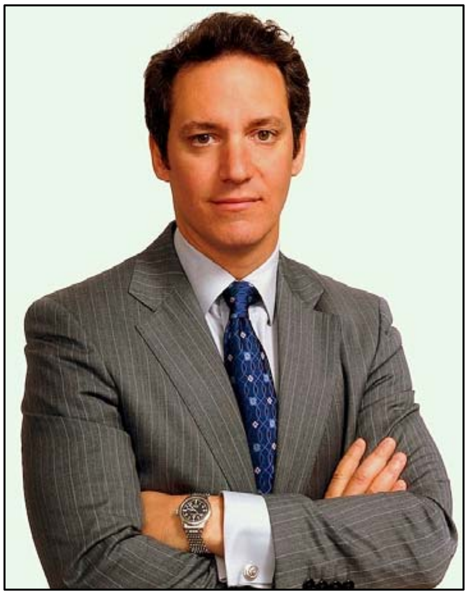


Mr. Follini has 25 years of experience in construction and professional real estate. He founded every company he has been involved with and he has in-depth experience in the acquisition, development and management of several types of real estate including: healthcare real estate/medical office; media infrastructure (film studios); industrial; land development; and senior housing.

Recently, Mr. Follini created the **BLACKSWAN** webzine (www.blackswanblog.com), an innovative news and interview webzine highlighting alternative real estate investment assets. As **BLACKSWAN's** Publisher, Mr. Follini is a frequent lecturer and conference speaker around the country on the topics of healthcare real estate investment and alternative property assets.

Mr. Follini earned a Bachelor's Degree from Tufts University as well as an Economics Degree from the London School of Economics. Mr. Follini was raised in New York City and he and his family currently reside in Sag Harbor, NY.

IMPACT OF HEALTH REFORM ACT 2.0

by CJ Follini

The administration of President Obama has finally delivered a $940B bouncing humdinger of a healthcare law after gestating for over a year and about four months overdue. While I am still forming personal opinions about the bill and its raison d'etre, I will sidestep politics, the appalling behavior of some of our idiotic politicians (I wish I could draw cartoons), and restrict this article to my humble assessment of the potential impact of this law on our business – *healthcare real estate investment*.

In November, I wrote a BLACKSWAN article about the possible consequences of the bill being considered which is why I titled this article '2.0' The following is by no means comprehensive since the enormous complexity of the new law will require many months to begin to grasp all the nuances; so many more articles on this topic to follow. Here are my first impressions:

31 Million Americans (At Least) To Get Health Coverage = 57 Million Square Feet New

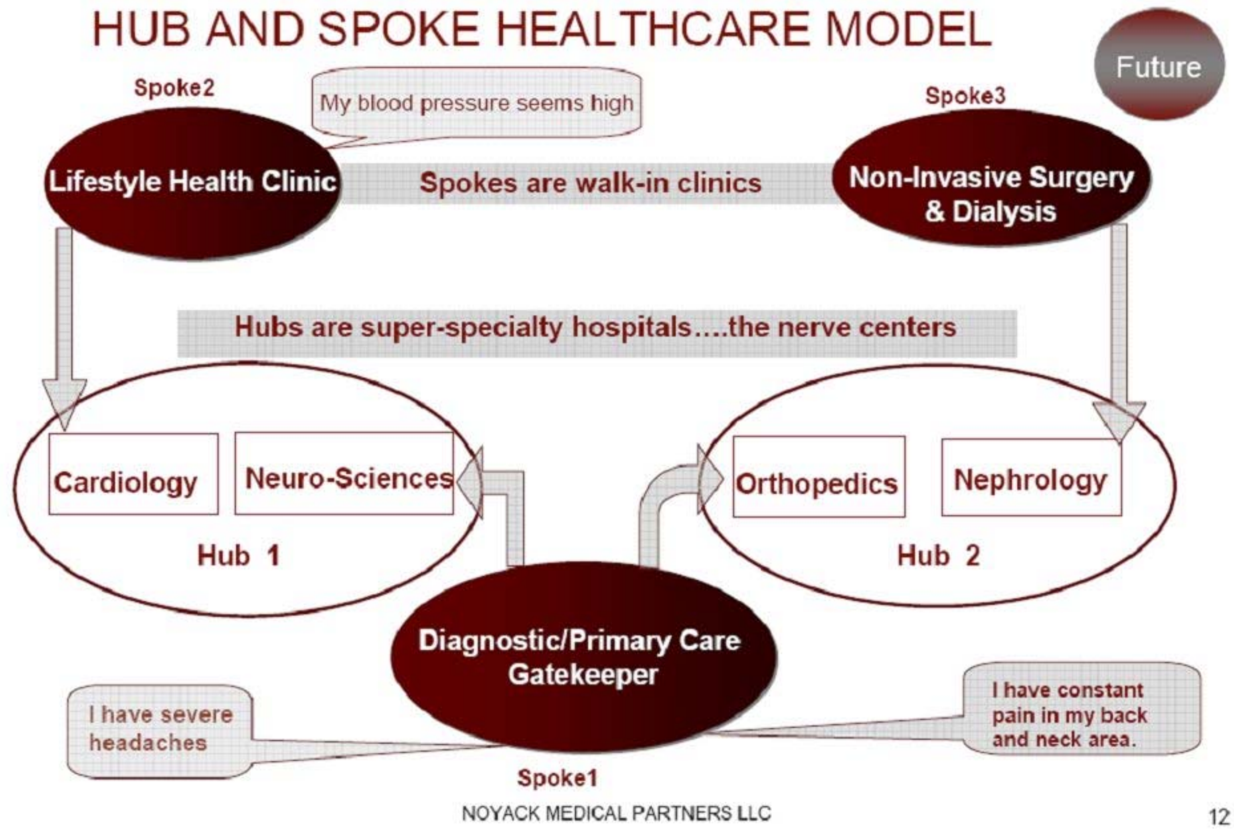
According to the 2007 U.S Census Data, 45 million Americans were uninsured and maybe as many as 25 million were underinsured. If only 31 million of these people receive coverage under the newly-passed Universal Health Act then it is conceivable would ultimately trigger construction of roughly 57 million sq. ft. of new medical facilities based on the standard industry multiplier of 1.9 sq. ft. per insured. of new medical office space for each new outpatient.

In 2006, the State of Massachusetts passed the Massachusetts Healthcare Reform Law which required nearly every resident in the State to obtain health insurance. This law was credited with adding 439,000 residents (6.8 percent of the state's population) to the insurance rolls. According to the Massachusetts Division of Health Care and Policy, as of October 2009, the uninsurance rate in Massachusetts was 2.7 percent. What was the effect of this sweeping healthcare reform on the state's medical office space segment? According to the CoStar Group, in the three-year period since the legislation passed, Massachusetts increased their medical office inventory by approximately 2 million square feet (a 13.2 percent increase).

Outpatient vs. Hospital Stay

Another factor that will affect the demand for medical office space is the changes in how healthcare is delivered. Much of the current supply of medical office space was developed at the time when the previous health care model was operating. Much of this space is becoming functionally obsolete and will need to be retrofitted based on today's technology and demand for efficiencies. Obviously this also presupposes an overwhelming emphasis on outpatient or ambulatory care vs. hospital stay. This conclusion is reasonable given the law's reduced reimbursement for in-patient treatment vs. outpatient.

The new model for the delivery of healthcare will significantly focus on outpatient care. This could result in spatial efficiencies such as combining an ambulatory surgery center with advanced imaging and other diagnostic services while also having a synergistic mix of physician office space in the building or in a nearby MOB. This model relieves the pressure on area hospitals where normally, the uninsured public have no choice but to go to a hospital emergency room with even the most common of ailments. Having multiple conveniently accessible outpatient facilities also allows major hospital systems a way to expand out into the community from their major campus location and have their on-staff physicians treat new patients, which could ultimately lead to admittance to the main hospital only if the need arises. The diagram below illustrates the *Hub and Spoke Future:*



All of the above is configured to make trips to the hospital campus much less frequent. Much of the infrastructure to support this model still needs to be built. This means, I believe, that off-campus facilities will gain equal importance to their on-campus brethren. So either cap rates for on-campus decline or they increase for off-campus or…both.

