



4Q20



MEDICAL OFFICE BUILDING QUARTERLY UPDATE

Medical Office Building Values Resilient Through Volatile Year

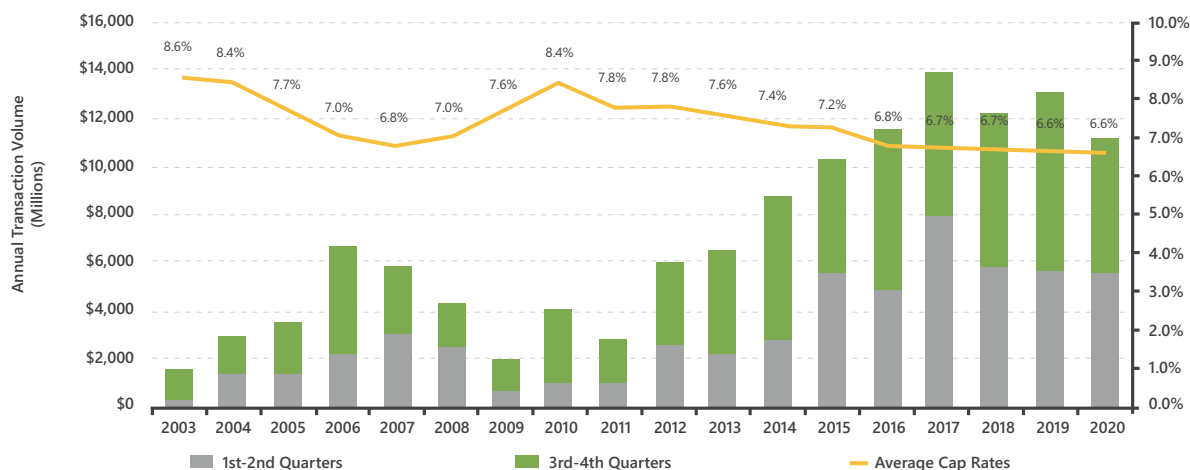
March 2021

Medical office cap rates reached historic lows as demand for medical office buildings remained strong in a supply constrained market.

Introduction

Few asset classes have demonstrated the resiliency that medical office building (“MOB”) values have shown in 2020, a year that was unlike any other due to the impact of the COVID-19 pandemic. An H2C analysis shows that while COVID-19 decimated valuations of hotel properties, retail, and senior housing, average cap rates for MOB hit an all-time low of 6.57 percent, while average price per square foot exceeded \$300 for the first time. Total MOB transaction volume in 2020 reached \$11.3 billion, marking the seventh consecutive year with over \$10 billion in volume. However, MOB sales volume was 14 percent lower than in 2018 and 2019. (See Figure 1.)

FIGURE 1



The drivers behind the record pricing that exists for MOB is the perceived “stickiness” of the tenant bases, the essential nature of the services healthcare tenants provide, and the limited supply of high-quality opportunities brought to market in 2020. The limited supply drove buyers to respond aggressively to acquisition opportunities presented, creating an attractive environment for sellers that should continue into 2021.

The MOB asset class has exhibited consistent growth in recent years, supported by increasing demand for outpatient services delivering strong historical performance. MOB sales prices have steadily increased over the past five years. Dollar value per square foot has increased more than 30 percent since 2015, an H2C analysis shows. MOB continues to be viewed as one of the lowest-risk real estate investments should an economic downturn persist due to COVID-19. The growing, secular demand for medical office investment can be seen in the significant increase in investment volume since 2012. Compared with traditional commercial office facilities, the MOB subsector continues to outperform, with a higher average price per square foot and a lower average cap rate. High quality of construction throughout the MOB industry and improving underlying tenant credit are additional factors.

