



Greer (S.C.) Medical Campus. Photo courtesy of Healthcare Trust of America Inc.

WHY HEALTH SYSTEMS MONETIZE MOBS

Tenet Healthcare VP says resources are best spent on core business

By John Mugford

When a top officer with Dallas-based Tenet Healthcare Corp. talks about his company's relationship with its ancillary real estate, his explanation might sound a bit confusing to someone not involved in the medical sector.



Nicholas Bonrepos

Nicholas Bonrepos, the VP of real estate development for Dallas-based Tenet (NYSE: THC), describes it like this: "We are in the healthcare business, not the real estate business – but we are in the real estate business."

His point is that Tenet is in the real estate business whether it wants to be or not; the firm operates 49 acute care hospitals, 57 outpatient centers, and has nearly \$4.2 billion worth of property and equipment on its books (as of Sept. 30, 2009).

"Tenet Healthcare has no words that say 'real estate' in its name," Mr. Bonrepos added. "Yet we are a huge real estate company."

However, Tenet would prefer to be a much smaller real estate company. In early 2008, the firm announced that it planned to sell a portfolio of 34 MOBs with a total of 2.4 million square feet of space. It hired Jones Lang LaSalle Inc. (NYSE: JLL) to market the properties, which are mainly in Sunbelt states.

As of early 2010, when this publication went to press, the deal still had not happened – mainly because of complications related to the recession and troubles in the capital markets.

"I will tell you right now, timing is everything, and we sucked in the timing," the colorful Mr. Bonrepos says of the company's decision to monetize the MOBs just as the economy went south. But he has kept his sense of humor.

"But as I said, this has been talked about for 12 years, so at least it's not my fault," he says with a smile.

During its first quarter (Q1) earnings conference call with

investors in early May 2009, Biggs Porter, the company's CFO, said: "At this point we are not under an active letter of intent on the MOBs, so we are going to ... consider whether we will start to sell them individually, or whether we will hold them for a longer (time) than we had originally planned."

He added that the company was considering holding off on any sale until 2010 or later – which has apparently been the case.

Even so, Tenet had every intention of selling the large portfolio at the time Mr. Bonrepos talked about the decision in 2009.

MOBS ARE ANCILLARY

When it comes to a hospital's relationship with its owned real estate, namely MOBs, Mr. Bonrepos makes reference to another product, the hand drill.

"People are not interested in the drill itself," he says. "People want the hole."

The same goes for a healthcare system owning real estate.

"We don't, as a company, want to own real estate," he says. "We want what happens because of the real estate."

When a health system builds a new hospital, it typically spends \$1 million or more per bed, making it easy to see "why an MOB on the campus is truly ancillary," he says.

"(The MOB) is very important to the developer. But if you think in terms of that building being on our campus, it's the same thing as renting out the upstairs bedroom in your house to someone. You'd like to know who they are and ... what they're doing. But you really don't get too involved."

RELATIONSHIPS MATTER

However, when it comes to keeping the doctors happy in an MOB, then a health system wants to make sure it chooses the right firm to run, own, manage and lease the space.

"This is why relationships are the underlying theme when it comes to choosing a buyer," Mr. Bonrepos says about

monetizing ancillary real estate. “We want to know if the new owner’s interests are aligned with our interests. If they are just interested in buying a property cheap, slapping some paint on it, leasing up the vacancy and driving up the rents ... then flipping it, that’s not the (company) we want to do business with.”

The relationship a hospital or health system has with the owner of its MOB is so important, says Mr. Bonrepos, that getting the highest price for the properties is not the main priority.

“In our process of evaluating and selling these assets, we were willing to look at maybe not getting the top dollar as long as we’re getting the right dollar, or the right person, to own the properties,” he says. “First of all, we’ve been thinking about this for 12 years. It’s not something that just popped up and we decided to do this. So we wanted to go through and determine whether it was going to be good for the company and good for our core competency ... delivering healthcare to customers.”

In going about that process, Tenet officials considered all of the reasons why its hospital administrators would be concerned. As it turned out, the administrators were fearful about losing control of the properties and losing their relationships with the physicians in them. They also feared that new owners would allow competitors to rent space on the campus and raise the rents to levels where doctors would complain back to the CEO.

“All of those issues are real concerns for the hospital CEOs and CFOs, and we had to address them,” Mr. Bonrepos says. “We told them, ‘Look, we’re not going to throw these buildings out to just anybody. We’re going to have control with a ground lease or deed restrictions. ... And we will not allow competitors to come onto our campuses.’”

REASONS TO MONETIZE

Just as a hospital has concerns about selling MOB, there are also many reasons for a system not to own MOB.

“We’re asking the CEO to schmooze the doctors to bring them to the campus, then in the next minute we’re asking the CEO to go knock on the door and collect rent,” Mr. Bonrepos says. “One of those things is not going to get done. ... It’s too much to ask.”

Another concern for a system that owns MOB is complying with all of the regulations concerning such ownership. Experienced medical real estate firms understand such issues.

“I’m telling you, next to the nuclear power industry, healthcare is the most heavily regulated industry in the country,” he says.

“Everybody talks about the Stark Laws, and by being in the real estate landlord business, there are pitfalls in which Stark will come back to bite you.”

Mr. Bonrepos noted that Tenet has been downsizing in recent years, selling off about 80 hospitals.

“Maybe we never should have owned all of those hospitals to begin with,” he says. “Now, we’re growing not through acquisitions, which really formed the company, but through organic growth, internal growth, and doing a better job.”

He adds: “If we’re focused on real estate, which is not our core competency, then we’re not focused on that internal growth; we’re not focused on what we should be doing.”

In determining whether it wanted to monetize the MOB, Tenet went through a lengthy due diligence process. Part of that process included making sure that selling would not have a negative impact on the company.

“We didn’t want to hurt our earnings per share, our margins,” he says. “And we had to look at the NOI of those properties versus what we were going to do with the money garnered from the sale. When you go through this process, you have to take a look before and after and look at what you are going to do with the cash. One question is, ‘Is there a need for that cash?’”

Hospitals are very cash-intensive, mainly because they can “always buy the newest and greatest piece of equipment in order to make themselves better,” Mr. Bonrepos says.

“Well, you have to have that capital employed in your business to be able to do that,” he added. “The process we went through was to make sure that the hospital administration understood that this transaction was for the betterment of the company and its core competency and its mission, not just to get rid of the real estate, or not just to pay down debt. It’s for the purpose of delivering our product.” □



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