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Industry Pulse

CALIFORNIA – Talk about controversy. California’s healthcare receiver for the state’s prison system, **J. Clark Kelso**, has devised a plan to build seven new prison hospitals with a total of 10,000 beds. The plan to build the newer and better hospitals for inmates came in response to a judge’s ruling that the healthcare provided by the state’s prisons is inadequate. A report in 2005 determined that California inmates died about once a week because of because of the system’s poor healthcare services. One would think Californians would be embracing Mr. Kelso’s plan. However, many are questioning the size, scope and cost of the proposal. Building the 10,000 beds – for a current prison population of 170,000 inmates – is expected to cost about \$8 billion over 25 years. Mr. Kelso is also drawing some ire from residents and lawmakers alike, as he is asking for \$250 million right away to begin planning for the facilities. He also

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Development is not dead

HREI™ EDITORIAL BOARD CALLS PIPELINE ‘ROBUST’

By John Mugford

Yes, Virginia, there is healthcare real estate development taking place.

Sure, new development is nearly nonexistent in most other commercial real estate sectors right now. And, even in healthcare, there are some potential pitfalls to consider in moving forward in these difficult economics times, such as whether doctors can continue to afford space in newly constructed, higher-priced medical office buildings (MOBs).

Also, while current project bookings look strong for many firms through the end of 2009, the pace could slow as 2010 approaches and hospitals face even more financial challenges. But, then again, for now and the next year or so, it appears that development is and will be taking place in healthcare.

As members of the editorial advisory board of **Healthcare Real Estate Insights™** met in Dallas last month to discuss the current state of the industry, this realization occurred to the professionals in the room.

SPECIAL REPORT

Nearly 20 **HREI™** board members were gathered around a conference table at the offices of host Trammell Crow Co., where editorial board member Kevin O’Neil is the senior managing director of healthcare real estate.

It was Mr. O’Neil, in fact, who brought up the point – that development is indeed occurring – as board members talked about the many difficulties the industry is facing today, such as meeting much more stringent

(See “Development” on Page 15)

Erdman begins new era

VENERABLE COMPANY TOUTS NEW NAME, RESOURCES

By Murray W. Wolf

When this reporter last visited the offices of Marshall Erdman & Associates (MEA) Inc. in Madison, Wis., a few years ago, the venerable healthcare design-build firm was still housed in a historic but cramped headquarters building at 5117 University Ave. – a cavernous concrete block and wood truss structure, built in large part from materials salvaged from a long-ago airport remodeling project.

When I returned this fall, it was to a

\$20 million, five story, 133,000 square foot, LEED (Leadership in Energy and Environmental Design) Gold-certified office tower at One Erdman Place in a modern business park on Madison’s far west side.

Q & A

The venue is not all that is new. In the wake of its March 2008 merger with Cogdell Spencer Inc. (NYSE: CSA), the firm now goes by the formal name of Erdman, a Cogdell Spencer

(Please see “Erdman” on Page 12)

Rates fall but lenders remain cautious

INTEREST DECLINED LAST MONTH BUT CREDIT MARKETS CONTINUED TO BE TIGHT

By Murray W. Wolf

Amid the anticlimactic “news” earlier this month that the United States is officially in a recession (and has been since December 2007), recent central bank reductions to the Federal Funds rate helped push interest rates lower, and spreads widened for the Commercial Mortgage Backed Securities (CMBS) market.

rate, which tracks short-term tax-exempt bonds, was 0.85 percent on Dec. 12, when these statistics were gathered. That compares with 1.26 percent on Nov. 7. Likewise, the 1-month LIBOR and 10-year Treasury rates were 1.04 percent and 2.57 percent, compared with 1.62 percent and 3.82 percent last month.

BPS and 2,741 BPS. Of course, the changing spreads have recently had little practical consequence; no CMBS debt has traded since June.

What does it all mean? Despite the rate declines, hospitals and health systems are still finding it more difficult and expensive to borrow money for inpatient projects than they did in 2007, and healthcare real estate developers are still finding it more difficult and expensive to secure financing for medical office buildings (MOBs) and other outpatient projects. And MOB acquisitions were at a virtual standstill last month. □

CAPITAL MARKETS SNAPSHOT

The Bond Market Association (BMA)

Money Rates (as of 12/12/08)

BMA Rate	0.85%
1-month Libor	1.04%
10-yr Treasury	2.57%
Tax-exempt AAA	4.43%

CMBS Market Trends

AAA Spread to Treasury (bps)	1,002
BBB Spread to Treasury (bps)	5,027
Latest Monthly Issuance (billions) - Dec-08	0.00 billion
LTM Average Monthly Issuance (billions)	1.01 billion

Medical Property Construction Loan Index

Interest Spread over 1-month LIBOR (bps)	300
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Notes:

BMA Rate - the short-term tax-exempt bond index, or the Bond Market Association (BMA) Municipal Swap Index, is the benchmark for all floating rate payments in the U.S. municipal swap market, where most healthcare providers source their capitals. BMA is now part of SIFMA - Security Industry and Financial Markets Association - *Bloomberg*

1-mo Libor - average one month London Inter-Bank Offered Rate (LIBOR), the short-term borrowing cost between commercial banks - *Bloomberg*

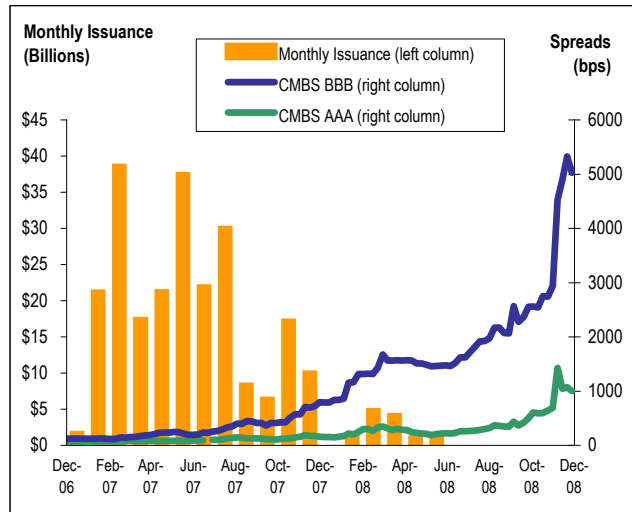
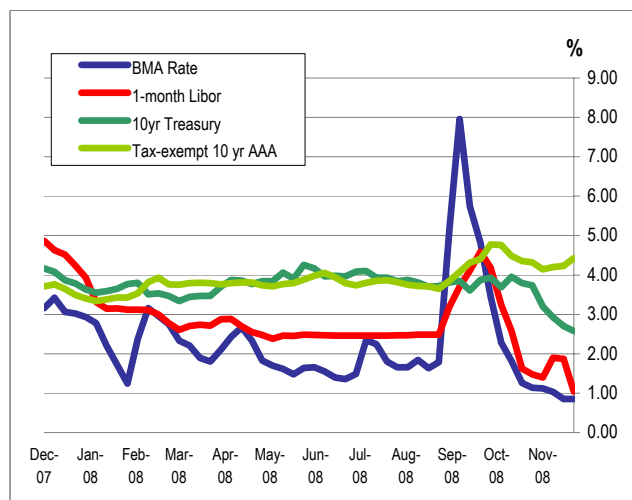
10-yr Treasury - market yield on U.S. Treasury securities at 10-year constant maturity - *Federal Reserve*

Tax-exempt AAA Rate - 10yr GBA Rate, the average option-adjusted yield for 10-yr AAA rated General Obligation Municipal Bonds - *Bloomberg*

CMBS Spreads - US Fixed Rate CMBS Super Senior AAA and Conduit BBB Average Life 10Y Spreads to Treasury. The indices are a cross section of bonds in the Commercial Mortgage Backed Securities Markets. The spreads are mid market levels for average names, based on reports issued from Morgan Stanley - *Bloomberg*

CMBS Issuance - US Conduit CMBS Monthly Issuance, for current month and Last Twelve Months (LTM) average - *Commercial Mortgage Alert*

Construction Loan Index - average interest rate spread over 1-month LIBOR for a 60-80K SF on-campus MOB development in a solid real estate market with 75% pre-leased and 90% financing - *Cain Brothers survey*



Source: Data provided by Cain Brothers & Co.

Disclaimer: The data is believed to be accurate but is not guaranteed. Wolf Marketing & Media LLC, publisher of Healthcare Real Estate Insights™, is not responsible for its accuracy.

Oaks Development Group buys MOB

NORTH CAROLINA-BASED FIRM ADDS 35,000 SF SAN ANTONIO ASSET TO PORTFOLIO

Staff Reports

The Texas office of Cary, N.C.-based Oaks Development Group recently closed on the purchase of the new Shavano Oaks II, a 35,000 square foot medical office building in north central San Antonio.

TRANSACTIONS

Construction of the medical facility was completed in October, with tenant build outs slated for completion in early 2009.

Oaks Development Group placed the building under contract while it was under construction and started marketing the property to prospective tenants. About 70 percent of the space was preleased when Oaks Development closed on the acquisition.

According to a statement from Oaks Development, the firm plans to make ownership stakes available to tenants of the building.

Under the ownership plan, tenant-owners would receive pro-rata distributions from operations and refinancing as the value of their investment increases over time.

The newly constructed building is ready for occupancy, according to Oaks Development, and the company has received commitments for about 85 percent of the building through signed leases and letters of intent.

The acquisition price was not disclosed.

