United States
Research & Forecast Report

Medical Office Highlights
2015 Outlook

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Positive Outcomes and Positive Returns: The Resurgence of the Medical Office Market

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Key Takeaways

- Despite uncertainty regarding the full impact of the Affordable Care Act (ACA), overall tenant demand for healthcare real estate continues to increase. That demand is supported by expectations of an increase in the number of people insured and the aging of the large baby boom population.
- Medical office vacancy rates are at the lowest level since the recession and continue to decline. However, the market is bifurcated with higher vacancies in older, less adaptable buildings.
- Absorption continues to increase. Modern, flexible, well-located spaces that facilitate collaboration and are capable of handling rapid changes in technology are in the highest demand.
- Both the amount of new supply coming online and the amount of space under construction have been trending down since the recession and remained low in H1 2014.
- Rents have remained stable, in part due to the low interest rate climate.
- Investor demand in the medical office asset class remains strong, particularly for investment or near-investment grade properties.
- Capitalization rates continue to compress from already historically low levels. A bifurcation exists, however, with a wide spread between cap rates for investment-grade product and below investment-grade properties.

Healthcare Trends

The healthcare industry is in a transition period due to the impacts from several sea change issues. The Affordable Care Act (ACA) is accelerating the trend of health system and physician acquisitions, consolidations and alliances. Advancements in technology are profoundly altering the means of healthcare delivery and administration. Concurrent with these changes is the ballooning population of older Americans who will require more healthcare services, although the impact of this demographic trend varies significantly by local area. The net effect of these changes is rising demand for healthcare services, albeit amid ACA uncertainty, provider and consumer cost pressures, regional industry and demographic variations, and a greater need for flexibility given the accelerating rate of technological change.

United States Market Stats

ANNUAL	2014	2013	2012
Healthcare annual employment growth	1.6%	1.6%	1.8%
Personal consumption spending on healthcare*	$2.01T	$1.92T	$1.85T
% Change	*4.3%*	*3.5%*	*5.1%*
FIRST HALF**			
Overall MOB vacancy rate	10.9%	11.5%	11.6%
Asking rent PSF (weighted average)	$23.97	$24.29	$24.71

Investment Stats

YEAR-END			
MOB transaction volume	$8.87B	$7.46B	$6.73B
FOURTH QUARTER			
Average price paid PSF	$223	$220	$208
Average cap rate	7.2%	7.4%	7.7%

Notes: * 2014 data is Q3 seasonally adjusted annual rate, % change is vs. Q3 2013
** In 44 surveyed Colliers markets
Sources: Bureau of Labor Statistics, Bureau of Economic Analysis, Real Capital Analytics, Colliers International

Demographics

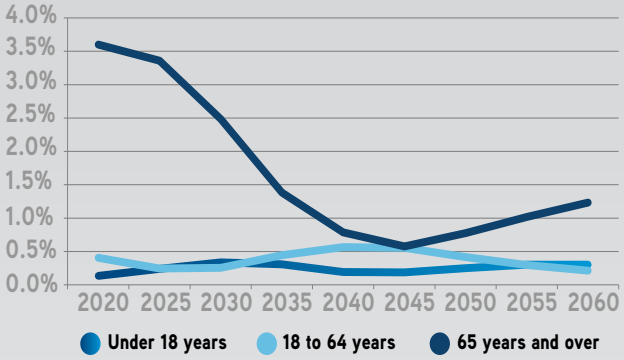
The aging of the baby boomer population, defined as those born between 1946 and 1964, remains the primary long-term demographic driver of demand for medical services at the national level. According to the most recent Census projections, population growth in the 65+ year-old cohort is expected to remain higher than growth rates in the younger age cohorts through at least 2060, with particularly strong growth during the next 20 years. Through 2035, the 65+ cohort is projected to increase by two-thirds, or by more than 31 million people, to account for more than one-fifth of the U.S. population.

The growth in the older population will translate into a significant increase in healthcare spending. Based on conservative estimates, the 65+ population accounts for $0.50 of every $1 of healthcare spending. Also, medical and technological advancements are extending life expectancies and driving lifetime demand for healthcare services to unprecedented levels. In addition, baby boomers are opting for elective procedures, such as cosmetic and exploratory surgeries, as well as complementary and alternative medicine at a higher rate than previous generations. These trends will contribute to increased spending on healthcare given this cohort's disproportionate share of aggregate U.S. healthcare spending.

