



## H2C INDUSTRY INSIGHTS • REAL ESTATE

### Medical Office Building Quarterly Update

# MOB Pricing Holds Steady in First Full COVID-19 Impacted Quarter

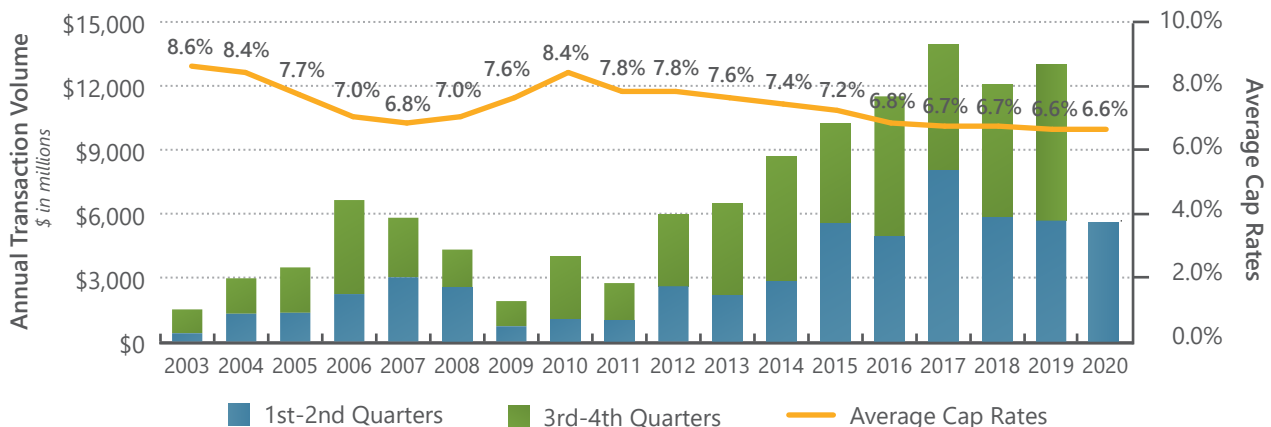
August 2020

*Cap rates are nearly flat and values have held as demand continues outpacing supply in desirable MOB asset class.*

This is H2C's first quarterly medical office building ("MOB") report since the impact of the COVID-19 pandemic played out through an entire quarter of activity. Notably, H2C had one of its most active quarters in advising health systems in their monetization and disposition efforts, with over \$200 million in transaction volume advised.

While COVID-19 has had a dramatic impact on other asset classes, such as senior housing and retail, where values are purported to be down 20-25 percent since March 2020, the MOB sector has shown resilience in values through the quarter, with average cap rates nearly flat at 6.62 percent and average price per square foot growing to \$290. MOB sales volume in the second quarter totaled \$2.3 billion, the lowest second-quarter volume seen since Q2 2014; however, pricing and cap rates held firm. Also noteworthy is that first-half MOB sales volume is only down 3 percent from 2018 and 2019, thanks to a robust Q1.

