

from hub to MOB

a strategy to extend your hospital's reach

Medical office buildings (MOBs) are valuable tools that support the growth and development of healthcare systems.

Hospitals that decide to develop a medical office building (MOB) should never discount the significance of such a project. A MOB development project is an important strategic initiative for a hospital, with broad implications. The goal, therefore, should not be simply to construct a building to house the hospital's physician services. Rather, the project should focus on a MOB's many strategic advantages, including the ability to strengthen the hospital's position in its market, increase the utilization of the hospital's services, and improve the bottom line.

Such a project also should never be initiated without due preparation. Important steps in the process include evaluating the market and the feasibility of the project and determining the logistics of the physical building. Every hospital has unique conditions and challenges that must be addressed to create the best structure for success. Yet the advantages of a MOB are common to all hospitals, and certain principles apply in every case.

The Strategic Advantages

Perhaps the most important strategic advantage of a MOB for a healthcare provider—be it a hospital, an individual physician, or a physician group—is its ability to be an effective tool to generate referrals for the provider's services. Hospitals can benefit from physician tenants who utilize hospital services. And physicians and physician groups can benefit from the presence of other medical tenants in the MOB.

When properly developed with the right mix of services and tenants, MOBs also can have a regional impact on the provision of healthcare services. Off-campus satellite locations expand a hospital's geographical presence, raising the organization's profile. Through referrals, a well-conceived MOB can increase a hospital's patient admissions by drawing patients from an area that may have been underserved.

Moreover, a well-planned MOB can serve as a marketing tool to support a hospital's physician recruitment and retention efforts. It provides physicians with a convenient location and comfortable and efficient office space,

AT A GLANCE

When used effectively for strategic purposes, a successful MOB will:

- > Align physicians with the hospital
- > Increase ancillary utilization, improving the hospital's bottom line
- > Support physician recruitment
- > Allow the hospital to reallocate capital for operational needs
- > Improve the hospital's image
- > Expand the hospital's geographical market share
- > Enhance physicians' revenue

and it can be structured to provide physicians with an investment opportunity that gives them a strong incentive to remain at the location.

With advancements in technology, a MOB provides a cost-effective structure to house outpatient services that may otherwise be located in the hospital, allowing expensive hospital space to be

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used for higher-paying inpatient services. A hospital that can deliver services to its patients or physicians in an outpatient setting at a lower cost than in its inpatient facility can improve its margins and decompress its main campus. Also, a hospital that can provide a service at a lower cost than a competitor gains a cost-competitive advantage. Thus, as the number of services and procedures that can be performed in an outpatient setting continues to grow, so too does the need for MOBs.

Preliminary Steps and Considerations

The importance of conducting market research and a feasibility study to evaluate the viability of developing a MOB should not be discounted. Examining the rental rates and vacancy rates of comparable MOB competitors, growth trends in the area, income levels, and population demographics (ages, family sizes, and educational levels) will help determine the potential success of such a venture.

A pragmatic feasibility study should help the hospital determine whether to continue down the path of development or not. In some instances, the study findings may indicate that, for one or more reasons, a MOB may not make economic or strategic sense for the hospital. In such an instance, the hospital could consider reformulating the project so that it might better suit the market and have a greater likelihood of success.

As the viability of the project is investigated, the hospital also should determine *how* to approach the project should it choose to proceed. Joint ventures and third-party ownership are options to consider, providing the hospital with the ability to reserve its capital for more important things such as technology and physician recruitment. In some cases, the hospital may wish to

retain ownership and call upon a real estate developer to serve as “development manager,” or an owner’s representative.

MOB Participants

The typical participants in the strategic development of a MOB are the hospital, the physicians, and, in certain instances, the healthcare real estate developer.

The hospital. MOB projects most often are strategic initiatives of hospitals. Typically, a hospital’s strategic objectives for such a project are to optimize the use of the hospital facility, promote market growth, and gain the opportunity to align with key physician groups. With the right tenant mix, the MOB creates for the hospital a network of referrals and professional relationships within the same four walls. The MOB allows lower acuity and lower revenue services to be moved out of the hospital, thereby clearing space in the hospital that can be utilized for higher return acute care services.

The “right tenant mix” can be different for different hospitals. Specialty physician service line mixes can vary according to area demographics and consumer needs, as well as according to the size and maturity of the healthcare market within the given area. Smaller hospitals in rural settings are, by nature, more primary care focused, whereas larger hospitals in urban markets are more often focused on and organized by specialty and subspecialty service lines, allowing them to market services that are aligned with these specialties.

An important decision for a hospital may be whether to construct the MOB on the medical campus or in a strategic off-campus location. MOBs on a campus can help redirect patient flow and create convenience for physicians and patients, whereas off-campus MOBs can tap into a geographical area otherwise not available to the hospital, serving as a feeder site or a means for attracting more patients.

Another important strategic consideration is the quality of the MOB office space. High-quality office spaces can serve as an incentive for attracting and retaining physicians.

Proper design and construction can improve a physician's practice and space efficiencies, therefore improving the physician's productivity.

Space also should always be readily available for interested physicians. Maintaining excess capacity helps ensure that the hospital will remain competitive.

The physicians. Physicians typically are attracted to MOBs because these facilities provide an opportunity for a physician to practice in an office setting designed and constructed with the needs of a medical practice in mind. Again, with the right mix of medical tenants in the MOB, each physician tenant enjoys the benefit of creating business relationships with other physician tenants who may provide referrals to his or her practice or to whom he or she may refer patients. A comprehensive MOB provides a convenient service to patients in that they enjoy the benefits of one-stop shopping for their medical needs.

