



MEDICAL OFFICE DEVELOPMENT MARKET UPDATE

■ Q3 2019



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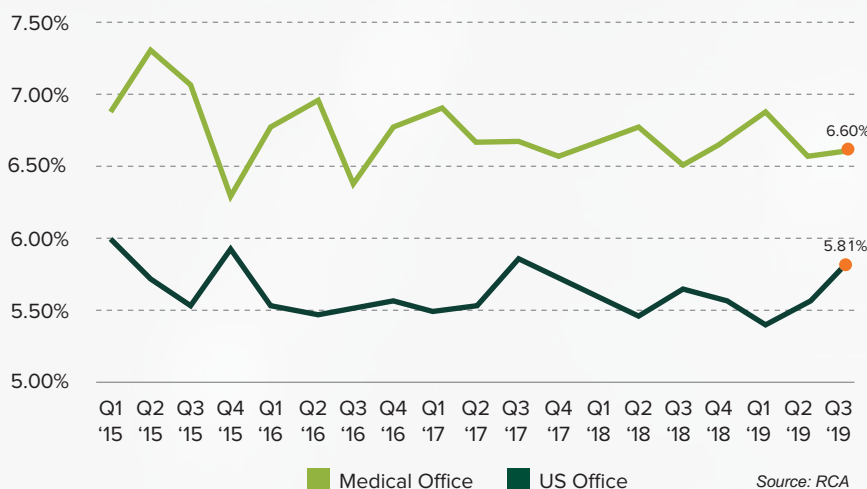
Q3 2019 MEDICAL OFFICE DEVELOPMENT MARKET UPDATE

Medical office property sales have flattened slightly in Q3 2019, a trend which is likely to continue into the New Year. However, strong employment and aging demographics, aligned with favorable sector trends, will boost performance. Additionally, surging M&A activity is accelerating the push towards lower-cost delivery locations, such as outpatient centers, as well as buildings that facilitate collaboration across specialties.

The third quarter of 2019 saw a total of 361 transactions valued at approximately \$2.65 billion, down 17% year-over-year. The average price per square foot (PSF) declined 11% to \$290, along with the cap rate, which was down 9 bps to 6.59%, pushing out the 12-month average from 6.62% to 6.67% over the previous quarter.

Challenges are confronting medical real estate and the overall healthcare market, notably financial scrutiny and profitability, demographic changes, and the drive to retail locations which are likely to continue into 2020. However, positive trends likely to dominate through the near-term include the expanding range and availability of technology, telehealth, and consumer devices and the growing number of health system mega mergers and new investment players entering the marketplace. These mergers serve to consolidate bargaining power among fewer, larger firms covering a broad spectrum of costs, including real estate. Space needs may also be reduced as merging health systems consolidate redundancies.

CAP RATE TRENDS



Q3 2019 MARKET AT A GLANCE

361

Q3 2019 TRANSACTIONS

\$2.65b

Q3 2019 SALES VOLUME

▼17%

DECREASE FROM Q3 2018

\$290

AVERAGE PRICE/SF Q3 2019

▼11%

PRICE/SF DECREASE FROM Q3 2018

6.67%

12-MONTH AVERAGE CAP RATE

INDUSTRY TRENDS

CONSTRUCTION

2019 saw a medical office development pipeline of approximately 9.5 million square feet nationally, down from 12.5 million square feet in 2018 and a pre-recession high of 19 million square feet in 2008. This reflects tighter construction lending, rising development costs, and higher labor costs. New construction will be concentrated around medical hubs.

VACANCY

After peaking in 2010 at 10%, we have seen net absorption continually outpace supply, reducing the national vacancy rate to 8% in 2018. This trend is expected to continue through the remainder of 2019, further tightening vacancy rates to 7.9%.

RENTS

The average asking rent increased to \$22.45 per square gross in 2018, an increase of 2.56% from 2017. Rent growth has expanded at an average of 1.39% annually from a low of \$20.36 in 2012. Rent is expected to continue to grow in 2019 even with a decrease in construction, driven primarily by competition for prime properties and new properties demanding a premium. Nine markets boast a PSF premium in excess of \$30, of which more than half are located in California.

