NATIONAL REPORT

Marcus & Millichap

MEDICAL OFFICE BUILDINGS

2022

Demand for Medical Office Space Normalizes; Investors Flock to Sector in Defensive Strategy

Resumed appointments, aging population enhance medical office space needs. Medical offices have generally weathered the downturn better than traditional offices. After an initial span when individuals were delaying routine procedures and elective surgeries, demand for the services offered in medical offices has improved. While some people continue to practice caution amid the emergence of new COVID-19 variants, ultimately many of these appointments must be fulfilled. All the while, the population is aging, which brings along certain medical realities. These factors together underpin the current strong tenant demand for medical offices. Vacancy in the sector only rose 80 basis points to 9.5 percent in 2020, less than a third of the jump seen in traditional offices. Availability started to tighten late last year, aided by a contracting construction pipeline. This is in turn benefiting rent growth. In the closing months of 2021, the average asking rate was broaching $22 per square foot, up more than 4 percent since the end of 2019.

Favorable demand outlook constrained by staff shortages, burnout. While the long-term demand for medical procedures and medical office space will continue to expand, in the short term, medical practitioners face a substantial impediment to growth in staffing shortages. The health crisis has been particularly hard on healthcare workers. A September 2021 national poll revealed that more than a third of healthcare workers felt that their relationship with friends, their personal finances and their day-to-day lives have gotten worse since the pandemic began. More than half say that their mental health has worsened in the health crisis. These unfortunate sentiments are associated with higher burnout. The healthcare and social assistance employment sector remained 3 percent below its pre-pandemic headcount late last year, with a near-record high quit rate of 2.7 percent in October 2021. Medical practices are aware of this dilemma; 73 percent of them ranked staffing as their largest pandemic-related challenge entering 2022. The inability to onboard staff may keep medical practices from expanding this year, combating what are otherwise strong demand tailwinds.

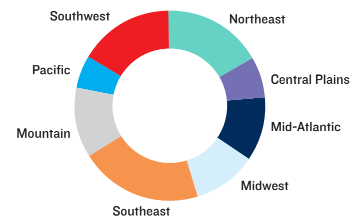
Investment Trends

Southwest and southeast headline strong investment landscape. Investment demand has endured better for medical over traditional offices. Sales velocity only dipped 10 percent in 2020 compared to 2019, before improving by more than 40 percent in 2021 for a record trading year. The most medical offices changed hands in Phoenix, Los Angeles, Atlanta and Southeast Florida, aided by favorable demographics. Excluding Los Angeles, entry costs in those metros were also below the national average.

Investors targeting stabilized assets with quality tenants. Amid the ongoing health crisis, medical office investors are favoring properties occupied by tenants with strong ties to the location. This includes specialized floorplans and ample equipment common to offices for MRIs, dental work, dialysis and oncology services. This correlates with demand for longer lease terms of 10 years or more. Regional or national health systems and large physician groups also appeal to investors due to high credit grades.

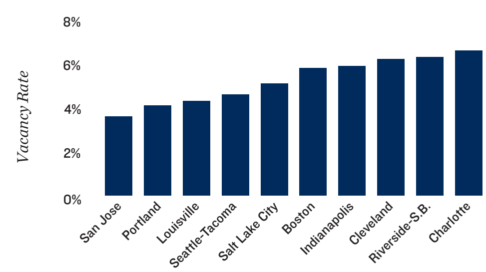
Comparatively stable yields draw buyer demand for well-tenanted assets. The mean cap rate has hovered in the high-6 percent to low-7 percent zone since 2016, with yields on institutional grade assets falling into the mid-5 percent band. Investors concerned about the risk profile of other property types are shifting to medical offices for a more stable outlook and higher comparative initial returns.

2021 MOB Completions By U.S. Region*

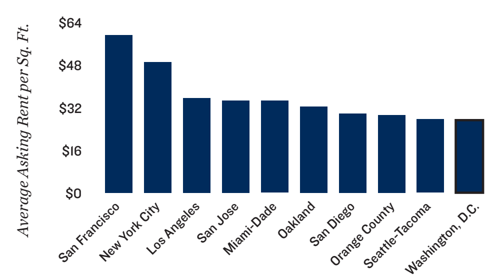


Regional shares based on estimated U.S. total of 7.8 million square feet.