Although growth in the baby boomer population is driving healthcare demand across the U.S., the extent of the impact varies significantly by state, city and local community. At the state level, Alaska, Utah, Texas, North Dakota, Washington D.C., Colorado and California have the lowest percentages of residents aged 65 or higher. However, in absolute terms, California and Texas have the first- and third-highest populations in this age group, while Alaska, Washington D.C. and North Dakota also rank low according to this metric. Similarly, the most populous U.S. metropolitan areas dominate the list of markets projected to have the largest change in the 65+ population between 2014 and 2019. In percentage terms, Sunbelt and Western markets are expected to post the fastest growth in the 65+ population during the next five years. Local variations in demographics underscore the importance of a detailed, market-specific demographic analysis during healthcare site selection, development and investment.

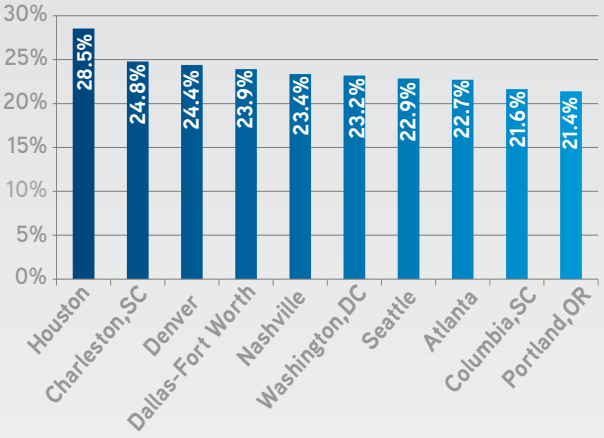
The other major demographic trend influencing the healthcare industry is the maturation of the millennial generation, defined as those born between 1980 and 1999. Because of the greater healthcare needs of the older population, the aging baby boomer population has captured most of the headlines with respect to healthcare industry growth. However, the millennial generation is actually slightly larger than the baby boomer population, at about 87 million millennials versus 76 million baby boomers, and millennials already are influencing the future of healthcare delivery. As the first generation to grow up with the internet, millennials possess similar expectations for healthcare delivery as other aspects of their lives, including convenience and flexibility. They also are comfortable with sharing personal information electronically. In addition, many millennials will be involved with decisions regarding their aging parents' healthcare in the future and will demand technology to help them manage this care and information related to it.

U.S. Population Avg Annual Forecasted Growth: 2015-2060



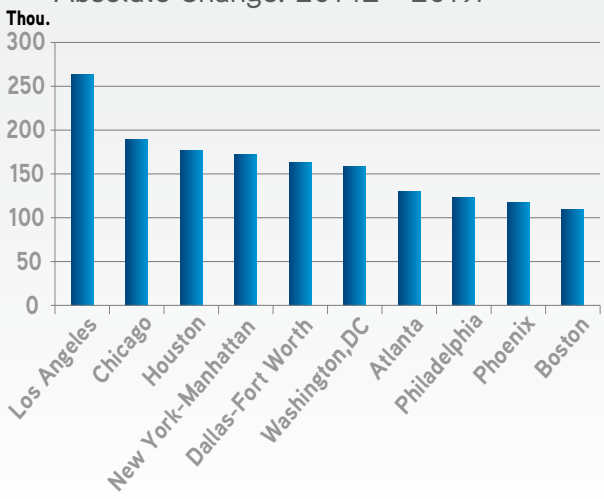
Sources: Census Bureau, Colliers International

Largest Forecasted 65+ Population % Change: 2014E - 2019F



Note: Ranking is of the 44 US markets included in this report
Sources: STDB, Colliers International

Largest Forecasted 65+ Population Absolute Change: 2014E - 2019F



Note: Ranking is of the 44 US markets included in this report
Sources: STDB, Colliers International

The growing influence of the millennial generation is one reason for the large amount of capital entering the healthcare technology space and driving innovation in the industry. One example is ZocDoc, an online scheduling system that allows patients to make and modify appointments, research and review providers, and fill out paperwork online before the appointment. Another is One Medical, a primary care healthcare group that locates in urban residential and commercial areas proximate to its consumer base and offers technological conveniences such as online appointment scheduling and prescription refills and patient-provider email communication. The ongoing maturation of the millennial cohort, as well as further advancements in technology, will continue to influence the healthcare industry, including tenant location and building type preferences, through the long term.

