United States
Research Report

2016 HEALTHCARE MARKETPLACE

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Healthcare Real Estate Continues Strong Performance

Michael Roessle Director of Office Research | USA

Colliers' analysis of the healthcare industry and its effect on commercial real estate in the U.S. points to a soaring healthcare landscape with expected increases in investment and further "retailization." In 2016 and beyond, there will continue to be strong demand for medical office space as healthcare spending rises and demand from an aging population grows.

Investor appetite is driven by higher yields compared to other asset classes, low interest rates and a stable tenant base with strong credit. The solid fundamentals of this asset class, combined with the projected aging population growth, are attracting investors not accustomed to investing in medical office buildings. Strong demand should continue into 2016, with the recent interest rate rise having minimal effect.

The retail sector is also expected to benefit as medical clinics, urgent care centers and other outpatient facilities lease space in shopping centers where retailers have left vacancies. There are often favorable lease terms in centers with several vacancies and these areas offer greater visibility and more convenient locations to their patients.

We expect healthcare costs will continue to rise as the Affordable Care Act (ACA) has enrolled millions of Americans who are actively using the coverage they are now paying for. This, combined with the projections in growth of the population 65 years and older, leads to the estimate of a near doubling of healthcare spending - from $3 trillion in 2014 to $5.5 in 2024.

As hospitals and healthcare systems are under pressure to reduce costs while increasing the quality of care, there has been a wave of merger and acquisition activity that is expected to continue into 2016. These hospitals and healthcare systems are seeking to improve efficiencies, reduce duplicate facilities and gain greater negotiating leverage with insurance companies.

Key Takeaways

- **Vacancy Rates: Demand for Medical Office Buildings (MOBs) continues to be strong across the country.** Through three quarters of 2015, the vacancy rate stood at 9.5% nationally, which is a drop of 30 basis points (bps) from the same period in 2014, 130 basis points down from the peak in 2010. The last time the national vacancy rate was this low was in the second quarter of 2008.
- **Absorption: While absorption has slowed, it has remained positive in 2015; totaling 5.8 million square feet through the third quarter of 2015.** That leasing represents a decline of 15.1% over the same period in 2014 and a 58.6% drop from the high of 14 million square feet absorbed in the first three quarters of 2008. As employment growth in the hospital and healthcare systems continues, absorption should remain positive throughout 2016.
- **Rent: Average asking rents for medical office buildings were generally flat in 2015, reaching $22.95 per square foot in the third quarter.** That represents a 0.3% gain from this time last year and a 4.1% gain from the low of $22.16 per square foot seen in the beginning of 2013.
- **Sales: At the end of the third quarter of 2015, the rolling 12 month sales volume ($12.9 billion) hit a new peak, which has contributed to downward pressure on cap rates.** After three quarters of 2015, the rolling 12 month cap rate stood at 7.2% and continues the downward trend seen since yields hovered over 8.0% in 2010. Availability of capital combined with low interest rates, an aging demographic and the effects of the Affordable Care Act (ACA) have been heating up the demand and competition for medical office properties.
- **Technology: Consumers have embraced technology to take a more active role in their care while providing caregivers with crucial information that can lead to more personalized courses of treatment, earlier diagnoses, prevention of unnecessary costs and easier direct communication.**
- **Retail Effect: The "retailization" of healthcare has continued to take leaps forward as providers look for lower-costs and locations that are easily accessible to customers.** As the ACA boosts the number of people with insurance and consumers adopt more responsibility for payment, they are moving from the historical payment model to treating healthcare as any other retail product in terms of choice and cost.
- **Mergers & Acquisitions: Merger and acquisition activity continued to roll in 2015 as the pressures to cut costs and reduce spending while increasing the quality of care have**

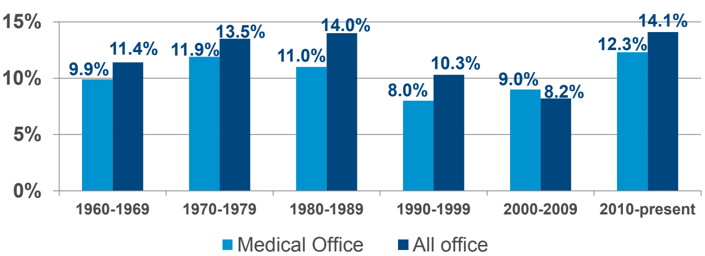
led physician practices, hospitals and healthcare systems to combine for greater negotiating leverage and improved efficiencies.

- **Financial Health: U.S. health expenditures topped $3 trillion in 2014 and are projected to grow by another 5.3% when the totals for 2015 are finalized.** A combination of millions of newly insured people and an aging population have led to this growth in spending.

