



The Recession-Proof Anchor?

Why Medical Uses Boost the Value of Mixed-Use Projects

By Jay Lask

Mixed-use developers have a great opportunity to benefit from major shifts in the health care marketplace. Increased competition, new technologies and changing demographics are pushing medical construction to all-time highs. These forces are also beginning to reveal deep synergies between medical uses and retail, restaurant, entertainment, office and residential uses.

Stable Growth

Health care related construction has enjoyed steady growth rates between 7% and 15% since 2002, according to management consulting firm FMI. That steady growth differs wildly from other types of construction. For example, office construction annual growth rates have ranged anywhere from a high of 20% to a low of -26% during that same 5-year period. In 2009, FMI pre-

dicts that health care construction will reach \$49 billion compared to \$63 billion of office construction.

The steady construction growth in health care is being driven in large measure by continued growth in health care spending — a figure that now stands at over \$2 trillion annually and is expected to grow at an average rate of 6.2%, per year, through 2017. The high growth rate in spending is related to the nation's aging population. In 2006, there were 37 million Americans over age 65. In twenty years, that number is expected to double. According to government statistics, health care spending for those over age 65 is nearly \$15,000 per year versus approximately \$4,500 for working-age adults. This disparity has a lot to do with disproportionate number of chronic diseases afflicting older Americans, such as heart

disease and diabetes, ailments which require routine medical care.

New pharmaceutical products and associated direct-to-consumer marketing campaigns are also driving up new health care spending. Drugs and devices aimed at combating obesity are also on the rise as American's continue to suffer the consequences of unhealthy lifestyles.

New Types of Medical Centers

The rise in health care spending is not the only driver behind new medical construction. Many hospital systems are investing heavily in specialty care facilities that focus on one type of medical care, such as cardiac care or cancer.

Specialty centers are possible today because advanced medical technologies are more affordable. Major urban hospitals used to be the only place where critically important diagnostic and imaging technologies were found. Today, specialty centers and even physicians offices are able to afford these important tools.

Health care providers have also found that specialty care centers are far more profitable to operate than hospitals because they provide more outpatient services which generate higher margins than inpatient care. Technology has also made outpatient care possible for many ailments that used to require inpatient care. The centers can also act as satellite locations to larger inpatient facilities and extend a health system's brand further in the region.

Profit margins became a major focus for hospitals starting in the late 1990s when the government cut Medicare and Medicaid payments significantly. For some hospital systems, specialty care centers have become a way to support their non-profit mission to provide charity care to vulnerable populations. For other health care operators, they are a profitable niche with far fewer barriers to entry than in years past.

Why Mixed-Use is Good for Medical

The increased competition among health care providers has encouraged them to act more like traditional retail operators. They are now very focused on locations that are visible and accessible to highly trafficked roadways. They are keenly aware of demographic shifts and focused primarily on higher income areas with a greater proportion of privately insured patients.

Competition is also driving health care providers to provide nicer amenities. As in retail, health care providers have found that women are more likely than men to choose where the family receives medical care. Quality of care being equal, having attractive retail options nearby offers a competitive advantage. People requiring health care services are demanding convenience; short or no waiting, streamlined registration, prompt reporting of health care testing results, lower costs and convenient clustering of non-health care services to reduce their daily shopping needs. More obvious synergies include pharmacies, restaurants, banks and book stores. These traditional lifestyle and town center tenants provide a built-in amenity and this new focus is considered to be the consumer impact on health care.

At **Richwood**, Madison Marquette's town center/mixed-use project located in Harrison Township, New Jersey, South Jersey Healthcare is seeking to open a 100,000 square foot medical office building and surgical center adjacent to the proposed town center component. While visitors are waiting during a patient's surgery or while patients are waiting for an appointment, the facility hopes to offer restaurant-style pagers that enable them to shop, dine or run errands during down times. These offerings are a significant improvement over traditional hospital waiting rooms, cafeterias and gift shops. The medical component will also include medical offices and a wellness center.

While non-urban health care providers now have the latest technologies, they are still competing with major urban hospitals for the best physicians and nurses. Ur-

ban hospitals still maintain the recruiting edge because of their long-standing reputations. Environments such as Richwood though, offer a compelling alternative with similar amenities to an urban neighborhood. It is especially compelling when the project is located near communities where doctors already reside and commute from every day. Additional incentives can also be designed to encourage hospital employees to live in the residential portion of a mixed-use project.

Why Medical is Good for Mixed-Use

The primary appeal of mixed-use projects is the value premium associated with combining multiple uses. Enough evidence exists to show that tenants and home buyers are willing to pay a premium to be located near the right mix of alternative use amenities. Medical enhances that premium while also offering a source of more predictable performance.

