



Market Intelligence for Healthcare Real Estate Developers, Designers, Lenders, Contractors, Brokers, Investors and Executives™

They were MOB sector pioneers

ED NORDBERG AND MEDICAL OFFICE PROPERTIES INC. WERE AHEAD OF THEIR TIME

By Jessica Griffith

Today, investors from pension funds to real estate investment trusts (REITs) view medical office properties as a solid niche in which to sink some equity. But a decade ago, few outside the healthcare community wanted to own buildings populated with physicians and surgeons.

COMPANY PROFILE

Into this market arrived HealthCare Financial Partners REIT, a private REIT with a portfolio of nursing homes. The REIT became a publicly-traded company under the ticker "HCF," and operated as such until it was sold in July 1999 to Heller Financial Inc. (now part of GE Capital) for \$750 million.

HealthCare Financial Partners executives had branched out in the late 1990s by purchasing four medical office buildings (MOBs), and the partners quickly noticed that the buildings were performing well and maintaining high occupancy rates.

By 2001, some of the former REIT execs were so enthused by the MOB market that they formed Medical Office Properties Inc. to concentrate solely on acquiring medical offices.

The firm eventually accumulated 22 MOBs until, in one fell swoop in May 2004, Medical Office Properties sold its entire portfolio to CNL Retirement Properties Inc. for \$256 million. Following a nine-month transition

in which Medical Office Properties continued to manage the portfolio, the company closed up shop.

Since then, quite a few people in the industry, as well as folks here at Healthcare Real Estate Insights™ have wondered what happened to the executives from the trend-setting MOB investment firm. That's why we decided to track a handful of them down, asking them to reflect on their former company, discuss their current ventures and offer perspective on the MOB market.

Birth of a trend

Medical Office Properties was clearly in the right place at the right time, although several former executives say that they might have sold their MOB portfolio too soon. That's because, since then, the medical office market has shifted from an industry blip to a hot property sector.

"It was partly success by design and partly fortuitous," says Edward P. Nordberg Jr., the former CEO of Medical Office Properties.

"I would not have predicted then that the market would have been as rapidly well-received. It exploded in a five-year period."

MOBs did not constitute a distinct asset class before the late 1990s, says Henry "Hans" Wittich IV, the former senior vice president of acquisitions for Medical Office Properties who recently joined Denver-based NexCore Group LP's new East Coast office.

Mr. Wittich says before MOBs became such a hot commodity, healthcare real estate usually referred to senior housing properties such as nursing homes or assisted living facilities.

"Ed (Nordberg) had the vision to recognize a change in the landscape," says Mr. Wittich.

In addition to Messrs. Nordberg and Wittich, Medical Office Properties' management team included: Peter J. Farrell, president and CEO; Sean P. Murphy, executive vice president (EVP), general counsel and secretary; Daniel L. Willison Jr., EVP; Daniel W. Colhoun III, senior vice president (SVP) of acquisitions; and Hilde M. Alter, chief accounting officer.

Mr. Wittich adds that, prior to Medical Office Properties' emergence as a key player, investors were looking for investments other than suburban office buildings.

At the same time, they also wanted to avoid the risks associated with healthcare real estate, namely the regulatory issues surrounding senior housing.

And even though other companies had taken an interest in MOBs before Medical Office Properties, most firms remained local players, Mr. Nordberg says.

"No one had tried to build a national platform," says Mr. Nordberg, now the chairman and CEO of Wakefield Capital Corp. in Chevy Chase, Md.

(Continued on next page)

(Continued from previous page)

A scalable model

As they ventured into the MOB sector, the executives at Medical Office Properties initially planned to acquire properties in the Washington, D.C., region, but they quickly realized the model would work in every major market in the United States, says Mr. Colhoun, who now works with Mr. Wittich in NexCore Group's East Coast office.

He and his colleagues observed two significant facts about MOBs back then, Mr. Colhoun says. They performed well, and few investors other than doctors and hospitals took an interest in these assets.