A local office of mortgage broker Holliday Fenoglio Fowler LP, a unit of HFF Inc. (NYSE: HF), arranged \$6.9 million in construction financing for the building.



Oaks Development Group recently closed on the purchase of the new Shavano Oaks II, a 35,000 square foot MOB in north central San Antonio.

HREI™ photo

Memorial Hermann nears completion of MOB sales program

HOUSTON – Houston-based Memorial Hermann Healthcare System is nearing completion of a three-year plan to sell most of its off-campus MOB's.

The massive health system came even closer to that goal in recent weeks when it sold two MOB's in suburban Sugar Land, located southwest of Houston, to Norvin Partners Ltd., a New York-based investment firm. Norvin Partners, which has a major focus on medical properties, acquired Memorial Hermann Sugar Land Health Center I and II for about \$15 million.

Some reports indicate the firm paid up to \$16 million for the properties, which have a total of about 120,000 square feet of space.

Based on the \$15 million price tag,

Norvin paid about \$125 per square foot (PSF). The facilities comprise the 80,000 square foot Health Center I building and the 40,000 square foot Health Center II building.

Norvin officials say the company plans to upgrade the buildings, which are located near Texas State Highway 6 and U.S. Highway 59. The buildings are 97 percent occupied and include tenants such as Sugar Land Surgical Hospital, the anchor tenant, Memorial Hermann, Texas Children's Hospital and The University of Texas M.D. Anderson Cancer Center.

According to Memorial Hermann officials, the health system made a decision three years ago to sell all of its office buildings not connected to hospital campuses, as well as to partner with private companies on the development of new MOB's. At that time, Memorial Hermann had about 750,000 square feet of off-campus MOB space.

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With the sale of the Sugar Land MOBs, the system now has just two single-tenant, off-campus buildings remaining. Those properties have a total of 75,000 square feet of space.

With the acquisition, Norvin Partners now has a Texas portfolio of 900,000 square feet of medical buildings, including 600,000 square feet adjacent to the Texas Medical Center. Houston-based Transwestern was recently chosen to lease and manage the Sugar Land MOBs for Norvin Partners.

Texas oilman buys hospital for 60 cents a foot

AMARILLO, Texas – Texas oilman Dennis Caldwell, the owner of Caldwell Production Co. in Borger, Texas, recently acquired the former St. Anthony's Hospital in Amarillo. The building has long been a landmark in the city, and the oilman paid \$300,000 for the 550,000 square foot building, which works out to about 60 cents PSF.

Mr. Caldwell told a local newspaper that he has no specific plans for the property, adding that there are multiple possibilities. He noted that he plans to hire a consultant to help him determine the best use for the property.

St. Anthony's Hospital, which had 356 beds at its peak, was founded by four nuns back in 1901. In 1996, the hospital merged with High Plains Baptist Hospital, forming Baptist St. Anthony's Health System. Healthcare services were moved piecemeal from St. Anthony's to the High Plains Baptist campus.

Baptist St. Anthony's Health System tried to sell the former hospital building for five years, at one point hiring Assiter Auctioneers of Amarillo. Mr. Caldwell says that no matter what he decides to use the building for, it needs plenty of repairs.

More Transactions

■ **PG&J Properties**, a group of Scottsdale, Ariz.-based doctors, recently acquired an MOB near **Scottsdale Healthcare Shea Hospital**. The group bought the building in north Scottsdale for \$1.9 million, or \$326 PSF. The seller, **Scottsdale Medical Building LLC**, was represented by the local office of Santa Ana, Calif.-based **Grubb & Ellis Co.** (NYSE: GBE). The buyer was represented by **Ensemble DevMan of Arizona**. The doctors' group plans to relocate its offices to the building, which was 35 percent leased at the time of the sale.

■ An MOB traded hands recently in Mechanicsville, Va., located outside of Richmond. A private firm, **Morgata LLC**, acquired a 12,000 square foot MOB from a private seller, **Meadowbridge LLC**. The price was \$1.6 million, or about \$133 PSF. The buyer plans to expand the facility, increasing the size of a physical therapy center in the building. The broker on the deal was **Birck Turnbull** of the Richmond office of **Thalhimer/Cushman & Wakefield Alliance**.

■ An undisclosed, private buyer recently acquired the **North Austin (Texas) Medical Park**, a three-building, 27,930 square foot property across the street from **St. David's North Austin Medical Center**. The medical buildings are 96 percent occupied and include tenants on triple net leases. The broker on the deal was the local office of **CB Richard Ellis Private Client Group** network, which also lined up financing for the transaction. The sale price was not disclosed.

■ A California-based investor recently acquired a 25,850 square foot MOB in Cleburne, Texas, located south of Fort Worth. The firm, **Housing Investment Development Corp.**, acquired the **Cleburne Medical Center** in early November from Southlake, Texas-based **Candor Surgical Development** for \$5.2 million, or \$201 per square

foot (PSF). The MOB was completed earlier this year. Its tenant list includes the **Cleburne Surgery Center**, **Hulen MRI** and **Cleburne Orthopedics & Sports Medicine**.

■ **Moses Cone Memorial Hospital** in Greensboro, N.C., recently hired an outside company to run and lease a long-term, acute care unit within its hospital. The hospital received an exemption from a federal freeze on opening such units and then chose Mechanicsburg, Pa.-based **Select Medical Corp.** to operate its 30-bed, long-term acute-care unit. The contract begins in spring 2009. Select Medical operates 93 similar units in 25 states. Moses Cone received approval for the unit in June 2004, shortly before the **Centers for Medicare and Medicaid Services (CMS)** put a moratorium on any such centers. Long-term acute care hospitals (LTACs) treat patients who need to stay in the hospital for at least 25 days.

■ The Detroit office of **Marcus & Millichap Real Estate Investment Services** recently announced the sale of **Henry Ford Health System's Macomb Gynecology Unit** in Warren, Mich. The sale price was \$660,000, or \$220 PSF. The cap rate was listed at 8.26 percent. The 3,000 square foot space is located within the **Martin Medical Building** in Warren. **Bill O'Connor** and **DeVon Jackson** of Marcus & Millichap represented the seller. The buyer has not been disclosed.

■ Charlotte, N.C.-based **OrthoCarolina** recently signed a long-term lease for a future 26,000 square foot MOB in Charlotte. By leasing the new facility, OrthoCarolina will be able to consolidate its two **CMC-University Hospital** locations into one. The 3.5-acre site is being developed by Charlotte-based **MarkPiercePoole Properties Inc.** and **Greencastle Capital Management**, also of Charlotte. Construction will begin in January and is slated for completion in the first quarter of 2010. □

Lillibridge on a roll with new projects

LATEST DEVELOPMENTS INCLUDE MOB_s, AMBULATORY CENTER, HEALTH VILLAGE

By John Mugford

In recent months, newspaper headlines too numerous to count have noted that the country's economy is in difficult straits.

OUTPATIENT PROJECTS

But also in recent months, Chicago-based Lillibridge, a healthcare real estate firm, has announced a number of new medical development deals and projects it is working on throughout the country.

The people at Lillibridge are quick to point out that the company's robust pipeline – which totals more than 25 projects in various stages of development and planning – does not necessarily indicate that the healthcare industry and, subsequently healthcare real estate, is immune to economic woes.

In fact, the folks at Lillibridge note that while the firm's pipeline should remain strong throughout 2009 because of previous development agreements, the number of development deals industry wide could see a slowdown starting in 2010. Experts say that even though demand for outpatient facilities should continue to rise in years to come because of demographics, such a slowdown could be prompted by financial difficulties faced by numerous hospitals and health systems both large and small.

“While we've seen robust demand up until now, a number of systems are starting to freeze capital expenditures moving forward because of uncertainties related to the economy and the capital markets,” says Todd Lillibridge, the company's chairman and CEO.

“Right now, they're just not sure what's going to happen. Their cost of capital has increased significantly, they've had to endure the variable-rate debt debacle, the auction-rate debt debacle, and they've seen their investment portfolios drop in value.”

As noted, however, Lillibridge's portfolio is indeed robust right now. (**Healthcare Real Estate Insights™** is developing an article that will focus on how Lillibridge has grown its development capabilities and pipeline. We plan to publish the story in early 2009.)

Last month, we reported that Lillibridge was developing a three-story, 76,000 square foot medical office building (MOB) on the future campus of the 100-bed Viera (Fla.) Hospital.

Since then, Lillibridge, which typically does not divulge project costs, announced that it has closed on agreements to develop five outpatient facilities with a total of more than 460,000 square feet of space. Those projects are:

- A 60,000 square foot, three-story MOB on the campus of East Orlando (Fla.) Hospital, which is part of Orlando-based Florida Hospital health system. The building, which is called Surgical Medical Plaza, is to be anchored by a 12,000 square foot ambulatory surgery center (ASC). Other tenants would include new physicians as well as employed physician medical groups, all of whom could utilize the surgery center.

- An 85,000 square foot MOB and outpatient center next to Florida Hospital Kissimmee, located in the city of Kissimmee, which is about 15 miles south of Orlando. Major tenants in the building would include an ambulatory surgery center, an

outpatient imaging center, as well as orthopedic and OB/GYN groups. Florida Hospital has plans for a future patient tower that would mirror the look of the new MOB.

