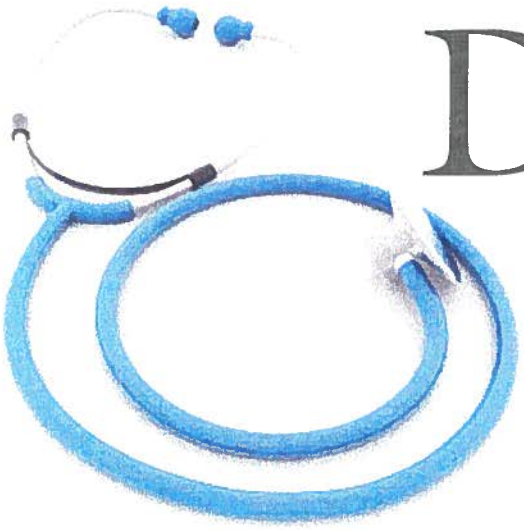


Doctors in the House

By Amy Wolff Sorter

Burleson, TX, located 20 miles south of Fort Worth just off Interstate 35 West, is a town of approximately 37,000 souls. On the east side of the interstate, just north of Farm-to-Market Road 1187, stands Texas Health Huguley Hospital Fort Worth South, a 223-bed acute-care facility complete with two intensive care units, an emergency department and an open-heart surgery center. Huguley has been around for decades, serving the healthcare needs of southern Tarrant County and northern Johnson County. Furthermore, the Texas Health Resources health care system, one of the largest faith-based, nonprofit healthcare delivery systems in the United States, has a huge toehold in this region.

Yet right across the road from Huguley, in almost David-and-Goliath fashion, Dallas-based Baylor Healthcare System, in conjunction with Duke Realty's healthcare arm, is building a 38,000-square-foot emergency medical center, scheduled to open in May 2014.

According to experts, the above scenario isn't unusual in the brave new world of healthcare and its real estate component.

"Anyone will go anywhere these days," observes John B. Mugford, editor of Healthcare Real Estate Insights. "Putting up a medical office building or an emergency department across from a competitor's hospital is becoming the norm, unless it doesn't make much business sense."

According to Don Dunbar, executive vice president, Midwest and South Regions for the Indianapolis-based Duke Realty, building a new emergency care center across from the huge, established Texas Health Systems hospital makes perfect business sense for Baylor Healthcare. Baylor currently operates Baylor All Saints Hospital, a 525-bed facility in Fort Worth. As such, the Burleson emergency department is a logical extension of those services. "The current trend in healthcare is that the patient prefers one provider or another. So the provider almost has to be everywhere," Dunbar comments.

The Concept of Healthcare Real Estate

Once upon a time, healthcare real estate referred to acute care hospitals and the medical office buildings on those hospital campuses. Inpatient and outpatient services were clearly delineated, with the hospital handling the former and tenants in the MOBs, for the most part, taking care of the latter services. But these days, "people use the term healthcare real estate to encompass everything from stand-alone emergency departments with ambulatory surgery centers to a building with any kind of doctor presence," Mugford says.

Dan Prosky of Griffin-American Healthcare REIT II Inc. narrows the definition somewhat further, pointing out that the best definition of healthcare real estate involves a location where a patient is seen by a provider. "This means medical office buildings, skilled nursing facilities and hospitals," says Prosky, who is president and COO of the Los Angeles-based REIT.

Richard Rendina, CEO of Rendina Cos. in Jupiter, FL, adds that healthcare real estate no longer necessarily needs to be close to a hospital campus, nor does it only encompass purpose-built medical office buildings. "We're seeing healthcare systems occupying space in traditional retail centers," he says, pointing to the stand-alone primary and urgent-care centers in shopping centers as examples.

Even as the definition of healthcare real estate becomes more flexible (and as investors and developers attempt to play catch-up with the concept), experts believe it's still a relatively stable sector. William S. Transou, principal-broker with WST Realty Corp. in Charlotte, NC, points out that healthcare providers aren't going to up and relocate to a new space on a whim. "Once you get them in and keep them happy, it's stable," says Transou, who recently partnered with Benjamin E. Bivens of Charlotte-based Bivens Investment Group LLC to form the healthcare real estate buying entity MedSouth Healthcare Properties LLC.

As such, the product remains a desirable commodity, even as it's becoming scarcer for investors. Bivens, for example, points out that the larger REITs, which once shunned healthcare real estate in the $10-million to $50-million price range, are seriously considering examining investments in that price range due to the lack of available product on the market. And Mugford points out that, while the demand for healthcare real estate remains high, there is, and will continue to be, small availability of the product coming to the market.

The Patient-Centric Model

Part of the issue is that as healthcare delivery is shifting, the real estate from which it's delivered is, as well. Yesterday's healthcare

model kept physicians and medical office buildings close to hospitals, so physicians could make their rounds at the hospital. This was great for the physician, but for the patient, not so much. It also meant that the real estate investment of choice was on-campus medical office buildings.