Employment and Economic Trends

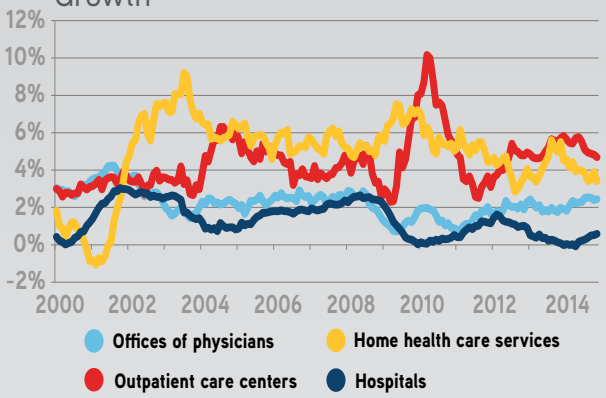
Bucking the national trend, the healthcare sector added jobs throughout the recession and continues to expand to meet growing demand for services. U.S. healthcare and social assistance employment increased by 1.6% year-to-date through September 2014, and nearly all of the markets included in this report added jobs during that period. However, the trend varies significantly within the subsectors that comprise healthcare employment, reflecting changing provider and consumer location preferences and healthcare delivery mechanisms. At one end of the spectrum is the outpatient care centers subsector, which has been expanding in the 4%-6% range for the last three years. That growth reflects the shift in many medical procedures to lower-cost outpatient facilities closer to the target consumer base. Also reflecting this trend is strong growth in home health care services employment. In contrast, hospital employment growth has been close to zero for the last few years, as smaller community and non-profit hospitals in particular, struggle with reduced reimbursements and increased administrative costs.

Although still by far the highest in the world, U.S. healthcare spending has been growing at a slower pace in recent years due to factors including the recession and subsequent slow recovery, as well as lower reimbursement rates. Healthcare expenditures as a percentage of GDP soared from 8.9% in 1980 to 17.4% in 2009 and have remained at that level through 2013. Healthcare spending on a per capita basis also has moderated, with 2.9% growth in 2013 compared with annual growth rates in the 7%-8% range in the early 2000s.

Industry Consolidation and Bankruptcies

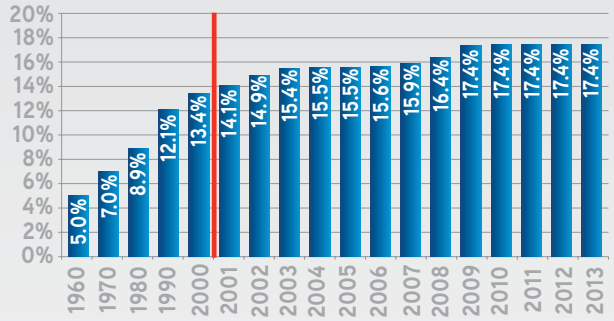
Nearly four years after it was signed into law, the ACA's full impact on the healthcare industry and real estate market remains uncertain. However, elements of the law already are driving or contributing to major changes in healthcare, including consolidation within the industry in order to reap the benefits of economies of scale given thinning margins. Between 2009 (when the ACA was signed) and 2012, the annual number of hospital mergers and acquisitions (M&A) more than doubled, from 50 to 107, with a large number of for-profit systems acquiring non-profit organizations.

