Health Care - The Evolving Site of Service

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Over the past decade, health care has evolved both in how it is accessed and administered. Whereas care was once accessible only in hospitals and physician offices, today health care sites of service have shifted to include a myriad of venues and modes, including ambulatory surgery centers and telehealth. As a result of increasing health care costs, stakeholders are constantly looking for innovative ways to bend the cost curve and create incentives to achieve high quality, lower cost care alternatives, particularly focusing on the site of service. The following summary discusses the specific reasons for this shift, the significant impact of COVID-19 on this existing trend, and the developments and opportunities in private credit that have followed.

What is the Site of Service?

The site of service is the physical location where a patient gets care. Traditionally, hospitals and physician practices have served as the sites of service, but over the past decade, health care delivery has progressively shifted from inpatient to outpatient facilities. Today, sites of service have been expanded to include ambulatory surgery centers, primary care clinics, retail clinics, urgent care centers, independent diagnostic testing facilities, nurse managed health centers, virtual platforms and the patient’s home.

The Drivers of Change

A confluence of factors can be attributed to the shift in health care delivery from traditional sites of care to the growing list of outpatient care sites including: financial incentives, patient preferences, technological innovation and the increased reliance on telemedicine.

Financial incentives

The stakeholders and entities involved in the payment for health care are driving the most significant changes in the health care ecosystem. Rising health care expenditures have provoked payers to explore alternative means of distributing care. In 2020, the U.S. health expenditure totaled $4.1 trillion, or $12,350 per person, accounting for 19.7% of the nation's GDP.[1] In 2019, hospital spending represented close to a third (31%) of overall health spending, and physicians/clinics represented 20% of total spending.[2] Because rising health care costs squeeze profits and wages, there has been an increased focus for governments and employers to find ways to incentivize patients to get care at the lowest cost, and in the highest-quality setting. This has created a shift in payment methodologies, changing from fee-for-service to value-based payment systems, which incentivizes providers to be more efficient while lowering unnecessary costs. Because the emphasis shifts from symptom management (in a fee-for-service model) to a more holistic system of patient care (in value- based models), physicians are more likely to utilize quality, low-cost health services like alternative care sites, instead of more traditional sites of service.

Patient preferences

Patients are increasingly affected by rising health care costs due to the financial weight of higher premiums, co-pays, co-insurance and deductibles. As a result, the health care industry is witnessing a greater increase in consumerism among patients who are shopping for health care services based on considerations like cost, location and convenience. As patients take on increased financial responsibility for care, they are making more sophisticated decisions as to where they receive that care, opting for low-cost sites of service.

Technological innovation and telehealth

Technological innovation continues to change how health care is accessed and administered. Mobile technology, high-tech digital devices, electronic medical records and information systems permit payers and providers to accurately measure clinical outcomes and manage the continuum of medical care in sites of service that extend beyond the hospital and physician practice. As technology has advanced, new treatment platforms, including video and phone telehealth, have allowed patients to access health care from virtually anywhere. The brick-and-mortar site of care has made room for expanding venues of care and insurance companies have begun to adapt their reimbursement systems accordingly, allowing for compensation for care received across these expanding sites of service.

The Impact of COVID-19

While the catalysts listed above have influenced the health care sector for years, COVID-19 has had a particularly significant impact in accelerating the trends and transitions that have already taken place. Initially, treatment began moving from high-cost physical locations to low-cost ones, followed by a second phase in which physical locations in general moved to virtual sites of service. COVID-19 has accelerated both of these shifts. Hospitals have either been too full, or patients have been too hesitant to get treated at these traditional sites of service. Because of these factors, patients have become more comfortable in being treated either at smaller clinics or through virtual platforms. Additionally, while there was once a greater number of obstacles regarding regulations related to such provisions of care, the pandemic has caused the U.S. government to lower regulatory restrictions, paving the way for easier access to new sites of care.

Case Study: Telemedicine

Although telemedicine has been emerging as an important player in the delivery of health care over the past decade, the pandemic caused the use of and access to telemedicine to grow on an unprecedented scale. During the pandemic, telehealth accounted for over 30% of total outpatient visits. As providers began offering telemedicine as an alternative to in-person care, telemedicine emerged as an important tool to conserve the short supply of PPE, keep patients and providers safe and minimize unnecessary overcrowding of emergency care spaces, all while maintaining continuity of care. Even prior to 2020, lack of access to primary care, lack of access to health insurance and the promise of 24/7 care at emergency departments overwhelmed the resources of emergency departments across the nation. Telemedicine has emerged as a solution not only to reduce emergency department bottlenecks that waste critical emergency resources, but as a way to greatly reduce the cost of care. The average telemedicine visit costs $40-50, compared to the average emergency room visit, which can cost closer to $2,000.[3] In one study, the cost savings for patients with access to telehealth visits were between $19 and $121[4], mainly from avoiding trips to the ER. For the cost-cutting benefits, the patient-centered care and increased access to health care, providers generally expect that telehealth is here to stay. Accordingly, investment activity involving telehealth has been tremendous. In fact, telehealth investments hit an all- time high of $4.2 billion in the first quarter of 2021, which was nearly double the $2.2 billion raised in the same quarter of 2020.[5]

