

Medical, Meet Office

Attracting Healthcare
Users to Office Buildings



In the new paradigm of remote and hybrid work, many companies are re-evaluating their real estate footprints and shedding unneeded office space. As vacancy continues to rise, multifamily or medical office conversions are increasingly offered as potential solutions for underperforming office buildings. Yet each conversion opportunity presents unique complexities that require careful consideration to ensure success.

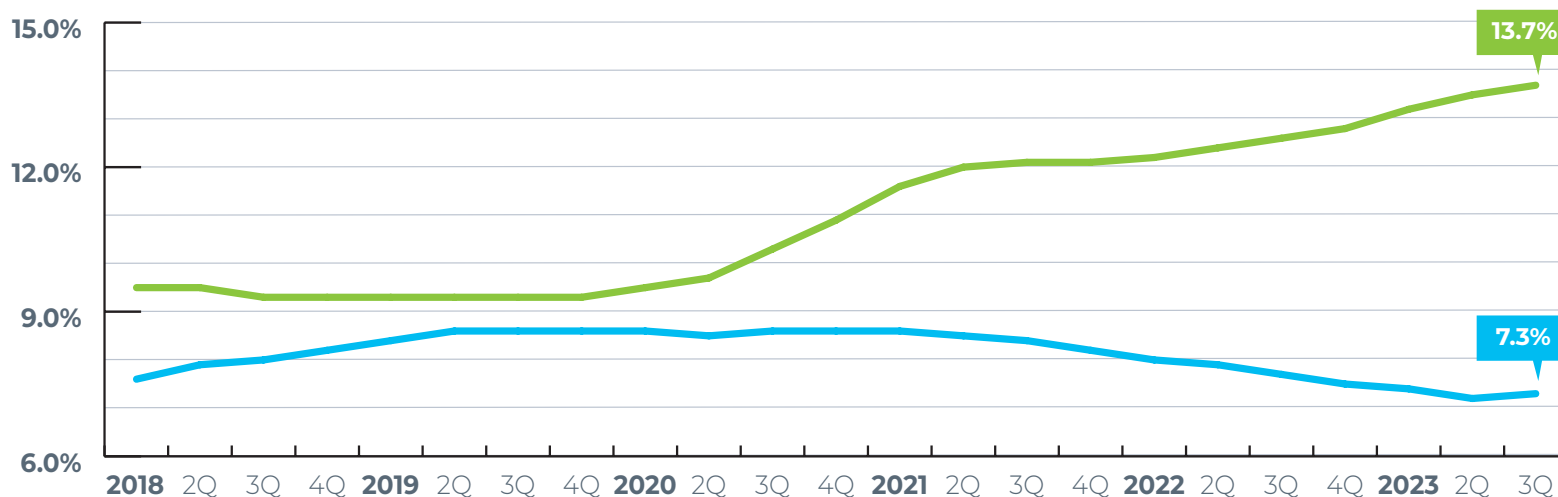
THE REALITY OF BRINGING MEDICAL TO OFFICE

- + Certain healthcare specialties can make a building less desirable – or even unattractive – to traditional office tenants.
- + Conversion is capital-intensive, as a building must meet higher design requirements of healthcare users, such as plumbing for exam rooms or more stringent building codes for ambulatory surgery centers.
- + Medical rents typically command a premium over traditional office rents, but conversions can only generate positive returns when a property is acquired significantly below replacement cost.
- + Conversions are more likely to be successful in high-growth Sun Belt markets with low barriers to development (e.g., Dallas and Charlotte), especially for projects that can deliver quality, move-in-ready space at lower cost than expensive, purpose-built MOBs.
- + While markets with high barriers to development (e.g., San Francisco and New York City) have less competition from purpose-built MOBs, higher real estate costs have led healthcare users to repurpose smaller professional offices (a.k.a. “office with medical”) across wider geographic areas. It remains to be seen whether tenant demand would support speculative conversion of larger buildings without backing of a major healthcare system.

OFFICE & MEDICAL OFFICE VACANCY

Office Vacancy (U.S. Total)

Medical Office Vacancy (Top 100 Markets)



Source: Transwestern, CoStar, Revista

DETERMINING THE RIGHT STRATEGY FOR THE ASSET

Landlords typically weigh two primary strategies for converting an office building for medical use: **wholesale conversion**, where a property is converted all at once, or **piecemeal conversion** where medical tenants backfill office space floor by floor or suite by suite.

Wholesale conversion is better suited for high-vacancy properties that require a significant repositioning before being re-leased as office or medical.

Piecemeal conversion is generally preferred in buildings with an existing tenant base. However, as healthcare occupancy rises, a building may reach a tipping point where it is perceived in the marketplace as medical office. At this juncture, most large and mid-size office tenants will likely vacate. Smaller professional offices may better tolerate incoming medical uses.

Engaging experienced architects and brokerage professionals early in the formulation of a business plan is critical to ensuring a conversion project generates expected returns. Design teams can assess construction costs and navigate complex building codes for medical uses, while leasing experts can assess property and market conditions to formulate a robust marketing plan that minimizes downtime.



