliance standards.

So, if a hospital system acquires a California hospital without first conducting a facility condition assessment, they might need to spend an unexpected $500 million to $1 billion in the near future on a major rehab of the building.

By conducting the assessment before completing the M&A deal, the acquirer can value the property or organization it’s buying more accurately, and make sure that expensive mandates are part of the price negotiation.
• **Physician networks**
  Does the hospital of interest have the right doctors in the right areas? It’s an important question to ask, as physician coverage affects population health, access, and convenience. To remain competitive in the future healthcare landscape, it’s essential that hospitals give patients access to the doctors they need when they need them where they need them.

• **Location strategy**
  When hospitals merge, there can be significant opportunities to merge facilities as well. In fact, some sites can be consolidated from two to one, saving 20 percent in operating costs.

**Finding a third-party partner**

These considerations are just a few of the many concerns that hospital executives must evaluate when consolidating.

But let’s face it, hospital executives are in the business of healthcare, not real estate. They need to be focused on their mission and the health and satisfaction of patients. So, to make the best real estate decisions, many turn to a third party.

It’s now possible for healthcare organizations to find a partner with deep understanding of the healthcare business and real estate considerations. A real estate firm that can make informed decisions based on their breadth and depth of expertise in the industry. And, one that can provide the full critical analysis needed before, during and after a merger or acquisition – not just solely for the transaction itself.

Bottom Line: While there is more pressure than ever to merge and acquire, hospitals must look at all angles rather than immediately running to the nearest buyer or seller. Gaining visibility into their complete real estate picture is an important aspect of the M&A process. And this often requires a third party partner to help navigate the complex landscape so they are able to make an informed decision; one that ensures their long-term viability – and not their extinction.

---

**Shifting the way hospitals think about real estate**

Many companies can fully quantify their real estate holdings and associated occupancy costs, but most healthcare industry players – hospitals in particular – have lagged behind other sectors in this regard. Now, external pressures are forcing hospitals to realize that occupancy costs are the third or fourth largest line item on their P&L statements, so they are changing the way they look at real estate strategies. This means establishing centralized database systems that let them track and analyze the full cost of their portfolios. Getting control over information reveals a lot of “hidden costs” tied up in hospital footprints – some of which can be reduced or avoided once they’re uncovered.