



OCTOBER 23, 2019 | RICHARD LAWSON

Here Are the Best US Cities for Medical Office Investors

More Institutional Investors Are Buying Into the Sector, CoStar Analysis Shows



U.S. cities in the Sun Belt, such as Houston, top the list of ideal places for medical office investment. (CoStar)

Real estate investors are taking more interest in medical office buildings as higher prices and risks in other property types have squeezed annual returns, according to a CoStar analysis.

The report, titled “Investing in Medical Office: Just What the Doctor Ordered,” shows the cities with the fastest-growing population of seniors combined with the least amount of competition for tenants or medical office construction underway.

The U.S. cities meeting both those criteria include Orlando, Florida; Las Vegas; Tampa, Florida; Charlotte, North Carolina; and San Jose, California.

“The demand story is very compelling,” said Kevin Cody, a senior CoStar consultant who wrote the report with Paul Leonard, a managing consultant with CoStar, and Alexander Levy, a CoStar consultant.

Medical office sales rose 10% to \$17.5 billion this year, 2.7 times higher than the peak prior to the last recession, as more institutional investors took interest.

About \$4.5 billion of sales over the past year were for portfolios of more than 50 million square feet, which is a big increase over previous years and indicates larger funds.

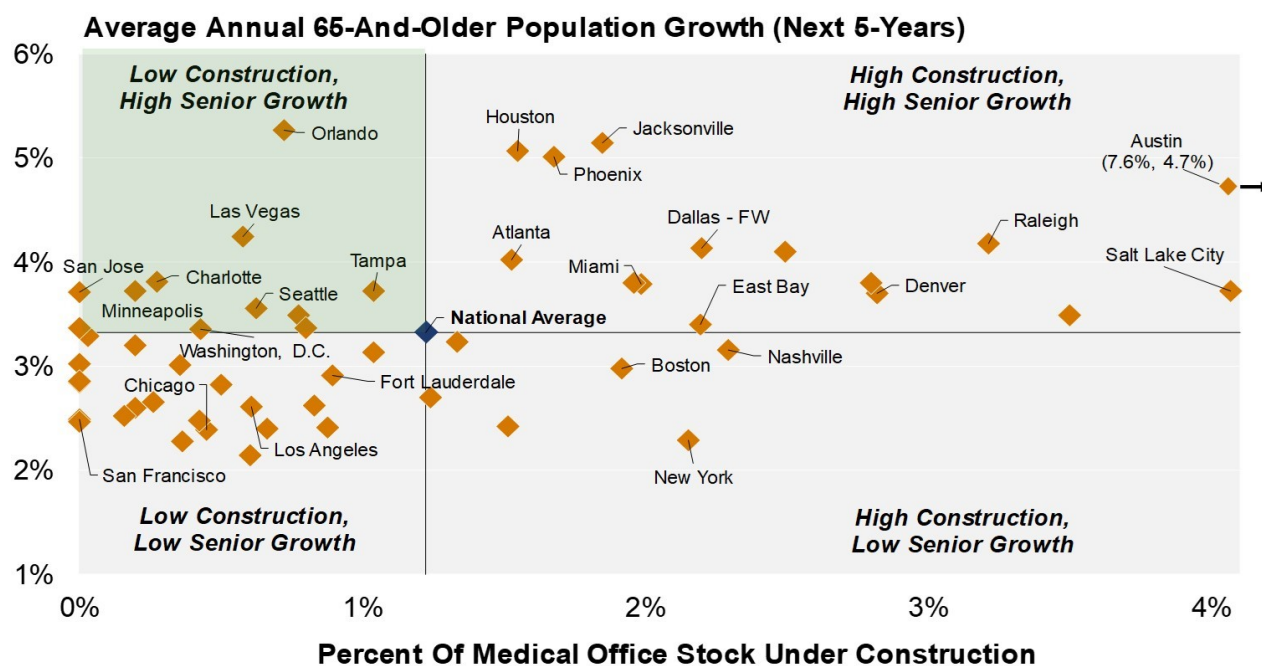
“This is an indication that the medical office sector is garnering more attention from institutional investors,” such as insurance companies and pension funds, the report says.

A portfolio of medical office buildings fetch top dollar but building a portfolio big enough to attract institutional investors is one of the greatest challenges. Medical office buildings are smaller than traditional office buildings and average about 16,000 square feet.

“Portfolio sales have averaged a 46% price-per-square-foot premium over individual sales since 2015,” according to the CoStar report.

Private investors and doctors own a bulk of the medical office space, with real estate investment trusts representing the largest share of institutional ownership. Some of the largest holders of medical office space include Healthcare Trust of America, Ventas and HCP.

