

Healthcare Systems Navigate Rising Expenses, Declining Revenues

But medical office buildings still remain a darling for investors.

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Consumer spending in the healthcare and medical office sector has been revived since the rough ride it went through during the pandemic.

Long-term issues affecting the healthcare clinical workforce continue, according to Cushman & Wakefield, most notably a growing labor shortage, as well as a rise in inflation and shifting sites of care—all of which are expected to affect growth and performance of healthcare commercial real estate.

A recent C&W report showed that in 2022, health systems have reported a 37% increase of median labor expenses per discharge as compared to pre-pandemic expenses in 2019, according to The Advisory Board.

Revenue Declining, Many Operating at Negative Margin

“Not only have expenses risen for health systems, but revenue also has declined because of drops in inpatient visits, discharges and billable operating minutes,” the report said. “Additionally, most pandemic-era federal and state support funds have since expired, adding further stress to hospital operating budgets.”

Furthermore, the American Hospital Association estimates 33% of hospitals are operating at a negative margin.

“Health systems will likely be forced to make difficult decisions regarding capital expenditures, including investment in new real estate projects, as well as consider further consolidation opportunities,” said the report.

Reimbursement Rates Not Keeping Pace with Inflation

Thomas Allen, founder and CEO of Practice Real Estate Group, tells GlobeSt.com, “Healthcare is not that

different from other businesses. Operating margins are being squeezed by higher labor and supply costs, and insurance-driven practices are taking hits due to reimbursement rates not increasing at the same pace as inflation.

“The good news is that in growing markets demand is increasing and there is a shortage of providers. Due to inflation, existing real estate product will be in greater demand and landlords should be able to bump rents as renewals come up as new product will be significantly more expensive.”

Medicare Population Growing at ‘Fastest Rate Ever’

Craig Gambardella, Vice President at TSCG MD, tells GlobeSt.com, “From 2020-2021, there was a 0.6% decrease in commercially insured individuals. This population tends to account for the highest profitability across the healthcare system.

“On the flip side, the Medicare population is growing at its fastest rate ever, with Medicare reimbursements only declining. This can certainly put a strain on any health system and its profitability. The highest growth of older, commercially insured individuals, not surprisingly, is in the Sunbelt and the southwestern US. Population migrations tend to foreshadow care level demands.”



Kevin Yen,
Principal, Investments, BentallGreenOak

MOB Remains a Safe Haven

Kevin Yen, Principal, Investments, BentallGreenOak, tells GlobeSt.com, “Near term, medical office buildings will continue to be viewed as a “safe haven” investment.

“Smaller investments are seeing more interest than large scale portfolio acquisitions due to lack of available debt/loan in the market today.

“Investors are focused on tenant profile (credit strength), in-place lease terms, and physical quality of the building, as well as locations; where do the patients live and where else can they find the same medical services other than going to the main hospital?”

He said Inflation and operating cost will continue to create near-term headwinds for hospitals and health systems.

“However, health systems will find creative ways to work with the CRE community to continue expanding their revenue generating businesses, which will continue to be off-campus, electives-oriented services as health systems look for ways to boost top revenue lines,” according to Yen.

Deal Flow is Strong

Yardi Matrix analyst, Jeff Adler, tells GlobeSt.com that medical office buildings are seen as a great alternative asset with investors moving to the sector which is seen as a more stable alternative to suburban office holdings.

“Rents are at record highs, deal flow is strong, and demand is outpacing supply amid tight vacancy rates and stable cap rates and the fundamentals are solid,” according to Adler.

Abundance of Capital Looking for Returns

Jay Johnson, U.S. practice leader, healthcare markets, JLL, tells GlobeSt.com that investment demand and values remain strong for medical office due to the underlying demand fundamentals of healthcare space users and the abundance of capital looking for investment returns.

“Non-clinical space is seeing the greatest shift to new modes of working, including remote telework similar to the changes being seen in the general office market,” Johnson said.

“Clinical space is also seeing a transformation, but not as significant or as clear in the magnitude or speed

of change. Virtual telehealth spiked during Covid, but, with the exception of behavioral health, has largely subsided to near pre-Covid levels.

“This is a result of regulations and reimbursement requirements specifying the site of care, care-delivery habits, and physician and consumer preferences. A population that is increasing and aging is also driving demand for more healthcare and, unless and until care delivery models change, is driving demand for healthcare real estate.

Need for Healthcare Has Not Waned

Alison Flynn Gaffney, division president, healthcare, JLL, tells GlobeSt.com, “With financial challenges already contributing to delays in investment in infrastructure and more to come on the horizon, the need for healthcare has not waned.

“More now than ever creating access and capacity planning must be cornerstones of any healthcare systems strategy to remain viable and mission focused. Spending must be thoughtful beyond the immediate crisis and not transactional. Also, the opportunity to utilize expertise as an advantage when thinking about workforce challenges is something I believe is under-tapped.

“Healthcare is in the business of people – how the industry builds its future – should have the patient and team member front of mind. Healthcare is no different when it comes to people, choices, and the recognition that the workplace is different now and we will not be going backward.”

Think Smarter with Space

Brett Buchwald, VP at SKCR in Atlanta, tells GlobeSt.com that in markets across the country, particularly Atlanta, rents are skyrocketing as demand soars, mainly driven by inflation.

“Because of this upward trend of rising rents and demand, tenants should be readjusting their budgets and brainstorming how they can cut back on costs before moving into a new building to help mitigate the financial impact of these rising prices,” Buchwald said. “Thinking smarter with your space will ultimately save your practice thousands of dollars in the long run.”