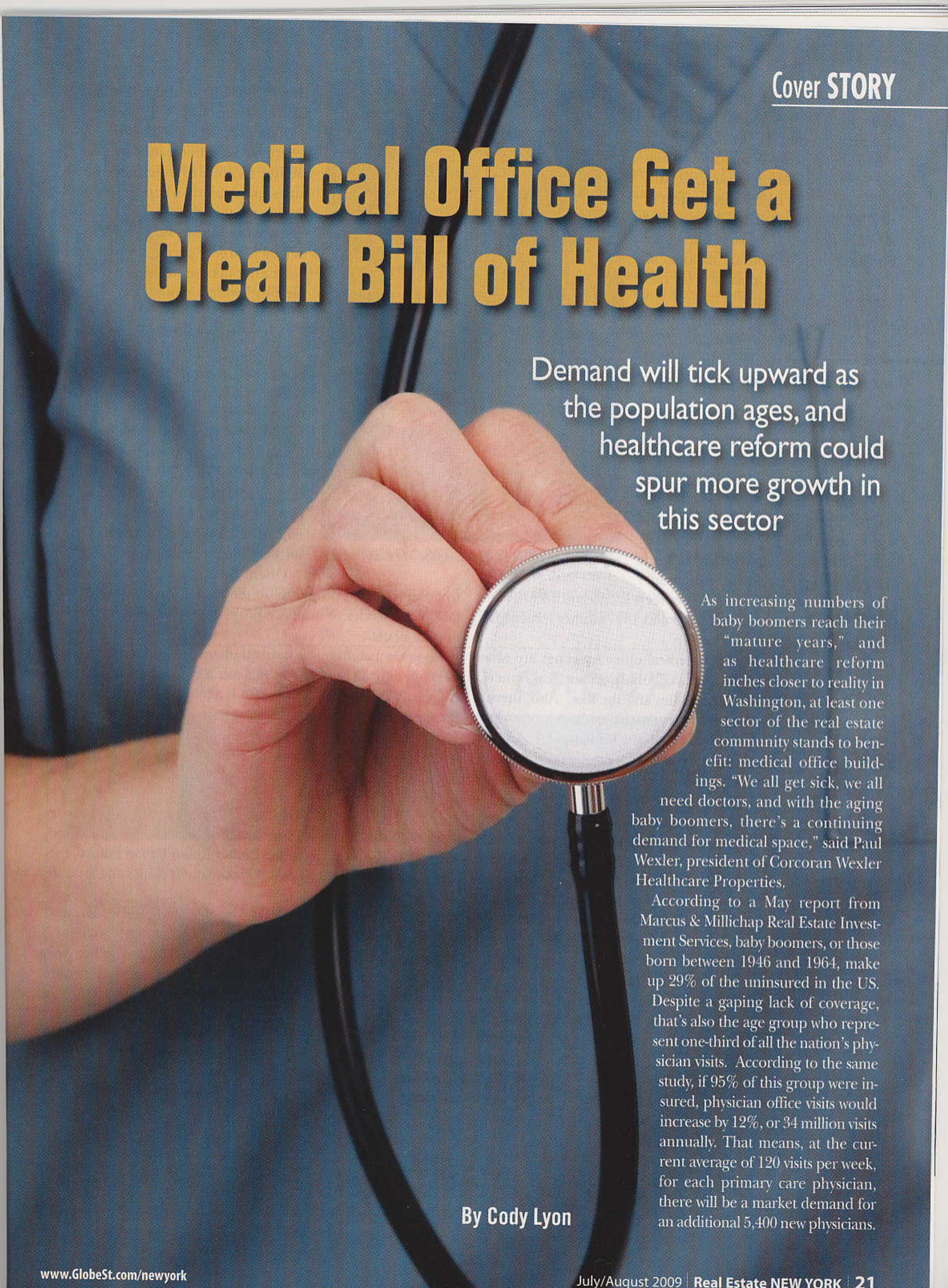

Medical Office Get a Clean Bill of Health

Demand will tick upward as the population ages, and healthcare reform could spur more growth in this sector

By Cody Lyon

As increasing numbers of baby boomers reach their "mature years," and as healthcare reform inches closer to reality in Washington, at least one sector of the real estate community stands to benefit: medical office buildings. "We all get sick, we all need doctors, and with the aging baby boomers, there's a continuing demand for medical space," said Paul Wexler, president of Corcoran Wexler Healthcare Properties.

According to a May report from Marcus & Millichap Real Estate Investment Services, baby boomers, or those born between 1946 and 1964, make up 29% of the uninsured in the US. Despite a gaping lack of coverage, that's also the age group who represent one-third of all the nation's physician visits. According to the same study, if 95% of this group were insured, physician office visits would increase by 12%, or 34 million visits annually. That means, at the current average of 120 visits per week, for each primary care physician, there will be a market demand for an additional 5,400 new physicians.

Those physicians will need nearly 10 million square feet in additional office space nationwide.

Broadly speaking, by increasing coverage to 95%, of all age groups, doctors would need 21.4 million square feet of new MOB. "We're talking about adding significantly to the demand side of the equation," says Al Pontius, national director of office and industrial properties at Marcus & Millichap.