Figure 1: MOB Sales Volume and Cap Rate Trends<sup>1</sup> • \$ in millions

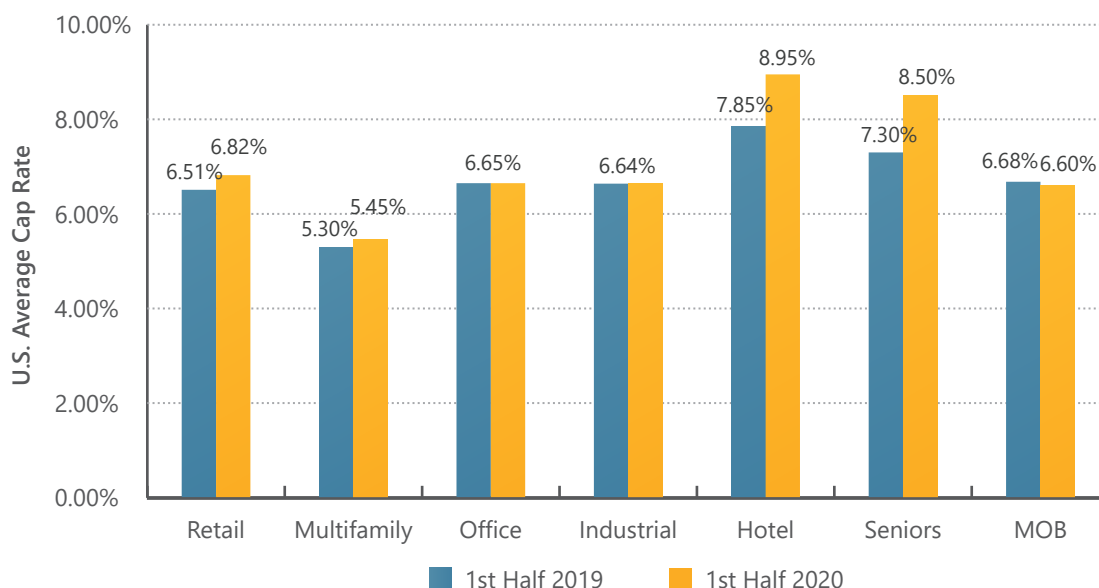


<sup>1</sup>Source: Real Capital Analytics

A notable observation in Q2 data is that publicly traded REITs, which have been net acquirers of MOBs over the past four years, were net sellers in the quarter. The delineation was likely driven by select REITs monetizing assets coupled with the lack of acquisitions made due to volatility in their stock prices, particularly during the first portion of the quarter.

Lower volume combined with stable values purport the ongoing lack of supply in the MOB space, as cited in previous H2C reports. Investors view the MOB space as a “safe haven,” where assets are necessary in the provision of healthcare versus other asset classes, such as retail, where the functional utility of brick and mortar locations is at a significant crossroads. In other asset classes, COVID-19 has driven the further elimination of certain locations and select tenants’ insolvency.

**Figure 2: Year-over-Year Cap Rate Comparison Across Major Asset Classes<sup>1</sup>**



<sup>1</sup>Source: Real Capital Analytics

Volume is anticipated to be lower in 2020 compared with previous years, but select factors suggest that values should remain strong in the MOB sector, such as low interest rates, high demand, low supply, and capital availability.

Although real estate headlines may suggest pricing headwinds for other asset classes, now is an opportune time for private investors to sell their MOBs, particularly those looking to place sale proceeds into asset classes that have higher risk-adjusted yields. This is a departure from the historical rationale for holding medical office real estate while the broader real estate capital markets demonstrated robust pricing over the past three years.

Notably, hospital and health system owners of medical office real estate may be in an advantageous position to sell in 2020 and beyond. According to the American Hospital Association (“AHA”), pandemic losses are expected to total \$323.1 billion in 2020, which brings health systems to an inflection point with their owned real estate. Monetizing healthcare real estate is an efficient approach to bolstering liquidity and mitigates temporary loss of non-emergent procedure volume that strains balance sheets. H2C is a leader in health system real estate monetization, having executed over a billion dollars in transaction value in recent years. H2C anticipates this trend will continue and that more health systems will look to transact in the next 12 months—most likely in the form of a sale/leaseback.

## Investment Sales and Trends

H2C handled the largest provider monetization of 2020 thus far in its work with Tower Health (NR/BBB+/ BBB), which monetized 23 properties for \$203.4 million, closing in June. All of the assets were located in Eastern Pennsylvania, and the properties were master leased for 18 years. The properties ranged in size from 4,600-92,000 square feet, with uses that included surgical, women's health, family medicine, behavioral, rehabilitation, imaging, and psychiatry, among others.

In the second quarter's largest transaction, Welltower (NYSE: WELL) sold 23 properties to Chicago-based MBRE in two transactions that closed in May and June. The 23-property portfolio consisted of outpatient MOBs and was 97 percent occupied, with a weighted average lease term ("WALT") of eight years. The dispositions coincided with a large monetization of senior housing assets that were acquired by a separate buyer. The MOB portfolio price was \$500 million and was reported at a 5.45 percent cap rate.

MBRE was the largest acquirer of MOBs in Q2, having closed on \$560 million of MOBs, followed by IRA Capital, which acquired \$160 million across 11 properties, and Oak Street Real Estate Capital, which acquired \$210+ million across 25 assets, 15 of which closed in Q2, with the remaining 10 closed in July.

