

GREATER PHOENIX | MEDICAL OFFICE

3Q 2015

Accelerating success.

Activity Strengthens in the Medical Office Market

Key Takeaways

- Medical office vacancy in Greater Phoenix has been improving in recent quarters, ending the third quarter at 16.7 percent. The most significant vacancy declines have been recorded in on-campus buildings.
- Rents inched higher during the third quarter, but are a tick lower than one year ago. The strongest rent gains are being recorded in on-campus buildings, while the weakest performance has been in large, off-campus buildings.
- Sales for medical office buildings slowed by more than 10 percent during the third quarter and pricing trends were mixed. Several large multi-tenant buildings changed hands during the third quarter, including a few that sold for more than \$250 per square foot.

Greater Phoenix Medical Office Market

After a slow first half of the year, conditions improved in the Greater Phoenix medical office market in the third quarter. Net absorption spiked in the third quarter, repeating a trend that emerged in the second half of last year. The surge in absorption has driven vacancy lower, and rents have begun to tick higher in recent months. With occupancies firming, landlords will ultimately begin to implement some modest increases, but this could take a few more quarters of improvement before a clear upward direction of market rents fully takes shape.

Investment trends are mixed, with activity picking up for traditional multi-tenant medical office buildings and slowing in condos. These trends will likely continue in the quarters ahead, as the consolidation that has been occurring in the healthcare industry should allow for greater activity at the high-end of price spectrum. With investors seeking buildings offering higher yields and tenants with sound financial profiles, medical office properties will likely remain a popular choice with institutional investors.

Market Indicators Relative to prior period	Market Q3 2015	Market Q3 2014
Vacancy	↓	↓
On-Campus Vacancy	↔	↓
Completions	↑	-
Net Absorption	↑	↑
On-Campus Net Absorption	↓	↓
Asking Rents	↑	↓

Second Quarter Employment Trends*

Total Nonfarm Phoenix Metro	↑	↑
Healthcare Employment Phoenix Metro	↑	↑
Total Nonfarm United States	↓	↓
Healthcare Employment United States	↓	↓

*Source: Bureau of Labor Statistics

Summary Statistics	Phoenix Market	On-Campus MOB	Off-Campus MOB
Vacancy Rate	16.7%	16.5%	17.5%
Change from 3Q 2014 (bps)	-120	-190	-110
Net Absorption (thousands SF)	104.4	16.1	88.3
New Construction (thousands SF)	20.2	20.2	0
Under Construction (thousands SF)	46.9	46.9	0
Asking Rents Per Square Foot Per Year	\$22.70	\$26.32	\$21.82
Change from 3Q 2014	-0.3%	0.5%	-0.8%

Vacancy:

- › Vacancy in the Greater Phoenix medical office market dipped to 16.7 percent in the third quarter, the fifth decline in the past six quarters. Vacancy is 120 basis points lower than during the third quarter of last year.
- › Vacancy in on-campus buildings has retreated 190 basis points year over year to 16.5 percent as of the third quarter. Vacancy in on-campus buildings has fallen 320 basis points in the past 24 months.
- › Vacancy is also improving among off-campus medical office buildings. The rate ended the third quarter at 17.5 percent, down from 18.6 percent one year ago. Net absorption in off-campus buildings totaled more than 90,000 square feet in the third quarter, bringing the total for the past 12 months to approximately 200,000 square feet.

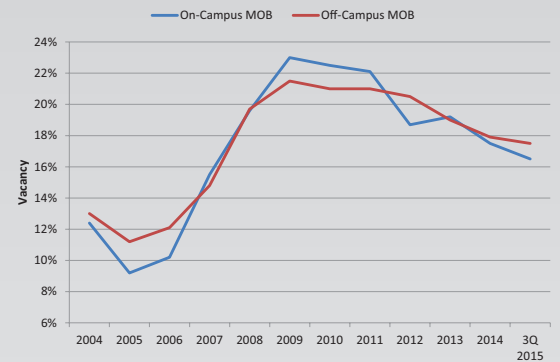
Rents:

- › Average asking rents of \$22.70 per square foot are 0.3 percent lower than one year ago, but rents have increased in each of the past two quarters. Asking rent trends have been uneven from quarter to quarter, but the prevailing trend is for flat asking rents in medical office buildings.
- › Asking rents in on-campus buildings have ticked higher, rising 0.5 percent year over year to \$26.32 per square foot. Since year-end 2013, average on-campus asking rents have advanced 4 percent.
- › Asking rents in off-campus buildings have retreated 0.8 percent year over year to \$21.82 per square foot as of the third quarter. Large, multi-tenant buildings have been hit the hardest; asking rents in off-campus buildings of 50,000 square feet and larger have fallen 3.6 percent in the past year to \$23.25 per square foot.

