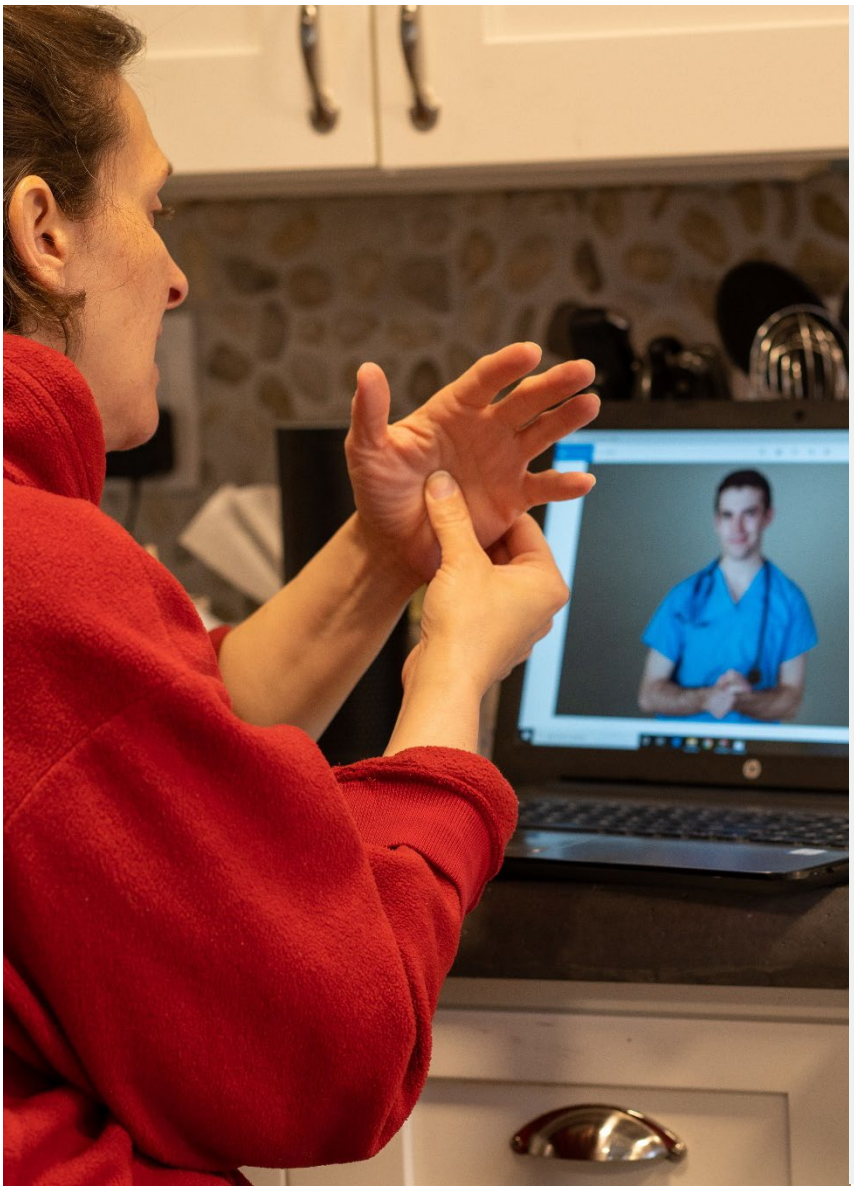
United States | 2020

Research

Healthcare Real Estate Outlook

Adapting to a new reality

COVID-19 has rapidly accelerated healthcare delivery trends, disrupting both patient and clinician preferences. Real estate must adapt to this new reality.



What are three key concepts healthcare providers and investors should embrace?

#1
Telehealth advances will supplement, not supplant, onsite care.

#2
COVID-19 will accelerate segmentation of wellness and acute care in real estate.

#3
Medical office investment is well-positioned to remain strong in a post-COVID environment.

#1 Telehealth advances will supplement, not supplant, onsite care.

What do we mean by telehealth, also known as telemedicine?

Telehealth is the interactive, electronic exchange of information for the purpose of diagnosis, intervention or ongoing care management between a patient and/or healthcare providers situated remotely.

