HEALTHCARE REAL ESTATE ADVISORS

February 2011

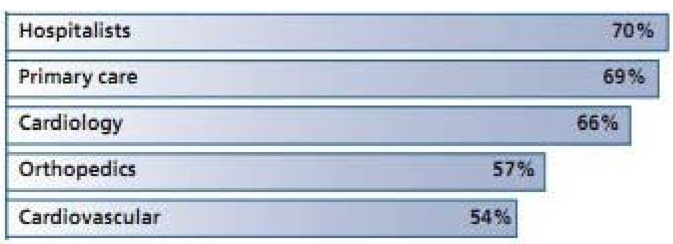
Hospital mergers & acquisitions

2011 brings continued opportunities and activity in the hospital sector.

This week, RegionalCare Hospital Partners has signed a letter of intent to acquire Rhode Island-based Landmark Health Systems. The Providence Journal reports that "over the next four weeks, RegionalCare will be conducting due diligence at the hospital and negotiating the terms of an asset purchase agreement. The letter of intent sets March 15 as the target date for signing the agreement."

Community Health Systems, Inc. announced that it has executed an agreement to acquire substantially all of the assets of Mercy Health Partners in northeast Pennsylvania. According to the Scranton Times-Tribune,"parent company Catholic Health Partners decided to seek a buyer in October, citing an inability to generate enough capital to make necessary investments in the facilities. Mercy Health Partners CEO Kevin Cook said he hopes the sale will be finalized by mid-June."

In which of the following physician specialties do you expect acute care hospitals' M&A activity to increase?



HealthLeaders Media Intelligence: Hospital Mergers & Acquisitions 2010 report

---

Private equity and public hospitals

Two of the year's largest transactions were acquisitions of charitable hospitals by private-equity firms - Vanguard Health System's $1.3 billion investment in cash and commitments of Detroit Medical Center, and Cerberus Capital Management's $830 million acquisition of Caritas Christi Healthcare.

While these types of transactions may cause concern that the for-profit mandate of a private entity will undermine the mission or identity of a charitable or community institution, these concerns may prove to be unfounded. It may be the best, or only, way to preserve some institutions. For instance, in the Vanguard-Detroit Medical Center 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.

Whether healthcare entities are facing opportunities for rapid growth, positioning themselves for acquisition, or finding that they must rigorously control costs, the need for smart, strategic real estate decisions is mission-critical.

In their *2010 Hospital M&A Intelligence Report*, *HealthLeaders Media* found that next to access to capital, CFOs ranked gaining agreement on a valuation of their organization as the most challenging part of the process. Real estate is among the major factors that must be assessed during the valuation process.

From a real estate standpoint, buyers and sellers also must understand the regulatory environment. We've seen clients who find regulatory hurdles higher than expected. If an organization is planning service lines that have not yet been approved in a given jurisdiction, and are delayed or must abandon projects after significant investments of time and capital, it's essential to understand the regulatory routines from a facility standpoint.

How to reduce or eliminate a lease obligation

An assignment is the transfer to a third party of all rights and interests the tenant holds under a lease. In a sublease, the transfer usually covers a portion of the leased space or the entire property for a period shorter than the lease term. If your lease says nothing about subleasing or assignments, you're free to do either. Most landlords, however, are acutely aware of the profit potential this would give you. Usually they're also concerned about controlling the character and quality of tenants in their facilities. Often the landlord's lease flatly prohibits a tenant from assigning or subleasing its space. In a variation that is little better, a landlord will permit subleasing only with their consent, and they'll agree to be "reasonable.

Be especially wary of leases that flatly prohibit assignments or give your landlord unfettered discretion to prohibit one. In many cases, a merger or acquisition will result in an assignment because your lease is transferred to a new legal entity. This means you'd be in default and could be forced out - especially in a rising market. The landlord also may try to impose capitalization requirements on an assignee, demanding, for example, that any potential merger partner have assets at least equal to yours. Yet in a merger you may not be in control. Similarly, your landlord may require that any subsidiary to whom you assign your lease have assets as solid as yours. But subsidiaries are seldom as well endowed as their parent companies. A clause like this seriously hampers your business flexibility, especially if your landlord requires you to remain primarily liable even after you assign the lease, and gives the landlord little more protection.

HCREA in the news

CFO Magazine asked us for our commentary on current market conditions, and *Western Pennsylvania Hospital News* featured us in its current issue. Both articles may offer insights you can use to maximize opportunities and savings for your facility.

Link to Western Pennsylvania Hospital News

Link to ***CFO Magazine***

Market outlook

According to a new report from the Altarum Institute's Center for Studying Health Spending, the healthcare sector has reached an all-time high of 10.7% as a share of total employment. The job rate grew in all of the major health care settings, with outpatient care centers showing the highest 12-month rate of increase (5.3%) and hospitals the lowest (0.7%).

With an average national office rental rate of approximately $22 and office vacancy rate near 17 percent, healthcare space users can expect to continued opportunities to reduce costs and maximize their leverage in the marketplace.

Exhibit 8: Health sector share of total employment

Visit us at **www.hcreadvisors.com**