



Vince Cozzi



Roni Soffer



Todd Varney, Barry Weinbaum and Malcolm Sina

OPTIMISM, CONCERN

One thing is sure, sales to rise in 2010

By John Mugford

As we move into 2010, there is certainly cause for optimism among some of the best-known professionals and companies involved in healthcare real estate. Many are predicting an uptick in medical office sales as the economy stabilizes and certain investors look for safe sectors in which to place their capital. Some of these same professionals also foresee an increase – perhaps later in 2010 or beyond – in demand for outpatient development as hospitals regain their bearings and focus once again on their business strategies.

Still others predict a stabilization of the capital markets – or at least some clarity to where things are headed in that regard.

Then again, there are certain issues and trends that worry healthcare real estate professionals, perhaps keeping them up at night as they ponder the future of the industry. Those include, among others, an increase in the number of doctors employed by hospitals and a rising number of real estate firms entering the healthcare arena.

When we gathered the members of the **Healthcare Real Estate Insights™** Editorial Advisory Board for our annual meeting in November – in a meeting room at a new healthcare facility near Orlando, Fla. – they talked about a number of topics concerning this sector. While much of the dialog during the meeting was proprietary and is not being reported here, we made sure to have an on-the-record discussion, for publication, about what board members predict for the year and years ahead.

Nearly two dozen **HREI™** editorial board members or their alternates attended the meeting, which was held at Oakmonte Village at Lake Mary, a recently opened facility developed by Royal Gardens Senior Living, which is part of North Miami, Fla.-

based Gazit Group USA Inc. Gazit is also the parent company of a company well-known in the medical office building (MOB) sector, ProMed Properties, an owner of 15 MOB's in the eastern United States and Canada. Roni Soffer, the president of Israel-based Gazit Globe, which trades on Tel Aviv Stock Exchange as GLOB, is a member of the editorial board.

SALES VELOCITY TO PICK UP

As noted, most of the board members foresee MOB sales velocity picking up steam in 2010. One of the main reasons for the predicted increase, they said, is the fact that investors with available capital are and will continue to look for places to put that capital. Those major investors include both publicly and privately held healthcare real estate investment trusts (REITs).

“We hear so much today about preservation of capital, with the stock market losses that have occurred and with all of the commercial real estate equity losses that have taken place,” said Malcolm S. Sina, CEO of Palm Beach Gardens, Fla.-based DASCO Cos., a developer and owner of MOB's. “The private REITs aren't under as much pressure as the public REITs, who feel a need to invest in escalating rents on an annual basis. Some of the private REITs are going to focus on preservation of capital and provide a 6, 7, 8 or 9 percent return in a low-interest rate environment.”

Mr. Sina said he believes that the ability of private funds and REITs to raise plenty of equity for the acquisition of MOB's is going to continue into 2010 – as was the case in late 2009.

“If that capital gets a little bit of an inflation hedge and they get their money back, there will be more people who are going

invest on an individual basis or in a fund like that, more so than they are today,” he said. “And I think medical office is going to be a vehicle for them to do that.”

However, even though publicly traded REITs have been successful in their equity raises of late, observers should not assume that those companies are ready to engage in bidding wars for every MOB put on the market, according to Vincent M. “Vince” Cozzi, the managing director of acquisitions for Ventas Inc. (NYSE: VTR), one of the largest healthcare REITs.

“I think we need to be a little careful in assuming that just because the REITs have raised a lot of money that they are under any pressure to put it to work and that they will begin competing for assets,” he said. “I think that much of the equity was raised in order to de-lever.”

If the REITs believe they will be in a better position with a lower leverage rate on their balance sheets – even if most of their capital is in the form of equity – then Mr. Cozzi does not foresee the REITs investing in properties with low returns.

“I see REITs needing to get returns on stabilized acquisitions that are north of 8 (percent) in order to invest accretively,” he noted. “So I’m not as confident that there’s going to be a flood of capital that will push cap rates back down.”

Even if capital does not “flood” into the market, Mr. Cozzi believes that well-capitalized REITs are likely to lead the sector’s activity in the next couple of years, both through acquisitions and in providing equity for high-quality developments.

FLIGHT TO QUALITY

Several board members noted that during the next year or so, or longer, there is likely to be an emphasis on high-quality assets, both in acquisitions and development.

“It seems to happen in every recovery – there’s a flight to quality,” Mr. Cozzi said. “As a result, I expect the investment focus to be around core, high-quality assets with high-quality hospitals systems that are well-leased and at the top of their markets.”

James M. “Jim” Moloney, the San Francisco-based head of real estate for the investment bank Cain Brothers LLC, said he foresees an uptick in MOB transaction volume during the next six months or so, as a result of private equity investors.

“Because of the strength of the balance sheets of the public REITs and also private equity, there are pretty limited sources of private equity and that tends to be high net worth pools of capital, but I think the buoyancy in those two areas will drive increasing transaction volumes and narrowing cap rates in the next six months or so,” he said.

While quite a few of the board’s MOB brokers predicted an increase in sales velocity, Brent Tharp, senior VP of originations with GE Healthcare Financial Services (GE HFS), warned that volume is not likely to return to the heyday of 2005 to 2008.

“Overall, while I agree that transaction volume should increase, I still think it is going to be anemic relative to where it was, and that could mean it doubles from what it was this year or whatever, but it is not going to be where it was two or three years ago,” he said. “During that period, people were doing deals that were considered marginal. Those same deals, if done today ... are not going to happen, at least from a lender’s standpoint.”

