

MedicalOffice

RESEARCH REPORT

Marcus & Millichap

Midyear 2008

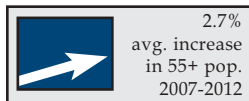
MEDICAL OFFICE ASSETS RESISTANT TO AILING ECONOMY

Demand for medical office space continues to be driven by several factors, including the migration of more procedures from hospitals to an outpatient setting, the expansion of existing practices and the increasing obsolescence of aging assets. Additionally, the growing trend of hospitals expanding to offer medical services at off-campus satellite facilities is expected to accelerate in the future as medical practitioners and hospitals continue to seek out methods to reduce cost structures. The principal force, however, remains the shift of baby boomers into later stages in life, as the number of those ages 55 and older is forecast to expand by nearly 11 million individuals through 2012. More importantly, as the population in general is physically active longer, the number of physicians' office visits among this key cohort is rising, necessitating the demand for more doctors, and consequently more office space.

Medical office assets are expected to weather the current economic storm better than other product types due to heightened consumer demand for health care. In addition, medical office tenants tend to be more stable and stay for longer terms than tenants of other property segments. As such, investor demand for medical office properties remains strong, despite an uncertain economy and restrained lending practices. In addition, unlike many other product classes where sales have deteriorated and cap rates have climbed, investment activity continues to be robust for medical office assets. Through the first half of 2008, sales activity was on par with last year's figures, while cap rates across the country compressed by an average of 30 basis points to 7.1 percent.



Economy: Nearly 440,000 jobs were eliminated during the first six months of 2008, though the pace of reductions will slow through the remainder of the year. Approximately 650,000 positions are expected to be lost, a drop of 0.5 percent. The educational and health services sector, which includes most medical professions, will add more than 300,000 new jobs this year, a 1.8 percent increase.



Demographics: The population of those ages 55 and older continues to grow. Total expansion of 14.3 percent is expected through 2012 in this cohort for an annual average of 2.7 percent, approximately four-and-one-half times the rate of the next fastest-growing age group.



Construction: After roughly 16 million square feet was completed in 2007, developers are forecast to add 17.5 million square feet of medical office space this year. Construction levels remain well above the 8.6 million square feet brought online annually since 2000. The Southwest/Mountain region will lead the nation in construction with 5.1 million square feet, nearly identical to last year.



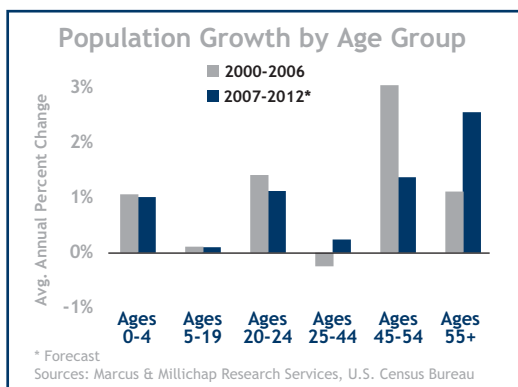
Vacancy: The U.S. average vacancy rate increased 60 basis points in the first six months of the year, though the rate of declining occupancy is expected to slow through the second half. Vacancy is forecast to rise 80 basis points in 2008, ending the year at 11.1 percent. The most significant increase is forecast in the West/Pacific Northwest region, due to heightened construction levels.



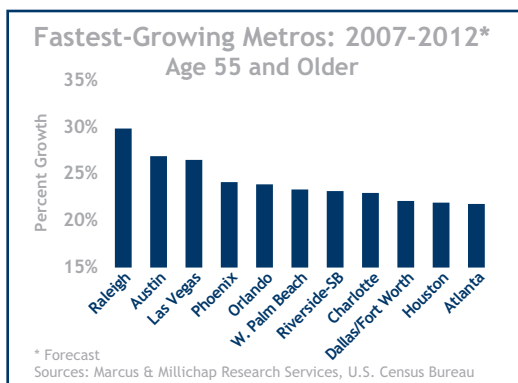
Rents: Robust construction activity and higher vacancy rates will prohibit owners from implementing considerable rent gains through the rest of 2008. Through the second quarter, rents were virtually flat across the nation. Overall, asking rents are forecast to post a modest 1 percent uptick this year to average \$23.94 per square foot.