- A 150,000 square foot, three-story outpatient medical facility called Meridian Health Village in the township of Jackson, N.J., about 20 miles east of Trenton. The health village is slated as a satellite facility for Meridian Health, which has four hospitals in New Jersey. Construction on the health village is slated to begin in spring 2009 and be complete by summer 2010. Meridian Health Village is to include an internal medical/family practice area, a women's and children's health area, and a section for medical and surgical specialists. The building would also house a surgery center, imaging center, urgent care center, rehabilitation services, phlebotomy laboratory and patient education area.

- Two MOB_s on the future \$184 million Hillcrest Community Hospital campus in Waco, Texas. The MOB_s would have a total of 166,000 square feet of space. One of the MOB_s is the three-story, 107,000 square foot Hillcrest Community Medical Office Building; the other is planned as a 59,000 square feet facility that would serve the future Hillcrest Women's & Children's Hospital, which is part of the new campus. Ground was broken for the MOB_s in October and completion is slated for summer 2009. Hillcrest Health System's Web site indicates the MOB_s will cost a total of \$32.5 million. Lillibridge is working with an investment partner, White Plains, N.Y.-based Seavest Inc., in the development of the MOB_s.

- A 14,000 square foot outpatient surgery center with four operating rooms on the campus of Tomball

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(Texas) Regional Medical Center in suburban Houston. The facility is slated to open in April 2009.

Lillibridge is providing the design work and programming for the new outpatient center; it will also serve in an advisory role during construction. The building is to be owned through a joint venture of Tomball Regional Medical Center and the physician-tenants.

In other news from Lillibridge, the firm recently announced that it has been hired to manage all aspects of a campus redevelopment project for the Methodist Medical Center of Illinois (MMCI) in Peoria, Ill.

The redevelopment project includes a 180-bed addition, a new 80,000 square foot community pavilion, and a parking deck with a covered skywalk. Overall, the project would add 480,000 square feet of space; it is slated to be a Leadership in Energy and Environmental Design (LEED) certified project.

Construction on the hospital addition is scheduled to begin in early 2010 and be completed by late 2012. The six-level parking structure, which is currently under construction, will be attached to the hospital via a new covered skywalk. The parking structure is slated for completion in late summer 2009.

Lillibridge has also been hired to oversee two off-campus projects for MMCI.

Growing campus near St. Louis to get new MOB

O'FALLON, Mo. – Because of high demand for physician office space, St. Louis-based BJC HealthCare recently announced plans to expand its two-year-old Progress West hospital campus in O'Fallon, Mo. The expansion plan calls for the building

of a 60,000 square foot MOB and a 40,000 square foot data center on the 48-acre campus.

The new facilities are expected to cost a total of about \$50 million.

The MOB will free up space in the hospital, as physician offices currently occupy about 20,000 square feet in the acute-care facility.

A BJC spokesperson told local news outlets that physicians are demanding more on-campus office space, as the medical office portion of the hospital is fully occupied.

The Progress West campus is located in growing O'Fallon, a town of about 75,000 people in St. Charles County. The city is in the far northwest suburbs of St. Louis.

The \$75 million hospital opened in February 2007 and currently has 38 staffed beds. The system's plans, however, call for expanding the hospital to 144 beds in phases over the next five years.

BJC is the largest health system in the St. Louis area with 13 hospitals in Missouri and Illinois.

The architect on the MOB and data center project is St. Louis-based Arcturus. While a general contractor has not been chosen, St. Louis-based S.M. Wilson & Co. has provided pre-construction planning services for the project.

Construction is set to start in early 2009 with completion scheduled for the first quarter of 2010.

In a local news story, Arcturus principal John Mueller said both of the new facilities will be built using sustainable design to meet LEED certification. The medical office building will have sun-shading devices, low volume water-use plumbing fixtures and energy-efficient mechanical units.

Ryan Cos. to build 100,000 SF MOB in Michigan

AUBURN HILLS, Mich. – Minneapolis-based Ryan Cos. US recently announced plans to build a 100,000 square foot MOB near a regional shopping mall in Auburn Hills. The Class A Oakland Crossing Medical Center is slated for an 18-acre site near the 1.4 million square foot Great Lakes Crossing Shopping Mall.

A groundbreaking for the four-story medical building is scheduled for spring 2009, with completion slated for summer 2010.

Mason Capitani and Gary Grochowski of Troy, Mich.-based L. Mason Capitani are handling marketing and leasing for the future building.

Graham Group developing MOB near Tampa, Fla.

HILLSBOROUGH COUNTY, Fla. – The Graham Group of Des Moines, Iowa, is developing a \$15 million outpatient center in growing northwest Hillsborough County, which is located east of Tampa. Construction started in recent weeks on the four-story facility, which is being developed for Tampa-based BayCare Health System.

The BayCare Outpatient Center at Hampton Lakes will have 52,000 square feet of space and be home to a variety of physician offices as well as a center for sleep disorders, and a radiology and laboratory testing center.

The physicians are likely to be primary care doctors as well as specialists in pediatrics, orthopedics, sports medicine and urology. The MOB is expected to open next summer.

The architect on the project is Boston-based TRO Jung/Brannen; the general contractor is Tampa-based Diaz Fritz Abel.

Construction slated to start this month for Texas MOBs

BURLESON, Texas – Construction is scheduled to begin this month on three medical buildings in Burleson as the start of a new campus. Arlington-based Texas Health Resources (THR) is planning the campus, which would eventually have nearly 100,000 square feet of space.

The developer of the first three buildings is Fort Worth-based Innovative Developers Inc. The single-story buildings would include two medical facilities, one with 29,000 square feet and the other with 8,000 square feet, and a 3,500 square foot pharmacy. The first phase of the project is expected to cost about \$8 million.

Included in the buildings will be MRIs, CAT scans and ultrasound equipment. Also planned are a fitness center with a lap pool, cardiac rehab services, imaging and physical therapy. The first phase would also include 256 parking spaces.

Completion of the first phase is scheduled for spring 2010. In the future, THR is planning to add an additional 51,000 square feet of medical space on the campus.

Rezoning could lead to MOBs on Novant campus

WINSTON-SALEM, N.C. – Even though it has not announced development plans, Winston-Salem-based Novant Health recently received a rezoning approval for 6.4 acres it owns across the street from its main hospital in the city, Presbyterian Hospital.

According to Novant officials, the rezoning allows the development of up to 775,000 square feet of medical space, as well as a 12-level parking structure. Probable uses for the site

include new medical offices as well as acute-care space.

Local reports indicate the Presbyterian campus is growing rapidly. For example, the hospital is currently expanding two wings for a total cost of \$168 million. That expansion is part of an overall \$301 million upgrade at Presbyterian.

Novant is also expanding its footprint in what is known as the Triad region of Winston-Salem, Greensboro and Highpoint. It broke ground last month on the future Kernersville Medical Center, a 50-bed \$84 million hospital.

‘Pill Hill’ to be revitalized in El Paso, Texas

EL PASO, Texas – A local real estate development firm recently announced plans to rejuvenate the city’s original “Pill Hill” area with a new medical office complex. The site currently contains a vacant hotel and 13 small, single-story MOBs built in the 1950s.

El Paso-based TVO Development plans to turn the 16-acre site into a new medical office complex that would be called City View Medical Plaza. It would have several multistory buildings, retail space and a food court. The site is located across the street from Sierra Medical Center, which is part of Sierra Providence Health Network. Sierra is part of Dallas-based Tenet Healthcare Corp. (NYSE: THC).

In the El Paso Times, Paul Gilcrease, a TVO vice president who is overseeing the project, said: “This presents an opportunity to come into a great location and bring back the vibrance that development had decades ago. We’re cleaning up, basically, an eyesore and most likely will increase the tax base.”

TVO acquired the property in April from a California company for an undisclosed amount. It later closed

the struggling 74-room Cliff Inn. The property has a current appraised value of \$3.5 million. TVO did not disclose the expected cost of the project.

TVO officials told the newspaper that the overall project is expected to take three to five years to complete.

Tenet Healthcare, Sierra Providence’s parent company, is in the process of trying to sell three of the five MOBs it owns near Sierra Medical Center. An official with Tenet said that the TVO development should not “hurt” Tenet’s MOBs because El Paso does “not have an abundance” of medical office space.

More Outpatient Project News

■ Construction is scheduled to begin next spring on a 52,600 square foot MOB on the campus of **Cullman (Ala.) Regional Medical Center**, located about 45 miles north of Birmingham, Ala. Birmingham-based **Krumdieck A+I Design Inc.** is the architect.

■ A \$5.2 million renovation and 26,000 square foot addition was recently completed at **Southdale Medical Office Building** in Edina, Minn. The MOB is located near the 390-bed **Fairview Southdale Hospital**. The construction firm on the project was Bloomington, Minn.-based **Kraus-Anderson Construction Co.**; the architect was Minneapolis-based **KKE**. **Dennis Zylla** of Minneapolis-based **Grubb & Ellis Northco Real Estate Services** directed the development.

■ The Florida office of Cary, N.C.-based **Oaks Development Group** is moving forward with plans for an MOB on 2.1 acres it owns in Palm Coast, Fla. Oaks Development recently closed on a construction loan for the 20,000 square foot MOB project; site work is scheduled to begin by the end of the year. **Sun Trust Bank** of Cary handled the loan closing. □

Oakland hospital moving on rebuilding

COST OF 155-BED TOWER NOW ESTIMATED AT \$682 MILLION – UP FROM \$550 MILLION

Staff Reports

Highland Hospital/Alameda County Medical Center in Oakland is finally moving forward on plans for a replacement hospital in order to comply with California's seismic safety guidelines.

