

GREATER PHOENIX | MEDICAL OFFICE

4Q 2015

Accelerating success.



Population and Employment Growth to Spark Medical Office Demand in 2016

Key Takeaways

- Medical office vacancy in Greater Phoenix has improved in each of the past six calendar years, ending 2015 at 16.9 percent. Vacancy dipped by 100 basis points in 2015.
- With vacancy tightening, rents pushed up slightly in 2015. Average asking rents increased in both on-campus and off-campus buildings.
- Sales for medical office buildings were mixed. Sales of medical office condos slowed, but activity gained momentum in non-condo, traditional medical office properties. Prices rose and cap rates ticked somewhat higher, averaging in the high-7 percent to mid-8 percent range.

Greater Phoenix Medical Office Market

The Greater Phoenix medical office market strengthened in 2015, particularly in the second half of the year. Vacancy ended the year below 17 percent, the lowest figure since mid-2008. Local vacancy is expected to continue this gradual pace of improvement, even as a few new development projects come onboard. Part of the improvement in the local medical office market is being driven by a strong pace of employment growth in the healthcare sector. More than 9,000 jobs were added in this segment of the local economy in 2015, representing growth of more than 4 percent. Similar additions are likely in the year ahead, particularly with local population growth—and the corresponding need for healthcare—set to accelerate.

While property fundamentals are generally on an upswing, the investment market is mixed. Sales of traditional medical office buildings gained momentum in 2015, mirroring the trend in the broader office market, but prices only ticked higher. Activity in the medical office condo market slowed, although prices continued to press higher even as fewer properties sold. Looking ahead, the investment climate should benefit from increased tenant demand for space and rising rents. Interest rate risk appears minimal, despite a rate increase by the Federal Reserve in late 2015. Further Fed action is expected to be minimal in the near future, limiting upward pressure on cap rates.

Market Indicators Relative to prior period	Market Q4 2015	Market Q4 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	On-Campus MOB	Off-Campus MOB
Vacancy Rate	16.9%	18.1%	16.7%
Change from 4Q 2014 (bps)	-100	-150	-110
Net Absorption (thousands SF)	27.5	5.4	22.1
New Construction (thousands SF)	46.9	46.9	0
Under Construction (thousands SF)	119.9	59.9	60.0
Asking Rents Per Square Foot Per Year	\$22.71	\$25.28	\$21.90
Change from 4Q 2014	1.4%	2.6%	1.2%

Vacancy:

- › Vacancy in the Greater Phoenix medical office market ended 2015 at 16.9 percent, 100 basis points lower than one year ago. This marked the sixth straight year that vacancy declined, although the pace of improvement has been modest, averaging less than 70 basis points per year.
- › Vacancy in on-campus buildings ticked up in the fourth quarter, ending 2015 at 18.1 percent. Despite the recent increase, vacancy in on-campus buildings improved by 150 basis points in 2015, following a 90 basis point dip in 2014.
- › The vacancy rate in off-campus medical buildings is also improving. The rate ended the fourth quarter at 16.7 percent, down from 17.6 percent one year earlier. Net absorption in off-campus buildings totaled more than 185,000 square feet in 2015, although deliveries of 81,000 square feet contributed to that total.

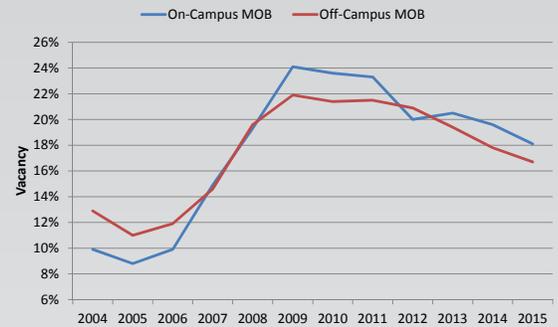
Rents:

- › Asking rents are gradually trending higher, but the pace of increases is lagging the rate of traditional office space. Asking rents ended 2015 at \$22.71 per square foot, 1.4 percent higher than at the end of 2014.
- › Asking rents in on-campus buildings rose 2.6 percent in 2015, ending the year at \$25.28 per square foot. This marks an acceleration in the pace of rent growth; in 2014, asking rents ticked up just 0.6 percent.
- › Asking rents in off-campus medical office buildings rose 1.2 percent in 2015, after ticking slightly lower in 2014. Asking rents rose in each of the final three quarters of the year, suggesting that there could be some momentum that carries over into 2016 assuming demand for space remains healthy.

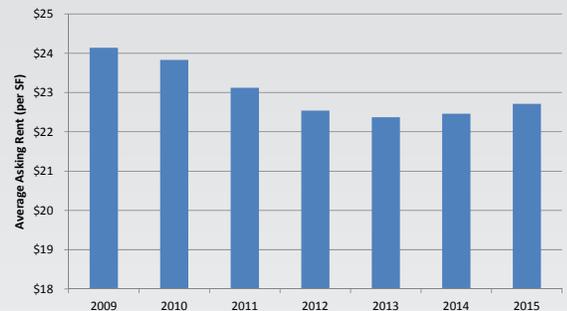
Investment Trends:

- › Fewer medical office condos changed hands in 2015, as sales activity lagged 2014 levels by nearly 25 percent. Transactions were particularly slow to close the year, dipping approximately 35 percent from the third quarter to the fourth quarter.
- › Even as sales activity in condos slowed, prices still pushed higher. The median price in condos sold during the fourth quarter was \$166 per square foot, 12 percent higher than during the third quarter. In 2015, the median price spiked 26 percent from 2014 to \$159 per square foot.
- › While condo activity decelerated in 2015, sales velocity for non-condo medical office buildings surged 39 percent higher than levels recorded in 2014.
- › The median price in sales of traditional medical office buildings was \$118 per square foot in the fourth quarter, 11 percent lower than the third quarter figure. For the full year, the median price inched up 3 percent to \$126 per square foot. Most properties traded with cap rates in the high-7 percent to mid-8 percent range.

