



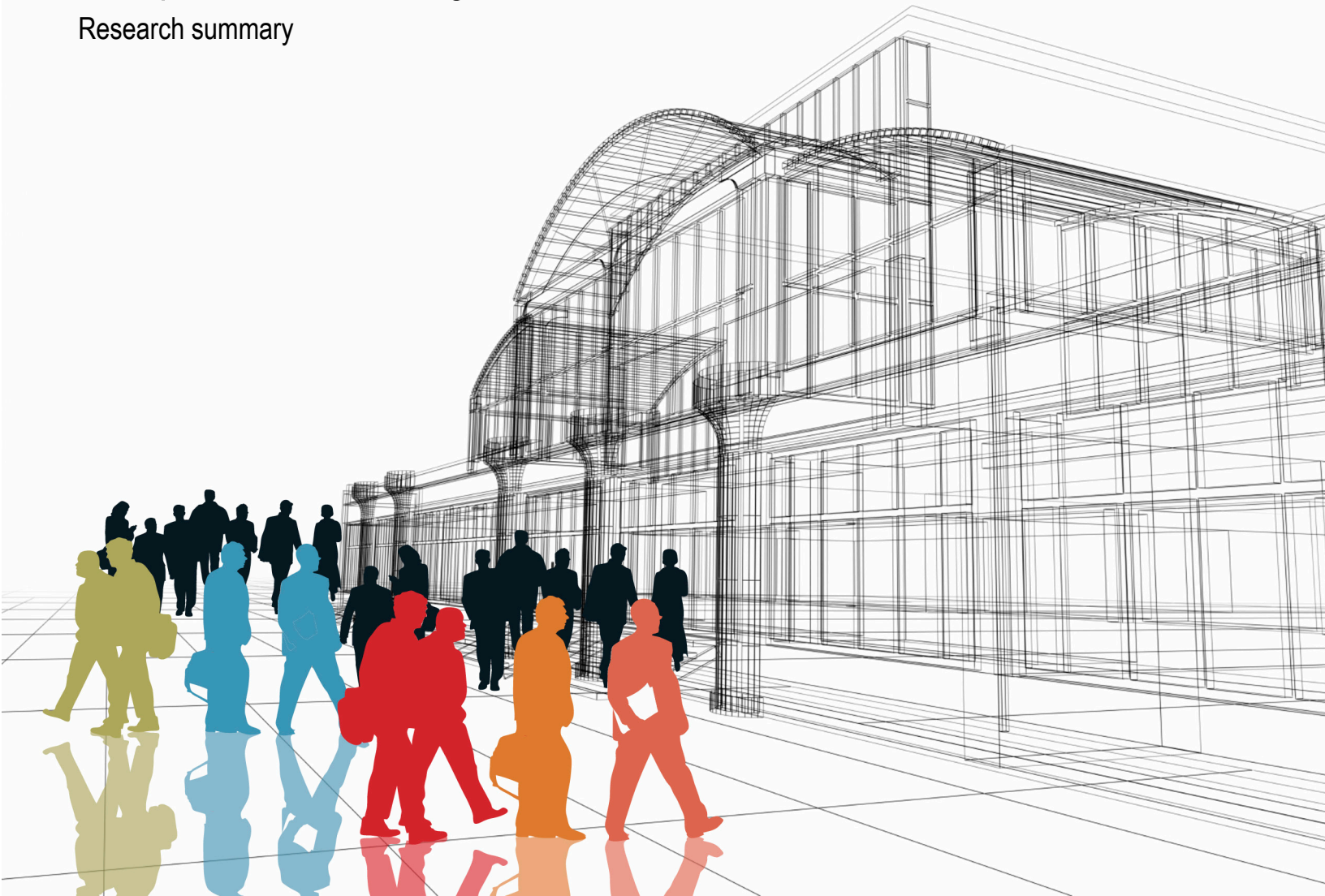
JONES LANG  
LASALLE®

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# Improving healthcare systems through strategic real estate and property management:

Best practices in running real estate and facilities

Research summary



# Executive summary

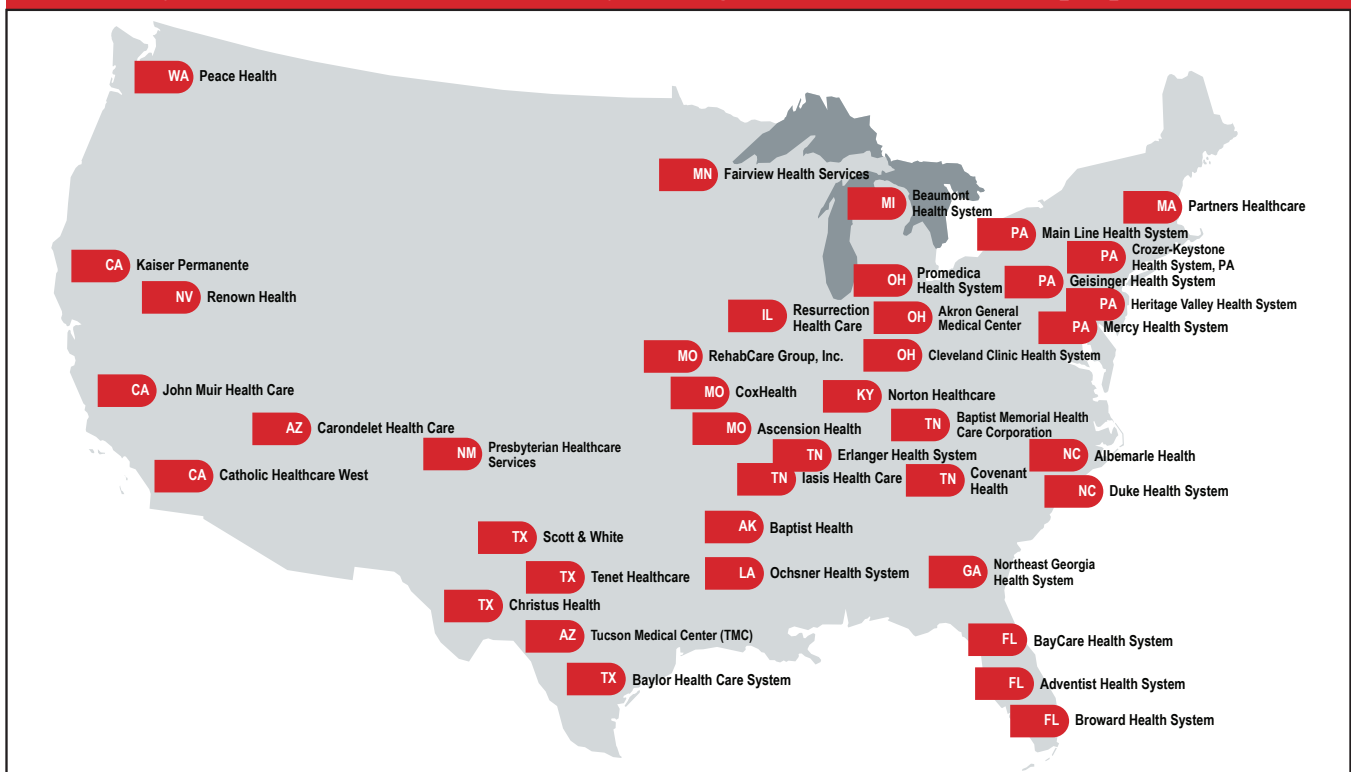
Over the last decade, a growing number of healthcare systems in the U.S. found that the way they manage their property holdings – the land, medical office buildings and hospital facilities that can account for as much as 70% of their total assets – had become essential to staying competitive. Long overlooked in many systems as a function they needed to centralize and master, many hospital systems have become far more sophisticated in the way they manage hospitals and other properties.

In looking at the declining fortunes of the healthcare services industry in the last five years, it's not difficult to understand why. Hospitals and physician offices, a \$1.27 trillion-a-year sector, were hit hard by the acute recession of 2008-2009. A 2008 study of more than 400 U.S. hospitals of all sizes found that half were unprofitable, compared with 33% of hospitals that suffered operating losses just two years earlier. The result: Healthcare systems have had to greatly tighten their belts.

But costs aren't the only source of pressure. Increasing the quality of the care – at hospitals and the other medical facilities that healthcare systems own today (physician offices, outpatient clinics, etc.) – has become a major concern. With the prospect of national healthcare reform making Medicare and Medicaid reimbursements no longer based on fees but rather on medical outcomes, it becomes easy to see why hospital systems are scrambling to become more efficient and effective.

One response has been for independent hospitals or small hospital systems to merge with larger healthcare systems. There were 77 mergers and acquisitions of U.S. hospital companies in 2010, the most since 2001, and 112 deals combined in 2008 and 2009. For these institutions, taking advantage of economies of scale in purchasing and other areas became essential. And M&A activity in 2011 continued unabated, with the acquisition of struggling non-profit systems by private equity companies, for-profit hospital chains and larger non-profit systems.