INPATIENT PROJECTS

The rebuild is now expected to cost about \$680 million – up from an original estimate of about \$550 million. The public hospital recently sent requests for proposals (RFPs) to two pre-qualified bidders: Greeley, Colo.-based Hensel Phelps Construction Co. and Clark Design/Build of California. The firms have until Feb. 24 to submit bids for the project. Clark Design/Build, which has offices in Oakland, is a subsidiary of Bethesda, Md.-based Clark Construction Group LLC.

County officials recently said the rebuild should cost about \$682 million, including \$360 million to build a new, approximately 155-bed acute-care tower at Highland Hospital, which currently has 236 beds. Other costs would include demolition of the existing tower.

County officials say they plan to line up short-term loans to finance the project, starting in the county's 2009-2010 fiscal year, which begins July 1. Those short-term loans would be replaced by long-term certificates of participation in 2015 or soon after, according to officials.

Hospital officials have filed paperwork with California's Office of Statewide Health Planning and Development (OSHPD) requesting a delay to meet the original seismic deadline of 2013. The architect working on planning for

the project has been San Francisco-based HOK Inc. The overall plan also calls for the development of an on-campus outpatient satellite building.

El Paso hospital breaks ground on \$154M expansion

EL PASO, Texas – Thomason Hospital in El Paso recently broke ground on what is being billed as the largest healthcare expansion in the history of the far western Texas panhandle. The \$154 million project would eventually have a total of 354,000 square feet of new acute care space as well as renovated space.

The largest aspect of the project is the future 60-bed, 225,000 square foot children's hospital, which will be connected to the main hospital. A ground breaking is scheduled for February on that portion of the project, which was approved by local voters.

The remainder of the project would include a new 29,000 square foot clinic with imaging, orthopedic services, a pharmacy and lab services. The expansion would also include a new surgery center and an expansion of the area's only Level 1 trauma center.

The designers on the project are San Francisco-based KMD Architects and El Paso-based MNK Architects. The construction manager is Birmingham, Ala.-based Robins & Morton and the program manager is Chicago-based Jones Lang LaSalle Inc. (NYSE: JLL).

In addition to the acute-care space, Thomason is also building the future \$12.3 million, 29,000 square foot Northeast Clinic. The project is slated for completion in March 2009. The architect is MNK and the general contractor is El Paso-based Arrow Building Corp.

The El Paso medical community is also home of the new Paul L. Foster School of Medicine at Texas Tech University Health Sciences Center. Officials with both Thomason and the medical school are actively recruiting doctors to the area from all parts of the country.

Planning starts for future replacement in Jamestown, N.D.

JAMESTOWN, N.D. – Design work began recently on the future \$40 million replacement facility for Jamestown Hospital in eastern North Dakota, about halfway between Fargo and Bismarck. The architect on the project, Rick Dahl of St. Paul, Minn.-based BWRB Architects, recently began planning for the future 25-bed hospital, which would be built outside of downtown Jamestown near U.S. Interstate 94.

The new hospital would be a replacement for a 56-bed downtown structure built in 1935. Hospital officials say building a 25-bed facility makes sense for two reasons: It is large enough to care for the average daily number of patients, and it allows the hospital to be classified as a rural Critical Access Hospital (CAH), meaning it would receive higher reimbursement rates for Medicare and Medicaid patients.

WakeMed starts \$20M campaign for kid's hospital

RALEIGH, N.C. – WakeMed Health & Hospitals says it needs \$20 million to fund construction of a new children's hospital on its campus in Raleigh. The new children's hospital, which would have 34,000 square feet and 45 beds, would be located on the

top floor of an under-construction patient tower on the system's main campus in Raleigh.

The WakeMed Foundation recently announced the launching of its Just for Kids Campaign. The first donation was announced by Raleigh-based General Parts Inc., which operates the Carquest chain of auto-parts stores. The company gave \$1.5 million.

The new children's hospital would have 23 inpatient beds, 10 pediatric intensive care beds and 12 observation beds. WakeMed's new patient tower and the children's hospital are scheduled to open in early 2010.

Presbyterian wins CON battle for beds in Charlotte

CHARLOTTE, N.C. – Charlotte, N.C.-based Presbyterian Healthcare, which is part of Winston-Salem, N.C.-based Novant Health Inc., recently received approval from the state to add 27 beds to its hospitals in Huntersville and Matthews. Both of those cities are located outside of Charlotte.

Rival healthcare provider Carolinas HealthCare System of Charlotte, N.C., had also submitted a Certificate of Need proposal to the state to add 27 private beds to its main hospital, 874-bed Carolinas Medical Center.

The 27 beds became available through the 2008 North Carolina Medical Facilities Plan, which annually determines the need for healthcare services throughout the state.

Presbyterian plans to add 15 acute-care beds to its hospital in Huntersville, where it is in the midst of planning for a 69-bed, \$26.6 million new patient tower. The system also plans to expand its women's services program.

Presbyterian's plan to add the 12 beds to its 100-bed hospital in Matthews is expected to cost about \$570,000. The

system plans to reconfigure its current space to add the new beds.

Alta Bates Summit planning tower for about \$300M

OAKLAND, Calif. – Alta Bates Summit Medical Center in Oakland, which is part of Sacramento, Calif.-based Sutter Health, in recent months received the go ahead to use about \$72 million to move forward on its plans to rebuild the hospital.

The hospital received the funding authorization from the boards of its parent firms, Sutter and Alta Bates Summit. It will now move forward on design work, navigating through the regulatory approval process, and some preconstruction services.

The latest plan for the rebuild of Alta Bates Summit, which is needed to meet California's seismic safety guidelines, has an estimated price tag of \$300 million; that plan would include a new inpatient tower of unspecified size and a new emergency room. That option was chosen over building a replacement hospital with cost estimates reaching as much as \$600 million.

Uniontown, Pa., project gets money from state

UNIONTOWN, Pa. – Uniontown (Pa.) Hospital recently received word that it will receive \$8.4 million in state aid toward its \$59 million expansion and renovation project.

The state will provide the hospital with \$422,000 annually for the next 20 years to help construction of a new four-story patient tower. The 56-bed tower would have all private rooms. The plan calls for additional work on the campus, including an addition to the emergency room. The hospital is located in Fayette County, Pa., about 45 miles south of Pittsburgh.

The project marks the first time in more than 20 years that major construction has taken place on the campus. The first floor of the four-story building is scheduled to open in April 2009. The state's investment comes from the Infrastructure and Facilities Improvement Program, which helps fund debt service payments for various infrastructure and building projects.

More Inpatient Project News

■ A \$9 million, 45,000 square foot renovation project was recently started at the **Ely-Bloomenson Community Hospital and Nursing Home** in Ely, Minn. The project, which is slated for completion in May 2010, would update existing hospital space and add physician and occupational therapy areas, administrative office and a new ambulance garage. The construction firm on the project is Bloomington, Minn.-based **Kraus-Anderson Healthcare Project Management Group**.

■ The **University of Pennsylvania Health System** recently announced plans for the **Clyde F. Barker Transplant House**, a future facility on its campus in Philadelphia. The facility is described as a "home away from home" for transplant families, about one-third of which travel from out of state. The \$2 million facility is being modeled after the **Ronald McDonald Houses** created for out-of-town families with hospitalized children.

■ Waukesha, Wis.-based **ProHealth Care** plans to begin construction in spring 2009 on a \$15 million, three-story parking ramp at **Waukesha Memorial Hospital**. The ramp would have space for 964 vehicles and be located on an existing parking lot on the campus. The project is slated for completion by the end of 2009. The hospital currently has 1,917 parking spaces. □

Consultant to aid in UT's Ike recovery

KURT SALMON ASSOCIATES DOING STUDIES AT MEDICAL BRANCH IN GALVESTON

Staff Reports

The University of Texas Medical Branch (UTMB) at Galveston recently hired Atlanta-based consulting firm Kurt Salmon Associates to conduct a market, facility and financial analyses after the branch was devastated by Hurricane Ike.

COMPANIES

The Category 4 hurricane hit the Texas coast in early September and caused an estimated \$700 million in damages to the branch's main hospital and campus.

The consulting firm is expected to help develop a model that would restore a clinical presence to Galveston Island. In a prepared statement, UT System Interim Chancellor Dr. Kenneth I. Shine said: "We are committed to doing all that is possible to ensure a vibrant future for UTMB as it works diligently to restore its education, research and clinical care activities." Kurt Salmon Associates is expected to report its recommendations by the end of January. UTMB plans to reopen up to 200 inpatient beds and an emergency room as soon as possible.

In the meantime, however, the UT system recently announced that it plans to lay off about 3,800 of the branch's 12,000 or so employees. System officials say they have no choice in light of the fact that the branch campus is losing about \$40 million a month since Hurricane Ike hit the coastal island.

Two of the branch's major components – research facilities and the medical school – will not be downsized. Instead, the research enterprise, which receives about \$160 million a year in grants, is poised to expand in the future.

UT system officials say the Galveston hospital, which had more than 500 beds, would likely be reconfigured as a smaller hospital with about 200 beds. The branch had been seeing a decline in demand even before the hurricane.

Officials, who are hoping to receive as much as \$400 million in relief aid from the Federal Emergency Management Agency (FEMA), say rebuilding the hospital could take several years.

Optimal Outcomes completes MOB in St. Pete, Fla.

