

GREATER PHOENIX | MEDICAL OFFICE

2Q 2015

Accelerating success.

MOB Demand Gains Momentum as Population Growth Surges

Key Takeaways

- Medical office vacancy in Greater Phoenix ended the first half at 17.1 percent, lower than one year ago, but improving at a modest pace thus far in 2015.
- Rent trends have been mixed, trending lower for most of the past 12 months, but inching higher during the second quarter.
- Sales prices for medical office buildings are pushing higher. Both condos and traditional medical office buildings have posted double-digit median price increases from 2014 levels.

Greater Phoenix Medical Office Market

The Greater Phoenix medical office market finished the first half of 2015 on a bit of a slow note, with net absorption positive, but more modest than in recent periods. The lack of significant change in the local medical office market is not a sign of a lack of activity in the local healthcare industry, however, as mergers and acquisitions continue at a healthy pace. One such transaction involved Banner Health's acquisition of the University of Arizona Health Network, which made Banner the largest private employer in the state with nearly 40,000 employees.

Banner Health also made headlines from a real estate perspective during the second quarter, entering into leases in Midtown Phoenix for more than 260,000 square feet of traditional office space for clerical functions. The company—which holds more than 40 percent of the hospital market share in Greater Phoenix—is expected to move over 800 employees into the Midtown buildings by the end of this year. The pending impact of Banner's growth on the medical office market is tougher to quantify, as much of its clinical work is being moved into facilities that the hospital system already owns.

Market Indicators Relative to prior period	Market Q2 2015	Market Q2 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	Phoenix On-Campus MOB	Phoenix Off-Campus MOB
Vacancy Rate	17.1%	16.2%	18.0%
Change from 2Q 2014 (bps)	-160	-210	-160
Net Absorption (thousands SF)	32.3	29.1	4.2
New Construction (thousands SF)	0	0	0
Under Construction (thousands SF)	67.2	0	67.2
Asking Rents Per Square Foot Per Year	\$22.31	\$26.07	\$21.21
Change from 2Q 2014	-1.8%	1.4%	-2.9%

Vacancy:

- › Vacancy in the Greater Phoenix medical office market ended the first half of 2015 at 17.1 percent, 160 basis points lower than the rate one year earlier. Vacancy in the medical office segment has steadily trended lower since averaging more than 19 percent from 2009-2011.
- › Vacancy in on-campus buildings is lower than the overall average, with the rate ending the second quarter at 16.2 percent. While vacancy in on-campus buildings is improving, it remains much higher than pre-recession levels of 10 percent or lower.
- › Off-campus medical office buildings had vacancy of 18 percent as of the end of the second quarter, an improvement from 19.6 percent one year ago. Net absorption in off-campus buildings has topped 240,000 square feet over the past 12 months, but much of the total was recorded in the second half of 2014.

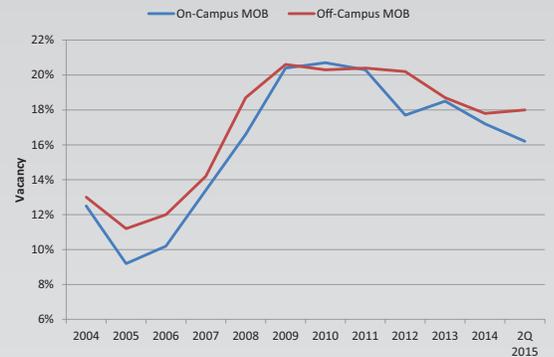
Rents:

- › Asking rent trends have been uneven in recent quarters. The average asking rent ended the second quarter at \$22.23 per square foot, up slightly from the first quarter figure. Despite the recent uptick, average asking rents are still 1.8 percent lower than one year ago.
- › One of the segments of the medical office market that is being hit the hardest with rent declines is large, off-campus buildings. In off-campus buildings over 50,000 square feet in size, average asking rents have dropped more than 6 percent in the past 12 months. These buildings face competition from other existing buildings as well as build-to-suit options.
- › Asking rents in on-campus facilities have stabilized. The average asking rent in on-campus medical office buildings has increased 1.4 percent year to date to \$26.07 per square foot. Asking rents in on-campus buildings are nearly 5 percent higher than the post-recession low point.

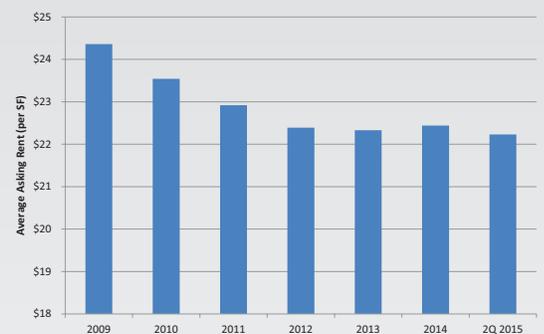
Investment Trends:

- › Sales of medical office condos ticked higher in the second quarter, outpacing levels from the first quarter by 9 percent. Despite the rise, sales velocity in the first half of 2015 is down nearly 30 percent from levels recorded in the first half of last year.
- › The median price in the first half of 2015 for medical office condos was \$148 per square foot, a 19 percent increase from the 2014 median price. Pricing remained elevated in the second quarter, with the median reaching \$151 per square foot over the past three months.
- › Sales activity for non-condo medical office buildings advanced 10 percent during the second quarter, building on momentum from the first three months of the year. Compared to the first half of last year, sales velocity for non-condo medical office buildings has spiked 50 percent thus far in 2015.
- › In addition to an uptick in transaction activity, prices also surged in the second quarter. The median price for non-condo medical office buildings was \$164 per square foot in the second quarter, bringing the median price in transactions closed year to date up to \$141 per square foot, 17 percent higher than the 2014 median.

