

The New Pulse



The OakBend facility provides the latest in doctor amenities and is equipped to handle upgrades to technology as they become available.

of Healthcare Development

■ By Stephen M. Doyle

As the recently passed healthcare reform bill advances toward implementation, many hospitals and doctor groups remain reluctant to execute long-term real estate decisions. This is largely due to the uncertainty surrounding the new legislation's impact on their medical business. The delivery process of healthcare services is shifting, with many doctors returning to the security of hospital systems rather than embarking on the traditional entrepreneurial approach of private practice. Real estate development efforts within the healthcare market will also require modification to better align with current trends.

Keep Your Eye on the Ball

Similar to any real estate development opportunity, understanding the client's business, motivations and goals are critical. When McShane Development Company and OakBend Medical Center, the largest full-service healthcare provider in Fort Bend County, Texas, began discussions regarding the possibility of developing two new medical office buildings (MOBs), understanding the strategic drivers behind the expansion became a crucial first step.

It began in late 2007, when OakBend Medical Center announced it was moving forward with plans to build a second hospital campus on Highway 59 and Williams Way in Richmond, Texas. OakBend sought to provide more convenient access of its healthcare services to the growing communities within the area. Its goals were to increase visibility and to solidify its position as the premier healthcare provider to area residents. OakBend identified a 16-acre site for its new three-story, 90-bed hospital and



included the development of two new 60,000-square-foot MOB in its expansion plans.

OakBend's expansion effort included relocating several medical services from the main hospital to the new second hospital, allowing room to expand its "signature services" at the main campus such as stroke, geriatrics, cancer, heart, wound care and orthopaedics. This would allow OakBend to capture greater market share in addition to positioning itself as a more attractive employer for physicians who often work at more than one hospital. Furthermore, the dual-campus strategy would provide OakBend with advantages in economies of scale in staffing, supplies and operating costs.

On-Campus vs. Off-Campus

Once the strategic drivers for the new hospital campus were outlined, OakBend determined it would add one MOB adjacent to the new hospital while the second MOB would be developed at a third off-campus location. The on-campus facility, OakBend Doctors Center -- Southwest Freeway, was proposed as a three-story, 60,000-square-foot MOB on a 3.97-acre parcel just steps from OakBend's new second hospital campus. By simultaneously planning the development of an off-campus MOB, OakBend would



also secure greater market share in the surrounding communities by providing routine care and emergency services closer to patients' homes. The hospital system filled this niche with the development of the OakBend Doctors Center -- Grand Parkway, a two-story, 60,000-square-foot MOB in Richmond, Texas, situated several miles from the second hospital campus.

Leasing Strategies in a Changing Climate

As the owner of both MOBs, McShane Development sought to fill the buildings with tenants

as quickly as possible since assembling the right mix of tenants has implications in meeting the lease-up goals of the project. OakBend Medical Center committed to lease and occupy portions of each building, in alignment with its corporate strategic plan. OakBend Imaging Services and OakBend Medical Group both occupy tenant spaces within each of the two new MOBs. Additional private practitioners, pharmacies, physical therapists and government groups, including the U.S. Department of Veterans Affairs, have leased space in both facilities. The assortment of tenants provides synergies and conveniences for patients who may utilize services from more than one tenant within a single visit.

Timeshare Options

Timeshare suites are growing in popularity within both on-campus and off-campus MOB environments. Typically, timeshare suites are modest in size (usually under 2,500 square feet) and offer standard medical suite features

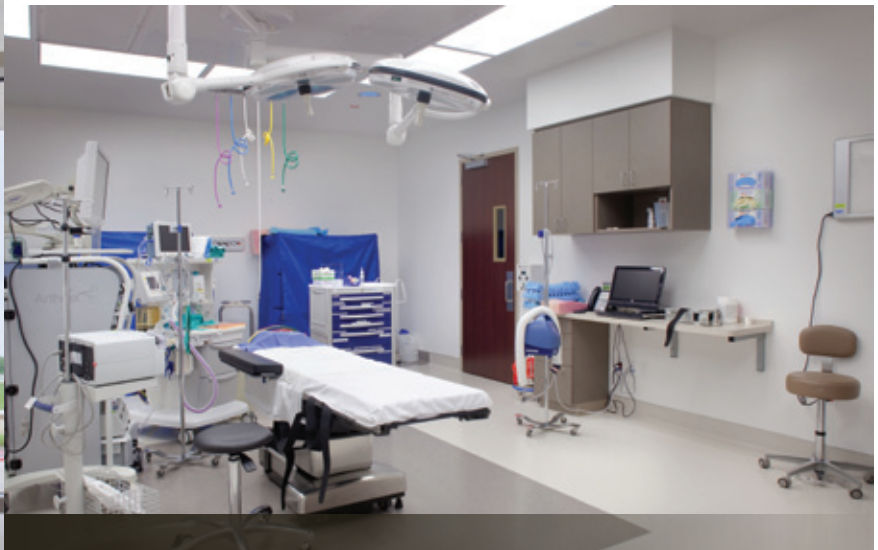
Before meeting with a potential hospital client, prospective developers should clearly understand the hospital system, its specialties and the surrounding competition. It is also imperative to open dialogue with the correct executive who leads real estate decision making. Developers should have readily available sources of capital lined up, since this is a key component of receiving favorable consideration from any hospital system.



that include multiple exam rooms, waiting/reception area and a physician office. Oftentimes, additional amenities such as a procedure room, nurse's station, kitchenette and back office with lockers to accommodate multiple regular users is incorporated to accommodate a wide variety of healthcare practices.

