CMBS Research

Urgent-Care Centers--The Cure for Ailing Real Estate or Just a Bandage?

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Morningstar Perspective

As landlords face more retail consolidations, many have turned to nontraditional tenants, including medical and urgent-care centers, to improve occupancy at their retail properties. Morningstar Credit Ratings, LLC expects more retail space to be used for medical services, as baby boomers age and millennials start families. We found $739.8 million in commercial mortgage-backed securities with exposure to urgent-care centers as one of the five largest tenants, but this may understate total exposure, because many centers lease smaller spaces. While this mixing of medical and retail may put a bandage on the slow bleed from retail tenants’ bankruptcy filings, it isn’t without risks. Impediments include consolidation in the urgent-care industry, competition, and possible changes to the Affordable Care Act.

Table 1 – 10 Largest Urgent-Care Loans

<table>
<thead>
<tr>
<th>Deal</th>
<th>Property Name</th>
<th>Loan Name</th>
<th>City</th>
<th>State</th>
<th>Allocated Balance ($)</th>
<th>% of Gross Leasable Area</th>
<th>Lease Expiration</th>
<th>Loan Status</th>
<th>Specially Serviced</th>
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</thead>
<tbody>
<tr>
<td>MLCFC 2007-6</td>
<td>Riverbridge</td>
<td>MSKP Retail Portfolio - A</td>
<td>Greenacres</td>
<td>FL</td>
<td>51,201,512</td>
<td>0.5</td>
<td>5/31/2034</td>
<td>Current</td>
<td>No</td>
</tr>
<tr>
<td>MLMT 2007-C1</td>
<td>Bayside Shopping Center</td>
<td>Bayshore Shopping Center</td>
<td>Bay Shore</td>
<td>NY</td>
<td>30,100,000</td>
<td>3.6</td>
<td>1/31/2025</td>
<td>Current</td>
<td>No</td>
</tr>
<tr>
<td>MSC 2007-ID14</td>
<td>Arcadia Towne Center</td>
<td>PDG Portfolio Roll-Up</td>
<td>Phoenix</td>
<td>AZ</td>
<td>18,165,897</td>
<td>0.2</td>
<td>11/30/2020</td>
<td>Current</td>
<td>Yes</td>
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<tr>
<td>COMM 2014-CR20</td>
<td>Brawner Shopping Center</td>
<td>Brawner Shopping Center</td>
<td>Stafford</td>
<td>VA</td>
<td>17,200,000</td>
<td>5.6</td>
<td>11/30/2020</td>
<td>Current</td>
<td>No</td>
</tr>
<tr>
<td>CSMC 2006-C1</td>
<td>Providence Pavilion Shopping Center</td>
<td>Providence Pavilion</td>
<td>Mableton</td>
<td>GA</td>
<td>16,411,357</td>
<td>3.6</td>
<td>9/30/2019</td>
<td>Current</td>
<td>No</td>
</tr>
<tr>
<td>CFCRE 2011-C1</td>
<td>Las Colinas Village Shopping Center</td>
<td>Las Colinas Village</td>
<td>Irving</td>
<td>TX</td>
<td>16,145,610</td>
<td>7.0</td>
<td>6/30/2021</td>
<td>Current</td>
<td>No</td>
</tr>
<tr>
<td>MSBAM 2013-C9</td>
<td>The South Loop Shops</td>
<td>The South Loop Shops</td>
<td>Chicago</td>
<td>IL</td>
<td>15,598,192</td>
<td>3.8</td>
<td>3/31/2020</td>
<td>Current</td>
<td>No</td>
</tr>
<tr>
<td>UBSSB 2012-C4</td>
<td>Evergreen Terrace</td>
<td>Manassas Retail Portfolio</td>
<td>Manassas</td>
<td>VA</td>
<td>15,316,256</td>
<td>5.1</td>
<td>5/1/2030</td>
<td>Current</td>
<td>No</td>
</tr>
<tr>
<td>VNO 2010-VNO</td>
<td>Watchung</td>
<td>VNO Portfolio</td>
<td>Watchung</td>
<td>NJ</td>
<td>13,496,490</td>
<td>0.1</td>
<td>2/28/2024</td>
<td>Current</td>
<td>No</td>
</tr>
<tr>
<td>BACM 2007-5</td>
<td>North Benson Center</td>
<td>North Benson Center</td>
<td>Renton</td>
<td>WA</td>
<td>13,045,075</td>
<td>10.5</td>
<td>11/30/2024</td>
<td>Current</td>
<td>No</td>
</tr>
</tbody>
</table>

