2024 Healthcare Real Estate Outlook

Five trends driving the healthcare industry forward

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Research

United States

2024

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Executive summary

5 big things to expect in healthcare in 2024

1 Focus on organizational fitness

Health systems and providers will look to real estate to reduce costs and improve revenue. By reevaluating and revamping staffing and processes, implementing technology and partnering with or hiring experts, healthcare organizations will leverage both the organization and assets of real estate to better enable their core mission.

2 Rising wages + tight talent pool

While wage growth has slowed, structural imbalances in the healthcare talent pipeline remain. To compete in a tight labor market, top healthcare systems and providers will examine how real estate can drive efficiency and help with talent retention.

3 Consolidation + integration

Consolidation of health systems and vertical integration will continue, especially as financial distress continues to challenge providers. As mergers take place, health systems must take care in both the pre- and post-merger phases to ensure full integration and optimization of real estate locations.

4 Disruptions accelerate consumer-focused care

New entrants to the healthcare space, including technology companies and private equity, are accelerating the shift from inpatient to outpatient care. While healthcare systems are often slower to innovate, increased focus on overall patient health and better integration of technology will lead to further “retailization” and “amenitization” of care.

5 Taking artificial intelligence from theory to practice

Leading health systems and providers will use AI as a partner for providing care, including the optimization of facilities to improve efficiency and quality. Property owners will implement AI to make real-time facilities adjustments and improve maintenance efficiency. While it comes with an upfront cost, investment in AI now will create efficiencies later.

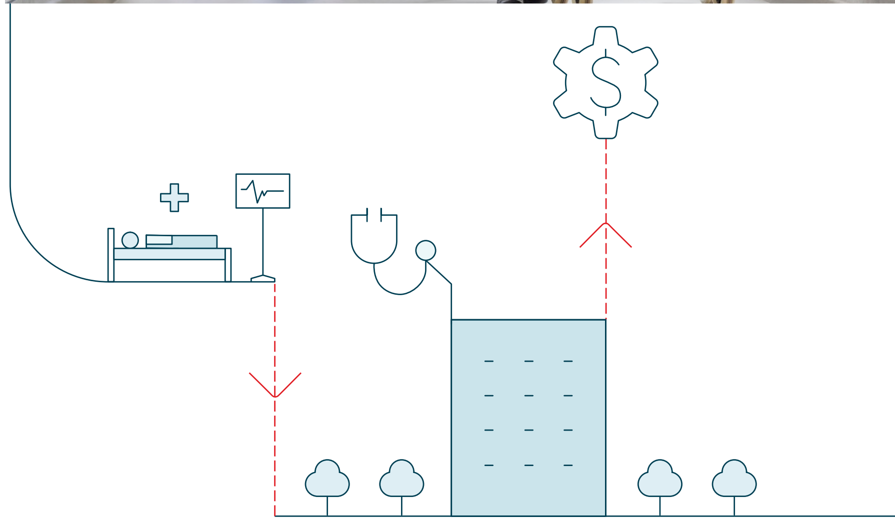
01

Focus on organizational fitness

Tight margins and a challenging capital environment will continue in 2024, causing health systems and care providers to look to their real estate to reduce costs and improve revenue. Increasingly, that will include scrutinizing their internal real estate function and organization in addition to the more traditional emphasis on the operating costs of the owned and leased properties.

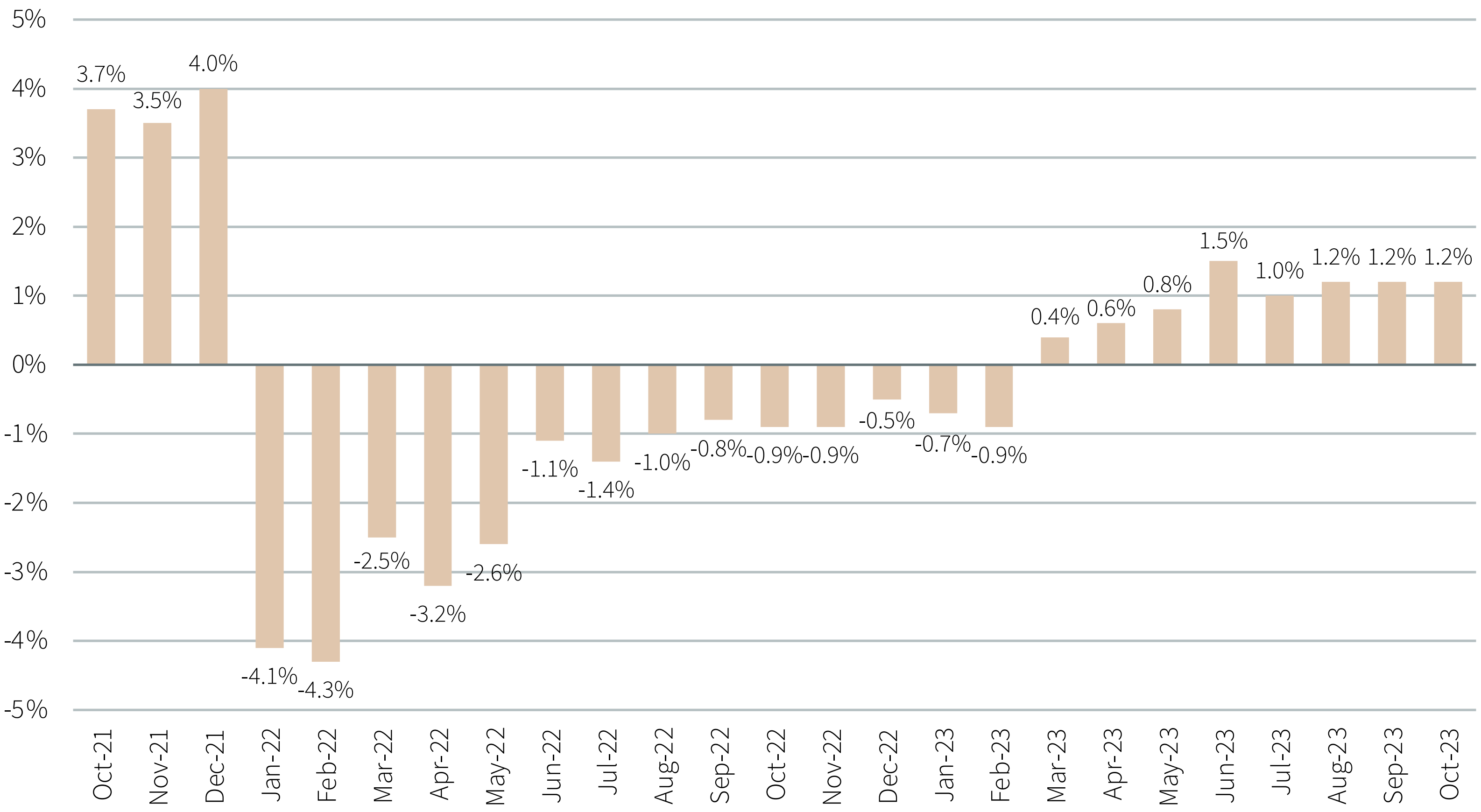
Upgrading teams to support the mission

Health systems and providers will upgrade their real estate departments by reevaluating and revamping their staffing and processes, including instituting value or performance metrics. Additionally, they will adopt enabling technology and leverage the expertise and capabilities of external service partners. The goal will be to harness the full value of both the real estate and facilities department and the operating performance of the locations they are responsible for procuring and maintaining. Doing so will allow the organization to be more strategic about their real estate and make changes that improve operations and enable the organization's mission and business objectives in the face of challenging economic conditions.