Figure 3 : Cap Rate Trends<sup>1</sup>

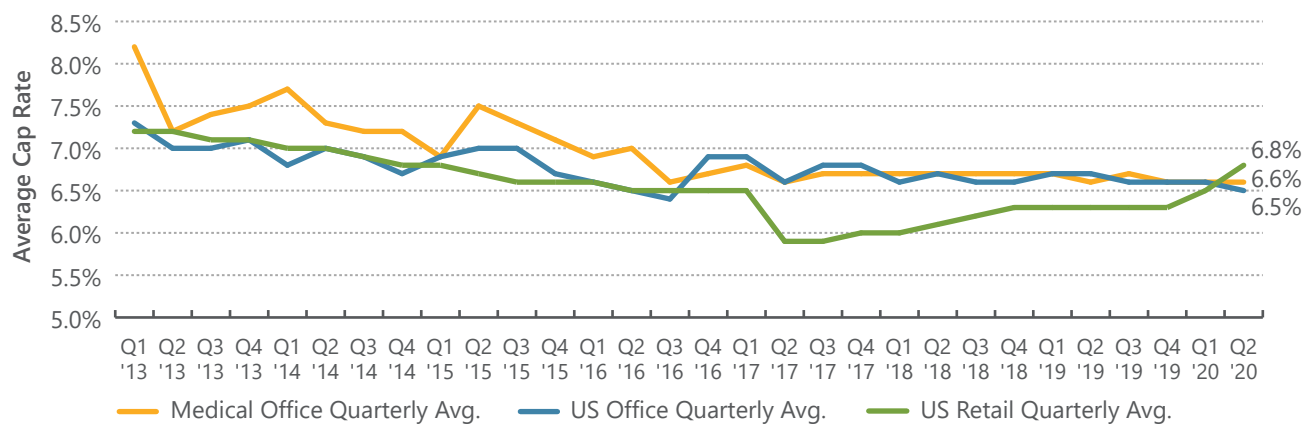
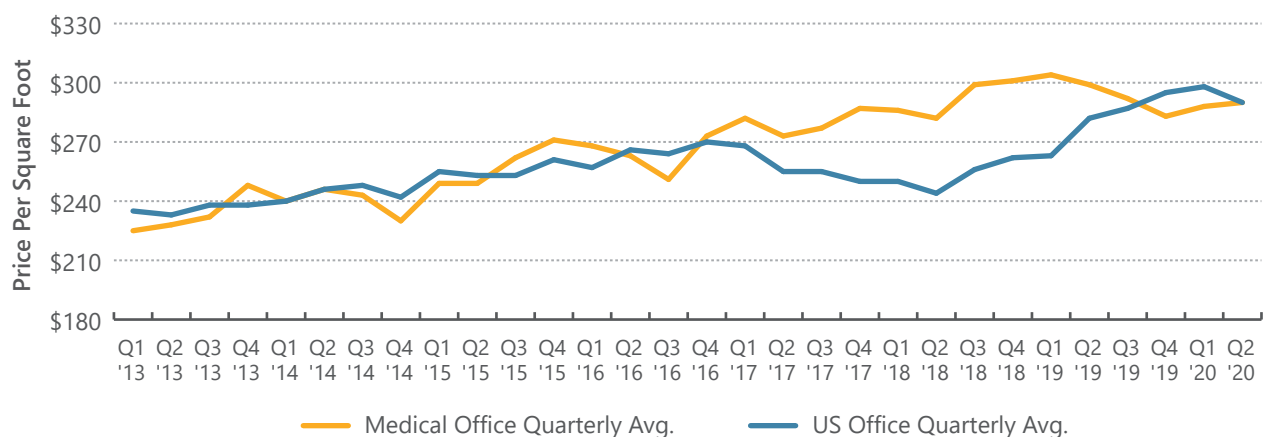


