



**COMMERCIAL REAL ESTATE**

# Change coming for medical office building marketplace

**T**oday the U.S. spends more than \$8,000 per person annually on healthcare, public and private combined. Most other countries spend between \$2,000 and \$5,000 per person. Americans deserve better healthcare choices so we can stop paying retail. While there will be no "Black Friday" deals in healthcare just yet, change is coming.

Healthcare changes had to be initiated quickly because the inefficient U.S. healthcare system brought the country near the brink of bankruptcy. But reform won't happen overnight. It will take about three years to see an improved, more efficient and stable healthcare system. But at least we are moving in a positive direction regardless of our healthcare system's final form and name.

ACA (Affordable Care Act) is expected to add 25 million people to the rosters of medically insured by 2016. Yes we had a bumpy tech start. Who among us never had a network go down? But people today age 65 and over already account for one-third of all U.S. health care expenditures, and this baby boomer segment will grow by more than 18 million additional people over the next ten years. So the launch of American healthcare reform is kicking off not a second too soon.

I participated in the RealShare Medical Office national conference last month in Scottsdale, Arizona. The manner in which healthcare is delivered to Americans is changing. Increased demand for new types of medical office building design is part of that, along with locations different from past conventions to meet the needs of healthcare service providers of the future.

Yesterday's strategic hospital planning mantra was something akin to, "Build it and they will come." Doctors would put their offices nearby and patients would travel there, regardless of shifting population demographics and patient inconvenience. Today, hospitals have adopted strategies that shopping center developers have been successfully employing for decades. This new direction in commercial real estate parlance is the "Retailization" of healthcare.

Today's healthcare providers (hospitals and doctors):

» Bring healthcare to locations closer to where people live and work.

» Are more retail oriented with a "patient friendly" open design for greater flexibility of space, allowing for different uses, more out-patient services and more office sharing among



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specialists. Look for smart comfort amenities including free Wi-Fi, cafes, business offices, automated parking and electronic patient tagging so the receptionist knows when a patient enters the building.

» Add satellite offices by renting in retail centers or owning medical office buildings on out-parcel pads in anchored or shadow anchored centers.

» Increase operating hours (approaching 24/7 in some cases) to better serve patient schedules.

» Use hospitals less for in-patient services.

» Use ambulatory surgery centers and urgent care centers more for out-patient services.

» Continue to consolidate hospitals and medical practices to be more efficient and effective, down from 8,100 hospitals in the U.S. at the end of the '80s to 5,900 hospitals today.

» Move away from older (pre-2007), low tech, small footprint (2,000 to 5,000 square foot), single specialty medical office buildings with little to no visibility to newer, high tech, larger footprint (7,000 to 12,000 square foot) buildings with open design for flexibility, multi-specialty operations (for one stop patient healthcare shopping) with highly visible easy accessible retail locations.

» Move away from quiet, out of the way locations. Older medical office buildings are at risk of higher future vacancies unless they upgrade technology and amenities to compete.

» Move toward busy, major artery locations closer to current population centers for better patient access and convenience.

» Utilize excess vacant hospital space for

more patient friendly services like restaurants, dry cleaning, child care, coffee shops and retail stores to create a more pleasing full service environment. Since 85 percent of people who enter a hospital are not patients, there is a ready market that can benefit from more retail services on the hospital campus.

» Use more sale/leaseback transactions to lower liabilities and increase cash positions, since shorter leases of 5 to 10 years are better than longer mortgages with 15 to 25 year terms; lower overhead (increase profit) through lower rent payments; limit exposure to Stark law liability since increased enforcement is a key aspect of ACA. The Fraud Enforcement and Recovery Act (FERA) expands the scope of False Claims Act, which is the basis of most whistle-blower lawsuits, imposing a clear obligation on healthcare providers to repay Medicare and Medicaid reimbursements disqualified under Stark law. Forgetting to properly sign a lease on file is one example of a new Stark law violation. Stark law compliance headache and expense can be dramatically reduced by shifting medical office building ownership to a third party investor while controlling the building via a leaseback arrangement for the medical business.

The net effect of policy changes and shifting demographics (aging baby boomers) will be increased demand for medical office space. The current shortage of doctors will get worse since the volume of medical students has not kept pace with increased healthcare demand. And this will get further exacerbated by the anticipated wave of older doctors retiring over the next few years.

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