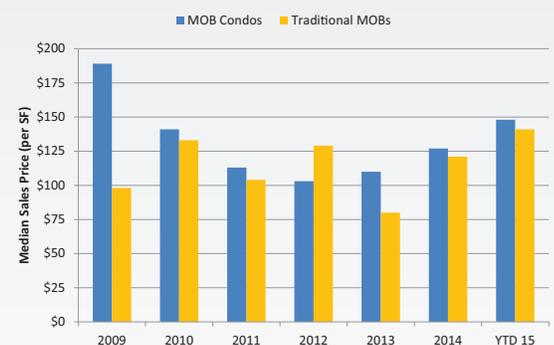
Vacancy by Submarket Cluster



Asking Rents Trends



Investment Trends

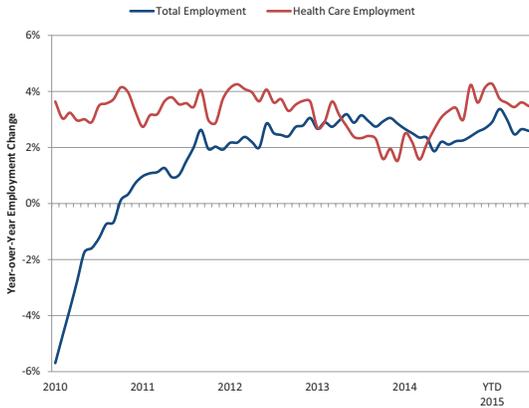


Outlook:

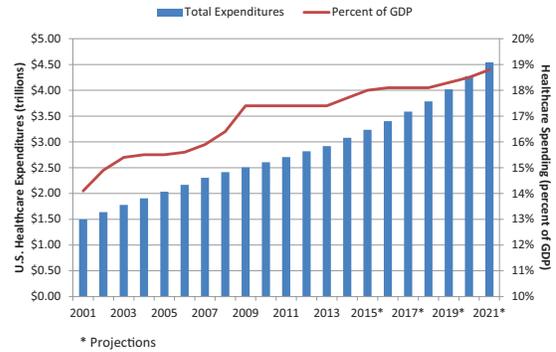
The Greater Phoenix medical office market is expected to strengthen in the coming quarters, as the growing employment base and resumed population expansion will support demand for healthcare services. After being Greater Phoenix's leading sector for employment growth from 2008-2010, the pace of expansion in the healthcare sector slowed following the passage of the Affordable Care Act. Recently, however, local growth in healthcare employment has accelerated, which will ultimately translate to increased tenant demand for space.

One reason employment growth in the healthcare sector is back in full swing is the resumption of healthy population growth in the Phoenix metro area. Local population growth slowed to approximately 1 percent per year during the recession, but the rate accelerated in 2014 and current forecasts call for return to annual gains of 2.5 percent or higher in the coming years. This population expansion will be the fuel that sustains demand for healthcare in the Greater Phoenix market in the years ahead.

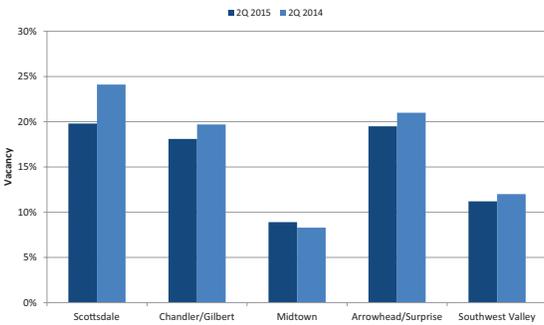
Greater Phoenix Employment Trends



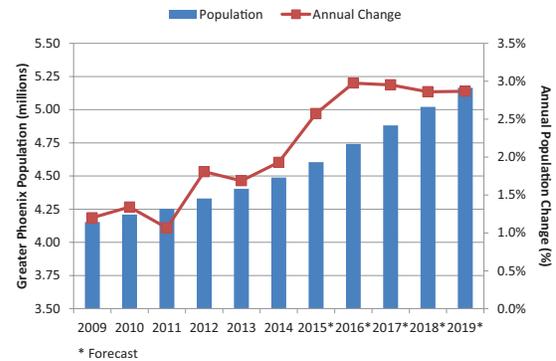
U.S. Healthcare Expenditures



Greater Phoenix MOB Vacancy by Submarket



Greater Phoenix Population Trends



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