# Recession Resistant Real Estate


Rance Sanders

Real estate and health care might sound like risk-laden market segments these days, but Birmingham-based Sanders Trust has found a vein that runs across the two, yielding recession-resistant returns.

By Chris McFadyen

Rance Sanders is president and CEO of The Sanders Trust, a privately owned real estate investment trust that specializes in the health care sector — primarily physician office buildings adjacent to big city hospitals. The health care segment within which this Birmingham-based company operates offers insight into both the changeable health care market and the depressed real estate sector. Combine the two with a view to undervalued assets and you can yield a Warren Buffet-style premium, Sanders says.

Since its beginning in 1989, The Sanders Trust and its predecessor Starr Sanders Properties have developed or acquired 41 medical properties in 14 states, totaling almost $500 million in value. It's current property portfolio totals $175 million. Bart Starr, the Hall of Fame quarterback, has been a partner in the company since 1989, when Starr served as chairman. He is now vice chairman.

**The macro commercial real estate business has suffered a downturn in the economy, and the cost of funds to borrow is considerably higher**. That's the background for the large commercial, retail and industrial real estate markets. Ours is a sub-sector of the commercial market — health care real estate. It is considerably less vulnerable to the cyclical nature of commercial real estate. For on-campus medical office buildings — where the average tenant stays 11 to 14 years — the occupancies are considerably above 90 percent. In the health care sector, with the aging population, the demand is for more technology and more doctors.

**By and large, the economy of today has little effect on the health of our business.** It has a limited effect on the health care industry as a whole. When people lose their jobs, they lose their insurance and when they are sick they are cared for through Medicaid or cared for at a not-for-profit hospital. As a result, the reimbursements have diminished over the last two years, and the margins have diminished, as well. That said, there is considerable demand among hospital systems in our sector: the physicians occupying space that have to be located next to a hospital, specialist doctors. And their occupancy rates are high, although we are limited with regard to the rental rates we can impose.

**Public health care real estate investment trusts, by and large, have continued to do well.** Most have increased dividends on a regular basis. The level of growth has stabilized, flattened out. Many have gone back to the market, anticipating buying properties at better values.

**We have invested $76 million in seven properties in the last 20 months**. For us, that's a pretty good pace. Definitely the values are better than two or three years ago, when the market was peaking. We sold a handful of properties at the peak and took the proceeds from those sales and redeployed them over the last several months, at values of 8 percent or the mid-8s in terms of our return. Primarily our properties are in the Eastern and Central time zones. We go as far west as Kansas, and north to south from Michigan to Florida. We like to be able to fly to see our property in a day. Our sweet spot is $10 million to $15 million per property.

**Our core property is a class-A, on-campus medical office building connected to a hospital, with the hospital one of the top systems in its market, a market share of number one or two.** It's critical for us to understand the hospital and its strategy and how the building fits into that strategy. We are stewards for the hospital CEO's relationship with his doctors. He puts a great deal of trust in us, and we subordinate our interest to his relationship with the doctors. These are not commodity assets. They are truly strategic, and that's why the occupancy is so high, in contrast to a commercial office building in the suburbs.

**We're the front line of physician recruitment.** Typically, the CEO calls

our asset manager and says, "Will you call on Dr. Smith? We really want him in the building." He's more likely to come to the hospital because of the CEO and their ancillary services and not us. But we make it easy for him to get into the building, and we handhold.

**With the uncertainty in health care, young doctors are less entrepreneurial, have less of an interest in taking on risk.** They look for the security of the hospitals and focusing on the nuts and bolts of their practice.

**The trend to third-party management began in the mid to late 90s.** Hospitals are so capital-intensive, and federal statutes restrict the flexibility that hospitals have, with STARK laws: They can't give space to doctors to recruit doctors to their campus. That's considered a de facto kickback. Restrictions create a buffer between the management and the doctor. And third-party ownership gives hospitals a way to improve their balance sheet, so they can borrow money cheaper. And they're no longer in the real estate business, but in the business of providing health care to the community.

**We have been approached many times to go public, but we have no interest in that.** We use our own money, and life is a lot simpler. We are funded internally, by myself, my father and Bart Starr. Bart is a significant participant in what we do. He has been vitally involved since 1989. He is now vice chairman and not as active in the business as in the past. But he has been very instrumental in calling on hospital CEOs.

**I was a student of Warren Buffett's theories of investment, and in the late '80s, I looked at the underlying value there was in how the market valued medical office buildings compared to how they valued commercial office buildings.** It was upside down. The market viewed health care real estate as having less value and more risk, although there are fewer turnovers in these buildings and they are recession-resistant assets. I recruited my father, and I got Bart Starr to come in with me full time. I was in law school with Bart Jr. At the time, his dad was a head football coach and he was looking for investments. I pitched him, and I had no expectation he would have any interest, but because he knew me and that I had had some success in real estate, he agreed to throw his hat in with me. He started with a company predecessor, Starr Sanders Properties, which we stared in 1989, exclusively dealing in health care real estate. Another one of our participants in Starr Sanders was Dr. Jim Andrews.

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