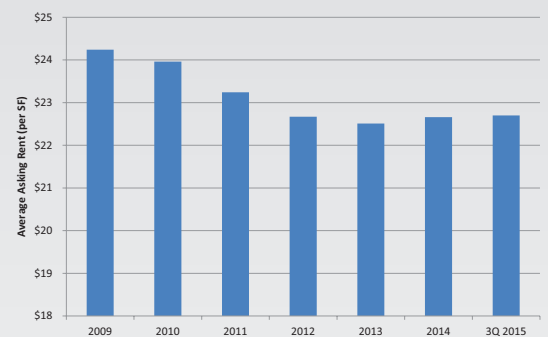
Investment Trends:

- › Medical office condos transaction activity slowed by nearly 15 percent during the third quarter. The slowdown has been a persistent trend as sales velocity year to date has lagged the 2014 pace by nearly 25 percent.
- › The median price in medical office condos during the third quarter was \$149 per square foot, down less than 2 percent from the second quarter. To this point in 2015, the median price is also \$149 per square foot, up 17 percent from the 2014 median price.
- › Sales activity for traditional medical office buildings slowed by approximately 18 percent during the third quarter, after a fairly steady first half of the year. Even after accounting for the recent dip in activity, year-to-date sales of medical office buildings are up 38 percent compared to the same period in 2014.
- › The median price in traditional medical office building sales has been \$141 per square foot thus far in 2015, a 17 percent increase from the median price in 2014. Prices rose during the third quarter, with the median price reaching \$159 per square foot, and a handful of properties selling for more than \$250 per square foot.

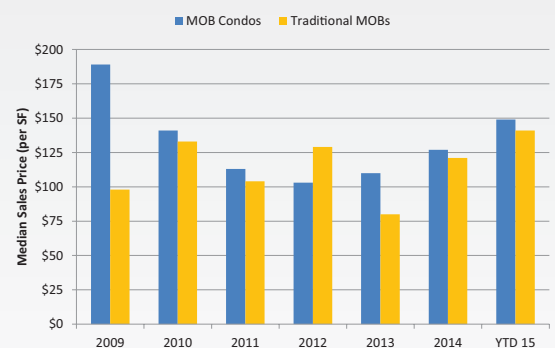
Vacancy by Submarket Cluster



Asking Rents Trends



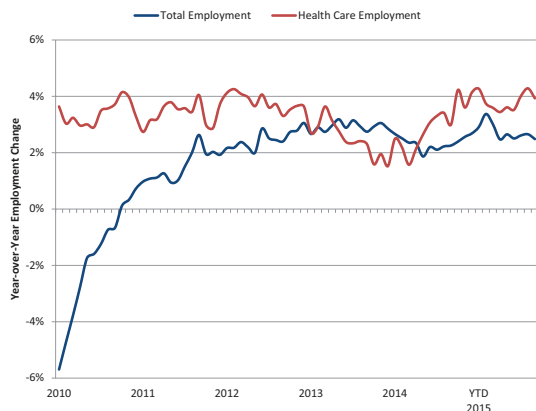
Investment Trends



Outlook:

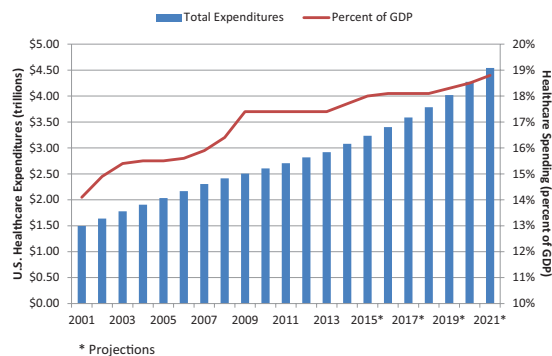
The Greater Phoenix medical office is poised to end 2015 on an upswing. After a fairly slow start to the year, net absorption accelerated in the third quarter and additional tenant move-ins are scheduled for the fourth quarter. Tenant demand for medical office real estate is being sparked by demand for medical services, which is being fueled by local employment and population growth. These drivers are forecast to accelerate significantly in 2016, with a greater number of employment sectors likely to add workers at healthy paces in the months ahead.

Greater Phoenix Employment Trends

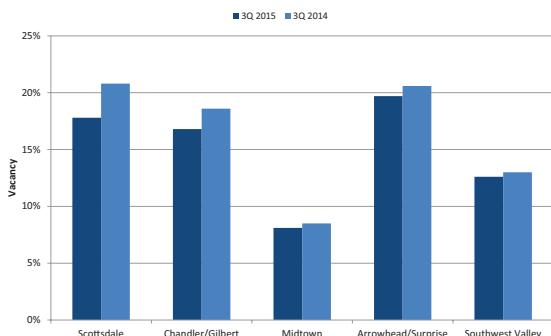


The investment outlook for medical office properties is brightening, as much of the uncertainty that has dragged on the market in recent years is lifting. This is resulting in accelerating sales activity of traditional multi-tenant medical office buildings and rising prices. While each election cycle brings some degree of uncertainty surrounding the future of the Affordable Care Act, the expansion of coverage that has occurred over the past few years is expected to persist.

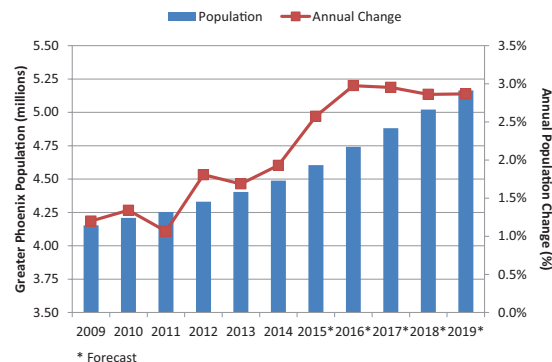
U.S. Healthcare Expenditures



Greater Phoenix MOB Vacancy by Submarket



Greater Phoenix Population Trends



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