Low interest rates, high demand, low supply, and capital availability will continue to support values in the MOB sector, despite the lower transaction volume in 2020. It should be noted that a robust transaction volume in the second half of 2020 (“H2 2020”), driven by an active Q4, was 17.2 percent higher than H2 2019 volume, an H2C analysis shows. Also, H2 2020 showed an 8.6 percent increase in price per square foot over the previous year. This suggests that the sector no longer is affected by economic uncertainty due to the COVID-19 pandemic, positioning the sector for continued record investment leading into 2021. (See Figures 2, 3, and 4.)

FIGURE 2

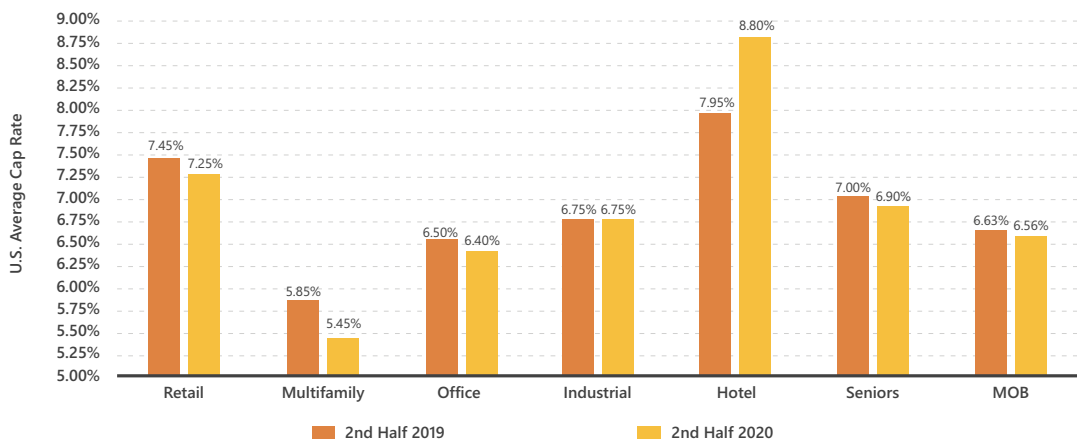


FIGURE 3

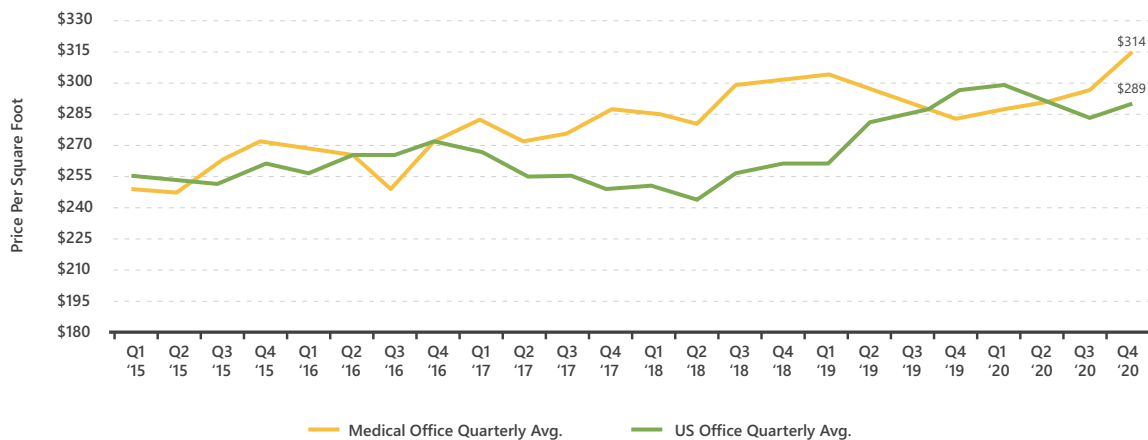
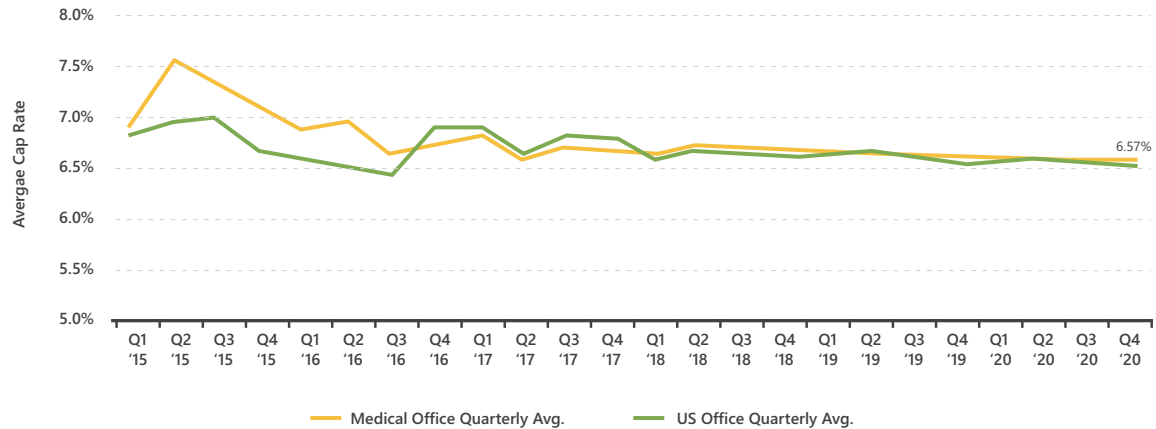


