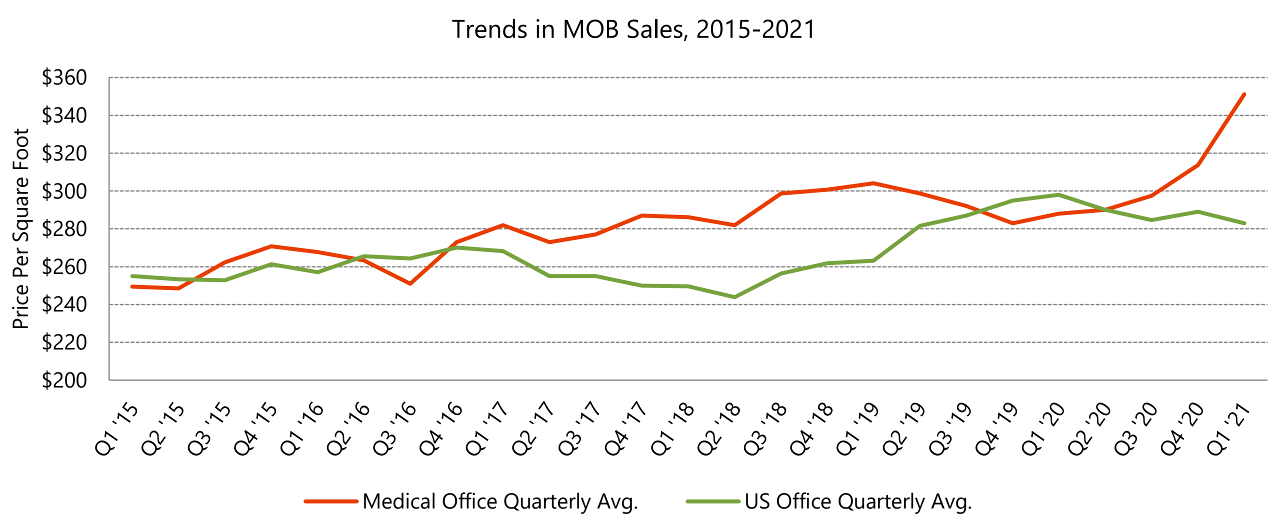
Strong Demand and Limited Supply Create Window of Opportunity in Medical-Specialty Assets and Value-Add Medical Office Buildings

As demand continues to outweigh supply, value-add medical office buildings are steeply discounted against single-tenant healthcare properties, making it a great time to buy.

Introduction

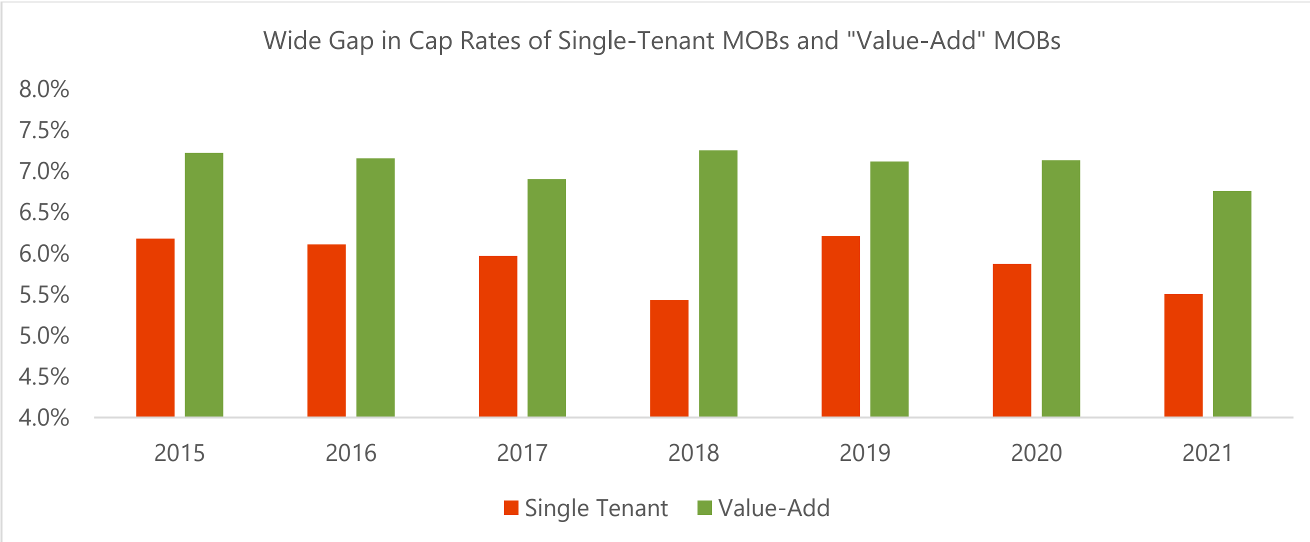
The first quarter of 2021 saw $1.8 billion in sales volume in the medical office building ("MOB") sales market across 149 transactions encompassing 233 properties, an H2C Securities Inc. ("H2C") analysis shows.



