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MONETIZATION *has its Merits*

For the last decade, there has been a growing trend by hospitals to allow third parties to own facilities on their campuses. What originally started as a trickle, evidenced by infrequent sales of individual properties, has become a very significant and consistent flow of portfolio transactions. Over time, hospitals have become more astute about the market's desire for their real estate and the capital that is attracted to it. Let's explore further this growing trend and the reasons it is occurring.

Coming into Vogue

In 2000, approximately \$622 million of medical office buildings (MOB's) were sold.¹ Capitalization rates were in the 10.0 to 10.5 percent range. At that time, many commercial real estate participants — including developers, lenders, equity investors and others — were very unfamiliar with healthcare facilities. It was an ignored real estate class because there were extremely limited alternate uses, if any. Few landlords had experience at managing physician tenants, and many had no experience at underwriting

hospital financial performance. Furthermore, these players had little or no understanding of the hospital-physician dynamic.

Comparatively, during the first three quarters of 2006, over \$2.5 billion of MOB's changed hands.² The average cost per square foot now exceeds \$200. What happened? A significant reason was education. As developers, lenders, and investors became more familiar with the nuances of medical real estate and the benefits of a stable tenant base and a strong hospital presence, hospital CFOs became more informed about the values that markets placed on their real estate.

There is now a substantial imbalance between supply (properties) and demand (capital). Investment capital is coming from pension funds, foreign sources, Wall Street funds, private equity, and REITs. We are experiencing a seller's market as more investors bid on a limited supply of properties, driving prices up and cap rates down.

A Capital Gap

Why are hospitals selling real estate? First, understand that the capital markets have looked favorably on the healthcare industry over the

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Founded in 1987, DASCO Companies is a national full-service medical real estate development and acquisition firm. With headquarters in Palm Beach Gardens, Florida, DASCO's regional offices are located in Chicago, Dallas, Denver, Houston, Orlando, Los Angeles, Scottsdale and Washington, DC.

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1. Real Capital Analytics
2. Marcus & Millichap

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last few years. Travel to any hospital campus and you'll likely find robust construction activity. From cancer wings and bed towers to MOB's and parking decks, there is a construction boom occurring across the healthcare landscape. Furthermore, consolidation is continuing at a healthy pace, enhanced by interest rates that are still low by historical standards. Hospitals, both for-profit and tax-exempt, have thus found an abundant supply of funds for their capital spending projects.

However, despite this ample supply of money, there still remains a large gap between needs and resources. No matter the credit strength of the hospital or the size of the healthcare system, these healthcare providers are being forced to prioritize projects. The pressing need for new medical technologies and more efficient facilities far outweighs the resources at their disposal. Thus we see the growing trend of monetizing non-core healthcare facilities.

A medical office building on the campus of Orlando Regional Hospital, an acquisition monetized by a DASCO client.



Photo credit: Celebrity Kids

Steps to Success

A hospital will typically hire a real estate consultant to assist with their monetization effort. Financial, physical and strategic assessments are performed. A financial assessment includes such steps as a lease compliance analysis, the creation of operating statements, and valuations of the properties. A physical assessment might include reports on the property's physical and environmental condition and estimates for deferred maintenance. A strategic assessment reviews the

hospital's overall healthcare delivery strategy and how the targeted facilities satisfy elements of that strategy.

After assessments are completed, the consultant prepares marketing materials and a list of potential bidders. A request for proposal (RFP) is distributed, responses are received, the list is narrowed, and bids are refined. Upon choosing a finalist, more specific purchase and sale terms and conditions are negotiated followed by a closing. A critical factor in a successful monetization is choosing a buyer who

There have been many changes in health care in the last 20 years.



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has plenty of experience managing physician tenants, understands the hospital-physician dynamic, and who has the expertise to develop future facilities as the need arises. The highest bidder may not be the most desirable long-term owner.

One of the most important documents for the hospital is the ground lease. Most monetizations are structured so the hospital retains ownership of the land while the buyer owns the improvements. This document allows the hospital to maintain control over tenancy, uses, and even subsequent purchasers, so as to prevent undue competition on its own campus.

In summary, there has been a dramatic shift in the management and ownership of non-core healthcare facilities. Market conditions continue to favor the hospital as seller. However, they must be judicious in their choice of a real estate partner; that new neighbor must respect and understand the special dynamic that exists on a hospital campus. As long as hospitals continue to struggle with the growing gap between their clinical needs and capital resources, experienced and well-capitalized third-party owners and developers will continue to serve a need.