CONVERSION STRATEGIES

WHOLESALE CONVERSION

- + Entire building repositioned at once
- + Suitable for assets with ultra-high vacancy (>50%) or substantial rollover risk
- + Requires capital to renovate entire building and fund tenant improvements
- + Spec suites ideal to minimize cash flow risks from downtime
- + Opportunistic investment strategy

PIECEMEAL CONVERSION

- + Building converted to medical one floor or suite at a time
- + Ideal for buildings with mid-to-high vacancy (25%-40%); existing office tenants rollover as more medical users enter building
- + Requires capital for renovation and to fund tenant improvements
- + Closer to value-add investment strategy

ASSESSING BUILDING ATTRIBUTES BEFORE MOVING FORWARD

Due to the unique location and design needs of healthcare users, not all office buildings are suitable for medical uses. Weighing key attributes of a conversion candidate can help guide decision making and investment dollars.

IDEAL BUILDING CHARACTERISTICS FOR MEDICAL USERS

 <p>Strategically located near medical clusters</p>	 <p>Near residential areas/foot traffic</p>	 <p>High visibility & signage opportunities</p>	 <p>Easy ingress/egress</p>
 <p>High parking ratios, convenient parking, or valet</p>	 <p>Attractive architecture</p>	 <p>Covered entrance</p>	 <p>Well-appointed lobby</p>
 <p>Efficient floorplate</p>	 <p>Minimum 12-foot ceiling heights</p>	 <p>Ability to provide plumbing for exam rooms</p>	 <p>Elevators large enough to accommodate gurneys</p>

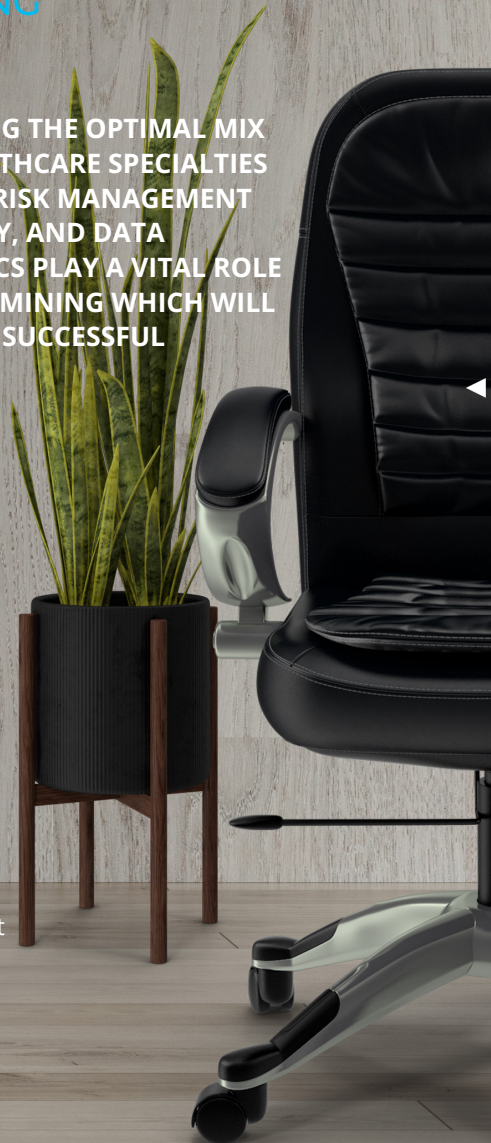
TARGETING PROSPECTS BEST SUITED TO THE BUILDING

Foot traffic to certain healthcare specialties can tarnish the professional image that traditional office users desire from their building. Deconflicting office and medical uses is critical when adding a medical use to a traditional office building or attempting a piecemeal conversion strategy. Without proper management, these conflicts can accelerate turnover of office tenants and impair project returns.

Selecting the optimal mix of healthcare specialties is a key risk management strategy – just as tenant screening is for traditional office – and data analytics play a vital role in determining which will be most successful. For operators implementing a piecemeal conversion, selecting specialties better suited for an office environment can raise the threshold where office tenants begin to perceive a building as medical office. For instance, the threshold with wellness-focused specialties such as dermatology and fertility could be as high as 30%-40% of occupancy, but pain management or an oncology clinic could lower the threshold to just 10%-20% of occupancy.

Conflicts can be further mitigated by segregating medical tenants to certain floors or by elevator bank, although this becomes less practical in buildings with fewer floors or limited elevator capacity.

**SELECTING THE OPTIMAL MIX
OF HEALTHCARE SPECIALTIES
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IN DETERMINING WHICH WILL
BE MOST SUCCESSFUL**



THE COMPATIBILITY CONTINUUM: HEALTHCARE SPECIALTIES IN OFFICE

“SOFT” MEDICAL

Wellness-focused specialties better suited for office buildings

- + Plastic/cosmetic surgery
- + Fertility
- + Rheumatology
- + Dermatology
- + Immunology
- + Medical genetics
- + OB/GYN/women's health
- + Urology/men's health
- + Podiatry
- + Gastroenterology (surgery/endoscopy off-site)
- + General dentistry
- + Speech therapy
- + Dieticians
- + Chiropractors
- + MedSpa

“MIXED” MEDICAL

Specialties suitable in a building that is transitioning to medical office

- + Primary care
- + Orthopedics
- + Ophthalmology
- + Pediatric dentistry
- + Orthodontists
- + Mental health practitioners
- + Clinical/research trials

“HARD” MEDICAL

Specialties suitable for dedicated medical office buildings

- + Ambulatory surgery centers
- + Gastroenterology (surgery/endoscopy on-site)
- + Pediatrics
- + Oncology
- + Medical imaging
- + Physical therapy
- + Rehabilitation
- + Urgent care centers
- + Walk-in clinics
- + Pain management
- + Diagnostic/drug testing



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Fall 2023



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About Transwestern Real Estate Services

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