The opportunity to expand into new markets with a minimal financial commitment on the part of the medical practitioner demonstrates the appeal of the timeshare concept. Private practitioners can commit to a timeshare suite for one day per week and gain considerable market presence without a significant impact to the bottom line. Hospitals, as lessees to developers, can coordinate the expansion of services utilizing timeshare suites to launch new healthcare offerings or to broaden the reach of services throughout a larger geographical area.

"A noticed change in the medical office leasing market is the number of requests for shared space and timeshare options. Doctors who leased larger spaces



Abundant natural light, native finishes and comfortable gathering areas add to the customer service experience.

Medical office development requires readily available sources of capital, since this is a key component of receiving favorable consideration from any hospital system.

are now finding that they do not need the amount of space they are committed to," says **Patrice Marks**, leasing agent and vice president at National Realty Network, a commercial real estate leasing firm that specializes in medical office space. "Recently, building owners have been contacting me to schedule appointments with their tenants to help them find suitemates." McShane Development is currently launching a 1,400-square-foot timeshare suite at OakBend Doctors Center -- Southwest Freeway to accommodate this growing need.

"With healthcare cutbacks, doctors are concerned about escalating rents but need to occupy high-quality space to accommodate advances in technology and remain on top of the field," remarked **Dr. David Godfrey**, venture partner of McShane Development on the 10740 MOB in Dallas, Texas.

New Drivers of Medical Office Space

Doctors returning to hospitals for employment instead of establishing or continuing private practices represent a national shift in the way healthcare services are being delivered. Doctors are not necessarily vacating large amounts of office space; rather the demand for new space is now increasingly being driven by hospitals as opposed to private practices. This dynamic change is resulting in more hospital

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Numerous physician groups occupy space within the MOBs as well as pharmacies, physical therapists and private practitioners like the Texas Sports Medicine Institute.

systems leasing space on behalf of doctors as opposed to more demand from individual doctors or private physician groups. As hospitals continue to grow, they will further their demand to lease medical space – either under a master lease with the developer – or with individual suite leases to offshore valuable space within the hospital for more profitable areas of business.

Hospital systems are likely to continue to outsource a myriad of services, such as food service, security, certain medical staff positions and real estate functions. This is good news for the real estate and development community as the industry can continue to look to hospitals as sustainable sources of business.

Know Before You Go

Before meeting with a potential hospital client, prospective developers should clearly understand the hospital system, its specialties and the surrounding competition. It is also imperative to open dialogue with the correct executive who leads real estate decision making. Developers should have readily available sources of capital lined up, since this is a key component of receiving favorable consideration from any hospital system.

Developers must also perform exceptional due diligence once the deal is set in motion. Particularly for deals occurring on the hospital campus, developers may run into unforeseen obstacles related to long-term ground leases. Examples include agreeing on the length of the ground lease, types and limits of improvements allowed on the parcel and how to handle the lease expiration. Additional consideration needs to be given to the surrounding parcel. A typical ground lease only includes the land upon which the building is built and a five-foot perimeter surrounding the building. Since the lessor does not own the site improvements, it is impor-

tant to implement a well-crafted reciprocal easement document that ensures the continuation of current parking, vehicular access and pedestrian access. The document should also address the shared costs of site, parking and landscape upkeep and maintenance.

Navigating Healthcare's New Reality

Healthcare is a market that is looked upon favorably during all fluctuations of the economic cycle. While this sounds attractive from a real estate perspective, the constant uncertainty surrounding the healthcare delivery system has considerably slowed new activity.

REITs still view MOBs as an attractive asset class due to the typically low turnover of physicians. Once

doctors lease medical office space, they tend to stay put - especially within an on-campus environment. Today, there is certainly more demand than supply for a stabilized MOB (a building over 90 percent occupied). Many owners of MOBs are holding these facilities until they reach stabilization in order to maximize profits. This creates a large group of owners who are practicing long-term holding techniques in a market where medical office facilities are not trading rapidly. When leasing activity increases and buildings are stabilized, expect REIT activity to increase, as well.

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Today, OakBend is enjoying numerous benefits from its initiative with McShane Development including the achievement of its original goals and is now setting the stage once again for the future. As the healthcare market continues to shift, healthcare developers need to remain flexible to assist hospital systems to realize their strategies within the new healthcare marketplace. ■

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