Source: Advisory Board

From stopgap to structural
Telehealth is a broad concept, encompassing a range of services from a simple phone call or email with clinicians to clinician-assisted virtual exams at a clinical location. While telehealth has been in existence for decades, it was restricted from expanding due to limitations on reimbursements, Health Insurance Portability and Accountability Act (HIPAA) liability issues and practitioner concern around malpractice. The acceleration of telehealth usage during COVID-19 was forced out of necessity and enabled by a large-scale relaxation of reimbursement and privacy rules through the Coronavirus Aid, Relief and Economic Security (CARES) Act. The result was that for the first time, a critical mass of patients and practitioners alike were able to utilize and extract the benefits of telehealth, mostly substituting onsite appointments with simple e-visits.

CARES Act dramatically expanded telehealth reach

Restrictions lifted on where, how and with whom patients can access virtual care

Changes to Medicare telehealth

Patients can access telehealth from home

Originating site requirement now includes homes and any health care facility

Telehealth visits can use smartphones
Phones with audio/video capabilities and “everyday” platforms like FaceTime and Skype are eligible

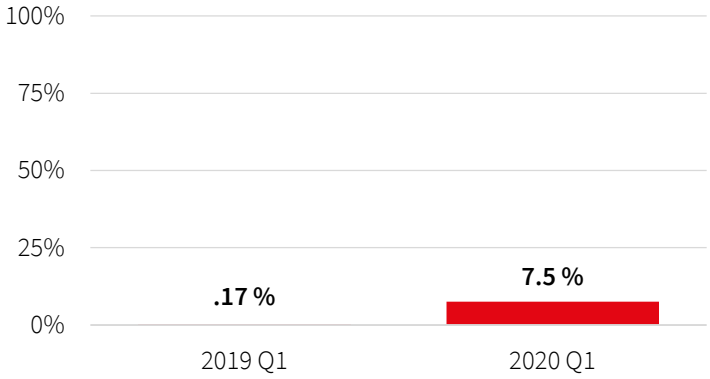
New patients can get telehealth visits
HSS won’t audit to confirm an existing relationship between patient and provider

All providers are eligible to use telehealth
All healthcare professionals eligible to bill Medicare for their professional services can now use telehealth

Source: Advisory Board

Telehealth skyrockets during COVID-19.
Telehealth captured many headlines this spring, catapulting into the national consciousness. While telehealth use certainly surged, occupying a much more prominent place within the care spectrum than before, it's important to examine it within the proper perspective. According to FAIR Health's private insurance claims data, during the first quarter of 2019, only 0.17 percent of all services, or less than one-fifth of 1 percent, were provided via telehealth. In 2020, first quarter usage jumped to about 7.5 percent, and the April and May levels, not yet available, are forecasted to be higher. This increase demonstrates both the new importance of telehealth and its still-secondary role within care services provision.