Vacancy Rates Continued Their Descent in 2015

Medical office building vacancy rates continued their downward trajectory in 2015, reaching 9.5% at the end of the third quarter of 2015, fully 320 basis points below the rate for all office space nationally. This 30 bps drop from 2014 emphasizes the sustained demand for space as health systems continue to expand their footprints. For some historical context, 2015's vacancy rate is a full 130 bps drop from the 10.8% rate at the peak registered in 2010. Vacancies have declined steadily each year since, and we are not far from reaching the 9.1% rate seen at the height of the economic boom in 2007. While the market is experiencing solid vacancy declines overall, the recovery has been bifurcated, with higher vacancies typically seen in older buildings that are more difficult to adjust to changing clinical service needs and new technologies.

Vacancy Rates by Building Age

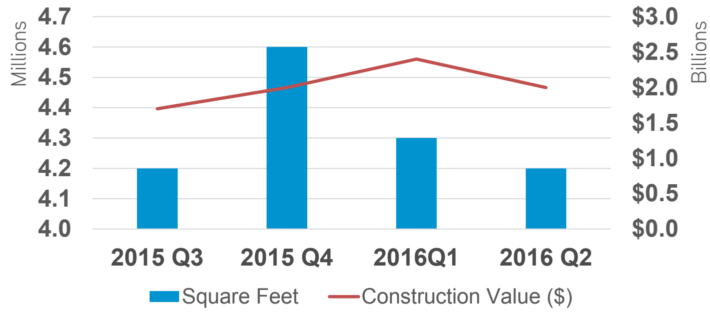


Sources: CoStar, Colliers International

This trend of declining vacancies can been seen in markets as diverse as the Los Angeles Basin, Phoenix and Las Vegas–all of which registered year-on-year drops of at least 50 bps. The Las Vegas market saw a particularly strong decrease of 150 bps to 17.8% from 19.3% in Q3 2014. Phoenix was nearly as strong, registering a 120 bp annual dip to 16.7% from 17.9%. This was the fifth decline in the last six quarters in the market. The L.A. Basin medical office vacancy rate dropped 60 bps over the past year, reaching 8.0% in the third quarter of 2015. Though demand for medical office space in Houston has weathered the plunge in energy prices better than many sectors, vacancy rates rose by 90 basis points in Q3 to 11.5% (from 10.6% in the corresponding period one year ago).

The stable and restrained pace of new construction during the recovery has helped reduce the backlog of vacancies in existing space. After a high of 24.9 million square feet of new supply delivered in the U.S. in 2008, the pace of deliveries has fallen significantly, hovering near 4.0 million square feet per quarter in 2015. According to data from Revista, the MOB deliveries in 2015 are expected to total 16.7 million square feet in 283 properties. Including the expected deliveries of hospital construction, total new supply in 2015 will amount to 28.1 million square feet in 245 properties. The amount of space under construction has also been restrained in recent years following the boom in 2007. The current pipeline of MOBs under construction totals 38.7 million square feet with a value of $18.3 billion, while 84.4 million square feet of hospital construction has a value of $68.3 billion.

MOB - Forecasted Completions



Source: Revista

Total Construction Pipeline	MOB	HOSPITAL	TOTAL
# of Properties	542	647	1,189
Total SF	38.7M	84.4M	123.1M
Total Construction Value	$18.3B	$68.3B	$86.7B
Median SF/Project	45.0K	50.0K	46.0K
Median Construction Value/Project	$14.0M	$37.5M	$21.0M

Source: Revista

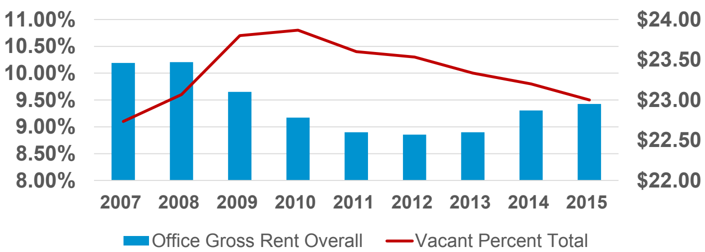
Medical Office Absorption Remains Positive

Absorption registered gains of 5.8 million square feet nationally through the first three quarters of 2015, which is a 15.1% decline from the same 6.8 million square feet a year ago. Several years of strong positive absorption–including the period between 2012-2014 when annual totals were between 8.5 and 10.2 million square feet–combined with the limited new supply of the last few years has fueled the steady drop in vacancies and rises in asking rents across the country. Barring any unanticipated shocks to the U.S. economy, strong absorption should continue for at least the short term as the measured pace of strengthening in this sector suggests this is not part of a bubble typically signified by abnormally rapid growth. Still, the dynamic and complicated changes facing the healthcare industry as a whole could alter these variables in the long-term and should be monitored.

