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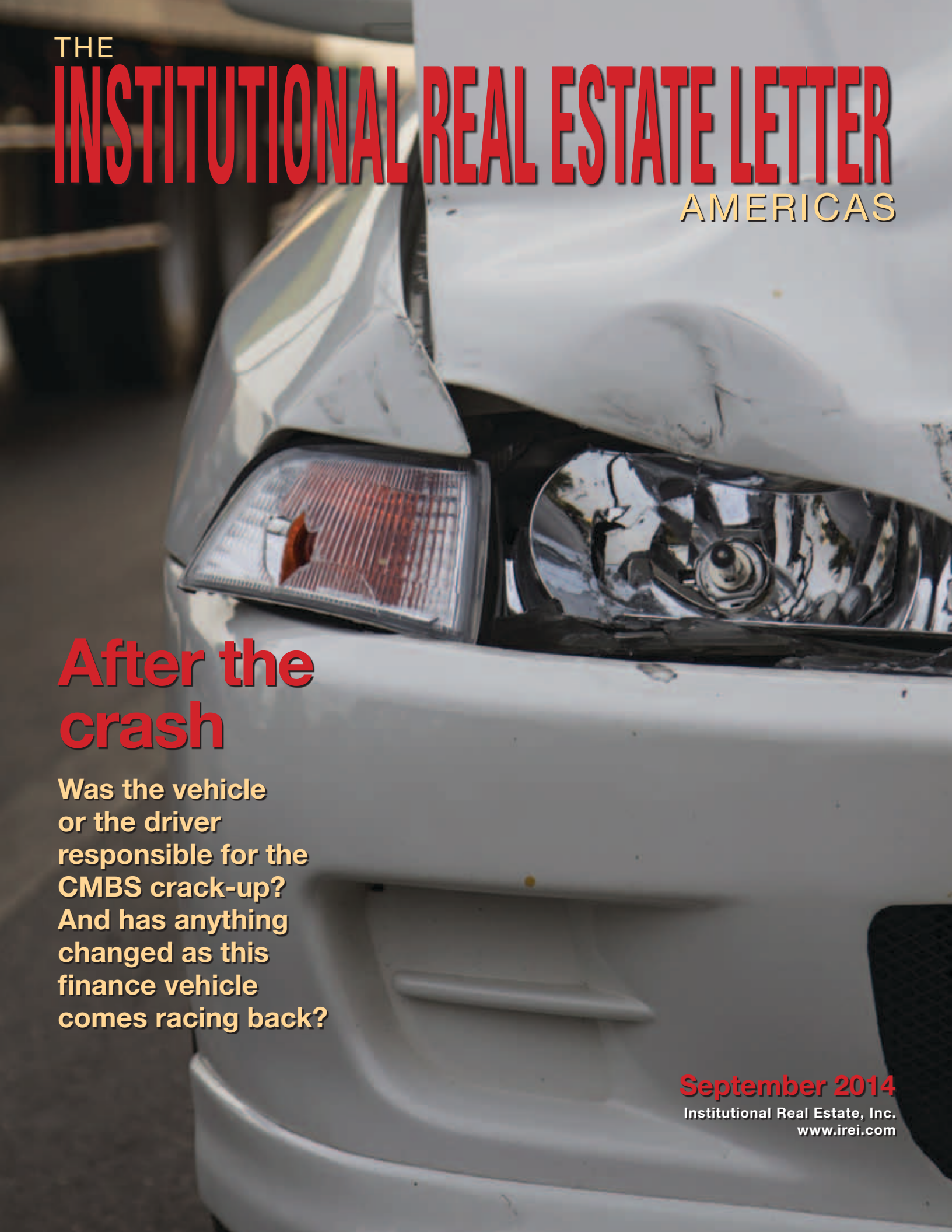

After the crash

Was the vehicle or the driver responsible for the CMBS crack-up? And has anything changed as this finance vehicle comes racing back?

