



THE RETAILIZATION OF HEALTHCARE

A MARRIAGE OF CONVENIENCE OR THE ANSWER TO ALL OF OUR PROBLEMS?

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The retailization of healthcare has been a hot topic recently in healthcare and real estate industry circles alike. But what does this term really mean? From a healthcare perspective, it describes the evolution of the delivery of healthcare from a physician-centric model to a more consumer friendly, patient-centric model – much the way retail goods and services have long been delivered to customers. This means providing healthcare services in a much more accessible, convenient and patient-friendly manner than in the past. Most people have experienced the traditional model of receiving healthcare where you would travel a long distance to a sterile hospital campus to visit your primary care physician, often having difficulty finding a parking space due to the fact that all of the closest spaces were “Reserved for Physicians.” The walk to your physician’s office might take you past the emergency room or a pediatric cancer center that would only add to your already uncomfortable feeling of going to the doctor. You were told by the physician’s office to show up 15 minutes before your scheduled appointment, only to see your doctor 45 minutes after your scheduled appointment. It is no wonder why people did not like going to the doctor!

Under the new delivery model, it is the comfort and convenience of the patient, not the physician, that is paramount. Population health initiatives are attempting to shift the focus of healthcare from simply treating sick people to proactively keeping entire populations of people well, while at the same time reducing costs of delivering care. In order to achieve these goals, providers are being forced to pay attention to patient satisfaction metrics and are beginning to provide healthcare services in more comfortable and convenient environments. This means diverting many traditional non-acute healthcare services away from the acute care setting and into comfortable and easily accessible buildings in the neighborhoods where their patients live and work. Inherent in this shift is a recognition that consumers have a choice in their healthcare and convenience and accessibility are key drivers in this choice. In addition, providers recognize that if they can deliver healthcare in a more pleasant and convenient setting, they are more likely to see patients on a more regular basis, which will enable them to better control outcomes and prevent chronic disease. As a result, this emphasis on retailization is good for both the patients and the providers.

How Retailization Manifests Itself in the Real Estate World

Many have conflated the broad concept of retailization of healthcare discussed above with the proliferation of healthcare uses in traditional retail real estate settings. While the two are no doubt related, and the latter is a derivative of the former, they should not be confused. Retailization is a broad concept, but its most obvious manifestation is in the choice of real estate used for the delivery of healthcare services. In that regard,

over the past several years we have seen many healthcare uses such as primary care, urgent care, imaging, diagnostic services and emergency services migrate from the traditional hospital and/or medical office building setting into purely retail environments. There are two primary factors contributing to this migration – one healthcare related, and one wholly unrelated to healthcare. The first is the shift in the healthcare delivery paradigm discussed above (i.e., increased convenience and accessibility for patients). As convenience and accessibility have become critical drivers in the

population health movement, healthcare providers have recognized the need to “go where the people are.”

In the retail world, store locations have historically been chosen for their proximity to large population centers, and the best retail locations happen to be those in the population centers with the highest per capita income. Those demographics are attractive to healthcare providers for the same reasons they are attractive to the retailers.

(continued)

From this perspective, locating healthcare uses in retail shopping centers makes perfect sense.

The second factor contributing to the rise of healthcare uses in traditional retail settings is the fundamental change in the delivery of retail goods brought on by stiff competition from e-commerce. While this has nothing to do with healthcare per se, there is a common thread of consistency with the first factor – i.e., convenience. Just as healthcare providers are finding more convenient ways to deliver healthcare services, so have retailers found a more convenient way to deliver retail goods – the internet. This has led to a crisis in the brick and mortar retail real estate industry, as retailers and retail real estate owners have scrambled to address their own shifting paradigm. With a vast reduction in the number of available anchor tenants and all retailers requiring fewer locations and less space per location, retail tenancy is rapidly declining and landlords are looking for ways to fill the void. Healthcare uses, long locked out of prime retail locations because of the cost of the real estate as well as use restrictions prohibiting them, now don't look so bad to retail landlords and have stepped in to fill some of the available space at a price they can afford to pay.

