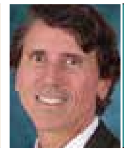

By Rick Tobin
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Reading the Future of Medical Office Buildings

The Affordable Care Act and aging baby boomer generation may impact this niche

The health care industry continues to evolve and prosper as the baby boom generation ages over time. Broadly defined, baby boomers are people born in the United States between 1946 and 1964. As a result of this boom, each day for the next 16 years, about 10,000 people will be turning 65 years old, so it appears that there's a substantial supply of future medical patients.

Major regulatory changes have created a whole new game for the health care sector, however, and these changes have potentially major consequences for the commercial real estate industry. Will more patients mean more demand for medical office buildings? The answer is not so clear.

New regulations

With most of the provisions of the Patient Protection and Affordable Care Act — more commonly known as the Affordable Care Act (ACA) or "Obamacare" — taking effect this past January, it's still anyone's guess if the new law will be a factor in increasing or decreasing the long-term demand for medical office buildings. What impact will the regulations have on the number of health care professionals working in the medical arena?

Many doctors publicly threatened to retire early because of their concerns about costs and insurance reimbursements this year and beyond. Although it's difficult to say how many of these doctors will carry out their threats, this and other questions about the future of the health care industry come to mind as a result of the new regulations. Will up-and-coming medical students be able to start practicing in the current regulatory climate after incurring skyrocketing university costs? If not, will there be a shortage of available doctors for the growing number of patients seeking health care?

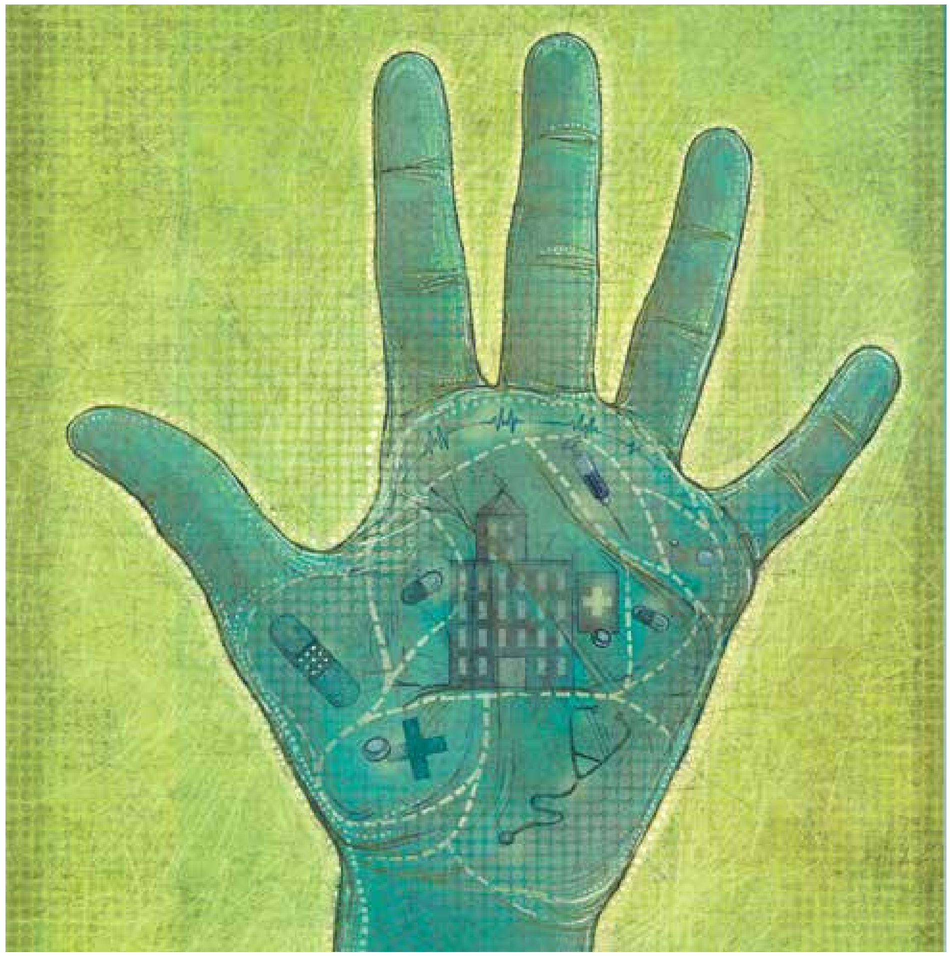

Illustration: Dennis Wunsch

Exact numbers of previously uninsured Americans who will have health insurance as a result of the ACA are difficult to pin down, but ACAsignups.net estimates that more than 9 million people signed up by the end of this past year, and original projections from the Congressional Budget Office

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estimated that 32 million Americans would gain coverage over the life of the ACA. Time will tell if these numbers are accurate.