But that's no longer the case, especially as the role of physicians—especially primary care physicians—is changing. "Depending on your insurance, if you end up in the hospital, the chances are pretty good that your case will be overseen by a general physician, employed by the hospital. That's a primary care physician in the hospital who is responsible for you only while you're there," says Craig Beam, managing director with CBRE Healthcare Services out of Newport Beach, CA. This is one trend that has led healthcare delivery away from the main hospital campus. In addition to the above-referenced healthcare-retail partnerships, "medical office buildings and ambulatory care centers are going into the community," Beam says. "They're decoupled from being on hospital campuses."

This has led to systems such as Baylor to build specifically within communities, where the population centers are. And while the Baylor's Burleson emergency department won't be physically connected to a hospital, the emergency patient who might require admittance to an acute care hospital can either opt for Huguley across the road, or take the 15-minute ride up Interstate 35 to Baylor All Saints.

Notes Bronx, NY-based Simone Development principal Joseph Deglomini Jr., "Healthcare systems are trying to position their buildings in areas closer to where the population is growing. They're trying to make it easier for patients to get to a facility, and to see different types of practices under one roof, rather than being bounced around to different doctors in different locations."

Much of this is also being driven by the growth in the aging population—and the diseases inherent in this cohort. Older patients may not want to deal with driving 20 miles to a hospital campus, where they'll have to park and then walk far to a medical office building to visit their doctors. As such, Bivens Investment Group LLC's president and broker, Benjamin E. Bivens, thinks the hospital-MOB campus is becoming antiquated.

Rather than that system, Bivens, who is based in Charlotte, believes that healthcare systems will offer umbrellas over their patient population basis, and offer services specific to that population. "The real future of healthcare real estate involves working with the providers themselves, and how they're managing the patient population in the community," he adds.

Alphabet Soup

Part of patient management and healthcare real estate trends are occurring in response to the Patient Protection and Affordable Care Act of 2010, or Affordable Care Act for short. Political rhetoric aside, since 2010, healthcare experts have debated the impact of the ACA on healthcare real estate, with no firm consensus coming out of those discussions.

CBRE's Beam says there is little doubt that Obamacare will change the way in which healthcare is delivered—meaning it will change healthcare real estate space usage. "The uninsured currently access healthcare through emergency departments," he says. "We think that with more people insured, they'll access healthcare through a doctor, rather than the emergency department." As such, he notes, look for an expanding demand for physician spaces.

THE OLD HEALTHCARE REAL ESTATE MODEL THAT DEFINED WHERE SUCH PROPERTIES WERE BUILT, AND WHAT TYPES OF SERVICES THEY OFFERED, IS GOING BY THE BOARDS. NOWADAYS, THE SERVICES, AND PRACTITIONERS, ARE LOCATED WHEREVER PATIENTS ARE WILLING TO TRAVEL.

But Prosky doesn't necessarily agree about Obamacare's impact on healthcare real estate. "Sure, it will drive more people into having health insurance," he says. "It's a big boon to anyone in healthcare, but to us, it's simply insurance reform."

The main driver on healthcare real estate, he continues, is the move from the current fee-for-service model of healthcare delivery to that of accountable care organizations, or ACOs. The concept behind ACO is less about paying for what is done, and more about how well physicians can successfully manage the health of patient populations. What the ACO concept says, in other words, is that "we'll pay you not for how much work you do, but for how well you do the work," Beam says.

Prosky says such accountability is leading to bundled payments among practices and merger and acquisition activity as practices and healthcare systems consolidate to spread the risk of patient care. This, in turn, is leading to the dwindling of the one- and two-person practices and a boost in the large physician practices and physicians as hospital employees, rather than as independent contractors. "We'll see much larger provider groups in the future as a result," Prosky says. "That, to me, is more of an issue than the Affordable Care Act."

But Beam points out—and Mugford agrees—that even before ACA became a buzzword in the healthcare industry, outpatient-centric care was already a trend. "What ACA is doing is forcing the issue a little faster," Mugford points out. "The industry needed to examine ways to save costs and it's still doing so."

Regardless of why and when accountability has become such a buzzword, boosting efficiencies and streamlining costs are a huge part of today's healthcare industry—and the real estate from which it operates. "It's a matter of getting economies of scale so [healthcare systems] can reduce expenses," Dunbar says. "Also, strategically, they don't have to build as many new facilities."

The move toward efficiency and cost savings is also leading to monetization of current facilities as healthcare systems and physicians attempt to get out of the real estate business. "Consolidation among hospitals and competing priorities for capital are driving more medical office building monetizations by hospitals," Rendina notes. "The increase in physician employment is creat-

ing the need to restructure or sell many smaller physician-owned medical office buildings. These trends are creating more opportunities for commercial real estate professionals."

