CHAPTER7

JOINT VENTURES AND STRATEGIC ALLIANCES

By Owen Collins and Charles J. Herman, Jr.

Assisted living companies find opportunities for synergistic strategic alliances with integrated hospital, based health systems.

MANAGING THE CONTINUUM OF ELDER CARE: PARTNERING WITH ASSISTED LIVING COMPANIES

The Assisted Living industry is one of the fastest growing segments of the healthcare and senior living industry. Virtually all types of elderly services providers are attempting to become involved with this fast growing industry segment. Strategic partnering is an emerging trend in the continued expansion of many Assisted Living companies.

Partnering provides a safer entry point into the Assisted Living industry for other health care provider organizations than going it alone. In the vertically integrated platform for the delivery of care, Assisted Living services and acute care hospital services each represent an important segment in the continuum of care and are beginning to actively work together. Many industry professionals believe the greatest opportunity for Assisted Living companies is to create synergistic strategic alliances with integrated hospital-based health systems.

It is important to note that hospital-based integrated health systems are not the only options for Assisted Living companies looking to expand through strategic partnering. Other health care organizations who are beginning to realize the benefits of partnering with Assisted Living companies include managed care, skilled-nursing facilities, congregate care retirement communities, universities, municipalities, and secular organizations.

THE CHANGING MARKETPLACE

With increased managed care penetration and integrated health care delivery systems accepting full-risk for the care of the Medicare eligible population, Assisted Living companies recognize the "gatekeeper" role and the influence hospitals will have with the elderly population, including those needing limited nursing supervision. Although Medicare does not pay for Assisted Living today, it may in the future with continued privatization of Medicare through managed care contracting. Therefore, many Assisted Living providers are aligning with other healthcare providers in their market.

Due to several years of rapid expansion, today's capital markets are approaching the Assisted Living industry more cautiously. Assisted Living companies could benefit from equity contributions and inexpensive access to capital financing by partnering with integrated health systems. Furthermore, many health systems have excess capacity and desire to make use of under-utilized beds and/ or undeveloped land.

Joint ventures with Assisted Living providers can be critical to health systems seeking access to new patient referral sources. Also, an integrated delivery system that includes Assisted Living enables health systems to cost effectively manage at-risk Medicare populations. Assisted Living can provide health systems access to a relatively low-cost care setting. Assisted Living also will provide health systems with alternate revenue streams when profit margins are under increased pressure from managed care and government payment programs.

SHIFTING RISK

Shifting risk down to the least common denominator is key in the evolution of the health care industry from a cost-based reimbursement or fee-for-service system to a capitated payment system. The government will continue to privatize Medicare and Medicaid, by encouraging or mandating beneficiaries to enroll with private-sector managed care plans. By contracting with managed care organizations, government is better able to identify and predict annual health care expenditures.

In the early stages of managed care, risk sharing generally was limited to the primary care provider. In highly penetrated managed care markets today, managed care organizations are shifting the entire risk down to the integrated health system through fully capitated risk contracts. In low and moderate penetrated managed care markets, today's provider may be tomorrow's insurer.

Managed care organizations and integrated health systems, as insurers, are attracted to Assisted Living because it offers a lower-cost alternative to caring for the elderly. Additionally, Assisted Living fulfills an important role in managing the overall health of the resident. The managed care philosophy is congruent with the preventive care emphasis that Assisted Living envelops. Specifically, insurers recognize the important impact that the timely dispensing of medication and assisting with other daily activities can have on the promotion of good health for the elderly. The graying of America and the increasing penetration of Medicare risk plans creates opportunity for Assisted Living companies and health Systems to position themselves as low-cost providers and the managing agents of the elder care continuum.

THE IMPACT OF ASSISTED LIVING BECOMING MORE OF A MEDICAL MODEL

During the early 1990s, the Assisted Living industry consisted of two divergent product lines. Assisted Living providers could have a hospitality model or a medical model. Both health care policy makers and payers alike, are increasingly viewing the Assisted Living industry more as a medical care model in a residential care setting, as well as a less costly alternative to patients needing less-intensive care. This view is evidenced by the federal government's development of its Medicaid Waiver program and why so many states are choosing to participate in the program. Some industry sources have asserted that upwards of 40 percent of nursing home patients, in some states, could be discharged to Assisted Living facilities.

In *Gray Dawn*, a book by Peter G. Peterson that examines the aging worldwide population, the author indicates that prior to the industrial revolution, people aged 65 and older represented roughly two to three percent of the world's total population. He estimates the age 65 and older population may grow to about 25 percent, perhaps even 30 percent of the total population in some countries by 2030. The Assisted Living market potential is enormous, however the rules of the game increasingly are influenced by payers, consumers and other health care managers. Strategic alliances that are mutually beneficial may be critical to the short- and long-term success of the Assisted Living company and the integrated health system.

JOINT-VENTURE ACTIVITY IN THE MARKETPLACE

The marketplace is abundant with the formation of strategic alliances between unrelated and like providers who look to capitalize on each other's particular expertise, market position and financial strength.

In August 1998, Sunrise Assisted Living, Inc., a publicly-traded national provider of Assisted Living services, and Inova Health Systems Services, Inc., the largest integrated health care delivery system in the metropolitan Washington, D.C. area, agreed to affiliate. Through the affiliation the partners intend to create a coordinated program of health care and Assisted Living services for area seniors.

The agreement calls for Sunrise to manage Inova's two Assisted Living facilities and provide development and management services for an additional four to eight local Assisted Living communities. Inova is a not-for-profit integrated health care system consisting of hospitals and other health services, including home care, nursing homes, mental health services wellness classes and freestanding emergent and urgent care centers. Inova's mission is to provide quality care and to improve the health of the diverse community it serves. Sunrise is one of the nation's largest Assisted Living providers.

Alterra, Inc., one of the nation's largest Assisted Living operators, formerly known as Alternative Living Services Inc., recently announced the formation of a strategic alliance with HCR Manor Care. Alterra will buy 29 HCR Manor Care Alzheimer's/dementia care and Assisted Living residences. HCR and Alterra intend to establish and capitalize a joint venture to develop Alzheimer/dementia care and Assisted Living residences over the next three to five years. Total development is expected to be about $500 million. Alterra and HCR also agreed in principle to form a new company to provide a variety of ancillary services to Alterra residents, including rehabilitation therapy and hospice care.

Mercy Services for Aging (Michigan) and Catholic Health Partners (Ohio) have been active in forming strategic partnerships with both not-for-profit and for-profit entities. An early managed care entrant into the Assisted Living industry was Independence Blue Cross, which entered into a venture with Pitcarin Properties in forming New Seasons, a Pennsylvania based Assisted Living company.

CONCLUSION

There are multiple options to structure strategic alliances, ranging from affiliation agreements to preferred provider agreements, to mergers and acquisitions. Organizations need to evaluate their appetite to integrate and willingness to surrender some degree of control.

Obviously, from a demographic perspective, the demand for Assisted Living will continue to grow as the population ages. Economic and other market factors will also drive up demand for Assisted Living services, The federal and state governments, and hospital and skilled-nursing providers are looking at the Assisted Living industry to provide an economic alternative to meeting the needs of the elderly. Access to capital, capacity and the integration into the continuum of care will likely be essential ingredients to the future expansion of Assisted Living.