GLOBAL HEALTHCARE SERVICES

Newmark Knight Frank

COVID-19
HEALTHCARE REAL ESTATE UPDATE

REAL ESTATE STRATEGIES IN UNCERTAIN TIMES

The COVID-19 pandemic continues to impact the world's personal health environment and global economy.

Our thoughts are with the victims, families, first responders and our healthcare clients who are on the front lines battling this virus. As the pandemic has caused worldwide uncertainty and continued speculation, we have seen a tremendous response from healthcare providers, community leaders and the federal government to curb the spread of the virus and keep Americans safe. The innovations in testing to increase access and provide quicker results is ramping up. The United States has responded and acknowledges that from a clinical perspective, understanding the virus and identifying recovered patients will have a massive impact on the numbers reported and on the overall threat of the virus.

In the United States, healthcare providers are tasked with administering care in their communities and preparing themselves for the surge of cases that are estimated to come over the coming weeks. Every area of the health system, including supply chain, real estate, facilities and labor are in triage mode to react so that hospitals are not overrun and there is not a shortage in supply. Undoubtedly, the rapid spread of the virus has impacted the global economy in every sector. However, we are confident that our healthcare system will adjust, respond, provide care and navigate the economic challenges ahead. Our team is encouraged by the collective response and is confident that through this challenging time, our country will innovate, survive and become stronger and more effective in approaching future crises.

On the following pages, our Global Healthcare Services team assesses several of the initial impacts and analyzes possible adjustments. We have included a financial outlook for providers, along with highlights from the stimulus package that will help mitigate some of the impact. Additionally, we have outlined preliminary thoughts on issues and strategies around real estate and capital markets that providers may be facing.

FINANCIAL OUTLOOK

From a financial standpoint, Moody's Investor Services has changed the nonprofit and public healthcare sectors' outlook to negative from stable. Providers have been forced to postpone elective surgeries, the major driver of profitability, to focus on the surge of COVID-19 cases and to increase inpatient bed availability. As a result, health system revenues will decline and the recovery will be dependent on the lasting outbreak in specific communities. Moody's does assume the outbreak will be somewhat contained by the second half of 2020. Other factors contributing to the negative outlook include the rise in labor costs and supplies. It is unclear whether reimbursements from the COVID-19 treatment will be fully covered. Furthermore, clarity on the healthcare stimulus will come as the federal government works through passing several funding packages.

MITIGATING SHORT-TERM REAL ESTATE RISKS

Given the fluidity of events, providers can be proactive and position themselves to protect their financial interests as related to their real estate obligations. Providers will be facing declining revenues and underutilized space, but actions can be taken to mitigate short-term risks.

While temporary, landlords and occupants should be aware of waivers to sanctions governing Stark Laws involving noncompliant real estate arrangements, including rental charges, fair market value remuneration and other leasing and referral arrangements. These temporary waivers provide hospitals and physicians with more flexibility during the pandemic, but will only remain in effect for the lesser of either (i) 60 days from issuance or (ii) the termination of the national emergency declared March 13, 2020, or the public health emergency declared January 31, 2020.

We also anticipate that force majeure clauses will govern in many situations and therefore advise that providers review their leases to clearly understand their rights. If there are questions, we advise consulting with counsel. Not paying rent could lead to a default, and it is important to understand that before taking action. The lease may grant rights that could impact how a tenant should approach their landlord. Once the legal landscape is clear, we advise that practitioners engage their landlord(s) to let them know of their challenges. Irrespective of the absence or presence of rights, the realities and magnitude of our country's situation will likely lead some landlords to vary their policies in order to avoid mass evictions followed by difficult re-tenanting. An additional item to consider in this process is existing debt structures on the property, considering lenders have rights to approve or reject any amendments to leases, including schedules of rent.

Going forward, consider incorporating a Pandemic/National Emergency clause in leases that specifically allows for rent abatement during any period that federal, state or local government requires a shutdown of business and/or tenant is unable to access premises.

