

Valuing Health Care Real Estate Interests:

FMV Issues & Trends in Healthcare Real Estate Valuations

May 29, 2019

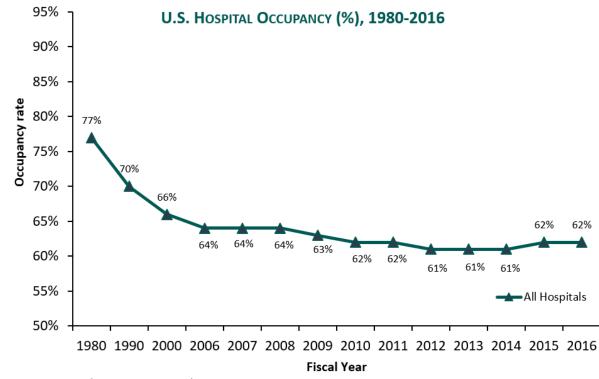
Victor H. McConnell, MAI, ASA, CRE Director, Real Estate Services VMG Health Denver, CO victor.mcconnell@vmghealth.com

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HEALTHCARE REAL ESTATE MARKET TRENDS & OVERVIEW

Shift to Outpatient Settings



- From 1975 to 2015, # of beds decreased from ~1.5M to 900k, a ~40% decline
- Over same period, U.S. population grew ~50% and OP visits doubled
- Hospital occupancy fell from 77% in 1980 to in the low- to mid-60s (%) post-2010.

Source: Medicare Payment Advisory Commission



HEALTHCARE REAL ESTATE HAS EXPANDED TO ENCOMPASS MORE THAN A DOZEN PROPERTY TYPES.

CIRCA 1960

- Nursing Home
- Medical Office Building

VS.

Hospital

Seniors Housing

- Independent Living Facility (ILF)
- Assisted Living Facility (ALF)
- Continuing Care Retirement
- Community (CCRC)

 Skilled Nursing
- Facility (SNF)

CIRCA 2019

Outpatient Buildings

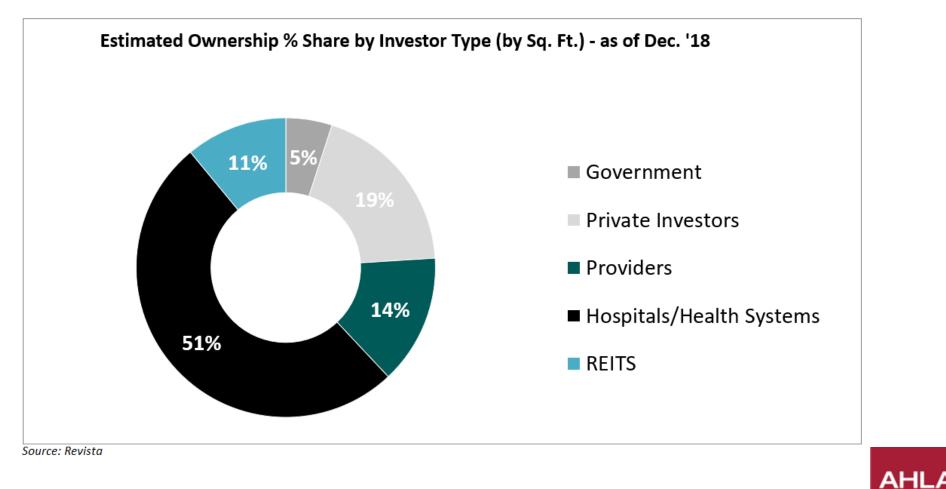
- Medical Office Building (MOB)
- Urgent Care Center
- Free Standing ED
- Ambulatory Surgery Center (ASC)
- Cancer Clinic
- Diagnostic Imaging Center

Hospitals

- Inpatient Rehab Facility (IRF)
- Long Term Acute Care Hospital (LTACH)
- Surgical/Specialty Hospital
- Critical Access Hospital
- Micro Hospital
- Psychiatric Hospital
- Acute Care Hospital

OWNERSHIP OF HEALTHCARE REAL ESTATE (OUTPATIENT SECTOR)

Roughly 2/3 is still owned by health systems or other providers (80%+ for inpatient sector).



