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Medical Office Building Quarterly Update

Record First-Quarter Acquisition Volume, Solid Activity as COVID-19 Environment Plays Out

May 2020

Average Medical Office Building Cap Rates Continue to Decrease as Supply Lags Demand

During a relatively normal transaction environment for the majority of the first quarter, average medical office building ("MOB") cap rates reached a historic low of 6.62 percent. However, because transaction data is a lagging indicator of activity, H2C has grounded its insights around first-quarter MOB activity with observations obtained through current marketing of MOB portfolios in a COVID-19 environment.

While real estate investment trusts ("REITs") have been the largest investors for three out of the past four quarters of transaction volume and accounted for 21 percent of MOB volume in Q1, H2C expects

REIT acquisitions to decrease dramatically in Q2. This assumption is based on the sharp decline in REIT market shares over the prior quarter, falling by one-third to one-half at the time of this writing. While REITs face significant financial fallout from the effects of COVID-19 at the tail end of Q1 and into Q2, in the first quarter, Welltower (NYSE: WELL) made acquisitions totaling \$119.6 million across 15 properties, Urban Edge Properties (NYSE: UE) invested in one \$76 million property, and Healthcare Realty Trust Inc. (NYSE: HR) purchased \$68.5 million across four properties. Other active REITs included Physicians Realty Trust (NYSE: DOC), which bought one property for

\$49.1 million, and Global Medical REIT (NYSE: GMRE), which made investments totaling \$42.1 million across three assets.

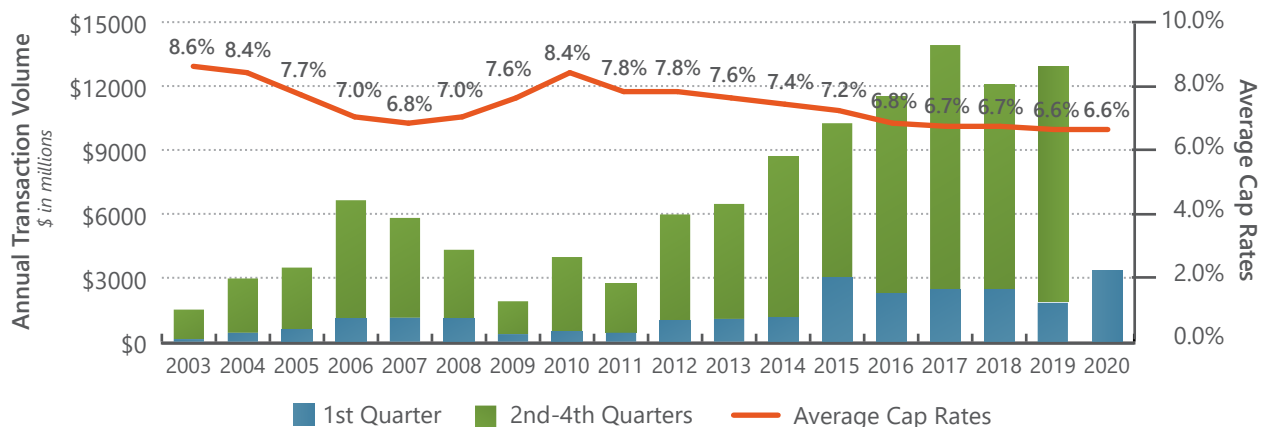
Private equity investors, albeit in a far-more-fragmented allocation of buyers, accounted for most of this quarter's transaction volume, with \$1.4 billion of volume, and H2C anticipates these investors will account for a larger portion of transaction volume in Q2 and Q3 of 2020 as REIT activity declines. In Q1, private equity investors were led by Chicago-based MB Real Estate ("MBRE"), which purchased four properties for \$75.2 million, and Montecito Medical Real Estate, which purchased four properties for \$56.6 million.