With the rapid onset of the COVID-19 crisis and the many questions we have received from health systems and independent providers, we are outlining the following high-level suggestions of how to manage as the situation unfolds:

1. Engage counsel if you need help understanding your rights.
2. Do pick up the phone and call the landlord – have discussions and develop mutually acceptable solutions.
3. Put everything in writing.
4. Do not stop paying rent without first initiating a respectful and proactive dialog with the landlord (especially for retail tenants).
5. Most landlords will need approval from their lender for any lease modification and many lenders are reluctant to agree to changes.
6. If rent abatements are offered, typically those abatements will be amortized over the life of the lease or added to the end of the lease as additional months on the term.
7. Legislation is already being proposed to require rent forgiveness in certain situations.

CREATIVE FINANCING STRUCTURES FOR DECLINING FINANCIAL OUTLOOK

From a financial perspective, providers are preparing for a dip in days cash on hand (DCOH) during this phase or seeking alternatives to finance short-term critically needed items. These items include equipment or interim real estate solutions to accommodate the increasing need for inpatient and ICU capacity. 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 prepare 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 the longer term (15+ years).

CAPITAL MARKETS OUTLOOK

The COVID-19 outbreak has caused disruption in both the debt and equity capital markets for commercial real estate. While the healthcare sector demonstrates recession-resistant characteristics, it has not been isolated from these downturns.

For the equity markets, Public Healthcare REITs, which represented the most active buyer pool for the past 18 months, have largely taken pause in response to a stock price correction across the entire sector. While Public REITs are temporarily sidelined for new acquisitions, private discretionary capital has remained selectively active. REITs seeking liquidity may benefit from potential capital infusions from private sources still actively seeking portfolios for recapitalization.

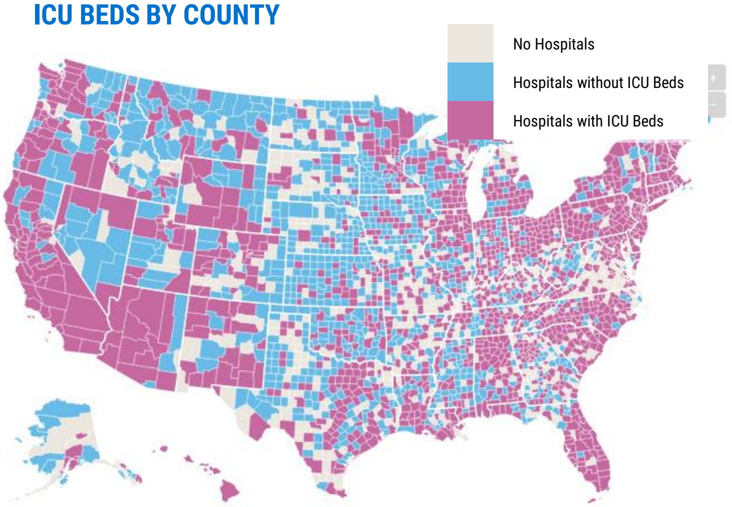
With fewer buyers likely to be active in the coming months, size and scale are expected to have an impact on pricing and transaction terms. The healthcare sector may see an uptick in cap rates as a result of fewer active investors seeking higher yields to account for the near-term uncertainty and market volatility.

As for the debt markets, banks and private lenders utilizing balance sheet funding are still open for business and are quoting. Credit spreads have widened despite declines in the underlying benchmarks, with the result being rates holding steady or seeing a modest uptick. CMBS and securitized lending appear to be sidelined for the time being. During the execution phases, physical due diligence and closing logistics make lending execution a challenge, and contractual agreements and transaction documents are being modified to reflect the “new normal” of business during the COVID-19 pandemic.

IDENTIFYING COMPLIMENTARY ASSETS TO INCREASE BED CAPACITY

There are several estimates being published that forecast the availability of hospital beds as the COVID-19 pandemic grows in the United States. Models are projecting that ICU beds will reach full capacity as the virus spreads. Certain communities that are experiencing a surge of cases are looking to underutilized real estate assets in the market that can be configured to accommodate field hospitals. The facilities identified to expand bed capacity include hotels, convention centers and existing underutilized healthcare facilities.

