

Current Trends in Healthcare Real Estate

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The trend in healthcare real estate, in the Puget Sound region and nationally, can be summed up with one word: “big.” In addition to the need for scale in order to address the high cost of electronic medical records and to amass the large number of patients required to form Accountable Care Organizations (“ACOs”), the consolidation of healthcare systems, of smaller practices into larger systems, the expansion of already large healthcare systems into new territory, and the expected sheer number of citizens newly insured via the Affordable Care Act tie into this theme. An article in the June 29, 2013

Economist describes the trend at the national level: “The most visible change so far is that big hospital companies are getting bigger. In the latest of a string of recent mergers and takeovers, on June 24th Tenet Healthcare said it would buy Vanguard Health Systems for \$4.3 billion including debt. The combined group will have 79 hospitals and 157 outpatient clinics.”

In the Puget Sound region, mergers and affiliations of hospital systems continued over the past six months, following on the heels of the large alliances of 2011: Swedish Health Services with Providence Health & Services, and Valley Medical Center with University of Washington Medicine. In September, UW Medicine penned another affiliation, this time with Vancouver, WA-based PeaceHealth. PeaceHealth in turn formed an alliance with Skagit Valley Hospital and Cascade Valley Hospital. Earlier, in April, the affiliation between Franciscan and Highline Medical Center in Burien was finalized. In August, the planned affiliation between Harrison Medical Center and Tacoma-based Franciscan Health System was cleared to move ahead. Also in August, MultiCare

Health System and Grays Harbor Community Hospital finalized an affiliation. The average citizen may need a chart in order to keep track of all of the changes.

Again, the local activity echos the national trend. The Economist: “All sorts of combinations are being seen, says Martin Arrick of Standard & Poor’s, a credit-rating agency: big, stockmarket-listed chains like Tenet and Vanguard are merging; Catholic hospitals are getting ecumenical with non-Catholic ones; and non-profit outfits are partnering with for-profits. There were more than 200 such deals in 2011-12, according to Irving Levin Associates, a research firm. This does not include many purchases by hospitals of doctors’ clinics.”

Alongside affiliations and mergers in the Puget Sound area, the past six months have seen the expansion of some of the larger healthcare systems into new or upgraded space. Virginia Mason and Seattle Children’s both completed major expansions of their main campuses, and Swedish Edmonds announced an upcoming \$60 million expansion of its campus. Newly announced or opened clinics in the South Sound

region include MultiCare in Maple Valley and Lakewood, Valley Medical/UW in Maple Valley, and Franciscan in Bonney Lake. In Seattle's University Village shopping center, construction is underway on Virginia Mason's new 15,000 SF pediatric clinic. The clinic opening is scheduled for this winter.

The "biggest" medical community in Washington, First Hill in Seattle, experienced some recent shifts in ownership and tenancy. First Hill Medical Pavilion at 1124 Columbia (formerly known as the Seattle Life Sciences Center) sold in January of 2013. The new owner, Trammell Crow, announced plans to upgrade and expand the building by 60,000 SF. The sale of the First Hill Medical Building, at the intersection of Minor and James in Seattle, closed in October, 2013. Vacancy rates remained low in the neighborhood with the largest recent lease deal being The Polyclinic's occupancy of the 14,000 SF top floor of the Elmer J. Nordstrom Medical Tower. Visit clincspace.com for medical office vacancy rates throughout the region, updated quarterly.

Away from First Hill, Seattle's Northgate medical office market will soon have a (big) new and upgraded development to accommodate health systems hoping to expand in the tight North Seattle market. The sale of Northway East will close in January, 2014, and First Western will develop the adjacent parcel as a new medical office building. On a parcel on the same block

as Northway East, Neighborcare Health, in partnership with King County, is planning to develop a 35,000 SF medical center to offer medical, dental, and mental health care. Completion is scheduled for the Fall of 2015. One of the larger medical office complexes south of Seattle, the 99,000 SF Sunrise Medical Center in Puyallup, is on the market and will likely change hands in late 2013 or in 2014. Also in Puyallup, Group Health recently purchased a building they 100% occupy: the Puyallup Medical Center. It was purchased from Benaroya for \$26.3 million (\$481 per SF). Overlake Medical Pavilion, the second largest medical office building on the Eastside, in Bellevue, is steadily leasing up, with new leases signed this year with Overlake Hospital, and with the Denver-based Eating Recovery Center.

Of course the "big" news in healthcare, both nationally and locally, is the implementation of the Affordable Care Act ("ACA"). Guess what? Suite sizes and exam room sizes are growing larger to accommodate the collaboration required by this reform. Also, according to CBRE Capital Markets Pulse: July 2013, healthcare real estate portfolios are growing to encompass post-acute care facilities, also a result of the new law, which emphasizes cost-effectiveness paired with strong penalties for patient readmissions.

New leaders will have the considerable challenge of continuing

to implement the ACA. At the region's largest hospital system, Providence now has Swedish's former CEO Rod Hochman at the helm. In October, Swedish announced the hiring of Anthony Armada from Advocate Lutheran General Hospital in the Chicago area, replacing Kevin Brown, who accepted the top job at Piedmont Health in Atlanta. The South Sound's largest not-for-profit healthcare system, MultiCare, announced the second quarter 2014 retirement of Diane Cecchetti after fifteen years as CEO and 25 years with the nonprofit. What size shoes are these to fill? One word: "big."

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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.

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