INVESTMENT & MARKET TRENDS – HEALTHCARE REAL ESTATE

- ✓ Total Sales Volume Slightly Down (~5%) in 2018 v. 2017
- ✓ Average Sales Price PSF Has Leveled Off
 - After years of growth, \$/SF was fairly level in 2018, though YoY remained up (10-15%)
- ✓ Price Remains Higher than Replacement Cost (115%)
 - Impacts buying vs. building vs. leasing decisions for users & influences investment decisions
- Increased Investor Attention, Domestic & International
 - Domestic funds focused on healthcare, new international capital willing to invest in inpatient or outpatient real estate.
 \$2.6B in Chinese capital invested in U.S. HRE in 2016.
- Portfolios & Monetizations, & Reverse Monetizations
 - 2016 Single Largest Health System MOB Monetization: Catholic Health Initiatives Physicians Realty Trust (\$703.5M for 52 properties)
 - 2017 Sale of all of Duke Realty's 6.6 million sq. ft. of MOBs to HTA for \$2.88
 - 2018 Welltower-Aurora \$433 million transaction ("Reverse Monetization"); CNL portfolio
- Rising Construction Costs
 - Labor costs have increased in many markets; continued cost pressure expected
 - Build-to-suit terms changing

Sources: PwC Medical Office Building Investor Survey, Revista, Hammond Hanlon Camp (H2C), MVS, Turner Construction

WITHIN THE HEALTHCARE REAL ESTATE SECTOR, RISK PROFILE VARIES SIGNIFICANTLY ACROSS HEALTHCARE VERTICALS.

✓ Perceived risk differences in MOBs vs. other outpatient assets (such as ASCs) have changed.

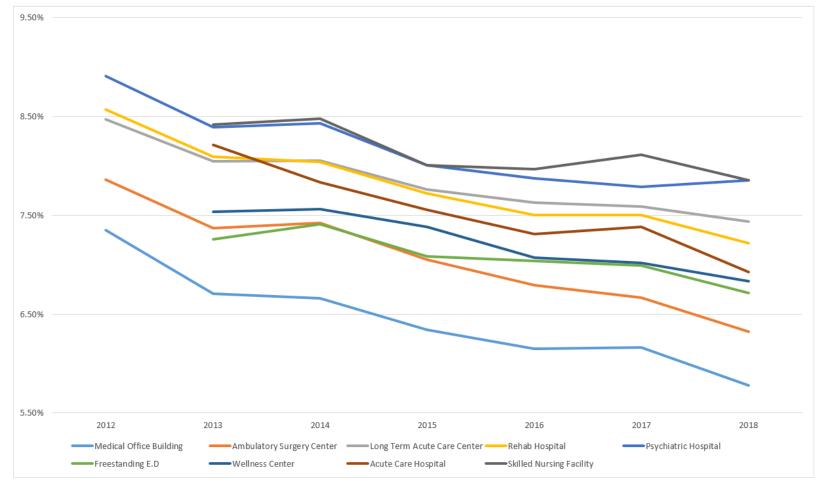
✓ More investors willing to buy inpatient assets.

✓ Aging facilities require more capital expenditures to continue to operate.

✓ Acute care sector facing headwinds (both for-profits and non-profits).



