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28
YEARS
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Physician Real Estate Ownership: Market Update & Key Considerations

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Agenda



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Mr. Jackson is a +20-year healthcare real estate industry veteran. He has been with HealthCap Partners and its predecessor, The Cirrus Group, for over 12 years, serving as Managing Partner since January 2015.

1. Mid-Year Update: Medical Outpatient Building Market
2. Key Considerations in Physician Real Estate Ownership
 - a) Setting the Stage
 - b) Ownership Structure
 - c) Financing
 - d) Property Management
 - e) Asset Management & Leasing
 - f) Common Pitfalls to Avoid
3. Questions and Answers (5 minutes)

Brief Introduction

HealthCap Partners, LLC is a private Dallas-based real estate development and investment company specializing in creative capital solutions for the healthcare industry

- Established in 1996 as The Cirrus Group LLC; merged with HealthCap, LLC in 2012 to form HealthCap Partners, LLC
- 28-year track record specializing in healthcare real estate investment, development, financing, leasing, ownership, management and dispositions across the continental U.S.
- \$2.5 Billion of healthcare real estate development and investment transactional experience across 29 states (+50 properties in Texas alone) spanning the full spectrum of healthcare property types:
 - 116 Medical Outpatient Buildings
 - 30 Specialty Hospitals & Post-Acute Facilities
 - 5 Senior Housing Communities
- Majority of projects have included physician investment partners





Mid-Year Update: Medical Outpatient Building Market



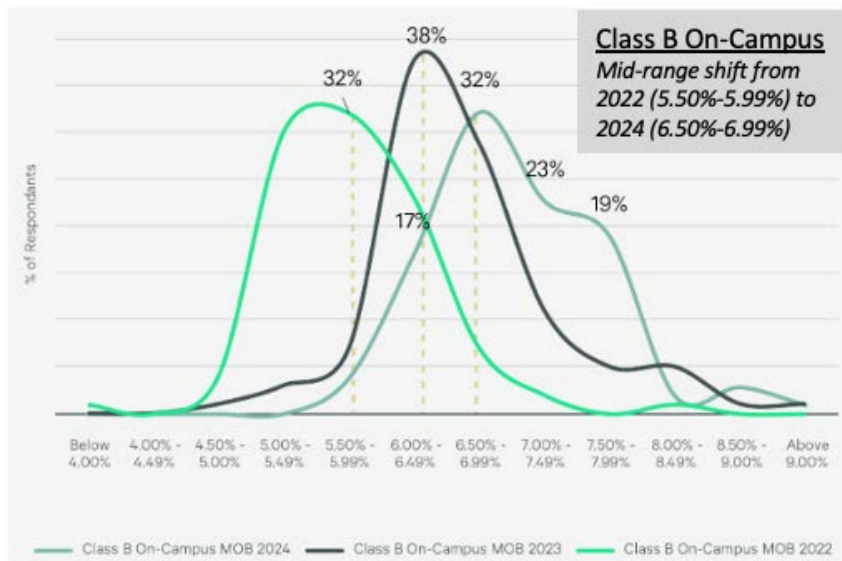
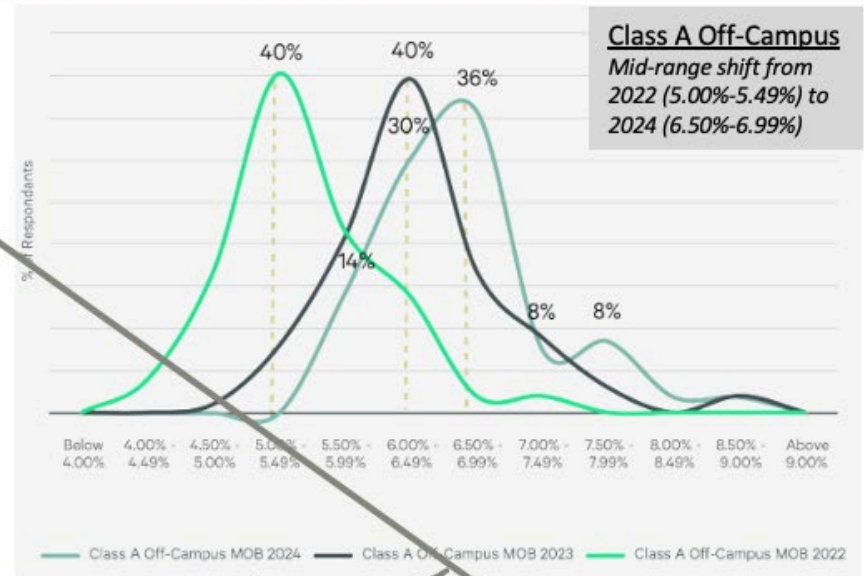
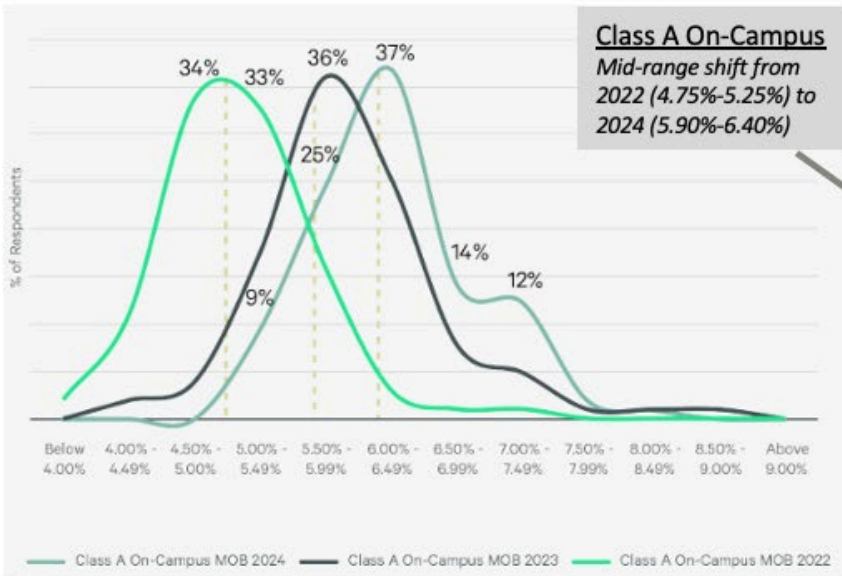
Mid-Year 2024 Medical Outpatient Building Market Update