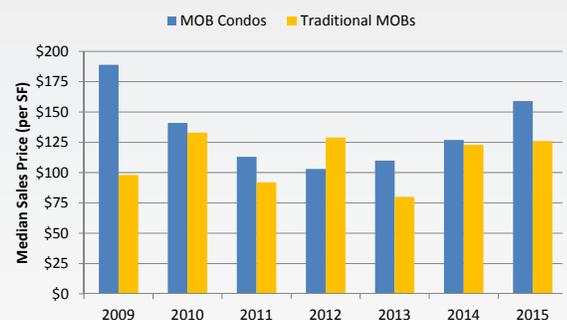
Vacancy Trends



Asking Rents Trends



Investment Trends

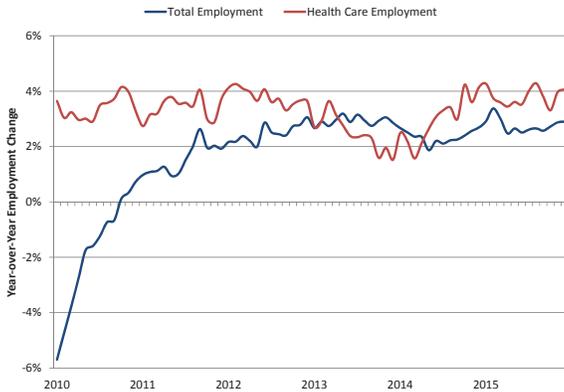


Outlook:

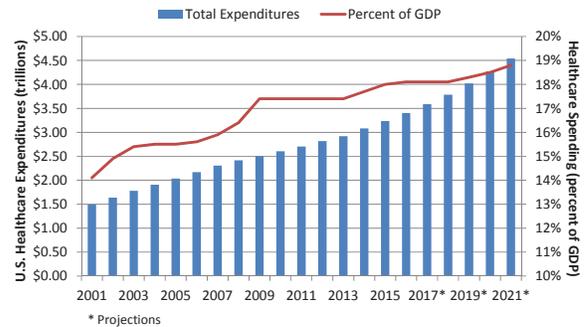
The forecast for the Greater Phoenix medical office market is favorable for 2016, as demand will be spurred by both employment growth and population expansion. Early estimates call for population growth of more than 2 percent in 2016 and job growth topping 3 percent. These gains will translate directly into greater demand for healthcare services, which will fuel tenant demand for medical office space. While practices continue to consolidate and seek to increase efficiencies, this is happening with less frequency than it was immediately following the passage and implementation of the Affordable Care Act.

The investment outlook for medical office properties is brightening, as property fundamentals have stabilized and are beginning to improve. The greatest rise in activity has been in the midsize multi-tenant buildings ranging from 10,000-25,000 square feet. Collectively, these transactions, which typically feature between 5 and 10 tenants, accounted for nearly 60 percent of the total activity in 2015. As the calendar turns to 2016, another election could create some uncertainty surrounding the future of the Affordable Care Act. For 2016, however, the impact from Congress should play a limited role.

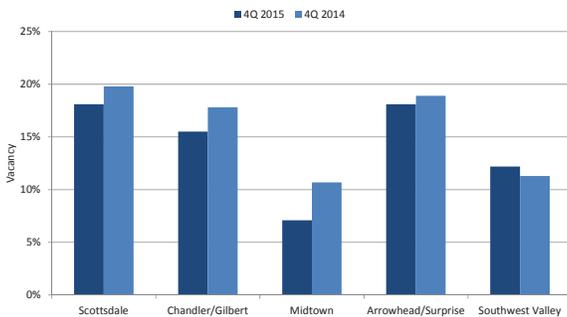
Greater Phoenix Employment Trends



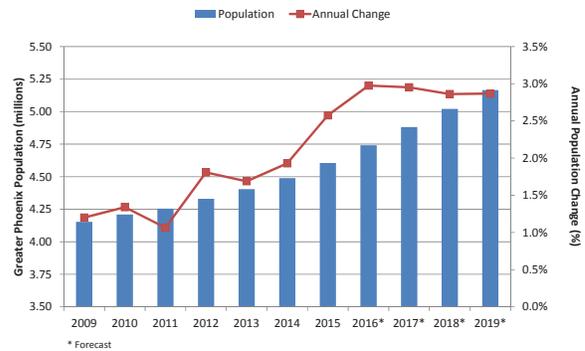
U.S. Healthcare Expenditures



Greater Phoenix MOB Vacancy by Submarket



Greater Phoenix Population Trends



FOR MORE INFORMATION

Bob Mulhern
 Managing Director | Greater Phoenix
 +1 602 222 5038
 Bob.Mulhern@colliers.com

Jim Keeley SIO
 Founding Partner | Scottsdale Office
 +1 480 655 3300
 Jim.Keeley@colliers.com

Pete O'Neil
 Research Director | Greater Phoenix
 +1 602 222 5029
 Pete.ONeil@colliers.com