Health Care Subsector Employment Growth



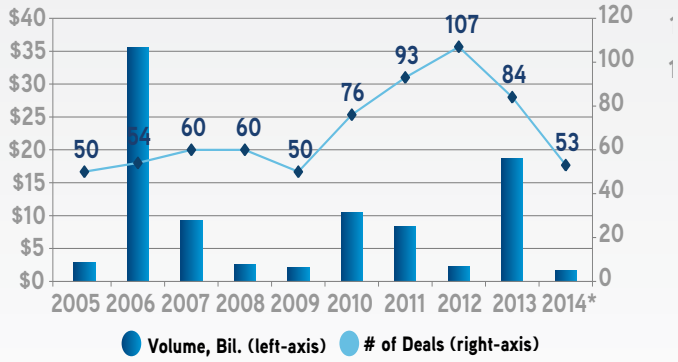
Note: Growth rates are year-over-year; all data are seasonally adjusted; latest data as of Nov-14
Sources: Bureau of Labor Statistics, Colliers International

National Healthcare Expenditures as Percent of GDP



Sources: Centers for Medicare and Medicaid Services, Colliers International

Hospital Mergers & Acquisitions



* Year-to-date through November
Sources: Becker's Hospital Review, Irving Levin Associates Health Care M&A Information Source, Colliers International

M&A deal volume decreased in 2014 with 53 deals year-to-date through November, but this statistic masks still-strong interest in M&A and system affiliations. One reason for the drop-off in closed M&A deals is that some deals are falling through due to unexpected problems with the acquisition target discovered during due diligence. Also, a large number of affiliations and alliances between systems (as opposed to outright takeovers) continue to occur.

One consequence of these M&A transactions and system affiliations is the creation of dominant medical systems that wield significant influence in the markets that they serve. Also, hospital systems are focused on acquiring and aligning with the "best and the brightest" physicians and practices, creating a bifurcated healthcare system and further concentrating influence within top-tier medical systems. From a real estate perspective, M&A can result in significant overlap in functions and services, reducing staffing and office space needs in those areas.

The other side of the M&A coin is the large number of hospital bankruptcies, including at least 20 bankruptcies in 2014. Weaker systems, especially smaller, freestanding non-profit and community hospitals, are struggling with lower patient volumes and profit margins. Those challenges are partially due to costs associated with ACA compliance, including electronic health record (EHR) system requirements, as well as reduced reimbursements. As a result, some of these hospitals are unattractive acquisition targets or partners for larger, healthier medical systems, which is forcing them into bankruptcy and further concentrating influence in the hands of stronger, increasingly dominant local and regional health systems. Furthermore, some hospitals are filing for bankruptcy in order to make their assets more attractive acquisition targets for other healthcare systems. The bankruptcy trend is likely to continue during the next 5-7 years as weaker systems are unable to compete with larger, more financially sound systems seeking to capture greater market share and influence.

Another trend that continues is the rising share of hospital-employed physicians due to increased cost pressures and the challenges of ACA compliance. A recent survey by Jackson Healthcare found that 20% of primary care physicians were employed by hospital systems in 2014, which is double the 10% share in 2012. We expect this trend to continue, further concentrating influence in the hands of increasingly powerful regional hospitals and health systems.

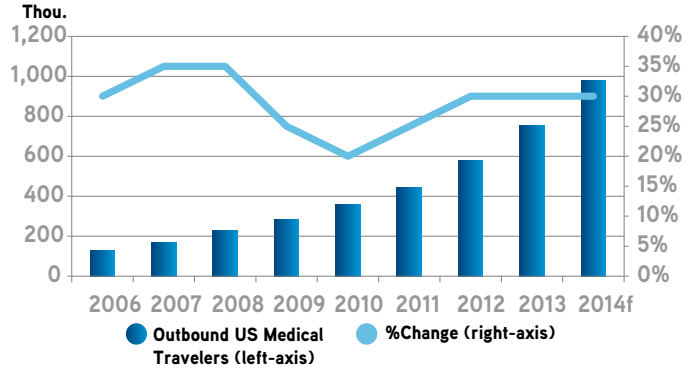
Globalization of Healthcare

Like many other industries, healthcare is becoming increasingly global due to a number of factors, including:

- Technological developments
- Patients' desire for access to particular specialists, shorter wait times or lower-cost procedures
- Medical systems' desire to grow their patient bases and provider networks/expertise

Although still a small portion of the overall healthcare market, medical tourism has been growing rapidly in recent years. According to Patients Beyond Borders, the number of outbound U.S. medical travelers for surgeries or treatments for diagnosed conditions has increased more than sevenfold since 2006 to a projected 979,000 travelers in 2014. Reasons for that increase include the lower costs available in many other countries for procedures such as cosmetic surgery, hip and knee replacements and dental implants, as well as a desire to seek care from specialists located abroad. Many U.S. medical systems are seeking to boost their presence overseas and grow their global brands, including the Cleveland Clinic, Mayo Clinic and University of Pittsburgh Medical Center, which have all opened medical centers in other countries in recent years.