Consistent with historical trends, Welltower was the largest buyer of MOBs in 1Q 2020 across the investor spectrum, acquiring \$119.6 million in outpatient medical office properties totaling more than 568,000 square feet. Of the 15

properties acquired, the majority of transaction activity occurred in the Midwest Region, where overall transaction volume increased \$90.9 million over the prior quarter. Strikingly, all acquisitions by Welltower were single-asset

transactions, a shift from its preferred strategy of MOB portfolio acquisitions, but in line with prior H2C MOB reports that show the overall slowdown of portfolio transactions.

Figure 1: MOB Sales Volume and Cap Rate Trends¹ • \$ in millions



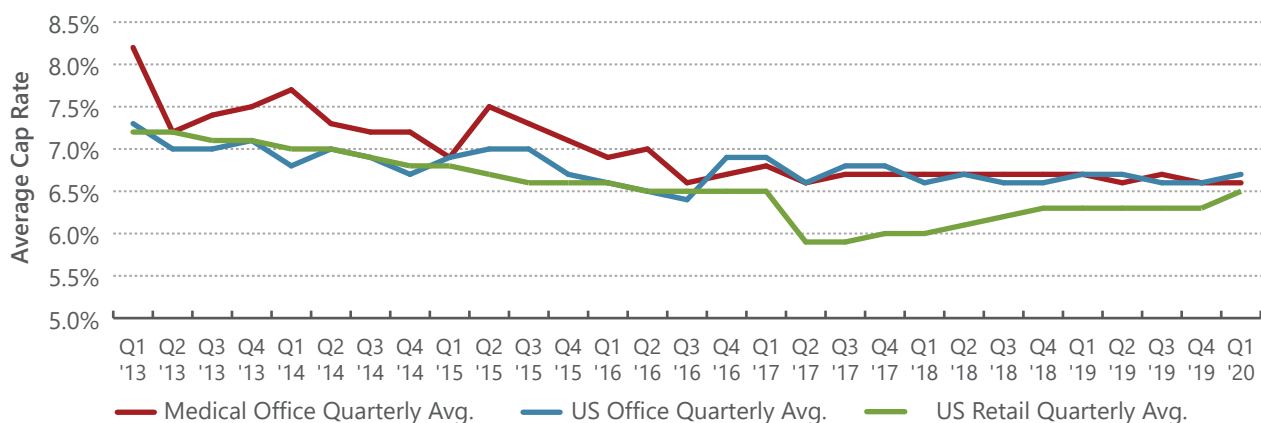
Transaction volume for the quarter was \$3.2 billion—a record first quarter in volume. Notably, the average size of MOBs sold in Q1 was 5.3 percent smaller than in Q4 2019, coming in at just over 34,000 square feet. Given this dynamic,

and as alluded to in H2C's Q4 2019 MOB Report, smaller assets have increased in appeal due to the shortage of larger MOBs to meet acquisition goals.

As stated in previous H2C MOB reports, alignment of buyer and

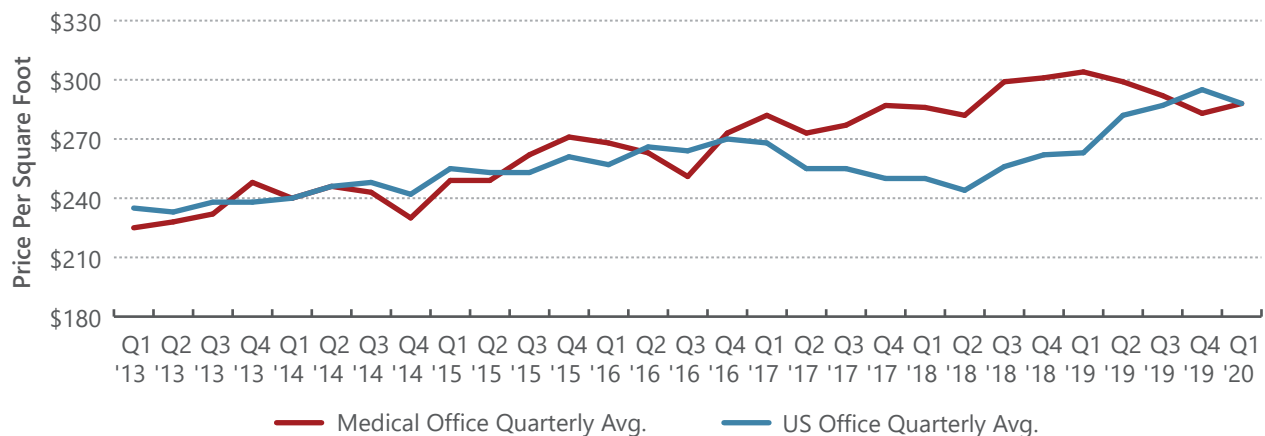
seller expectations seems to be in sync, as average cap rates have been consistently trending downward—albeit slowly—despite significant variation in number of properties sold and transaction volume.