Source: H2C analysis of industry data.

The buyer pool for single-tenant medical office buildings is the largest it has ever been, based on H2C's findings through its sales processes. Over the past 12 months, new entrants and historically retail-focused net lease investors have made acquisitions in the MOB space and are competing with healthcare-real estate investors for the limited supply of quality opportunities in the marketplace. The high level of competition for these offerings has driven cap rates to all-time lows, which hit 6.5 percent on average in Q1. For net-leased, single-tenant MOBs, the trailing 12-month average cap rate stands at 6.0 percent, an all-time low as well, with several transactions taking place in the low-5.0 percent range.

The low supply and high demand for single-tenant net-lease MOBs, combined with a slow leasing environment throughout the pandemic, has created a wide gap in cap rates of single-tenant MOBs and "value-add" MOBs, buildings that offer the ability for an investor to grow the underlying net operating income through additional leasing or taking in-place leases to market rates.

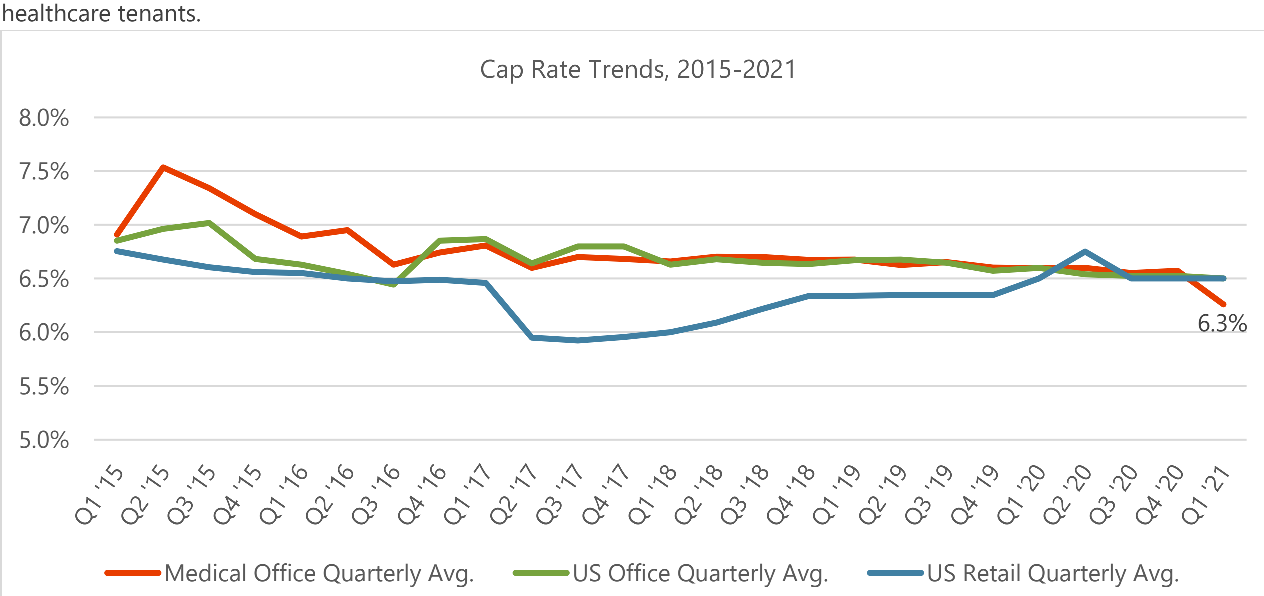


Source: H2C analysis of industry data.