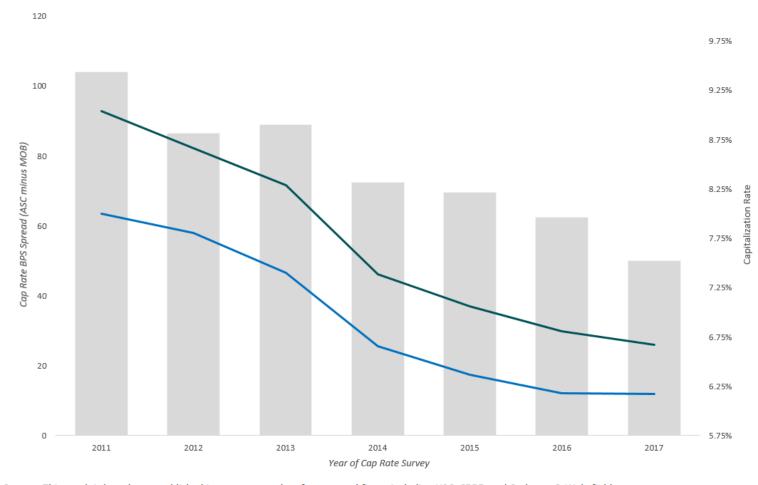
TRENDS IN PERCEIVED RISK: CAP RATE TRENDS BY HRE VERTICAL



Source: Derived from CBRE annual Healthcare Real Estate Investor/Developer Survey. Survey conducted in 1st quarter each year, and survey question was "what will be a 'market' capitalization rate for the following single-tenant healthcare investments in the coming year? Assume 10-year remaining lease terms and average credit."

TRENDS IN PERCEIVED RISK: MOB VS. ASC CAP RATES

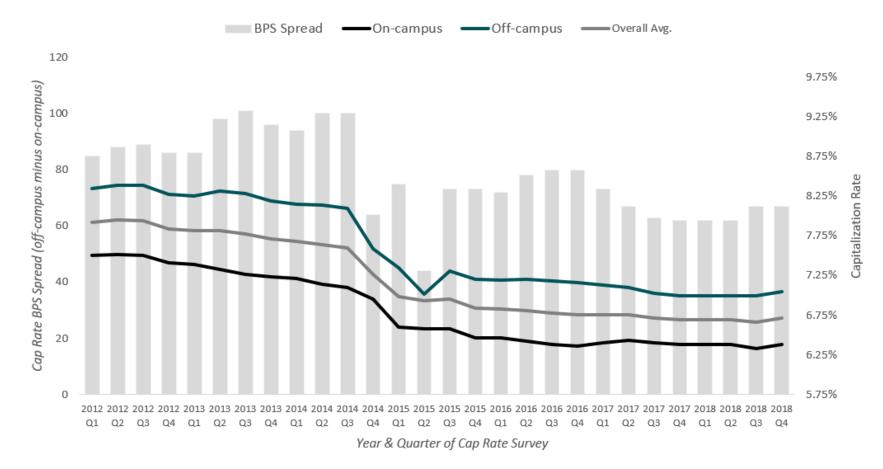
BPS Difference —Cap Rate - MOB —Cap Rate - ASC



Source: This graph is based upon published investor survey data from several firms, including H2C, CBRE, and Cushman & Wakefield.

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TRENDS IN PERCEIVED RISK: ON- VS. OFF-CAMPUS MOBs

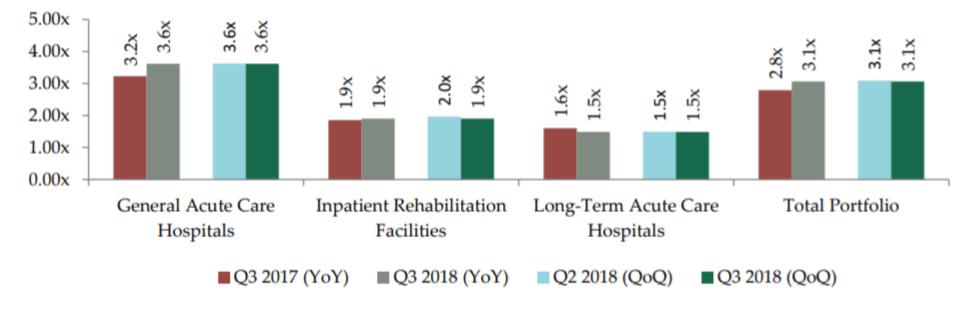


Source: PwC National Medical Office Buildings Market Investor Survey

RENT COVERAGE RATIO DATA - HOSPITAL SECTOR

Critical to understand how real estate relates to operations on specialty healthcare real estate assets.