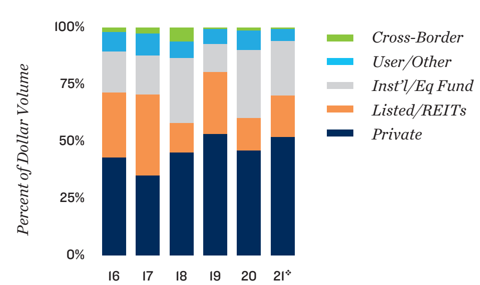
2021 Lowest Vacancy by Metro*



2021 Highest Asking Rent by Metro*



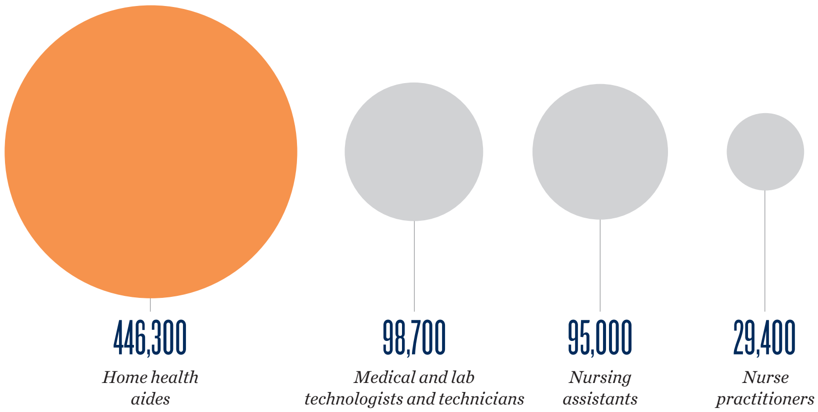
MOB Buyer Composition



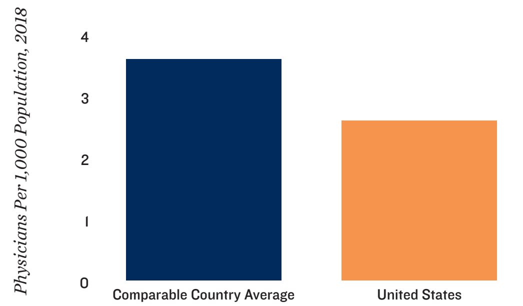
** Estimate*
*** Trailing 12 months through 3Q*

Even Before the Pandemic, the Country was Short-Staffed on Healthcare:

Pre-Pandemic Projection: By 2025, the US will likely face a shortage of:

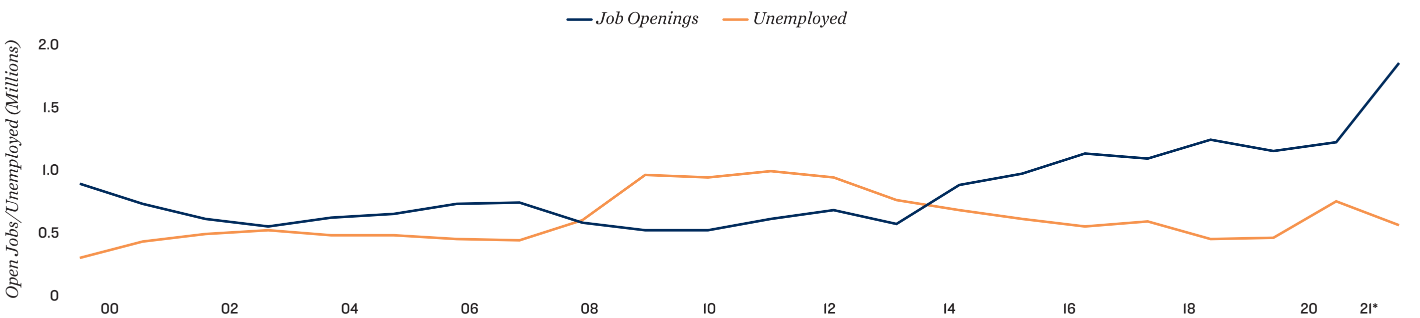


Physicians Under-Represented in U.S. Population



Conditions Have Worsened Since:

Number of Healthcare Jobs Well Surpasses Pool of Prospective Hires



** As of October*
Sources: Marcus & Millichap Research Services; Moody's Analytics; Economy.com

2022 Medical Office Building Forecast

9 million square feet

Construction:

Following disruptions and delays to construction stemming from the pandemic, developers are accelerating activity this year, bringing the volume of supply additions closer to par with 2020. An ongoing shortage of raw materials and construction labor increase the risk that some projects are delayed, however, which may lower the final arrival count from the 9 million square feet currently projected to open this year.

20 basis point decrease

Vacancy:

While development is accelerating, deliveries will still trail totals from the years leading up to the pandemic, and much of the space is already accounted for. This dynamic, paired with an improving patient flow, will help lower medical office vacancy to 9.2 percent this year, 40 basis points above the pre-health crisis level.

2.5% increase

Asking Rent:

Rent growth should slightly moderate this year following a year where accelerated gains were brought on in part by the economic reopening. The average asking rent will rise to $22.61 per square foot, with six markets above the $30-per-square-foot threshold spanning the Bay Area, New York, Miami-Dade and Los Angeles.

Alan L. Pontius
Senior Vice President | National Director, Healthcare Real Estate Division
Tel: (415) 963-3000 | al.pontius@marcusmillichap.com

For information on medical office buildings, contact:
John Chang
Senior Vice President | National Director, Research Services
Tel: (602) 707-9700 | john.chang@marcusmillichap.com

Price: $250

Sources: Marcus & Millichap Research Services; CoStar Group, Inc.; Moody's Analytics; Real Capital Analytics; U.S. Census Bureau.