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Affordable Care Act Drives Surge in Healthcare Real Estate Activity

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Medical acronyms abound: ACL, BP, CBC. We are all familiar with their meanings, either from our work in the profession, by deciphering our own charts, or through watching medical dramas on TV. Another acronym has now become part of our healthcare lexicon: the ACA (The Patient Protection and Affordable Care Act) went live on January 1, 2014 after more than 2 million Americans signed up in 2013. It will continue to drive many healthcare real estate decisions in the near future.

Sales News

Bloomberg News, in a January 14, 2014 article, "Obamacare Packing Medical Offices Spurs Deal Surge" reported some Real Capital Analytics numbers summing up the sales side of 2013: "Sales of properties leased by doctors and other health-care providers reached $6.67 billion in 2013, the second-highest total in 13 years. . . Buyers including real estate investment trusts paid an average of $270 a square foot, up from $262 in 2012 and the most on record." Cap rates, as reported in the same article, were at a six-year low in 2013, and construction created only 15 million square feet in the past two years, compared with 41 million square feet in 2008 and 2009, so the supply of medical office buildings appears to be tight.

Heavy demand and tight supply ruled the medical office building sales market in the Puget Sound area as well. Healthcare real estate here finished the year with a flurry of sale transactions with health systems, institutional investors and private owners all in the mix. On First Hill, Healthcare Realty completed its acquisition of the First Hill Medical Building for $34.9 million, or $426.33/SF. The transaction highlighted the strong pricing that assets with quality leases can capture in a core MOB market. In Burien, Highline Medical Center sold its Specialty Campus to Acadia Healthcare for $20 million, renaming the facility to Cascade Behavioral Health. To the north, the Kruger Clinic Building was purchased by the Public Hospital District No. 2 of Snohomish County (d/b/a Verdant Health Commission) for $13.4 million at a price per square foot of $318. The sale by Goodman Real Estate helped the district expand the Swedish Edmonds campus footprint to include the highly visible corner on 216th and Highway 99. Looking south, Clise Properties acquired the 99,000 SF Sunrise Medical Campus in Puyallup/South Hill for $40.2 million at a 7.17% cap rate. The asset is an off-campus outpatient medical community with a diverse tenant mix, 10 miles south of MultiCare Good Samaritan Hospital. In Bonney Lake, Franciscan Health Systems purchased the 45,702 SF Franciscan Medical Pavilion for $9.6 million. In Bellevue, the 17,450 SF Bellevue Medical Park along 116th Avenue NE was sold by the owner/user Neurological Associates of Washington to an investment group for $6.3 million, or $361/SF.

Two major mergers were announced in late January and early February. Potentially impacting eastern Washington, Community Health Systems (CHS), a 135 hospital system based in Nashville acquired Health Management Associates (HMA), a 71 hospital system based in Naples, FL. CHS is now, according to Becker's, the largest for profit hospital chain in the country. CHS already owned Deaconess Medical Center in Spokane and Valley Hospital in Spokane Valley, and now owns HMA's Yakima Regional Medical Center and Toppenish Medical Center. In addition, Providence Health & Services, a hospital system with locations throughout the west, is merging with PacMed, a Seattle-based group of nine multispecialty clinics.

Leasing News

Nationally, the ACA is continuing to shake up the leasing side of healthcare real estate, which is being affected by several new trends, according to a November 18, 2013 Becker's Hospital Review article, "Your Competitor is No Longer the Hospital Down the Road; There's Much, Much More to Worry About." Author Lindsey Dunn cites a study by Accenture indicating that retail visits are expected to account for 10% of all outpatient visits by 2015. The other two trends described in the article, towards telehealth and e-consult services, and towards insurance companies acquiring medical groups also bear watching.

While leasing activity in the Puget Sound region was unusually quiet during the last part of 2013, we are not in a DNR situation. There was some movement, and the national retail trend surfaced in several of the Puget Sound region's health systems. Group Health announced that it is partnering with Bartell Drugs, and the first of these retail clinics opened in the University Village Bartell's on January 16 of this year. Virginia Mason opened a new University Village 20,000 SF clinic in early December, which included the relocation of their pediatric clinic from Sand Point and the introduction of a number of specialties, including lab and radiology. Finally, MultiCare opened a new Lakewood clinic at the Lakewood Pavilion shopping center in mid-December.

Other leasing activity included the UW Medicine moving to a new 33,492 SF Eastside clinic along Northup Way, relocating from 116th Ave NE in Bellevue. In West Seattle, Swedish Health Services leased 8,000 SF for a pediatric clinic in the City Watch Building currently being built-out for delivery in 2014. Additionally, January is already off to a strong start. Large deals are not yet inked but we expect to see a number of new leases signed by the end of Q2. Our sense is that healthcare professionals and executives are moving forward with long-delayed plans with a keen eye on ACA-driven changes in demand.

Some in the industry have noted the ACA is causing the "creative destruction" of the healthcare market—it is changing the fee for service system to a system focused on population health. The financial problem with the pre-ACA system is highlighted in a November 18, 2013 article in FierceHealthFinance entitled "U.S. Most Expensive, Bureaucratic Nation in World to Obtain Healthcare." The article references a Commonwealth Fund survey of 20,000 people in 11 industrialized countries. The survey found that the "United States spent more than $8,508 per capita on healthcare. That's 50 percent more than the second-most-expensive country, Norway, which spends $5,669 per capita. U.S. residents also routinely spent $1,000 or more on out-of-pocket care, far more than any other nation." Whether or not the ACA fixes this problem will take years to sort out, but the SOB (not the profane version, but the gasping version) that it was causing last year seems to have calmed down, and the buyers and sellers of healthcare real estate are confidently moving forward, while leasing activity appears to be accelerating.

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Carr has assisted with the leasing requirements for some of Seattle's largest multi-specialty physician groups, the monetization of medical office buildings and excess land for a variety of regional and community hospital systems and the acquisition of medical office buildings for investors and physician groups alike. He has been with CBRE since 2001 and consistently ranks among the top CBRE Brokers in Washington State. He can be reached at paul.carr@cbre.com or 206-292-6005.