Positive margins return, but still well below 2021 levels

U.S. hospital CYTD operating margin index



Source: Kaufman Hall

Thinning margins

The healthcare sector has endured a difficult few years, with health systems and providers facing tight margins. Median hospital margins were negative for over a year between January 2022 and February 2023, according to Kaufman Hall, and half of hospitals and health systems are still operating at a loss despite deceleration in wage growth and inflation. The Centers for Medicare & Medicaid Services (CMS) conversion factor (the amount paid per relative value unit) will decrease by 3.4% from 2023 to 2024, although reimbursement for some primary care and mental health treatment will increase.

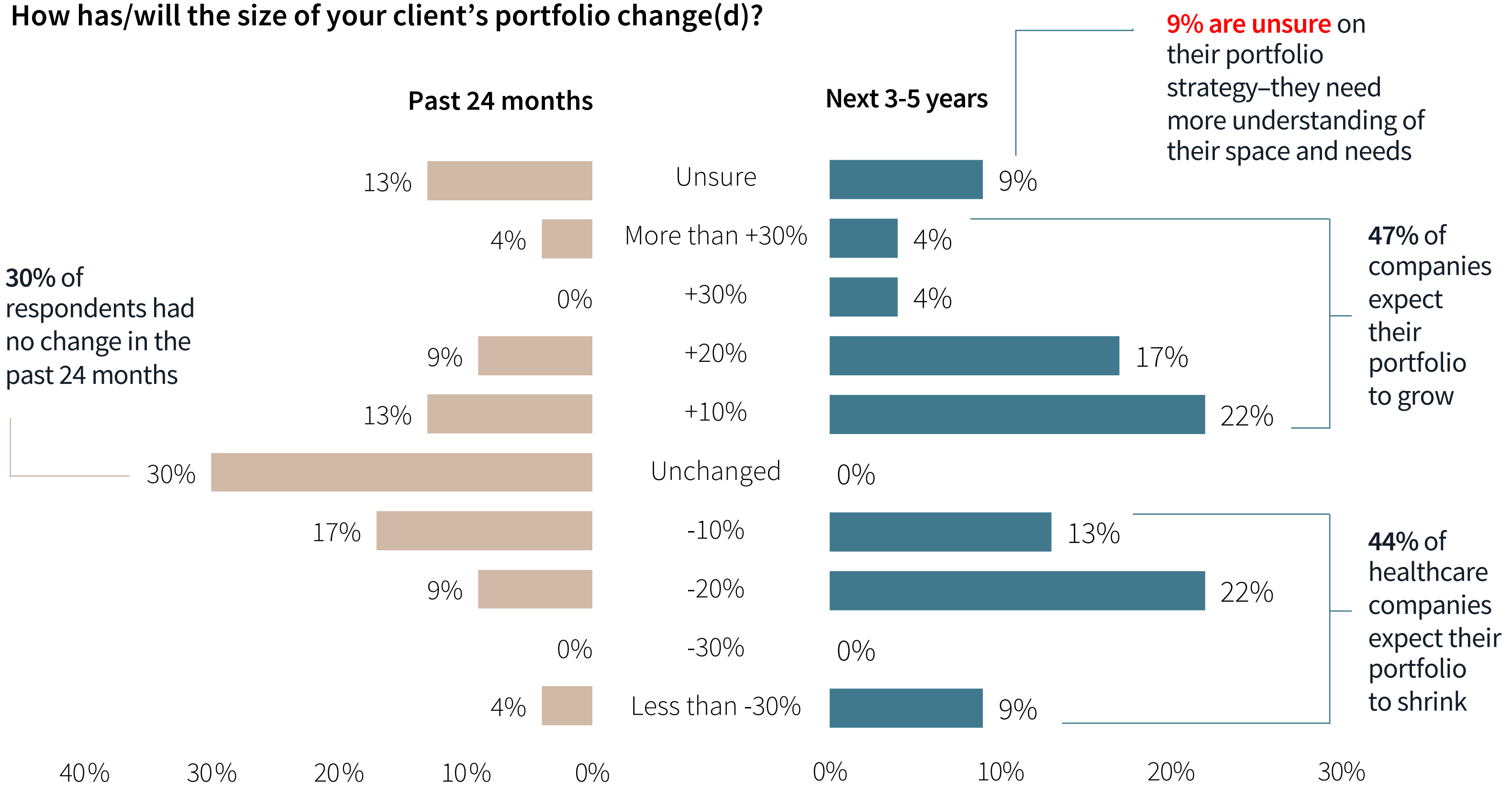
Optimizing portfolios to cut costs

In a July 2023 survey, JLL healthcare and life sciences clients ranked reducing operating costs as their top priority. Restoring healthy margins would allow providers to focus funds on growth, innovation and other changes that are necessary to enable an affordable and sustainable model. For 2024, though, the focus will largely be on optimization and cost reduction, with transformation to reemerge at some point in the future.

Real estate costs make up a significant chunk of a health system's budget at 8%—12% of total spend according to Modern Healthcare. Adjusting real estate portfolios and optimizing property and facilities management and maintenance can free up additional dollars to be redeployed for patient care and related mission priorities. This is especially true in a season of change, and portfolio change is a near certainty for healthcare providers in the next 3-5 years. In the JLL survey, almost an equal number said their portfolio would grow (47%) as would shrink (44%) in this time frame.

A significant minority of healthcare companies made no changes to the size of their portfolio in the last 24 months, but 91% anticipate change in the next 3-5 years

How has/will the size of your client's portfolio change(d)?



Source: JLL Work Dynamics Survey, August 2023

Reducing occupancy costs and unlocking capital

Financial pressures from wage growth and inflation have been compounded by rising interest rates that are not expected to decline significantly in 2024. Uncertainty over interest rates has affected pricing and yields for new development, making construction financing more difficult and causing a slowdown in construction.