Medical Office Rental Rates Hold Steady

Asking rents for medical office space posted an annual gain of 4.1% in Q3, reaching $22.95 per square foot. This is the third consecutive year of asking rent increases for the sector and the highest figure since the $23.10 per square foot seen in 2009. Even with these recent increases, asking rents have remained relatively stable, fluctuating less than $1.00 since 2007. As a comparison, asking rents in the general office market have also seen positive growth, with Class A properties in CBDs rising 6.8% annually to $48.62 and Suburban Class A properties increasing 3.5% to $28.59. CBD Class A office properties have seen five straight years of rent increases while suburban properties have registered four consecutive years of rent growth.

Medical Office Vacancy Rate & Asking Rent



Source: Revista

Medical Office Sales Continue Strong Performance

2015 was a banner year for medical office sales as capital continued to flow into the sector and strong pricing continued to drive down cap rates. Demand for this asset class should remain healthy throughout 2016, and the modest interest rate rises anticipated this year are unlikely to alter the investment landscape significantly. Vast amounts of capital continue to compete for available investment opportunities, which has led to yields declining to near 7% nationally, with the Northeast and West regions of the country generating yields in the low to mid 6% range. Prices per square foot have reached record levels, pushing above $240 per square foot nationally and above $330 per square foot in the Northeast.

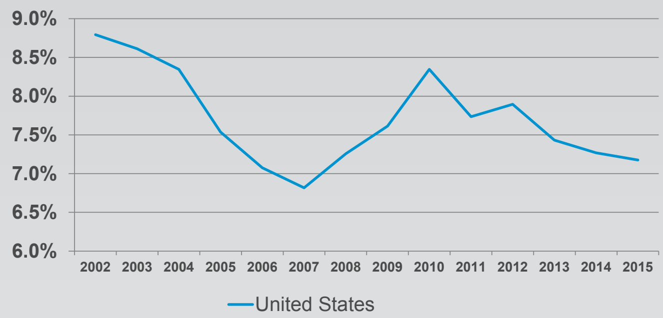
Sales volume continued its record pace in 2015: by the end of the third quarter the rolling 12-month total reached $12.9 billion, far surpassing the trough of $2.2 billion at the end of 2009. As another measure of market strength, that $12.9 billion figure represents 8.7% of all office sales, a sizeable jump from the sub-6% total seen in much of 2014.

The positive market dynamics have drawn investors not traditionally accustomed to investing in medical office properties. Factors include the availability of debt, shrinking yields in other asset classes (particularly in gateway markets) and demographics that point to continued growth in the demand for healthcare services. Projections by the Centers for Medicare & Medicaid Services (CMS) forecast total, national health expenditures climbing from a forecasted 2015 total of $3.2 trillion to nearly $5.5 trillion in 2024.

2016: A Positive Outlook

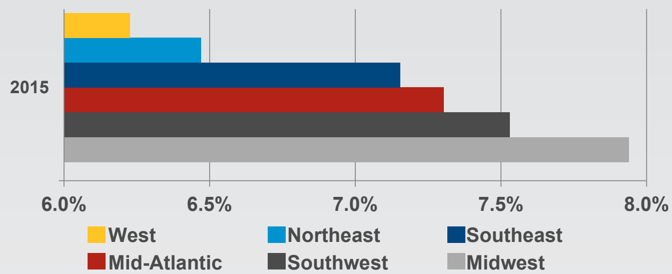
The MOB sector should continue its strong and steady performance through 2016 as healthcare industry employment growth and demographic trends all line up favorably. Now that some of the uncertainty around the ACA has passed and a clearer understanding of its regulations are in place, many barriers to further development and leasing performance are coming down (with a caveat to keep an eye on the political debate surrounding

