

Managing a health system's real estate strategically

Healthcare organizations have extensive real estate holdings – most have more than half of their balance sheet invested in property, plant and equipment. Very few, however, have a *strategy* for managing their real estate.

This type of passive approach can lead to critical performance issues, as market shifts go unnoticed and long term investment opportunities are lost. This paper will explore the components of a real estate strategy; why having one is more important today than ever, and how your organization can unlock the strategic potential of real estate to improve overall performance.

Shifting your approach for the future

Whatever beliefs you hold about the future specifics of the healthcare environment – reimbursement, incentives, your response – change is a given and an inescapable reality.

Healthcare organizations that believe their current positioning and attitudes will prevail in five or ten years may find themselves unprepared for the new healthcare environment in which they will be operating. Success will be measured by an organization's willingness to scrutinize every square foot of its operation and determine how each component can be successful independently while also adding value to the whole.

Most organizations are in the process of modeling their new future from a clinical program and financial standpoint. They are looking closely at their processes, cost of delivery and degree of integration while leaving decisions about real estate on the sideline.

This happens because real estate cuts longitudinally through the organization. It touches everything and is touched in turn by every element of the business, yet it is fragmented and difficult to grasp. The opportunity and the challenge is to turn these often non-performing assets into strategic ones.



Challenges for systems

Systems, regardless of size, present additional challenges when trying to approach real estate strategically. They are often the product of mergers and acquisitions, built opportunistically over time. If approached with a clean slate, few systems would distribute assets the way they do now. Add in a decentralized organizational structure designed to preserve autonomy for business units and you have a more challenging landscape as we move to an 'accountable care' healthcare model.

Real estate is best managed at the system level, leveraging scale and best practice across the enterprise to optimize performance. Some *planning* may currently occur at the system level, but *management* is often site based and many have authority to pursue solutions individually. By shifting to a system wide structure for decision making, organizations can move away from managing individual parts and become driven by a "success of the whole" mindset.

Whether your organization delivers services from one or multiple sites, chances are you can no longer afford to forego the performance improvement opportunities that go hand in hand with a solid strategic real estate program. There are six elements of a comprehensive real estate plan, and we'll explore each in the next section.

Elements of a comprehensive real estate plan

The following six issue areas, when viewed together and from the perspective of executive system leadership, form a comprehensive picture of the organization's current performance and future opportunities to improve it.

“Portfolio Optimization is the process of matching location and capacity with business strategy”

1. **Portfolio Optimization** – When the words ‘real estate’ are uttered – particularly in a healthcare institution – an image is conjured of physician office buildings and other ‘off site’ locations that are owned and/or occupied. However, this definition is too narrow and is being replaced by the one used by the rest of corporate America: that of all space owned or occupied by the organization in pursuit of its mission. Why are we *here*? How many patients do we intend to serve *here*? What is our performance level *here* relative to our peers?

This definition includes everything owned or leased, including hospitals, service centers, and even nearby houses purchased opportunistically or received as bequests. This mindset will be increasingly more important as organizations seek to simultaneously broaden (geographically) and focus (in terms of service mix) their reach in the future. Key questions to ask include:

- What and where are your assets? How are they deployed?
- Does your system align with your business strategy? Are you in the right locations in the right markets?
- Is your portfolio performing optimally in terms of throughput and promised return? Is there untapped capacity inside the walls?
- How would you migrate to a better configuration? Is there a way to do more with less if approached differently?
- How do you measure return on various scenarios and integrate long range real estate strategy with capital planning?

“The goal in Occupancy Cost Management is to apply global best practice to produce sustainable savings”

2. **Occupancy Cost Management** – Do you know your overall cost of occupancy and actively manage it as a key measure of system performance? In many organizations, facility management is a cost center, squeezed annually during the budget process and then forgotten. Worse, it is often housed in multiple cost centers, each managed differently with fragmented responsibilities and reporting relationships. When properly managed, however, facilities can be a strategic partner in delivering sustainable cost savings and executing business strategies that dramatically improve operating margin. This requires access to best practices and processes which unlock the power of the whole organization.
 - What is your overall cost of occupancy? What steps do you take to actively manage it?
 - How does your spending on facility management labor and purchased services compare to that of your peers?
 - How do you (today) assure your management processes and tools reflect contemporary standards and best practices, not just relative to competitors but across the healthcare industry and, where appropriate, from outside healthcare?

“The ownership paradigm in healthcare is changing as flexibility and speed to market become increasingly important”

3. **Ownership Strategy** – Access to tax-exempt debt has bred a knee-jerk ownership mindset among leaders of not-for-profit healthcare providers. In some cases this is appropriate, but increasingly organizations recognize that a host of factors challenge the model of what must be owned. Among the critical factors are competition for scarce capital, a need for future flexibility, and a finite and closing window on strategic opportunities. Many institutions now question whether they should continue to own everything in their portfolio or if they should shed some of those assets. And, should they develop future projects with their own resources or utilize someone else's?
 - What are the criteria your board has set to determine whether a project should be owned and what are your guidelines for utilizing debt financing? Are they prudent in this environment?

