

MEDICAL OFFICE MARKET NEWSLETTER

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2010 Q4

The Greater Cincinnati medical office market remained stagnant throughout 2010. Only three new buildings totaling 92,969 SF were completed this past year (compared to 642,714 SF of new medical space throughout 2009). There are two buildings totaling 47,700 SF that will be completed by the middle of next year, and Mercy Health Partners broke ground on its 550,000 SF hospital at North Bend Road in October. Six additional projects totaling 317,000 SF could break ground next year. The main driving factor behind new medical developments remains hospital systems, with speculative development remaining non-existent. Of the twelve projects annotated above, 79% of the total square footage completed, under construction, or planned is directly from local hospital systems.

The operating status of Greater Cincinnati's hospital systems is much clearer than it was a year ago, with the sale of Jewish Hospital to Mercy Health Partners complete and the Health Alliance of Greater Cincinnati becoming UC Health. Hospital systems continue to aggressively compete with each other to recruit physicians away from other hospitals or private practices. This is not only a Cincinnati trend, but a national trend as well. According to a recent Medical Group Management Association survey, the share of responding practices that were hospital-owned increased to 55% last year, up from 50% in 2008 and 30% five years earlier. In the past quarter alone, a few notable transactions included:

- **The Christ Hospital** acquired the orthopaedic physician practices of Marc Schneider, MD, Dr. Daniel Funk, and Freiberg Orthopaedics and Sports Medicine. The Christ Hospital is employing these physicians and employees under the name The Christ Hospital Orthopaedic Associates.
- **TriHealth** acquired the Greater Cincinnati Associated Physicians (GCAP) Western Hills medical practice. The five physicians in this group will operate under their original name, Rudemiller Family medicine, and will be joining the TriHealth system of care effective February 1, 2011. The remaining twenty-six physicians from GCAP will be joining the **Mercy Medical Associates** network.
- **Catholic Health Initiatives** (a sponsor of TriHealth) acquired Bethesda Inc.'s Consolidated Health Services Inc. home health unit. Headquartered in Milford, Consolidated Health Services operates in 30 markets and includes American Nursing Care, Patient Transportation Services, AmeriMed, and Cornerstone Medical.
- **St. Elizabeth Healthcare** acquired Northern Kentucky Heart PSC and Cardiology Associates PSC, creating the St. Elizabeth Heart and Vascular division. The combined Northern Kentucky Heart and Cardiology Associates operations have 13 physicians and 3 locations.
- **The Christ Hospital** acquired the Advanced Urogynecology and Pelvic Surgery practice of Mickey Karram, MD.

The Patient Protection and Affordable Care Act (PPACA) and the Health Care and Education Reconciliation Act of 2010 continue to be extensively debated. As this newsletter is published, House Republicans have introduced the Job-Killing Health Care Law Act, which would repeal both PPACA and the Health Care and Education Reconciliation Act of 2010. The Congressional Budget Office (CBO), in concert with the Joint Committee on Taxation (JCT), issued a preliminary analysis of the repeal bill concluding that repeal of PPACA would increase the federal budget deficit by \$145 billion from 2012 to 2019, and by \$230 billion from 2012 to 2021. Republicans are disputing these calculations.

Additionally, out of the three cases brought to court challenging the constitutionality of PPACA, two Clinton-appointed judges have ruled PPACA's requirement that people buy their own health insurance is constitutional.

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George H.W. Bush-appointed Judge Henry E. Hudson in Virginia has ruled against PPACA. A fourth case brought by Attorney Generals from 20 states is waiting to be decided by Judge Roger Vinson, a Reagan appointee. We now have “unsettled” healthcare law, and these decisions will most likely be appealed to Federal Appeals Court, with the constitutional questions ultimately decided by the Supreme Court –unless President Obama and the new Congress reach an agreement on insurance coverage.

Section 6001 of PPACA, which prohibited physician-owned Medicare hospitals from expanding after March 23, 2010 and banned construction of any new physician-owned Medicare hospitals that were not Medicare certified prior to December 31, 2010, has resulted in construction stopping at 45 hospitals nationwide (according to Physician Hospitals of America). PHA and Texas Spine & Joint Hospital (TSJH) filed a lawsuit challenging the constitutionality of Section 6001 of PPACA. Judge Michael H. Schneider, U.S. District Court Judge, in the Eastern District of Tyler, Texas, cancelled the December 9, 2010, trial date and gave notice of a forthcoming opinion. In a brief order, Judge Schneider ruled that the Court does have jurisdiction to hear the case, but that he found Section 6001 does have retroactive effect. The lead council for PHA and TSJH stated he was “pleased the Court has decided it has jurisdiction over this case, and has determined that stopping the development of physician-owned hospitals in progress is retroactive in effect. The Supreme Court of the United States has always highly disfavored retroactive laws. We await the Court’s decision about why this one is not illegal.” Judge Schneider has not issued his opinion as of the publication date of this newsletter.