Medical Office Cap Rates - United States



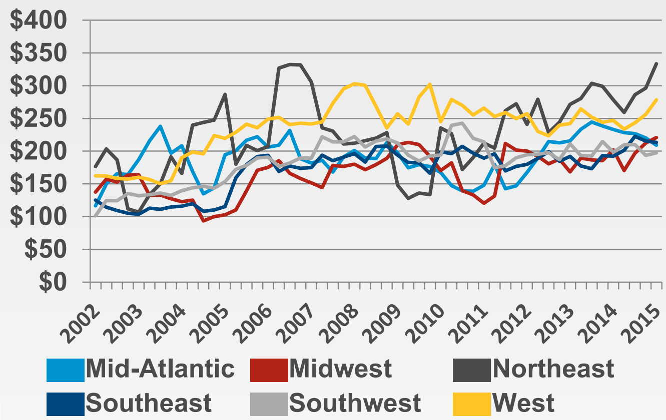
Source: Real Capital Analytics

Medical Office Cap Rates by Region



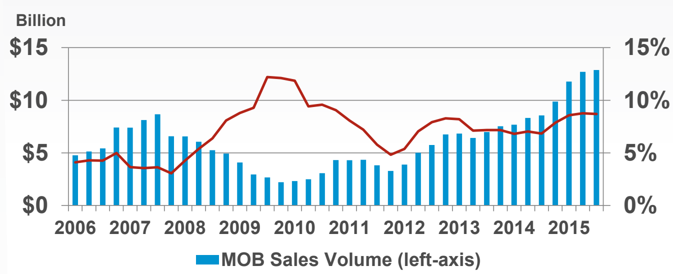
Source: Real Capital Analytics

Medical Office $/SF by Region



Source: Real Capital Analytics

Medical Office Sales Volume



Note: All data are 12 month trailing

Source: Real Capital Analytics

the ACA and results from the elections in 2016). With millions of newly-insured people and a continuing recovery in the more general economy, we should see the positive trends of 2015 carry forward.

This combination of the high numbers of newly-insured people (nearly 17 million according to a study by the RAND Corporation), clarity surrounding the ACA, steady demand from aging Baby Boomers, and economic growth should keep investors attracted to this sector. Still, changing models in the provision of health care can upend the dynamics of medical real estate in the longer term, which is our next topic.

2016 Healthcare Industry Trends: Opportunity or Threat to Real Estate?

With strong demand and favorable growth indicators for medical office real estate from 2015, the outlook for 2016 should be one of continued, steady and positive financial performance. But much of that depends on the healthcare industry overall. Even with the encouraging shifts in reimbursement and steady demand for services, the industry continues to face unprecedented uncertainty and change driven by multitudes of converging trends: complex demographic forces, revolutionary clinical treatments, population health management, provider shortages, and a myriad of other challenges. The outlook for and subsequent performance of healthcare real estate is inextricably tied to the interaction and impact of these changes. This report identifies four key health care trends that will directly impact medical real estate and explores how these four areas will offer opportunities or pose threats in 2016 and beyond.

1. Technological Transformation

Healthcare technology continues to advance to meet demands from patients, providers and payers. The emergence of wearable and shareable technology has enabled consumers to take a more active role in their care. At the same time, it can provide caregivers with crucial information that can lead to more personalized courses of treatment, earlier diagnoses and easier direct communication which can aid in avoiding unnecessary costs. On the consumer front, the proliferation of wearable devices, such as FitBit and Jawbone, are rapidly advancing beyond merely tracking the number of steps taken each day to providing information on sleep, heart rate and body temperature. Also, more advanced monitoring devices are consistently being developed. This data is invaluable for care providers to continuously track and record vital signs rather than relying on a point-in-time snapshot of a patient's condition. Monitoring blood sugar more accurately for diabetic patients, constant monitoring of heart function in cardiac patients, more customized medication adjustments, and tracking medication compliance are all emerging standards of care enabled by advances in technology.

An InMedica study predicted that the number of patients with chronic illnesses who are being remotely monitored will increase from 308,000 in 2012 to 1.8 million by 2017. Remote monitoring can be effective in preventing highly expensive hospitalizations, readmissions after discharge and emergency department visits through proactive early identification and response to symptoms of a worsening condition. All of this reduces the need for direct patient care and thus medical real estate.

As technologies expand and data capabilities become more robust, it is transforming not only how and what care to provide but when and where to provide that care. The traditional business model of patients traveling to their physician's office for routine treatment is being replaced by telemedicine. From providing care online, over the phone, or with remote monitoring, these forms of virtual care reduce the time and cost of recurring office visits. As part of this movement, one of the largest U.S. healthcare chain, Community Health Systems (CHS), announced it was launching a major telehealth program to allow patients access to urgent care services 24 hours a day. According to figures from analytics firm IHS, the market for telehealth in the U.S. is predicted to explode from $240 million in 2013 to $1.9 billion in 2018. With the changes in reimbursement for bundled payments and the push for population health management, telemedicine offers a lower cost approach to direct patient care.

