INDUSTRIAL NEWS

Healthcare still a real estate star

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No question – 2012 was the year of healthcare. In one of the most significant rulings in recent memory (perhaps since the awarding of the Presidency to George W. Bush in 2000), the Supreme Court upheld President Obama's health care law in a nuanced interpretation of Federal versus states' rights. This will go down in the history books as comparable to the passage of Medicare in 1965 because the historic 5-4 decision will affect the way 30 million uninsured Americans receive and pay for their personal medical care. And it has guaranteed that medical will remain one of the leading sectors of real estate: the national vacancy rate for medical office buildings is currently 10.9 percent, much lower than the 12.5 rate for the office sector as a whole. Approximately $5 billion of healthcare property traded in 2012, and that figure should rise by 10 percent in 2013.

So, what do real estate people need to know about reform? Passed by Congress in 2010, the Affordable Care Act (ACA) will cost $938 billion and will reduce healthcare spending by $138 billon, according to the independent Congressional Budget Office. It is a restructuring of our system that will have long-term effect on healthcare providers and their balance sheets. One impact will be that scale will matter in the future. The new value-based purchasing and bundled payments that Medicare will make to providers will make it imperative for them to be part of more efficient, larger systems and groups. So smaller hospitals will merge or be acquired and small physician practices will join larger groups. The same will happen to small insurance companies which will need scale in order to compete on the insurance exchanges where people will buy coverage. So, we are less likely to see new construction by small independent systems (say those with one or two hospitals or medical office buildings) and more growth by large providers, including academic systems.

Enter the ACO

While the fate of Obama Care hung in the balance, the acronym, ACO became the voluntary dance that nobody wanted to show up to too early. ACOs (Accountable Care Organizations) are essentially consortiums promoted as a bigger, better model that manages health at the population level across a broader swathe of the healthcare spectrum. So, an ACO might include a hospital, various specialty groups, surgery center, imaging, Emergency Department, even nursing homes, with all payments made to the head of the ACO (usually the hospital) which would then disburse to the rest of the group. But ACOs are tough, requiring greater accountability with providers having to report on 33 different performance measures to ensure they aren't skimping on care. Well, despite the contingencies, the ACO has arrived. Last July, 89 participants joined the 27 existing ACOs in the program collectively serving more than 2.4 million beneficiaries. Four hundred more organizations submitted a notice of intent to apply between Aug. 1-Sept. 6, 2012 to join an ACO in 2013. What ACOs epitomize is the new philosophy of care -- bundled payments and shared savings pegged to outcomes rather than fee-for-service; communication and integration between providers; and a strong focus on primary-care.

ACOs aside, the new post-reform world is still taking shape but, from our perspective, we can draw some conclusions about the look of healthcare going forward:

- Cost and outcomes will be king – Medicare, which will be 75% of all spending by 2030, will be cut; hospitals will be penalized for high readmission rates; and providers will need to trim their operating expenses by 20% to stay solvent
- In light of consolidation, standard leases within medical office buildings will be larger (from 1,000-3,000 square feet to 5,000-8,000 square feet for larger physician practices). We are seeing 15-year triple net leases and a lot of 7-year leases with TI that is higher and annual rent increases of 2-3%.
- The real estate investment community, including the REITs , pension funds and private equity groups, will continue to hold medical real estate as a favored product class, along with multifamily and industrial.
- Primary care physicians will increasingly be at a premium as tenants because they will act as gatekeepers in the post-reform world
- The biggest user of healthcare are people with chronic conditions (about 145m people and projected to grow to 171m by 2030) so snow-bird states will show a lot of growth.

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