ADAPTIVE REUSE OF HEALTH CARE FACILITIES: UNDERSTANDING THE BASICS

For nearly 30 years, Palm Valley Cinema provided the community of Goodyear, Arizona with the biggest, newest Hollywood movie releases, from Saving Private Ryan to Rogue One: A Star Wars Story, until it closed in 2016. However, new plans for the cinema will be focused on saving patients rather than providing a source of entertainment. The 50,000 square foot space will be converted into a medical facility for the Abrazo Community Health Network that will provide outpatient services including imaging, multi-specialty care, internal medicine, pain management, wound care and physical therapy in the local service area. This transformation from movie theater to medical clinic illustrates a growing trend in health care real estate: adaptive reuse.

WHAT IS ADAPTIVE REUSE?
Adaptive reuse describes the process of taking an existing building and repurposing it to serve a function other than for which it was originally built. From projects as large as Ford Motor Company’s plans to convert the historic Michigan Central Station in Detroit into a tech campus focused on self-driving cars, to smaller projects like a bank in Waukegan, Illinois that was converted to an ambulatory care center, adaptive reuse takes many shapes and serves many purposes, including expanding health care services within a community. The Certified Commercial Investment Member Institute (“CCIM”) predicts that adaptive reuse projects will constitute 4 percent of all commercial real estate projects in the United States over the next five years.

WHAT DRIVES ADAPTIVE REUSE?
1. **Cost Savings** — CCIM estimates that adaptive reuse projects can result in cost savings of 15 to 20 percent when compared to demolishing an existing structure and rebuilding a new structure.
2. **Speed to Market** — Adaptive reuse projects are generally less time-consuming to complete when compared to the time needed to demolish and build a space from scratch.
3. **Fewer Greenfield Opportunities** — With increased commercial development over the past few decades, there are fewer "greenfield" or undeveloped sites for new development, especially in space-constrained urban areas.
4. **Availability of Vacant Structures** — In many urban areas, there are higher quantities of outdated facilities available for repurposing. Adaptive reuse puts vacant property to work, removes blight to the neighborhood and increases the city’s tax basis.
5. **Economic Incentives** — Communities desiring to preserve landmarks or historical buildings in their areas may be willing to offer grants, property tax abatements, tax credits and other incentives to make adaptive reuse projects financially feasible for a developer.
6. **Environmental Benefits** — According to the United States Environmental Protection Agency, sources of building-related construction and demolition debris account for approximately 48 percent of the waste stream every year. Reusing rather than demolishing existing buildings reduces the amount of resources required, puts less waste in landfills and consumes less energy than demolishing buildings.

WHAT CHALLENGES ARE ASSOCIATED WITH ADAPTIVE REUSE?
1. **Data Collection and Reporting** — The commercial real estate industry currently lacks qualitative metrics for assessing the financial success and long-term effects of adaptive reuse projects.
2. **Regulatory Hurdles** — Adaptive reuse projects by their nature require the owner to secure a number of regulatory approvals, including planning and zoning approvals, building permits and environmental approvals. The process for securing all necessary approvals can be expensive and time consuming.
3. **Awareness and Acceptance** — Institutional investors have generally ignored adaptive reuse projects because of the risks associated with such projects. Similarly, lenders appear to be reluctant to offer loans for adaptive reuse projects due to the dependence on local market knowledge and the absence of recognized market data for underwriting.

QUESTIONS FOR HEALTH CARE ENTITIES TO CONSIDER
Although adaptive reuse may be a growing trend in the commercial real estate industry, such projects may not be available or beneficial for
all health care entities. Accordingly, health care entities should carefully consider the following questions in determining whether adaptive reuse is a viable alternative to traditional development projects.

1. **Existing Assets** — Does the entity have any vacant, currently unproductive assets, such as an old hospital or medical clinic, that could be sold to a developer to repurpose or renovate? For example, could a currently vacant hospital be sold to a developer to convert into apartments. Especially in urban markets where space is limited, even dated structures could be a valuable asset to prospective developers.

2. **Location** — Is the health care facility located in an urban area? Adaptive reuse projects are predominantly located in dense, urban areas, as most facilities are turned into apartment buildings or mixed residential/commercial facilities. Accordingly, these projects may not be viable in rural areas with lesser housing needs.

3. **Tax Credits** — Are tax credits or other incentives available where the proposed adaptive reuse project is located? Many developers depend on these incentives to fund these projects, so without public, monetary support for the project, developers may be unable or unwilling to, for example, agree to purchase an old hospital and repurpose it into a hotel.

If you have any questions or would like additional information about health care real estate matters, please contact:

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