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WESTERN REAL ESTATE BUSINESS®

Connecting Real Estate in the West

DEVELOPING WORKSPACES THAT ATTRACT AND RETAIN TALENT

Mental and physical health and well-being is now a top priority for many firms competing over talent.

By Jennifer Walton

As competition to attract and retain top talent continues to heat up in the marketplace, many companies are looking to provide workspaces that can set them apart in the battle for the best employees.

Companies have always looked for ways to set themselves apart, and the workspace is becoming an increasingly popular — and necessary — way to differentiate. Offices were merely places to do work in years' past. They're now a mechanism for increasing productivity, collaboration and inspiration; a selling point in recruiting and retention; a way to increase a company's brand recognition; and a tool to improve the bottom line. Companies now demand even more and look for offices that not only create a better work environment but a healthier workforce.

As a culture, we spend nearly 90 percent of our time indoors, and our surroundings have a significant impact on our health, happiness, productivity and well-being. Our predominantly indoor lifestyle results in the need to create a built environment

see WELLNESS, page 29

A WELL-certified space examines how lighting affects the user's circadian rhythm and adjusts the lighting structures to maximize health benefits.

Medical office properties remain highly sought after by commercial real estate investors. Above is a property in San Rafael, Calif., owned by Meridian.

TOP 5 TRENDS DRIVING HEALTHCARE REAL ESTATE DEVELOPMENT

Thanks to technology and the Affordable Care Act, the healthcare industry has entered a new period that won't just affect providers and patients, but real estate developers as well.

By John Pollock

The healthcare industry is in a transition period. The Affordable Care Act (ACA) is accelerating health system and physician acquisitions. Cutting-edge technology is altering the means in which healthcare is administered and delivered. In addition to those changes, the population of older Americans who will require more healthcare services is ballooning. The net effect of these changes is a rising demand for healthcare services.

1. Demand is up. Supply is down. While there still remains uncertainty regarding the full impact of the ACA, the healthcare real estate market appears to have weathered the storm. Tenant demand has continued to grow driven in part by the increase in the number of people insured and the aging of the large Baby Boom population. In 2014, we saw the vacancy rate dip below 11 percent nationally in the medical office market for the first time since the recession. This demand is particularly strong for high-quality, well-located product, as indicated by vacancy rates under 10 percent in the major West Coast markets of Seattle, Portland, San Francisco and Los Angeles.

see HEALTHCARE, page 30

INSIDE THIS ISSUE

TOP 5 TRENDS DRIVING HEALTHCARE REAL ESTATE DEVELOPMENT

HEALTHCARE from page 1

2. Bigger is better. Between 2009 (when the ACA was signed) and 2012, the annual number of hospital mergers and acquisitions (M&A) more than doubled. One major consequence of these M&A transactions and system affiliations is the creation of dominant medical systems that have a major influence in the markets that they serve as they focus on acquiring top tier physicians and practices. A recent survey found that 20 percent of primary care physicians were employed by hospital systems in 2014, which is double the number of primary care physicians from 2012. (Since direct employment is not allowed in California, employment is achieved through the use of the foundation business model.) Critical to attracting physicians and increasing market share is the ability to provide high quality facilities that are also visible and accessible to patients. We expect the trend of M&As to continue, further giving influence to the increasingly powerful regional hospitals and health systems. The downside to these M&A transactions is that the weaker, non-profit hospitals will simply not be able to compete with these large, extremely financially-sound systems.

Meridian is also developing medical office space in Palmdale, Calif. This one is occupied by DaVita, which provides a complete range of dialysis treatments and support services for patients living with chronic kidney failure.

Petaluma Health Center occupies the medical office building in Rohnert Park, Calif., located at 5900 State Farm Drive.

3. Convenience is key. The demand for convenient and flexible healthcare services, often referred to as the "retailization" of healthcare, is forcing health systems to locate real estate beyond the traditional hospital campus and medical office building complex. Many health systems are now positioning primary care and specialties such as dialysis clinics in standalone buildings or retail centers that are convenient to both patients and physicians. Kaiser Permanente, California's largest HMO, recently announced a partnership with Target to open clinics in several of its Southern California stores. We expect this trend to continue in the coming years giving the cost advantage of providing basic services in retail settings as opposed to higher acuity hospitals.

4. Flexibility is crucial. Healthcare space itself is changing, mirroring what is happening in commercial real estate in general. Doctors and staff are now requiring more open and flexible layouts, enabling them to move freely throughout the space and utilize multiple work stations rather than being anchored to a single location or office. The change from solo and small group physician practices to multi-physician, multi-specialty practices is also affecting the size of medical space needed. While the transition to larger, more efficient networks would seem to imply a reduction in square footage per physician is needed, in fact the opposite is being observed for many reasons. One reason is the increased use of nurses and physician assistants, which increases efficiency and enables practices to serve more patients in less time. Also, some procedures such as imaging and minor surgeries, which in the past were typically done in a hospital, now are occurring in an outpatient environment. The result of being able to see more patients per day and perform more procedures without needing a hospital is in fact increasing the square footage requirements per physician.

5. Investor demand is strong. Medical office properties remain highly sought after by commercial real estate investors. Medical office sales volume totaled $3.3 billion in Q4 2014, the highest quarterly total since Q4 2006. REITs in particular are paying extremely aggressive prices for top tier assets. High quality institutional grade assets are the most heavily pursued by investors, trading at cap rates at or in many cases below record low levels. In 2014, cap rates in the West Region trailed only the North East Region. REITs still dominate the healthcare acquisition market, accounting for 46 percent of buyer volume in 2014, which was up from just 16 percent in 2013. Further reflecting this incredible demand, we are now seeing some projects acquired and closing before they are even completed. With the strong historical stability of the MOB property type and favorable demographic trends, Meridian expects sales activity to remain strong throughout the upcoming years.

Pollock

Based on the recent data, demographic trends and the lack of development opportunities, we expect the healthcare real estate sector to remain strong for the foreseeable future.

John Pollock, COO, Meridian, a full-service real estate developer and owner of medical real estate based in San Ramon, Calif.

The company develops space up and down California. This medical office building is located in Berkeley, Calif.

Meridian acquired an 8,171-square-foot former post office building for $2.1 million in Walnut Creek, Calif., and invested $2.3 million to convert its use to medical for a dialysis clinic.

Meridian built this freestanding single-tenant building for DaVita on an outparcel in front of Home Depot in Pomona, Calif. The addition of medical services into this struggling center helped to increase traffic and breathe life into an otherwise dying center.