

A Reprint from *Tierra Grande*


# Medically Necessary

## Medical Market Evolves to Survive

By Harold D. Hunt

**W**ill Rogers said, "Even if you're on the right track, you'll get run over if you just sit there."

The ultracompetitive medical industry exemplifies this conventional wisdom, with headline-making treatments and science-fiction-like surgical procedures introduced almost daily. In this field, innovation equates with survival; stagnation can be the kiss of death.

Real estate developers marketing to the health care industry are discovering that more than ever, they, too, must keep up with the specialized needs of their clients to stay competitive.

### Developing Medical Space

Medical offices are typically more expensive to build than traditional office space, primarily because of the extensive plumbing, cabinetry and electrical capacity required. Although these finish-out costs are usually passed on to tenants, they drive initial project costs up.

**FLEXIBILITY** is a selling point at Corporate Centre Kirby, where tenants lease space offering various finish-out options. (Top) Buildings have 26-foot ceilings, allowing for conversion to two stories. (Left) A dialysis clinic featuring a light, bright atmosphere and televisions at each patient station was among the center's first tenants.

Many medical professionals also look for the flexibility to expand their space without relocating because moving a medical practice is extremely expensive. In addition to the costs of moving medical equipment and fixtures, there are unknown indirect costs related to asking patients to adapt to a new location. Consequently, medical tenant turnover is generally low.

While this creates a stable environment for existing investor-owned properties, it negatively impacts the financial feasibility of new medical office construction. Lenders typically require extensive preleasing, usually 60 to 70 percent, before they agree to finance new medical space. As a result, construction of speculative space is limited.

Two recently built properties provide an interesting look into the latest trends in medical space.

## Park Cities Medical Plaza (Dallas)

The predominance of managed care programs, which limit doctors' fees, has resulted in steady downward pressure on physicians' incomes. Some physicians are now focusing their practices on medical services that generate the highest income, such as surgery.

About two years ago, Cirrus Health Services, a subsidiary of the Dallas-based Cirrus Group, began working directly with local physicians to determine if there was a need for an outpatient ambulatory surgery center in the Park Cities area of Dallas. Project feasibility was based on demographic factors, such as potential patient population size and affluence, and the presence or absence of competing facilities. Cirrus then determined the overall tenant mix needed to provide the most practical bundle of medical services.

"This was one of the most critical steps in the development process," says Jason Dodd, director of real estate services and a partner with The Cirrus Group. "Without a strategic approach, medical deals like this are impractical. Our strategy is nothing like speculative office building."

The group decided that the Park Cities Medical Plaza (PCMP) would be a three-story, 39,000-square-foot facility with a day surgery center as primary tenant. The Texas Department of Health mandates that surgery patients in this type of facility be allowed a maximum of 23 hours to recover in the center, thus excluding trauma and intensive heart surgery patients.

Choosing a surgery facility, which requires sizeable square footage, to be the primary tenant meant that a large block of space would be preleased, increasing the property's financial viability. The surgical center occupies one-third of the building's leasable space; another third houses a full-service imaging center, including radiology, MRI and CATSCAN facilities, which supports the surgical facility.

Cirrus was able to accommodate the surgery center's cost-intensive and complex build-out requirements. The high income level generated by surgical services has allowed more of the development's cost to be shifted to the surgical center, which is effectively subsidizing the remaining tenants' rental rates.

Surgeons with office space in the building benefit from proximity to surgical facilities. Travel time typically required between surgery and seeing patients in the clinical setting has been significantly reduced.

The Texas Sports Medicine and Orthopaedic Group is an anchor tenant in PCMP. Previously located down the street, the group had been sending their surgery cases to other area hospitals. Now the group sends a steady stream of day surgery patients to the PCMP surgical center.

The Park Cities area is one of the most affluent in Dallas, so the other tenants chosen to round out the mix primarily

service upper-end clientele. They include cardiologists, a Heart Health and Wellness Center, a plastic surgeon and a "boutique" physician who works on retainer and services a limited number of patients. In keeping with the upscale environment, valet parking is available to patients.

Building medical developments with a specific focus — in this case, a surgical center — has worked well for Cirrus. The company is currently developing four other medical office properties in the Dallas-Fort Worth area and has completed 12 other health care facilities in the Dallas-Fort Worth and Houston markets.

## Corporate Centre Kirby (Houston)

The Texas Medical Center (TMC) in Houston employs more than 61,000 on its 700-plus acre campus. It is the largest concentration of medical facilities in the world. The complex boasts 22 million square feet in physical plant space with projections for an additional 10 million square feet to be developed during the next decade.