Select investors, such as Meridian, Stockdale Capital Partners, Atkins Companies, Anchor Health Properties, and Flagship Healthcare Properties, have taken advantage of this dynamic by acquiring MOBs, monetizing stabilized assets, and expanding their presence over the past 12 months.

There is a clear arbitrage present in the marketplace. H2C predicts that the appeal of value-add MOBs should grow substantially in 2021 as investors see upside in a stabilizing leasing market for healthcare tenants as restrictions ease and space concerns are addressed by providers. An additional driver in appeal of value-add MOBs could be rising costs for development. Many value-add opportunities offer the ability for investors to acquire assets at below-replacement cost.

The low supply and lowest-ever recorded cap rates in the MOB space have also driven investors to sub-asset classes such as inpatient rehabilitation facilities ("IRF"), behavioral health facilities, and traditional office buildings leased to healthcare tenants.



Source: H2C analysis of industry data.

As highlighted in H2C's Q4 2020 MOB Report, few asset classes demonstrated the resiliency in values that the MOB sector showed. The MOB space's momentum is expected to continue into 2021 because supply continues to lag demand and new entrants in the space are seeking additional exposure through acquisitions. Although cap rates could see some fluctuation if interest rates are to rise, one wouldn't expect rising interest rates to diminish investor appetite for MOBs, which should act as a mitigating factor in any valuation slide due to interest rates.

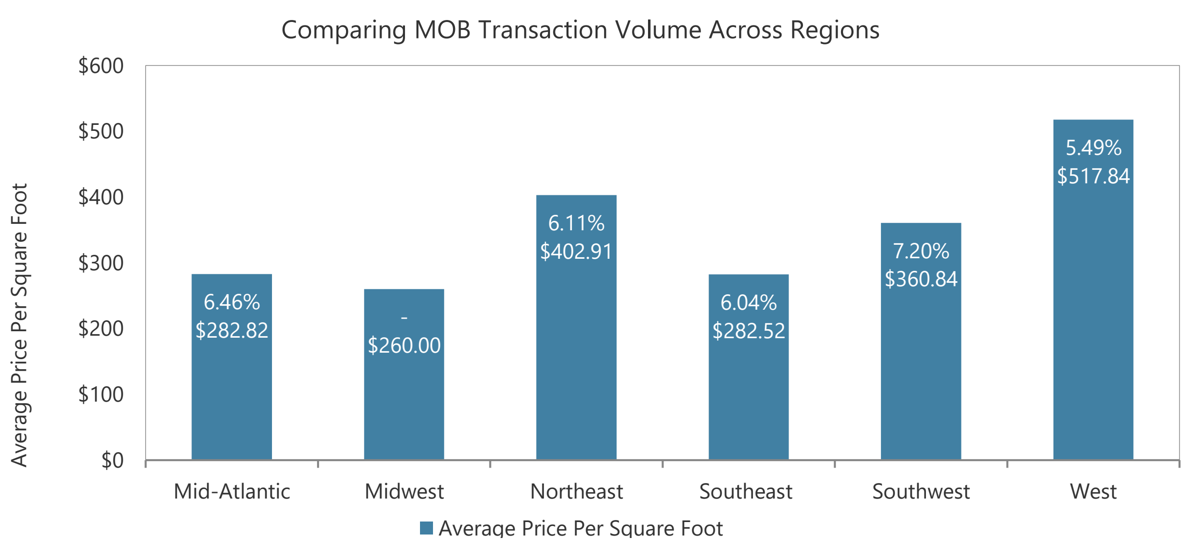
Investment Sales & Trends

The largest transaction in the first quarter was LaSalle's $74.0 million acquisition of a Class A MOB in Beverly Hills, Calif. The 49,721-square-foot MOB, located at 9033 Wilshire Blvd, and known as Archway Medical Plaza, is less than one mile from downtown Beverly Hills and within three miles of three acute care hospitals. The property was renovated in 2011 and is anchored by USC's Keck Medical Center (Aa1/AA/AA-), which has a surgery center at the property and offers services including internal medicine, neurosurgery, orthopedic surgery, urology, and voice therapy. The seller sold it for slightly less than they acquired the property in 2015, but the 4.8 percent cap rate and price per square foot of $1,488 were notable.