Jones Lang LaSalle conducted a survey with 40 leading U.S. Healthcare systems to understand how they manage their real estate and properties



But for systems big enough to make it in the new environment, size is not enough. They need to make a slew of changes to be cost competitive, deliver high-quality healthcare, give easy access to all their potential patients, and attract them away from the competition. Leading systems are pursuing those changes. They include putting more clinics in the suburbs, making those clinics more multidisciplinary, establishing fewer but better centers of excellence for the system as a whole, making acute space more hospitality-oriented, designing new facilities around streamlined clinical processes, and presenting the system's facilities in a uniform and favorable light. None of these things can be done without the right facilities environment. And the right environment won't be there in time if a provider's real estate and facilities strategy is not totally in synch with its business and clinical strategies.

We conducted research this year with 40 U.S. healthcare systems that collectively account for more than \$140 billion in annual revenue – about 11% of the total spent at hospitals and clinics. Our research found that the way these systems manage their real estate and facilities is critical to whether they can accomplish today's key mandates. We believe our most significant finding is this: Hospital systems that manage real estate and facilities in a centralized function and synchronize their strategies with their organizations' business and medical strategies have a huge competitive advantage over systems that continue to delegate property decisions down to the community level.

Organizations like Geisinger Health System and Duke Health System demonstrate the significant role that a system-wide real estate and facilities function can play in improving care and reducing costs. Only when such a headquarters function works closely with top management to guide and execute major real estate and facilities decisions, in support of business and clinical strategies, does a healthcare system gain the capabilities to prosper in the future environment.

## How healthcare systems are improving the way they manage real estate and facilities

The historical way that hospitals and hospital systems managed their real estate and facilities – i.e., at the community level – is what accounts for today's problems in managing these assets. However, most of the healthcare systems that we interviewed had centralized some aspects of construction, leasing medical office buildings and outpatient clinics, and running hospital facilities.

### Key observation:

A mere 18% of the 40 healthcare systems surveyed in our study are strategically managing their property assets. The operating margins of these systems are on average four percentage points higher than those that manage their property assets locally.

### Key finding:

Systems that had centralized many more aspects of real estate and facilities management generated significantly more benefits, not only in the cost of their property assets, but the degree to which they could contribute to better quality and more accessible care.

Many had gotten a central grip on new construction (for both renovations of existing facilities and building of new facilities). Numerous systems had centralized some aspect of medical office leasing. Some systems standardized the way they manage hospital facilities, and for a few, facilities management personnel reported to headquarters, not the community hospital CEO.

From extensive interviews with executives in 40 U.S. healthcare systems, both for-profit and non-profit, and most with more than \$1 billion in annual revenue, we found numerous practices in real estate and facilities that were cutting costs, freeing up funds for clinical investments, and helping to improve the quality of care. We organize these practices in four basic areas of property management:

- **Transacting:** This is about striking better leases and determining which properties should be owned vs. leased. Other systems are using the lease/own mix as a way to be able to stay flexible and accommodate future changes in strategy. Baptist Memorial Health Care has shifted from owning to leasing MOB's, which reduces the chances of having unproductive assets if a physician group partnership falls apart. Duke Health System has gone 90% lease, 10% own of such properties to be "very flexible in being able to change our real estate footprint."
- **Managing:** Many systems were managing hospital facilities at the local level. That made it difficult for them to enjoy the bulk purchasing economies in the cost of elevator maintenance, HVAC repair, and other cost centers. As an example, one system saved \$1.5 million alone over the last five years by using one elevator maintenance firm for its seven acute-care hospitals. Another system centralized facilities and construction across its hospitals. The move helped boost productivity of facilities personnel from 30% to 75%. Catholic Healthcare West, a \$9.8 billion system, has cut energy consumption 26% over six years (or \$5 million annually) by centralizing energy management. Over the next 10 years, the organization is targeting another 20% drop in energy consumption.