Telehealth as a percent of all private insurance services: 2019 vs. 2020

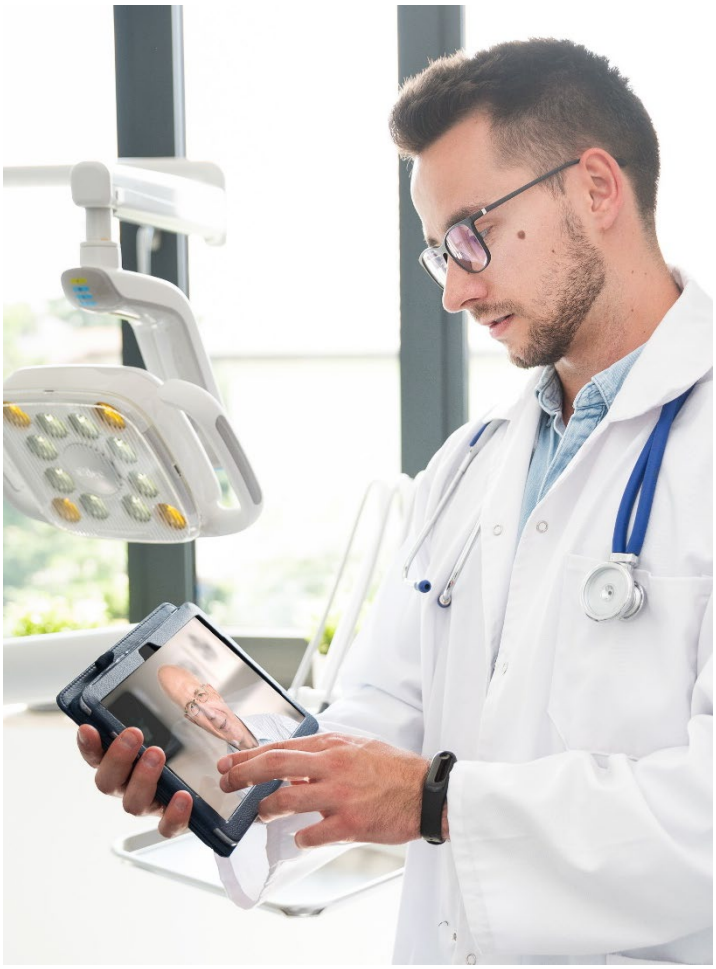


Source: FAIR Health, JLL Research

Sustainable and truly integrated telehealth is a long-term play.
It may seem at first glance that telehealth has the potential to reduce demand for real estate. However, it is important to remember that telehealth is currently buoyed by a short-term accommodation for reimbursement under Medicare (although this is not necessarily true with respect to commercial payors).

However, it is the critical, unresolved factors of pay parity and HIPAA considerations that will ultimately determine the universal level of telehealth usage.
HIPAA waivers and pay parity between live and telehealth visits are not included in the Senate's priorities. Without addressing these components, telehealth growth will reach a natural limit, supporting rather than supplanting an increasing number of routine care intervals. Early post-pandemic CMS guidance for calendar year 2021 proposes the continuation of home-based telehealth services, but as an administrative cost in service of continued patient-practitioner relationships and care compliance. In other words, providers would not be reimbursed for telehealth visits and could not substitute telehealth for an in-person appointment. This guidance further clarifies the supporting, secondary role that telehealth is likely to play with respect to care provision.

Telehealth can "expand the pie" by providing increased access to healthcare and producing more live-care follow-up appointments.
Telehealth provides a convenient point-of-entry that millions of Americans have embraced during the COVID-19 lockdown. The ease, efficiency and convenience of telehealth care provision will increase patient commitment and retention, leading to more live-care appointments that will at least partially offset the substitution effect from virtual appointments. In addition, telehealth can reach patients in remote and underserved locations, prompting them to subsequently visit a care facility after an initial consultation. Telehealth also improves compliance with prescribed treatment plans, including follow-through on required appointments, and may be especially well-suited for remote management of long-term chronic diseases, allergies, diabetes, infusion, pacemaker monitoring and multiple sclerosis. As medical technology continues to advance at a rapid pace, an increasingly sophisticated suite of implantables, wearables and even robotic telemedicine carts will enhance home monitoring and management capability. This device-enabled "hospital at home" concept can maintain long-term health safely, increasing the trust and familiarity between patients and practitioners, which should ultimately result in more patient demand for follow up procedures at a physical care facility.



Telehealth increases overall care demand, enhancing the need for healthcare real estate.

Category	Subcategory	Definition	Potential effect on CRE demand
Telehealth	Synchronous	Live, two-way audiovisual	Displace
	Asynchronous	Transmitting information	Enhance
	Remote patient monitoring	Traditional use of telehealth	Little change
Digital Therapeutics	Replacement therapies	Use of software in place of pharmaceuticals	Enhance
	Treatment optimization	Monitoring and compliance	Enhance

Sources: McKinsey, JLL Research

With an understanding of the potential long-term role of telehealth, here are four ways that healthcare organizations can consider the impacts of telehealth on real estate:

Develop telehealth care provider suites.
It is important to remember that though patients will be receiving telehealth calls or remote monitoring at home, practitioners will still need space for calls or electronic communications as well as remote monitoring and diagnostic equipment. Medical office buildings could provide suites for technicians and nurses to manage ICU, emergency and home care patients virtually, equipped with internet redundancy, appropriate lighting, screens and acoustics, and assured privacy for HIPAA regulatory compliance.

Reconfigure public spaces.
Even as more basic care and monitoring can transition online, patients will still need office visits for advanced treatments as well as more extensive physical evaluation and use of advanced diagnostic equipment (some of which is highly regulated through certificate of need). The need for waiting room space may be mitigated by widespread adoption of online patient registration. An onsite kiosk could also potentially handle both registration and the administration of downstream interventions from virtual visits (e.g., blood pressure readings, prosthetics, vaccines and other injections, cultures and blood tests). However, social distancing, especially within a medical facility, may overwhelm if not dominate space requirements until the epidemic ends or is brought under control. To prioritize patient safety, social distancing space requirements will supersede other considerations.