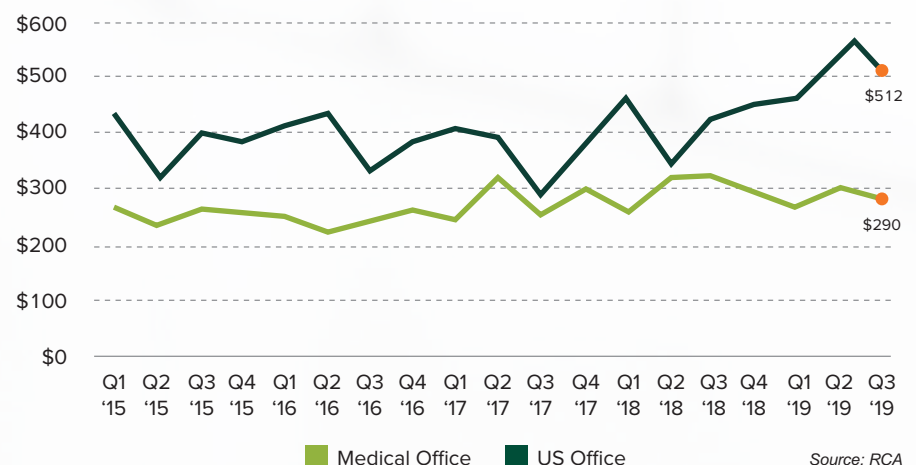
INVESTMENT SALES & TRENDS

Hospitality Properties Trust (NASDAQ:SVC), a Massachusetts-based real estate investment trust (REIT), has dominated sales activity, making up 7% of Q3 2019 transactions, with the largest percentage in the South Central region at 30%. A marquee transaction in the region involved a 100% occupied, 16,212 square foot medical office building (MOB) in Beaumont, Texas, which offered a variety of imaging services. The property sold for \$4,117,751 and \$254 PSF, exceeding regional PSF and sale price averages and matching the national PSF average. This property was one of 11 properties transferred between Hospitality Properties Trust as the buyer, and Spirit MTA REIT as the seller. Transactions were executed in various locations throughout the country and

constituted a nearly 55% share in the South Central region.

Illinois-based and privately-owned MB Real Estate (MBRE) was also a significant participant in Q3 2019, with a 5% share of transaction activity nationally, leading in the Southeast region in square footage and PSF. A notable transaction in Monroe, North Carolina involved a 100% occupied, two-story multi-tenant MOB. The major tenant, Novant Health, offers a range of diagnostic tools and therapies for pulmonary conditions, including rehabilitation. The transaction between MBRE and Shefa Realty LLC totaled \$18,528,000 and approximately \$460 PSF, exceeding national and regional averages for both sale price and PS; the latter nearly 80% higher than the national average.

PRICE/SF TRENDS



REGIONAL REVIEW

The Western Region led in transaction volume and PSF in Q3 2019, second only to the Mid-Atlantic region in average sale price. With only a 4% decline year-over-year and a 1.5% decline from Q2 2019, the West exhibits resilience and consistency in average PSF.

Cap rates in the majority of regions have softened, suggesting a possible flattening nationwide with the exception of the West and Northeast regions, which have seen a 100 bps and 50 bps hardening year-over-year, respectively. This is likely attributed to Welltower's acquisition of a multi-tenant MOB that exceeded both PSF and sale amount for the nation and region in H1 2019.

Beginning in the first half of Q3 2019, we saw the 10-Year Treasury Yield fall below the 2-Year Treasury Yield, a pricing anomaly known as a yield curve inversion which is often seen as an early indicator of a recession. Each of the last seven recessions were preceded by an inverted yield curve. For investors competing for capital, property values will be adversely affected because cap rates will rise.

NORTHEAST

California-based and privately-owned AHI acquired a 67,231 square foot, four-story MOB in Haverhill,