A MOB also can provide investment opportunities for the physicians. Offering physicians the ability to invest in the project gives them a potentially rewarding financial opportunity, as long as the investment arrangement is structured to ensure compliance with all relevant legal restrictions on such arrangements. Here, the real estate developer can play a role in buffering the hospital

from a direct contractual relationship with the physician tenants.

The healthcare real estate developer. Every MOB project is unique, so the real estate development team should have the level of understanding of the healthcare industry and business operations and the flexibility to address all of the hospital's concerns throughout the process. When considering sponsoring a MOB, hospital administrators have the option to tackle the project themselves or involve a healthcare real estate developer.

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The necessity to fill square footage cannot outweigh the needs of the hospital to fill the MOB with the *appropriate* tenants—that is, proper combinations of specialists to achieve the hospital's physician recruitment plan. A real estate developer typically fills the role of “development manager” or owner's representative throughout this process, and it is important that the hospital clearly define this role during the process of engaging the developer. The developer must be able to coordinate negotiations between the hospital and the physicians, keeping the project on track while satisfying the needs of both parties.

Although the real estate developer is primarily charged with finding tenants to fill the MOB to make it a viable investment, the hospital also has needs that should be communicated to the developer. The hospital should make these needs clearly understood while also demonstrating the flexibility and open-mindedness to make full use of the real estate developer's expertise. Too often, hospitals can create limitations to the structure that will challenge the developer as he or she seeks to fill the building with a beneficial tenant mix. The hospital should remain open to every

option that can help it achieve its objectives while maintaining the necessary strategic controls.

The Structure

The MOB's ownership structure can affect many aspects of the project, including financing terms, physician participation, use restrictions, and investment strategies. The hospital's comfort level with allowing other parties to participate in the MOB project plays a significant role in determining what form of ownership it may allow for the MOB. There are many ways to creatively structure ownership of a MOB while still maintaining the appropriate and necessary operational controls that healthcare systems require and making the project attractive to physician tenants and investors.

Third-party ownership, for example, provides the hospital with an arm's-length relationship with its physicians, removing the possible appearance of improprieties. With third-party investors, hospital funds can be preserved and used for the hospital's operational needs. The hospital is free to focus on its area of expertise, providing healthcare services, while an experienced developer takes on the task of developing, constructing, leasing, and managing the MOB. The hospital gains the benefit of having a MOB filled with medical practitioners without the obligation of having to commit millions of dollars or assuming the financial risk of the real estate development project.

Third-party ownership of the MOB is not without risk. Problems can arise, for example, if the hospital and the third party have drastically different goals and objectives for the MOB. There needs to be an understanding of what types of tenants will be sought for the MOB and what, if any, limitations will be placed on the medical tenants as to the services they can perform.

Another structure option is a joint venture—the creation of a partnership between two or more parties, such as the hospital and the physicians. To succeed, a joint venture typically requires a willingness from both parties to relinquish some control. It is critical that the two parties become partners rather than competitors, working

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together to create an alliance in which they both can reap the benefits. Otherwise, they could risk overloading the market.

Reluctance by either party to negotiate key points can create a roadblock for the developer charged with outlining the intricacies of the structure. The ability to compromise is paramount so that as each party brings something to the table, each walks away with a successful and profitable business. If the parties are willing to combine their efforts, and share the start-up cost and operational risk, the result is a win-win situation in which both parties stand a better chance of succeeding and achieving a positive ROI.

There also are many important considerations that must be addressed if the hospital decides to retain full ownership of the MOB. For example, taking into account the needs of the physician tenants, the hospital must define use restrictions and who is deemed as an "acceptable" tenant. And the hospital must define the conditions for the possible resale of the property in the future. These issues need to be clearly defined in the ground lease or in the covenants and restrictions should the land be sold to a third party.

It is paramount that a sponsoring hospital maintains an arm's-length approach to leasing when physicians are tenants. Physician tenants' leases

must be structured at fair market value and the terms must be commercially reasonable to ensure that the arrangements do not run afoul of fraud and abuse or civil monetary penalty laws. The importance of this caveat should not be discounted, but a detailed discussion of how to ensure the arrangements are legally sound is beyond the scope of this article.

The Future

MOBs in the future will provide more than just medical office space. These facilities are likely to continue to evolve into more comprehensive

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ambulatory care centers. As technology for medical equipment continues to advance and procedures that were once performed only in an inpatient set-

ting are becoming increasingly available in outpatient facilities, MOBs are, in step, becoming ideal facilities for housing these new technologies. It is not uncommon today to see MOBs with diagnostic imaging centers, ambulatory surgery centers, urgent care centers, and women's centers.

Clearly, demand for high-quality medical office space will continue to grow with the continued advancement of technology and the ability to locate new services in office building settings. Indeed, the premium prices that institutional investors are paying today for high-quality MOBs are one indication of the strong market for such facilities, and given their usefulness as excellent venues for lower-cost, convenient, and consumer-friendly medical services, there is good reason to expect that this strong market will continue in the foreseeable years. MOBs are well on their way to becoming more comprehensive buildings—in essence, hospitals without beds. ●

About the author



David C. Arnold is president, Irgens Health Care Facilities Group, Milwaukee, and a member of HFMA's Wisconsin Chapter (darnold@irgensllc.com).