Outbound US Medical Travelers



Note: Includes travel for surgeries and diagnosed conditions only
Sources: Patients Beyond Borders, Colliers International

Technological advancements, as well as healthcare cost containment efforts, also are reviving interest in telemedicine. Telemedicine is not a new phenomenon, but it is one that historically has faced a number of barriers, including restrictive reimbursement policies and significant variations in coverage by state. Although obstacles remain, the shift in emphasis from fee-for-service to value-based reimbursements is boosting interest in lower-cost treatment procedures such as telemedicine. Also, new and evolving technologies such as medical apps and wearables are enabling better remote patient monitoring, and electronic health records are facilitating the transmission of patient data among providers. Finally, the surge in demand for medical services due to demographic trends and ACA implementation is spurring interest in lower cost, convenient treatment methods such as telemedicine by both patients and providers. Telemedicine holds tremendous potential to further "flatten" the global healthcare industry with U.S. providers and systems able to expand their reach and brands into other states and countries.

Healthcare Real Estate Trends

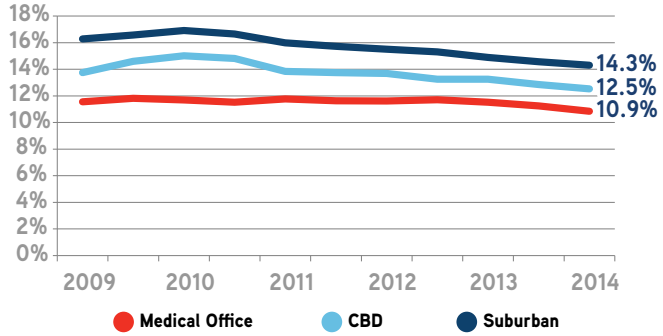
Colliers' medical office data includes on-campus, off-campus, single- and multi-tenant medical office buildings, as well as office buildings in which medical tenants occupy 50% or more of the space. In most markets, inventories include buildings totaling 10,000 square feet or more. However, in some of the larger markets, the minimum building size threshold is 25,000 square feet. Our coverage universe includes 44 U.S. markets encompassing approximately 423 million square feet (msf) of medical office space. As measured by CoStar, the entire U.S. medical office universe totals approximately 903 msf.

Vacancy and Absorption

The medical office market continued to tighten through mid-2014, when the vacancy rate dipped below 11% for the first time since the start of the recession. Tenant demand remains strong, particularly for high-quality, well-located product. In addition, construction activity has been decreasing the last few years amid uncertainty regarding the ACA's impact on the healthcare real estate market, as well as tight lending standards for most types of commercial real estate development.

Relative to both CBD and suburban traditional office, medical office proved to be a tighter and more stable property type during the recession and recovery. Both the CBD and suburban traditional office vacancy rates peaked in H1 2010 at 15.0% and 16.9% respectively. Since then, the CBD vacancy rate has decreased by 248 basis points (bps) to 12.5%, and the suburban vacancy rate has decreased by 261 bps to 14.3% in H1 2014. By contrast, the medical office vacancy rate peaked at just 11.8% in H2 2009 and has been trending down gradually since then with a 97 bps decrease from the cyclical peak to its current level of 10.9%. Factors contributing to stability in the medical office space are long lease terms (typically 7-10 years), as well as the high cost and significant amount of time required to make the tenant and specialty-specific improvements to a medical office space. Such factors often deter tenants from relocating.