Figure 2 : Cap Rate Trends¹



¹Source: Real Capital Analytics

Figure 3: Price per Square Foot Trends¹



Cap rates reached an all-time low based on the trailing 12-month average cap rate of 6.62 percent, while average price per square foot of MOB's remains near its all-time high, currently at \$286 per square foot. Given the declining supply of MOB's to feed the market's dry powder and an attractive interest rate environment, H2C anticipates that pricing will remain steady in 2020 unless significant supply is added to satisfy the increasing demand.

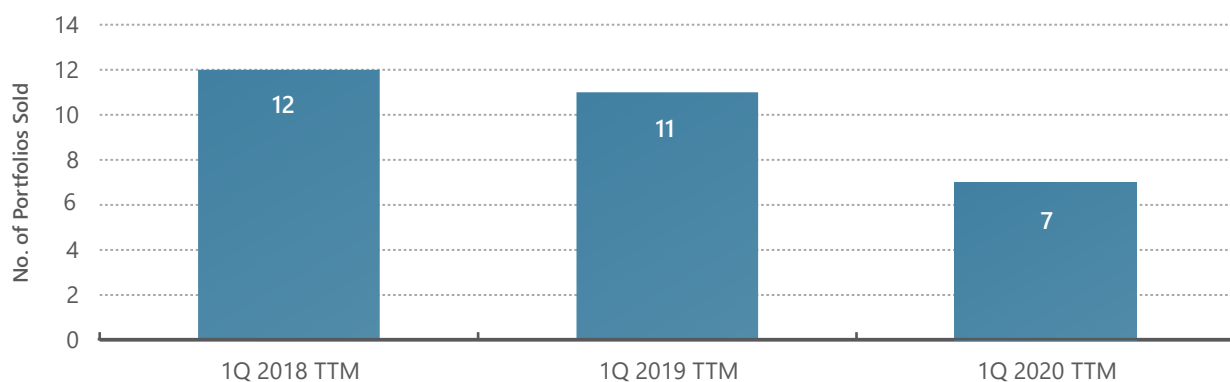
Investment Sales and Trends

Seven large portfolios (with large defined as having eight assets or more and in excess of \$75 million) transacted in the trailing 12-month period ending with Q1 2020. This is a fraction of the large portfolios transacted during the same 12-month period in 2017 and 2018. The lack of larger portfolios, particularly in the second half of 2019, led to an increasing number of investors looking at smaller

MOB's, which were packaged to create a larger gross sales volume to appease acquisition appetite. H2C anticipated that there would be substantial demand for large portfolios, projected to hit the market throughout 2020, and that prediction has come to fruition during the sales processes of two \$100+ million health system sale/leaseback transactions, which H2C is currently handling.