- Theme for 2024 has been persistent elevated interest rates driven by Fed rate policy and continued uncertainty about U.S. economy ... until Jackson Hole!
- Sun Belt region primary target for most healthcare investors, particularly Atlanta, DFW, Nashville, Miami/S. Florida & Phoenix
- MOB portfolios nationwide have been very stable over past several years, with most landlords reporting same or higher occupancy compared to prior year
- For MOBs in Top 100 U.S. markets (on TTM basis as of 6/30/24):
 - Occupancy rates increased to 93.1%
 - Revenue per square foot rose 2.2%
 - Tenant retention rate was 84.1%, up 0.63%
- Additional National MOB statistics as of 6/30/24:
 - Investment volume of \$2.5B in Q2, up 60% over Q1, bringing TTM total volume to \$7.7B
 - Average Sale Price: \$291/SF
 - Average Asking Rent (NNN): \$24.86/SF, up 0.5% over Q1 and 1.4% over prior year
 - Average Cap Rate: 6.9%, down 10 bps from Q1
 - First quarterly decline in cap rates since Q2 2022 ... *this is good news as cap rates are inversely correlated to price*

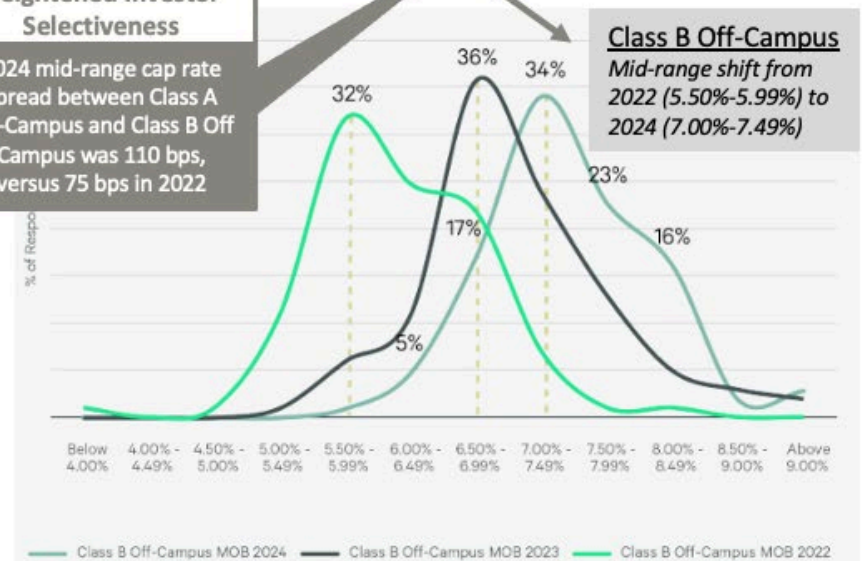


Investor Survey on Multi-Tenant MOB Cap Rates

Upward Cap Rate Movement and "Pricing Discovery" Since 2022



Heightened Investor Selectiveness
2024 mid-range cap rate spread between Class A On-Campus and Class B Off-Campus was 110 bps, versus 75 bps in 2022