Health systems and providers will need expert real estate strategy as they position themselves to serve growing populations and expand rising specialties such as behavioral health and long-term acute care. Health systems and providers currently own more than half of existing healthcare real estate, according to Revista. Those tight on cash may consider unlocking and redeploying capital trapped in their real estate through monetization strategies such as a sale-leaseback to an experienced medical property investor or a straight disposition sale to divest underutilized assets. However, they should carefully consider the implications for all entities within their organization that occupy or utilize the asset, including the increased operating expense for space that is leased back by system-owned physician groups.

Stable occupancy and growing rents will allow owners of healthcare real estate to address the fitness of these assets, while occupiers will carefully evaluate leases and owned assets, ensuring they are in line with overall strategy. Higher levels of re-leasing are expected in the next few years, according to real estate research firm Greenstreet. MOB rents, which have historically increased at about 3% per year, will see faster growth, in the 5% range, upon renewal in 2024. Rising rents will allow owners to improve the fitness of their facilities by addressing deferred maintenance. Hospital system owners who lease part of their real estate will also move to NNN rents to shift more costs onto tenants.

Location strategy to drive revenue

Real estate, through identifying the right locations, can drive revenue growth for a health system or provider, bringing the topline up. In the 2023 JLL Healthcare Patient Consumer Survey, location/proximity was ranked as the second-highest factor for a healthcare decision behind “accepts my insurance.” Patients traveled the shortest time for primary, urgent and emergency care and were willing to travel longer for more specialist care. By strategically placing locations using demographic and consumer analysis, health systems can drive revenue by growing patient populations.

02

Rising wages + tight talent pool

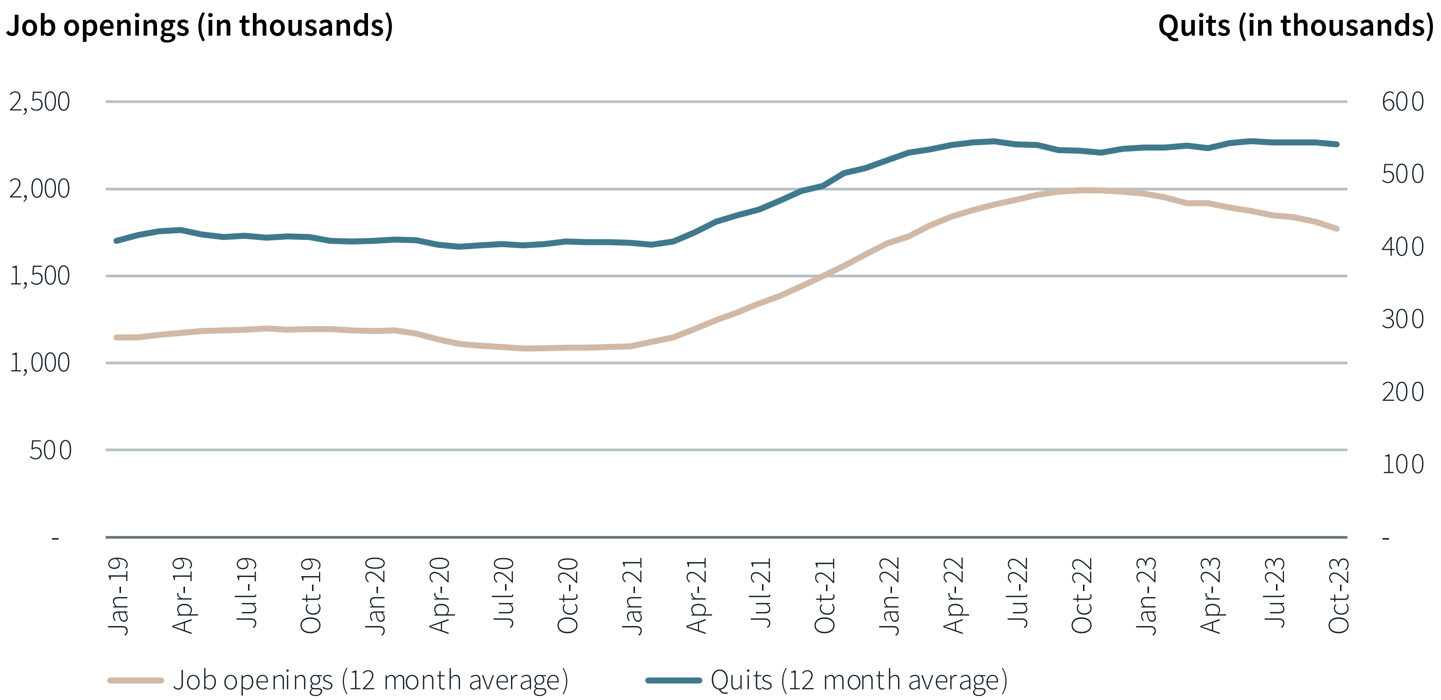
Costs are rising for staff wages, and health systems are responding by raising prices in benefits negotiations to pass this on to payors. While wage pressures are easing from record-high rates, including contract labor during the pandemic, the structural shortage of healthcare workers will continue to be a challenge in 2024. Difficulty in retaining and recruiting medical, care and facilities staff may affect patient care and prevent health systems from adding new services and facilities.

Healthcare workforce gap

Healthcare and social assistance jobs saw a dramatic increase in resignations and job postings starting in 2021 as the pandemic compounded an already demanding occupation. While job openings are starting to decline slightly, the quit rate has held steady, with about 2.5% of the healthcare workforce leaving their positions every month. While some quit for another healthcare position, of those who resigned between April 2020 and April 2022, 54% went to another industry or left the workforce, according to a McKinsey study. Total healthcare volume is expected to grow by 9.9% from 2022 to 2027, according to the Advisory Board, and healthcare and social assistance employment is projected to grow only 7.8% in the same period, according to Oxford Economics.

Unless significant changes are made, the deficit of healthcare workers will only worsen, which could cause delays in patient care, continued burnout among workers and slow the timeline to open new healthcare facilities.