The convergence of these seemingly unrelated factors has created a "marriage of convenience" between healthcare providers looking for good real estate convenient to their patient population and retail landlords looking to fill orphaned space in their retail malls and shopping centers with non-traditional uses. In addition, since health systems are increasingly becoming the largest employers of physicians, they often become the tenants in these spaces, providing a much better credit to the lease than if the tenant was smaller physician group.

Real Synergy or Simply a Marriage of Convenience?

So why are healthcare providers flocking to retail centers at a time when brick and mortar retail is in decline? Is there really any synergy between healthcare and retail uses or is it simply a marriage of convenience? A brief review of the historical relationship between retail and healthcare may help shed some light on this. For years, retail landlords eschewed healthcare uses and their legal documents often specifically included healthcare as a "Prohibited Use," along

with other undesirables such as massage parlors, second-hand stores and bowling alleys. While excessive use of parking and fear of sick people contaminating shoppers were some of the reasons provided for the avoidance of healthcare uses, the most persuasive reason given was that healthcare didn't fit into the landlord's desired "tenant mix." In other words, the fear was that people would go to their doctor visit and then get in their car and return home. Medical space was not conducive to people staying for the afternoon and shopping in multiple stores before leaving.

So what has changed? From the retail landlord's perspective, each of these factors contributing to the undesirability of healthcare uses remains. The only thing that has changed is that the universe of retail tenants has contracted and e-commerce has fundamentally changed the brick and mortar retail environment. Now shopping centers are welcoming with open arms the types of tenants that just a generation ago they had the luxury of avoiding. This is not only true for healthcare, but look at the proliferation of massage studios and bowling alley/entertainment venues that are now populating retail malls and shopping centers. Do the retail landlords really want this as their desired tenant mix, or are they being forced to adapt?

The challenges in the retail industry have presented opportunities for healthcare systems looking to expand their footprint. These healthcare systems and their affiliates are happily backfilling vacant retail space because it allows them to enter into their desired markets without forcing them to invest in building new facilities from the ground up. In many cases, speed to market is critical and thus this is the quickest way to enter into a new market. It also allows providers to test a new market without making a permanent investment in that market. But make no mistake, the healthcare provider does not necessarily care about the synergy with the retail space; it is purely about the location for the healthcare provider. The healthcare provider could easily stand-alone without the surrounding retail space, but could the same be said about the retailers? For these reasons, I would suggest that no real synergy exists except that both uses like the location. It is, therefore, a marriage of convenience.

Can the Model be Sustained?

If no real natural synergy exists except for

location, can this marriage of healthcare and retail stand the test of time? While attracting healthcare uses may help shopping center owners deal with the lost tenancy caused by the shift in retail shopping habits, it does not address the underlying fact that the retail industry is going through a transformational change and may never return to the glory days of shopping malls and power centers. The retail real estate industry has already started to address this concern by looking to fill space with more services, restaurants, entertainment and experiential uses, but is there any more synergy between those uses and healthcare? Probably not. It remains to be seen if the shift in retail to a more experiential environment will succeed in the long-term, but one thing is clear - while healthcare uses can typically stand alone without the need for co-tenancy, retail centers without strong anchor tenants will continue to struggle. That is the reason that healthcare tenants (especially healthcare systems) may possess more leverage in their lease negotiations with retail landlords than they realize.

Issues Created by the Convergence of Healthcare and Retail Uses

In addition to a lack of natural synergy, several other issues are created by the convergence of healthcare uses with retail uses. While not insurmountable, these are issues that both the healthcare tenant and the retail landlord must consider before joining forces. First, one must understand that healthcare systems and hospitals have historically controlled the environment on their campuses. When they allow third-party partnership of buildings on their campus, they still tightly control who the tenants are, what the uses are and even where they park. On the other hand, when these providers migrate off their own campus and choose to locate in retail centers, the tables are turned on them. They can't control who their neighbors are or what those neighbors do. In many respects, they are at the mercy of their retail landlords. That is an uncomfortable position for an entity that is used to having complete control.