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Key Considerations in Physician Real Estate Ownership



Setting the Stage

- Many potential benefits to physician real estate ownership
 - Wealth creation, ancillary revenue source, operational control, etc.
- Myriad considerations related to commercial property investment
 - Market, site, building, zoning & entitlements, ownership structure, financing strategy, regulatory restrictions, management approach, risk management, etc.
- Goals & objectives
 - Level of management and control
 - Maximizing investment performance versus strategic business and clinical objectives
- General advice is to work with commercial real estate experts that align with goals and objectives
 - Leasing agents, transactional & mortgage brokers, project managers, property managers
- Malcolm Gladwell's 10,000-Hour Rule
 - "We promise not to perform surgery in our spare time if you promise not to perform real estate management in yours"

Ownership Structure Considerations

- Physician/practice sole ownership versus joint venture investment partner
- Characteristics of typical JV structure include:
 - Experienced real estate operator serves as General Partner (GP) with varying levels of control for Limited Partner (LP) physician owners
 - GP responsible for day-to-day management including but not limited to partnership structuring and administration, loan structuring and administration, refinancing, property acquisition, development management including oversight of design and construction contracting and consultant performance, schedule management, accounting and reporting, property management, vendor contracting and management, partnership and property insurance, leasing, asset disposition(s), regulatory compliance, adherence of governing partnership agreements, and more
 - Voting rights and liability protections for LPs
 - Amount of physician equity investment can vary significantly – minority (<49%) to majority or all with GP typically having a “carried interest”
- Under physician/practice sole ownership, control and decision-making fully vested with physician owners; physician owners may self-perform or partner with experienced real estate service providers to perform various functions for a fee
- Related considerations include risk/reward tradeoff, alignment of interests, management time commitment, expertise

Real Estate Investment Joint Ventures

Benefits

- Depending on property/portfolio size and scope, large pool of experienced general commercial and specialized healthcare development and investment companies that could be potential partners
- Aligned interests with expert partner
- Shed responsibility for day-to-day property and investment management
- Liability limitations and protections
- Ability to leverage scale, expertise, and reputational benefits of JV partner

Considerations

- Pool narrows if GP in minority equity position (<50%) and/or for smaller deal size
- GP carried interest
- Control over major decisions typically held by, or shared with, GP
 - E.g., Future sale, refinance
 - Buy-sell, ROFO/ROFR, buy-out rights
- JV partners may have pre-defined investment horizons that may conflict with physician goals

Financing Considerations

- Recourse versus non-recourse, limitations and related impacts
- LTV/LTC ratios
- Amortization period
- Availability of interest only period
- Pre-payment flexibility
- Future funding opportunities and flexibility
- Floating versus fixed rate, collars, swaps, etc.
- Borrower's track record as an MOB owner can affect many of these debt terms

Property Management Considerations

- Property management functions often delegated to a Practice Manager in physician sole ownership model
 - Often not a primary responsibility but it can be a demanding and time-consuming job
- From an asset management perspective, property management is integrally tied underlying property valuation
 - Overall building appearance, cleanliness, routine preventative maintenance
 - Proper budgeting and reserves for maintenance and repairs, capex and improvements, and associated historical books and records
 - Tenant retention, existing tenant referrals or feedback loop for new lease prospects
- Vendor relationships, knowledge of market rates and terms for services, preferred/scale pricing, contracting expertise (e.g., termination rights, risk mitigation)
- Specialized skills and experience required

Asset Management & Leasing Considerations

- Leasing:
 - Property valuations are significantly impacted by lease term and structure, tenancy mix and credit
 - Knowledge of market rates and terms and competitive property intelligence
 - Requires a proactive strategy and approach which should be performed in conjunction with qualified professional broker with specific medical office expertise
- Risk mitigation: Property & casualty insurance coverages and strategy, operational protocols, and costs
- Proactive property and partnership tax management (e.g., valuation protests)
- Partnership accounting, financial reporting for investors and lenders, investment distributions, etc.

Common Pitfalls to Avoid

We routinely see the following scenarios which can negatively impact value and/or significantly reduce the pool of interest buyers in a sale:

1. Above market rental rates; experienced investors expect rents to be market for purposes of appraisal and risk mitigation (rent replacement purposes when current leases expire).
 - Above market rental rates are typically the result of over designed buildings, front-end budget overruns, ownership funding higher than market tenant Improvement (TI) allowances, and/or related tenant-ownership setting rental rates high with goal increasing sale proceeds
2. Selling a property with low remaining lease term on single-tenant building, (e.g., shortly before lead physician retires) or low weighted average remaining lease term in multi-tenant building
3. Buildings with highly unique design, poor layout, excessive common areas, poorly laid out or inadequate parking, and/or significant deferred maintenance issues



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Questions & Answers