FIGURE 4

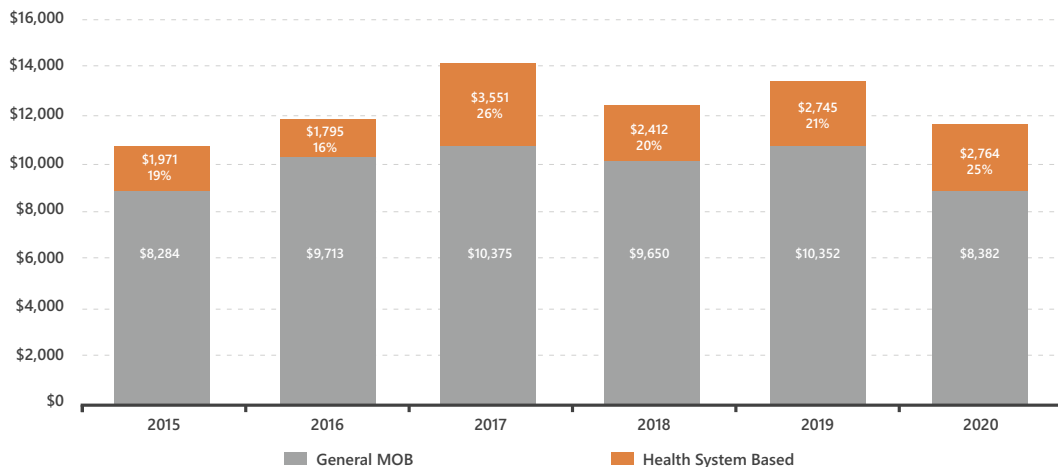


Notably, health systems comprised more than 20 percent of the transaction volume in the fourth quarter, a stark difference from the 10 percent historical average. There has been a dramatic uptick in health systems seeking to optimize their real estate portfolios. Throughout 2020 and in the fourth quarter, health systems acquired assets they leased, sold assets they owned, purchased development sites, and redeveloped properties to utilize. Not only is it clear that there is no “one size fits all” strategy when it comes to portfolio optimization, but it’s also apparent that providers are actively considering their real estate footprints.

As highlighted in H2C’s Q3 2020 H2C MOB report¹, health systems continue to stand out as potential sellers of MOB in 2020 and future quarters. According to the American Hospital Association (“AHA”), pandemic losses are expected to total \$323.1 billion in 2020. Monetizing real estate is often a favorable way to bolster cash positions at attractive yields. Health systems considering MOB sales can potentially put the capital raised through asset sales toward new acquisitions, repay debt, or use it as a cash buffer to protect against further financial uncertainty. H2C is the leader in health system real estate monetization, having led more health system real estate sales than any other firm. We anticipate that more health systems will look to a potential transaction, often in the form of a sale/ leaseback or joint venture, over the next 12 months.

