

# Serving Brand Quality Ambulatory Facilities at Reasonable Costs in Rural Markets





## — Outline

Executive Summary .....	1
Introduction .....	2
Challenges .....	2
Case Studies .....	5
Conclusion .....	8



## — Executive Summary

**Health systems are tasked with the difficult job of delivering affordable care to rural communities.** Due to escalating input costs, underutilization by potential patients, and reimbursement disparities (among other factors), it is extremely challenging to control expenses and sustainably provide healthcare services in rural settings. Since real estate represents one of the largest fixed costs that health systems must plan for—often comprising 10-15% of operational budgets—executing an efficient real estate strategy is paramount to the long-term success of rural clinics. This paper explores the unique real estate challenges that arise when leasing or developing new ambulatory space in rural communities and outlines some proven strategies to mitigate cost impacts for providers.

### **Key Findings**

When health systems pursue leased space or face lease renewals in rural markets, landlords typically have the upper hand due to limited inventory. To counteract this imbalance, tenants must create leverage where little naturally exists. This may involve surfacing off-market opportunities, reframing nontraditional property types (retail, office, community facilities) as viable alternatives, or introducing the potential for new development to the negotiation. Even the perception of competition can materially improve outcomes on rental rates, tenant improvement allowances, renewal options, and other lease terms.

When developing new space in rural markets, early alignment of the project team is critical to ensure all vendors internalize the cost parameters and collaborate on an appropriately designed solution. This demands an intentional mindset shift: asking not just “What features are needed?” but “How efficiently can we design this facility while also delivering the high-quality services required by the community?” There is no silver bullet for rural development. Instead, success hinges on a disciplined collection of well-executed elements—such as challenging assumptions and value engineering—to achieve functional, brand-aligned outcomes at viable costs.

## — Introduction: Understanding the Rural Healthcare Landscape and the Importance of Managing Real Estate Costs

Health systems, despite typically being quasi-public-private entities, face the same business realities as other U.S. businesses when delivering healthcare. Hospitals must balance soaring input costs and the imperative to remain solvent with the commitment to affordable care for end users. This balancing act is acutely challenging in rural settings for several reasons. Rural hospitals serve smaller, often aging populations, resulting in fewer patients, lower procedure volumes, and reduced revenue per facility—exacerbated by fixed costs that do not scale down proportionally. For instance, 48% of rural hospitals operated at a financial loss in 2023, with 46% continuing to report negative margins in early 2025 and 432 facilities now vulnerable to closure due to persistent underfunding. Additionally, Medicaid reimbursements—which constitute a significant portion of rural healthcare revenues (up to 25-30% in some markets)—typically cover only 60-70% of private insurance rates, creating substantial shortfalls that strain viability. These dynamics not only threaten the sustainability of rural healthcare services but also highlight the urgent need for health systems to aggressively control and optimize real estate costs to preserve access to care.

Like most businesses, real estate costs play a pivotal role in healthcare delivery, often accounting for a major share of capital and operational costs. In rural communities, where revenues are inherently lower and margins thinner, these costs are magnified. Whether negotiating a new lease (or renewal) against a difficult landlord or partnering with a developer for a ground-up facility, rural markets present distinct obstacles that erode leverage and inflate expenses to health systems. **Davis Moore has assisted numerous healthcare clients in overcoming these hurdles by deploying targeted methods to execute effective ambulatory real estate strategies, ensuring facilities that uphold brand standards and quality care without exceeding financial limitations.**

## — Challenges in Rural Healthcare Real Estate Leasing and Development

While obstacles exist for both leasing existing facilities and developing new space in rural markets, the most common real estate challenge facing healthcare providers is the lack of available medical inventory. In many rural areas, there are few, if any, purpose-built medical facilities, and options that are the right size are even more rare.

Frequently, the only vacancies are within retail centers. These are typically single suites ranging from 1,000 to 2,000 square feet, which are far smaller than most medical requirements. To achieve the necessary footprint, providers would need four or five contiguous suites to become available simultaneously, which is uncommon. Occasionally, a large retail box space is available, but these are often oversized for medical use and not actively marketed if a corporate tenant is still paying rent despite no longer operating. This situation can result in delayed or non-existent landlord responses to proposals.