## Healthcare Real Estate Maturity Model

	Locally managed	Centrally administered	Centrally managed	Strategically managed
Transacting	<ul style="list-style-type: none"> <li>Leases and titles are managed locally</li> </ul>	<ul style="list-style-type: none"> <li>Leases and titles are administered centrally</li> <li>There is a single repository</li> <li>All leases are compliant, arms-length agreements</li> </ul>	<ul style="list-style-type: none"> <li>Transactions are negotiated centrally</li> </ul>	<ul style="list-style-type: none"> <li>The portfolio is managed to               <ul style="list-style-type: none"> <li>Preserve future flexibility</li> <li>Liberate capital for clinical purposes</li> </ul> </li> </ul>
Managing	<ul style="list-style-type: none"> <li>Real estate and facilities are managed locally</li> </ul>	<ul style="list-style-type: none"> <li>Real estate and facilities are administered centrally</li> <li>Processes are standardized</li> <li>Purchasing power is consolidated</li> <li>There is a system-wide process for prioritizing needs</li> </ul>	<ul style="list-style-type: none"> <li>Property assets are appraised annually</li> <li>Total required spend is understood</li> <li>Utilities costs are further reduced with unconventional approaches</li> </ul>	<ul style="list-style-type: none"> <li>There is a system-wide facilities master plan aligned with the overall strategy</li> <li>Adequate funds are forecast and allocated for real estate and facilities operations</li> </ul>
Planning	<ul style="list-style-type: none"> <li>Real estate and facilities are planned locally</li> </ul>	<ul style="list-style-type: none"> <li>Plans are submitted locally, vetted and prioritized centrally</li> </ul>	<ul style="list-style-type: none"> <li>There is a system-wide plan tied to the clinical and business plan</li> <li>There are shared facilities for the whole system</li> <li>There is a strategy for repurposing acute space</li> </ul>	<ul style="list-style-type: none"> <li>The real estate and property strategy facilities the business and clinical strategies</li> <li>Real estate may be used to generate revenues</li> </ul>
Building	<ul style="list-style-type: none"> <li>Design and build are managed locally</li> </ul>	<ul style="list-style-type: none"> <li>Design and build are managed centrally</li> <li>There are standards and preferred suppliers for design and build</li> </ul>	<ul style="list-style-type: none"> <li>Designs are repeatable               <ul style="list-style-type: none"> <li>Promote a standard look and feel</li> <li>Are informed by best practices</li> </ul> </li> </ul>	<ul style="list-style-type: none"> <li>Buildings are designed around redesigned clinical processes</li> <li>Buildings are designed for future flexibility</li> </ul>

The most advanced systems have let go the constraints of locally managed facilities altogether and operate from a facilities master plan drawn up for the system as a whole. Mercy Health System, for instance, went through the process of doing a physical plant assessment on all of its properties. Previously, physical plant was not always at the top of the priority list.

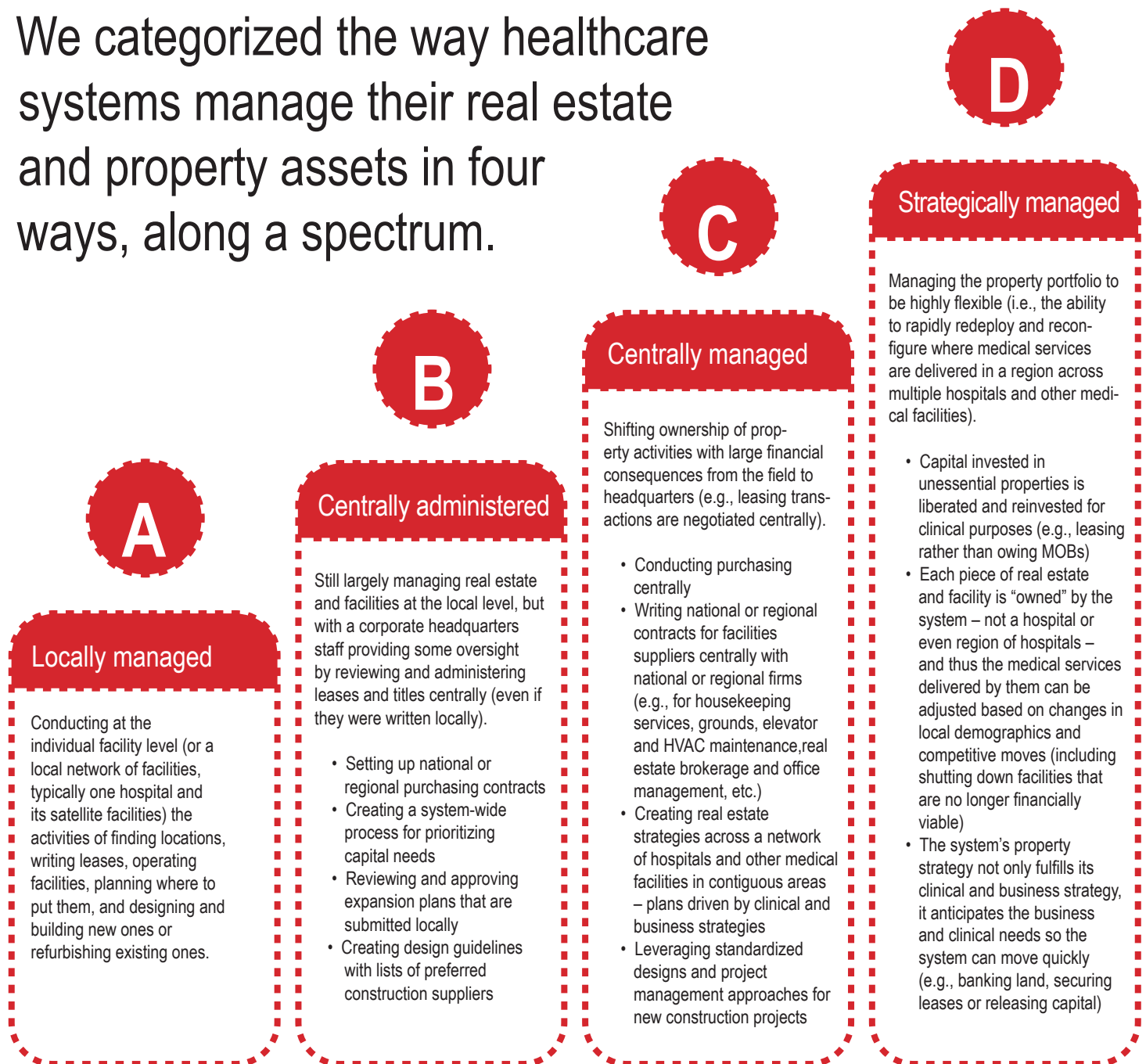
For example, getting a new chiller installed sometimes required including it in a clinical upgrade project. By tracking facilities across its four hospitals, the headquarters function of the Philadelphia-area system is much more in tune with the costs of maintenance, when things must be replaced, and how to plan those expenditures.