Market Trends and Opportunities for Private Lenders

As we all know, private equity investment in healthcare has grown dramatically over the last decade. Estimated annual deal values have grown from $41.5 billion in 2010 to $119.9 billion in 2019, for a total of approximately $750 billion over the last decade.[6] This explosive growth has had an impact on hospitals and health systems, creating well-financed competition which heretofore didn’t exist. Uncertainty around ongoing healthcare reform, accelerated consolidation, limited access to capital and the rise of patient consumerism has created unprecedented pressure on hospitals and health systems to innovate and supplement their core business lines. Many hospitals and health systems have legacy facilities which create even further pressure as the site of service changes.

Hospitals and health systems have been looking to diversify and transform their businesses. Private equity presents a potential solution for them. At the outset, private equity investments targeted specialties with high potential profit, including orthopedics, dermatology, urology and gastroenterology.[7] Now, we are seeing an increased focus on risk-contracting and value-based opportunities. A possible next phase is PE-backed health systems that build out their networks with niche offerings in order to provide specific expertise that is competitive and profitable.

There are ample opportunities for private credit in the healthcare market. Many of those opportunities are being driven, in-part, by consumerism. Private lenders may want to consider focusing on sectors that can take advantage of consumerism and move care to lower-cost settings while delivering high-quality health outcomes prove to be particularly viable areas of opportunity and innovation. In particular, ventures that focus on keeping patients out of the traditional inpatient acute care and emergency settings like urgent care, home care and hospice services have a great deal of promise. More recently, urgent care facilities have become the initial treatment point for patients and have established themselves as a key site of service. Participants in the home health industry have started furnishing and expanding a robust set of services in a senior patient's home, including telemedicine-enabled primary physician care. Similarly, behavioral health and ambulatory surgery centers are areas ripe for innovation and transformation between the right health system and private equity partners. Retail pharmacies are also partnering with private equity on patient-based initiatives where they can offer low-cost, smaller-scale health care services across a larger footprint.

Lenders should also be aware that, from a regulatory standpoint, newly-adopted Anti-Kickback Statute safe harbors and Stark Law exceptions have helped to create additional certainty relating to value-based contracting activities, including use of less expensive sites of services. On December 2, 2020, the U.S. Department of Health and Human Services issued two Final Rules in conjunction with its "Regulatory Sprint to Coordinated Care," an initiative aimed at reducing regulatory burdens on the expansion of value-based care. These regulations are expected to continue accelerating the transformation of health care payment mechanisms from traditional fee-for-service systems to value-based payment models that tie provider reimbursement to increased quality, reduced costs, enhanced care coordination and improved patient outcomes.

Lastly, one of the most promising avenues for growth and opportunity that lenders may consider is the telehealth sector. As described above, the COVID-19 pandemic has accelerated the volume of care administered virtually, and this will only expand to include a larger number of services and options for patients. Post-pandemic, telehealth will continue to be a mainstream option for care, making this area ripe for investment and further development.

As the demand for healthcare services consistently increases, PE-backed investments in healthcare are poised for significant growth. The healthcare sector is expected to experience long-term performance potential coupled with limited volatility, as witnessed during the COVID-19 pandemic.

[1] https://www.cms.gov/Research-Statistics-Data-and-Systems/Statistics-Trends-and-Reports/NationalHealthExpendData/NHE-Fact-Sheet

[2] https://www.healthsystemtracker.org/chart-collection/u-s-spending-healthcare-changed-time/#:~:text=Hospital%20spending%20represented%20close%20to,of%20total%20spending%20in%201970

[3] https://www.natlawreview.com/article/tele-triage-covid-19-crisis-s-transformation-emergency-care-and-potential-post

[4] https://www.ama-assn.org/practice-management/digital/how-telemedicine-helped-health-system-s-patients-avoid-ed

[5] https://www.fiercehealthcare.com/tech/global-investments-telehealth-ai-startups-reached-record-levels-q1-2021#:~:text=Tech-,Global%20investment%20in%20telehealth%2C%20artificial%20intelligence%20hits,new%20high%20in%20Q1%202021&text=Telehealth%20investment%20hit%20an%20all,ago%2C%20according%20to%20CB%20Insights

[6] https://publichealth.berkeley.edu/wp-content/uploads/2021/05/Private-Equity-I-Healthcare-Report-FINAL.pdf

[7] https://www.medicaleconomics.com/view/private-equity-healthcare

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