Repurpose newly available space.
Space that may become available within existing premises could be recaptured for telehealth support, prompting renovations and new buildouts. High-value imaging, diagnostics, injectables, wound care, advanced and acute treatments, obstetrics and laboratory requirements will take priority with respect to physical space needs.

Reimagine the potential for live practice.
Though there is a core group of vulnerable and less-mobile patients who greatly benefit from telehealth availability, preserving and rethinking the option of in-person visits is valuable to a large segment of the population. There is a benefit to preserving and rethinking the option of in-person visits, even as the trend toward telehealth rises. The Advisory Board estimates that between 20 percent and 80 percent of practitioners could potentially work from home as providers continue to reactivate services. However, this statistical analysis does not incorporate a critical component that advances quality outcomes: establishing a personal relationship with a patient. Providers have an opportunity to carefully consider how their real estate can facilitate in-person visits and how they communicate safety measures to patients; this can vary based on specialty as well as ease and applicability of virtual care.

Behavioral health poses an interesting example. Although they can easily see patients virtually, many specialists in this segment are largely resistant to doing so, given that so much of their diagnostic protocols are captured in nonverbal cues.

Structural growth in medical office demand will include but not be limited to telehealth: COVID-19 impact on future MOB demand

	Health-driven changes	Economic-driven changes	Strategic-driven changes
Key theme	**Social distancing**	**Capital preservation**	**Workforce deployment**
Immediate tactical response	• Telehealth where at all possible • Postponing or canceling elective procedures to dedicate space to COVID-19 testing or overflow care	• Focus on cash and liquidity • Balancing risk with need to resume operations for cash flow growth • Revised/shortened capital plans	• Shift to extended hours for COVID-essential staff needs
Short-term CRE impact	– Capacity will be limited by need to limit number of patients to a reassuringly low number	– Tenants may be asking for rent relief or deferment; however, plenty of anecdotal evidence for intact asking rents	– Massive headcount reductions based on deferred procedures, though this is starting to change
Long-term CRE impact	+/- Specialties that cannot operate virtually will require larger spaces for social distancing, while telehealth could cut into space requirements for others	= Tenants may be more conservative when considering space needs, especially for public areas such as lobbies and waiting rooms	= Given the aging population and a long-term increase in demand for care, the healthcare workforce will continue to grow

Short-term impact on MOB demand: negative. Long-term impact: neutral to positive.

Regardless of the net impact of telehealth, the following factors should grow demand for medical office space over time:

1.
Growth in demand for medical services. The growing and aging U.S. population is continuing to drive increases in demand for healthcare services. If done well, advances in technology and telehealth, with an aligned payor system for reimbursement, can capture and retain these patients as their need for services increases, attaching them more securely to the healthcare system and promoting more per capita in real estate square footage for both the inpatient and outpatient environment.

2.
Outpatient care migrating from hospital facilities. The COVID-19 era put a bright spotlight on ambulatory care and non-medical uses that exist within the four walls of inpatient facilities. Health systems furiously endeavored to move ambulatory and administrative uses out of the hospital facility to prepare for the potential surge of inpatient demand and to limit transmission of coronavirus. It is expected that much of ambulatory care will transition permanently to outpatient medical facilities, whether on-campus or off-campus, creating a wave of demand for medical office space in the near term.

3.
Redesigns inspired by the integration of telehealth. If done well, telehealth can maximize productivity per square foot, potentially changing and reducing, but not eliminating, the need for significant square footage. Each practice will need to determine which procedures to make virtual and which to keep live and how to adapt space to the modes of clinical operations.

These forces will likely combine to increase both the clinical acuity and the value of medical real estate in the future. The trajectory and pace of adoption of telehealth will depend heavily on changes in reimbursement to support virtual care, assurance of HIPAA compliance, and consumer and clinician preferences. These factors will redefine how much real estate the industry requires on a net basis across a range of treatment segments for inpatient, outpatient and post-acute care.

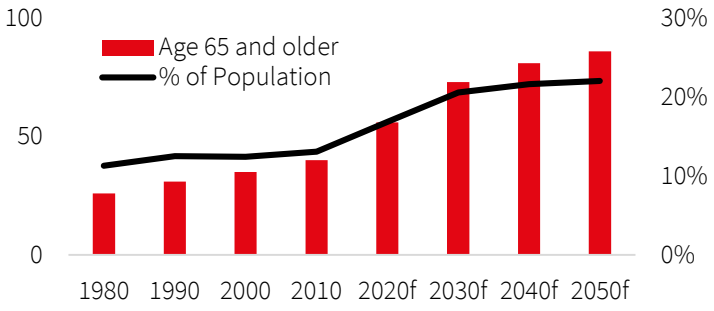
#2 COVID-19 will accelerate segmentation of wellness and acute care in real estate.

