What 5 emerging 2014 healthcare trends mean to you
Early into 2014, trends have already emerged that are shaping the delivery of healthcare this year. While their influence on the patient experience may be well known—or at least widely discussed—among executives, a less known but highly important consideration is their effect on providers’ real estate portfolios. Owned and leased property assets are rarely the opening topic of boardroom conversations. Hospital physical plants and other buildings often take a back seat in priority to issues on the clinical side such as accountable care, ICD 10s, Medicare/Medicaid reimbursement, acquisition and assimilation of physician practices, and on and on.

However, real estate deserves close scrutiny because it is a major factor in supporting your healthcare organization to realize its mission. Property, plant and equipment occupancy costs are typically the third largest operating expense and represent almost 40% of your balance sheet, so they impact finances tremendously. Reducing them not only improves flexibility, but frees up more funds for highly desired clinical improvements. High performing, safe facilities are also critical to delivering the most efficient, best quality care to patients.

As a global real estate firm with a leading healthcare business platform, we present Jones Lang LaSalle’s (JLL) perspective on five major healthcare trends, what they mean to your organization, and questions you should be asking your team to assure that your system will not just survive, but thrive in the months and years ahead.
Reimbursement changes are magnifying the emphasis on managing costs:

A variety of factors are converging to change reimbursement processes—and generally lower rates—from Medicare/Medicaid, the new public and private exchanges, and commercial payers. According to Moody’s Investors Service, the hospital industry faces more than $300 billion in reductions to Medicare payments alone through 2019 as part of healthcare reform. There is an unprecedented need to restructure healthcare organizations to meet demands by consumers, employers and the government alike to provide greater value, but at a lower cost. Increased patient volume from health insurance exchanges and expanding Medicaid rolls will add to the challenge. Providers are under tremendous pressure and some health systems face a need to reduce costs by 20-30% overall to retain current profitability.

Implications for your organization:
Strategically, healthcare organizations will need to better integrate in two directions:

- Horizontally through hospital-hospital acquisitions and alliances; forming much larger entities to better collaborate, prioritize programs, increase purchasing power, consolidate services and cut costs.

- Vertically as more hospitals become all-encompassing health systems; buying physician practices, ambulatory centers, diagnostic centers, home care services, durable medical equipment and wellness companies.

These strategic scenarios are driven in part by the need to prepare for new payment systems that will reward providers based on outcomes and patient satisfaction. They involve a streamlining of operations through centralization and restructuring when advantageous, and standardization of real estate practices and processes to reduce risk and increase efficiency.

The result: an opportunity to drive significant real estate cost savings across your entire organization.

Real Estate questions to ask your senior management team:

First and foremost: “Can you accurately document what our system spends on occupancy costs?” The honest answer is almost always, “No.” Most hospitals don’t even know what they should be spending. True to the old adage, “You can’t manage what you can’t measure,” it is critical to first establish your occupancy cost: the sum total of all of your space expenses associated with operating and maintaining both owned and leased properties.

Second: “Are we managing our portfolio in a consistent fashion across all locations?” Too often, especially in the wake of expanded entities created by mergers and acquisitions, real estate management is inconsistent—and often, bad. Move toward managing your overall portfolio in a centralized manner, not location by location, with established best practices to reduce waste and variability.

Think of your organization as more of a private sector operating company, taking advantage of economies of scale and experience-proven processes, than a holding company where everyone does their own thing—often with unfortunate results.

Speaking of operating company best practices, hospital leaders should ask, “Are we partnering with best in class organizations for comparative advantage, focusing our resources on the delivery of healthcare services while our partners provide services outside our core competency at a lower cost?” Look beyond common vendors such as foodservice and cleaning to consider partnering with experts who can drive value in facility management, lease administration and transaction services, and project management. Using expert resources that bring the latest state of the art technologies, processes, systems and personnel, your organization will realize efficiencies and effectiveness to both reduce cost and improve quality of care.
Decreasing available investment capital challenges:

The past decade has seen fierce competition for available investment capital among stakeholders within hospitals and health systems. All of the potential uses are compelling: from investing in medical equipment technology such as the latest DaVinci robot, to acquiring leading edge electronic health record systems, to expanding the ambulatory care network, to updating or replacing aging hospital infrastructure. To compound the problem, investor analysis is typified by Moody’s, which has assigned the healthcare sector a negative outlook since 2008. This makes it even tougher for hospital leaders to acquire needed capital at the best rates.