NATIONAL TRENDS



- ◆ **Demographic Trends:** Aging baby boomers will continue to buttress demand for medical office space, as the country's growing need for health care is magnified by an expanding geriatric population. The Southwest/Mountain and Southeast regions, both havens for retirees, are expected to lead the nation in population growth in the 55-plus cohort, gaining just over 20 percent each by 2012 and supporting strong fundamentals in these regions. Investors will want to monitor the progress of medical reform over the next several years as the controversy surrounding universal health care continues. Any reform that could lower the cost of health care would greatly increase the number of people seeking medical treatment, thereby creating the need for more workers and, in turn, more medical office space.

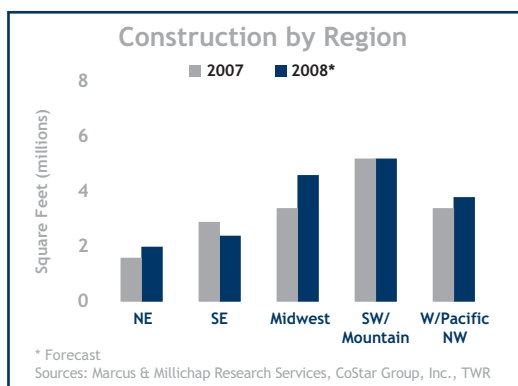


- ◆ **Construction Trends:** Medical office developers are on track to boost inventories by 17.5 million square feet this year, up from 2007 and almost double the average annual completions since 2000. Growing suburban areas are increasingly popular for medical office development, mainly due to ancillary demand from the construction and expansion of hospitals and regional medical facilities. Additional demand for space has been spurred by the trend toward in-office procedures.

- ◆ **Rent/Vacancy Trends:** Increased deliveries continue to push the nationwide vacancy rate higher. The average rate has climbed 60 basis points since the end of 2007, and another 20 basis point increase is expected by year end. Elevated construction will maintain upward pressure on vacancy well into 2009 as new space fills, with rates hovering in the low-11 percent range. Accordingly, rent growth has stalled, with little to no gains expected until vacancy moderates. Asking rents are expected to finish 2008 at \$23.94 per square foot.

- ◆ **Investment Trends:** Solid performance is supporting robust buyer demand for medical office properties. Both transaction and dollar volume have remained essentially unchanged during the first half of 2008, despite the current real estate slowdown. Cap rates have continued to compress and now sit at 7.1 percent, down 30 basis points from the end of 2007. The median price has increased almost 2 percent during the same period to \$211 per square foot.

NORTHEAST



- ◆ **Construction Trends:** Developers are on track to deliver 1.9 million square feet in 2008, up from nearly 1.1 million square feet last year. Construction remains concentrated in the Northern New Jersey and New York metros, where builders are targeting a high populace of maturing residents.

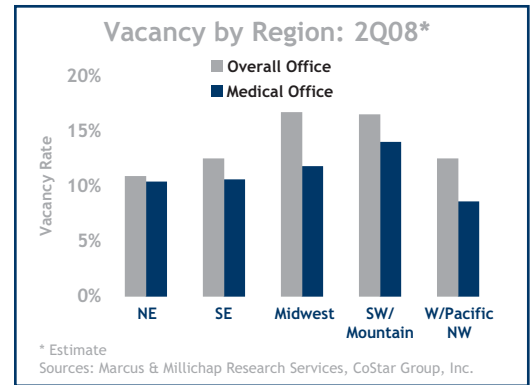
- ◆ **Rent/Vacancy Trends:** Demand continues to lag supply as new product precedes occupants. As such, vacancy climbed 70 basis points during the first half of 2008 to 10.2 percent. The result was a 0.4 percent drop in rents over the same period to \$24.06 per square foot.

- ◆ **Investment Trends:** Demand for Northeast medical office properties has generated further cap rate compression, while transaction activity for the first six months of 2008 is on par with levels recorded during the same period last year. Cap rates are currently in the mid- to high-6 percent range, down from 7.1 percent at the end of 2007. Assets in suburban locations have taken center stage, resulting in an overall lower median price of approximately \$190 per square foot so far in 2008, a 5 percent drop from 2007.

