



## The Changing Health Care Model: How Will It Impact MOBs?

The delivery system of health care will change more dramatically over the next 10 years than it has in the previous 50. Not only will the delivery system be stressed with implementing new regulations, but also it must be prepared to serve the aging baby boomer population that will double its health care demands. Ultimately, these challenges will generate opportunities that will trickle down to benefit the real estate market.

Although the reform act is expected to evolve through future legislation, it will not be repealed or significantly changed in any prescriptive way, making the business environment more predictable for health care providers. Now that the foundation of an integrated health care system has been established, hospitals and physicians are now beginning to make long-term commitments regarding future real estate and capital needs. These decisions will accelerate over the next few years, affecting a sea change in the medical office market.

Numerous trends are beginning to emerge from the drive to provide quality, but cost-effective, health care services. These outcomes will dramatically affect both the delivery of real estate, and the relationships between the landlord/developer and the physician and/or hospitals. The health care trends impacting real estate demands are the result of three primary goals: 1) integrating health care; 2) reducing costs; and 3) meeting new generational demands. Some of those trends benefitting the real estate market are outlined below.

■ **Hospital Credit on the Lease.** Who is the current customer of the hospital? Make no mistake, it is the physician. The doctor controls where a patient goes for procedures and how much care is provided, putting the doctor in charge of the hospital's largest income source and cost categories – nurses,



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staff, supplies, etc. – yet he is not a hospital employee. As hospitals race to lower costs, they are purchasing practices and employing physicians in an effort to more closely control costs and referrals to the hospital. Not only do hospitals want more control, but today's new generation of physicians believe that employment will provide them with a better quality of life, rather than ownership.

Currently, 60 percent of all physicians/practices are privately owned, practicing solo, or are part of a group not associated with a health plan or hospital. That number is diminishing quickly and is expected to drop to 50 percent by the end of 2011, and to 40 percent by the end of 2012. The traditional physician/tenant is changing, as more leases will be written directly with the hospital as the tenant.

■ **Sale and Development Opportunities.** Overhauling existing systems to create new integrated and cost effective systems in addition to meeting new mandates for reimbursement, is a costly venture. Additionally, the capital

required to purchase practices and absorb their operating costs, including rent, requires a tremendous amount of capital by the hospitals. The new legislation also has strict requirements for electronic storage and delivery of medical records also requiring more capital investment by the hospitals.

One way a hospital can raise capital is through the sale of real estate assets. Additionally, divesting of hospital-owned real estate provides the added benefit of removing many of the conflict-of-interest issues that arise between a hospital/landlord and physician/tenant. Traditionally, hospitals have been significant owners of medical office space; however, they are increasingly selling and leasing back these facilities, shifting from a landlord to a tenant role.

■ **Drive for more Medical Office Space.** As the baby boomer population ages, the consumption of health care services will increase exponentially. People aged 65 and over access health care four times more than younger people. The resulting demand for health care facilities will increase commensurately. We have only begun to see the effect of this demand wave. In 2030 when we hit the peak, the needs for medical office square footage will be enormous. This squeeze will begin as early as 2012/2013, when the current lag in development begins to meet the increasing demand of this massive demographic shift. Additionally, it is predicted that a fully insured population will place a large demand on the system that will ultimately result in the demand for more doctors and more medical office space.

Another evolutionary shift is the upcoming provision of medical insurance to uninsured people through the newly passed Health Care Act. Currently, 30 million to 40 million uninsured people are being treated in hospitals. If they are

already being treated, will insurance create new care needs? No, but it will calibrate where people will consume healthcare and its ultimate cost. The most expensive place to provide health care is at a hospital, costing as much as four times that of similar procedures off property. By shifting these consumers to less expensive preventive procedures and off-property facilities, health care margins will improve, while enhancing the demand for non-hospital medical office space.

■ **The Traditional Medical Office is Changing.** The small privately owned doctor's office can no longer survive in this new integrated, low-cost medical environment. Practitioners are consolidating their practices in order to gain more negotiating power with insurance companies and vendors. This has resulted in the need for larger facilities and additional medical office space. Because medical offices are seeking new, more convenient locations to better provide services to their patients, the demand for medical office space is no longer constrained by the need to locate near a hospital. As health care becomes more available to Americans, medical offices are spreading into suburban areas, shopping centers, and other non-traditional medical office locations, driving increased demand for medical office space.

Despite uncertainties in how the Health Care Act may be amended over time, the overall push for integrated low cost healthcare is here to stay. The demand and make-up of medical office space is undergoing a sea change that ultimately will drive an increased demand for medical office space. Outpatient facilities will experience continued increased demand as hospitals become less landlord-centric, and doctors' offices increase in size. There is no doubt that the Health Care Act will have a positive impact on real estate.▲