The stable growth rate of health care spending and medical construction suggests that it is less prone to market volatility than other uses. Demand for medical care is irrespective of economic conditions — a dynamic that is only enhanced by the government's large role in health care spending. With regard to financing, many of the regional hospital systems funding growth enjoy very good credit ratings. The lease terms for medical tenants also tends to be longer than traditional office and retail tenants. Medical office leases are typically 10 years and medical center leases run far longer. While medical buildings often cost more to build up front, they are also easily converted to other uses if the need arises.

For all of the above reasons, many consider medical to be a "recession-proof" anchor. While they are certainly not immune to economic declines, it is true that they do not feel the economic shocks as hard as retail.

Medical uses also bring mixed-use projects closer to the community ethos associated with new urbanism and sustainable development. While it does drive new

HEALTH CARE PROPERTY TYPES

Hospitals:

Acute Care Hospitals: Full-service hospitals offering a broad array of medical services.

Long-Term Acute Care Hospitals: Provide long-term care to patients with complex medical issues.

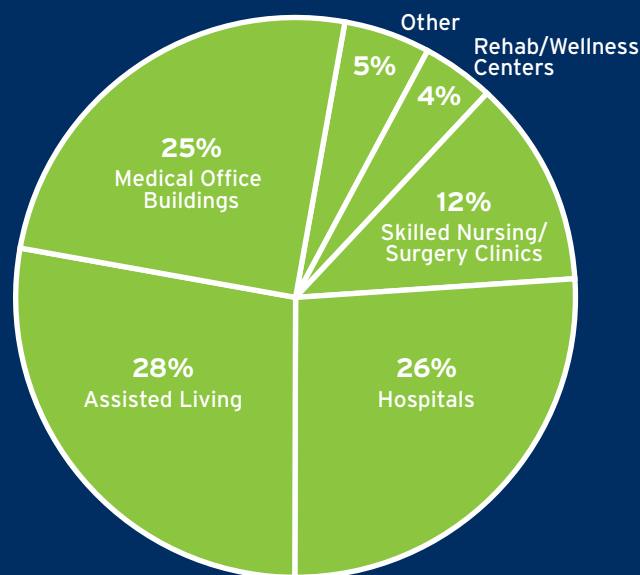
Specialty Hospitals: Provide acute care for specific areas such as cardiac or obstetric.

Assisted Living Facilities: Licensed providers of personal care services and housing for those needing assistance but without substantial medical care.

Medical Office Buildings: House physician offices, diagnostic centers and rehabilitation clinics with specialized building infrastructure.

Rehab/Wellness Centers: Dedicated to the prevention and promotion of the diseased and of the healthy.

Skilled Nursing Facilities: Provide rehabilitative and custodial nursing care to patients that do not require the extensive services of a hospital.



Sources: Green Street Advisors, Madison Marquette Market Research

URBAN HOSPITALS RECLAIM NEIGHBORHOODS

Urban hospitals are responding to competition from new suburban rivals by activating the street retail that surrounds them.

These activation strategies start by orienting many traditional, ground-floor hospital spaces to face the exterior. At Thomas Jefferson University's medical campus in Philadelphia, the patient services and pharmacy components were turned outward to help activate the neighborhood. Nearby retail space was tenanted with restaurants and service retail to help complement the hospital and connecting medical school.

Urban hospitals have three main stakeholder categories that must be addressed. The first is hospital staff and administration – who often work long, odd hours and require retail that can serve them throughout the day. Patients and their families are also major stakeholders who require easy access to quick-service restaurants and service-oriented retail. In the urban setting, hospitals

must also consider surrounding office populations who share the need for service and restaurant offerings.

When evaluating leasing alternatives, hospitals must consider other factors beyond how well a retail concept will serve stakeholders. Hospitals also want retailers that will reinforce their health and wellness mission. They prefer restaurant concepts that offer healthy menu items and fresh foods and often avoid concepts that offer alcohol or allow smoking, further adding to the overall sense of well-being.



Au Bon Pain, Thomas Jefferson University Hospital

visitors to the project, it also provides convenient access to another necessity and contributes to the overall sense of community in the project. For example, consider how convenient it would be for those living in the senior housing component of the project to have doctors from the nearby medical facility make house-calls. Or, how economical it would be for the local fitness center to serve rehabilitation patients during the day and working adults during the morning and evening hours.

Finding the Right Match

As with any mixed-use project, it is critical that each use is carefully calibrated to match the project's overall positioning in the market. Certain medical uses such as cardiac care and cancer centers are more likely to synergize with retail and residential that cater to older adults. Similarly, pediatric care and wellness centers are more appropriate for family-oriented projects.

There also needs to be a high level of comfort between the health care provider and the developer. Since lease terms are so long and the footprint so large, the stakes are higher. Fortunately, there is a strong desire on the part of both developers and providers to see these relationships grow and prosper.

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