4th Quarter Medical Office Sale Transactions

- **3960 Red Bank Road, LLC** (Neyer Properties) purchased 3960 Red Bank Road (37,044 SF) from Red Bank Village I, LLC (Miller Valentine Group) on 12/30/10 for \$2,000,000 (\$53.99/SF).

4th Quarter Medical Office Lease Transactions

- **The Christ Hospital** subleased 33,885 SF from Kroger at 7545 Beechmont Avenue in Anderson. This new outpatient center is scheduled to open in May 2011. Services provided will include: cardiology, obstetrics and gynecology, internal medicine and family medicine, physical and occupational therapy, laboratory services, diagnostic services, and other services.
- **Wellington Orthopaedics & Sports Medicine** leased 18,920 SF at Western Ridge Medical Office Building Two (6909 Good Samaritan Drive).
- **Tri-State Centers for Sight** leased 4,520 SF at Western Ridge Medical Office Building Two (6909 Good Samaritan Drive).

4th Quarter Construction Completions

- TriHealth’s **The Good Samaritan Medical Center at Western Ridge** (6949 Good Samaritan Drive) was completed and opened to patients in September. The first building is 47,985 SF (two stories). Tri-Health has leased the first floor, **Queen City Physicians** has leased 11,200 SF, **Group Health Associates** has leased 6,000 SF, and 4,800 SF is available on the second floor. This new facility has a 24-hour, 16 bed emergency room, comprehensive diagnostic services, and 24-hour laboratory services.

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- **Medpace Inc.'s** first new headquarters building (132,000 SF) at 4820 Red Bank Road was completed in December 2010. Medpace will move 600 employees from its Norwood facility to this site, and will have at least one additional building constructed as part of the new 29-acre development at Madison Road and Red Bank Expressway. Medpace plans to add an estimated 760 jobs to this site by 2014.
- Al Neyer, Inc. completed a new 20,284 SF facility for the **Department of Veterans' Affairs** in Middletown in November. This new outpatient clinic will be open in January. Services provided by the new Middletown Community Based Outpatient Clinic include primary care, optometry, podiatry, full-service laboratory, mental health services and pharmacy.
- Construction was completed in December on 2929 Highland Avenue for the **Cincinnati VA Medical Center**. This Class A medical and administrative building encompasses a 24,700 SF facility and includes a 100-space parking structure.

Projects Under Construction

- **Great American Tower at Queen City Square**, totaling 825,000 SF, will be completed in January 2011. Great American Insurance will occupy 540,000 SF, and Frost Brown Todd will occupy 100,000 SF, leaving 170,000 SF available for lease. Great American will vacate over 400,000 SF in several buildings in the CBD.
- The future of **Kenwood Towne Place**, comprising 270,000 SF, remains uncertain.
- Galbraith Medical Center (4605 Galbraith Road) remains on schedule for a February 2011 completion. **Partner Professional Staffing** will be the anchor tenant in this two-story, 18,000 SF building and will occupy the second floor (9,000 SF).
- Duke Realty broke ground on **Western Ridge Medical Office Building Two** (6909 Good Samaritan Drive). This single-story, 29,700 SF building has 6,280 SF available. **Wellington Orthopaedics & Sports Medicine** has leased 18,920 SF and **Tri-State Centers for Sight** has leased 4,520 SF. This new facility should be completed by mid-2011.
- Ground was broken in September for the new 109,000 SF **FBI** campus at Montgomery Road and I-71 in Kenwood. The **FBI** will be relocating from the CBD when their four-story building is complete by November 2011. The FBI signed a twenty year lease on this \$50 million building, where it will house its Special Weapons and Tactics and Hazardous Materials units. Plans for the western part of the site include a 160-room hotel and a nine-story, 266,000 SF office tower. The total size of the entire site is 6.26 acres.
- **Mercy Health Partners** broke ground in October on its new West Side hospital, Mercy Hospital West. Located near I-74 off the North Bend Road exit, the facility will encompass 550,000 SF and have 250 beds. The \$200 million hospital is scheduled to open in 2013. Services will include heart care, a cancer center, an orthopedics center, a women's health center, neurology service, and obstetrics/maternity care.