Medical Office Vs. Traditional Office Vacancy Rates



Note: Latest data through 1H 2014; data based on the 44 markets tracked by Colliers
Source: Colliers International

The medical office market also has exhibited consistency across regions. In H1 2014, the region with the highest vacancy rate (the Northeast at 11.3%) was separated from the region with the lowest vacancy rate (the South at 10.6%) by just 70 bps. Between 2009 and 1H 2014, the South, Midwest and West vacancy rates all remained between 10% and 13%, while the Northeast vacancy rate increased gradually from 8.6% in 1H 2009 to 11.3% in 1H 2014. By market, the lowest vacancy rates in H1 2014 generally were in small, Southeastern markets (e.g. Charleston, Greenville); markets with little or no construction activity during the last five years (e.g. Savannah, Miami); and markets with favorable economic and demographic trends (e.g. Boston, Seattle, Portland, OR). Likewise, many of the markets with the highest vacancy rates experienced a large amount of new supply coming to market in recent years (e.g. Chicago, Atlanta), or had deep recessions and/or slow economic recoveries (e.g. Las Vegas, Phoenix). However, markets such as Chicago and Atlanta are starting to absorb this excess inventory, resulting in larger vacancy rate decreases between 1H 2013 and 1H 2014 than the decrease in the overall U.S. vacancy rate during the same period.

Lowest Vacancy Rate by Market - 1H 2014

MARKET	VACANCY RATE
Savannah	2.7%
Charleston, SC	2.8%
Boise	4.1%
Greenville, SC	4.4%
Grand Rapids	5.5%
Boston	5.5%
Nashville	6.1%
Richmond	6.3%
Seattle	6.8%
Columbia, SC	6.9%
U.S.*	**10.9%**

* Based on the markets tracked by Colliers
Source: Colliers International

Also representative of the stability in the MOB space are absorption trends in recent years. All of the regions posted positive absorption each year between 2009 and 2013, and the MOB market was on track to continue this trend in 2014 with more than 1.7 msf of positive absorption during the first half of the year. The booming Houston market, also home to the world's largest medical complex (Texas Medical Center), accounted for nearly one-quarter of absorption among the markets tracked by Colliers during H1 2014.

Most YTD Absorption - 1H 2014		
MARKET	ABSORPTION	% OF U.S. ABSORPTION
Houston	427,345	22.9%
Atlanta	252,097	13.5%
Omaha	166,987	9.0%
Chicago	164,683	8.8%
Philadelphia	148,889	8.0%
Seattle	144,574	7.7%
Bakersfield	129,210	6.9%
Charlotte	119,657	6.4%
Washington, DC	109,017	5.8%
Denver	84,136	4.5%
U.S.*	**1,865,743**	--

* Based on the markets tracked by Colliers
Source: Colliers International

Construction

Despite decreasing vacancy rates and gradually loosening construction lending standards, medical office development activity continued to decrease through mid-year 2014. Uncertainty regarding the effect of the ACA has contributed to limited construction activity consisting primarily of well-located, build-to-suit projects. Also, the movement of some procedures and services to retail clinics and urgent care centers has lowered the need for traditional medical office space for these types of treatments, resulting in less development activity. Among the markets tracked by Colliers, the amount of space under construction decreased by more than half between 1H 2009 and 1H 2014, from about 7.7 msf to 3.7 msf. Completions decreased even more dramatically, from 6.6 msf in 1H 2009 to 2.4 msf in 1H 2014.

Regulations also affect healthcare construction trends in some states. In particular, Certificate of Need (CON) programs, enacted broadly in the 1970s with the intention of restraining healthcare inflation, continue to restrict construction of healthcare facilities in many states. Although the federal CON mandate was repealed in the late 1980s, many states have retained their CON programs or elements of them, delaying or limiting development activity. Indeed, of the markets included in this report, those with the strictest regulatory environments account for 26.5% of the inventory but just 10.4% of the amount of space under construction. With some exceptions, states in which CON laws are still in effect are concentrated in the eastern half of the United States, with particularly strict development regulations in the Northeast states. The lack of regulation in states without CON laws increases the risk of hospital oversupply due to the easier path to development. Medical office properties proximate to weaker hospital systems in less regulated states can be riskier due to the potential for hospital oversupply in those states, particularly given the current proliferation of consolidations and bankruptcies in the industry.

Construction activity will likely pick up in the coming years as the impact of the ACA becomes clearer. Also, strong demand for modern, flexible space will spur development of new medical office buildings concentrated near dominant hospitals and health systems and targeted population groups. Medical space capable of handling rapid advancements in technologies, as well as services that previously were provided in the higher-cost hospital environment, also will drive construction of new medical office space. As is already occurring, many medical systems and third-party developers will choose MOB construction over costly retrofits of older, outmoded medical office properties.