Source: Morningstar Credit Ratings, LLC
Appeal of Retail Locations

Consumers’ demand for convenient, flexible healthcare services is driving physicians and health systems to vie for real estate beyond the traditional hospital campus and medical office building complex. Urgent-care centers, which offer flexible hours and the option to see a healthcare practitioner without having to go to the emergency room or waiting to see a general practitioner, have been strip-mall staples for years. Recently, their numbers have grown, as private equity and venture-capital funds, as well as hospitals and insurers, see the cost savings these centers can provide. The number of these centers rose 22.6% from 2014 to 2016, according to the Urgent Care Association of America, a nonprofit industry group based in Naperville, Illinois. With the vacuum that retailers have left, rents in some centers are now cost-effective. U.S. shopping center rents average $14.73 per square foot as of the first quarter of 2017, per CoStar Group, Inc., compared with medical office rents of $21.46 per square foot.

Demand for urgent-care services is fueled by growth in two key constituencies that are entering prime years for healthcare consumption: aging baby boomers and millennials with young families. IBIS World, an industry research firm, reportedly sees urgent-care revenue growing to $19 billion by 2020. Looking at medical consumption by age reveals that healthcare spending for the 65 and older population was $18,988 per person in 2012, the latest year available, over 5 times higher than the spending per child ($3,552) and nearly 3 times the spending per working-age person ($6,632), according to the Centers for Medicare & Medicaid Services. Demographic trends are key to driving growth in certain areas. Alan Ayers, vice president with industry consulting and software firm Practice Velocity, said that growth has mostly occurred in the Midwestern and Sun Belt states, because the Northeast already has a high saturation of hospitals and established primary-care facilities. In addition, the growth in the Midwestern and Sun Belt states is likely because of the high proportion of elderly residents in those states, especially Florida. Four of the top five states with urgent-care centers, per the Urgent Care Association of America—Texas, New York, California, and Florida—are also among the top five states with CMBS exposure.

Nontraditional capital sources such as private equity and venture-capital funds have fueled much of the industry’s growth, having invested more than $3 billion into urgent-care clinics from 2010 to 2015, according to PitchBook. Investors find these clinics attractive for many reasons. They typically have strong corporate guarantees and familiar tenants, and most medical leases feature rent escalations. Many larger private equity firms see opportunities for growth by capitalizing on the increased demand that demographic changes are bringing to retail health, according to CohnReznick LLP, an accounting, tax, and advisory firm.

Private equity firms aren’t the only ones that see potential, as urgent-care center investment has gained traction among insurers and hospitals. Hospital chains including HCA Holdings, Inc. and Tenet Healthcare Corp. have bought urgent-care centers and are
developing their own, and UnitedHealth Group’s Optum unit acquired urgent-care franchise MedExpress, including its 141 facilities. In addition, hospitals and insurance companies view urgent-care centers as a way to contain costs by keeping people out of the hospital, preventing unnecessary admissions and emergency-room visits, according to Managed Care magazine.

Minimal regulatory hurdles and federal healthcare reform have also contributed to the growth of the urgent-care industry. Urgent-care operators are not required to register with the government or get accreditation by the Joint Commission, a nonprofit organization that accredits more than 20,000 healthcare organizations and programs in the United States. Government policy has implications for urgent-care centers, as consumers obtain insurance through the ACA. According to anecdotal evidence, urgent-care centers are seeing more insured patients because of the ACA. Any changes to the ACA could constrain urgent care’s growth, because insurance rolls look set to drop under proposed legislation. While the GOP-backed American Health Care Act recently passed the House, the Senate will likely change the terms of the bill if it passes anything at all, so significant uncertainty surrounds how urgent-care trends will be influenced by ACA-related changes.

Morningstar believes that expansion may slow because new delivery methods (such as telemedicine or in-home urgent care), worksite clinics, and the expansion of clinics within existing stores present competition for urgent-care centers and may damp future expansion. For instance, CVS Health Corp. nearly doubled its retail healthcare footprint, with 1,125 clinics operating under the MinuteClinic® name as of March 31, 2017, up from approximately 640 locations at the end of 2012.

The Mixing of Medical and Retail
In the past, landlords of large shopping centers or strip malls would have dismissed medical tenants in favor of highly desired retail tenants. But in the wake of downsizing among retailers, owners of shopping and mixed-use centers, looking for entertainment and other services to fill vacant spaces, have embraced urgent care as a strategy that can revitalize a center. Landlords are leveraging medical and urgent care to bring back traffic to retail spaces and fill vacancies left by struggling shops, restaurants, and others. For example, Stat Health is preparing to open an urgent-care clinic at a former Pizza Hut site (which is not in CMBS) in Riverhead, New York, according to riverheadlocal.com.