The largest non-REIT transaction

Figure 4: Large Portfolio Transactions¹ • Medical Office Quarterly Average



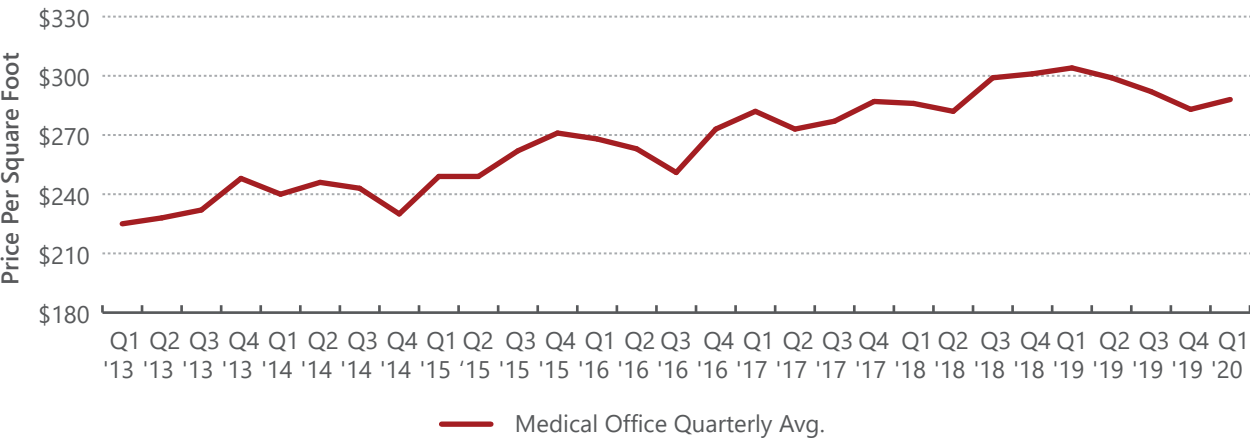
¹Source: Real Capital Analytics

of the quarter occurred when The Howard Hughes Corporation ("Howard Hughes") sold a single MOB to Harrison Street Real Estate Capital ("Harrison Street") in March. The \$115 million transaction consisted of an outpatient cancer center totaling 208,000 square

feet. The MOB is 100 percent leased to University of Texas MD Anderson Cancer Center (Aaa/AAA/AAA), the top-ranked cancer care center in the nation by U.S. News and World Report. The MOB is the largest cancer care center in the nation and had no shortage of

interest. As highlighted in H2C's Q4 MOB Report, price-per-square-foot trends continue to remain at near-all-time highs due to the lack of supply in the MOB marketplace. The cap rate for this transaction was rumored to be below 5 percent.

Figure 5: Price Per Square Foot¹



Regional Review

In pace with previous years, the Western region accounted for 22.3 percent of this year's transaction volume, trailing transaction volume in the Southeast region by \$6.5 million. However, the West retained the lowest average cap rate compared with other regions, at 5.92 percent. It should be noted that the West's Q1 2020 cap rate has decreased by 14 basis points compared with the previous quarter and is in line with four of the other five regions, which have all experienced decreasing cap rates over the prior quarter.

The Northeast, Southeast, and Southwest's cap rates ranged from 6.47-6.88 percent, below the Midwest and Mid-Atlantic regions.

In past quarterly MOB Reports, H2C has alluded to the fact that the West and Northeast have seen an increase in average cap rates while other regions have seen cap rate compression—most notably the Southeast, where cap rates have decreased nearly 44 basis points since the passing of the Federal Tax Cuts and Jobs Act ("TCJA"). Recent investments have clearly shown a relationship with population movements as more and more

retirees flee high-tax states for locations within lower-tax, business-friendly states in the Southeast and Southwest.