In recent years, healthcare providers have increasingly sought to improve health outcomes and lower costs by managing overall population health. They have done this by providing easier and more convenient access, improved service, and an emphasis on well-being and prevention rather than treating problems at high-acuity points. This heightened focus on a more robust baseline level of underlying patient health is clearly intrinsically valued by practitioners and health systems. How do we know? Because it is pervasive despite the fact that only six percent of payment plans operate in a capitated model where payors are directly incentivized to develop long-term care plans rather than treat individual issues. Providers understand that the two major groups driving care demand—millennial heads of households and the growing 65+ demographic—value preventive and personalized care to take advantage of the ever-increasing possibility of a long, healthy lifetime for themselves and their families. Millennials in particular desire a full complement of lifestyle components to mutually reinforce the concept of the wellness-centric lifestyle, which includes not just healthcare but retail commercial, educational, residential and other services. Additionally, COVID-19 has rendered preexisting conditions even more dangerous, further enhancing the value of wellness and preventive care.

By drawing a sharp distinction between inpatient and outpatient care, COVID-19 has reinforced and accelerated this trend. What are the critical components for success in each area?

A growing, aging U.S. population

65+ population (millions) and percentage of total population



Sources: Oxford Economics, World Bank/United Nations Projections

Wellness driven by convenience.

Wellness emphasizes prevention and a healthy lifestyle, which favor lower-acuity, lower-cost facilities that can be located in the heart of population centers easily accessible to patients as consumers. In addition, advances in technology and changes in reimbursement have led to an increasing number of procedures being performed on an ambulatory basis, further allowing practitioners to locate closer to the consumer. Future success for outpatient care will likely involve a combination of the following directives:

- **Increase efficiency of outpatient facilities.** This includes grouping primary care and specialty care in consolidated locations, with accompanying services such as imaging, pharmacy and laboratories in larger buildings with larger footprints. The largest providers have increasingly adopted this "medical home" model. It may also include achieving the WELL Building Standard ™, meaning that the facility has achieved certain elevated standards for safety and hygiene, which may be especially beneficial to attracting healthcare tenants, staff and patients in light of COVID-19.

- **Pursue tenancy in retail locations.** Ideal locations for both retail and healthcare share many common demand drivers—high traffic and visibility, neighborhood proximity and parking access. With both destination and neighborhood shopping center availability and affordability on the rise, healthcare tenants may increasingly locate within retail properties to benefit from foot traffic and accessibility. Retail and healthcare co-branding and cross-promotional opportunities can also enhance neighborhood center tenancy, which is of strong interest to retail property owners. While retail leases, approach to tenant improvements and mechanical systems are very different from traditional medical properties, retail centers are emerging as an attractive option for many healthcare tenants.

- **Maximize revenue opportunities on a single site.** Given the importance of location and convenience to the success of a healthcare facility, operators could maximize their advantages by using their assets to pursue multiple revenue streams. This could involve promoting flexibility for different types of care delivery at different times—for example, specialty and primary care practice groups leasing out unused portions of their operating rooms to other tenants on a shared basis to generate revenue in the event of demand fluctuation. MOBs may also pick up admin and lower-acuity clinical functions that shift away as hospitals sharpen their focus on high-acuity needs. To ensure that they are obtaining the highest possible value from their real estate, providers are also more willing to outsource facilities and project management services in strategic partnerships. For instance, health systems in many markets contract out emergency departments and anesthesiologists for cost reduction.

Hospitals driven to high-acuity care.
COVID-19 increased the need for higher-acuity space within hospitals and pushed lower-acuity and administrative uses into alternative locations, both altering the hospitals' functional mix and heightening a public perception that hospitals are for very sick people. The epidemic may be temporary, but its effects will likely accelerate the long-term trend toward hospitals focusing on higher-acuity inpatient care. Future success for hospitals will involve both embracing the shift to higher-acuity care and assuaging consumer concern about safety within hospital facilities, including a combination of the following short- and long-term approaches:

- **Modify the function of existing space.**
  As hospitals become increasingly focused on higher-acuity care, they must also continue to manage contagion risk, at least until the current epidemic ends. Systems can optimize real estate and reduce the potential for contamination by modifying existing spaces (e.g., combined operating/recovery suites) and consolidating and specializing type of care by facility within the system, which worked well for many systems during the height of COVID-19. Administrative and lower-acuity functions will likely be relocated. Telehealth can also help triage cases from home, thereby limiting emergency room visits (and potentially causing a need to rethink current emergency department models) or divert treatment to an off-campus urgent care location.