Figure 4: Price per Square Foot Trends<sup>1</sup>

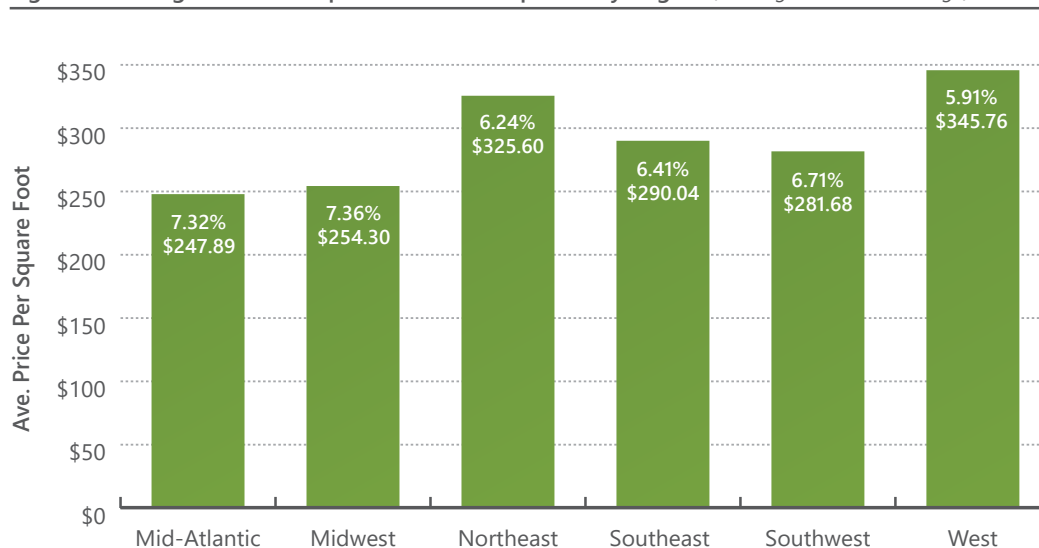


<sup>1</sup>Source: Real Capital Analytics

## Regional Review

For the first time since 2018, the Northeast region had the greatest transaction volume compared with other RCA-tracked regions, at \$623.9 million. Despite the increase in transaction volume, average cap rates for the Northeast are still higher than levels from 2015-2017, a stark contrast pointed to by H2C in previous reports regarding the desirability of MOBs in high-tax states since the Tax Cuts and Jobs Act of 2017 was enacted. Average price per square foot in the Northeast region remained high, settling at \$380 per square foot, due to the lack of developable land in the region. Approximately 25 percent of the region's volume was attributed to the first tranche of the Tower Health portfolio and two assets within the Welltower/MBRE transaction; however, it was still an active quarter for volume in the Northeast.

Figure 5: Average Price Per Square Foot and Cap Rate by Region (Trailing 12-Month Average) <sup>1</sup>



<sup>1</sup>Source: Real Capital Analytics

### Northeast Region

In June, IRA Capital acquired 1155 Northern Boulevard in Manhasset, N.Y., a suburb in Long Island that is 15 miles east of New York City. The three-story, 51,050-square-foot MOB was 94 percent leased and anchored by Mount Sinai (A3/A-/A) and NYU Langone (A3/A/NR). Services offered at the property include internal medicine, gastroenterology, cardiology, and surgical. The \$18.2 million purchase equated to \$357 per square foot and a 5.2 percent cap rate.

Boston-based Albany Road Real Estate Partners purchased 180-200 Corliss Street in Providence, R.I., in May. Services at the properties include men's health, imaging, pharmacy, primary care, laboratory, behavioral health, infectious disease, and immunology. The three properties total 175,000 square feet and are leased to Lifespan and The Miriam Hospital. The \$42.5 million purchase equated to \$243 per square foot and a 7.4 percent cap rate.

### West Region

White Plains, N.Y.-based Seavest Healthcare Properties acquired the Martin Luther King Jr. Community Hospital MOB on the campus of MLK Jr. Community Hospital (131 beds) in Los Angeles from the developer, Trammel Crow Company. Located at 12021 S. Wilmington Avenue, the 52,000-square-foot MOB was completed in March 2020 and is long-term leased to a public-private joint venture between Los Angeles County, University of California (Aa2/AA-/AA), and MLK Jr. Community Hospital. Services located at the property include an ambulatory surgery center, provider care space, wound care, telehealth, imaging, dental, sterile processing, and pharmacy. The \$43.3 million purchase price equated to \$832 per square foot.

A joint venture between Anaheim, Calif.-based Milan Capital Management and ALTO Real Estate Fund sold a 46,318 square foot, multi-tenant MOB located in a suburb of San Diego to a publicly traded REIT. The seller acquired the property in August 2015 for \$9.5 million and grew occupancy from 55 percent to 90 percent at the time of sale, which was bolstered by the renovations and improvements made since acquisition. The \$16.7 million price equated to \$360 per square foot and a 5.8 percent cap rate.

## Southwest Region

Minneapolis-based MedCraft Healthcare Real Estate acquired 10350 E. Drexel Road in Tucson, Ariz., in May. The 44,000-square-foot MOB was completed in 2016 and is long-term leased to Tucson Medical Center (NR/NR/NR). Services at the MOB include family care, urgent care, infusion, imaging, and rotating specialists such as orthopedics, cardiology, physical therapy, dermatology, obstetrics, and gynecology. The \$9.1 million purchase of the leasehold interest equated to \$207 per square foot.

