

Surgical Centers – From A Real Estate Perspective

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The healthcare real estate investment market is arguably one of the favored commercial investment vehicles for a large portion of the serious and strong institutional players and many private investors. The favorite flavor in this arena is multi-tenant medical office buildings. The nuances and specifics to describe the various types of healthcare property investments are much too detailed and comprehensive to discuss in this article. The area for discussion here is the sector known as Ambulatory Surgical Centers (ASC) and those surgical centers that have a few hospital beds allowing for more complex surgeries requiring overnight stays. Since these facilities are licensed as hospitals, their reimbursement rates may be higher. The valuation of the real estate occupied by the ASC is totally different from the valuation of the actual business. The operations of the ASC are vital to the value of the real estate but it is not actually part of the real estate transaction. Other types of healthcare property investments will be featured in future articles throughout 2012.

The ASC concept, from both a physician and real estate investment perspective, has evolved from a “build it and they will come” strategy, that proved to be more complicated and riskier than anticipated, to a more comprehensive analytical balanced structure for success. To make better investment decisions, investors in ASC-occupied real estate, both physician and non-physician, have become much more sophisticated. A certain amount of failure created from a previous naïve state of mind will always create wisdom. Real estate advisors and brokers have also had to dig deeper for a better understanding of this asset class in order to properly advise their clients, the owners of the real estate, as to the market value of the property and selling strategy, if that is the desired route. The owners of the real estate could be a partnership that includes the physicians that practice in that location who want to do a sale-lease back or the owner may be an investor or group that have no stake in the operation of the surgical center. In both cases, when listing the real estate leased to an Ambulatory Surgical Center, or one licensed with hospital beds, it is just as important to understand as much about the operations and physical aspects of the ASC as it is to know the basic income and expenses.

There are many key components of the surgical practice that add value to the real estate. If the property is owned by an outside investor and leased to the surgical center the lease will typically dictate what level of information the tenant is required to provide to the landlord. Sometimes it is limited and having a great relationship between the parties will allow for a greater exchange of information. In addition to the economics of the real

estate, including rent and lease structure, the following are important aspects of the surgical center that, if known, will have an impact on property value.

Historical Performance of the Surgical Center

The real estate value is primarily driven by the rent roll income and term of the lease. The strength of the physician practice behind the lease is also very important. The sustained historical financial performance of the surgical center will indicate the risk level of the investment. Another aspect of the historical performance is the analysis of the in-network vs. out-of-network billing.

Diversification and Case Volume of Surgical Specialties

The types of physician specialties drive the profitability of the center. If the center is licensed for hospital beds, it opens up opportunities for more complicated procedures to be performed. It is important to know which doctors drive the most business to the practice and their relationship to the practice partnership.

Management Company

Many surgical centers have outside management companies that manage the business aspect. Sometimes the management companies have an ownership stake in the overall business. Understanding who the management company is and their reputation and qualifications is necessary.

Business Development

The physician makeup is critical to the success of the overall practice because, as in any business, it is important to keep the pipeline full with active new business. The business development is influenced by many factors including the referral network, diversity of specialties, age diversification of the physicians (indicates recruiting activities) and hospital affiliations or alignments.

Market Dynamics

Market dynamics can influence the long-term success of the surgical center. The factors to consider include location, demographics and population growth, competition in the area, hospital locations and activities, roads, accessibility, area perceptions, and many others.

Clinical Automation

The status of electronic health records implementation is an indication of a substantial investment and a commitment to become more efficient. If nothing has been done or is planned in this area it could be a red flag that the surgical center may be facing a large financial commitment in the future.

By understanding the financial and physical aspects of the real estate coupled with the underlying drivers of the tenant (the surgery center business), one can underwrite the complete package and make wise investment decisions.