- **Communicate proactively to patients.**
  The COVID-19 pandemic has created hesitance on the part of patients to reenter the hospital environment. Reassuring patients that they are safe and protected within the hospital setting is critical for systems to resume the elective procedures that will produce much-needed revenue—this will separate the systems that can restore revenue versus those that continue to suffer. The process will include seamless PPE procurement and effective communication of healthy building operation protocols. Public promotion of heightened facility safety standards should be part of the health system's marketing campaign. Participating in third-party programs such as WELL Building Standard™ could be an edge.

- **Consolidate care functions.**
  Better segmentation of patients and ability to control facilities, whether a permanent or temporary as-needed configuration, will be key to minimizing disruption of services during future pandemics or crises. If each facility focuses on a primary function for which they are most suited, they can work together in concert to keep each function segmented and prevent cross-contamination. Consolidation of care functions among systems (e.g., designating one hospital within a system to focus on one dedicated condition, whether COVID-19 or otherwise) began to spring up during the most severe portion of the pandemic, and could be scaled up or made a part of long-term planning.

#3 Medical office investment is well positioned to remain strong in a post-COVID environment.

Medical office investments have been highly favored for the past several years due to their defensive investment qualities—long-term leases, stable occupancy and income, strong tenant credit quality and tenant retention. As investors reactivate and seek out safe havens, these qualities, along with a few key cyclical drivers, are expected to promote the standing of MOBs in the new investment environment.

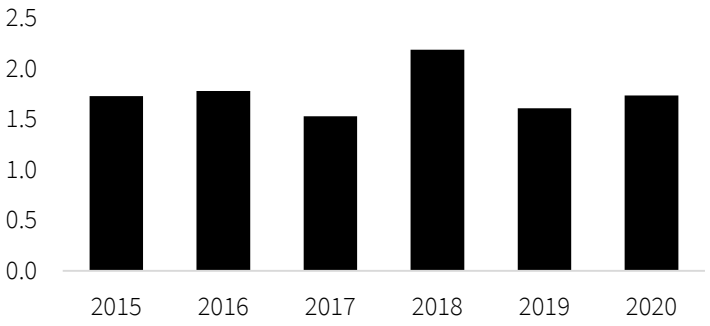
MOBs enjoy cyclical as well as structural tailwinds.
Outpatient medical properties currently benefit not only from direct relief of $130 billion from the CARES Act, but also from the $2.1 trillion set aside for small businesses. Independent physicians and small practice groups were eligible for the Paycheck Protection Program, supporting employee payrolls and rent payments. While many clinical operations were reduced or shuttered during COVID-19 peaks, tenants continued to pay rent. Along with the known long-term drivers for MOBs, this financial support helped maintain durable interest among institutional investors with "dry powder" and strong credit. Rent collections by the largest owners of medical office space were consistently noted in the high 90 percent range throughout the lockdown period, with limited rent deferment and relief required.

MOB fundamentals showcase sector stability.

- Medical office occupancy across approximately 1.5 billion square feet in the United States has fluctuated in a remarkably narrow band, between 91.4 percent and 92.6 percent between the depths of the Great Financial Crisis and today. With national office occupancy ranging from 82.1 percent to 85.8 percent during the same time frame, the appeal of medical office to investors seeking stable occupancy is easily understood. Tenant retention in the most mature portfolios of institutional MOB investors is reported at an average in the high 80 percent range, greatly surpassing typical commercial office retention, due to the high investment in infrastructure required by medical tenants, as well as barriers to entry such as certificate of need uses like surgery centers and imaging.

- **New outpatient medical space construction has remained consistently around 17 to 20 million square feet a year, roughly 1.8 percent of inventory nationally, well below the national average of 2.1 percent for commercial office.** New supply typically provides modern functionality and scale, usually lacking in Class B and older vintage buildings. There is virtually no speculative medical office development, with most developers and lenders alike demanding preleasing of 50 percent to launch new construction. These qualities have helped support steady occupancy with slowly growing inventory.