Still, given the risk to patients, there are concerns about the technology changes in healthcare. While smart phones apps proliferate and their usage soars (64% of American adults own a smartphone and 62% of smartphone owners have used their phone to look up information on health conditions, according to a study by Pew Research), the reliability and integrity of the healthcare information provided lacks the robust regulatory controls on direct care provided by licensed professionals. For example, in a 2013 report by the House Ways & Means Committee it was estimated that the 109 new regulations (13,000 pages) imposed under the ACA would translate to an estimated 190 million hours of paperwork per year for businesses and the healthcare industry – regulations that don't apply to the information on many healthcare websites. The safety of remote devices used by untrained, often unwell, consumers along with the reliability of the data reported raises questions of liability to the healthcare provider who provides treatment based on that information. With cyber threats and breaches rampant, the security and privacy of vital health information is under constant attack (massive healthcare data breaches occurred in 2015, including the nearly 80 million records compromised at Anthem, Inc., 11 million records hacked at Premera Blue Cross and 10 million records exposed at Excellus Health Plan). While not as measurable, there is the concern over a less personal relationship between patient and healthcare provider as technology enables distant and data driven care. Nonetheless, healthcare systems continue to invest billions in their information systems and platforms to drive and support these technologies. Many prominent healthcare systems such as Providence Health & Services, Kaiser Permanente and Cleveland Clinic, had or have recently started venture funds to invest in technology being developed by startups. According to a report by Rock Health, venture funding of digital health companies in 2015 is on pace to match or exceed 2014's record-breaking total of $4.3 billion; $2.1 billion has been invested through the first half of 2015.

Opportunity: This rise of technology in healthcare requires space to accommodate the related changes to how patient care is delivered. As self-service check-in kiosks and patient-location tracking systems become more common, floor plans need to change to enhance patient flow and to maximize space for patient/provider consultations. In addition, healthcare systems that offer shared medical appointments need strong audio/visual capabilities so off-site providers can join the consultations. The demand for technologically-advanced medical office buildings is helped by the shift in procedures to outpatient facilities from the costlier hospital settings where many of those services were performed in the past. With the costs and interruption to retrofit existing space, it can be less expensive to simply build anew. These factors could drive development for new medical office real estate.

Threat: As telehealth services and remote monitoring take hold, the need for direct patient care could plummet. Virtual office visits for minor, urgent and follow-up care require no real estate and could spur providers to reduce the number of exam rooms in their offices. The size of diagnostic equipment is decreasing (handheld ultrasound devices) making them more portable and reducing the need for storage space. As other technologies emerge and drive care into the consumer's hands or home, the need for medical office space could decline.

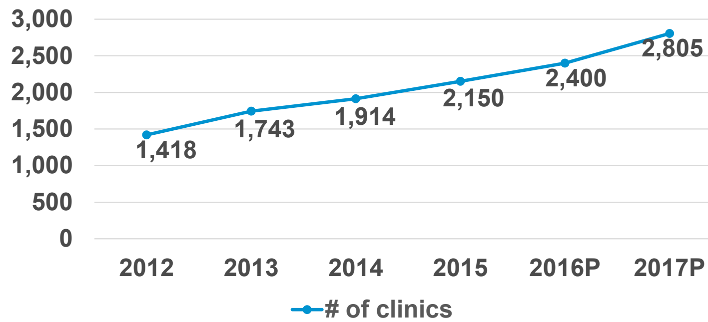
2. Healthcare as a Retail Market

As the Affordable Care Act (ACA) boosts the number of people with insurance and consumers adopt more responsibility for payment, we are shifting from the historical reimbursement model to treating healthcare as any other retail product in terms of choice and cost. This rise of patient consumerism plays a large role in the rise of retail settings for health care use.

- The retail building: Many medical providers, including physicians, dentists, and physical therapists, are being drawn to shopping center locations to leverage the enormous volume of foot traffic. This serves a dual need as landlords seek to fill vacant retail spaces and medical providers want to be visible and easily accessible to existing and potential patients. Prominent signage and the visibility of shopping center locations offer a form of built-in marketing as these facilities aren't tucked away on a hospital campus or in a traditional medical office building. The aging population is in particular need of the convenience and ample parking offered by many of these locations. In addition, the retail setting offers lower occupancy costs compared to traditional medical office settings, particularly if a landlord has high vacancies that push them to consider nontraditional retail space tenants and offer generous free rent and tenant improvement packages.
- The retail health clinic: As millions of new people get health insurance under the ACA, both hospitals and primary care providers struggle to keep up with demand. This has created the opportunity for retail health clinics to ease some of that burden. Patients as consumers are attracted to the convenience and cost of retail clinics as they offer longer hours, shorter wait times and on-site pharmacies. The shift in philosophy from hospital systems and retail clinics as adversaries to partners is also driving the expansion of this approach to care. Healthcare systems are attracted to the lower costs associated with operating in existing real estate footprints and keeping minor medical issues out of expensive emergency departments. The main drawback so far has been winning over consumer confidence in the quality of care provided in these more casual, retail settings, particularly as the seriousness of the health problem increases.