ICU BEDS BY COUNTY



Source: Kaiser Health News Analysis of hospital reports filed to Centers for Medicare and Medicaid Services

HELP IS ON THE WAY: THE CARES ACT

On March 26, the government passed a $2 trillion stimulus package that includes billions of dollars for the healthcare industry. The key CARES Act initiatives that will help the healthcare community are as follows:

"PAYCHECK PROTECTION PROGRAM" LOAN AND FORGIVENESS PROVISIONS

The SBA has underwritten loans for years to help companies meet working capital obligations after a natural disaster. The "Paycheck Protection Program" is an expansion of the SBA Act that may provide up to $10 million in loans at 4% interest for business, including 501(c)(3)s, with fewer than 500 employees. The largest benefit may be the provision that allows borrowers to apply to have all or a portion of the loan forgiven. The loan amount is based on a formula that takes the average monthly payroll expenditure for the previous 12 months and multiplies that by a factor of 2.5. Businesses receive loan amounts equal to the lesser of either that amount or the $10 million limit.

The unforgiven portions of the loan are repayable over 10 years. While repayment deferrals ranging from six to 12 months are also available, the unique aspect of the program is its forgiveness provision. For businesses that maintain their workforce for an eight-week period after the funds are received, a portion or all of the loan may be forgiven. Whatever portion is forgiven is tax free.

PUBLIC HEALTH AND SOCIAL SERVICES EMERGENCY FUND

The CARES Act adds $100 billion to the Public Health and Social Services Emergency Fund to reimburse providers for expenses and lost revenue attributable to COVID-19. Presently, this fund is administered by the Assistant Secretary for Preparedness and Response (ASPR) under the U.S. Department of Health and Human Services (HHS). In a single act, this agency goes from administering an annual budget of $2.6 billion to a $100 billion program. The provisions cover not only lost revenue, but also certain capital expenditures that may result from COVID-19 preparedness.

The process and direction around how to receive the benefit of the funds will take some time. The key for all providers is to organize your information and determine the most compelling way to present your sustained losses to HHS.

MEDICARE

Key provisions of the act that relate to Medicare are as follows:

- Medicare advance payments
- Medicare sequestration relief
- Delaying Medicaid Disproportionate Share Hospital reductions
- Expanded Medicare coverage for telehealth

The changes will allow providers to start recovering more quickly. Also, the provision for telehealth coverage, enabling virtual technology deployment, will allow other payers to begin to reimburse care provided via telehealth. In our previous Healthcare Outlook, we discussed telehealth growth and the opportunity to provide streamlined care.

Overall, in recent weeks, the government has stepped in and reduced interest rates to zero to stimulate the economy; Congress, Senate and the Executive Branch have put differences aside (to some degree) to pass the CARES Act. This Act will go a long way in helping to stimulate the economy and compensating the organizations that have taken the biggest hit – healthcare included. The stimulus package is the first step in the right direction to mitigate the impact COVID-19 has on the financial well-being of the healthcare industry.

ABOUT NEWMARK KNIGHT FRANK

Newmark Knight Frank ("NKF"), operated by Newmark Group, Inc. ("Newmark Group") (NASDAQ: NMRK), is one of the world's leading and most trusted commercial real estate advisory firms, offering a complete suite of services and products for both owners and occupiers. Together with London-based partner Knight Frank and independently-owned offices, NKF's 18,000 professionals operate from approximately 480 offices on six continents. NKF's investor/owner services and products include investment sales, agency leasing, property management, valuation and advisory, diligence, underwriting, government-sponsored enterprise lending, loan servicing, debt and structured finance and loan sales. Occupier services and products include tenant representation, real estate management technology systems, workplace and occupancy strategy, global corporate services consulting, project management, lease administration and facilities management.

ABOUT GLOBAL HEALTHCARE SERVICES

Newmark Knight Frank's Global Healthcare Services team is one of the largest and most experienced healthcare real estate teams in the country, advising healthcare clients seeking to maximize value on assets and implement long-term business strategies. The Global Healthcare Services team provides clients with a single-source solution for every phase of acquiring, financing, developing and disposing healthcare real estate. The team comprises real estate transaction and consulting professionals with more than 130 combined years of experience serving hospitals, health systems and medical office building owners throughout the U.S. and across the globe.

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