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The Reform of Medical Real Estate

By Bill Wiebe, SIOR, CCIM, CRE

"No matter what the outcome of the 2008 presidential election with regard to a national health care system, the real estate dimension of health care is a growing, dynamic, and visible area that deals with issues ranging from the cost to the location to the architecture and design of facilities ranging from acute care hospitals to specialty medical office buildings."

That was the beginning of my article in 2008 for "Changes Coming in Medical Office Space." We now are embarking on an increase in total health care dollar consumption of \$25 billion to \$60 billion over the next five years. Some 120 million square feet of new space is expected in the United States alone. Globally, healthcare has become a trillion-dollar endeavor.

Here are my predictions for the next five years and how they may affect you:

Physicians and physician practices will either be employees or will form alliances with the large hospital systems, generating a need for disposal of properties and a choice towards new construction.

Construction of the new facilities will require the aid of third-party real estate professionals, who will (1) aid in the decision-making process and in choosing locations, based on market knowledge and strategic market assessment and/or (2) play a central role in the bidding process for new construction, with trained project managers assisting the hospitals in the RFQ process.

Hospital systems will require the help of *third-party real estate management* to assist them in the ongoing management of properties and leases.

Suburban-based hospitals will be the norm; average size will drop from 600,000 square feet to 300,000 square feet, with a concentration of "24-hour hospitals."

Long-term care facilities will be the substitute for patients who need extended care.

Construction of *hospitals and healthcare facilities* will have to adapt to the new technology. This means that some processes based on nanotechnology will reduce the square footage needed, while some of the new surgery areas will increase based on the robotic technology that requires additional space for the larger surgical robotics. Patient rooms that will increase the square footage but reduce the incidence of airborne diseases will all have an effect on real estate decisions. In either case you as a real estate professional will be needed to help them navigate their way to accommodate this technological change.

Therefore the boom will be driven by:

- Hospital systems
- Physician practices
- Medical office buildings
- Medical schools and community-based colleges for nursing
- Allied health care manufacturers that produces the hospital equipment that is changing every five years
- Special-care facilities such as diabetes and access centers
- Suburban--based surgical centers
- Diagnostic centers

- Retirement centers including, skilled nursing facilities, assisted living facilities, and independent living facilities

In all, that's approximately 22 percent of the real estate pie.

And guess what my fellow SIORs...the members of the healthcare community are looking for people like you to assist them in their real estate decisions. Yes the time has come where the torch has been passed. Location of facilities is no longer a personal decision; decisions are based on solid demographics and a strategic market assessment. Hospitals are finally looking at the real estate community to manage those decisions.

Other key factors affecting health care real estate decisions are:

Demographic shifts: Population migration away from the urban core will continue to attract new opportunities for health care providers in suburban locations. Health care providers will seek practice locations that will attract affluent, well-insured individuals.

The convenience factor: Patients want an environment that is service-oriented in every respect. Parking must be readily accessible, patient wait times must be minimal, and service capabilities should be comprehensive.

Accommodating new technology: Clinical excellence and convenience shouldn't be mutually exclusive. As technology becomes more affordable, physicians will seek to make it a part of their practice, whether mandated by the government or not. Technology must enhance physician productivity and increase practice capacity. This increase in efficiency usually produces a requirement for additional parking.

Changing structure of medical practice: Growth of medical practice through mergers will continue to support the increased cost of infrastructure and create opportunities for better financial performance. Larger medical practices will seek market-branding opportunities to avoid dependence

on any individual practitioner. Already today, fewer physician specialists are dependent on the hospital environment for growing their practice.

Bright Outlook for Medical Office Buildings

Medical office building (MOB) cap rates are in the 7 percent to 8 percent. Indeed, when I met recently with the head of Harvard Real Estate in the Boston area, I found the rates to be even lower. They are generally 100 to 200 basis points better than other investment property. Due to MOB's declining risk, REITs are expected to increase momentum in the investment market. The capital vs operating lease upcoming mandates will only enhance that return.

The outlook for growth in MOB product is significant. Physicians are treating their practices like retail businesses, desiring to locate close to several hospitals and thriving residential areas. However, due to the high-tech amenities of MOB's, pre-leasing must be high. MOB's are an attractive market because vacancy rates are low—typically 5 percent to 10 percent—leases are generally 60 percent longer than other tenants', and renewal rates are in the 90 percent range—higher than average. The strong demand and high-end supply growth is expected to continue over the next 10 years.

Hospitals and Medical Office Buildings Embrace New Design Philosophies

Probably the most famous description of the impact of buildings on people came not from an architect or a researcher studying workplace performance, but from a politician. It was British Prime Minister Winston Churchill, who said: "First we shape our buildings; thereafter, they shape us."

No segment of the facilities market has taken that observation more to heart than health care facilities. Today, the concept of evidence-based design is drawing interest because it moves beyond the general idea that the physical environment affects occupants: It seeks to gauge the impact of specific designs on productivity, employee and patient morale, and patient outcome.

When most of us think about the future of medicine, architecture and real estate are not the first things that come to mind.

We think of advances in medical research and technology—better imaging techniques, robotic surgery, and genetic engineering (from which miracles are now expected). But in fact, hospitals and medical office buildings are experiencing important positive changes in architecture and design.

Don't touch that dial...we are moving to some new uncharted areas. This ain't a cycle it's a paradigm shift. 