¹Source: Real Capital Analytics

Figure 6: Changes in Cap Rates by Region¹ • Trailing 12-Month Average

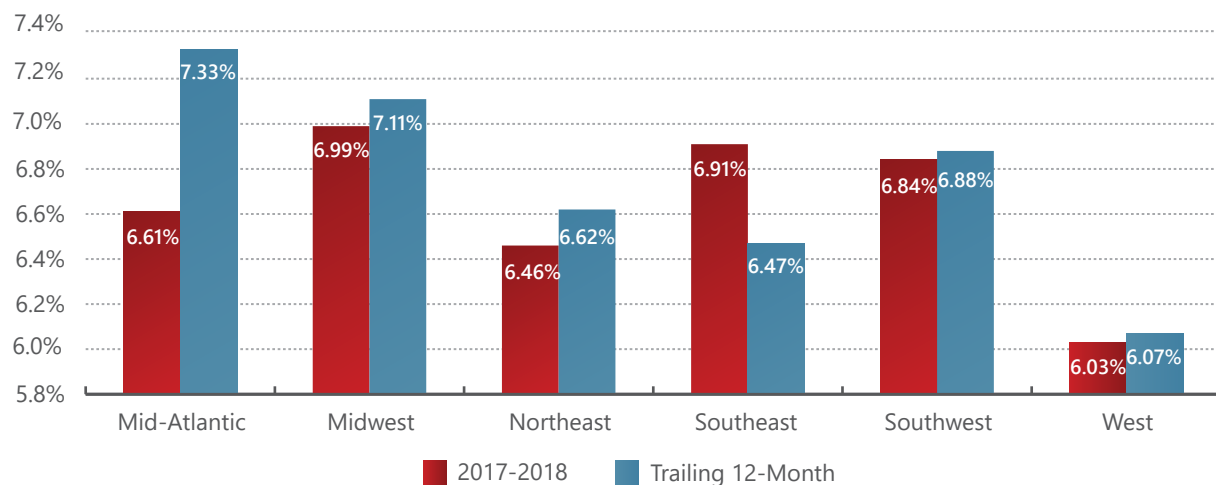
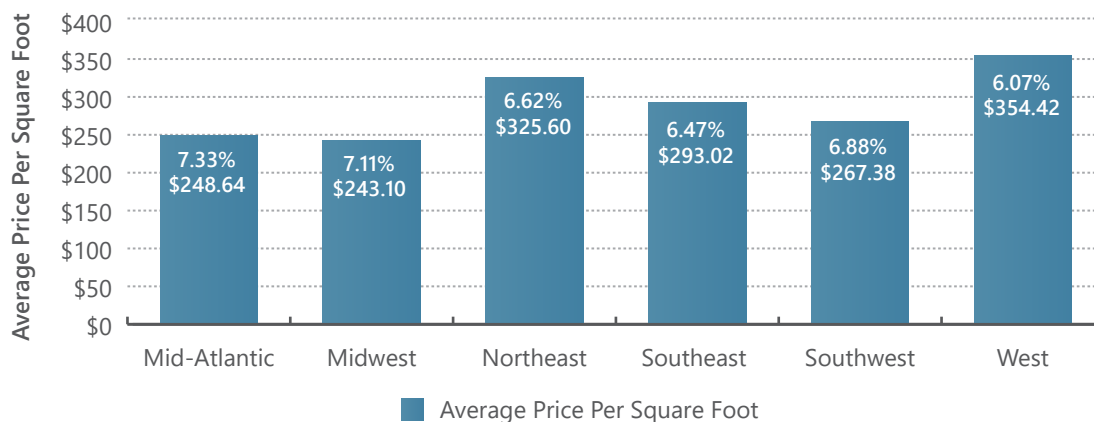


Figure 7: 2019 Average Price Per Square Foot and Cap Rate by Region¹ • \$ in millions



Northeast Region

In February, MBRE Healthcare purchased 5959 Big Tree Road in Orchard Park, New York, from a local developer and investor. The single-story, 115,317-square-foot MOB, which was developed in 2013, is leased to UBMD Physicians Group, the largest medical group in Western New York and an affiliate of the University of Buffalo. Services offered at the property include sports medicine, rehabilitation, diagnostic imaging, casting, orthopedics,

and treatment of musculoskeletal ailments. It sold slightly below the original asking price for \$44.5 million, or \$386 per square foot.