Landlords of medical space in rural markets also understand the supply-demand imbalance. With limited alternatives, providers have little negotiating leverage when seeking new space or renewing an existing lease. As a result, landlords can often command above-market rents or limited landlord provided concessions for tenants, driving up costs for providers who lack viable options.

For tenants, the key to structuring a favorable transaction is creating leverage. This may involve uncovering off-market opportunities, evaluating alternative property types, or even exploring new development solutions. Without these strategies, healthcare providers risk entering into lease arrangements that are costly and inflexible.

Similar to the challenges of leasing space in rural communities, developing new ambulatory facilities in these areas can be extremely difficult due to elevated construction costs, rising interest rates, and the enduring profitability pressures of rural clinics (e.g., lower reimbursement rates and lower procedure volumes). Since 2020, construction material prices have surged by over 40% overall, with more than 80% of key inputs (such as steel, lumber, and concrete) experiencing average increases of 19-37%, driven by supply chain disruptions, inflation, and tariff uncertainties. Compounding this, the 10-year U.S. Treasury rate—a standard benchmark for construction financing—has climbed from 0.69% in 2020 to 4.04% as of September 16, 2025, dramatically elevating borrowing costs and rendering many projects uneconomical. These headwinds have created a building environment where cost escalation is the norm, and every project contains a heightened level of risk. Yet, health systems cannot defer expansion; they must continue investing in rural infrastructure to bridge access gaps. To render these projects viable, systems and developers must adopt an entrepreneurial approach, prioritizing cost discipline from the beginning of each project. While no single “silver bullet” exists for rural development, Davis Moore has identified best practices and execution tactics that consistently yield lower-cost outcomes. **Key among them are:**

- **Initial Team Alignment:** At the outset of a new development, team partners—including architects, contractors, and project managers—often overlook the project’s objectives and the fiscal constraints. To combat this, it is critical to align the full project team early, explicitly communicating the client’s goals, budget thresholds, and risk tolerances. This alignment fosters proactive collaboration, embedding cost awareness into every decision and preventing scope drift that could jeopardize the business case for the facility.

- **Appropriately Designed Solution:** Another frequent pitfall is the assumption by legacy vendors that health systems prioritize premium, urban-scale aesthetics in all builds, resulting in overbuilt facilities ill-suited to rural economics. This “on-campus” mentality can inflate costs by 20-30% through unnecessary features. To counter this design creep, the project architect and team must evaluate a spectrum of construction methodologies—such as pre-engineered metal shells, wood framing, prefabricated EFIS panels, or modular systems. This approach provides an array of viable options, enabling the selection of designs that are visually compelling, functionally robust, and aligned with brand quality, yet optimized for rural budgets.
- **Challenging Assumptions:** At Davis Moore, we maintain that successful projects do not come from isolated events, but rather from sustained diligence: aligning teams upfront and iteratively refining across due diligence, design, and pre-construction phases. In rural contexts, this means relentlessly questioning “obvious” assumptions—such as standard material specs, site configurations, or permitting timelines—to unearth efficiencies. For example, optimizing the building orientation to reduce site work costs and utility layouts can shave 5-15% off budgets without sacrificing utility.

One of the most pivotal elements for efficient development is controlling shell building costs, which form the foundation of total project expenses. By applying these principles, Davis Moore has delivered lean shell structures in recent projects that translate to affordable rents for tenants, while ensuring facilities remain operationally sound and community-serving. The table below illustrates what can be accomplished through efficient design and controlled costs:

Client	Large Physician Group	Large Physician Group	Large Hospital System	Large Hospital System
Year Built	2023	2023	2023	2024
Building Size	20,000 SF	20,000 SF	14,000 SF	20,000 SF
Cost of Shell Building Per SqFt	\$139.00 / SF	\$134.00 / SF	\$109.00 / SF	\$127.00 / SF