At the same time, some health systems have been acquiring real estate, often taking advantage of low interest rates and investor demand in the bond market to finance the acquisitions. Despite the pandemic-related operating losses sustained by hospitals in 2020, some health system liquidity remains high due to CARES Act funding and abundant access to capital. The popularity of MOB buybacks and ownership is fueled in part by the cash savings opportunity they can create. During the pandemic, health systems are highly focused on reducing cash expenses. MOB buybacks can eliminate rent payments and help cash occupancy costs. (See Figure 5.)

FIGURE 5



Investment Trends

The largest acquirer of MOBs in 2020 was Chicago-based Remedy Medical Properties, Inc. (“Remedy”), the privately held investment firm formerly known as MBRE Healthcare. Alongside its joint-venture equity partner, Kayne Anderson, Remedy bought \$2.5 billion in MOBs in 2020, more than double the volume of the second-largest acquirer.

Notably, REITs were not as active in 2020 compared to past years, in part due to the volatility in their share prices that occurred as the stock market lagged through the latter half of Q1 and into Q2. Welltower (NYSE: WELL), made acquisitions totaling \$125 million in 2020 and sold over \$2 billion in healthcare real estate, in stark contrast to 2019, when Welltower led the industry in acquisitions, at \$2.2 billion.

Investment Sales

In the fourth quarter’s largest transaction, Milwaukee-based Hammes Partners sold a 29-property, 1.2 million square foot MOB portfolio consisting of assets located across 11 states. The sale of the portfolio to Remedy closed in December for \$605 million.

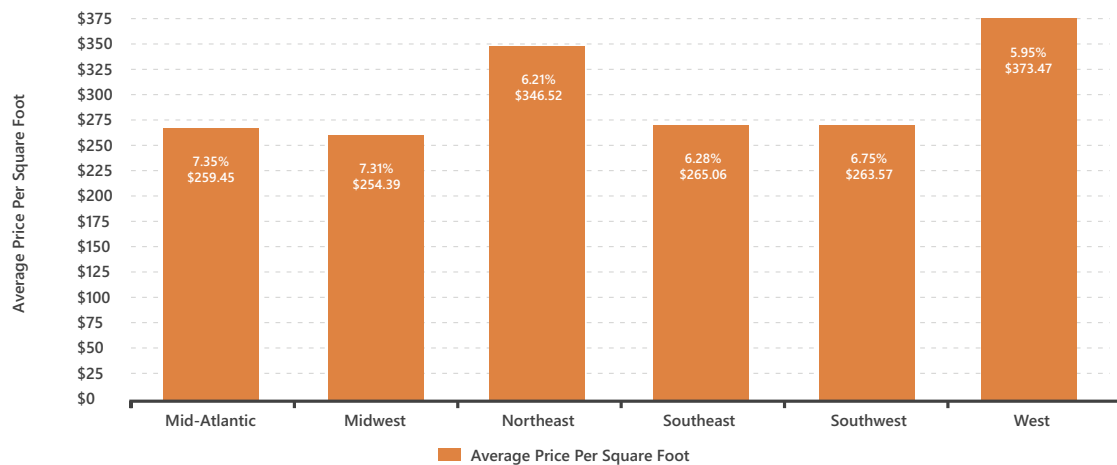
In the second-largest transaction of the fourth quarter, Welltower monetized an 80 percent interest in a 24-property MOB portfolio to Wafra, a privately held institutional fund manager. The 10-state portfolio, which is 97 percent health system tenanted, was valued at \$550 million. Welltower will retain a 20 percent interest and continue to manage the property.