- **Planning:** Taking a more strategic approach to fully analyzing the viability and impact of existing outpatient facilities and MOBs has become critical to healthcare systems. It also feeds into assessing critical needs of future facilities. A number of systems saw big benefits from taking real estate decisions out of the hands of local hospitals so that they could be made for the benefit of the system as a whole. BayCare Health System opened a 48-bed hospital in one of its Tampa Bay-area hospitals dedicated to long-term acute care. That has helped free up space at other BayCare hospitals for patients with shorter stays. Simply getting a handle on what properties were on their books helped a number of healthcare systems raise cash. Baylor Health Care System sold its MOBs over the last decade. After putting an executive in charge of facility design and construction, one system quickly identified 130 properties that could be put up for sale. Other systems are using real estate to generate non-medical revenue through businesses that are introducing people to their system. Crozer-Keystone has a fitness center for this purpose. The most advanced systems plan their real estate several years ahead to make sure that it facilitates the corporate and clinical strategies. Renown Health has a planning process that takes into account all of its real estate (leased and owned) and the growth and demographics in its Reno, Nevada/Northern California service area.
- **Building:** By managing design and construction centrally, several systems are lowering construction costs, reducing the risk of project overruns, and bringing a common brand image to their facilities. Geisinger Health System introduced standard construction designs across facilities in the 42 Pennsylvania counties that it serves. The system believes such standardization has played a role in boosting care quality and growth from \$955 million in 2001 revenue to \$2.3 billion in 2010. Others changed the way they allocated capital to hospitals for major projects. Still other systems have hired architects in-house to manage design projects. That has helped systems eliminate expenditures on designs that are later shelved. Systems like Mercy Health centralized building design so that patients and families see a common look and feel. The most advanced health systems are designing buildings that position them to prosper in the forthcoming era of accountable care. Other systems are building hospitals around redesigned clinical processes to maximize both efficiency and patient experience. BayCare is building new facilities focused on consumer expectations and evidence-based design practices, which they believe accelerate healing and provide patients and their family members with a more soothing and less “sterile” environment.

## Structuring property management for bigger benefits

Our research found whether a healthcare system gets those kinds of benefits depends largely on how it organizes its real estate and facilities operations. From our interviews, we found that the way they managed their real estate and facilities assets fell into one of four categories. These categories can be seen as a continuum on which property management moves from being a decentralized and tactical function to a centralized, strategic one. Those that had centralized many more aspects of real estate and facilities management generated significantly more benefits, not only in the cost of their property assets, but the degree to which they could contribute to better-quality and more-accessible care. The categories are:

We categorized the way healthcare systems manage their real estate and property assets in four ways, along a spectrum.



