JLL

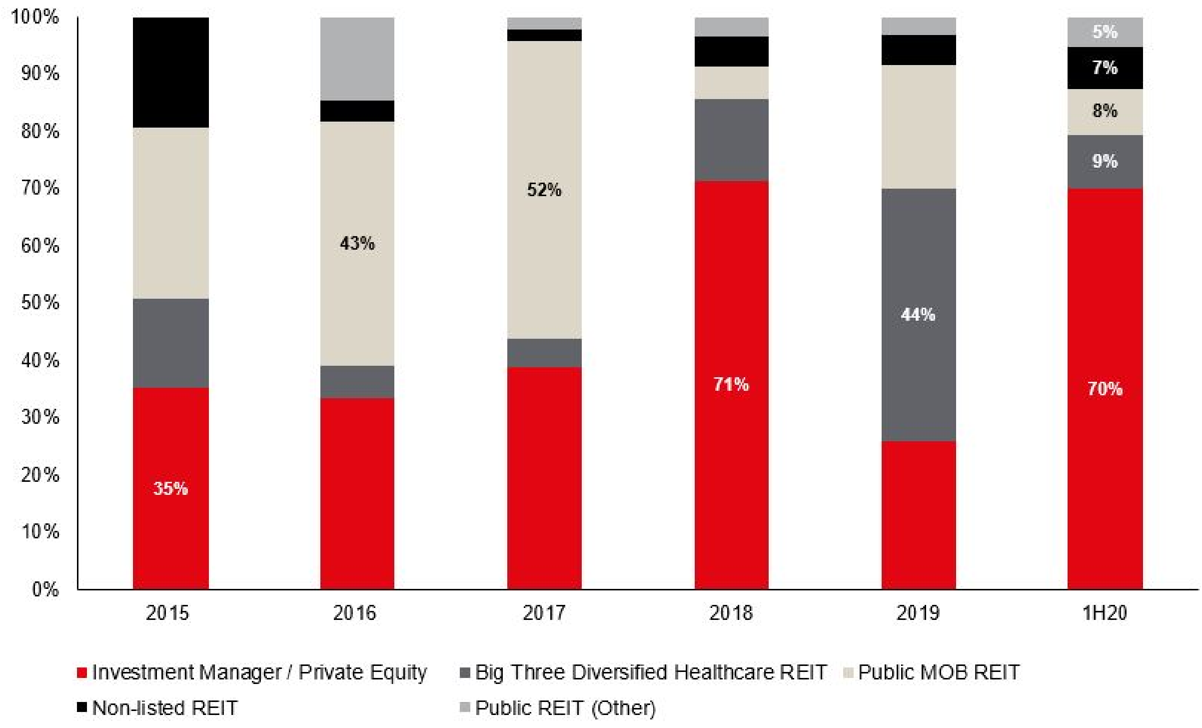
Healthcare
Capital Markets

Medical Office
Perspectives

September 2020

Sizeable dry powder unleashed for desirable medical office investment as the market pivoted from peak conditions to COVID

Top Medical Office Buyers, by Buyer Type



Source: JLL Research, SEC Filings

Key points:

- Institutional managers and private equity concerns dominated first half 2020 medical office sales, acquiring 70% of the $5.5 billion of trades. This percentage is similar to the 2018 concentration from this buyer pool. The durability of demand and consistency of performance through economic cycles that characterizes the MOB sector was amplified by the fact that first half 2020 sales of $5.5 billion sales represented a 10% year-over-year increase from the $5 billion total in first half 2019, and comprising a remarkable 14% of all office sales in the first half 2020. Buoyed by dry powder, institutional managers and private equity concerns were able to benefit from favorable purchasing conditions. While debt financing conditions fluctuated during the spring peak of COVID-19, medical office lending was consistently well-supported by commercial bank lenders, which reflects the high credit quality of healthcare provider tenants in the lenders' underwriting.

- Experienced REIT investors also recognized the purchasing opportunity during the first months of COVID-19, acting swiftly and prudently to raise their liquidity levels. However, their pricing power was inhibited due to interest rate and share price volatility. Share prices of REITs were off 54% at the outset of COVID-19 for the broad healthcare sector, weighed down by some of the hardest hit subsectors. The share selloff led select private equity investors to buy into public REIT shares as implied cap rates reached recent historically high levels, out of line with private markets. The market recovery during COVID allowed REITs to gain back substantial ground as the positive fundamentals of healthcare were able to surface. This is best illustrated by the class of MOB-only REITs (HTA, HR, DOC) that recovered to within 4% of their pre-COVID levels by June, supported by consistent rent collections in the high 90% range throughout their portfolio holdings. Importantly, REITs benefited from the downdraft in benchmark interest rates over the past few months, along with a remarkably resilient bond market, with select issuers offering 10-year bonds at or near 2% coupon rates. REITs are well-positioned in the future with their sizeable issuance of attractively priced long-dated bonds, which provide competitive liquidity for investment.

- The continued high level of MOB investment in the first half 2020 is a testament to the virtues of this property class. Thanks to robust, ongoing fundraising, private investors were prepared to act quickly when the opportunity arose, availing themselves of low interest rates and favorable lending terms, while gaining a competitive short-term buying advantage with respect to REITs. With consistent tailwinds for medical office, the diversity of buyer types in healthcare will be able to benefit as markets stabilize, clearly demonstrating the widespread appeal of MOB. Second half activity is expected to be strong based on new listings in the market and a significant uptick in buyer interest as closed transactions provide the pricing discovery that many investors seek.

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