YOY and Sequential Quarter Comparisons by Property Type



Source: Medical Properties Trust (NYSE: MPW) SEC Filings



FAIR MARKET VALUE

Fair Market Value vs. Strategic / Synergistic and Investment Value

 Adjusting reimbursement rates to market participant rates Market participant cost savings Fair market value rent rate Post-Transaction compensation Adjusting reimbursement rates to acquirer's contracted rates Acquirer specific cost efficiencies (such as volume, staff, expense profile, etc.) Related-party rent arrangements Pay for referrals 	Fair Market Value	Strategic / Synergistic Investment
 Volume, staff, expense profile, etc.) Fair market value rent rate Related-party rent arrangements 		
	Market participant cost savings	
✓ Post-Transaction compensation ★ Pay for referrals	Fair market value rent rate	Related-party rent arrangements
	Post-Transaction compensation	Pay for referrals

HEALTHCARE REAL ESTATE: FAIR MARKET VALUE

Fair Market Value Considerations

What is Fair Market Value (or Fair Market Rent)?

Three Approaches to Value



Cost Approach (Return-on-Cost)

What is replacement cost?



Sales Comparison Approach (Rent Comparables Approach)

What is a comparable? Per Bed vs. Per Sq. Ft.?



Income Approach (Rent Coverage Ratio)

What are the projected cash flows?



HEALTHCARE REAL ESTATE: FAIR MARKET VALUE

Leasing Considerations



Structure

- Gross landlord pays expenses
- Modified Gross landlord and tenant each pay portion
- Triple-net tenant pays expenses



Tenant Improvements

- TI allowance for interior buildout
- Typical vs. specialty, tenant or landlord
- What happens at renewal?

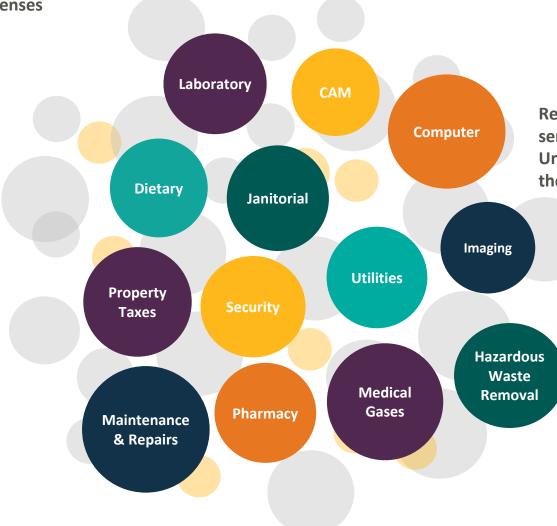
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Other Considerations

- Term length
- Escalations
- Rent abatements
- Stark, AKS, CR
- Options, Use Restrictions, Non-Competes

HEALTHCARE REAL ESTATE: FAIR MARKET VALUE

Operating Expenses



Real estate expenses and ancillary services are often comingled. Understand what is and what isn't in the subject lease v. the comparables.

HEALTHCARE REAL ESTATE: VALUATION REPORTS

✓ Assessing a Valuation Report

- Is the appraiser, broker, or consultant competent?
- Local market expertise v. sector-specific expertise
- What was their scope of work? BOV v. Appraisal. Only a licensed appraiser can provide an "appraisal report".
- What is their value conclusion and the associated assumptions?

✓ Best Practices and Red Flags

- Are the comparables comparable?
- Has the appraiser inspected the property and the comparables?
- Does the appraiser understand and address operational or legislative issues which may affect the real estate value?

Risk Tolerance: How long is an appraisal report "good for"?