Regional definitions are available on page 4.

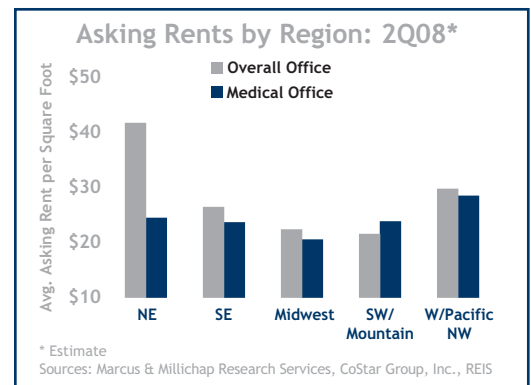
SOUTHEAST

- ◆ **Construction Trends:** Developers are scaling back deliveries this year, with 2.3 million square feet of space scheduled for completion, an 18 percent reduction from 2007. An ever-increasing retiree population in Florida will drive space demand, and developers will respond by building nearly 1.1 million square feet by year end.
- ◆ **Rent/Vacancy Trends:** An uncertain economic outlook has reduced occupancies in the Southeast region, with vacancy rates now hovering in the low- to mid-10 percent range. The rise in vacancy is expected to be short-lived, however, as future demand is buttressed by the region's attractiveness for life after work. Owners have increased rents a modest 1.4 percent so far this year to \$23.25 per square foot.
- ◆ **Investment Trends:** An outlook for strong, long-term fundamentals continues to boost property prices. Sales velocity has remained healthy, with activity in the first half slightly above that in the same period of 2007. Cap rates remain in the mid-7 percent range, while the median price has appreciated 3 percent from the end of last year to \$210 per square foot.



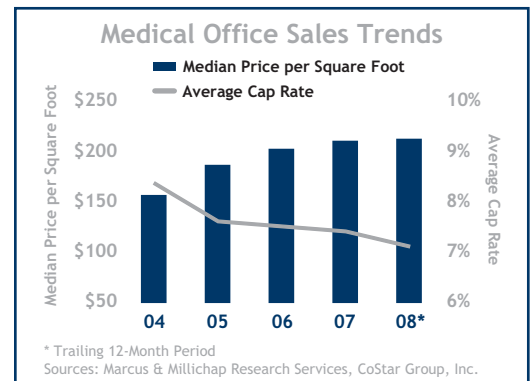
MIDWEST

- ◆ **Construction Trends:** Developers are on track to deliver 4.5 million square feet of medical office space in 2008, up almost 40 percent from last year. Major metros in Ohio will lead the Midwest, with more than 1.6 million square feet slated for delivery this year, compared with 1.1 million square feet in 2007.
- ◆ **Rent/Vacancy Trends:** Despite a dramatic increase in development, strong demand has kept vacancy in check, rising only 30 basis points during the first half of 2008 to 11.3 percent. The average rent increased 0.2 percent in that time to \$20.13 per square foot. Similar trends are expected through the remainder of the year as lease-ups continue.
- ◆ **Investment Trends:** Sustained buyer demand for medical office assets in the Midwest resulted in increased transaction velocity in the first half of 2008. The median price remained unchanged at \$142 per square foot since the end of 2007, while cap rates compressed 30 basis points to 7.8 percent.



SOUTHWEST/MOUNTAIN

- ◆ **Construction Trends:** Solid job gains and robust economic growth have generated rapid population expansion throughout much of the Southwest. As a result, developers are expected bring 5.1 million square feet of medical office space online this year, similar to completions in 2007. Builders remain active in the major Texas metro areas, where job growth is leading the nation. Developers are exhibiting increased caution in Phoenix and Tucson.
- ◆ **Rent/Vacancy Trends:** Elevated construction levels have put upward pressure on vacancy, although rates are expected to moderate through the remainder of the year. Vacancy has increased 90 basis points since year-end 2007 to 13.4 percent. The addition of newer Class A inventory helped to push rents up 2.2 percent through the first half of the year to \$23.42 per square foot.
- ◆ **Investment Trends:** During the past six months, sales activity for medical office assets has slowed somewhat. The median price remains flat at approximately \$198 per square foot, while cap rates are averaging in the high-6 percent range.



Regional definitions are available on page 4.

