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Property Metrics Highlight Durability; Retailers Expand into Healthcare Spaces

Medical office vacancy stable in three-year span. The medical office sector continues to exhibit resilience to pandemic-related disruptions. From 2019 through the first quarter of 2023, vacancy in medical office properties has only risen 50 basis points nationally. The sector has been bolstered by the necessary nature of medical office visits, as well as the expectation that healthcare demand will rise long-term with the ever-aging population. At the same time, less than 12 million square feet of medical office space was slated for 2023 delivery as of June — only 1.0 percent of current inventory — making near-term supply headwinds unlikely. Still, performance in sector fundamentals varies based on location-specific factors, such as resident demographics, existing local stock and metro-level construction pipelines.

Vacancy in retirement hotspots plummets. Extreme growth in the 65-plus cohort has generated demand for medical care. Properties in areas with fast-growing elder populations have outperformed metros with slower growth in this cohort, such as cold-weather markets including Chicago or New York. Dallas-Fort Worth, for instance, noted a 190-basis-point drop in medical office vacancy from 2019 through March 2023, coinciding with a 17 percent surge in the metro's age 65-plus cohort. Other metros with similar population trends have performed likewise. Areas where the age 65-plus cohort grew more than 15 percent, such as West Palm Beach, San Antonio and Phoenix, all noted vacancy falling by nearly 200 basis points or more over the three-year span.

Retailers' healthcare entrance may aid medical office use. Large retail chains have recognized the demographic shift in the U.S. and long-term potential in the healthcare sector. In 2019, Walmart introduced Walmart Health to provide healthcare services, and the number of these centers will have nearly doubled by 2024. Walgreens also completed an \$8.9 billion deal late last year to buy Summit Health, expanding the company's reach into primary, specialty and urgent care. Similarly, Amazon acquired One Medical with virtual, in-office and lab services. Other major retailers have also increased their ability to provide medical services. Retailers developing a presence in the healthcare sector could carry into smaller-scale expansions — particularly in space proximate to these retailers to offer specialized care — boosting user demand for new and existing medical office space.

Medical Office a Bright Spot in the Sector

Active buyers focus on medical offices. Over the last three years, medical office properties have accounted for an increasing number of office sector transactions. The property type has exhibited resilience in the post-pandemic environment and has maintained a relatively stable average sale price at just under \$300 per square foot. Following the Federal Reserve's rapid interest rate hikes, however, sector deal flow has slowed. Additional complications to transactions stem from lenders. In 2022, over 75 percent of medical office financing came from local, regional and national banks. Bank closures earlier this year and the subsequent tight lending conditions could temper sales activity near-term.

Healthcare-related space maintains a reputation for stability. Medical office space benefits from not being as closely tied to the economic cycle as other property types, including traditional office spaces. Leases tend to be signed for longer periods, limiting erratic vacancy swings, and healthcare is generally a non-discretionary service. Clarity in the role of telehealth as a supplement to in-person care, and medical offices having fewer labor challenges than other healthcare spaces, could boost investor confidence in the long-term growth potential of the sector.

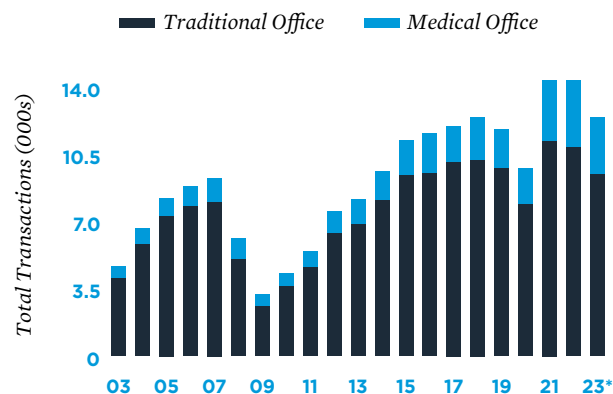
9.2%

1Q Medical Office
National Vacancy

17.5%

1Q Traditional Office
National Vacancy

Medical Office Captures Greater Share of Sales



* Trailing 12 months through 1Q

Sources: IPA Research Services; CoStar Group, Inc.; Moody's Analytics; Real Capital Analytics; U.S. Census Bureau



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