Massachusetts-based Shields Health Care Group sold its recently developed MOB in Shrewsbury, Mass. The single-story, 41,643-square-foot MOB was built-to-suit by the Shields Health Care Group and was sold to The Surgery Center Shrewsbury, an affiliate of the University of Massachusetts (Aa2/AA-/AA), with which Shields Health Care Group

had an operating relationship, in February. Services at the property include plastic surgery, foot/ankle and hand/upper-extremity procedures, sports medicine, and general musculoskeletal procedures. The \$30.3 million purchase price equated to \$726 per square foot.

West Region

In January, Healthcare Realty Trust acquired the Taj Mahal Medical Center located at 23521 Paseo de Valencia in Laguna Hills, Calif., from The Muller Company, a local investor

¹Source: Real Capital Analytics

and developer. The 79,539-square-foot, class A MOB, developed in 1964 and renovated in 2011, is 100 percent occupied by Sand Canyon Urgent Care, a local urgent care provider with one other location in California. Services offered at the MOB include primary injury care, urgent care, imaging services, hydration therapy, occupational medicine, and travel vaccines or flu shots. The \$42 million purchase price equated to \$528 per square foot.

Crescent Heights, a private, national investor, acquired the Wilshire Medical Center, located at 6200 Wilshire Boulevard in the greater-Los Angeles area, from a private, local investor. The 17-story, 112,985-square-foot MOB was developed in 1970 and is in need of significant capital expenditures. The property is 46 percent occupied in anticipation of building renovations and is currently leased to multiple tenants, including Westside Wilshire Medical Group, Urgent Orthopedic Care, and Select Physical Therapy. It is strategically located less than 1.5 miles from Cedars-Sinai Medical Center, one of the largest not-for-profit academic medical centers in the nation, with 886 beds. The purchase price of \$54.3 million equated to \$480 per square foot.

Southwest Region

As previously noted, in March, Harrison Street purchased 100 Fellowship Drive in The Woodlands, Texas, from Howard Hughes. The three-story, 208,000-square-foot MOB, which was developed in 2017, is leased to MD Anderson Cancer Center. Services offered at the property include cancer pain management, clinical nutrition, diagnostic imaging, and social

work counseling. The \$115 million acquisition equated to \$553 per square foot.

California-based private investor The Landry Family Trust purchased the Rancho Santa Fe Center, located at 13055 West McDowell Drive in Avondale, Ariz., for \$17.8 million, or \$241 per square foot. The 73,961-square-foot MOB was developed in 2003 and has undergone multiple renovations since inception. Tenants include the Arizona Vein and Laser Institute, Nextcare Urgent Care, and Banner Physical Therapy, an affiliate of Banner Health (NR/NR/AA-). Services offered at the MOB include physical therapy, pain management, infectious disease, cancer research, and women's health. The property is located just over one mile east of Abrazo Community Health Network's West Campus Hospital (179 beds). Notably, the property is located within a qualified opportunity zone.

Midwest Region

In January, Welltower acquired the Hauser-Ross Eye Institute, located at 1630 Gateway Drive in Sycamore, Ill., from IRA Capital as part of a 16-property portfolio transaction. The 36,500-square-foot, class A MOB was developed in 2015 and is 100 percent occupied by the Hauser-Ross Eye Institute, an Illinois-based specialized treatment physician group with 18 physicians spread across five locations. Services offered at the MOB include LASIK surgery, cataract treatment, corneal transplants, glaucoma care, and retina services. The allocated \$16.3 million purchase price equated to \$445 per square foot.

Nebraska-based private investor Noddle Development purchased the Village Point Health Center, located at 110 North 175th Street in Omaha, Neb., for \$30.1 million, or \$311 per square foot. The 96,764-square-foot MOB was developed in 2011 and renovated in 2015. Tenants include Children's Physicians, an affiliate of Children's Hospital & Medical Center (A1/NR/AA-), and Nebraska Medicine (NR/AA-/AA-). Services offered at the MOB include an outpatient surgery center, outpatient rehabilitation, family medicine, and women's health.