H2C led the sale of a three-property, \$86.7 million inpatient rehabilitation facility (“IRF”) portfolio that closed in December. The portfolio comprised three 57,000-square-foot, 42-bed IRFs located in El Paso, Texas, Fargo, N.D., and Clarksville, Ind., two of which were tenanted by Cobalt Curahealth Rehabilitation and the third by Post Acute Medical. The geographically diverse offering was well-received and closed in less than 120 days from process launch, demonstrating the attraction of IRFs as a sub-asset class in the MOB space.

Regional Review

The Midwest region exhibited the greatest transaction volume compared with other RCA-tracked regions, with \$1.2 billion in sales, \$600 million of which was accredited to the Hammes Portfolio monetization alluded to earlier. Notably, Q4 saw stability in cap rates across most regions, an H2C analysis shows. The exception: the Southeast, with cap rates dropping nearly 50 basis points, settled at an average transaction cap rate of 5.9 percent. This marks the lowest average cap rate in the Southeast recorded in seven years and is likely due to the growth in volume of high-quality MOB acquisition opportunities in the region, which has seen new developments rise to keep up with population growth. Cap rates in the Southwest also decreased, dropping by 35 basis points to an average cap rate of 6.54 percent. The West saw the highest average price per square foot among all RCA-tracked regions, with an average price per square foot of \$390. This marks the second consecutive quarter where the West has outperformed all other regions in average price per square foot as well as average cap rate. (See Figure 6.)

FIGURE 6



Northeast Region

In November, Hospital for Special Surgery (“HSS”) (A1/A+/NR), the top national orthopedic practice for 11 years in a row according to U.S. News & World Report³, acquired two properties totaling 48,517 square feet on Manhattan’s Upper East Side. HSS, which is the anchor tenant in the buildings, acquired the assets from ABS Partners Real Estate. The \$70 million purchase price equated to \$1,442 per square foot, nearly a record in the MOB space.

In December, Hammes Partners purchased 600 Northern Blvd. in Great Neck, N.Y. The 95,332-square-foot property is anchored by Northwell Health (“Northwell”) (A3/A-/A-), with services including ophthalmology and obstetrics and gynecology. The property is located less than a half mile from Northwell’s 738-bed North Shore University Hospital. The \$38.1 million purchase price equated to \$399 per square foot.

West Region

Dallas-based Caddis Healthcare Real Estate purchased 2625 Shadelands Dr. in Walnut Creek, Calif. Known as Shadelands Medical Building, the 60,000-square-foot MOB is fully leased to tenants including Stanford Health, John Muir Health, and Muir Ortho, one of the largest orthopedic groups in Northern California. Services provided at the property include sports medicine, physical therapy, orthopedics, and family medicine. The \$23.2 million purchase price equated to \$387 per square foot.

In December, Nashville-based Healthcare Realty Trust (NYSE: HRT) acquired Saddleback Valley Medical Center in Laguna Hills, Calif. The five-story, 135,904-square-foot, multi-tenant MOB is adjacent to MemorialCare’s (NR/NR/AA-) 325-bed Saddleback Hospital, and a 3,500-acre, 55+ community in Laguna Hills. The purchase price of \$84.1 million equated to \$619 per square foot.

Southwest Region

H2C was active in the Southwest region, leading two transactions that closed in the fourth quarter.

In November, H2C represented a private developer on its monetization of two outpatient clinic buildings totaling 24,000 square feet that were leased to Yuma Regional Medical Center (“YRMC”) (NR/A/NR). Services at the properties include pulmonology, rheumatology, family medicine, and pediatrics. The \$6.9 million sale to Global Medical REIT (NYSE: GMRE) equated to \$288 per square foot and an 8 percent cap rate. The cap rate was impacted due to the tenant’s remaining term of less than five years.

On the last day of the year, H2C led the closing of YRMC’s sale/leaseback for an 11-property, 266,407-square-foot healthcare and ancillary real estate portfolio that was sold to Remedy. The \$59.9 million purchase equated to \$224 per square foot and a 6.2 percent cap rate. The average weighted lease term structured for the portfolio was approximately 14 years.