In June 2001, during tropical storm Allison, the center sustained an estimated \$2 billion in flood damage. Insurers are now hesitant to insure property in the basements of TMC buildings, creating increased demand for space near the complex.

Warehouse Associates, a Houston-based development firm, is capitalizing on its proximity to the TMC by building a new

*AN AFFLUENT CLIENTELE* was the driving force behind Park Cities Medical Plaza's elegant design (left) and hand-picked tenant mix. (Below) Top-of-the-line imaging facilities support the surgical center and private practices in the building, as well as those nearby.



flex/service center. Corporate Centre Kirby, the development's first phase, is 107,800 square feet of space in two buildings on seven acres of a 60-acre tract fronting South Kirby Drive.

"The idea for Corporate Centre Kirby was to achieve a high level of design aesthetics," says project architect Mark Verrett

of Verrett Architects. "The property has the look of a high-end, two-story property although it's basic tilt-wall technology."

A color consultant was used to determine the most attractive color mixes and proportions for the exterior walls. Such attention to detail is unusual in flex-service center space, but Verrett considered it necessary to attract higher-end medical tenants. Corporate Centre Kirby also offers less traffic congestion and more convenient parking than the TMC for both medical employees and patients.

David R. David, the project's developer, originally felt that support services such as labs or medical suppliers would show the most interest in the property. Instead, more traditional medical clients, including a dialysis clinic, medical offices and a home health care firm are among its first tenants.

The property's 26-foot ceilings appeal to prospective tenants because they offer a range of finish-out options. Businesses get a "mezzanine-ready" shell space that can be converted from one-story to two-story space for about \$14 per square foot before move-in. This essentially equates to a rent-free second floor. Other attractive design options are available, including dramatic two-story entrances.

Corporate Centre Kirby buildings were designed to accommodate a wide variety of uses with maximum flexibility. "Not many buildings can be converted from warehouse to medical lab or complete office without major changes," says Steve Salverino of Rosenberger Construction. "Here, parking is not a

problem, columns were oversized to facilitate the mezzanine construction option, and a 10-foot wide "leave-out" (space) was left in the foundation to allow cheaper and more efficient installation of the extensive plumbing medical tenants require."

Finally, the property is gated, with controlled access only. A custom security package known as "Virtual Guard" combines two security systems. One component electronically monitors the property. When sensors are tripped, off-site law-enforcement takes control of a camera system transmitting over the Internet.

The system offers one-way visual and two-way voice communications with intruders or with clients exiting the property. Another component provides automated electronic gates and access card readers. Although this system has been used extensively in gated residential communities, Corporate Centre Kirby is one of the first to apply it in a flex-space setting.

Demand for state-of-the-art medical treatment will no doubt continue to

increase as the baby boom generation nears retirement. This in turn will drive demand for state-of-the-art medical space. Although the risks in developing such specialized space are significant, innovative developers can also find opportunities for profit. ♣

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**"LEAVE OUTS" IN FOUNDATIONS** at Corporate Centre Kirby accommodate the added plumbing medical offices need.

## Medical Space Ownership Models

### Hospital-owned

Hospital-owned medical office space provides doctors space near a particular hospital with the objective of getting patients to use that hospital for treatment or services.

Because a hospital's primary profit center lies in servicing patients, not leasing office space to doctors, maintaining a high occupancy rate is less important to the hospital than to most commercial leasing operations. In fact, hospital-leased space is much like a "loss leader" item at a grocery store — its purpose is to provide a steady stream of patients seeking hospital services.

Doctors such as podiatrists or allergists, who rarely admit patients to a hospital, may even be discouraged from leasing office space in favor of neurosurgeons, cardiologists or others who admit patients more frequently.

### Physician-owned

Physicians and other medical professionals may choose to purchase their own office space. Some expect a long-term benefit from building equity in real property rather than paying rent. Others simply desire more control over this aspect of their business. Many doctors want to provide patients with a conveniently located office away from medical centers, because

dealing with a large hospital complex can be daunting.

Because doctors desire face-to-face communication with colleagues on a regular basis, they typically form practice groups. If member doctors are specialists who see many critically ill patients, they may choose to locate close to a hospital for liability reasons and convenience.

### Investor-owned

In contrast to the other ownership types, development of investor-owned medical space is based solely on financial feasibility. Facilities must offer the types of space medical professionals want in locations that serve the needs of both doctors and patients.



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