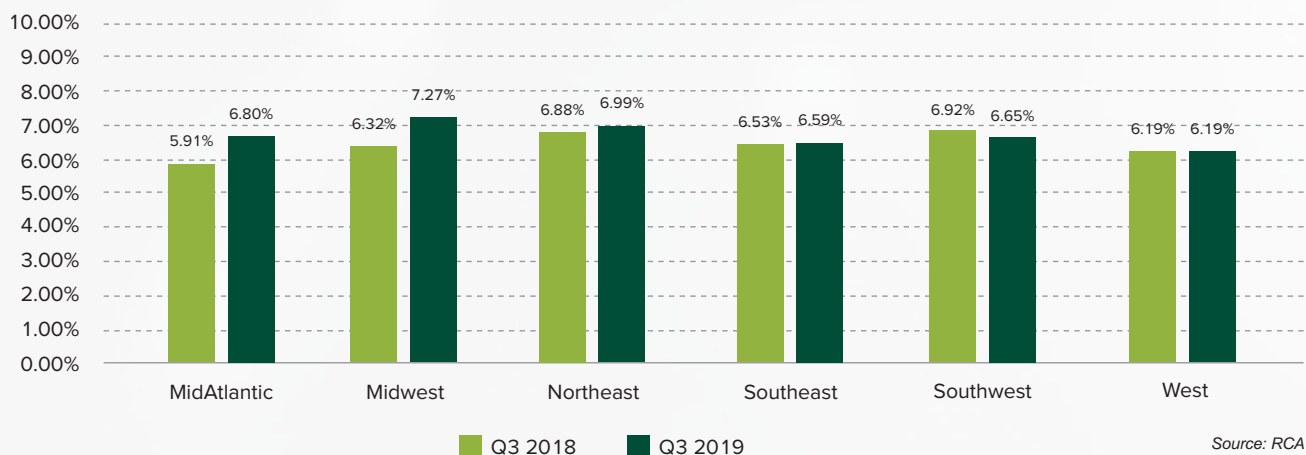
Massachusetts from Pen Med. The 100% leased Pentucket Medical Center holds a six-tenant roster anchored by Partners Community Physicians Organization (PCPO), a regional multi-specialty provider. PCPO is a wholly-owned subsidiary of Partners HealthCare, New England's largest healthcare system. The property transacted for \$15,500,000 and \$230 PSF, surpassing regional property sales by nearly 84% in PSF and average sale price.

Community Health Care Trust (NYSE: CHCT) acquired a 13,352 square foot property in Warwick, Rhode Island for \$6,059,300 and a 7.5% cap rate, exceeding national and regional PSF averages at \$287 per square foot. The sale involved a property that is 100% leased to Ortho Rhode Island, a leading orthopedic practice group with more than 45 physicians and 9 locations across the region. The property houses a full suite of orthopedic services including clinical offices, physical therapy, urgent care, and imaging services.

WEST

Private investor Hurlbut LLC acquired a 21,200 square foot property in Pasadena, California from private real estate investment firm Markwood Enterprises for \$11,750,000 and \$554 PSF. The property is a single-tenant MOB leased to Pacific Clinics, which offers a comprehensive continuum of

CHANGES IN CAP RATE BY REGION



REGIONAL REVIEW

behavioral healthcare services. The PSF foot is above the national and regional average, as well as the quarterly average, at approximately 118%, 75%, and 66%, respectively.

Global Medical REIT (NYSE:GMRE) acquired a 19,558 square foot MOB in San Marcos, California for \$11,850,000, \$606 PSF, and a 7.3% cap rate. The property is leased to California Cancer Associates for Research & Excellence (cCARE), the largest full-service, private oncology and hematology practice in the state. cCARE leases the third floor of the 57,333 square foot Nordahl Medical Centre, which is considered one of the highest quality MOB in San Diego County. cCARE provides a variety of services including medical oncology, chemotherapy, radiation oncology, imaging, pharmacy services, and clinical trials.

INTERMOUNTAIN

Arizona-based buyer Healthcare Trust of America (NYSE:HTA) acquired a 47,599 square foot portfolio consisting of two buildings from private seller Jan M. Peterson. Located in Meridian, Idaho, the buildings are 100% occupied and located across from St. Luke's Meridian Hospital Campus. The transaction represents HTA's first investment in fast-growing Boise, which HTA has identified for its long-term growth potential. The portfolio transacted for \$11,000,000 and \$231 PSF.

Illinois-based private investor MB Real Estate (MBRE) acquired a portfolio of 33,559 square feet in Colorado Springs, Colorado from private seller RSC I LLC. Built in 2007, the portfolio is located in the Briargate Business Campus. The top tenants include Center for Orthopedic Excellence of Colorado and Thomas S. Jennings, DDS, PC. The transaction raised the bar for third quarter transactions with a record \$12,100,000 sale price

and \$361 PSF. These numbers reflect positive year-over year numbers for the region in average sale price (50%) and PSF (60%).

SOUTH CENTRAL

Illinois-based private investor MB Real Estate (MBRE) acquired a 82,341 square foot portfolio of two properties located in San Antonio, Texas from a private seller for an undisclosed price. The portfolio consists of two multi-tenant MOB with an exceptional regional footprint and convenient patient access in surrounding communities. The proximity to medical centers, as well as the variety of healthcare providers and specialists that occupy space within the portfolio, provide a reliable referral program and improved satisfaction for patients.

MIDWEST

A joint venture between Georgia-based Invesco and Texas-based Caddish Healthcare Real Estate, both privately-owned, and Manus Associates, LLC has resulted in the acquisition of a 41,250 square foot, 100% leased property in Indianapolis, Indiana. The single-tenant MOB and ambulatory surgery center is the headquarters for 10 Hand to Shoulder locations throughout the Indianapolis area. Hand to Shoulder physicians, staff, and services will continue to occupy the building.