Implications for your organization: With the paradox of great demand for but short supply of capital, many hospital executives have diverted monies away from real estate investment beyond critical infrastructure maintenance and improvement programs. This has resulted in a steady increase in the average age of plant. Since 2000, this standard industry barometer experienced gradual increases and was hovering just under the bellwether 10-year-old mark, and two years ago this level was eclipsed. Any level at or above the 10-year mark is a concern to rating agencies. Yet, because of the intense competition for capital, executives must often choose whether to upgrade physical plants or to prioritize other initiatives that advance the mission of a hospital or system.

Even if your system offers the latest medical technology and treatments, patients will take notice—not in a positive way—if the buildings housing them are “held together by duct tape.” Healthcare is becoming much more retail focused. The front door matters. Facilities in sub-par condition can trigger downtime or equipment failures that impede delivery of care, even jeopardize life safety and regulatory compliance. You can’t not spend money to keep your facilities in top aesthetic, operating and safe conditions, but you can do it with maximum cost-effectiveness.

Real Estate questions to ask your senior management team:

“Have we done a thorough risk assessment of our capital assets? Do we have documentation that all facilities meet industry safety standards and regulatory compliance?” Also, challenge your team to evaluate your portfolio from a user perspective: “Is the look of our facilities consistent with the level of our services? Does it convey the message we desire to patients? Are our environments comfortable and inviting for both patients and staff?”

Moody's Average Age of Hospital Plant Medians
(Stand Alone Hospitals and Single-State Health Systems)

<table>
<thead>
<tr>
<th>Year</th>
<th>Age in years</th>
</tr>
</thead>
<tbody>
<tr>
<td>2007</td>
<td>9.9</td>
</tr>
<tr>
<td>2008</td>
<td>9.8</td>
</tr>
<tr>
<td>2009</td>
<td>9.9</td>
</tr>
<tr>
<td>2010</td>
<td>10.2</td>
</tr>
<tr>
<td>2011</td>
<td>10.5</td>
</tr>
<tr>
<td>2012</td>
<td>10.6</td>
</tr>
</tbody>
</table>
Decrease in transactions shifts focus to consolidation and integration:

There has been a slowdown in the once-brisk pace of mergers and acquisitions. Eighty major deals were announced in the first 11 months of 2013, down from 96 made during the same period in 2012. However, the days of the stand-alone hospital are numbered and healthcare systems are selectively acquiring or affiliating with entities in the most desirable markets.

Implications for your organization: As the era of mega-mergers subsides, healthcare systems will be more selective in deciding whom they will partner with or acquire. Due diligence will be critical to make sure that precious capital dollars are spent wisely.

Essential to the drive to build scale is positioning the organization to capture more covered lives to spread risk across a broader population/patient base:

- Pre-acquisition: An understanding of both potential risks in the condition of the physical assets and future repair/renovation requirements along with any occupancy risks such as physician leases that may not be in compliance with Stark or Anti-kickback regulations.

- Post-acquisition: The centralizing and consolidating of operations can streamline clinical and non-clinical service delivery, reducing the cost of care.

Real Estate questions to ask your senior management team:

When evaluating an acquisition candidate, ask: “How would this portfolio help us extend our reach geographically to achieve our mission and vision as an integrated delivery system? Have we conducted a thorough portfolio conditions assessment to fully understand the inherent risks and costs associated with the physical assets? Are we fully aware of any regulatory compliance risks such as Stark Law violations in any of the leases within the buildings to be acquired?”

As far as integration and consolidation, good questions might include, “Are our services and facilities best aligned to the needs of our present and potential patient base? How can we build and enhance our continuum of care at each of our locations? Are we optimizing occupancy in each location? What non-medical functions (such as data and call centers) could be consolidated—or moved off site—to achieve savings?”

As the era of mega-mergers subsides, healthcare systems will be more selective in deciding whom they will partner with or acquire. Due diligence will be critical to make sure that precious capital dollars are spent wisely.
Continued fine-tuning of physician and medical group integration:

While system-level healthcare transactions have slowed, hospital acquisition of medical groups continues to grow. Nationwide, deals involving physician medical groups increased 5% year-over-year to 20 deals during the fourth quarter of 2013. That’s also a 33% increase from the 15 deals announced in the third quarter of 2013. Physician groups will continue to play an increasing role in not only the financial results of healthcare organizations, but their success in supporting the industry’s transformation in focus from volume to value.