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HEALTHCARE REAL ESTATE GROUP

Marcus & Millichap's Healthcare Real Estate Group is comprised of real estate investment professionals who specialize in healthcare properties nationwide. In addition to offering specialized market knowledge, members of the Healthcare Real Estate Group are able to leverage the firm's network of more than 1,300 investment professionals to help clients meet their investment objectives.

For information on Marcus & Millichap's Healthcare Real Estate Group, contact:

Alan Pontius

Managing Director

Tel: (415) 391-9220

apontius@marcusmillichap.com

Marcus & Millichap

Real Estate Investment Services

Prepared and edited by

Thomas Hershey

Senior Analyst

Research Services

Tel: (602) 952-9669

thershey@marcusmillichap.com

For information on national office trends, contact

John Chang

National Research Manager

Tel: (602) 952-9669

john.chang@marcusmillichap.com

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WEST/PACIFIC NORTHWEST

- ◆ **Construction Trends:** After bringing 3.3 million square feet of space online in 2007, developers are poised to boost medical office inventory by 3.7 million square feet this year.
- ◆ **Rent/Vacancy Trends:** Although vacancy in the West/Pacific Northwest region has climbed 110 basis points during the past six months, the average rate remains the lowest of all regions at 8.4 percent. Additionally, supply-constrained markets, including Los Angeles and San Francisco, feature vacancy rates well below the regional average. Owners have limited rent growth as they wait for space to fill, while some areas have recorded slight declines. Overall, rents have remained essentially flat at \$28 per square foot, with minimal movement expected through the remainder of the year.
- ◆ **Investment Trends:** After record activity in 2007, sales have moderated to become more in line with the steady pace posted during the three previous years. Cap rates remain in the low- to mid-6 percent range, while the median price shows no signs of easing, rising 12.5 percent from the end of last year to its current \$312 per square foot.

SALES HIGHLIGHTS

Property Name	City, State	Sales Price	Square Feet	Price/SF
West Suburban Health Care	River Forest, IL	\$1,250,000	3,600	\$347
Murrieta Springs Medical Center	Murrieta, CA	\$10,350,000	31,361	\$330
Medical Office	Miami, FL	\$16,975,000	53,702	\$316
Medical Office	Keller, TX	\$1,039,000	4,253	\$244
Plumas Mixed-Use Medical Center	Yuba City, CA	\$4,420,000	18,417	\$240
Traverse City Medical Office	Traverse City, MI	\$2,925,000	13,000	\$225
Austell Medical Office Building	Austell, GA	\$2,662,000	14,750	\$180
Boynton Beach Medical Office Building	Boynton Beach, FL	\$9,400,000	52,598	\$179
Medical Office	Anaheim, CA	\$4,450,000	25,680	\$173
Palm Way Medical/Professional Centre	West Palm Beach, FL	\$1,600,000	9,641	\$166
Franklin Professional Park	Franklin, IN	\$3,250,000	20,117	\$162
Metro Medical Plaza	Phoenix, AZ	\$7,500,000	53,449	\$140
Baytown Professional Building	Baytown, TX	\$2,900,000	24,325	\$119
Woodlake Professional Building	Houston, TX	\$2,725,000	27,458	\$99
Baytown Primary Medical Tower	Baytown, TX	\$4,500,000	46,120	\$98
Mount Prospect Medical Dental Building	Mount Prospect, IL	\$970,000	12,194	\$80
Trail Creek Medical Center	Eules, TX	\$4,042,000	57,949	\$70
Parkway Medical Plaza	Houston, TX	\$1,850,000	53,937	\$34

Regional Definitions:

Midwest: Chicago, Cincinnati, Cleveland, Columbus, Detroit, Indianapolis, Milwaukee, Minneapolis

Northeast: Boston, New York City, Northern New Jersey, Philadelphia, Washington, D.C.

Southeast: Atlanta, Charlotte, Orlando, South Florida, Tampa

Mountain/Southwest: Austin, Dallas/Fort Worth, Denver, Houston, Phoenix, Tucson

West/Pacific Northwest: Las Vegas, Los Angeles, Oakland, Orange County, Portland, Riverside-San Bernardino, Sacramento, San Diego, San Francisco, San Jose, Seattle