There Are Outliers For Demand Forecast And Supply Risk



Sources: Oxford Economics; CoStar Portfolio Strategy

As of 19Q2

Cities with a low number of medical office buildings underway and a growing senior population are the best bets for investors. (CoStar)

Population Growth

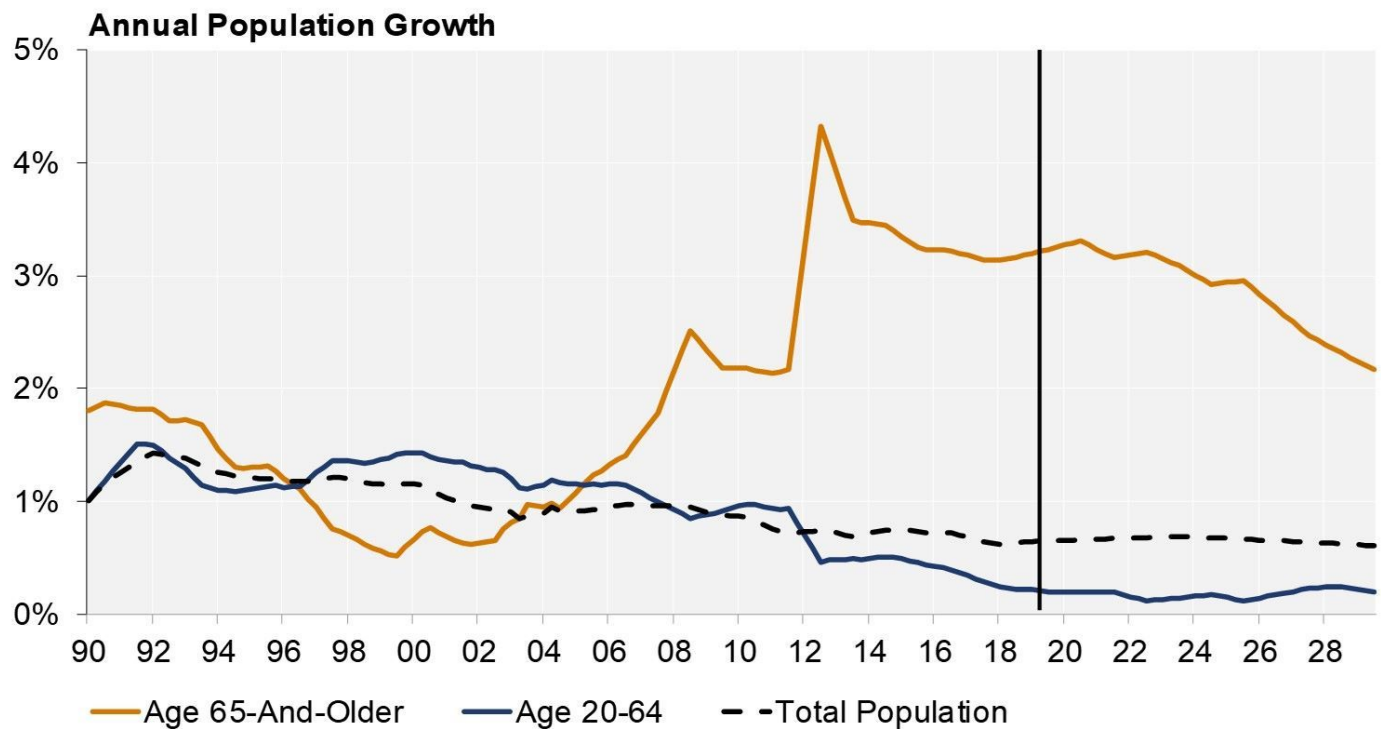
The 65-and-older population is expected to "grow by 17 million people over the next decade, expanding nearly five times faster than the overall population," the report notes. That age group,

which comprised 13% of the population in 2010, will make up 20% of the population by 2029.

The older population visits the doctor about twice as often as younger people and has the highest level of healthcare spending.

The U.S. metropolitan areas that are forecast to have the greatest population gain for people 65 and older are Orlando; Jacksonville, Florida; Houston; Phoenix; Austin, Texas; Las Vegas; Raleigh, North Carolina; and Dallas-Fort Worth.

The average medical office size needed per patient is 5 1/2 square feet, which is estimated to be 9.9 square feet for those 65 and older because of the additional healthcare requirements of that population. The additional medical office demand generated by the 65-and-older crowd is estimated to be 172 million square feet, according to the report.