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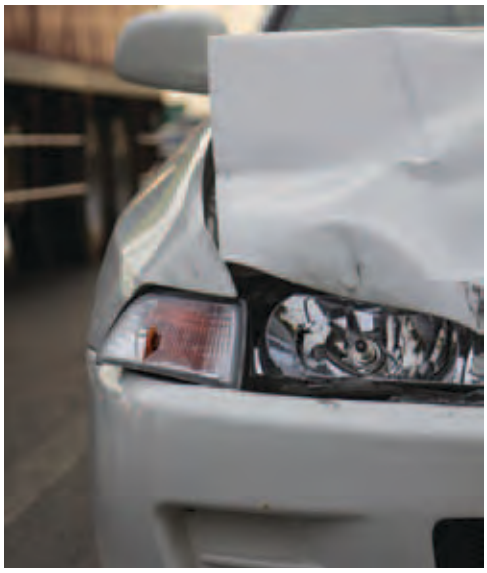

On the cover: Car crash

Redefining medical office

Technology, new markets and consumer demand are transforming healthcare

by Tom Errath and Dean Egerter

Investors have become increasingly interested in the benefits that have been associated with medical office buildings, based on their relative performance to traditional office during the recent economic downturn and capital markets dislocation. Investors have been attracted to the property type's low tenant turnover, compelling tenant credit profiles and ability to access financing. Given this more competitive investment environment and with recent market and Affordable Care Act changes that affect healthcare and its delivery systems, it is clear that, in addition to traditional medical office buildings, new forms of healthcare delivery real estate warrant institutional investors' attention.

Healthcare spending constitutes 18 percent of GDP, is growing, and is staring down the largest elderly population in history. To deal with this reality, the providers of health insurance have been focusing on purchasing healthcare more economically; doctors are redesigning practices to offer more team-based, patient-centered care; and financial incentives are prompting health systems to operate more efficiently. Some of these healthcare reforms began even before the recent changes brought about by the ACA.

Historically, medical office buildings contained only physician practices and unrelated medical services providers. In recent years, many in-hospital healthcare services have moved to lower-cost out-of-hospital environments necessitated by an imperative to reduce costs and made possible by technology advances that allow physicians to perform complex medical procedures

away from an acute care hospital. Several statistics highlight what has been occurring away from the hospital. Total outpatient visits grew from 300 million in 1990 to 675 million visits today. Ambulatory surgery centers are now widely accepted; outpatient surgeries grew from 11.7 million surgeries in 1991 to 17.4 million in 2013. Finally, outpatient services generated 25 percent of revenue in the early 1990s, while accounting for 44 percent of revenues today.

A proxy for the migration of medical services out of the hospital is what occurred with the traditional department store. At one time department stores carried all categories of merchandise on multiple floors. Books, sporting goods, electronics and appliances could all be purchased at the traditional single-location department store. Movement of these specialty departments to higher margin, lower cost, easier to access out-of-department store locations is analogous to what is happening in healthcare. Technological advances, cost reduction, new market penetration and consumer demand are all contributing to the trend, which is expected to continue if not accelerate in coming years. There are several facility types that now operate away from acute care hospitals offering ever-increasing and complex medical services.

The range of outpatient services and medical procedures that can now be done in just a few hours is growing each year.

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Medical office buildings

These multi-tenant facilities traditionally housed primary care physicians and were leased to any medical service provider who required space. Today's medical office buildings contain strategically placed mixes of primary care physicians, diagnostic services, pharmacy and other medical specialties that allow patients to access multiple healthcare service providers within a single facility. The type of procedures offered in today's medical office buildings are far more complex than would have been imagined even a decade ago, and the availability of complementary services in one facility provides the convenience desired by healthcare consumers.

Inpatient rehabilitation facilities

These medical facilities are post–acute care facilities located outside the acute care hospital offering recuperation and rehabilitation services to patients recovering from an acute care hospital stay. Inpatient rehabilitation facilities provide specialized rehabilitative care for patients requiring a combination of hospital-type care and intensive rehabilitation in a standalone setting. This patient focus allows faster discharge with fewer hospital re-admittances when compared with in-hospital rehabilitation facilities.

Physician-owned hospitals

These highly specialized facilities are owned and operated by physicians. Physician-owned hospitals can specialize by care type and importantly can select or reject patients regardless of their health condition or ability to pay. Recently, nine of the top 10 performing hospitals in the United States were physician-owned as ranked by the Centers for Medicare and Medicaid Services. Physician-owned hospitals have begun to "crack the code" as it relates to providing positive patient outcomes, not just the delivery of healthcare services, all within a convenient outpatient setting.