The result was a fragmented market in which most health systems owned their own properties. MOBs that were not owned by health systems typically were owned by local developers, leasing companies or other real estate entities, adds Mr. Farrell, the former president and COO of Medical Office Properties.

For years, MOBs typically were under managed, with little attention paid to vendor contracts or economies of scale. Tenants had become accustomed to accepting lower rents in lieu of needed capital improvements.

This was long the case even though MOBs are often in need of significant build outs and improvements to accommodate medical technology and provide a comfortable environment for doctors and patients.

Medical Office Properties' research indicated that capitalization rates for MOBs were higher than cap rates for suburban office properties. Cap rates are often used as a measure of a buyer's expected rate of return. Typically, a higher cap rate signifies a riskier investment, but Mr. Nordberg says his team considered medical office less risky than traditional office buildings.



Ed Nordberg



Dan Colhoun



Hans Wittich

"We felt the risks were lower because the hospital is a demand driver for space for physicians, and physicians don't move as frequently as typical office tenants," he says.

"We thought the higher cap rates were an inefficiency because people did not understand the risk."

The firm analyzed billions' of dollars worth of deals, Mr. Colhoun says.

Along the way, he and the other analysts developed an eye for appropriate projects. Even though competition in the sector began to build, Medical Office Properties had a solid head start and a refined method for its due diligence.

And while the executives acknowledge they probably sold too early, they also agree that it was logical for them to accept CNL's offer.

After all, the shareholders had participated since 1998 and a five- to seven-year hold period was considered appropriate, Mr. Nordberg says.

"In hindsight, we probably could have realized greater potential if we had held longer," he says. "But our returns across the portfolio were almost 40 percent."

Where are they now?

As noted earlier, Medical Office Properties managed the assets for

CNL for nine months after the sale, through January 2005. Mr. Nordberg and his colleagues used that time to gauge the market and consider other opportunities.

"Dan Willison, myself, Hilde Alter, Sean Murphy... after we stopped the asset management, that nucleus stayed together and we went down several paths," he says. "Should we stay in medical office, move to senior housing, create a fund?"

One result was the previously mentioned Wakefield Capital, a private investment firm that specializes in senior housing. The company owns about 80 facilities, most of which are assisted living or independent living complexes for older adults. In addition, Wakefield has two portfolios under contract with a total of 74 skilled nursing homes.

At least three other Medical Office Properties alumni continue to work with Mr. Nordberg at Wakefield Capital. Mr. Willison is president, Mr. Murphy is EVP and general counsel, and Ms. Alter is chief accounting officer. Mr. Murphy also remains of counsel with the Washington law firm Patton Boggs LLP, where he specializes in real estate, securities and corporate finance law.

"We like the demographics of senior housing," Mr. Nordberg says, citing demand and an aging population. Wakefield is contemplating an expansion into acute care, such as

“I would not have predicted then that the market would have been as rapidly well-received. It exploded in a five-year period.”

Edward P. Nordberg Jr.
former CEO
Medical Office Properties Inc.

specialty hospitals or surgery centers, but the firm has no immediate plans for acquiring such properties. The firm also owns a portfolio of research, laboratory and office space that it leases to Oregon Health Sciences University in Portland, Ore.

On-the-job training

Senior housing is a good fit for the talents and expertise of the former Medical Office Properties team, he adds. In acquiring those 22 MOB's back in the late 1990s, the people at Medical Office Properties honed important skills, such as determining the best assets to acquire. In addition, the group established an extensive network of industry contacts.

“Success is a bad teacher in some respects,” Mr. Nordberg says, but his years with Medical Office Properties taught him one lesson he intends to carry to Wakefield Capital.

“If you are investing for the long term, don't be afraid to pull the trigger,” he says. “We made more mistakes by being a little too tentative than by being more aggressive. If you understand the market and do your homework, don't be afraid to jump in.”

Messrs. Colhoun and Wittich also did not stray from the healthcare real estate sector. As noted, the two opened Denver-based NexCore Group's East Coast office, located in Baltimore, in October as managing directors of development and acquisitions.