AHL

Real Estate Rent:

- Exclusive v. Non-exclusive
- Should be "grossed up" (i.e. inclusive of operating expenses covered by landlord)
- Should be based on "comparable" space

Staffing:

• Medical Assistant, Receptionist

Ancillary Services:

• Telephone, internet, office/medical supplies, coffee, water, hazardous waste, paper shredding, magazine subscriptions, cable TV

Equipment:

- Exclusive office (e.g. desk, chair, computer)
- Exclusive exam room (e.g. stool, waste receptacles, exam tables)
- Waiting room personal property (e.g. chairs, end tables, wall art)
- Methodology: 1) inventory assets; 2) estimate FMV (current and residual); 3) determine amount to be financed; 4) apply market-derived interest rate for similar lease arrangements & add sales tax

AHL

Understanding Space

office 100 sq ft	office 100 sq ft		office 100 sq ft			office 0 sq ft
			CO	RRIDOR 5	0 sq f	ť
waiting/ check-in 230 sq ft		exan 120 s		exam 120 sq		estroom 20 sq ft

- Exclusive vs. Non-Exclusive
- Based on "comparable" space
- Rent should be "grossed up"
- Must have accurate space measurements



LANDLORD EXC. PRACTICE EXC.	420 SF 220 SF	office 100 sq ft	off 100	1.72		office 0 sq ft		fice sq ft
SHARED	400 SF 1,040 SF				COI	RRIDOR 50) sq ft	
EXC. SPACE PRACTICE COMMON ALLOC. PRACTICE NRA	640 SF 34% 136 SF 358 SF	waiting/ check-in 230 sq ft		exan 120 s		exam 120 sq f		stroom 0 sq ft

	FACILITY	Y USAGE DETAIL			
		Total	Landlord	Tenant	Shared
Common Area Allocation	Notes	Square Feet	Square Feet	Square Feet	Square Feet
Identified Exclusive or Shared SF	1	1,040	420	220	400
Less: Common/Shared Area Allocation	2	-	263	138	(400
Total Allocable Rentable SF		1,040	683	358	-
Building CAF (15%)	3	156	102	54	-
Total Allocable Rentable SF		1,196	785	411	-
Exclusive Use		Total			
Factor Calculation		Square Feet			
Tenant Exclusive Use SF		220			
Divided by: Total Exclusive Use SF		640			
Tenant Exclusive Use Factor	2	34.4%			
Common		Total			
Area Allocation		Square Feet			
Total Shared/ Common Area		400			
Times: Tenant Exclusive Use Factor		34.4%			
Tenant Allocated Common Area	2	138			
Annual Facility					
Usage Calculation		Low	High		
Total Allocable Rentable SF - Tenant	4	411	411		
Times: Gross (Full Service) Lease Rate	5	\$20.00	\$24.00		
Equals: Annual Facility Usage		\$8,223	\$9,867		

		COST SU	MMARY				
	Annual	Per	Per	Hourly Use	Annual	Monthly	Monthly Rat
Category	Expense	Week	Hour	Per Week	Rate	Rate	w/ Premiun
Staffing							
Receptionist	\$32,595	\$652	\$16.30	4.0	\$3,390	\$282	\$353
Medical Assistant	\$36,492	\$730	\$18.25	4.0	\$3,795	\$316	\$39
Total Staffing	\$69,087					\$599	\$74
Services							
Telephone Service:	\$1,056	\$21	\$0.53	4.0	\$110	\$9	\$1
Internet Service:	\$996	\$20	\$0.50	4.0	\$104	\$9	\$1
Medical Supplies:	\$2,830	\$57	\$1.42	4.0	\$294	\$25	\$3
Office Supplies:	\$1,437	\$29	\$0.72	4.0	\$149	\$12	\$1
Coffee Supplies:	\$240	\$5	\$0.12	4.0	\$25	\$2	\$
Water Services:	\$142	\$3	\$0.07	4.0	\$15	\$1	\$
Hazardous Waste Disposal:	\$1,020	\$20	\$0.51	4.0	\$106	\$9	\$1
Paper Shredding Services:	\$480	\$10	\$0.24	4.0	\$50	\$4	\$
Magazine Subscriptions:	\$350	\$7	\$0.18	4.0	\$36	\$3	s
Cable Television:	\$504	\$10	\$0.25	4.0	\$52	\$4	\$
Total Services	\$9,055					\$78	\$9
otal Staffing & Services	\$78,142					\$677	\$84
F&E Usage	\$2,520	\$50	\$1.26	4.0	\$262	\$22	\$2
acility Usage - Low	\$8,223	\$164	\$4.11	4.0	\$855	\$71	\$8
Facility Usage - High	\$9,867	\$197	\$4.93	4.0	\$1,026	\$86	\$10