The "Retailization" of Healthcare

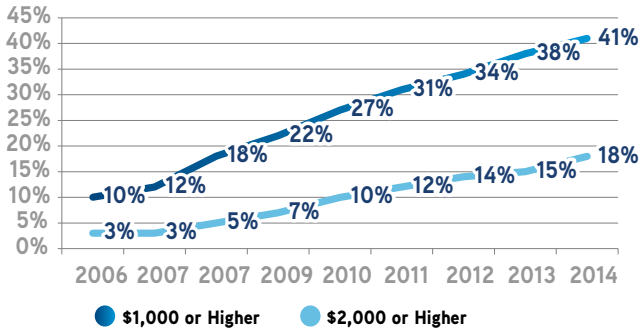
Consumers' demand for convenient, flexible healthcare services, akin to the retail industry, is driving demand by physicians and health systems for real estate beyond the traditional hospital campus and medical office building complex. Providers such as One Medical Group are locating in ground-floor and second-floor urban retail spaces in office buildings as well as mixed-use residential buildings for the convenience of their consumer base. Other health systems are clustering multiple physicians and medical specialties such as urgent care centers and dialysis clinics in suburban shopping centers convenient for both physicians and consumers. Technology is also a driver of the movement of medical services out of the hospital and into outpatient and retail settings as treatments and diagnostics such as digital imaging have become more mobile. Similar to retail, providers are using "big data" for demographic analysis and site selection.

Changes in healthcare are attracting new participants to the space, notably pharmacies and grocery stores offering basic services such as vaccinations and treatment for common, non-acute illnesses. These walk-in clinics provide convenient care, typically at a lower cost than a traditional doctor's office or urgent care center, as well as transparent pricing. Some hospital systems are partnering with retail clinics to provide low-acuity services to existing patients at a lower cost, such as Texas Health Resources' mid-2014 announcement of an alliance with multiple Dallas-Fort Worth-area CVS Minute Clinics. Minute Clinics is the current leader in the retail clinic market with over 900 locations and an additional 600 planned through 2017. Kaiser Permanente, California's largest HMO, recently announced a partnership with Target to open clinics in several of its Southern California stores with plans to expand into other states in which Kaiser operates. Staffed by nurse practitioners with access to Kaiser physicians via telehealth systems, the Target clinics will expand beyond the lower acuity services typically offered at retail clinics, such as vaccinations and flu shots, to include higher level services such as pediatric primary care and OB/GYN. The movement of electronic health records online is facilitating these types of partnerships as health systems and retail clinics are able to share patient information. The number of urgent care centers, which handle higher-acuity cases than retail clinics but still at a lower cost than a traditional doctor's office or emergency room, also is increasing, with nontraditional capital sources such as private equity supporting this growth.

Due to their proximity to the consumer base, retail centers often are the preferred location of wellness and holistic health clinics. Alternative healthcare is a fast-growing segment of the industry, having expanded at a 3.1% annual rate since 2009 to total about $12 billion in revenue in 2014, according to IBISWorld. For example, New Delhi-based, Ayurveda provider Santhigram Wellness opened several new wellness centers in 2014, bringing the number of U.S. locations to nine, and plans to expand further in the coming years. The company's New Berlin, OH location is in a former bank building, a trend that we may see more of in the future as the movement of more financial transactions online reduces the need for bank branches across the U.S. The wellness and alternative healthcare industry will likely continue to expand rapidly in the coming years due to both greater consumer interest in these treatments, as well as the shift in emphasis from fee-for-service to outcome-based results.

Although the retail clinic and urgent care center growth trend is already well under way, we expect it to accelerate in the coming years given the cost advantage of providing basic services in these settings relative to traditional medical office buildings and hospitals. The cost savings is attractive to insurers, but also to patients, many of whom are facing rapidly rising deductibles. According to the Kaiser Family Foundation's 2014 Employer Health Benefits Survey, the average annual employee deductible increased to $1,217 in 2014, up from $826 just five years earlier. Also, the National Business Group on Health found that the percentage of firms offering only a high-deductible plan to employees will reach 32% in 2015 compared with 22% in 2014.