A study by Accenture illustrates the proliferation of retail clinics in the U.S. According to the study, the number of retail clinics is projected to nearly double from 1,418 in 2012 to 2,805 in 2017.

Retail Clinic Growth



Source: Accenture

A study by Manatt Health shows that CVS MinuteClinic and Walgreens Healthcare Clinic are the dominant players–accounting for nearly 75% of market share in the category–with CVS racking up the largest number of health system affiliations (further emphasizing the shift from competitor to partner).

Major Retailers With Health Clinics

CLINIC NAME	# OF LOCATIONS	MARKET SHARE	HEALTH SYSTEM AFFILIATIONS
CVS MinuteClinic	901	50%	47
Walgreens Healthcare Clinic	437	24%	6
Kroger Little Clinic	140	8%	4
Walmart Retail Clinics	103	6%	46
Target Clinic	80	4%	2
RiteAid RediClinic	30	2%	3

Source: Manatt Health

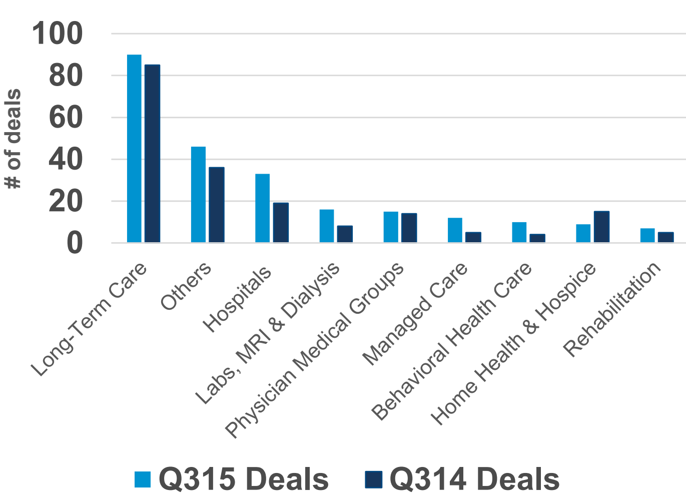
Opportunity: The long-term effect of this retail trend on real estate could be positive if these clinics continue to take space in vacant shopping centers, repurpose vacated big-box stores or build new stand-alone facilities in existing retail centers. As the retail landscape has been shifting toward e-commerce, the growth in demand for healthcare services in convenient locations can be a large driver in filling that void and driving vacancies down, particularly for neighborhood and community retail centers. Long-term leases with favorable terms are often available as landlords are recognizing the benefits of the additional foot traffic these clinics can bring to a retail center. Suburban health care villages are an example of a growing healthcare/retail partnership as a hospital anchors the center and the site includes a host of other medical services as well as retail and restaurant sites. This benefits both the healthcare and the retail real estate markets.

Threat: However, the explosion in growth of clinics located within existing footprints (CVS, Walgreens, Target etc.) does little to spur demand for more real estate in the sector. The cost benefits for both the retail chains and their health system affiliates are significant. It takes only about 300 square feet for a clinic within an existing structure, with immediate exposure to steady foot traffic bringing in many potential healthcare consumers. There is no net demand for real estate, for either retail or healthcare markets.

3. Merger and Acquisition Movement

The trend of mergers and acquisitions in the healthcare industry has continued its momentum in 2015, in terms of payers (Anthem's $54.2 billion acquisition of Cigna and Aetna's $37 billion acquisition of Humana), providers (the merger of Baptist Health South Florida and Bethesda Health) pharmaceuticals (the Pfizer-Allergan merger worth approximately $160 billion) and physicians (AmSurg's acquisition of Valley Anesthesiology & Pain Consultants in Phoenix which has roughly $160 million in annual revenue). The landscape has changed for all sectors of the industry, led by the low cost of capital and interest rates.

Healthcare M&A Volume



Source: Health Care M&A News

The appetite for mergers in 2016 is uncertain. While providers feel the need to scale up to have better negotiating positions with each other and to provide better quality, lower cost care, the Federal Trade Commission is challenging recent merger efforts. It has blocked three proposed mergers recently, in Huntington, West Virginia (Cabell Huntington Hospital and St. Mary's Medical Center), Harrisburg, PA (Penn State Milton S. Hershey Medical Center and PinnacleHealth) and in Chicago (Advocate Health Care and NorthShore University HealthSystem). The FTC claims these mergers would harm consumers with higher prices driven by these larger system's combined bargaining power with health plans.