Another issue created by the merger of healthcare and retail uses is the differential in the value of the medical rent from other retail tenant rents. In other words, when retail space is converted to a medical use, the rents increase dramatically due to the nature of the build-out. If the medical tenant ever vacates the space, it will be extreme-

ly difficult to re-convert the space back to retail, and doing so would most certainly devalue the property. Therefore, in many respects, once a conversion to medical use has occurred, it is a permanent change. The retail landlord needs to understand this when looking for a quick fix to its vacancy issues.

Additionally, changes in the healthcare delivery model have brought new and unanticipated players into the healthcare delivery business. Ironically, some of those players are the very same players that historically wanted to exclude healthcare uses from retail environments. Today, retailers such as Whole Foods Market, Amazon and CVS are pushing for exclusives in their leases and other real estate documents that would allow them to be the only providers of healthcare services in the shopping centers of which they are a part. This could pose a problem for a retail owner looking to use a variety of healthcare uses to fill space in the center.

Finally, as healthcare and other non-traditional retail uses become a larger piece of the shopping center pie, the shopping center undergoes an identity crisis. At what point does it stop being a shopping center and become a healthcare or entertainment complex? The answer to that question might impact who are viable buyers and/or lenders for the project. If a shopping center developer or owner is considering adding a large healthcare component to its retail development, it may be wise to create a commercial condominium legally segregating the various uses, which would allow the owner to sell or finance the individual units separately.

A More Synergistic Approach

In many ways, the introduction of healthcare uses to retail environments is more convenient than synergistic. To be sure, it has advanced the ball on the retailization of healthcare in the global sense, and it will likely continue to be a key method of healthcare delivery in suburban bedroom communities, because while you can virtualize shopping and even healthcare to an extent, you can't virtualize where people live and sleep. Nevertheless, while it is a good start in terms of turning healthcare into a consumer-driven model, it falls short of the ultimate goal in several key respects.

The good news is that the next evolution of retailization has already begun and it has the potential to allow healthcare providers to fully realize the goals of population health management, at least for a certain segment of the population. The new urbanism movement has led to the growth of mixed-use developments not only in the urban core of our cities, but also in the suburbs. The popularity of these mixed-use developments in many of our urban and suburban markets over the past several years has created an opportunity for healthcare providers to be included in master-planned mixed use communities from the outset, rather than simply backfilling available space in vacant retail centers. While these mixed-use developments certainly have a retail component, they often contain elements much more synergistic with healthcare than retail, such as residential and office, and mixed-use developers are extremely adept at taking into account the needs and desires of their various constituencies.

The ability for the healthcare provider to locate within a walkable distance to where a patient lives and works is a game changer in terms of advancing population health objectives. It allows the provider to become embedded in the community, rather than just convenient to it, and puts it in a position to understand the environment and better control the outcomes through the development of healthy living programs. A mixed-use community is a much more natural environment for population health objectives to take hold and flourish, and improving the health of the population is one of the under-rated benefits of the new urbanism movement. As communities continue to trend in this direction, look for healthcare systems to be a major player.

Conclusion

The changes in the delivery models for both healthcare services and retail goods and services present both challenges and opportunities for the healthcare industry and the retail industry alike. A thoughtful approach to these challenges and opportunities can produce a result where both industries are winners. The successful approach will necessarily challenge retail landlords and healthcare tenants to re-think their respective traditional approaches to real estate to reach a new equilibrium that satisfies each party's objectives.



About the author: Over the past 20+ years, Andy Dow has developed a reputation as one of the preeminent healthcare real estate attorneys in the United States. Clients from across the country seek his counsel and advice on a variety of transactions and strategies related to the healthcare real estate sector. Whether representing a health system in a monetization transaction or a healthcare investor in a portfolio acquisition, he brings a distinctive blend of real estate excellence and healthcare industry acumen to each engagement. As the Chair of Winstead's Real Estate Industry Group and its Healthcare Real Estate Practice Group, Andy leads a team of seasoned healthcare real estate professionals with an impressive stable of clients, including industry leading healthcare REITs, private equity investors, developers, operators, hospital systems, physician groups and lenders.
