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Medical real estate provides rare opportunity for builders

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Duke Realty Corp. has built millions of square feet of industrial and office space in Dallas-Fort Worth.

But the developer's newest project isn't another warehouse or corporate office suite.

Duke just started construction on a \$154 million Baylor Health Care System cancer center east of downtown Dallas that is one of the biggest medical projects in the state. It's one of a series of medical complexes Duke is building in the area.

The commercial builder – and others like it – has found that medical projects are among the few remaining opportunities in the current economy.

"The medical building field has become pistol hot," said Jeff Turner, Duke's executive vice president in Dallas. "The office building business is terribly slow right now – almost nonexistent. And industrial building has slowed down.

"The medical sector is a brighter light."

No wonder then, that in the worst construction slowdown in 20 years, developers are lured to the one industry still seeing substantial expansion.

"We think it will be a large part of our new business over the next several years," said Toby Grove, president of developer KDC.

The Dallas builder announced a major expansion of its medical division last month.

"We don't look at this as a temporary fix," Grove said. "We think it will be a large part of our new business over the next several years."

KDC – formerly Koll Development – has proposed a 12-story medical office building on Walnut Hill Lane across from Presbyterian Hospital. The developer is scouting for other medical building projects in Texas, California, Colorado and North Carolina.

KDC also plans to invest in existing medical and hospital buildings.

"Any industry today is trying to find ways to raise cost-effective capital," Grove said. "Selling real estate assets is one way of doing that."

More complex

Unlike standard-issue office and warehouse projects, medical real estate takes more time and effort to build and acquire, developers say.

"When you are talking about a building that may be 50 percent more expensive on a square-foot basis, you really have to understand it," Grove said. "Figuring out how to capitalize those may prevent some people from jumping into the business."

Maybe, but Duke Realty's vice president John Huff said the medical development business is already "getting pretty crowded."

Indianapolis-based Duke has a handful of medical projects under way in North Texas. It just finished an 83,000-square-foot administrative building at Baylor's East Dallas Campus. And next to Baylor's Plano hospital, Duke built a 140,000-square-foot medical office building.

The developer also is working on a 57,000-square-foot specialty hospital in Arlington north of Interstate 30 that is a partnership between Baylor and United Surgical Partners.

In Fort Worth, Duke is building a 210,000-square-foot outpatient clinic for the Veterans Administration.

"Our goal is to go into these major metropolitan areas and find one of the big hospital players that we can partner with," Huff said.

That's key to the success of such developments, said Jack Eimer, who heads the Dallas regional office of real estate firm Transwestern.

"These projects are proving to have a lower degree of success without the sponsorship or support of a hospital," Eimer said. "It's a little disconcerting if we are going to see a significant ramp-up of that kind of product."

Mixed feelings

Eimer says the credit crunch makes it tough to finance even medical developments. Still, he understands why so many developers are embracing the sector.

"If what you have been doing full time for the last several years is development, you have a whole lot of staff and overhead you have to direct into another area," Eimer said.

Companies that have specialized in medical projects for years have mixed feelings about the rush to their business.

"Most recently, we have seen many newcomers to the space as a result of the distress being experienced in some of the other property sectors," said **Chris Godfrey, director of finance for Dallas-based Cirrus Group**, which has been in the business for more than a dozen years.

But Godfrey knows the appeal of the medical building business.

"The fact is that health care real estate assets are typically well-positioned to weather economic downturns due to the recession-resistant, noncyclical nature of the demand for health care services," he

said.

"The demand drivers for health care properties are expected to remain very favorable over the next decade."