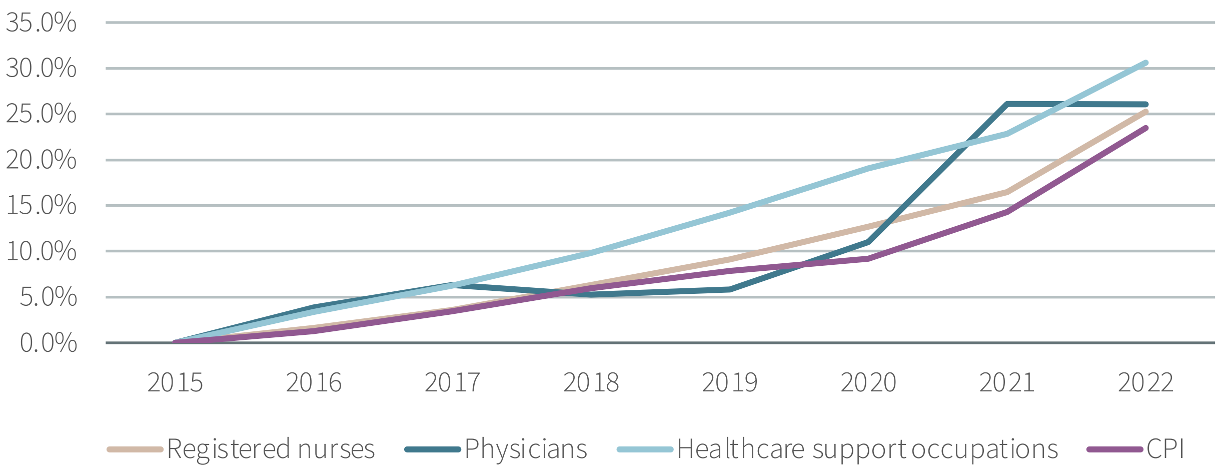
Healthcare and social assistance job openings & quits (rolling 12-month average)



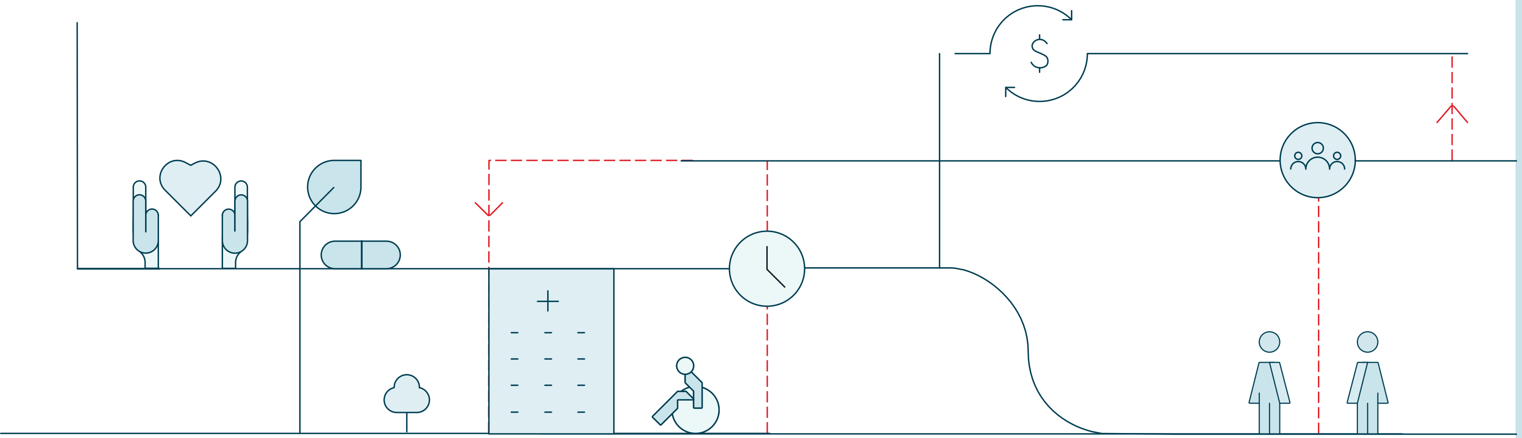
Source: U.S. Bureau of Labor Statistics, retrieved via FRED

Average annual wages for healthcare occupations

Percent change since 2015



Sources: Lightcast; U.S. Bureau of Labor Statistics, retrieved via FRED



Adjusting to higher wages

Wages for healthcare jobs have risen dramatically in the last few years, outpacing inflation and putting pressure on healthcare systems. Wages for healthcare support occupations, which compose about two-thirds of caregiving occupations, have risen the fastest, up 30% since 2015 with average hourly wages of $17.19, according to Lightcast data. Wage growth is expected to decelerate from 6.3% year-over-year growth in 2023 to 5.1% in 2024 and not return to sub-5% annual growth until 2026, according to predictions from Oxford Economics. Healthcare is essentially people taking care of people, so hospital systems and providers will have to adjust in other areas of their business to accommodate for sustained higher wage growth.

While not able to tackle all the challenges faced by healthcare systems, real estate can be part of the solution. Understanding how healthcare workers interact with their space through utilization tracking can help improve efficiency. Providing quality space, including spaces for rejuvenation during long shifts, can help reduce burnout. And although these changes come with an upfront cost, an employer needs to balance this against the cost of recruiting and retraining a new employee. The annual cost to retrain a bedside RN was $52,350, meaning the average hospital lost between $6.6 million and $10.5 million, according to a 2023 survey by staffing firm NSI.

03

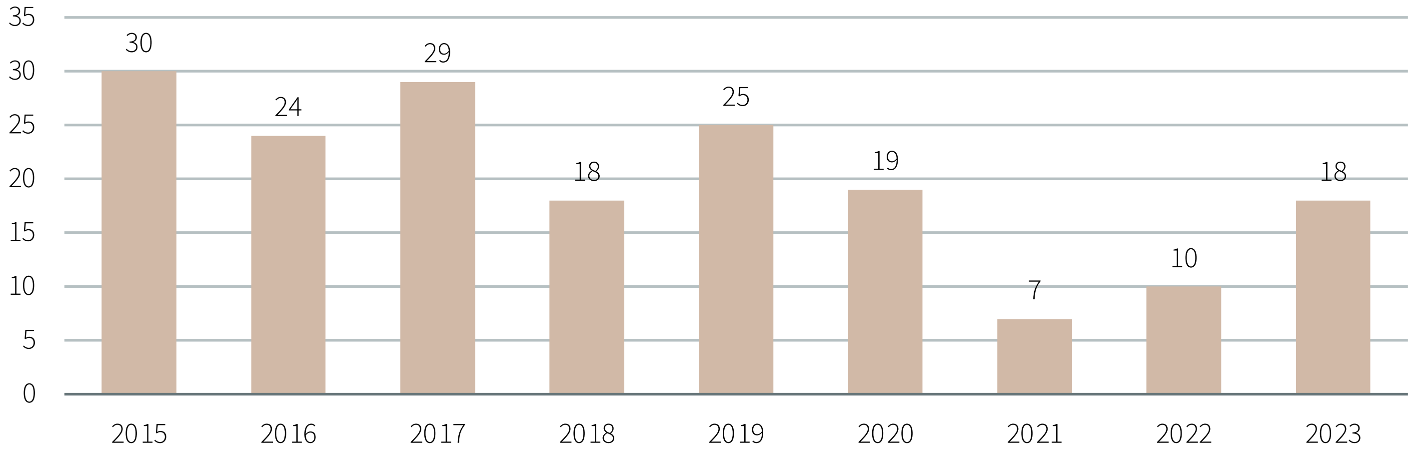
Consolidation + integration

The healthcare sector will continue to experience consolidation of independent hospitals, smaller systems and physician-owned practices under the umbrella of larger health systems. While held back by uncertain capital markets conditions, as rates stabilize, there will be a renewed interest in M&A in 2024. Mergers will be focused on adding components to their business, such as a hospital system expanding into freestanding imaging or retail-focused locations. The Federal Trade Commission is increasingly scrutinizing and blocking some healthcare mergers, attuned to concerns about rising costs of care and gaps in services.