Pontius points to Massachusetts health reform, where since 2006, 97% of the state's residents obtained some sort of health insurance according to a 2008 *Boston Globe*/Blue Cross Blue Shield survey. As a result, developers added 1.8 million square feet of new medical office space.

"Our business is advising real estate investors," Pontius says. He said the MOB report is meant to help them understand "the implications of health care reform." Pontius adds his company is forecasting year-end national vacancy rates in the MOB sector to be between 12.5% and 13%. That's a far cry from the between 17.5% and 18% vacancy forecast for general office space.

ABR's new 30,000 sf Medical facility at 429 East 75th St.

Generally, non-emergency-medical office buildings are what they sound like: home to doctors, ambulatory surgical centers, laboratories, rehabilitation facilities and the like. Also, there's a growing health information sector as more health providers convert paper-based records to electronic formats. Outside New York City, the fastest growing group of medical-office buildings has traditionally been stand-alone, suburban buildings created for medical-related users.

Jeffrey Cooper, executive director at Savills and head of that company's health care real estate practice, says, "Whatever happens with reform, more people will have medical insurance," encouraging an already emerging trend. He estimates 60% of people treated by hospitals are considered "inpatient," and that over the next five years, that will decline to 40%. He predicts newly insured will seek care in MOB or ambulatory centers.

Cooper says Savills got into the medical sector just four years ago "because a lot of our institutional clients were starting to look at investments in that sector. We learned it's very different from regular office, both in terms of reliability of cash flow and the types of deals being done." In those four years, Savills has done about $3 billion in health care real estate capitalizations.

Demographically, he says, most centrally located hospitals are putting satellite facilities in suburban communities, particularly where in more affluent neighborhoods. For example, "patients requiring some sort of ambulatory surgery prefer close-by facilities, rather than venturing to the main campus," which is often located in a city's interior.

Cooper says of medical office stock, "you want buildings either on the campus of an investment grade medical center or affiliation with a major medical center" if not actually on-campus. He says that generally speaking, these buildings usually include long-term leases. "If you're a doctor who's admitting patients to a hospital or handles patients who need hospital services like expensive radiological services, you're not going to move around."

Often, he says hospitals exert control over affiliated properties so they can make certain that the facility is a feeder of business, or service them with admissions or treatments.

He notes that distress is rare with these properties, since hospitals tend to make certain that whoever is running their buildings is stable. "The last thing they want is a lot of turmoil, so that the doctors get aggravated and want to move out or move over to the next hospital." He cautions that if an owner flips a property, "you'll never get another building on that hospital campus," Besides, Cooper says, medical campuses are usually not built unless they are over 50% preleased.

But with a lack of available land and a market more corporate than medical, New York's medical office market is somewhat limited. Still, according to the Center for an Urban Future, the city is home to 65 hospitals, 1,300 outpatient clinics and around 30,000 doctors.

CJ Follini, founder and CEO of Noyack Medical Partners, says New York City doesn't have a "traditional" campus definition of medical office. He says most MOB is located in some other type of asset or mixed-use development. Of the future, he says that with 10 million people, New York City will continue to see an uptick in demand for medical care.

He agrees, "Any version of healthcare reform will increase the pool of insured Americans." For investors, Follini advises that it's important to understand the macro-market of hospitals.

For example, "if I was a healthcare owner near Mt. Sinai Medical Center, I could live off it the rest of my life," while "if I was an owner near the now bankrupt Cabrini, I'd be very unhappy," Follini says. He adds that his portfolio, which includes One Hanson Place, currently Brooklyn's tallest building, is "doing great." Noyack's portion of this mixed-use residential tower, formerly the Williamsburgh Savings Bank building, is a 32,000-square-foot medical condo which has 15 offices covering a variety of practices.

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PAUL WEXLER
Corcoran Wexler Healthcare Properties.

But, speaking to the dominance of a corporate market, Wexler says "not every medical specialty pairs well with a corporate environment."

Marisa Manley, president of Commercial Tenant Real Estate Representation, agrees, but says this was more evident before the downturn. Owners often claimed they didn't want the extra traffic or said they weren't willing to do necessary build-outs.

Manly recently represented a large dental practice that was moving from Madison Avenue. She says they looked at nearby locations on the same street as well as Park Avenue, but even during these challenged times, "buildings didn't want them." She says "for the types of practitioners here in Manhattan, they're going to have strong preferences for finding an existing medical office, where the plumbing is in place." Manley adds that being near hospitals in not "an exclusive driver."

Offering up a symptom of the downturn, Manley says "some medical diagnostic labs and dental service providers are seeing somewhat decreased revenue." For example, she said "if you talk to a periodontist, they may say patients are stretching out treatments or scheduling fewer visits."

Attempting to capitalize on the city's increasing demand for medical office space, ABR Partners recently acquired and rehabilitated a six-story, 30,000-square-foot parking garage at 429 E. 75th St., near the Upper East Side's "hospital corridor." The property's owners are promoting it as a "first class medical facility.

"There's no fully dedicated brand new private building that's not affiliated with a specific hospital in New York, so we felt this was an opportunity that was compelling," says Brian Ray, managing partner at ABR. "We saw an opportunity, where the market is underserved. People are still going to the doctor, treatments are still being provided and obviously, this is still a positive sector within real estate."—RENY