Ambulatory surgery centers

These are a high-quality, lower-cost substitute for hospitals as venues for a variety of outpatient surgeries. These facilities specialize in surgeries and provide a full surgical suite to provide patient convenience and same-day surgical care. Outpatient surgical centers have dispelled the notion that all surgeries must be done in traditional acute care hospitals. A recent study of Centers for Disease Control data found that ambulatory center surgical patients saved an average of 25 percent compared with hospital surgical patients. At the same time, patient satisfaction outcomes are comparable or better than hospital surgical outcomes.

Urgent care centers

These facilities deliver medical care outside of a hospital emergency department on a walk-in basis. They have become one of the fastest growing segments in healthcare because they can treat many patients in a much shorter timeframe than a hospital emergency department. Most urgent care centers offer extended hours in the evenings and on weekends for patients to receive treatment when their physician is not available. A growing subset in the urgent care environment is the freestanding emergency department, which treats patients needing immediate emergency care away from the hospital. They are operated as extensions of a hospital's existing emergency department or are

operated as independent freestanding emergency departments by physician groups.

The growing number and type of facilities that now routinely operate outside the hospital is driven by the need to achieve more value in a healthcare system that is unsustainable as currently configured. Outpatient facilities have proven their ability to deliver patient value via cost savings, consumer preference and service delivery that is comparable or better than acute care hospitals. These trends, in conjunction with the changes that are occurring through the implementation of the ACA, suggest that healthcare service delivery models will continue to pursue high value out-of-hospital locations.

There are several trends that highlight why out-of-hospital healthcare facilities are likely to continue to proliferate.

Consumers are able to access nearly every other consumer service in this way and are now requiring the same from their healthcare providers.

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Healthcare value

Improved value is clearly the mandate that government, employers and consumers are now demanding from all healthcare providers. Outpatient facilities can be built in locations that are significantly less expensive to operate and provide either specialized or one-stop healthcare that is more economical than delivering the same service via the acute care hospital. New technologies, specialized care and less costly real estate allow outpatient facilities to deliver services less expensively.

Consumer preference

Outpatient facilities provide a consumer-preferred retail-like location near where patients live and work. Consumers are able to access nearly every other consumer service in this way and are now requiring the same from their healthcare providers. These often newly designed buildings also enhance the overall customer experience as compared with accessing services at a large urban hospital facility. As health systems realign their competitive models, the placement of these outpatient healthcare facilities in new markets allows health systems to operate within a competitor's market to access new patient populations.

Healthcare pricing

Information about how much a physician or hospital will charge before a patient receives a test and treatment has been difficult if not impossible to obtain. Recently, the federal government published Medicare data that provided detail on the wide price variation that exists throughout the country for healthcare services. Employers will exceedingly push for more price transparency and will push to use reference pricing (a not to exceed amount) for reimbursing certain procedures. This shifting of the financial risk of healthcare away from employers and to consumers makes consumers more sensitive to the cost of the service. The proliferation of high deductible health insurance plans, which are now the fastest growing in the sector, has also served to enhance patients' focus on cost. These changes in many cases give consumers incentive to seek lower-cost healthcare services, many of which are now delivered in outpatient facilities.

ACA forcing change

As the ACA becomes the market reality, including the requirement for mandatory insurance coverage, health systems are already positioning to handle those patients, and much of how patients will be accommodated will be through development of non–acute care outpatient facilities. In many ways the ACA will exert a positive influence on healthcare real estate as it helps create demand for outpatient facilities. The ACA requires hospitals to invest in and implement many costly new systems and procedures at a time when they are also facing lower Medicare reimbursements and private insurance payments. Outpatient facilities provide an ideal segue into the lower-cost healthcare environment.

The current and future healthcare environment favors out-of-hospital facilities as this type of healthcare real estate has contributed to changing the way healthcare is delivered. Healthcare practitioners housed in these facilities and the services delivered provide a sustainable value proposition to various healthcare constituencies. An outpatient-focused strategy delivers value to the consumer, the health system and insurance providers. It is also well positioned to prosper as the healthcare market evolves. ❖

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