Non-profits with better access to credit will lead the charge, especially academic or specialty hospitals that offer a quality, differentiated type of care. Academic and specialty hospitals are outperforming general acute-care hospitals with 70% and 53% inpatient occupancy, respectively, according to Kaufman Hall. Systems or providers that have a cash reserve now will be better positioned for the future. Those with a higher debt ratio or an upcoming refinance will be hurt by rising interest rates.

Hospital and health system transactions

Number of announced hospital and health system transactions by year



Source: Kaufman Hall

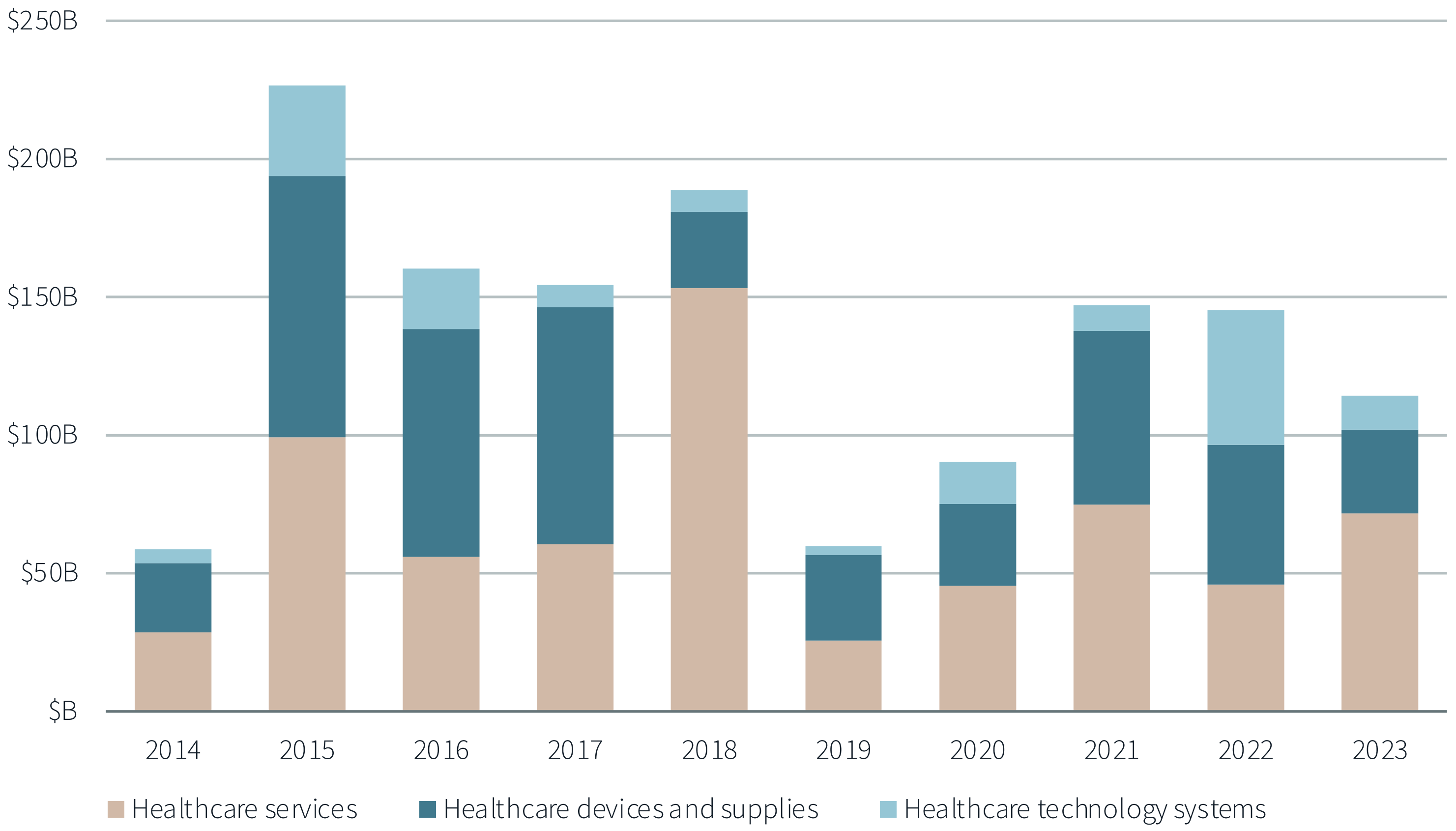
Vertical integration

Systems, payors and pharmacies are vertically integrating through mergers to better control costs and receive revenue from the same patients across the spectrum of care. Hospital systems are acquiring outpatient operators or primary care practices, enabling them to benefit from the shift from inpatient to outpatient care.

Vertical integration is not unique to health systems. UnitedHealthcare-owned Optum has been acquiring primary care practices and now employs or is affiliated with over 60,000 doctors. CVS also vertically integrated Medicare Advantage-focused primary care practice Oak Street Health in 2023, following prior acquisitions of Aetna in 2018 and pharmacy benefit manager Caremark in 2006.

Thinning margins and financial distress will continue to be a factor for health system M&A in 2024. Financial distress was a factor in 39% of the 18 transactions tracked by Kaufman Hall in their M&A Quarterly Activity Report in Q3 2023. In California, new seismic building codes mean a substantial looming investment for health systems—those without the capital will seek a financial partner or sale.