FAIR MARKET VALUE SUMMARY		
MESHARE COMPONENTS	Low	High
ir Market Value Conclusion Range - Monthly Staffing & Services Payment	\$762	\$931
air Market Value Conclusion Range - Monthly FF&E Payment	\$27	\$27
air Market Value Conclusion Range - Monthly Premises Payment	\$89	\$107
	Low	High
CONCLUSION	LOW	mgn
CONCLUSION Fair Market Value Conclusion Range - Aggregate Monthly Payment	\$878	\$1,065

BIO & CONTACT INFO



VICTOR McCONNELL MAI, ASA, CRE

Director - Real Estate Services

CONTACT 720.305.9306 victor.mcconnell@vmghealth.com

OFFICE ADDRESS 200 Columbine Street Suite 350 Denver, Colorado 80206 United States

EXPERIENCE

Victor H. McConnell, MAI, ASA, CRE is a director in VMG Health's Real Estate Services division and is based in the Denver office. He has real property valuation & consulting experience in 42 of the United States, including extensive experience with the valuation of healthcare related properties. Mr. McConnell has provided Fair Market Value and Fair Market Rent analyses to a variety of hospitals, physician groups, for-profit and non-profit health systems, as well as corporate and governmental clients. Mr. McConnell has also provided appraisals and valuation-related consulting services to REITs, lenders, and private equity firms to assist with risk assessment and due diligence. He also has experience with issuing commercial reasonableness opinions and is well versed in the regulatory nuances specific to the healthcare real estate sector. Consulting services performed by Mr. McConnell include constructing frameworks to assist with leasing compliance programs as well as profits distribution between equity partners in new developments.

Specific property types which Mr. McConnell has analyzed include acute care hospitals, cancer clinics, on- and off-campus medical office buildings (MOBs), ambulatory surgery centers (ASCs), diagnostic imaging centers, dialysis facilities, proton therapy centers, sleep labs, cath labs, skilled nursing facilities (SNFs), biomanufacturing facilities, surgical hospitals, rehab hospitals (IRFs), long term acute care hospitals (LTACHs), psychiatric facilities, hospice wings, laboratories, physical therapy clinics, and drugstores. Mr. McConnell's valuation experience also includes "zero cash flow" properties, corporate headquarters, and a variety of other commercial assets.

MORE ABOUT ME

Mr. McConnell graduated from Dartmouth College in 2004 and began his valuation career with a boutique commercial real estate firm in 2006. He has an MAI designation from the Appraisal Institute, an ASA designation from the American Society of Appraisers, and a CRE designation from the Counselors of Real Estate. Mr. McConnell presents regularly at healthcare real estate industry conferences, and was selected as an Emerging Leader in Healthcare Real Estate in November 2015 by Globe Street. He has published in venues such as AHLA, ABA, and Becker's Hospital Review. Clients served include six of the ten largest for-profit health systems and seven of the fifteen largest non-profit health systems.

AREAS OF EXPERTISE

Real Estate Valuation Real Estate Transaction Advisory Real Estate Counseling & Consulting Litigation & Dispute Resolution Due Diligence & Tenant Risk Analysis