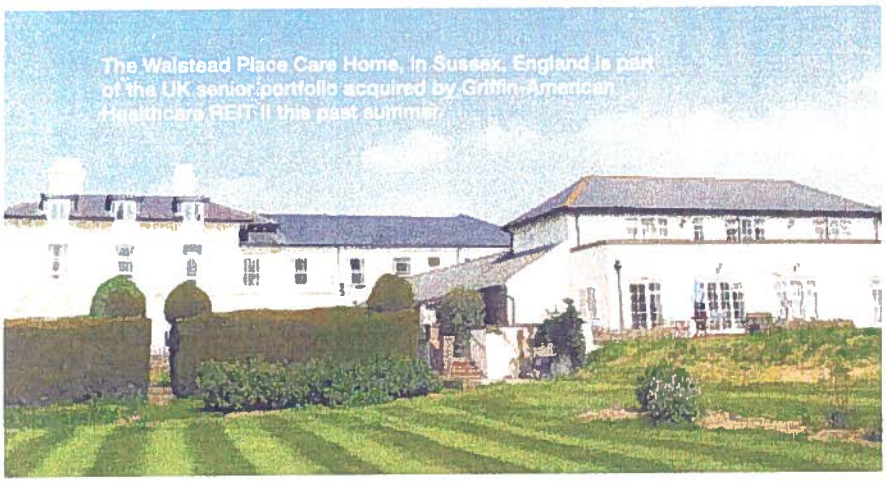
Wilmington Health medical office building in Wilmington, NC, recently acquired by MedSouth Healthcare LLC.

Building, Buying, Vacating

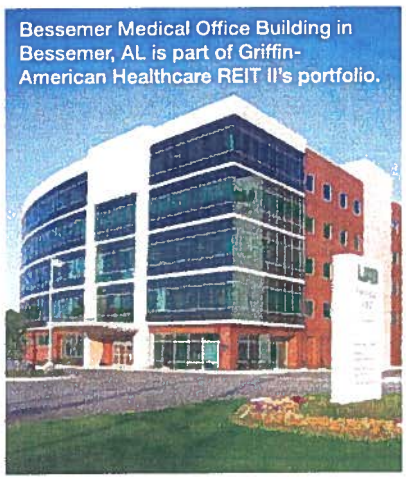
The experts point out, however, that even without ACOs and PPAC, the move is on to deliver healthcare more efficiently—and less expensively—to the masses. This, in turn, is leading not only to community healthcare centers, but also to reconfiguration of current healthcare space.

That reconfiguration is coming at an interesting time: another aspect of healthcare real estate is that many hospital buildings and medical office buildings in existence are functionally obsolescent. Simone's Deglomini points out, for example, that many of today's acute-care hospitals were built decades ago. The problem is, that with "new technology, those building are antiquated," he comments.

Furthermore, on the acute hospital end, "the shift is from doing everything in the hospital to moving those activities to the outside, as much as possible," Beam says. "Hospitals are morphing into ambulatory care spaces."


The Walstead Place Care Home, in Sussex, England is part of the UK senior portfolio acquired by Griffin-American Healthcare REIT II this past summer.

As such, while some acute care hospitals could be abandoned due to functional obsolescence, Duke Realty's Dunbar says the greater likelihood is that those hospital buildings could become specialized facilities. "Not all hospitals can be everything to everyone, nor should they be," he points out. "Rural hospitals, for example, might not be involved with catheterization. If they don't do at least three to five of those a day, they don't need to be in that business."


Bessemer Medical Office Building in Bessemer, AL is part of Griffin-American Healthcare REIT II's portfolio.

And those spaces need to be a lot more flexible than they were in the past. Mugford says healthcare real estate construction numbers are picking up a bit, but "there aren't as many small doctor practices you can fill buildings with, so you need to have heath systems commitments for those buildings to fill them," he points out.

Furthermore, with healthcare systems buying up private practices, there will be the attempt to eliminate conflict between the physician groups versus the hospital MOBs. "They're encouraging their practice groups to dispose of real estate to relieve conflict that might be created with ownership," says Transou of MedSouth. "That's a potential opportunity—as they're trying to dispose of real estate, there'll be buyers out there looking for it."

Acute-care hospitals could be making their way toward not just technologically advanced facilities, but health villages, consisting of on-campus fitness centers, retail, healthy food products—and even an onsite spa. As such, we could see a future of bedless acute-care hospitals and medical practices offering everything from ambulatory surgery to sophisticated MRI and other diagnoses activities.

"It's a whole new way of treating the patient," Deglomini says. "It's a way of trying to make it convenient for the patient, rather than dealing with it the way that was done before."

Rendina agrees, noting that the newer facilities blur the lines between inpatient and outpatient treatment, with efforts directed toward prevention and wellness along with treating the chronically ill. "I believe hospital occupancy of most new facilities will increase relative to historical percentages given the trend of increased physician employment," he says. "But since it's incredibly expensive to operate a hospital bed, the future will also be about keeping people healthy and reserving the beds for the sickest of the sick."

Even with changes impacting the sector, the basic function of healthcare real estate isn't going away anytime soon. Bivins notes that healthcare will continue to be driven, in part, by real estate. "You can't outsource healthcare," he observes. "At some point, you still need to go and shake hands with your doctor at some sort of location." The future issue will be, however, where that location will be, and from what type of real estate that doctor will be operating. ◆