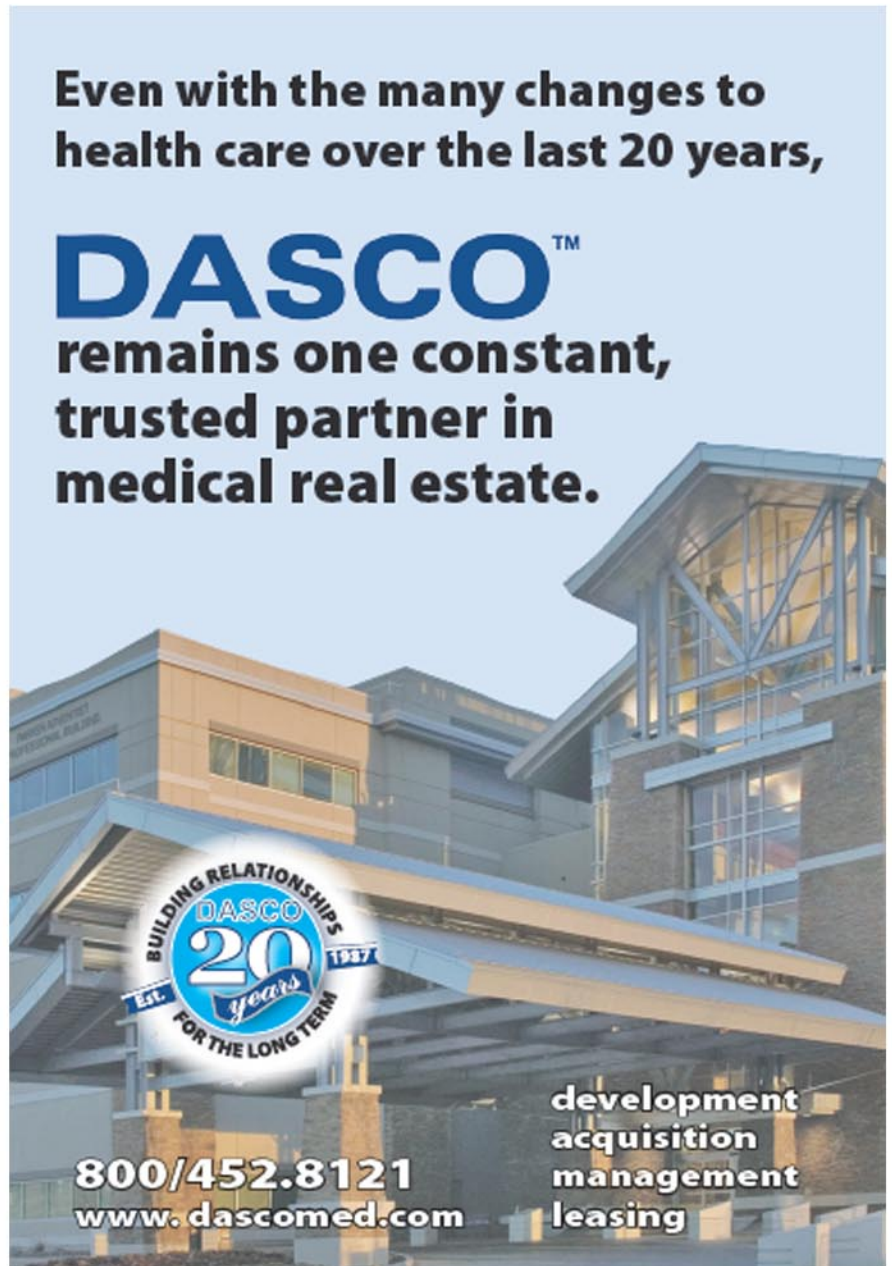
As the senior executive for business development at DASCO Companies, Gordon Soderlund is responsible for creating strategic relationships with healthcare providers around the country, introducing them to the full scope and array of services that DASCO provides. Mr. Soderlund has served as a spokesperson on topics covering healthcare real estate monetization and financing. He has presented to the ACHE Congress and to BOMA's Medical Office Building Special Interest Group, and has published commentary in the financial Times, Modern Healthcare and American Medical Association News publications. Mr. Soderlund also authored two chapters on finance and ownership in BOMA's healthcare real estate reference book entitled "Developing, Leasing and Managing Healthcare Real Estate."

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