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Planned Construction Projects

- **Phase I of The Banks** will comprise 304,525 SF of Class A office space, but the timing of this project remains uncertain due to its 60% pre-leasing requirement.
- **TriHealth** has plans to construct a 67,000 SF medical office building at Good Samaritan Hospital. The building will be built on the parking lot behind the current 61,000 SF medical office building. Group Health Associates will occupy the building. The timing of this project remains uncertain.
- **The Urology Group** hopes to begin construction on a new 45,000 SF, two-story building early next year, pending approval of \$13.6 million in tax-exempt recovery zone bond financing at Section Road in Norwood. This new building will house administrative offices and an ambulatory surgery center that will include labs, surgical rooms and radiology facilities. The Urology Group will relocate from 38,000 SF at 4700 Smith Road (Central Parke).
- **Neyer Properties** plans to build 40,000 SF of Class A medical office space at 5655 Harrison Avenue. Located at Harrison Avenue and Westwood Northern Boulevard on a 5 acre site, this new building will be built to LEED Silver standards. Planet Fitness has signed a letter-of-intent to lease 20,000 SF adjacent to the new building. The timing of this project will depend upon obtaining the necessary pre-leasing requirements.
- **The Christ Hospital** purchased four parcels in Green Township on 12/21/10, totaling 11.3275 acres, for \$5.1 million (\$450,231.74/acre). Green Township officials have approved Christ Hospital's plans to build a 60,000 SF medical office building on the site, located at Filview Circle and Harrison Avenue. Construction is expected to commence in March 2011, with a planned completion date in the first quarter of 2012. The three-story facility will house physician offices and have diagnostic and imaging capabilities. The site will also enable Christ Hospital to expand with a second building totaling 90,000 SF. Under the development agreement, Green Township will provide \$2.3 million for public improvements around the site. The township will fund these improvements through tax increment financing and the creation of a Joint Economic Development District.
- **USS Realty, LLC**, purchased 66.39 acres from The Factory Power Company (2.01 acres), Kirk & Blum Manufacturing Company (10.73 acres) and Unova Industrial Automation Systems (53.64 acres) on 12/23/10 for \$6,320,001 (\$95,200.95/acre) in Oakley. Another 7.16 acres is also under contract for this development, making this a 73.55 acre development. The initial plans for the site include 350,000 SF of retail space, a 55,000 SF movie theater, 200 apartments, and 250,000 SF of office space built to LEED standards. Demolition of this site will begin in February, and the total site cleanup (including any necessary environmental remediation) is projected to take 8-12 months. The development agreement for this project, currently named **Oakley North Redevelopment**, has been approved by the City of Cincinnati. New market tax credits are also available for qualifying users. Access to this site from the north will be enhanced by the Kennedy Connector (which is 100% funded through city and federal funds), and construction on this improvement should begin in the fourth quarter of 2011.

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Interesting Facts:

- According to the Centers for Medicare & Medicaid Services (CMS) Office of the Actuary, the government's official assessment of 2009 health expenditures noted :
 - Overall health expenditures increased four percent to \$2.49 trillion, or \$8,086 per capita for 2009
 - Expenditures for 2009 represent a one percent increase in economic significance: from 16.6 percent to 17.6 percent of overall gross domestic product (GDP)
 - Federal spending for Medicaid increased 22 percent 2009 compared to 2008, while state spending decreased ten percent
- There are thirty-seven health care professionals in 112th Congress (includes physicians, nurses, allied health professionals)—up from 30 in 111th. *(Source: Politico)*
- Total Medicaid enrollment million in 2009: 50.3 million—up 2.4 million over 2008, with half the increase among children. *(Source: CMS)*
- Official 2010 population: 308,745,538 Americans—up 9.7 percent since 2000, the slowest rate of growth since the 1930s. *(Source: U.S. Bureau of the Census Report December 21, 2010)*
- Electronic Health Record (EHR) use: from 2009 to 2010, physician usage of EHRs varied by state with a high of 80.2 percent in Minnesota to a low of 38.1 percent in Kentucky. EHR usage by office-based physicians increased from 18.2 percent in 2009 to 50.7 percent in 2010. *(Source: CDC)*
- Sixty-two percent of personal bankruptcies in the U.S. in 2007 were the direct result of health care expenses unpaid, up from 46 percent in 2001. Drugs were the largest out-of-pocket expense for 19 percent of those filing bankruptcy due to medical bills and illness in 2007. Interestingly, 75 percent of those bankruptcy filers in 2007 had health insurance. *(Source: American Journal of Medicine)*
- In 2008, 62 percent of drugs paid for by Medicaid payments (\$17.8 billion/75 percent of Medicaid total drug costs) were FDA approved; the remaining 38 percent of scripts representing 25 percent of Medicaid drug costs were for drugs not listed in the National Drug Code Directory. *(Source: Office of the Inspector General)*
- 25.2 percent of U.S. hospitals (982) are for-profit—up 31 percent since 1999. *(Source: AHA)*
- In the past five years, employee health costs have increased 47 percent while wages have increased 18 percent. *(Source: U.S. Bureau of Labor Statistics)*
- Sixty-five percent of doctors who changed jobs in 2009 moved into a hospital-owned practice and 49 percent of medical residents were hired by hospitals. *(Source: MGMA Physician Placement Starting Salary Survey: 2010 Report Based on 2009 Data)*
- Forty percent of private cardiology groups are currently integrating with hospitals or merging with other practices. *(Source: American College of Cardiology)*