Urgent-care operators have noted the benefits of retail space, including proximity to where patients work and shop, lower occupancy costs compared with traditional medical office buildings, and favorable lease terms and rents, particularly in weak retail markets. Well-located retail properties also offer a steady flow of foot traffic and visibility compared with facilities that are tucked away in a medical office building.
The growth of urgent-care facilities in retail centers could be part of a trend where other office-using tenants move into buildings with lower rents. For instance, a range of businesses, such as tax preparers, real estate brokers, or other small-office tenants, could fill shopping-center vacancies. We believe that an expanded tenant mix will drive traffic at these centers and generate more revenue through improved occupancy. Moreover, about 96% of urgent-care centers had more patient visits in 2015 compared with the year-earlier period, according to the Urgent Care Association of America.

Landlords and investors have repurposed and backfilled vacant bank branches with urgent-care tenants. There are plenty of vacant bank branches available, as the 10 banks that eliminated the largest numbers of branches between 2010 and June 2015 closed more than 3,000 branches, according to Bankrate.com, which cited FDIC data. Banks built in retail districts offer visibility, high-traffic locations, and ample parking, which appeal to medical tenants.

**Limitations for Converting Empty Big-Box Spaces**

While shopping centers and strip malls are prime locations for urgent-care centers, we believe big-box spaces and mall anchor stores are less likely to be backfilled with such tenants, because the spaces are less accessible or convenient. With urgent-care spaces in CMBS averaging approximately 5,400 square feet, mall or big-box spaces are more viable options for hospitals and other healthcare systems. For example, *Daily Freeman News* reported that Health Quest, a Hudson Valley-based consortium of hospitals and healthcare providers, wants to take over the former Macy’s space at the Hudson Valley Mall in Kingston, New York, which backed a loan that was liquidated out of CFCRE 2011-C1.

This is just one example of a larger clinic absorbing a large chunk of retail space. While other medical providers may consider spaces of up to 50,000 square feet, anything larger, such as an anchor space, may be a less likely option. “You occasionally hear about a big health care system taking 100,000 or 200,000 sq. ft. in a mall or shopping centers, but those instances are rare,” Garth Hogan, executive managing director of NGKF Global Healthcare Services, told *National Real Estate Investor*.

Compared with the larger mall- or power-center-based medical clinics, urgent-care centers occupy an average of just 8.9% of the leasable area of properties backing CMBS loans. Consequently, the loss of a tenant would be a small dent to most properties’ net cash flow because of these centers’ footprint.
Obstacles to Growth

While we expect more urgent-care centers in former retail locations, obstacles including overbuilding, winning over consumer confidence, and the rise of clinics in work sites and stores could temper growth. Urgent-care centers will continue to benefit from demographic factors such as greater demand for primary-care services amid a shortage of such physicians because of the rise in medical specialization. However, individual market expansion will depend on competition and patient demographics.

Although urgent-care centers don’t face the same kinds of competition that traditional small retailers face like big-box stores and e-commerce, competition for customers will intensify as telemedicine and the number of people who need healthcare grow. Insurance companies and the ACA control the amount of money providers make from each customer, forcing a need for volume drivers, increasing demand for strategic locations and forcing providers to balance belt tightening with expansion, putting less profitable locations at risk of failure.

Earning higher marks from consumers is also a challenge. In a National Public Radio poll of urgent-care patients, 25% described their care as "fair" or "poor." While the industry works at improving the quality of care provided in more casual settings, we expect the explosion of clinics within existing stores to present competition for services. Additionally, employers are opening worksite clinics for employees and their dependents to not only save healthcare dollars but to better manage chronic medical conditions that could lead to higher cost of care.

While the expansion of clinics in former retail spaces will continue, as long as it’s economical and attracts new patients, the effect on CMBS should be minimal because these tenants make up a small portion of most collateral properties’ gross leasable area. We’ve identified 104 properties in the CMBS universe that include an urgent-care-related tenant among the five largest tenants. Of these, there are only 11 properties, representing just 6.0% of urgent-care exposure by balance, where the tenant occupies more than 20% of the gross leasable area. As such, a downturn in the sector and the potential loss of tenants as a result would not increase the default risk for most loans.
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