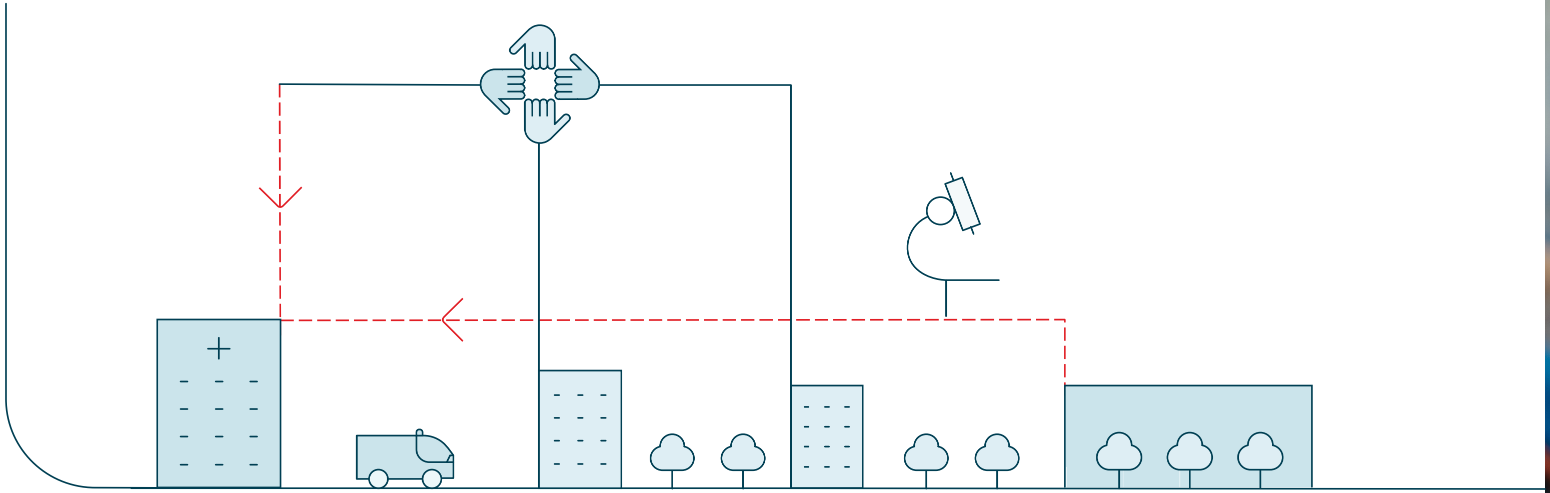
Healthcare mergers & acquisitions by segment



Source: Pitchbook, retrieved December 7, 2023

Merger optimization and integration

When mergers occur, health systems need to thoroughly conduct pre-merger facilities due diligence and address post-merger integration and optimization. Systems must harmonize the clinical or back-office role of each location, ensuring it contributes to the mission of care delivery for the newly-merged entity. Duplicated services resulting from the merger, underutilized locations and market gaps require careful analysis and strategies such as consolidation, disposition, reprogramming and relocation are needed to fully achieve the initial goals behind the merger decision. Top systems will need to organize teams with bandwidth and expertise and engage appropriate outside service partners to successfully achieve synergies.

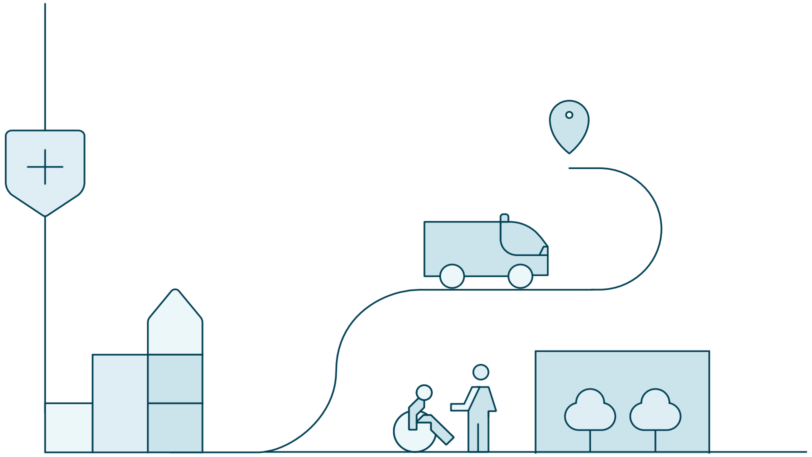


04

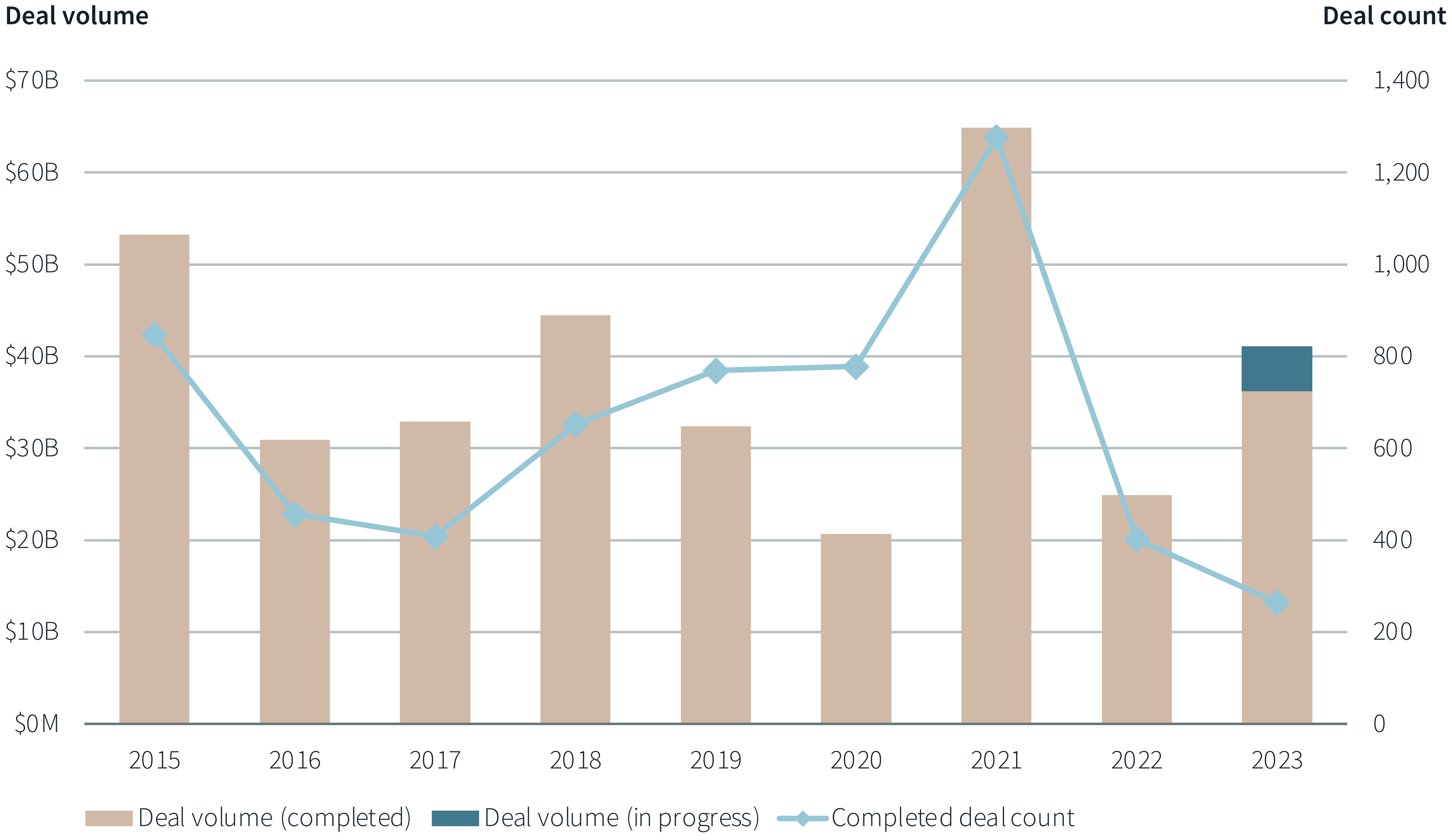
Disruptions accelerate consumer-focused care