## Case Study: New JV Endoscopy Suites and Clinic Space

- A large health system partnered with a local physician practice group in a joint venture (JV) to develop a new endoscopy clinic in Salisbury, NC. The practice also sought dedicated clinic space within the same building to streamline operations.
- To safeguard the business case amid rural economics, the facility needed to balance high-quality standards with cost efficiency, while accelerating the timeline to expedite service rollout and capture market share.
- Davis Moore crafted a tailored 14,000 SF solution that accommodated each tenant's programmatic needs—endoscopy suites for the JV and flexible clinic areas for the practice—while incorporating value-driven efficiencies. By rigorously challenging site layout assumptions and optimizing building orientation, we reduced construction costs by approximately 15%, preserving project viability.
- Overseeing full entitlement, development, and stabilization, Davis Moore streamlined processes to deliver the shell building ahead of the original schedule, mitigating interest carry costs and enabling earlier revenue generation.
- The outcome: A functional, brand-aligned facility that fulfills the JV's procedural demands and the practice's outpatient needs. Notably, the north-side design incorporates modular expansion provisions, future-proofing the site for anticipated growth without redundant investments.



## — Case Study: Creating a Right-Sized Solution in a Rural Market

- A large regional health system identified a rural market with rapid growth in which they desired to capture market share and needed to establish an ambulatory presence quickly. The system already owned a site in the market, but development complications made it an impractical near-term solution. A market survey confirmed what is common in rural settings: limited options, none of which were appropriately sized or functional without costly retrofitting.
- At the same time, a new retail center was under construction in the community. Although the in-line space was already fully pre-leased and not being marketed, Davis Moore identified the project and established direct contact with the owner. Through these discussions, we were able to negotiate an outparcel opportunity and work the client into the overall site plan, securing a single-tenant building tailored specifically to the health system's needs.
- The result was a facility delivered on an accelerated timeline, sized correctly for the anticipated patient volumes, and secured under lease terms that balanced the landlord's goals with the system's need for cost control and appropriate timing. By uncovering an off-market opportunity and structuring a creative solution, the health system achieved brand-aligned expansion without the delays or financial inefficiencies typically associated with rural projects.



## — Case Study: Rural Clinic Development in a Tertiary Coastal Market

- A major health system, having committed substantial capital to one of North Carolina's fastest-growing coastal regions, sought a straightforward, low-cost entry to establish its brand and cultivate a patient base for phased expansion. The initial footprint targeted 10,000 SF, with scalability for future needs.
- Through strategic collaboration, Davis Moore negotiated with a local landowner to position the system as the anchor tenant in a 2,000-acre master-planned community, securing prime visibility at the major thoroughfare entrance. The design emphasized expandability—via modular additions that minimize disruption to ongoing operations—while reserving exclusive development rights in adjacent parcels to shield against competitive encroachments.
- The result was a facility that upholds the system's quality benchmarks in a nascent rural market, yet remains fiscally prudent through streamlined specs and phased permitting. Moreover, the project timeline was compressed by 20%, delivering the building at a per-SF cost 12% below comparable alternatives, thereby accelerating ROI and reinforcing market positioning.

## — Conclusion

Health systems face a formidable challenge in serving rural communities, where clinics must span large service areas amid elevated costs and reimbursements that lag urban counterparts—often by 20-30% due to payer mix disparities. Real estate constitutes a substantial portion of these expenses, and it is essential that health systems proactively manage these costs to sustainably deliver care. In markets that lack medical inventory, negotiating leases demands ingenuity to build leverage, such as engaging emerging developers or repurposing retail spaces for adaptive use. Similarly, rural ground-up development is inherently capital-intensive and complex, with risks amplified by volatile inputs and financing. Achieving success requires meticulous upfront coordination, transparent communication with design teams about cost guardrails, and a commitment to challenging every assumption—yielding innovative solutions that achieve the project objectives without excess. By embedding these disciplines, health systems can construct resilient, cost-effective ambulatory networks that extend brand-quality care to underserved rural populations, fostering both community health and organizational longevity.



## — About Davis Moore

Physician practice groups and health systems turn to Davis Moore to solve their most critical ambulatory real estate needs. Over the past twenty years, Davis Moore principals have participated in more than 1,500 healthcare transactions that total to more than 18 million square feet all from the providers perspective. We understand the issues and opportunities that affect today's healthcare providers, since we only work for providers.

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