

8 Issues Surrounding a For-Profit Company's Acquisition of Non-Profit Hospitals

Written by Molly Gamble | [January 14, 2011](#)

Vanguard's recent acquisition of Detroit Medical Center is one of the latest transactions between a for-profit company and non-profit hospital system. There's been an uptick in this type of transaction recently, with major deals occurring in Chicago and Boston as well. Here are eight issues surrounding these types of transactions.

1. With the newly insured, non-profits are much more attractive to for-profit systems. Non-profit, urban hospitals with high Medicaid and uninsured populations will soon have a more attractive payor mix when healthcare reform and the newly insured are factored in. Since reimbursement changes are a bit further down the road, non-profits are highly attractive to for-profit buyers within the next five years. "For a private equity fund to look at a non-profit hospital, given the expected increases in the insured population and current reimbursement rates, the five year picture can look pretty good," says Robert Guenther, partner of SNR Denton in Chicago

2. Non-profits can look for two types of buyers. While all of these types of transactions are driven by the desire for economies of scale, non-profits can still expect to look for two types of buyers in this marketplace. The first type is the organization or company that is looking to enter your market. The other is an organization that has a presence, but now wants to expand their presence in the city or suburbs, according to Marisa Manley, president of Healthcare Real Estate Advisors in New York City. She references Vanguard's 2010 acquisition of two Resurrection Health Care hospitals — West Suburban Medical Center in Oak Park, Ill., and West Lake Hospital in Melrose Park, Ill. — which expanded their presence into Chicago's suburbs. Vanguard already owns five hospitals in the Chicagoland network.

3. Ongoing capital commitments may become more common than non-profit foundations. Traditionally, when a for-profit company acquired a non-profit, it would pay off debt and set up a foundation. Now, however, more acquirers may begin to move away from this model since it can result in the buyer relinquishing control. "Now for-profits are paying off debt and committing to fund X-millions of dollars in capital investment over a specified period of time," says Mr. Guenther.

4. Capital investments are not often big hurdles. When Vanguard acquired DMC, the for-profit agreed to make capital investments of \$850 million in the five years following the purchase, with \$500 million for special improvements (upgrades to a Children's Hospital, improvements to patient receiving and to operating rooms as well as an emergency department expansion at one facility). Another \$350 million will be used for routine capital needs. If for-profits believe the demographic and location will supply ongoing revenue stream, and they have the capital resources, then capital investment is not often a large hurdle.

5. The Catholic identity of a hospital is often not sold away. Transactions between for-profit companies and Catholic hospitals are often not approved unless the acquirer agrees to keep the hospital Catholic for a certain period of time or, at a minimum, agree to abide by the Catholic Ethical and Religious Directives, according to Mr. Guenther. Acquirers must negotiate specific terms of the sale with the Archdiocese or proper Catholic authorities.

When Boston-based Caritas Christi was sold to Cerberus Capital Management, a private equity firm, a stewardship agreement was negotiated with the Archdiocese of Boston, and the system remained Catholic. Cerberus could, however, cut the six Boston hospitals' religious ties, if they became "materially burdensome" and if Cerberus donated \$25 million to a charity of the archdiocese's choosing.

6. These transactions may raise questions over the hospital's mission. The debate over non-profit versus for-profit healthcare is not a new one. However, the question of for-profit healthcare's relationship with patients may be amplified when discussing private equity funds or other financial investors. "By definition, they have a time horizon when they need to exit. And in order to exit successfully, they must increase the hospital's value," says Mr. Guenther. With an exacerbated profit motive, people may question what will happen when it is time for the acquirer to exit or how they will increase the hospital's value in the meantime. When Caritas Christi was converted to a for-profit last year, the public voiced fears of profit-oriented healthcare. State regulators expect to monitor the new entity's decisions as a result.

Such transactions, however, may not always pose a threat, according to Ms. Manley. "They may be the best, or only, way to preserve some institutions. For instance, in the Vanguard-DMC transaction, Vanguard will continue the hospitals' charity care policy for 10 more years. Ten years is a long planning horizon for any institution in today's changeable economic environment. Non-profits have certain policies that aren't highly conducive to the bottom line, but this is not necessarily a deterrent to for-profit chains," says Ms. Manley.

7. The process of due diligence may become more complicated. From a real estate standpoint, Ms. Manley says buyers and sellers really need to understand the regulatory environment. "We've seen clients who find regulatory hurdles higher than expected," says Ms. Manley. If an organization is buying a hospital, and is planning service lines that have not yet been approved, they really need to understand the regulatory routines from the facility standpoint.

8. This is an uptick, but not necessarily a sweeping trend. While this type of transaction is on the rise, Mr. Guenther says we are nowhere close to seeing the majority of the country's healthcare providers becoming for-profit. "The healthcare M&A market is very cyclical, with waves of consolidation. I think this is certainly a trend, but I don't see it to be quite as prevalent as hospital consolidation was in the 1990s," says Mr. Guenther. However, this drive for efficiencies of scale will be an ongoing trend for quite some time. "No matter the outcome of healthcare reform, there will be a continuing drive for the efficiency and economies of scale. That appetite will continue to grow in the market."