- **Locally managed** – Real estate and facilities decisions are made at the local level – the community hospital and, in some cases, at each MOB. When the majority (or all) of property decisions are delegated down to the facility level or a health care system, each hospital strikes its own contracts (whether for MOB leases, elevator maintenance, food service, or HVAC repair). This gives a system little ability to pool its purchasing clout, and no ability to otherwise coordinate its property-related activities. Hospitals that could share expensive facilities are not likely to do so. We found only a few of the 40 healthcare systems we interviewed to be managing their property assets entirely locally, although many of them did so only 10 years ago.

- Centrally administered** – A headquarters real estate and/or facilities function plays an oversight role in plans developed and implemented at the local level. This, indeed, can improve decisions that were once made independently and without the regard for the healthcare system as a whole. MOB and clinic space leases and titles are administered centrally, which improves the chances they are compliant with federal law prohibiting more-favorable-than-market terms with physicians. In addition, hospital systems can consolidate purchasing of power, facilities maintenance and other services and supplies, which can generate major cost savings. Setting construction standards – in legal contracts, design guidelines, and project management approaches – can reduce the risk of cost overruns. And hospitals in need of facilities upgrades but without the funds for making them can benefit from having their requests considered in a larger pool of investment requests. However, because real estate and property plans emanate from the field up, they still reflect local priorities that are not made with an overall hospital system in mind. Ways to share facilities with other hospitals in the system, plans for shifting certain medical services to other hospitals, and other strategies that would help a healthcare system be more efficient and effective are not likely to be ventured from the field.
- Centrally managed** – In this model, a headquarters real estate and facilities function develops and implements the system’s property plans. We found a number of systems that had centralized some aspect of real estate and facilities – e.g., construction, facilities management, or non-hospital office management – but not all. These systems are able to consolidate purchases and extract big cost savings in areas ranging from electricity to architectural designs. And because they control areas such as construction, they can ensure that new design standards are implemented across the organization. That promotes a consistent look for hospital entrances, operating rooms, patient rooms, and other items, and also increases the chances that the most effective (and cost effective) designs win out. Importantly, these systems are better able to make real estate decisions with major consequences, including hospitals that should be closed and hospital service specialties that should be concentrated in certain facilities to increase volume, improve quality and reduce costs.
- Strategically managed** – We found only a few systems that could be placed in this category. Their headquarters real estate and facilities functions not only develop and implement plans, they develop them in close coordination with the system’s business and clinical strategies. This enables them to make moves that anticipate, for instance, the expansion of existing hospitals, placing of new clinics, or changing demands on new clinics. These systems bank land in places they think they might need them several years hence, or proactively develop multidisciplinary clinic designs that can be later rolled out for several clinics. They also lease space months ahead of the needs of the system to get better prices and make flexible space designs to allow changes in clinical strategy in the years to come. In other words, they enable the systems’ overall strategies by getting real estate and facilities decisions — many of which have a long lead time — far enough ahead that they don’t get in the way. A corporate real estate management team at one large system manages the entire \$4 billion real estate portfolio and is solely accountable for buying, leasing and divesting of real estate.

## About Jones Lang LaSalle Healthcare Solutions

Jones Lang LaSalle’s National Healthcare group works with hospitals and health systems throughout the nation delivering program management, strategic consulting, financial strategy, transaction and sustainability advisory services and facilities and property management. Through its work, the Healthcare group drives efficiencies and enhances quality through the unrealized potential of real estate assets and infrastructure.

## About Jones Lang LaSalle

Jones Lang LaSalle (NYSE:JLL) is a financial and professional services firm specializing in real estate. The firm offers integrated services delivered by expert teams worldwide to clients seeking increased value by owning, occupying or investing in real estate. With 2010 global revenue of more than \$2.9 billion, Jones Lang LaSalle serves clients in 70 countries from more than 1,000 locations worldwide, including 200 corporate offices. The firm is an industry leader in property and corporate facility management services, with a portfolio of approximately 1.8 billion square feet worldwide. LaSalle Investment Management, the company’s investment management business, is one of the world’s largest and most diverse in real estate with \$45.3 billion of assets under management. For further information, please visit our website, [www.joneslanglasalle.com](http://www.joneslanglasalle.com).



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