The shift from inpatient to outpatient care will continue its decade-long progression, and new entrants will accelerate the disruption. Technology companies, retail stores, private equity and for-profit operators will lead the shift to look at patients in a more holistic way. Health systems will follow this trend through broadening care offerings in a consumer-focused location strategy.

Entrants from outside of the healthcare space will continue to be first-movers. Private equity investors are driving innovations in outpatient care, such as adult care facilities and remote patient monitoring. Technology companies are also entering the healthcare space, bringing more consumer-focused primary care and digital health innovation.



Investment in healthcare services and care



Source: Pitchbook, data retrieved December 7, 2023

Primary care

With the purchase of OneMedical, Amazon announced that it intended to "make it dramatically easier for customers to get what they need to stay healthy." The service is intended to use technology to make care easier and more convenient through an app, telemedicine and retail-like locations.

Investment into primary care is increasing, and companies outside of traditional healthcare systems will continue investing and innovating models of care in 2024. Over the last five years, UnitedHealthcare-owned Optum has vertically integrated into primary care, purchasing numerous providers such as the Kelsey-Seybold Clinic and LHC Group. Pharmacies also expanded into the space. CVS Health completed the acquisition of Oak Street Health in January 2023, expanding its primary care footprint by 169 locations. New entrants into the primary care space focused on convenience will force traditional providers to examine their own facilities and technology systems and become nimbler to compete in 2024. Investment will often take the form of unique partnerships, such as Mass General Brigham's partnership with Best Buy for hospital-at-home services.

Digital health

Building on personal health data, this and other digital health start-ups are disrupting how care is delivered. While funding in 2023 was challenging for digital health start-ups, according to Pitchbook, behavioral health and care navigation showed steady venture capital funding. In 2024, investment is likely to focus on more early-stage companies given high-interest-rate conditions.

Value-based care

Given the rise in analytics driven by digital health combined with rising fee-for-service costs, value-based care is closer to causing major changes in the delivery and price of care. Medicare Advantage (MA) plans receive a set fee from CMS per participant and keep the additional that they do not spend, incentivizing the payors to limit healthcare spending for each enrollee. MA plans focus on overall health of the participant and provide care coordination and additional perks such as dental care and health club memberships.

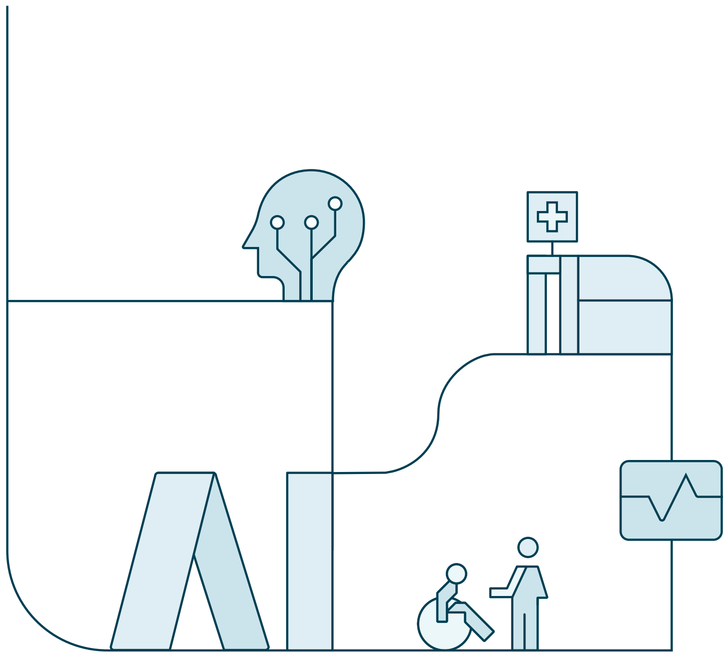
Value-based care may also come to employer-sponsored health plans. As employers face rising variable annual costs in fee-for-service models, they are looking for a way to offer a higher quality of care at a lower cost. Using data and analytics, health plans can increase payments to providers with better outcomes, not just paying based on the number of services provided. Digital tools can also help patients navigate to higher-quality providers and find the right level of care. Finding the right incentives and structure for value-based care is difficult, but such care models will make progress toward disrupting the healthcare landscape in the next year.

Following the consumer-focused model, health systems and providers will further the "retailization" of healthcare, locating close to the consumer, providing multiple services in one location and tying in other health-focused amenities. The health landscape is shifting, and as innovations such as digital health and analytics and new classes of drugs allow better overall health, health systems and providers with this focus will stand to benefit.

05

Taking artificial intelligence from theory to practice

In 2023, healthcare recognized the potential for AI to affect network planning, operations, cost management and patient care. In 2024, health systems, providers and adjacent healthcare services will increasingly use AI to assist with decision making to improve efficiency and quality in care delivery and in facilities management and real estate planning.