Implications for your organization: Pinpointing location alignment with physicians and other outpatient medical services will be critical to differentiating your system and positioning it for the future. The most successful healthcare systems will have the right services for the right patients at the right locations—and provide the best, most effective and cost effective care for populations served.

For systems acquiring or affiliating with medical groups, striking the right balance requires a careful analysis of whether the group’s current mix of services and office locations ideally match the demographics of the patients and populations you wish to serve. Location analysis may suggest that some facilities should be closed, consolidated with other physician office locations, expanded or renovated, or relocated to a newly built or leased location. Of course, each of these options contains its own set of challenges, from terminating, renegotiating or entering into new leases to locating capital and managing design and construction costs in developing a new ground-up facility.

In today’s fast-changing healthcare arena, it is also critical to design flexibility into all facilities so they can easily be changed in scope and function if necessary. The process is much like that of corporations with retail stores, where the location and design of facilities can make or break the business. In short, hospital executives who are not typically real estate experts must successfully navigate a wide range of complex portfolio options.

Real Estate questions to ask your senior management team:

Before your organization can develop a strategy to align physician locations and outpatient medical services with your broader population base, you have to know what your options are. Initial questions should include: “What real estate do we own and lease? Do we have an accurate rent roll with information on tenants: size, lease terms, rent, duration, termination, and other key conditions we need to know? To reposition the location of our physicians and outpatient services, do we know whether leases can be terminated or renegotiated, and at what cost? Have we considered alternative ownership options of our medical office buildings?”

Next, ask the important demographic questions: “How does our present roster of physicians and services align with where they’re needed? How do we need to change to meet market demand, now and in the future?”
Consumer choice will increase the importance of networks and branding:

As the reimbursement model changes to one where consumers will be responsible for more of the payment for their healthcare services through higher deductibles and co-pays, they will exert their influence on buying decisions. As technology enables improved access to price and quality data, consumers will shop for healthcare services based on their personal situation. Whether it’s through a public or private exchange, employer defined contribution plan or from governmental payers like Medicare or Medicaid, they will have increasing choices in managing their individual and family healthcare. Convenience of locations to meet working families’ ever-busier schedules, the composition of services provided through the network, and who their providers will be will all factor into the selection of network. Ongoing loyalty to healthcare providers will be less of a given than it has been in the past.

Implications for your organization: Like other consumer services, healthcare systems will be measured on the basis of overall value as a combination of quality, price and location. Each consumer will weigh these factors differently in making their healthcare choices; just as some buy luxury cars, while others select economy sedans, while still others purchase trucks. Likewise, in the minds of consumers, each healthcare organization will occupy a different spot in the quality/price/convenience continuum. How you define and communicate your brand directly to consumers has never been more important.

The “look and feel” of a hospital—which often takes a back seat to the focus on medical attention—will be important in driving consumer decisions. A facility must appear up to date to be perceived as leading edge, and it’s more than just a matter of changing logos and signage. Locations and building configurations should be easily identified and accessible to not only attract patients to the right facility for their immediate needs, but to minimize hassle for consumers.

Real Estate questions to ask your senior management team:

First, engage in a competitive advantage exercise: “Where do we realistically stand in quality, price and convenience versus our competitors? How does this align with where we want to be? In essence, what is our system’s brand, and what do we want to be in the minds of consumers?”

Next, ask whether your portfolio is supporting your brand: “How do our facilities look and feel compared to those of our competitors? How convenient are our access points to our target market? How do we need to improve?”
The good news

Sound real estate strategies create solutions:

As private sector operating companies have learned, there are real estate strategies that can influence all the important trends that will challenge healthcare systems now and in the future. JLL is a leader in assisting healthcare systems with addressing these strategies and developing compelling solutions that help organizations reduce costs, operate more efficiently, increase convenience—and most important—help fulfill their mission of delivering the highest level of care possible.

For more information, please contact:

Sydney Scarborough
Managing Director
JLL Healthcare Solutions
+1 312.228.3004
Sydney.scarborough@am.jll.com

Peter Bulgarelli
Executive Director
JLL Healthcare Solutions
+1 312.228.2564
Peter.bulgarelli@am.jll.com

jll.com