Midwest Region

In December, a joint venture between Kayne Anderson and Remedy acquired Presence St. Joseph Ambulatory Care Center located at 331 W Surf St. in Chicago, Ill. The property is occupied by Presence Health, now part of Ascension and AMITA Health (Aa2/AA+/NR), the nation’s largest not-for-profit health system. The property encompasses 193,000 square feet and benefits from being directly next to the AMITA Health St. Joseph Hospital Chicago campus. The purchase price of \$88.5 million equated to \$458 per square foot.

In October, Nashville, Tenn.-based Montecito Medical acquired Aurora Health Center located at 9000 Sura Lane in Greenfield, Wis. The 138,200-square-foot building is fully leased to Advocate Aurora Health (Aa3/AA/NR), its first Milwaukee-area outpatient surgery center. The facility features eight surgical suites, two pain management procedure rooms, two gastroenterology suites, and two outpatient interventional radiology suites and houses the system’s sports medicine services. The purchase price of \$74 million equated to \$535 per square foot.

Mid-Atlantic

In November, New York-based GIC acquired Pitt’s Innovation Hub at 5000 Baum Blvd. in Pittsburgh, Pa., for a majority interest. The 353,000-square-foot property is an adaptive reuse project as part of a historic building transformed into a hub for the Immune Transplant and Therapy Center to advance research, innovation, and health care. The facility is strategically located next to UPMC Shadyside Hospital. The purchase price of \$190.4 million equated to \$539 per square foot.

In December, Saudi Arabia-based Sidra Capital acquired the majority position in Arborcrest Corporate Campus, an 855,600-square-foot suburban office complex located in Blue Bell, Pa. The acquisition is part of Sidra's focus on buying properties that have long-term stability and tenants in the life sciences sector. Among Arborcrest's tenants are Signant Health (B2/NR/NR), which opened its new 110,000-square-foot headquarters at the complex. Other tenants include Pharmaceutical Research Association and Abington Memorial Hospital, which operates an outpatient clinic at the campus. The purchase price of \$225 million equated to \$344 per square foot.

Southeast

Charlotte, N.C.-based Flagship Healthcare Properties continued its acquisition streak in the southeast by acquiring 790 Concourse Parkway in Maitland, Fla., a suburb of Orlando. The 44,000-square-foot MOB is fully leased to four tenants and anchored by Maitland Surgery Center, an affiliate of Surgical Care Affiliates. The \$17 million purchase equated to \$386 per square foot and a cap rate of 6.3 percent.

In December, Healthcare Realty Trust acquired two properties in Gainesville, Ga., known as the Gainesville Medical Office Portfolio. Developed in 2018, the 138,819-square-foot portfolio is anchored by Northside Hospital which offers oncology/hematology clinic, orthopedic services, and North Georgia Eye Center, which offers an ophthalmology clinic and laser cataract surgery center. The properties are strategically located less than a half mile from the 557-bed Northeast Georgia Medical Center – Gainesville (NR/A/NR). The purchase price of \$50.1 million equated to \$361 per square foot.

Footnote:

1. "MOB Pricing Holds Steady in First Full COVID-19 Impacted Quarter," H2C, Aug. 18, 2020.
2. "AHA report: Hospital financial losses from COVID-19 expected to top \$323 billion in 2020," American Hospital Association," June 30, 2020.
3. "HSS Nationally Ranked No. 1 in Orthopedics by U.S. News & World Report for 11th Straight Year," HSS, July 28, 2020.

All exhibits are based on H2C analysis of industry data.

About Hammond Hanlon Camp LLC

H2C is a strategic advisory firm committed to providing superior advice as a trusted advisor to healthcare organizations and related companies throughout the United States. H2C's professionals have a long track record of success in healthcare mergers and acquisitions, capital markets, real estate, and restructuring transactions, acting as lead advisors on hundreds of transactions representing billions of dollars in value.

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