Thanks to the REIT Investment Diversification and Empowerment Act of 2007, which allows REITs to be involved in the business side of healthcare rather than solely generating revenue by managing real estate, there have been heavy REIT-led acquisitions in 2015. Many of the top deals of the year involved REITs purchasing healthcare systems and their associated real estate, both inpatient and outpatient. The increased cost sensitivity of health systems has led them to explore monetizing their large real estate portfolios to access that capital for upgrades in technology, acquiring independent physician groups and other inpatient facility investments.

Largest Deals of 2015

BUYER	SELLER	SALE PRICE*
Ventas REIT	Ardent Health Services	$1,600,000,000
Ventas REIT	ARC Healthcare REIT (HCT)	$1,286,465,414
Medical Properties Trust (MPW)	Capella Healthcare	$600,000,000
SNH REIT	Cole Properties Trust	$539,000,000
Health Care REIT	G&L Realty	$443,041,633
HCP, Inc.	Memorial Hermann Health System	$225,000,000
St. Louis University	Tenet Healthcare	$200,000,000
HCP, Inc.	Digital Realty Trust	$161,000,000
GA Healthcare REIT III	Kadima Medical Properties	$135,000,000
MBA Real Estate	Illinois Bone & Joint	$131,000,000
*Sale price of real estate only		

Source: Revistamed.com

As mergers bring together hospitals and physician practices into large, financially solid healthcare systems, they aggregate significant real estate portfolios. The full implications of this M&A activity on real estate demand have yet to be fully realized.

Opportunity: Having wider geographic coverage and larger headcounts can lead to increased space demand in existing medical office facilities, as well as those currently under development. These mergers allow healthcare systems to repurpose some inpatient areas as outpatient facilities and open more specialized hospitals and care centers. Investors in these assets enjoy the security of steady income generation projections and higher yields than some other assets, as spaces are typically leased on a long-term basis to tenants backed by healthcare systems with strong credit ratings.

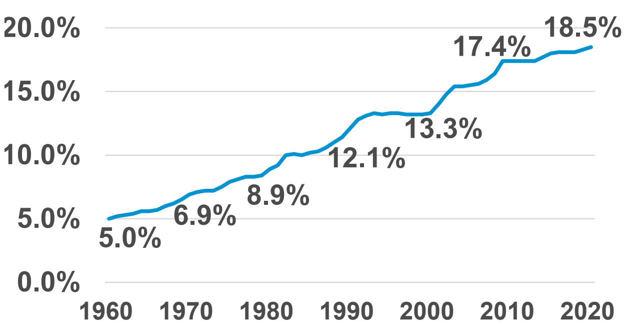
Threat: With these consolidations comes the potential for overlapping markets and redundant facilities. This can fuel the need to shed real estate where demand does not justify the operating costs of duplicate facilities. While these consolidations may ultimately benefit the consumer through improved operating efficiencies and increased capital to invest in upgrading facilities and technology, it could leave many of these facilities dark in the years ahead, with far less need for medical office real estate.

4. Healthcare's Financial Health

Despite the extensive efforts by government, employers and providers to reduce costs, healthcare costs continue to rise, albeit with slower but still steady increases.

- U.S. health expenditures topped $3 trillion in 2014 and are projected to grow by another 5.3% when the totals for 2015 are finalized.
- According to the latest figures from the Office of the Actuary in the Centers for Medicare & Medicaid Services (CMS) published in Health Affairs in early December, national health expenditures rose to $3.0 trillion in 2014, which was a 5.3% increase over 2013.
- Per capita spending on health care was $9,523 in 2014, representing a 4.5% boost from 2013.
- As a percent of gross domestic product, health expenditures amount to 17.5%, 20 bps higher than the prior year.

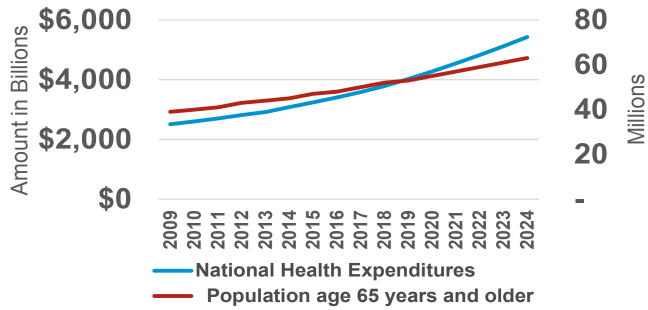
Healthcare Spending as a Percent of GDP



Sources: Centers for Medicare & Medicaid Services, Office of the Actuary

The projections for 2015 look just as strong, with the same 5.3% annual growth forecasted for health expenditures. Looking ahead, we see annual growth in spending rising above the 6.0% mark from 2019-2024. It is no coincidence that between 2015 and 2024, the U.S. population age 65 and older is projected to grow by 34.0% to 63 million people.