The largest portfolio transaction in the first quarter was completed by Artemis Real Estate Partners, which acquired a 10-property MOB portfolio totaling 270,831 square feet across six states. Approximately 50 percent of the portfolio is leased to investment-grade health systems, including Mercy Health (A1/A+/AA-), Novant Health (Aa3/AA-/AA-), and Penn Medicine Lancaster General Health (Aa3/AA/NR).

Regional Review

The West region had the greatest transaction volume compared with other RCA-tracked regions, at $503.6 million, $106 million of which was accredited to the Sharp Healthcare's purchase of Cambridge Medical Center in San Diego. Notably, Q4 saw a high fluctuation in cap rates across several regions, as cap rates in the Mid-Atlantic and the West decreased by over 10 percent, settling at an average transaction cap rate of 6.0 percent. This marks the lowest average cap rate in those two regions recorded in four years and is likely due to the growth in volume of quality MOB acquisition opportunities in the region. The West saw the highest average price per square foot among all RCA-tracked regions, with an average price per square foot of $518. This marks the third consecutive quarter where the West has outperformed all other regions in average price per square foot.



Source: H2C analysis of industry data.

Northeast Region

In January, WS Glastonbury LLC and its JV partner, Hubinger Street Associates LLC, recently purchased 2928 Main St in Glastonbury, Conn. The 20,720-square-foot property is anchored by PhysicianOne Urgent care and Durant Physical Therapy. The Property is located four miles from Connecticut Children's Medical Center. The $5.9 million purchase price equated to $285 per square foot.

In February, Remedy Medical Properties and its JV partner, Kayne Anderson Real Estate, recently acquired a 43,103-square-foot MOB complex in Orchard Park, N.Y., near Buffalo, for $13.1 million, or $304 per square foot. The one-story Medical Campus, built in 1972 and renovated in 2018, houses multiple tenants, including Catholic Health System (Baa2/BBB/NR) and Roswell Park Cancer Center.

West Region

In January, Healthcare Realty Trust purchased 336 E. Lewis St. in San Diego. The 22,461-square-foot building is anchored by UC San Diego Health (Aa3/AA/NR). The purchase price of $17.2 million equated to $764 per square foot at a 5.4 percent cap rate.

In March, Anchor Health Properties (Anchor) acquired an 81,236-square-foot Class A commercial office building in downtown San Diego, Calif. The asset was acquired through a joint venture with co-managed equity fund Chestnut Healthcare Fund II and Harrison Street. Anchor intends to redevelop and convert the building to a fully clinical medical facility. The property is strategically located near San Diego University’s $3.5 billion planned campus development and Scripps Mercy Hospital’s planned 710,000-square-foot inpatient tower. The purchase price of $25.3 million equated to $316 per square foot.

Also in March, Arapahoe Medical Center, a three-story medical office building located in Centennial, Colo., opened approximately 15 miles southeast of downtown Denver. The 59,359-square-foot property is currently 91 percent leased to a mix of 17 tenants comprising prominent physician groups and other healthcare providers. Specialties represented at the property include primary care, asthma and allergy, neurology, gastroenterology, dermatology, and physical therapy, among others. The weighted average remaining lease term is 4.8 years, with no tenant accounting for more than 10 percent of the rentable area. The purchase price of $14.8 million equated to $250 per square foot.

In April, Healthcare Realty Trust purchased Lake Plaza Office, a 34,000-square-foot medical office building in Colorado Springs, Colo. The property is strategically located near CommonSpirit Health's (Baa1/BBB+/BBB+) St. Francis Medical Center and leased to Ted Bills and Broadmoor Valley Pediatrics. The $8.2 million purchase price equated to $241 per square foot.

In April, All Points North Lodge, a comprehensive wellness and treatment campus located just outside of Vail, Colo., was purchased by WC Acquisition Holdings in a $57 million, or $740 per square foot, sale-leaseback transaction. All Points North Lodge, officially opened in March 2020, provides a resource for those struggling with addiction, mental health, and trauma. The five-star, resort-style campus, with more than 77,000 square feet of rentable space, recently completed more than $20 million in improvements in what used to be the Cordillera Lodge & Spa.