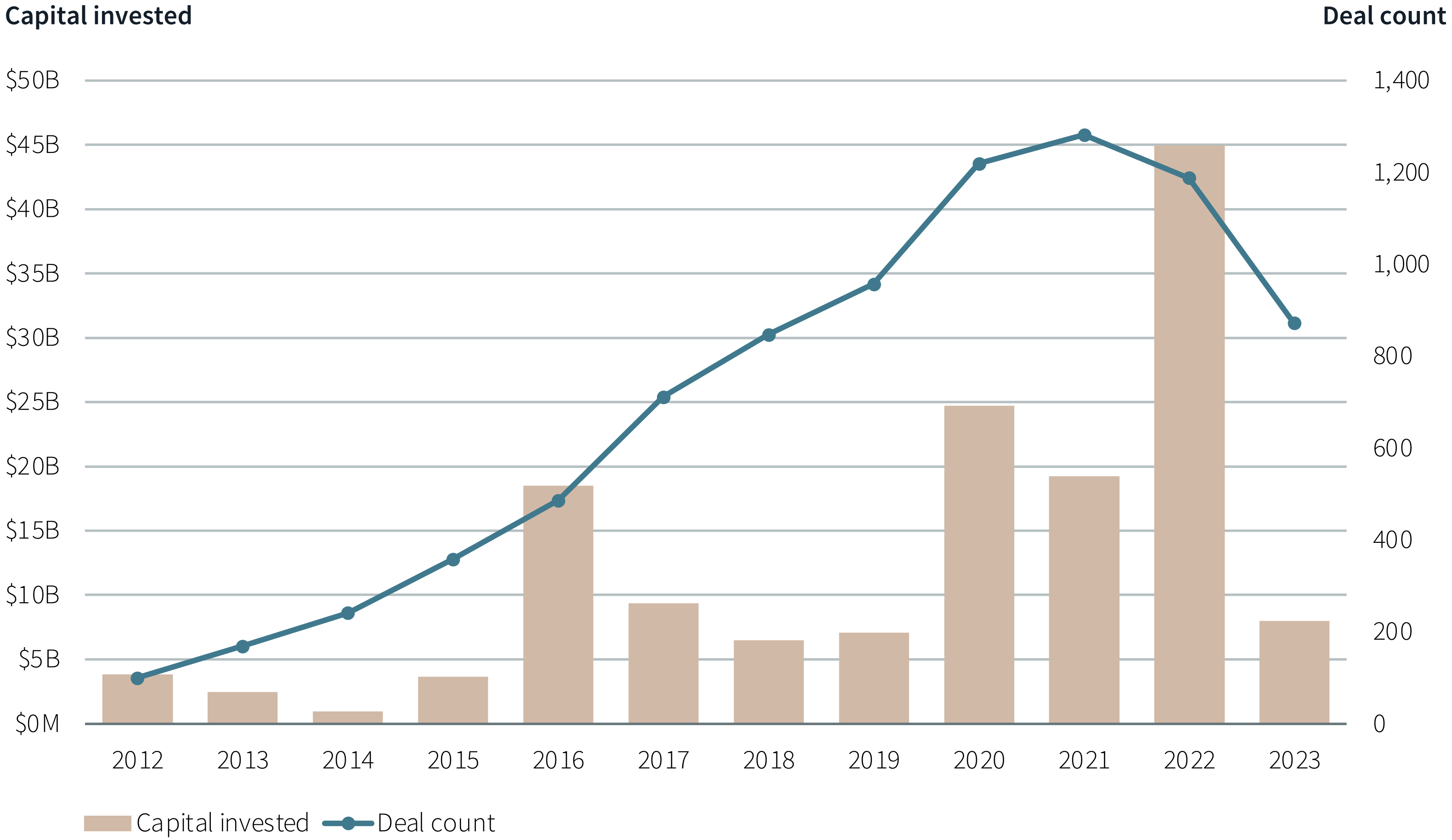
Potential uses for AI in patient care

- Care navigation and managing chronic conditions
- Help predict and diagnose health conditions
- Remote patient monitoring
- Analyzing surgeries for efficiency

Potential uses for AI in healthcare facilities

- Optimizing facility utilization and planning
- Predictive maintenance
- Improving energy efficiency
- Analyzing facility security

Investment in healthcare AI in the U.S.



Source: Pitchbook, retrieved December 13, 2023

How AI can impact patient care

AI is a partner, freeing up clinicians and administrators to focus on the parts of their jobs that only humans can do. With the labor shortage in the healthcare sector and increasing demand for care on the horizon because of rapid growth in the 75+ population, AI can help stem these shortfalls by doing more with the same staff. AI has already been integrated into some patient-facing care navigation platforms, diagnostics and remote patient monitoring. Integrating clinicians and facilities staff into the development and implementation of AI will allow for the greatest buy-in and utilization. However, adoption of AI in healthcare is going to be cautious and slower than in other sectors, given safety and regulatory concerns.

Three ways AI is impacting patient care

Care navigation

Through AI-driven care navigation platforms, health systems can direct patients to the right care, helping them understand their options and directing them to the right level of care, potentially lessening the burden on emergency rooms. AI care-navigation platforms can also integrate data from numerous patient portals and electronic records, allowing physicians and patients a more complete perspective on their health.

Diagnostics

Diagnostics based on integrated patient data can help call a physician's attention to hard-to-detect diseases, not replacing an expert physician's opinion but potentially streamlining the diagnostic process and limiting unnecessary medical tests. AI can speed up interpretation of medical imaging, reducing the time needed for expert analysis, potentially increasing the number of patients that could be seen in an imaging center.

Remote patient monitoring

Remote patient monitoring (RPM) powered by AI can help with nursing staffing shortages by allowing staff to safely monitor the health of those with chronic conditions at home without having to physically come into an office, allowing them to treat more patients. Rather than reducing the need for in-person care, RPM supplements it, allowing patients to get earlier intervention when there is an issue.

How AI can impact real estate and facilities

AI can also assist with optimizing facilities to improve patient care. Health systems can apply AI to understand how and where a provider's time is spent and interpret this to better plan facility usage. Currently AI portfolio optimization technologies are used for office space, such as VergeSense, which uses ChatGPT to answer how to best optimize spaces and portfolios. AI can also improve facilities management efficiency, such as Hank, which allows for real-time adjustments to HVAC systems, and Infogrid, which uses sensors to manage performance, optimize cleanliness and maintenance and monitor energy use and emissions. In 2024, leading healthcare systems will implement AI to improve healthcare facilities planning and efficiency, knowing that the upfront investment will pay off.

Looking ahead

In 2024, new entrants and technology will disrupt the healthcare industry, and rising costs and slimming margins will continue to put pressure on health system and providers. Macroeconomic forecasts predict inflation will slow, but prices and interest rates are expected to remain high. For healthcare systems, this means margins are likely to improve but will remain below the healthy 3% necessary for long-term stability, according to Kaufman Hall.

Barring any shocks, which are by nature unpredictable, this year will be a time to adjust strategically. Healthcare systems, providers and investors who closely examine their real estate team and strategy to optimize costs and drive new revenue will be better positioned to compete in this ever-changing industry.

Ready to reduce costs, mitigate risks and improve the patient experience?

Click here to contact one of our healthcare subject matter experts.

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