ST. PETERSBURG, Fla. – Local healthcare developer Optimal Outcomes LLC recently completed a 109,000 square foot Class A medical office building (MOB) in conjunction with Bayfront Health System in downtown St. Petersburg. The four-story MOB is called Bayboro 625 Sixth and James Heart Center.

In addition to providing space for the Bayfront Heart Center, the MOB gives physicians a chance to lease or acquire medical office space. The MOB is attached via skywalks to the 502-bed Bayfront Medical Center and the new All Children's Hospital.

According to a news release from Optimal Outcomes, the hospital had previously been in negotiations with another healthcare development firm. After those negotiations failed to result in a development agreement, Optimal Outcomes eventually entered an agreement with the hospital to develop the project.

The general contractor was the Tampa office of RJ Griffin & Co.; the architect was Dallas-based HKS Inc., which has an office in Tampa.

Ryan Cos. project in Maple Grove now 100 percent filled

MAPLE GROVE, Minn. – Minneapolis-based Ryan Cos. US Inc. recently announced that its Grove Health MOB in Maple Grove has reached 100 percent occupancy.

The 41,000 square foot MOB was developed, designed, and built by Ryan, which also manages the property.

The facility is part of a 157-acre mixed-use development called The Grove, which blends retail, medical and office space. The local office of Cushman & Wakefield is the leasing agent for the building.

The MOB is an area experiencing medical real estate growth that has been instigated by the building of a future hospital. The 80- to 120-bed Maple Grove Hospital, slated for completion in 2009, is a partnership of Minneapolis-based Fairview Health Services and Robbinsdale, Minn.-based North Memorial Health Care.

More Real Estate Company News

■ Ground was recently broken for the future \$400 million, 289-bed Silver Cross Hospital replacement project in Joliet, Ill. The general contractor is the Chicago office of Mortenson Construction, part of Minneapolis-based M.A. Mortenson Co. The hospital is located on a 70-acre campus and is scheduled to open in 2012. An interesting note concerning the groundbreaking ceremony: The same shovel used to break ground for the original hospital in 1892 was used for the recent groundbreaking.

■ Long Beach, Calif.-based **HCP Inc.** (NYSE: HCP) in late September announced that it has completed the integration of its \$3 billion acquisition of life science properties from **Slough Estates USA Inc.** (SEUSA), which had been the United States subsidiary of the British real estate giant, **Slough Estates plc**, which later changed its name to **SEGRO plc**. The sale closed in August 2007 and represented the entire U.S. portfolio owned by Slough, which basically closed up shop in the United States following the sale. As a result of the acquisition, HCP, a healthcare real estate investment trust (REIT), has a life science real estate portfolio of about 6.6 million square feet in 107 properties. Most of the properties are located in the San Diego and San Francisco Bay markets. The company's development pipeline also calls for the building of about 3.4 million square feet of life science space. With the completion of the integration, **Marshall Lees**, the firm's executive VP, who was previously with SEUSA, resigned to pursue entrepreneurial opportunities. As of June 30, HCP's overall portfolio totaled 706 properties, including 267 in senior housing, 107 in life sciences, 256 MOB, 25 hospitals and 51 skilled nursing facilities.

■ **S. M. Wilson & Co.** of St. Louis was recently selected by Chesterfield, Mo.-based **Sisters of Mercy Health System** as the general contractor for a \$35 million medical data center in Washington, Mo. The two-story, 40,000 square foot building would serve as the primary corporate data center for the Sisters of Mercy Health System's 20 or so hospitals and medical centers throughout the country. Construction is scheduled for completion in spring 2010. St. Louis-based **Arcturis** is the architectural firm on the project.

■ Two San Antonio area developers, **BP Healthcare Properties LP** and **GC Rowland Cos.**, broke ground in mid-October on a \$12.2 million, three-story MOB on the campus of **Christus Santa Rosa Hospital-Medical Center**. The future 69,000 square foot MOB,

which is slated to open in spring 2009, is located in the massive **South Texas Medical Center**, a conglomeration of hospitals, MOB and other healthcare facilities. The MOB is to be called **Villa Rosa Medical Plaza**. The land for the development is owned by **Christus Santa Rosa Health Care** and is being provided to the developers on a long-term ground lease.

■ The Houston office of St. Louis-based **HOK Group Inc.** announced that work was recently completed on the \$296 million expansion of **Methodist Sugar Land Hospital**, located in the Houston suburbs. HOK provided design services for the expansion. The original 37-bed community health center was expanded by 341,000 square feet to include more than 180 beds. The hospital has also been designed to grow to 256 beds in case of emergency. The new addition was constructed independently of the original hospital structure. In addition to the hospital expansion, construction has also started on a 120,000 square foot MOB, which is scheduled for completion in the third quarter of 2009. The hospital will grow incrementally to its ultimate goal of 600 beds, with additional room at the campus for more MOB and parking.

■ In other news from HOK, the company teamed with a local architect on design services for a five-tower expansion that was recently completed at **St. Joseph's Hospital** in downtown St. Paul, Minn. The expansion provided just 12 new beds in the 260-bed hospital. However, officials with the hospital's parent company, St. Paul-based **HealthEast Care System**, say the expansion was more about privatizing patient rooms than adding more beds. The new tower is part of a \$85 million expansion project at St. Joseph's. St. Paul-based **McGough Cos.** is the lead contractor on the overall project, with HOK teaming with St. Paul-based **BWBR Architects Inc.** The overall project is currently continuing with the renovation of several older sections of the hospital.

■ **Meadows & Ohly LLC**, a healthcare facilities developer and owner based in Norcross, Ga., recently completed an \$18.4 million, 100,000 square foot MOB on a new hospital campus in Hoschton, Ga. Hoschton is about 40 miles northeast of Atlanta. The MOB is the first building to open on a 166-acre hospital campus being planned by Gainesville, Ga.-based **Northeast Georgia Health System Inc.** The future hospital is expected to have 100 beds. The new MOB, **River Place Medical Plaza 1**, includes urgent care and laboratory services, as well as diagnostic imaging and physical therapy centers. Other larger tenants include the **Braselton Clinic**, a local internal medicine group, and **Advantage Sports Medicine**.

■ **Walsh Construction**, part of Chicago-based the **Walsh Group**, recently received a \$71.5 million contract from the **Naval Facilities Engineering Command** to construct a four-story addition at the **Great Lakes Naval Hospital** in North Chicago. When the project is complete – which is scheduled for 2010 – the Naval hospital and the **North Chicago Veterans Affairs (VA) Hospital** will merge and become the James A. Lovell Federal Health Care Center. The overall project, which has an estimated price tag of \$130 million, also involves some demolition and renovation work in order to connect the future Navy hospital addition to the VA hospital. The future hospital will be the first healthcare collaboration project between the VA and the U.S. Navy.

Healthcare Provider Financial News

■ **Tenet Healthcare Corp.** (NYSE: THC), based in Dallas, recently posted earnings of \$104 million, or 22 cents a share, for the third quarter (Q3). That's up from a net loss of \$59 million, or 12 cents a share, during

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 the same quarter last year. Tenet attributes the increased income to pretax gains on investment sales – most notably the sale of the healthcare services company **Broadlane Inc.** – which generated a net gain of \$140 million. During the quarter the hospital operator experienced 1.7 percent growth in same hospital total admissions, 2 percent growth in same hospital paying admissions, a 1.1 percent surge in same-hospital surgeries and a 2.6 percent jump in same-hospital inpatient surgeries, according to a press release from Tenet. Tenet's net operating revenue hit \$2.2 billion during the third quarter, up from \$2.1 billion during the same period last year. Looking forward, Tenet said it has revised its earnings expectations for fiscal year 2008, and now expects to break even, at \$75 million. The hospital operator said adjusted EBITDA has been revised to fall in the range of \$700 million to \$750 million.

■ The third quarter was not a good one for profits at HCA, the privately owned hospital chain based in Nashville, Tenn. While HCA's revenues increased 6.6 percent in Q3 from the same period of a year ago, the company's profits fell more than 70 percent, officials reported in recent weeks. Net income was \$86 million for the quarter, compared to \$300 million during the same period of 2007. Company officials say a primary reason for the drop was lower profits on hospital sales. The quarter's results included gains of \$50 million on the sale of facilities, compared to \$316 million in Q3 2007. The privately held company posted revenue of \$7 billion, compared to \$6.6 billion for the same time period in 2007. One reason for the drop in profits was provisions for doubtful accounts — patient bills not likely to be paid. The figure increased to \$819 million, or 11.7 percent of revenues, in Q3 of this year, compared to \$774 million, or 11.8 percent of revenues, in Q3 2007. □

ERDMAN (Continued from Page 1)

Company. And that was merely the latest in a series of dramatic changes that the 57-year-old firm has gone through during in recent years.

57 years, 5,000 MOBs

When reviewing Erdman's marketing materials, a statement that can raise eyebrows is the assertion that the firm has built nearly 5,000 medical office buildings (MOBs) – a staggering number in an industry where even prolific firms might develop only eight to 10 MOBs in a banner year. But the number is credible when you consider Erdman's longevity, its role in the projects and how the industry has changed during the past half-century.

The company's founder and namesake, Marshall Erdman, started a construction company in 1946, which was incorporated as MEA in 1951. The firm worked on a variety of residential and commercial projects – some for fellow Wisconsinite Frank Lloyd Wright – before zeroing in on the healthcare sector in the mid-1950s.