In April, Kayne Anderson and its JV partner, Remedy Medical Properties, purchased Gresham Station North at 1851 NW Civic Dr in Gresham, OR. The 100,322 square foot building is anchored by Adventist Health (NR/A/A+). The property is located less than two miles away from Legacy Health’s (A1/A+/NR) Mount Hood Medical Center. The purchase price of $30.9 million equated to $308 per square foot.

Southwest Region

In January, KB Exchange Trust purchased the APC Portfolio, consisting of two medical office buildings in Austin, Texas, and one in Round Rock, Texas. The 46,236-square-foot portfolio was a sale-leaseback transaction with Advanced Pain Care (“APC”). The portfolio is strategically located less than five miles away from nearby hospitals. The $22.5 million purchase price equated to $486 per square foot at a 5.7 percent cap rate.

In January, Flagler Investment Property Group purchased Orthoarizona, located at 1675 E Melrose St in Gilbert, AZ. The 49,600-square-foot property was built in 2018 and is located less than a half mile Mercy Health’s (A1/A+/AA-) Gilbert Medical Center. The $23.6 million purchase price equated to $477 per square foot. The transaction outsizes the $21.2 million sale of Spectrum Medical Commons, which was the metro’s largest medical office deal in the fourth quarter of 2020.

Midwest Region

In March, Stanford Health (Aa3/AA-/AA) opened 4535 Northern Sky Dr. in Bismarck, N.D., site of the former Independent Doctors clinic. The property totals 20,392 square feet and will house Sanford specialty services along with a Fyzical Therapy & Balance Centers franchise. The clinic will have 26 exam rooms, X-ray facilities, a lab, and a bone density scanner. Endocrinology, neurology, neuropsychology, physical medicine and rehabilitation, and rheumatology services will move from the Sanford Main Campus in downtown Bismarck to this location. The purchase price of $6.7 million equated to $329 per square foot.

In January, HTA acquired Mount Carmel St Ann's MOB located on Cooper Rd in Westerville, Ohio. The 99,000-square-foot MOB is 83% leased and located on the campus of Mt. Carmel St. Ann's Hospital. The purchase price of $191.1 million equated to $193 per square foot.

Mid-Atlantic

In February, Healthcare Realty Trust purchased Town Center Medical Building located at 14605 Potomac Branch Dr in Woodbridge, Va. The 26,496-square-foot MOB was built in 2010 and leased to NoVa Orthopedic & Spine Care. The property is located less than a half mile away from Sentara’s (Aa2/AA/NR) Northern Virginia Medical Center. The $12.8 million purchase equated to $481 per square foot.

Southeast

In February, Altera Development sold Hugh R. Black Medical Pavilion, located at 1650 Doctors Park Dr. in Spartanburg, S.C. The 108,878-square foot four-story medical office building located on the campus of Spartanburg Medical Center – Mary Black Campus, a 148-bed acute care facility. The property is currently 92 percent leased to eight tenants and anchored by Spartanburg Regional Healthcare System (A3/A/A), a five-hospital system with over 9,000 employees, 700 physicians, and over 200,000 emergency department visits per year. The $32.7 million purchase equated to $300 per square foot.

In March, Flagship Healthcare Properties acquired 410 Lionel Way in Davenport, Fla. The 49,136-square-foot MOB is fully leased to Heart of Florida Physician Group and AdventHealth (NR/A/A+) Medical Group. The facility is also located across the street from AdventHealth’s Heart of Florida Medical Center. The $10 million purchase equated to $204 per square foot.

Also in March, HTA acquired Duke Family Medicine in Durham, N.C. Developed in 1988 and renovated in 1999, the 40,725-square-foot medical office building is anchored by Duke Family Medicine, which offers comprehensive family medicine services for every member of the family, including annual physicals, sports physicals, ongoing care for chronic conditions such as allergies, asthma, and diabetes, and lab services, all in one convenient location. The property is strategically located on the Duke University Hospital Campus (Aa2/AA/AA). The purchase price of $16.3 million equated to $400 per square foot.

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