MEDICAL OFFICE

Medical Office Transformation

By Peter Hanlon
Director|Healthcare Practice Group
Cushman & Wakefield/Commerce

The medical office sector continues to transform in response to changes in both the economics of the healthcare industry and the demands of the consuming public. Economies of scale combined with increased desire by large healthcare providers to enhance the patient experience have led to larger, patient-centric medical office buildings and medical delivery facilities in the community.

Cushman & Wakefield's Salt Lake County Medical Office study for the second quarter of 2016 reflects the continued strength of this office sector. Asking lease rates continued to rise as vacancy declined over the past two years, with overall asking rates of $15.36 triple net and vacancy at 12.8 percent (as of June 30, 2016). Net absorption in the four quarters ending June 2016 was approximately 20,000 square feet. This is a strong showing considering the large amount of owner-user construction in 2015-2016, which is not included in these statistics.

On-campus medical-office properties command a premium in the market. Asking lease rates for these properties were, on average, $3.85 per square foot (PSF) higher than asking lease rates for off-campus properties. Similarly, during 2016, average vacancy rates at on-campus properties were 9.4 percent compared to 15.5 percent for off-campus properties. These factors reflect the higher demand by both physicians and hospitals to have healthcare providers in close proximity.

The national investment market for healthcare-related properties remained robust as well. According to Real Capital Analytics, sales of medical properties topped $10 billion in the U.S. during the four quarters ending June 2016. This is a decrease from 2015, which was the strongest sales year on record. Not only was total volume strong, but capitalization rates and price PSF continued to strengthen.

Salt Lake County Lease Rates and Vacancy

	ON-CAMPUS	OFF-CAMPUS
AVERAGE ASKING LEASE RATE (PSF)	$17.52	$13.67
AVERAGE VACANCY	9.4%	15.5%

Medical Office Building Sales Statistics

	United States	Salt Lake Co.
AVERAGE SALES PRICE (PSF)	$238	$251
AVERAGE CAPITALIZATION RATE	6.59%	6.59%

Salt Lake Medical Office
1060 East 100 South

University of Utah Farmington Health Center

A TRANSFORMATIONAL OUTLOOK

The trend in medical real estate development is shifting with the advent of ambulatory care centers (ACCs). These are single occupier, larger facilities that provide a broad range of primary, secondary and even tertiary healthcare. Multi-specialty groups, such as Intermountain Healthcare, Granger Clinic and the University of Utah, occupy large facilities of up to 180,000 square feet and provide cradle-to-grave services, such as pediatrics, OB/GYN, internal medicine, surgery and geriatrics to its patients. These newer facilities provide a patient- and family-friendly atmosphere with amenities, such as dining facilities, pharmacy/gift shops, physical therapy and even a grand piano. They are geared toward a positive patient experience.

New properties completed during the past two years include the remodel/expansion of the medical office building at The Orthopedic Specialty Hospital (TOSH) of 80,000 square feet; addition of 120,000 square feet at Intermountain Healthcare's Riverton Hospital and the 150,000-square-foot ambulatory care center constructed by the University of Utah Health Sciences in Farmington.

A focus on medical office space is also a side effect of the national healthcare overhaul. According to a recent article in the *Wall Street Journal*, medical office space was previously leased by individual doctors and small practices. In a movement accelerated by the Affordable Care Act (ACA), these physicians are "abandoning the independent-practice model to join large systems that are better able to create efficiencies and control costs."

While creating a focused need for all types of services, two demographic factors continue to push demand for medical office buildings locally. Utah's high birth rate combined with high corporate and individual in-migration will translate to increased demand for medical services in Utah. Additionally, with the youngest population in the nation, Utah will have a greater need for expanded services than other states as this young population ages.

On-campus buildings, which are largely controlled and/or occupied by hospitals, will continue to experience demand. Although many physicians would like to have some distance separating on-campus buildings from the hospital, the convenience of direct access to emergency care and referrals within an on-campus medical office building remains a strong draw, at which higher lease rates are paid.

There remains some uncertainty regarding reimbursements to physicians, large medical groups and hospitals as the growing pains of the ACA continue. This may dampen medical office development for the private sector in the short-term. However indications are that the medical sector, now accounting for approximately 12-17 percent of the country's GDP, will continue to outpace growth in the U.S. economy. This will lead to continued long-term investment in medical office buildings and related properties. ■

SPOTLIGHT

Peter Hanlon

DIRECTOR | HEALTHCARE PRACTICE GROUP
CUSHMAN & WAKEFIELD/COMMERCE

With over 25 years in real estate and banking transactions, Peter Hanlon specializes in healthcare-related real estate in Salt Lake County and the greater Utah market. No other commercial real estate agent has participated in more medical real estate transactions in Utah than Mr. Hanlon. His demonstrated expertise includes understanding the realities of financing medical and general real estate and the ability to analyze the cost/benefit of investing in, ownership of and leasing a particular property.

Mr. Hanlon was formerly vice president of Wallace Associates, a full-service real estate and banking consulting firm and a commercial loan officer of Texas Commerce Bank, a $20 billion subsidiary of Chase Bank.