INTEGRA Industry Insight

SNF Market Reactions Turn Positive

Integra Realty Resources – Healthcare & Senior Housing

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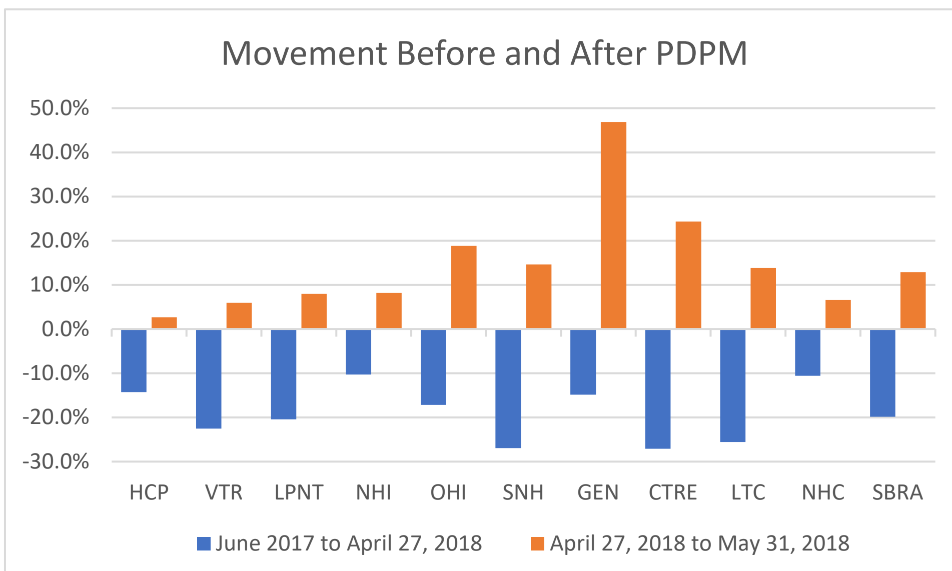
On April 27, 2018, the Centers for Medicare and Medicaid Services (CMS) announced a change affecting reimbursement for senior nursing facilities (SNFs).[i] In the wake of this announcement, as a way of gauging the response among investors and other market participants, we looked at the stock movements of publicly-traded healthcare REITs with SNF investments. We focused on 11 major firms[ii], including large-cap, medium-cap, and small-cap companies, to see how the SNF market reacted to major news affecting Medicare Prospective Payment System (PPS), the bread and butter of SNF reimbursement.

The new payment model, a type of PPS known as the Patient-Driven Payment Model (PDPM), will affect all Medicare-certified SNFs in their ability to forecast future Part-A revenue and related operating expenses. In a previous whitepaper, we provided some background on the new model and some of the expected winners and losers.

The three major indices, as represented by the Dow 30, the S&P 500, and the NASDAQ, had consistent growth over the last 12 months, from June 2017 to June 2018, increasing on average 16.6 percent. Meanwhile, the SNF stocks have decreased 6 percent during this same period. One glaring exception to this pattern happened after the PDPM announcement. During the thirty days after the PDPM announcement, these SNF stocks increased in value at a rate of 14.8 percent on average. This outpaced the broader stock market by a magnitude of about seven.



The change in performance among these SNF stocks indicate a positive reaction from industry investors and participants. With the PDPM announcement affecting reimbursement as well as expected therapy costs, these stock movements appear to signal that industry players consider PDPM to be a positive, especially in comparison to RCS-I. Altogether these developments seem to beckon a generally optimistic shift among the industry.

Sabra and Omega have the largest leased fee interest exposure to SNFs. In the past 45 days, their share prices have increased about 18 and 15 percent, respectively. These increases have occurred with raising interest rate headwinds.

Source: Yahoo! Finance

Turning to companies that are in operations, we see the same upward pattern with Quality Care, Genesis and Ensign. For Quality Care, they received a price lift in March, when it was announced that ManorCare (the tenant-operator) would merge into Quality Care (the landlord) and the company would become an owner-operator (again). This eliminated the risk of a major rent concession, as ManorCare continued to have difficulties meeting the high yield set years ago under better market conditions.

Source: *Yahoo! Finance*

Obviously, changes in Medicare reimbursements can profoundly impact SNF operations and profitability. A significant example of this occurred in 2010 when Medicare increased SNF reimbursements by more than 10 percent in a single year, causing the industry to experience huge increases in EBITDAR. Several large companies took advantage of the increase and conducted major recapitalization. However, by August 2011, Medicare took away those increases and share prices collapsed. Not only did we witness this process, but we predicted this was going to happen despite the loudest voices (the sell side) saying the rate increases were here to stay or that reductions would occur gradually. PDPM should not be so extreme on this upturn, nor is there a significant downturn from a take away, similar to 2011.

The players at the forefront of the change to PDPM will be better positioned for strong financial performance and the players who operate with “business as usual” will have a harder time. The “business as usual” companies may run into troubles and these troubles could translate into buying opportunities for the better positioned companies.

We recognize that determining stock price drivers is a thorny endeavor and that correlation is not the same as causation. This is especially the case with analyzing single stocks over a short timeframe. In our examples above, however, we help minimize these inherent risks by focusing on several stocks over a medium-term timeframe. Accordingly, we find probable cause to suggest at least a strong correlation between the announcement and the movement of SNF stocks, all of which indicate a strong response from SNF market participants and their optimistic expectations of the new payment model.

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[i] https://www.cms.gov/Newsroom/MediaReleaseDatabase/Fact-sheets/2018-Fact-sheets-items/2018-04-27-4.html

[ii] The eleven firms are the following: Large Cap - HCP, Inc (HCP); Ventas, Inc (VTR); Mid Cap - Lifepoint Health, Inc (LPNT); National Health Investors, Inc (NHI); Omega Health Investors, Inc (OHI); Senior Housing Properties Trust (SHPT); Genesis Healthcare, Inc (GEN); Small Cap - Caretrust REIT, Inc (CTRE); LTC Properties, Inc (LTC); National Healthcare Corporation (NHC); Sabra Health Care REIT, Inc (SBRA).