The Hub and Spoke Healthcare Delivery Model can only function in an age of electronic medical records (EMR's) The American Recovery and Reinvestment Act of 2009 has already allocated approximately $19 billion to aid and assist in the development of electronic medical records technology and companies like GE Healthcare are betting heavily on the bet. This could also drive an increase in the demand for EMR's to occupy space in MOB's.

Emphasis on Primary Care Physicians as Gatekeepers

As you can see from the diagram above, primary care physicians have just been drafted in the first round as the new quarterbacks of this healthcare team. But according to the American Academy of Family Practice Physicians, the U.S. health care system currently has about 100,000 primary care physicians and will need approximately 139,000 in the next 10 years just to keep up with the demand of aging Baby Boom population *before* the passage of the Universal Health Law. That's why Democratic lawmakers government funded graduate medical residency slots in primary care and general surgery. Additionally, the new law addresses an increase in funding for the National Health Service Corps, which helps repay student loans for physicians who work in underserved parts of the country and Democratic Senators included incentives that hopefully will increase the country's stock of primary care doctors.

Obviously, the amount of general practice physicians and the rate at which they eventually begin working within the healthcare system will *increase the velocity* at which the inventory of medical office space will be absorbed and further developed.

Location, Location, Location,

On-campus vs. off-campus; urban vs. suburban; East Coast vs. well, everywhere else. Every healthcare real estate fund, REIT or just plain investor has an opinion and investment style predilection about the above debates. But when it comes to the question of location vis a vis healthcare real estate, no one is talking about retail…and they should. The following press release – Mayo Clinic Plans Facility At Mall of America – tells all we need to know about the future of healthcare delivery and the location of its real estate. When a visionary healthcare leader like the Mayo Clinic makes this kind of decision, the rest of must take notice. GOOD REGIONAL RETAIL SITES WILL BECOME VITAL AS HEALTHCARE REAL ESTATE LOCATIONS.

I believe it's equally obvious that inner-city hospitals will benefit far greater than their suburban and for-profit counterparts from the new Obamacare. Why? Collections. Previously, credit loss from providing medical services to the uninsured through money-losing emergency rooms bankrupted many inner city hospitals such as St. Vincent and Cabrini in New York City. But now the government is there to backstop those losses and basically, credit enhance these inner city hospitals. And these newly flush will demand for new capital projects and seek third-party financing and ownership from traditional real estate investors for non-core facilities since tax-exempt bond financing is currently unavailable. So get ready for the inner city healthcare real estate gold rush.

Summary

Universal Health coverage is a game changer. Period. Since most health systems have been in a nine month holding pattern about capital expenditure and disposition decisions, and patients have been postponing routine visits and elective procedures, the passing of healthcare reform should lead to a burst in pent-up demand. The effect this will have on the MOB segment will be the eventual positive absorption and declining vacancy rates as well as the new development of state-of-the-art MOB's in well located areas. On a national level, I already stated that many believe it is not outside the realm of possibility this sector will need between 45 million and 60 million square feet of additional inventory over the next 10 years to handle the influx of patients.

Even before reform became an issue, medical office assets were deemed much more stable than traditional office properties. Health care remains the strongest sector of the economy, adding 222,000 workers as of midyear 2009 for a growth rate of 1.4%. Lenders are more favorable to health care deals, and only 1% of MOB's were classified as distressed at midyear 2009, equating to $200 million in troubled loans, according to a 2010 medical office outlook by Marcus & Millichap. Traditional office, by comparison, had almost $20 billion, or 3%, of assets at risk of default or foreclosure.

"We're finally seeing some stabilization of caps rates," Kevin Roy, health-care property specialist with Jones Lang LaSalle, tells CoStar Group. Roy noted that MOB's which were selling at a 6.5% cap rate 18 months ago may now trade in the high 8%'s or 9% today. That's at or near the 9% historical average calculated by JLL researchers for medical offices over a 15-year period.

All this sounds grand but it means nothing to any healthcare real estate investment professional dependent upon the capital markets. As far as I can see, they remain choppy waters at best. In fact, since some REITS that have raised tons of public equity cash must put that capital to work, they are proceeding on a scorched earth campaign of buying assets heretofore they would not have touched leaving nothing for the small to midsize companies. Only time will tell the wisdom of this path.