In any case, much of the health care industry is in a "wait and see" mode regarding the ACA's short- and long-term effect on their profession. In addition, there are mixed opinions and projections from mortgage professionals and commercial real estate brokers in regard to current and future investment opportunities in the medical office building sector. Will this niche thrive, stagnate or even regress because of the new health care rules and guidelines?

Higher demand

Although there are many significant questions and concerns about the ACA's overall long-term impact on the health care industry, there's no question that the number of patients requiring health-related services will increase. With about 10,000 citizens reaching age 65 each day, statistics point to the total number of medical visits in the United States increasing exponentially.

Per the U.S. Centers for Disease Control and Prevention, Americans age 65 and older averaged about 6.9 annual visits to physician offices, hospital outpatient departments and hospital emergency departments, in contrast to 3.7 visits for ages 45-64 and 2.3 visits for ages 44 and younger. The health care implications of this statistic and the aging baby boomer demographic point to tremendous future investment, brokerage and funding opportunities for the mortgage professionals and lenders that focus on the medical office building sector.

Medical office building construction has trended upward during the past few years after a sharp decline following the economic downturn. Marcus & Millichap recently reported that developers were on pace to complete 7.5 million square feet of new medical office space in the past year, with a number of major projects to be completed or to break ground this year. More than a third of these new properties will be at least 100,000 square feet.

Other sources are even more optimistic about the future. The Urban Land Institute projects that the aging population and its health care needs — in addition to the potential influx of more than 30 million formerly uninsured Americans into the health care system — will increase the demand for medical office properties by as much as 19 percent by 2019. This could add as much as 64 million square feet to the current amount of medical office buildings in the United States.

Location and type

Medical office buildings are considered by many commercial mortgage brokers and agents to be the most solid and consistent commercial property type outside of the multifamily sector. Besides the upward trend in new medical office building construction, this is backed by statistics showing that vacancy rates in many regions have declined to single-digit percentages as tenant demand continues to increase. In addition, numerous major real estate brokers and agents believe that the medical office building sector may be almost as "hot" as it's ever been in relation to new development, purchases and sales.

For example, some experienced, wealthy medical professionals are investing their personal funds into acquiring their own medical office properties, often located in small retail strip centers, or by purchasing or constructing their own large multi-floor buildings.

In cases where a medical office building is associated with a locally or nationally prominent hospital organization, the resulting affiliation can provide much greater tenant stability, higher rents and longer-term tenants. A hospital that becomes the anchor tenant or lessee in these large medical office properties also can provide much better credit ratings and loan-term options for the building's owners.

Physician owners and investors are in direct competition for these hospital-affiliated properties with real estate investment trusts and institutional investors, which combined to account for upward of 45 percent of the total sales volume in 2011 for medical office buildings. Smaller individual investors, in turn, may find they have much less competition for buildings that are not affiliated with hospitals in their region.

Prime regions

As of this past July, statistics from the U.S. Census Bureau indicate that the states with the most health care providers tend to be the ones with the largest population centers, such as California, Texas, Florida and New York. California tops the list, with its 97,288 health care companies making up 12.4 percent of the U.S. total. These are likely to remain the states with the most potential for the construction, sales and purchases of medical office buildings in the foreseeable future.

Besides these "usual suspects," the Central Plains region (Kansas, Nebraska, North Dakota and South Dakota) is a strong performer in the sector, based on its vacancy rate of 6.7 percent, the lowest in the United States as of this past third quarter. The Pacific Northwest, the Southeast and the Northeast are the next lowest, while California trails them with its rate of 9.2 percent.

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Regardless of the short- and long-term effects of the ACA, the aging baby boomer population points to the demand for medical services increasing in the United States. Although the overall health of the American populace may not necessarily be improving, the investment, brokerage and funding opportunities for the always-important and rapidly growing medical office building commercial real estate sector have the potential to provide mortgage professionals with healthier financial futures. ●