COVID-19 May Accelerate Retailization Of Health Care

By **Sandi Krul** (July 14, 2020)

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As we hopefully approach the other side of the COVID-19 curve, the fallout from the crisis may actually present a strategic opportunity for health care providers to expand their real estate footprint into nearby retail space.

In the past decade, there has been a noticeable movement of health care providers away from hospital campuses and medical office buildings, or MOBs, and into retail spaces closer to where patients live and work, and allowing health systems to free up on-campus space for provider-based care, by moving administrative offices into retail space. COVID-19 appears likely to strengthen this health care retailization trend.

One prominent retail conversion was Vanderbilt Health's takeover as an anchor tenant of the Hundred Oaks Mall in Nashville, Tennessee. Other noteworthy examples are Cedars-Sinai Medical Center's lease of the entire 32,000-square-foot commercial office space at The Runway in Playa Vista, California, and UCLA Health's opening of clinic space in the newly remodeled Westfield mall in Century City, California, and the newly developed Village in Woodland Hills, California.

In addition to health systems, certain specialty groups have also transitioned to retail space, such as the Southern California Orthopedic Institute's lease of 25,000 square feet of office — above retail — space at the Bridgeport Marketplace in Valencia, California. And, of course, urgent care centers are widespread in retail centers throughout the U.S.

This health care retailization trend seems primed to accelerate as a result of the financial devastation on retailers stemming from COVID-19. According to Foresight Research, in 2018, there were 5,800 big brand retail store closures in the U.S., which increased in 2019 to 9,300 closures.

We are now seeing a wave of COVID-19 bankruptcies, with well established brands such as 24 Hour Fitness Worldwide Inc., J. Crew Group Inc., Golds Gym International, Neiman Marcus Group and Pier 1 Imports recently filing for bankruptcy and leaving prime vacant retail space in their wake. These vacancies present an opportunity for health systems and providers to expand their footprint or relocate to ideal retail space.

Advantages of Health Care Retailization

Broader Visibility/Branding

A health care facility or clinic in a former retail big-box location or other retail space allows providers to push care out further into the community and offers much greater visibility and branding in the community, with effectively built-in continual advertising to shopping center customers and persons driving by. In contrast, MOB space visibility is generally limited to lobby directory and small entry door signage.

Convenience

Retail locations will generally have more convenient parking, as compared to MOB space.

Also, if the patient needs a driver, the driver can shop or get a cup of coffee without having to sit in the doctor's office waiting area.

More Effective Social Distancing

We do not know when we will have an effective vaccine or treatment for COVID-19, and many patients are wary of the density of MOBs, with crowded elevators and waiting rooms, and the potential for circulated air to carry airborne contaminants from adjacent medical offices. Since retail space is likely to have direct outdoor access, patients are able to wait outside even in their cars if the wait is long, and receptionists can text the patient when the doctor or nurse is ready to bring the patient into a private exam room. Though this may not be as significant an issue once COVID-19 is behind us, the benefits will continue during flu season and other epidemic periods.

Prime Retail Opportunities

The COVID-19 fallout may be the last straw for many brick-and-mortar retailers, especially with the increase in online capabilities to market and sell products, leaving retail vacancies that owners will be desperate to fill. So the time is ideal to take advantage of the availability of prime space, while owners may be more receptive to negotiation of attractive lease or acquisition terms.

After-Hours Flexibility

Providers will not be restricted by MOB office hours, and assuming the retail space has its own separately metered utilities, providers will not incur the additional after-hours utility mark-ups they are subject to in MOBs.

Cost-Effective Alternative to New Construction

It is expensive to construct new medical space, and so using shuttered retail space for the delivery of health care is one way to help drive down those costs. However, as described below, there are different pricing challenges with medical retail space that need to be taken into account.

Other Considerations

As with all leases, there are strategic, opportunity cost and cash flow considerations that need to be considered in evaluating whether it makes sense to expand or transition to retail space. The economic uncertainty resulting from COVID-19 also presents concern about financing availability, and the financial strength of landlords and contractors to meet their obligations. On the other hand, we may very well see tax credits and other government funding programs designed to strengthen the economy and that could support investments in the health care retail space.

Retail medical locations also present their own unique challenges that need to be considered. First and foremost, Charlie Dickhaus, a vice president of Realty Trust Group in Atlanta, emphasizes that:

> Retail space is generally better suited only for particular types of providers. Profitable specialists rely heavily on referrals that are strengthened by the natural "eco-systems" generated by providers referring to one another within medical office buildings — something retail space simply does not provide.

Bryan Lewitt, the managing director of JLL's South West Health Care Services Group, believes that ecosystems are less of an issue for health systems, other types of providers like primary care practices, optometrists and dentists, as well as providers that tend to gravitate to standalone spaces such as urgent care clinics, surgery centers and dialysis providers.

Both Dickhaus and Lewitt also point to other pricing challenges unique to retail space. For example, retail lease rates are generally higher than MOB space. Also, retail space is typically box space without ceilings, demising walls and multiple restrooms, and lack the more robust plumbing, electrical and other building system capacity that certain providers require.

So, build-out costs for retail medical space is likely to be higher and, depending on the type of provider and equipment to be used in the space, the existing retail utilities may not be adequate. Retail landlords are typically unwilling to provide the same high tenant improvement allowances that MOB landlords provide and on which many providers rely, though providers may find retail landlords more open to higher improvement allowances after the COVID-19 fallout.

Other concerns are that retail landlords are generally less familiar with issues unique to medical space leases (e.g., access restrictions related to patient privacy), so there may be a learning curve that results in a more lengthy and costly negotiation process. Retail landlords are also typically not as responsive as MOB landlords in addressing maintenance and other operational issues that arise during the term of the lease.

Lastly, while a tenant in an MOB can be fairly confident that it will share an MOB with other reputable tenants, likely other medical professionals or pharmacy, and that visitors to the MOB are unlikely to cause disturbance, there is less assurance as to the type of tenants and customers that surround retail space.

Notwithstanding the challenges, Lewitt, who helped broker the SCOI lease at the Bridgeport Marketplace, agrees that:

> With the shakeout of retail, exacerbated by COVID-19 and the bankruptcies of national retailers, there will no doubt be substantial opportunities for health care providers — particularly for those providers, like health systems, who target and compete with national retailers for large anchor locations, which have been harder to secure these past few years.

Both Lewitt and Dickhaus agree that that current circumstances present unique opportunities on the medical retail front, but that providers will need to carefully consider the pros and cons for their particular use and circumstances. They also both acknowledge that there may be regional differences, driven by factors such as building density and associated parking limitations, but that, what is not regional is the ecosystem synergy that drives certain providers to MOBs.

With real estate costs comprising one of the highest expenses for most health care providers, with the exception of payroll, transitioning or expanding into retail space needs to be carefully considered, and whether or not the move to retail space makes sense for a particular provider will, of course, be based on a variety of factors unique to that provider.

Still, COVID-19 presents providers with potential strategic real estate opportunities, so it behooves providers to consider whether it makes sense for them to take advantage of this opportunity right now, since it is unclear how long this window will remain open.

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