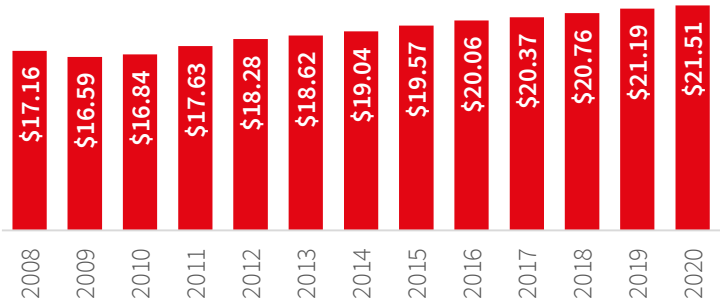
Deliveries as a percent of inventory—consistently low



Sources: Revista, JLL Research

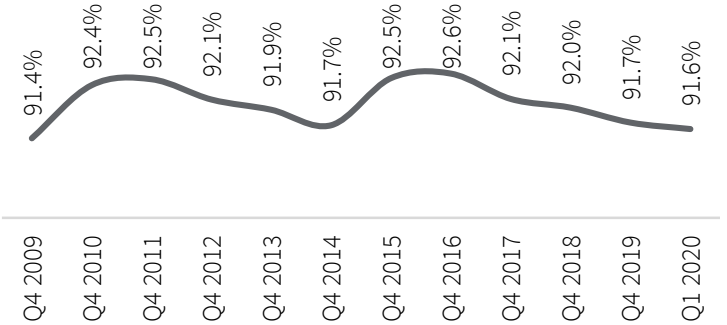
- Triple-net rental growth has benefited from strong occupancy and limits on new supply. Nationally, average medical office net rents have grown steadily from $18.28 per square foot in 2012 to $21.51 in early 2020, up 1.5 percent on a year-over-year basis and up 31.8 percent peak-to-trough from the low of $16.32 in the fourth quarter of 2008. The acceleration of rent growth leveled off in 2019 alongside a decrease in deliveries of new, high-quality space.

NNN rents supported by stable fundamentals



Sources: Revista, JLL Research

MOB occupancy characterized by long-term consistency

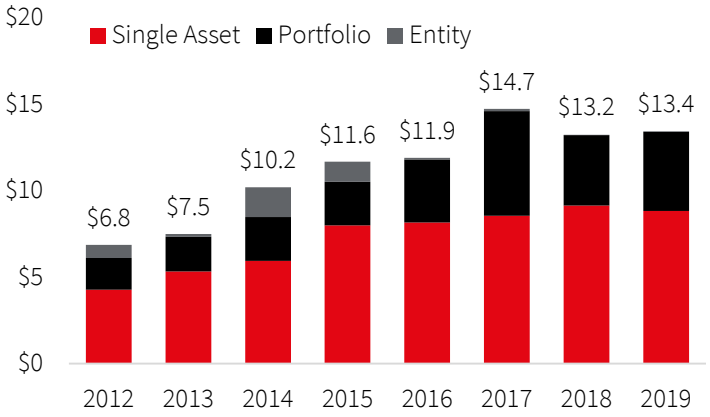


Sources: Revista, JLL Research

Investor activity in MOB endorses sector fundamentals. Interest in medical office has continued at a rapid pace ever since the Great Financial Crisis put a spotlight on the durable investment qualities of this property class. As investor awareness grew, typical sales volume per year more than doubled, from $6.8 billion in 2012 to $14.7 billion by 2017. Sales volume has remained above $13.0 billion for three straight years, illustrating its staying power as a true real estate investment sector. Industry participants note that there are billions of dollars of "dry powder" available today for investment, and M&A opportunities are likely to present themselves as COVID-19 has steepened the differentiation in health system resources. The fact that two-thirds of medical office square footage is owned by hospitals and health systems and physicians creates natural supply constraint within the sector. These providers have strong access to capital and continue to own, regardless of the runup in property value that the sector has enjoyed.