Mid-Atlantic

A joint venture between Flagship Healthcare Properties and Cato Management purchased the Blue Ridge Surgery Center, located at 2308 Wesvill Court in Raleigh, N.C., from a local, private investor. The single-story, 20,962-square-foot MOB was built in 1994 and is 100 percent occupied by the Blue Ridge Surgery Center, an affiliate of Surgical Care Affiliates. Services offered at the facility include orthopedic surgery, pain management, spinal surgery, and colorectal surgery. The \$10.4 million acquisition equated to \$496 per square foot. Notably, the MOB is located less than half a mile from UNC Rex Hospital's 665-bed campus.

In February, Global Medical REIT acquired 1814 Westchester Drive in High Point, N.C., a single-tenant, 97,000-square-foot MOB. Known as the Cornerstone Westchester Medical Office Building, the property was developed in 2007 and is leased to Cornerstone Health Care, which is wholly owned by Wake Forest Baptist Health (A/A2/NR). Services offered at the property include a

multispecialty clinic, neurology, urgent care, and diagnostics. The \$24.75 million purchase price equated to \$255 per square foot and a 7.4 percent cap rate.

Southeast

In February, TM Medical Properties purchased 302 South Royal Oaks Boulevard in Franklin, Tenn., from Anchor Investments. The single-story, 20,637-square-foot MOB, which was developed in 1998, is leased to Vanderbilt Health (A3/

NR/AAA), one of the largest academic healthcare providers in the Southeast. Services offered at the property include pain management, bone and joint care, neurological disorders, and spine care. The \$7.9 million acquisition equated to \$384 per square foot. The cap rate was reported to be 5.8 percent.

Dallas-based Caddis Healthcare Real Estate acquired a multi-tenant MOB located at 620 Cherokee Street NE in Marietta, Ga., from SK Commercial

Realty. The 21,263-square-foot property was completed in 2019 and is adjacent WellStar's Kennestone Hospital. The property is leased to OrthoAtlanta, Georgia Hand, Shoulder & Elbow. and NMotion Hand and Physical Therapy on a long-term basis. The purchase price of \$10.55 million equated to \$496 per square foot.

NEW YORK

623 Fifth Avenue
29th Floor
New York, NY 10022
212 257 4500

CHICAGO

311 S. Wacker Drive
Suite 5425
Chicago, IL 60606
312 508 4200

ATLANTA

3333 Piedmont Road
Suite 725
Atlanta, GA 30305
402 937 1350

SAN DIEGO

4655 Executive Drive
Suite 280
San Diego, CA 92121
858 242 4800

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The experienced professionals at H2C are well positioned to serve as your trusted advisors. We have the expertise to understand the unique complexities of the healthcare industry and an in-depth knowledge of the range of potential alternatives essential to designing and implementing highly successful business and financial strategies. We bring in-depth knowledge and experience across the full continuum of care and across a wide range of healthcare-related businesses.

H2C offers services in the following areas:

- Strategy design, development and execution
- Mergers, acquisitions and divestitures
- Capital planning and management
- Capital markets financial advisory and private placements
- Real estate advisory and execution services
- Bankruptcy and restructuring

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For more than 20 years, the real estate investment banking professionals at H2C have successfully served as advisors on real estate transactions in excess of \$12.5 billion nationwide. For more information on our real estate advisory group, please contact one of the following H2C professionals or visit our website at h2c.com.

Philip J. Camp
Principal
212 257 4505
pcamp@h2c.com

Brady R. Stern
Director
312 508 4203
bstern@h2c.com

Matthew T. Tarpley
Vice President
212 257 4516
mtarpley@h2c.com

E. Chris Byrns
Associate
212 257 4518
cbyrns@h2c.com

Mitchell J. Levine
Associate
212 257 4519
mlevine@h2c.com

Stuart L. Gilbert
Analyst
212 257 4506
sgilbert@h2c.com

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