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JOINT VENTURES BETWEEN HEALTH CARE PROVIDERS AND REITS: FIVE THINGS TO CONSIDER

Hospitals are increasingly becoming targets for investment by real estate investment trusts ("REITs"), with the past year seeing a number of high profile joint ventures between REITs and health care providers structured as RIDEA investments. While hospital/REIT joint ventures can help hospitals fund expansions or monetize valuable real estate assets, hospitals should enter into these arrangements fully informed of the potential risks and benefits involved. The REIT Investment Diversification and Empowerment Act ("RIDEA") allows REITs to participate in the net operating income of health care real estate investments.

Although RIDEA was passed in 2007, these arrangements have seen an uptick in popularity due in part to increased individual insurance coverage mandated by the 2010 Patient Protection and Affordable Care Act ("ACA") and the increasing growth of the over-65 segment of the U.S. population, both of which have resulted in an increased demand on health care providers, especially those serving the elderly. Prior to RIDEA, investments of equity REITs were limited to income from leases. In a typical RIDEA scenario, however, a REIT owns the real estate (land or buildings), leases it to a taxable REIT subsidiary under a triple-net lease, and the subsidiary then hires an eligible independent contractor to manage the facility. Joint venture opportunities between the REIT and the provider exist at the landlord level and the tenant level, with the operator typically being the provider itself.

In addition to receiving rental income, the RIDEA structure allows REITs to participate in the operating income of the health care provider. As REITs continue to diversify their portfolios through participation in the RIDEA structure, health care providers now have an additional option when considering financing partners. Below are a few factors that health care providers should consider when deciding whether to partner with REITs.

1. *Provides a Finance Vehicle to Monetize Real Estate*. RIDEA is an alternative financing option that allows providers to monetize their real estate assets, freeing up capital to invest in physician recruitment and information technology, which are important for staying competitive in the post-ACA world.

2. *Helps Providers Gain Access to Funds for Capital Improvements and Expansion*. A RIDEA structured financing requires the REIT to be much more invested in the success of the health care provider than with traditional financing options. Accordingly, REITs often provide additional funds for capital expenditures or expansion opportunities.

3. *Implicates Change of Ownership and Licensure Issues*. Providers must consider the licensing implications when structuring the joint venture with the REIT. Depending on local, state and federal laws, the modification to the operating entity (or parent company) could be categorized as a change of ownership for Medicare purposes or modify certificate of need obligations.

4. *Necessitates REIT-Favorable Provisions in Joint Venture Arrangements*. REITs push for provisions that minimize their risks in operating losses but generally require more participation in the upside of operating profits. For example, REITs often limit management fees to the operator if the location is not sufficiently profitable. Moreover, because RIDEA allows REITs to participate in the operating income of competing providers in a given market, REITs will often push for more limited noncompete provisions. A REIT partnership might also make it more difficult, either operationally or politically, for hospitals to terminate leases since their interests are more aligned with those of the REIT/landlord. Finally, REITs may require more involvement in operational decision making, which may come into conflict with the provider's mission and objectives.

5. *Provides a Permitted Structuring Alternative for Most Health Care Providers*. While the majority of recent transactions have involved senior housing portfolios, opportunities in this industry subset have become sparser. REITs will likely continue to look to invest using the RIDEA structure with hospitals and other health care providers as the senior living market becomes oversaturated.

RIDEA can be a powerful tool, but these arrangements present a variety of nuances. Hospitals and other health care providers should consult with counsel to adequately consider this financing option if looking to monetize their real estate assets or seeking funds for capital improvements or expansion.

If you have questions regarding RIDEA and health care provider/REIT joint venture arrangements, please contact:

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