In June, a private investor purchased 4690 Sweetwater Boulevard in Sugar Land, Texas. Developed in 2008, the 28,733-square-foot office building had maintained 100 percent occupancy since construction and at the time of sale was leased to six tenants, of which a majority were medical users. The tenant roster included Hamilton Vein Center, Fondren Orthopedic Group, and Bancroft Feldman Plastic Surgery. The property is located less than one mile from Houston Methodist Sugar Land Hospital (347 beds). The \$10.9 million purchase price equated to \$379 per square foot and a 7.3 percent cap rate.

## Midwest Region

H2C advised Columbus-based OhioHealth corporation ("OhioHealth"), a not-for-profit health system, on its strategic acquisition of six MOB's totaling 284,149 square feet from The Daimler Group, Inc., which developed the properties. Services at the properties include surgical, family medicine, women's health, neurology, and sleep services, among others. The \$80.6 million acquisition, which closed in June, allows OhioHealth to grow its occupancy within the respective MOB's and save money in the form of lease payments and potentially real estate taxes.

One of a handful of single-asset transactions to accompany its portfolio acquisitions that MBRE has made in 2020 was its purchase of 12855 N. Outer Road in a western suburb of St. Louis, Mo. Acquired in May for \$19.2 million, the 142,960-square-foot MOB was 82 percent leased and features a surgery center with two operating rooms and a cancer center with MRI, CT, and a linear accelerator. The tenant roster included Mercy Health (Aa3/AA-/NR), DaVita Dialysis (Ba2/BB/NR), and Urology of St. Louis. The cap rate was reported at 6.9 percent.

## Mid-Atlantic

Global Medical REIT (NYSE: GMRE) acquired the Dumfries Health Center, located approximately 30 miles southwest of Washington D.C. in Prince William County, this past April. The four-story, 99,718-square-foot MOB is leased to Spectrum Healthcare Resources, which serves active and retired military personnel and their families pursuant to a federal contract with Fort Belvoir Community Hospital. The sale required the buyer to assume an in-place CMBS mortgage, which limited the pool of potential acquirers. The \$19.3 million price equated to \$194 per square foot and an 8.8 percent cap rate.

In June, Charlotte-based Flagship Healthcare Properties acquired a three-property collection in Hickory, N.C., approximately 40 miles northwest of Charlotte. Known as Westover Park, the MOB's total 88,000 square feet and are 96 percent leased, with a tenant roster that includes the Veteran's Administration and affiliates of Frye Regional Medical Center and Wake Forest Baptist Health (A2/A/NR). Services offered at the properties include primary care, women's health, pulmonary, imaging, and lab. The acquisition of the three outpatient MOB's averaged \$220 per square foot and a 7.0 percent cap rate.

## Southeast

In April, Easterly Government Properties (NYSE: DEA) acquired 4444 Demetropolis Road in Mobile, Ala. The 79,212-square foot MOB, which was developed in 2018, is leased to the Department of Veteran's Affairs until December 2033. Services at the property include primary care, mental health, and lab. The \$39.5 million purchase price equated to \$499 per square foot and a 5.1 percent cap rate.

Nashville, Tenn.-based Montecito Medical Real Estate purchased two adjacent properties in Rogers, Ark., in April for \$15.9 million. The two buildings were developed in 2016 and total 35,811 square feet. Both are long-term leased to Mercy Health (Aa3/AA-/NR) and are located less than two miles from Mercy Hospital of Northwest Arkansas. Services at the properties include internal medicine, rheumatology, and orthopedics, including minimally-invasive joint constructed replacement and spinal procedures. The cap rate was reported to be 6.8 percent.

## About Hammond Hanlon Camp LLC

HAMMOND HANLON CAMP LLC (H2C) is an independent strategic advisory and investment banking firm with a singular focus on healthcare. Our commitment to exceed our clients' expectations begins with senior leadership on every engagement and continues with independent and objective strategic advice. Our belief in the markets and in the power of competition has resulted in loyal clients and long-term relationships.

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 transaction execution services
- Bankruptcy and restructuring

## Real Estate Investment Banking Practice

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](https://h2c.com).

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