MEA got its start working primarily with small physician groups to design and build what it called "doctors' parks," which were collections of smaller MOBs in the 2,500 square foot to 5,000 square foot range. The size and scope of the firm's work has expanded steadily during the ensuing five decades, perennially putting MEA at the top of annual national rankings for healthcare design-build firms in terms of dollar volume, square footage and number of employees.

Mr. Erdman passed away in 1995. Control of the company remained in the family until late 2003, when the Erdman heirs sold the firm to private-equity partners. MEA Holdings, which bought the company, included Luber & Co. and Baird Capital Management, both of Milwaukee, plus Erdman CEO Scott A. Ransom and Chief Financial

Officer (CFO) Brian Happ, and was later expanded to include other employees.

Revenue under the new owners grew to more than \$300 million in 2007 from about \$200 million at the time of the sale in 2003. Mr. Ransom and his team started a development company in 2005, beefed up head count, and he took the lead on building the new headquarters, which opened in December 2007. The Cogdell Spencer deal was announced only a few weeks after Erdman moved into the new facility.

(For more on the merger, please see "Frank Spencer speaks" on Page 1 of the March 2008 edition of **Healthcare Real Estate Insights™**.)

Mr. Erdman had been a client of Mr. Ransom's when Mr. Ransom was with Price Waterhouse, a predecessor of today's PriceWaterhouse Coopers LLP, one of the world's largest accounting firms. Mr. Ransom later joined MEA as CFO and became president and CEO after the 2003 buyout. Mr. Ransom remains president and CEO of the Erdman unit. We recently had the opportunity to meet with him at One Erdman Place to discuss his take on the healthcare real estate market and what's new with healthcare's oldest design-build firm.

HREI™: Scott, what are you seeing in the healthcare real estate marketplace?

Ransom: In general, the long term for healthcare facilities – for the foreseeable future – is going to be robust. Over the past 12 to 24 months, we've seen more RFP, RFQ activity than we've ever seen. (But with) what's happened in the capital markets and (with) the nervousness in general about the economy... what we're also seeing is that there are delays in decision making. There's a scarcity of available credit. For example, where the bigger, larger physician



Erdman CEO Scott A. Ransom in front of the design-build company's new headquarters building in Madison, Wis.
HREI™ photo

groups may go directly to the insurance companies for private debt placements, that's not as available. We're seeing the spread on financing sometimes two to three times more than what it was for our clients 12 to 24 months ago. So I think, in general, like every business in the United States ... what's happened to us in the last six to 12 months in the credit markets and the stock market and the economy in general has caused nervousness. And I think what you're going to see is just not a lack or decrease in demand... What we're going to see is that there are going

to be delays in decision making.

At any point in time, we probably had 40 to 50 projects under construction where we were doing the design-build work, and maybe another 75 to 100 that were in what we would call the feasibility to conceptual design stage, where we had been selected. In many of those cases, where you're in there at the very front-end feasibility, you're looking at: Are there opportunities here to bring in a capital partner? Could you joint venture with the physicians? Could there be a land lease from the hospital and a JV? That's really – getting to the Cogdell Spencer (merger) – what

to be delays in decision making.

HREI™: Before we talk about the recent merger, tell me about your company's first major change, which was the 2003 buyout.

Ransom: I had a good, strong understanding of our culture, our value proposition and our business model. What we really did was try to build off of the foundation of Marshall Erdman and really be more proactive, very attuned to the needs of the marketplace, and we had a lot of success during that time frame. And we also started a development company in 2005 because of the need we saw for bringing capital solutions and being a capital partner...

brought us together. Because what we were starting to do, they had done for the better part of 37 years. We really thought what we had here was we had the pioneer in design-build – we built almost 5,000 medical office buildings and had moved into inpatient in the late '90s – and Cogdell was arguably the oldest healthcare development company that really worked on partnering and J'ing with hospitals, with physicians...

So we were kind of at a fork in the road. Do we do it ourselves? Or do we look at a partner? And we were starting to get approached by major REITs (real estate investment trusts) in the healthcare space that saw our strong brand recognition and all the tentacles we had out in the marketplace, where the healthcare REITs ... the majority of them did not start from ground-up development. They acquired portfolios. And we were seeing a need to partner with them when a portfolio purchase was part of the overall deal. And that's how we really started to get acclimated to the healthcare REIT space, because historically those weren't who we ran into as our competition...

We actually hired Wachovia to essentially help us interview the marketplace, which included the healthcare REITs and other larger financial institutions like GE Healthcare. And as we went through that process, I think what both Cogdell Spencer and Erdman felt is it was a real synergy in capabilities – and culture. We were both still family run businesses. I didn't really change the culture other than try to build on it. And that's how we positioned it to the employees. And I think the key thing is that we brought a strategy to the marketplace which didn't exist... We're bringing a fully integrated (approach) – from concept and strategic planning all the way through property management and portfolio management.

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HREI™: Tell our readers about the new building and the name change.

Ransom: This was kind of my baby, this new headquarters... We were moving toward a name change of Marshall Erdman Associates to Erdman – to just kind of reinvigorate the brand a little bit. A lot of people referred to us as MEA or Erdman. We put that on hold (while the Cogdell Spencer merger was in the works). What we decided to do with the name, to show the integration, we've changed it to Erdman, a Cogdell Spencer company.

HREI™: Have you also changed how the firm is positioned in the marketplace?

Ransom: Before Cogdell Spencer, before the merger, we were going to market differently than just ... an architectural firm. What you were seeing in the space was ... essentially partnerships coming together. In some cases, you had an architectural firm with a contractor with, potentially, a development partner, and you may or may not have involved consulting firms. What we were coming to the market with was having that essentially under one umbrella and one contract and one ongoing (entity) as opposed to an entity established for just the project... So we were always coming at the market a little bit differently, than more than just even a design-build (firm) because design-build, a lot of times, that was a marriage for contract purposes only, for that one project, where we had it in house. We really felt we were the most fully integrated healthcare design-build firm. But we did more. We were also involved in the front-end feasibility and analysis, and kind of the business side of the project... So that's really where we have been and kind of grown and built the company off of that – more so than just being an architect and a contractor – and having that fully integrated in one house.

HREI™: You had already added a development capability. Why did you decide to team with Cogdell Spencer?

Ransom: What I think, bringing Cogdell's capabilities and the fact that they've gone to the public markets, going public, that they had been developing and joint venturing with physicians for 37 years – it would have taken us a significant amount of time to build up the portfolio and the capabilities that Cogdell (has)... There were other healthcare REITs that we looked at doing it with, too. This one just seemed at the right time to be the right fit for both companies to pull this off. And, fortunately, we did it before what happened to the credit markets. Because I'm not sure eight, nine months later we could have pulled it off.

HREI™: Has your marketing strategy shifted in the wake of the merger?

Ransom: We haven't really shifted... We've typically worked with and our targeted customer base would be the larger multi-specialty groups. There are varying degrees depending on the geographic area, like in the Midwest, there are a lot of large multi-specialty groups... So we're targeting those. How we cut our teeth is built with the physician side. And that's really brought us into the hospital side, where a lot of developers started more so on the hospital side – it being kind of an outsourced real estate function for the hospitals. Where we moved into the hospital space and the hospital-sponsored projects primarily through our reputation in working with physicians, which we think is pretty strategic, because that's the driving referral base. The viability of the whole medical office space is really understanding your physician's practice and having their trust. Now, about 50 percent of our projects are multi-specialty and specialty groups. You know, there can be large specialty groups that will do pretty significant projects. And there's an emerging trend toward more and more, larger multi-specialty groups, just because

of the efficiencies of managing the practice. And then about 50 percent is primarily market-dominant, not-for-profit hospitals in their location. And Cogdell Spencer ... something that we saw was that ... the customer base was pretty synergistic also. I mean, they focused on working with physician groups in local market-dominant, not-for-profit campuses. There would be leases of the land, but it was primarily ownership between Cogdell and the physicians, and with like 80 to 85 percent of them on hospital campuses. And we continue with that same targeted focus, and we're essentially the go-to-market strategy for all new facilities for the combined entity, and Cogdell Spencer is the portfolio management and the capital, along with property management.

HREI™: Is there anything else you'd like to mention that we haven't already discussed?

Ransom: As part of our advance planning consulting group, we not only have close to 50 LEED-certified professionals within the firm, we also are trying to help really lead – no pun intended – the effort in healthcare, and be one of the innovative leaders in healthcare sustainability and environmental. I think we have five LEED-registered projects right now in healthcare, they're looking for certification. I think sustainability in healthcare is at the top of everybody's minds. In general business, it's no longer a separate initiative... I think almost every client that I've been in meetings with will ask questions about what we're doing (with regard to) sustainability. So we really tried to get a jumpstart on that.

HREI™: Will tighter capital jeopardize that?

Ransom: If it's front-end planned, it really can be almost cost neutral. I think this building ... was about 1 to 2 percent more. But this thing had a lot of bells and whistles environmentally. We built this for \$190 a square foot. □

DEVELOPMENT (Continued from Page 1)

Kevin O'Neil of Trammell Crow Co. and Jonathan Winer of Seavest Inc.
HREI™ photo

underwriting requirements to get deals done, even for projects that are “good deals and make a lot of sense.”

“What I think is most interesting is that we’re even having a discussion about development,” noted Mr. O’Neil, “because if we were a group of general real estate executives not affiliated with healthcare we wouldn’t be talking about development at all. It’s not taking place in other sectors.”

Malcolm Sina, CEO of Palm Beach Gardens, Fla.-based DASCO Cos., a healthcare developer, said all sectors of real estate development are currently suffering.