Sources: Oxford Economics; U.S. Census; CoStar Portfolio Strategy

As of 19Q2



An aging population is pushing demand for medical office buildings. (CoStar)

Construction

Medical office construction hasn't matched demand despite the record length of the current economic expansion. About 25 million square feet of medical office space was built annually at the peak prior to the last recession.

Only 9.3 million square feet has been built over the past year. "At 1.2%, the share of medical office inventory that is underway is well below traditional office, which sits at 2%" as of the second quarter this year, the report says. "In fact, the share of traditional office stock underway surpassed that of medical office in 2014 for the first time since 2002, and the gap continues to widen."

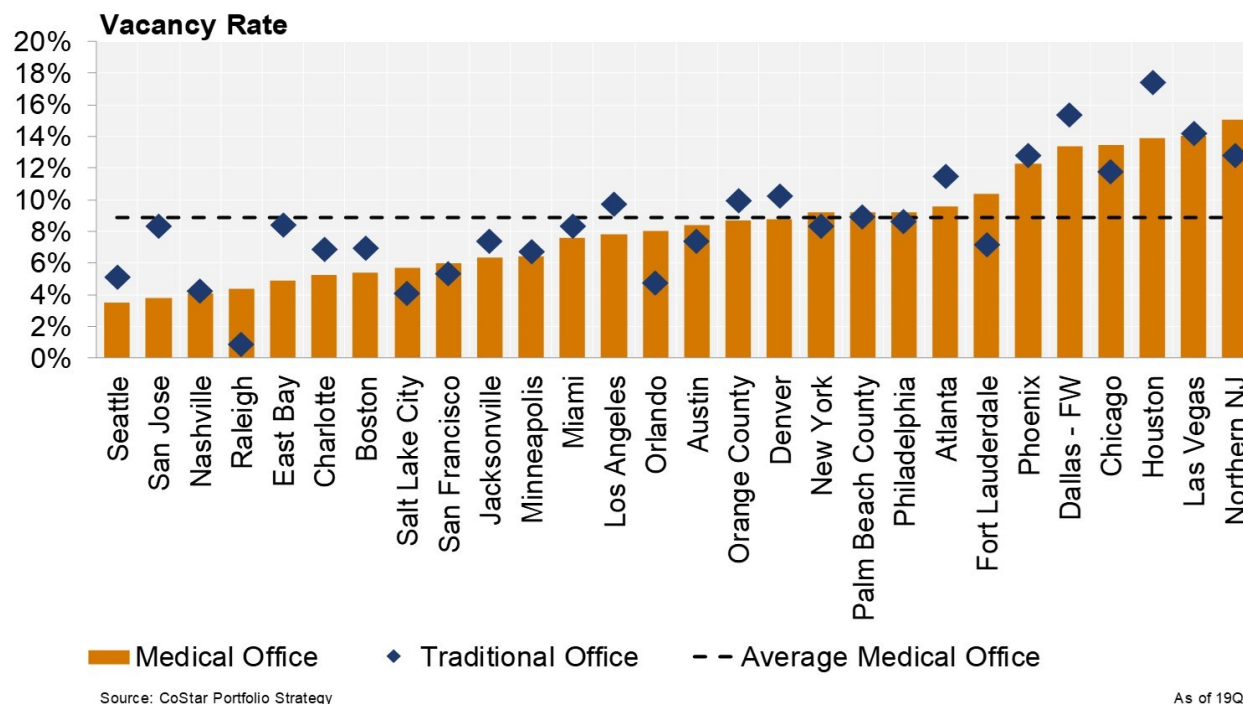
Developers and institutional investors have favored "trophy" traditional office space and projects with a mix of residential and

retail in urban areas.

Much of the demand for medical office space is in the suburbs, according to the report, which also was highlighted in a [recent CoStar webinar](#) on investing in the suburbs.

“Medical office is still a niche property type,” Cody said.

Medical Office Vacancy Varies By Market



The cities with the lowest medical office vacancy rates are Seattle; San Jose, California; Nashville, Tennessee; and Raleigh, North Carolina, according to the report. (CoStar)

A lack of significant building has kept vacancy rates in medical offices lower than traditional office space and has helped drive up rents. The cities with the lowest medical office vacancy rates are Seattle; San Jose, California; Nashville, Tennessee; and Raleigh, North Carolina, according to the report.

Though traditional office rent gains can be stronger, the report notes that medical office's rent growth is steadier and less volatile. New buildings can command rent premiums, which hit an all-time high of 14% over rents in older properties.

“Developers should find little resistance leasing-up and can charge rents well above that of older buildings,” according to the report.