Health Expenditures & Population Growth Projections



Sources: Centers for Medicare & Medicaid Services, Office of the Actuary

The rise in spending is largely attributed to the expansion of coverage under the ACA, as there was strong growth in both private health insurance, as well as Medicaid. This rise in spending follows years of much slower growth, as the millions of people who enrolled in coverage under the ACA are using the services for which they are now covered. Fitch, the bond rating agency, maintained a negative outlook for U.S. nonprofit hospitals and healthcare systems in their 2016 forecast. They believe that this sector will continue to be challenged by the rise of healthcare consumerism, minimal insurance rate increases, labor cost pressures and a shift of risk from payers to providers by the growth of value/risk-based contracting. Nonprofit hospitals are generally less equipped to cut costs and contain spending than major for-profit hospital systems. With few expectations that expanded insurance coverage will take the pressure off of operating margins, the healthcare industry faces continued scrutiny to reduce costs.

Opportunity: The core business of healthcare is inherently driven by demand for patient care, providing a stable foundation to support investment in the sector. The population is steadily aging, with data from the U.S. Census Bureau estimating that there were 43.1 million age 65 and older in 2012. That number is projected balloon to 83.7 million people by 2050, translating into a sizeable bump in revenue streams as demand increases for health care. The need for more facilities and services to manage the chronic illnesses of this aging population will be a major driver for growth. The financial structure to pay for healthcare services has evolved since the first 'sickness insurance' was introduced in 1847, through the creation of Medicare in 1965, to the launch of the ACA in 2010. Despite the controversy around these and future changes to reimbursement, healthcare is a required service that will continue to need real estate assets and investments.

Threat: Healthcare providers have three main expense categories: staffing, supplies and space. They have taken difficult steps to reduce staffing levels, trim offered benefits and limit pay increases. They have squeezed operating expenses through supply chain and revenue cycle management. With around 60% of their balance sheet invested in facilities, healthcare systems are confronting the need to reduce their occupancy costs. For investors in medical office real estate who built their financial models on regular rental rate increases and long lease terms, the reality is far less certain as tenants look to reduce their rent expense, with little certainty on lease renewal. For investors in hospital real estate, the questions around financial performance of the core healthcare business add greater uncertainty to the significant investment into these assets.

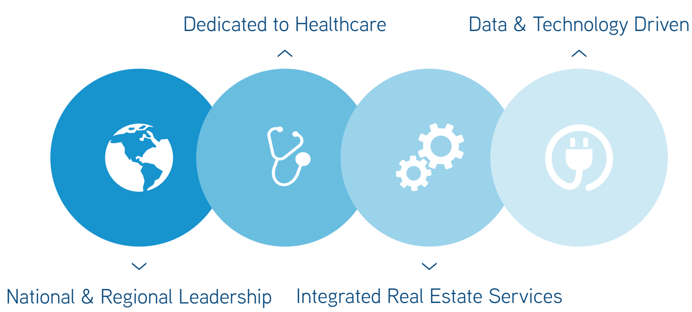
Conclusion

The positive trends in vacancy rates, asking rents and cap rates point to a continued healthy performance of the MOB sector through 2016. In a push to lower costs, health care providers are shifting care away from hospitals to outpatient facilities, further increasing demand. Investor appetite should remain robust as strong valuations and availability of capital will continue to drive activity. Demographic trends pointing to increasing demand for medical services and the credit-worthiness of hospital tenants will add to the positive long-term view of this asset class. Pursuits of mergers and acquisitions will remain strong as hospital systems continue to seek growth of market share and changes under the Affordable Care Act lead physicians to be employed by hospital systems rather than remain independent.

Healthcare facilities will have to adapt to the rapid changes in technology. Hospitals, ambulatory centers and MOBs are becoming fully digitally integrated. Therefore, existing facilities will have to be renovated and new buildings will need flexible designs to keep up with future technology. The need for these new and newly renovated structures will continue as we move forward and technology advances.

The impacts of technology, retailization, mergers and acquisitions, and financial uncertainty will all have an effect on healthcare real estate. The rapid pace of these changes in the industry makes it difficult to assess the exact impact they will have in the long-term. Monitoring whether at least some of these shifts are here for the long haul and will result in softening future demand for space or whether different models can continue to coexist and see demand grow is a topic worthy of debate in the coming years.

Our Commitments



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