Illinois-based private investor MB Real Estate (MBRE) acquired a single tenant MOB from Mark G. Hamming. Located in Park City, Illinois, the property is 100% leased by Illinois Bone and Joint Institute (IBJI), one of the largest orthopedic group practices in Illinois. With more than 90 physicians in every orthopedic specialty, IBJI offers care for children and adults from some of the most accomplished and respected orthopedists in the country.

REGIONAL REVIEW

MID-ATLANTIC

Tennessee-based and privately-owned Montecito Medical Real Estate acquired a 100% occupied, 86,855 square foot property in Lynchburg, Virginia from OrthoVirginia. The property transacted for \$29,000,000 and \$333.89 PSF, raising the bar and exceeding year-over-year and quarterly average sale price and PSF figures for the region. Constructed in 2008, the facility was built-to-suit for OrthoVirginia, which occupies 100% of the space. With 20 physicians on staff, OrthoVirginia is Lynchburg's largest multidisciplinary musculoskeletal practice, providing a range of services, including general orthopedics, physical therapy, sports medicine, and joint replacement care for patients. The building offers a prime location, less than a mile from Lynchburg General Hospital, and is the state's largest provider of orthopedic and therapy care.

SOUTHEAST

Tennessee-based and privately-owned, Montecito Medical Real Estate acquired a 12,304 square foot property in Wilmington, South Carolina from 1302 Properties, LLP. MMAC Acquisition Corp. of California purchased the former Southeastern Nephrology Associates (SENA) building for \$4 million from physician group 1302 Properties LLP, whose registered agent is nephrologist John M. Herion,

according to state documents and the practice's website. After its June merger with a Greenville practice, SENA is now Eastern Nephrology Associates and plans to remain in place long-term. The sellers were able to reinvest into the asset, allowing them to defer some capital gains tax and share in the future disposition proceeds. Additionally, they will be permitted to co-invest with the purchaser in a larger portfolio on an ongoing basis. The property transacted for \$4,000,000 and \$325 PSF, exceeding year-over-year and quarterly PSF values for the Southeast region.

Missouri-based and privately-owned Block Real Estate Service acquired a 100% leased and occupied, 18,869 square foot MOB from Seaside Ophthalmology. The single-tenant MOB is located in Brunswick, a major urban and economic center in southeast Georgia. The Seaside Ophthalmology location is staffed with four ophthalmologists and three optometrists. It also features an ambulatory surgery center staffed with board certified anesthesia, nursing, and technical professionals and equipped with the most advanced ophthalmic surgical equipment and instrumentation available. The property transacted for \$6,550,000 and \$347 PSF, an almost 30% increase in PSF averages year-over-year for the region.

REPRESENTATIVE BGL TRANSACTIONS

**Central Pennsylvania
Medical Office Portfolio**

172,847 RSF Multi-Tenant MOBs

— acquired by —

Hammes Partners

**PROGRESSIVE
VISION INSTITUTE**
The Eye Care Center

37,839 Total RSF
Six (6) Medical Office Buildings

— acquired by —

STORE capital

**NEW MEXICO
BONE & JOINT INSTITUTE**
ALAMOGORDO • RIOHOTO • LAS CRUCES

31,799 RSF
Single Tenant MOB & ASC

— acquired by —

BLOCK
REAL ESTATE SERVICES, LLC

**Seaside
Ophthalmology**

18,937 RSF Single-Tenant
MOB & ASC

— acquired by —

BLOCK
REAL ESTATE SERVICES, LLC

BGL HEALTHCARE REAL ESTATE

BGL's Healthcare Investment Sales team is an affiliate of Brown Gibbons Lang & Company (BGL), a leading independent investment bank and financial advisory firm focused on the global middle market. The firm's roots in corporate finance — including mergers & acquisitions, debt & equity placement, and financial restructuring — provides the Healthcare Investment Sales team with a deep understanding of the dynamics shaping the healthcare landscape. This, coupled with the team's expertise across all types of healthcare real estate assets, has enabled them to complete over \$3 billion in healthcare real estate sale transactions, including Medical Office Buildings, Ambulatory Surgery Centers, Acute-Care Hospitals, Specialty Hospitals, and Post-Acute Rehab Centers.

ABOUT BGL

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Additionally, BGL is a founding member of Global M&A Partners, the world's leading partnership of independent investment banking firms, which gives our clients access to resources in all major international markets, across more than 30 countries around the world.



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