- How have the recent changes in accounting rules related to treatment of long-term leases changed your approach?
- Are there elements of your portfolio which are non-core and would represent candidates for monetization?
- When working with at-risk developers, are you wise to preserve capital even if it burdens the balance sheet with a lease obligation or reduces your flexibility in directing future land use?

“A system’s scale should be utilized to secure consistency and manage execution risk”

- 4. Execution Approach** – Well thought-out plans are needed, but will have a more powerful impact when paired with a strategic execution plan. An effective corporate real estate organization is action-oriented, anticipating rather than reacting to the next move. Buildings must be built, renovated, and maintained. Resources – from energy to supplies to services – must be acquired. Repetitive transactions are opportunities to leverage the scale and buying power of the entire organization and work in partnership with the best and brightest service providers to achieve great outcomes for patients and staff. They are also places where organizations place themselves at risk if relationships or the transactions themselves are not consistently and thoughtfully managed. A healthcare organization’s approach to plan execution and partnership management are critical components to its success.
- What are the criteria by which you have selected the organizations who execute your real estate transactions? Do you review them regularly and monitor compliance with both internal audit and external best practice?
 - Do you have experts in-house who are capable of managing the complexities of large building projects and transactions? What are your processes for managing capital project risk?
 - Do you have an accurate view of upcoming critical lease events and current terms to maximize your portfolio value? Do you actively manage landlord charges to ensure your payments are based on appropriate rates and agreed pass through of operating expenses? How do you control executed documents and approval processes with respect to regulatory or compliance risk?

“An energy and sustainability approach can significantly impact an organization’s bottom line”

- 5. Energy Cost Control & Carbon Footprint Management** – Healthcare organizations are enormous consumers of energy and other non-renewable resources. Acquiring, managing and disposing of real estate presents opportunities for consuming less. Many organizations are held as public trusts and have a broadly defined fiduciary responsibility to the communities they serve to be stewards of the public health. All have growing awareness that corporate responsibility includes wise use of resources, but many haven’t uncovered the cost savings opportunity of a strategic energy program. Some have targets set by regulators, as well.

As a part of any review and strategy development, resource consumption should be measured and a plan for active management developed.

- Do you have a plan for addressing pending regulations, especially regarding carbon trading?
- Is your real estate portfolio “Green”? Why should you care, how can you get there and, more importantly, how can you stay there?
- Does your organization know the magnitude of energy costs as components of your budget and your margin?

“Few health care organizations are organized to effectively manage real estate, but it comprises over one-half of the balance sheet”

- 6. Organizational Effectiveness** – Best practices in corporate real estate management are often not applied in the health care industry. The specific technical problem represented by hospitals and the somewhat parochial nature of the healthcare industry have had the net effect of erecting barriers between the industry and corporate America on this topic. Yet there is much to be learned on the topics of asset management, efficient operations and precision in execution, and those organizations willing to look beyond their perceived boundaries have found a wealth of relevant examples.
- Does your real estate organization possess the scope of responsibility necessary to execute strategically on behalf of the institution? Is the organization appropriately designed for efficient delivery of results?

- Do you have the right expertise in the right jobs? What are your succession plans for key individuals?
- Are the reporting tools sufficiently robust to manage the resources entrusted in compliance with regulatory, audit and internal requirements?
- How well integrated is real estate with the business units and with key partner organizations such as strategic planning and finance? Is real estate an internal service provider or a strategic partner in delivery of the patient care mission?

Summary and conclusion

If the majority of your assets are in property, plant and equipment, yet you neither measure nor manage return on those assets, you need a strategy for real estate. If multiple people in your organization can authorize transactions or construction projects, you need a strategy for real estate. If you have significant deferred maintenance or routine 'surprise' variances against your facility management budget, you need a strategy for real estate.

The healthcare industry is heading into uncharted waters, where change is inevitable and will affect every facet of the business model and financial picture. In an environment where sources of capital will be increasingly scarce and management of the total cost of delivery will be a key measure of value, you can't afford to ignore real estate's impact on the bottom line.

Yet corporate real estate as a discipline represents a functional skill set that often lies wholly or at least in part outside the expertise of healthcare organizations, so unbiased advice is needed. Viewing the six issue areas outlined above longitudinally across the organization requires effort, but has the potential to yield enormous cost and operational benefits to your organization. When thoughtfully planned and meticulously executed, real estate and facilities can be transformed into high-performance assets that support a system's mission of quality care, satisfy its financial goals and improve an organization's competitive advantage.

About the author

Scot Latimer is a Managing Director in the Healthcare Solutions group of Jones Lang LaSalle and leads the capital asset strategy practice. Scot brings over 30 years of experience in advising organizations on effective business decision making. One of North America's most sought-after planning specialists, Scot has developed subspecialty expertise in strategic business planning and market forecasting, capacity and patient flow planning, campus and facility master planning, capital investment analysis and return/performance assessment, and detailed implementation planning.



For more information, you can reach Scot at +1 800 990 6061 or scot.latimer@am.jll.com

www.us.joneslanglasalle.com/healthcare

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Carbon Footprint Management	Energy and sustainability solutions
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