Following the portfolio sale back in

2004, Mr. Wittich remained with Mr. Nordberg's group during the transition but decided to stay with medical office buildings and not venture into the senior housing market.

“We bring a 30,000-foot view of the healthcare real estate market and we understand the dynamics of supply and demand in the market,” Mr. Colhoun says of himself and Mr. Wittich. “That helps us identify good potential investments.”

Relationships still key

Although market research is crucial, a client relationship can help close the deal, Mr. Colhoun adds.

“Due diligence is due diligence, but at the end of the day, you need to be able to relate to the sellers. Yes, they want the highest price, but if it is a group of doctors or a hospital, there might be lots of nuances to what they want. It might be the first time they've sold and we can relate to the sellers better than buyers who do not have healthcare experience,” he says.

Knowledge of the healthcare industry is crucial because the medical office market differs from traditional office, says Mr. Wittich, who worked in the suburban office market before joining Medical Office Properties.

One significant difference is the tenant strategy, he says. Owners of a regular commercial office building simply want to fill the space with tenants who have good credit and can pay their rent. MOB owners rely on the hospital to help determine appropriate tenants.

“It depends on their strategy,” Mr. Wittich says. “Do the practice groups that will be in the building fit with the strategy of the hospital?” For example, a hospital with a national reputation for heart surgery might want a renowned cardiac specialist in its MOB.

Mr. Colhoun says the NexCore East Coast office is negotiating several deals but has not announced any transactions.

Mr. Farrell, the former COO, left healthcare real estate after the sale to CNL. He is one of three partners in PADC Realty Investors LLC, a Washington, D.C.-based real estate investment and development company.

“I wanted to refocus and re-energize my interests in Washington, D.C.,” he says. PADC will focus on emerging neighborhoods and the company has purchased 2.7 million square feet of residential and office development in the district. The company also is under contract to buy a retail portfolio with 2 million square feet of redevelopment potential. PADC focuses on urban development but may expand to other Mid-Atlantic locations.

Experience counts

One of the drivers of today's strong MOB market is investor interest. The other impetus has come from the provider side, where many hospitals in recent years have chosen to sell their office buildings and invest that cash into their core businesses.

This so-called monetization of MOB's may have reached a plateau, but Mr. Wittich believes sales are likely to continue at their current rate. “A growing number of healthcare systems are adopting this as a strategy but it never happened at the pace investors anticipated,” Mr. Farrell adds.

(Continued on next page)

(Continued from previous page)

He cites two reasons. First, healthcare systems are institutions and thus it can take a long time for their management teams to decide and act on new strategies. Second, hospitals and MOB owners also must negotiate complex issues regarding the ownership and operation of such buildings.

The MOB market remains a solid investment, Mr. Nordberg notes. Although some markets are overpriced, plenty of MOBs still are trading below their replacement costs.

Even though the market will continue to attract new investors, the MOB sector is still not a place for inexperience, Mr. Colhoun warns.

“You have to be up on the healthcare industry,” he says. “You have to have

“Ed (Nordberg) had the vision to recognize a change in the landscape.”

Henry “Hans” Wittich IV
former SVP of acquisitions
Medical Office Properties

competitive capital and be smarter and faster than the competition.”

Mr. Wittich agrees.

“You have to do more due diligence,” he says. “If more people are focusing on it and the yields are not going to be as good, you have to be sure about your yields and be a lot more precise.”

Despite today’s sky-high interest in MOBs and the trend toward even more consolidation, Mr. Colhoun

expects the market to remain fragmented. One illustration of that consolidation is the original Medical Office Properties portfolio, sold to CNL Retirement Properties Inc. in 2004.

In May, Health Care Property Investors Inc. (NYSE: HCP) acquired CNL Retirement Properties, including the Medical Office properties portfolio, for \$5.2 billion. □

Jessica Griffith is a business writer specializing in commercial real estate.