“They’re all suffering a lot more than healthcare right now,” he said. “There’s probably fewer and fewer projects that are on the drawing boards across all of the sectors than I’ve seen in four or five years, and I don’t see anything that would bring it out of the pits for a couple of years.”

Jeffrey H. Cooper, a senior managing director who specializes in healthcare transactions for New York-based investment banking firm Savills,

pointed out why that’s the case.

“It’s the only asset class that has a demand driver for new development,” he said. “A project is typically not built unless it’s needed.”

As noted, that doesn’t mean the development of healthcare facilities is free of challenges.

Indeed, board members discussed many of those challenges during their wide-ranging discussion, which focused on looking back on 2008 and examining current industry trends. This discussion took place over the course of an hour and half and, after a short break, board members reconvened to talk about what they foresee for the industry in 2009 and beyond. We will report on that discussion in the January edition of **HREI™**.

As the board members discussed 2008 and the state of the industry, they talked about the current building pipeline and trends in development, the current state of the capital markets, the difficulties of lining up financing, how firms are still figuring out ways to arrange financing for projects and

acquisitions, the difficulties hospitals are facing and how that can both help and hurt folks in healthcare real estate, and other issues.

Bigger buildings

The first topic of discussion was development – the latest trends, the pipeline, and the potential difficulties facing the industry, including financing.

For starters, board members said they continue to see larger and more complex MOB projects – which has been a trend in recent years.

“Part of that has to do with the technology emerging today, where minimally invasive procedures can allow many of these procedures to take place in a 23-hour or less stay facility,” said Charles B. “Chuck” Vogt III, senior VP and chief strategy officer for Indianapolis-based BremnerDuke Healthcare Real Estate.

“The hospitals are watching how they use their capital and might want to push more and more services into our buildings. But it also could be the way that technology advances are going toward easier procedures and less intrusive procedures. We’ve seen the increase in cancer centers, orthopedic facilities, you name it.”

Todd Varney, executive VP of new business development for Jupiter, Fla.-based Rendina Cos., said numerous hospitals are starting to employ physicians instead of just being affiliated with them.

“As a result, hospitals are taking more space in our buildings and there’s a much bigger push to get away from the hospital campus and get out into the communities, which started a few years ago even though we’ve seen a lot more of this in the last 18

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months or so,” Mr. Varney said. “The buildings out in the communities, out in the suburbs, are much smaller than those being built on the campuses.”

On-campus MOBs and outpatient buildings, in fact, are the ones that Mr. Varney, and others, see getting bigger and more complex.

Sharon Harper, president and CEO of Peoria, Ariz.-based developer Plaza Cos., said as more hospitals and providers look to gain market share they are focusing on becoming specialty centers in order to stand out among the crowd of health systems. The result can be larger and more complex facilities, many offering higher-acuity services.

“They’re choosing to become centers of excellence in certain medical service areas, such as oncology, orthopedics and neurology,” she said.

“In Arizona, we’re really seeing the health systems looking to focus on aging, and children’s is very vibrant, as is cardiology. Also, in Arizona diabetes is another one of these specialties. That’s definitely a trend we’re seeing and this can have an effect on the types of development.”

A robust pipeline

As board members talked about healthcare development, the developers in the room were asked about the current pipeline of projects. Perhaps surprisingly, most said the pipeline for outpatient projects is quite robust, with projects booked through 2009.

The reason for continued development, board members said, is that demand should continue for outpatient facilities for years to come as the country ages, medical technology continues to advance, hospitals shift numerous services and procedures to outpatient settings, and other factors.

Mr. Sina of DASCO said his firm was in the middle of three-month period in which it was closing on about \$70 million worth of development deals.

“I really think the deal pipeline flow is going to be there,” he said. “I think what’s happened in the industry, with everyone having to go back to focusing on fundamentals, is the best thing that’s ever happened for our business.

“If you think about what we were talking about last year, at this very table, about some of the new people coming into the business and doing things foolishly, doing things you shouldn’t do in the medical real estate field, like doing projects with no pre-leasing, and doing things with less than 50 percent pre-leasing – just breaking all of the fundamental rules that we’ve all adhered to for decades. The focus moving forward will be on good business fundamentals again.”

Mr. Sina said he believes the backlog of projects will continue to build during the coming period of tough economic times and tight credit.

“A backlog will be there on the outpatient side, but I think it’s going to really build up on the inpatient side, because those deals are even tougher to get financed today than on the outpatient side,” added Mr. Sina.

“The outpatient deals are a little smaller in nature, more of a bite-sized group for the banks to be able to finance, rather than the big hospital projects, the \$100 million, \$200 million deals that are probably going to be put off more than the smaller outpatient projects.”

Gregory C. “Greg” Venn, president and CEO of Denver-based developer NexCore Group LP, said development is likely to continue to occur because MOBs are not necessarily “pure real estate,” but more of a commodity needed by the healthcare industry. As noted earlier, he said, MOBs are

built when demand dictates, not on speculation. He added that up until about three years ago, his company heard from numerous hospitals and health systems that wanted to continue to own their MOBs.

“They said they had the capital and that third-party development was not for them,” Mr. Venn said. “Now all of a sudden they’re saying, ‘You know, having someone else develop, own and manage the MOBs on our campus is not such a bad idea.’”

Mr. Vogt of BremnerDuke said his firm saw more development deals in 2008 than a year earlier.

“And I think there’s more to see next year,” he said. “What we have going for us as an industry is that the baby boom generation keeps getting older and people keep getting sicker – sorry to say that, but they keep eating more french fries.

“And as hospitals realize that their funds are not doing too well in the stock market, they’re going to look to us and look to our capital to build projects for them. So we’re seeing more projects this year than we have, we’ll have our best year that we’ve ever had. The pipeline is also quite full for next year. But I think from what we’re hearing is that most developers are going to start being more selective, making sure the hospital system is a good one.”

Mr Sina added: “I think we’re all seeing more deals, but on a percentage basis of the deals we see, I think fewer deals will get done than what we’ve done before, and that’s primarily because of what’s going on in the debt market.”

Trouble might loom

As the discussion about development and the strong pipeline continued, some warnings about difficulties started to creep into the conversation.

For example, board members noted that the credit ratings of many not-for-profit hospitals and health systems are likely to be reduced in coming months, hospitals might not be as able to enter operating leases for imaging centers, oncology centers, and other service lines in outpatient facilities, and that doctors will have more difficulty paying for the rising costs of tenant improvements (TIs) in new MOBs, among other issues.

“I think everyone in this business is going to be chasing a lot of projects, mostly good, fundamental projects that make business sense in terms of the businesses that need to go into the buildings,” said Todd W. Lillibridge, chairman and CEO of the Chicago-based healthcare real estate firm Lillibridge. “But then I think it will come down to the capital freeze portion of the discussion. You know, ‘We can’t equip it, we can’t deal with the price of the TIs, we have all sorts of accounting issues to deal with.’”

Mr. Sina said: “From my perspective, if anything thaws in development it will be the hospital’s ability to do operating leases for some of those diagnostic centers and oncology centers and things like that.”

He added that he believes having the Democratic party taking charge in Washington could pump more money into the healthcare providers’ coffers.

“The Democrats want more people insured, and therefore more people will be utilizing the facilities, particularly the outpatient facilities,” Mr. Sina said. “In a roundabout way, I think some of the pressures right now on the emergency departments could be alleviated financially, because where the uninsured are using those facilities as their primary care physicians, if they somehow get insurance it’s going to pump more money into the physicians’ hands and provide more of the imaging services that they might not have received before. So that could be a help.”



Todd Varney of Rendina Cos. and Chuck Vogt of BremnerDuke

HREI™ photo

Hospitals still might have problems getting the “overall capital” they need to build more facilities, he noted.

Mr. Jonathan L. “John” Winer, executive VP of White Plains, N.Y.-based Seavest Inc., said his firm has been seeing more and more hospitals using the development of MOBs to bring new doctors to their campus.

“On the one end you have the projects with heavy hospital involvement, a lot of hospital usage and big leases in the buildings,” Mr. Winer said. “And then the other side of the spectrum you have the hospitals taking just enough space to get a project started. What the hospital really wants in that instance is to bring more third-party doctors to the campus. So, they say that if someone builds a 50,000 to 80,000 square foot building, they’ll lease 10,000 square feet just so you can say the hospital is leasing part of it.”

Other board members said the reason many hospitals are hiring specialists and putting them into new on-campus MOBs – instead of just being affiliated with the specialists – is to be able to move many procedures out of the hospital and into the outpatient setting.

“And oh, by the way, the specialists are the only doctors who can afford the space in the new on-campus MOB,” said Mr. O’Neil of Trammell Crow.

Rising rents and TIs in newly constructed buildings, he said, is one of his major concerns in healthcare development.

“I have to ask the question, ‘How do you price things with something that resembles a spread, and what will a spread look like three years from now?’” Mr. O’Neil asked. “And that leads to the question, ‘How do you still deliver rents that doctors can afford?’ When you build an off-campus facility, that’s typically a strategy for primary care and internal medicine. But when you roll the rents at today’s construction costs, before those costs come down, how can some doctors possibly afford those given they’re typically making between \$100,000 to \$150,000 a year?”

TIs stabilizing?

On top of the high rents, physician-
(Continued on next page)

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tenants also face the prospect of sky-high TIs. In most MOB developments, doctors are provided with a TI allowance of about \$50 per square foot (PSF), board members said. On the other hand, most TIs actually cost between \$75 PSF and \$100 PSF.