Jonathan L. “John” Winer, a principal with White Plains, N.Y.-based Seavest Inc., an investor in medical facilities, said some

sources of private capital are no longer looking at investing in medical offices. That’s because those sources are looking for higher returns and have “moved on” from the MOB space.

“Some of the hot sources of private capital that were once interested in healthcare are now looking elsewhere. People who had been approaching us about wanting to provide capital or joint venture with us have said, ‘Nope, now we’re in an environment in which distressed assets and our return environments are 25 percent-plus. So I think it’s a little bit of a mixed bag out there.’”

INCREASED COMPETITION?

In addition to being asked about what they foresee in 2010, the editorial board members were asked if they have any concerns about the future of the industry: i.e., what might be keeping them up at night.

Thomas W. “Tommy” Tift III, president of Atlanta-based HealthAmerica Group LLC, said he, too, believes that MOB activity is going to pick up in 2010, both in leasing and sales.

But he said he’s also concerned that as the economy continues to sputter, more and more people and companies will enter the healthcare real estate arena in hopes of cashing in on an industry that has not suffered as much as the other sectors.

“I remember back in the early ‘90s ... when we had a real estate recession as well, and all of a sudden everybody and his brother became a medical developer and a medical broker,” Mr. Tift said. “In Atlanta, for example, there was an article in the paper last week saying there is a 12-year supply of office space in the metro area. I don’t believe that, but ... there are going to be a lot of people looking for stuff to do.”



Philip J. “P.J.” Camp, a principal with the New York-based investment bank Shattuck Hammond Partners LLC, agreed. He added that if “some of these newcomers to the space make high-profile mistakes, either with a development or ownership issue, that could hurt the experienced professionals and companies in the business.”

“All the new entrants in the market place, all the new developers coming out of the woodwork, and the private REITs buying medical office buildings headed by people who don’t have the knowledge and background in medical office buildings, well, this could have an adverse effect on the industry.”

Several board members noted that they are also concerned about what effect all of the loan rollovers coming due could have on healthcare real estate.

“What will this influx of rollovers of commercial real estate do to the overall credit markets and what are they going to do to the commercial real estate markets? I have no idea,” noted Mr. Camp. “It’s actually impossible to tell because it’s such an incredibly large number that it could go in so many different directions.”

All of the rollovers coming due are certain to have more of a negative effect on other sectors than healthcare real estate.

“The greatest risk certainly lies with commercial real estate,” said Mr. Tharp of GE HFS. “But I think that could have a negative impact on the MOB space as well. It all kind of goes together, but I think MOB loans, MOB debts will continue to outperform any other kind of commercial real estate product.”



Angela Mago, senior VP and national manager of the healthcare group for Cleveland-based KeyBank, said 2010 could be a difficult year for those with high concentrations of real estate on their books.

“I think we’ll see some failures and movement of product off the banks’ balance sheets and we’ll start to see those losses be recognized,” Ms. Mago said.

The regional and local banks will find pockets of opportunity, I think they will look for quality and the least amount of execution risk, and I think you’re going to see some IPO activity, and I do think that will prevent some consolidation opportunity for the well-capitalized REITs.”

CAPITAL IS STILL A CONCERN

For years, healthcare real estate professionals have educated hospitals and health systems about the benefits of having third-party service providers develop, own and manage their MOBs. But now, a couple of issues could make health systems once again decide to own such assets, several board members said.

“There are two major things taking place in this regard,” Mr. Camp said. “One is the accounting issue in which it will be more difficult for the hospitals to get that off-balance sheet treatment when it comes to their MOBs, especially if they are leasing a lot of the space.

“In addition, with more of the hospitals employing their docs, they can finance the MOBs with tax-exempt capital. I do think there is a maximum amount of tax-exempt funds the hospitals can receive, but I still think that’s going to continue to be an alternative for the hospitals.”

Mr. Winer of Seavest Inc., which uses pools of private investment money to invest in MOBs, agreed.

“I think the docs being employed by health systems is a big issue on the horizon,” Mr. Winer said.

He then provided an example of an MOB project in which a health system decided to develop and own the facility itself instead of finding a real estate firm to do so.

“We had been working on this project for two years or so and at the 11th hour the hospital came to us and said the building will be filled with all of its own doctors anyway, so they were just going to do the project themselves.”

As far as one of the board’s bankers is concerned, 2010 is going to be a tough year for banks.

SIZING UP STRATEGIES

Sharon Harper, president and CEO of The Plaza Cos., a healthcare real estate firm based in the Phoenix area, said she sees 2010 as a growth opportunity.

“In some ways Plaza Cos. has planned for a downturn in the market for some years,” she said. “However, we certainly never predicted that it would be as complex and as significant.” Even so, Ms. Harper foresees “significant growth” in 2010. Plaza Cos. plans to add staff, particularly in the facility management and leasing areas. Despite Arizona’s economic challenges, she said she sees growth opportunities in the healthcare and bioscience sectors.

As far as Mr. Soffer of ProMed is concerned, many companies will continue to hunker down during the recession, investing in their own properties.

“I think the owners and operators in this business will continue to invest in their properties and their tenants, as well as in their relationships with the health systems or medical universities,” he said. “Eventually they will succeed with their plans, and sometimes in these un-liquid times ... you need to build your equity and capital and improve your infrastructure, improve your properties and help your tenants to succeed during the recession.

“You need to improve your assets, renovate and improve your buildings, allowing your tenants to see more patients and be more efficient. I believe that eventually you can not hold this trend. People are going to continue to need to see their doctors and they are going to need to visit the hospital and the medical offices on the campus, and eventually you just need to be ready for the right opportunities.” □

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