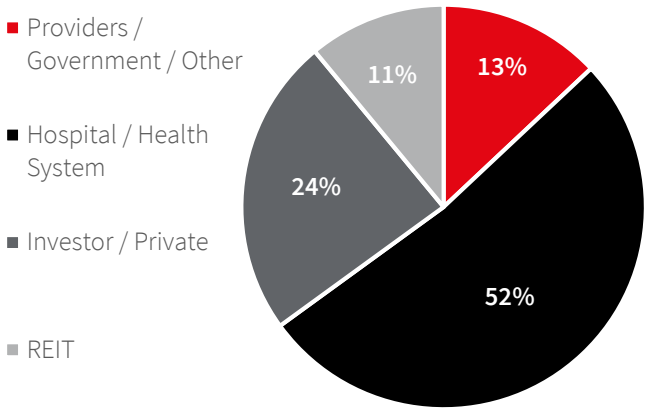
Medical office investment volume has reached a higher equilibrium

Investment sales volume ($US billions)

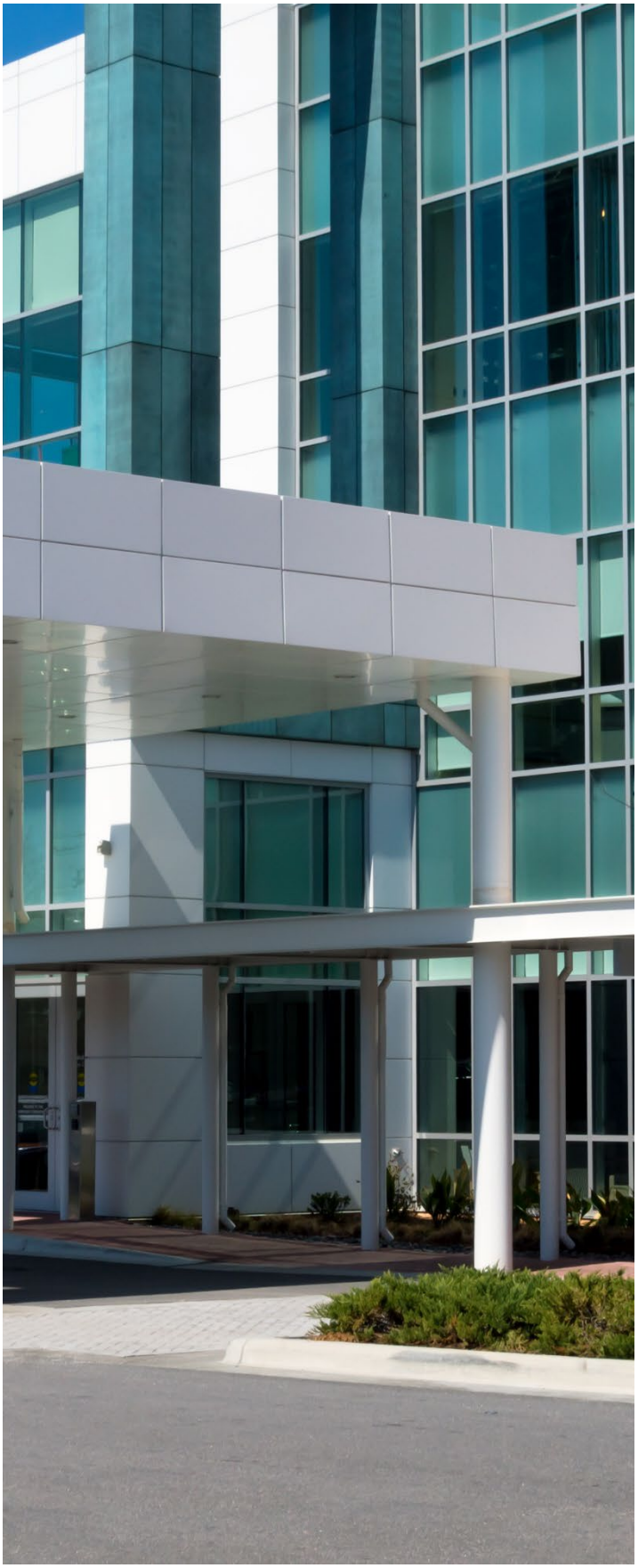


Sources: RCA, JLL Research

MOB ownership by type



Source: JLL Research. As of 10/2019.



A look forward

COVID-19 has driven industry changes such as the surge in telehealth and segmentation between wellness and acute care. These changes present a unique opportunity for well-informed healthcare organizations and investors. By adapting their real estate configurations and operational protocols, these organizations can position themselves well to continue to capitalize on the durable, demographic-supported, long-term demand offered by healthcare real estate.

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