However, Mr. O'Neil noted that the cost of TIs are stabilizing.

"TIs have become such an expensive part of the game, even though everyone is focused on the price of hard commodities, like steel and the pricing of core and shell buildings," he said. "But on a percentage basis, TIs have gone up dramatically higher and when you do the math on how that all adds up, it's a big hammer. And while it's not a pronounced trend just yet, that's actually where we've seen the most improvement lately, partly because it's a thing you price more frequently."

"I think the price of TIs got so ramped up because a lack of labor available to do that small of a piece of work," he added. "But I think things are righting themselves in that part of that market right now."

Mr. Lillibridge added: "One of the interesting things about the TI is that the advisors sitting around this table don't want us, the developers, to start out of the box without any preleasing. As a result we can't buy the TI with the shell and core. You'd like to benefit by the trend of a lower cost on TI, but if you're stuck putting a shell up and two or three years later you're finishing the TI jobs, you're caught in a difficult spot."

As far as Mr. Winer of Seavest is concerned, one of the fallouts of the housing downturn is the fact that doctors are having a hard time financing new TIs.

"Physicians now have limited options to get resources to build out their space," he said. "Really, this is where you're seeing leakage from housing

into our business. In the past physicians were borrowing against their homes to fund their TIs, and now that they can't do that. So we're seeing physicians struggling to get the financing together so they can build out their space."

Ms. Harper of Plaza Cos. said her company is receiving many requests from doctors to have the developer pay for the TIs through a "turnkey" agreement.

"In other words, they want us to act as their bank and to fund the TIs through increased lease rates. The trend is actually quite enormous in that respect right now," she said.

When asked how the company's investment partners and lenders are reacting to such requests, Ms. Harper noted: "For the partners, they're for it because the return for the investors is better, as the interest rate is 10 percent to 14 percent on that TI."

Brent Tharp, senior VP of originations for GE Healthcare Financial Services, added that many tenants also want their TIs to be financed at the same rate as the development – such as 8 percent, he said.

Mr. Winer added that rolling the costs of the TIs into a tenant's rent can work, but only if "you can get lenders to finance the above-market TI.

"Where it stops to work is when it has to be all equity, and lenders in this environment are taking a much harder look at the level of rents and TIs," he added. "They're saying, 'Go ahead and do your project, but we only think the market will support a level of rent that would be commensurate with \$50 per foot in TIs.' So if you really want to provide \$70, that will be all equity and that's when deals become very costly."

When such a building changes ownership, according to Mr. Cooper of Savills, "the group buying it is going to knock out what they see as the above-market rental portion. And you're



Jeffrey Cooper of Savills

HREI™ photo

not going to get the credit for those additional TIs that you put in. What's that going to do to long-term values? If your program is to develop buildings as a merchant builder and then sell, you're going to lose out."

Mr. Tharp said he recently considered a request from a group of doctors who built an MOB through a contractor, put what he called "Taj Mahal" tenant improvements into the building and then had rents of \$32 per square foot, triple net.

"And this building is not located on either of the coasts, where that type of rent would be more appropriate," Mr. Tharp said. "I can tell you without even looking at comps that that's well above market rent. So, they come to us and ask us what they can get, and we say we can get you 60 percent loan to value, that's all. Because if someone is going to sell that building, an investor is going to say, 'I'm going to buy at a 32 and assume you're going to be in there for the next 10 or 15 years.' Because that's the only way an investor is going to buy it for that price." □

Our coverage of the HREI™ Editorial Advisory Board meeting will continue in next month's edition, when we will report on the board's discussion of trends in healthcare real estate financing and investment.

An even closer look

LESS NEWS MEANS MORE IN-DEPTH COVERAGE



Dear Reader:

For the past several years, the amount of news briefs we've included in the pages of **Healthcare Real Estate Insights™** has been so great that at times it was difficult to print them all.

EDITOR'S LETTER

These news items included medical office building (MOB) transactions, outpatient and inpatient development projects, and updates from companies providing any number of services in healthcare real estate. There seemed

to be an endless supply of these items, to the point where we could not fit all of them into each monthly edition. As a result, we chose to print the items that seemed the most timely, relevant and newsworthy for that edition and saved the others for the next month. The only problem was that the next month would once again bring news items too numerous to print. The backlog would build and build – until now.

Recently, the amount of breaking news has dropped dramatically in the healthcare real estate sector, especially transactions. Dan Fasulo, managing director of New York-based Real Capital Analytics (RCA) Inc., says the research firm found just six MOB deals nationwide in all of November. Likewise, instead of having hospitals unveiling new inpatient projects, many are now announcing that they are putting certain projects on hold until the economy strengthens or capital becomes more available.

It looks like the days of having too many transactions and development news items to fit in our various sections are on hiatus. I'm sure many people in the industry can relate. But that's not all bad. If we don't need to devote as many pages to breaking news, that gives us the luxury of having the space to publish more in-depth feature articles. We can write articles that examine in greater depth how projects and transactions were financed, and how healthcare real estate firms are navigating tough economic times. And watch for us to publish plenty of interviews – such as Q&As with healthcare executives and real estate industry leaders – as well as other more detailed articles about how savvy firms are still succeeding in the healthcare real estate sector.

It's nice to have more room for such stories – stories that are important for our industry. And, of course, we'll be ready for the day when all of those news items come flowing in once again.

John B. Mugford, Editor



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INDUSTRY PULSE (Continued from Page 1)

wants \$3.1 billion by July 1 to begin construction. All of this comes at a time when California officials say the state is facing a deficit of at least \$11 billion – unless new taxes are enacted or budgets throughout the state are cut. The hospitals are proposed for prisons in six cities: Stockton, Vacaville, San Diego, Chino, Folsom and Camarillo. In some communities, residents are speaking out against the plan, saying the new facilities could cause added traffic congestion and deplete their local and community hospitals of key personnel. Others, however, say the projects could add to the job base and be a boon for local economies.

DALLAS – Now that voters in Dallas County, Texas, have approved a \$747 million bond that will allow venerable **Parkland Hospital** to build a replacement facility, more hard work and plenty of planning lies ahead. The overall project is expected to cost about \$1.27 billion and it includes an 862-bed, 1.7 million square foot hospital, a 380,000 square foot outpatient center, a 275,000 square foot medical office building (MOB), parking for about 6,000 vehicles and a new physical plant. A lot of planning needs to take place in coming months and one of the first tasks is to choose an architectural firm that will help design a master plan. Parkland officials are hoping to break ground in late 2010 or early 2011 – with the hospital opening by the end of 2014. **John Dragovits**, Parkland's chief operating officer, has told local news outlets that the recent economic downturn has led to two major changes in planning for the project. First of all, the hospital might be able to position itself for better construction pricing, as material costs have been dropping recently. Secondly, because credit markets are still "somewhat" frozen and interest rates are higher than Parkland officials originally anticipated, the hospital does not plan on "rushing" into issuing the bond, according to Mr. Dragovits. It hopes to wait for a more favorable interest rate. Because Parkland has

\$250 million in cash set aside for the project, construction is expected to start on time.

ORD, Neb. – Demand is the driver of a replacement hospital project in rural Nebraska. **Valley County Health System** of Ord, which is located in the central part of the state, broke ground in the fourth quarter on its future \$19.5 million, 67,000 square foot replacement hospital on land adjacent to the current hospital. Construction is slated to begin in March 2009 and be complete by the end of 2010. While the current facility is licensed for 25 beds, some of the space is being used for offices and other uses, according to a hospital spokeswoman. The new hospital is slated to have 16 beds in all private rooms – a change from the current facility. The design/build firm on the project is **TSP Inc.**, which has an office in Omaha, Neb. Once the new hospital is complete, the adjacent long-term care center would occupy some of the space in the older, vacant hospital.

SAN FRANCISCO – Like the planners at **Parkland Hospital** in Dallas, officials at **San Francisco General** are busy planning for the more than \$1 billion rebuild of their hospital. Voters in the city overwhelmingly passed a bond issue on Nov. 4 to build a new 282-bed, 442,000 square foot replacement facility. Since the vote, planners have been moving ahead with preparations for the massive project. The hospital, which is run by the **San Francisco Department of Public Health**, plans to start preliminary aspects of the

construction project in early 2009. A groundbreaking is slated for the fall of 2009 and officials expect the new structure to be open for business by January 2015. In addition, hospital officials are preparing to submit an application to the state asking for a two-year extension on meeting state seismic deadlines. They would ask that the deadline be extended from January 2013 to 2015.

ATLANTA – Obviously, the following news item is a sign of the current economic times and similar to reports we can expect to see in the near future. Hopefully, of course, that is not the case. **Piedmont Healthcare Inc.** of Atlanta in recent days announced that it is putting its plans for a 136-bed, \$194 million replacement hospital in the suburb of Newnan on hold. Piedmont had acquired the decades-old **Newnan Hospital** in early 2007. Like other acute-care hospitals and systems, Piedmont has experienced a decline in admissions and elective procedures, resulting in reduced revenues. Company officials said the system has frozen all capital expenditures, except for construction projects that are already under way or emergency equipment needs. It was actually the rising cost of financing that prompted Piedmont officials to put the Newnan Hospital replacement project on hold. Financing the construction at current interest rates would have cost Piedmont about \$9 million to \$10 million more annually than it originally planned. Officials added that they still plan to build the hospital and hope it can be up and running by 2011. □

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All topics are subject to possible change.