Percentage of Covered Workers Enrolled in High General Annual Deductible Plans



Note: Data is for single coverage plans
Source: Kaiser Family Foundation and Health Research & Educational Trust *Employer Health Benefits 2014 Annual Survey;* Colliers International

More broadly, the "retailization" of healthcare is indicative of the trend of providing services in the lowest-cost, most convenient location available, whether it be a medical office building, retail clinic or other type of building. For example, some companies and landlords are offering on-site medical services in office buildings, both as a talent attraction and retention tool, as well as to increase health and wellness among employees. As a way to stand out to potential employees in Houston's highly competitive energy industry labor market, Anadarko Petroleum offers employees at its corporate offices free access to an onsite medical clinic staffed by a physician and occupational health nurse. Also in Houston, Phillips 66's under-construction corporate campus will include a 1,000 square-foot dental office. The movement of healthcare services off campus and into the community, in both traditional medical office buildings as well as non-traditional settings such as retail and non-medical office buildings, is blurring the lines between property types.

Location and Space Utilization Trends

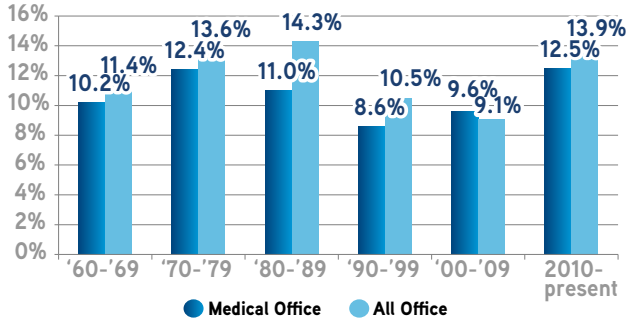
Healthcare space utilization and design is changing, mirroring trends in other types of commercial real estate. Technology is enabling a more open, flexible and collaborative layout, similar to changes in utilization of traditional office space. Doctors and staff require an open design that enables them to move freely throughout the space and utilize multiple work stations rather than being anchored to a single location. The efficient, flexible, collaborative environment is critical given the shift in caregiving from primarily the physician to a team of providers including the physician, as well as nurse practitioners, physician assistants and other medical professionals. Also, given the rapid and uncertain impact of future technological developments, flexible spaces are critical to medical office space not becoming functionally obsolete in the near term. Another significant trend is the movement of patient records onto electronic systems, which is reducing the need for on-site physical storage space. This is similar to the trend occurring among law firm occupiers, which are substantially reducing their footprints in traditional office buildings due to smaller law libraries and less need for on-site document storage.

The evolution from solo and small group physician practices to multi-physician, multi-specialty practices also is affecting demand for medical space. While the transition to larger, more efficient provider networks would seem to imply a reduction in required square footage per physician, we are observing the opposite effect for several reasons. One is that the greater use of "physician extenders" such as physician assistants and nurse practitioners is increasing provider efficiency, resulting in practices being able to serve more patients in less time. Also, some procedures that previously were provided in the hospital environment, such as digital imaging, radiation oncology and minor surgeries, now are occurring in the medical office environment. The result of these trends is an increase in square footage requirements per physician.

An offshoot of this trend is that space vacated by solo/small practices that are rolled into larger health systems or closed upon retirement is often going unfilled. The trend of physicians joining larger health systems, particularly among newer practitioners, means that there is less demand for these types of spaces. The cost of retrofitting these spaces for today's medical tenant is often prohibitive. Repositioning outmoded spaces for traditional office tenants frequently is not an option either given the large amount of existing traditional office space in many markets as a result of the office market's current slow recovery. Thus, a bifurcation exists between larger on-campus MOBs and off-campus, solo physician and small practice MOB space.

MOB market statistics reflect the bifurcation in the healthcare real estate market. Although medical office properties of nearly every vintage have lower vacancy rates than the overall office market, medical office buildings constructed in the 1970s and 1980s have higher vacancy rates than those built in the 1990s and 2000s. (The higher vacancy rate among buildings completed in the 2010s is largely due to vacancy in newly completed projects in 2013 and 2014.) In particular, many medical offices that thrived in the 1980s and 1990s, when many treatments moved out of hospitals into physicians' offices, now are sitting empty and unable to meet the needs of today's tenants, yet too expensive to retrofit. Newer buildings capable of accommodating accelerating technological changes will likely remain in favor among both occupiers and investors.

Vacancy Rates by Building Age

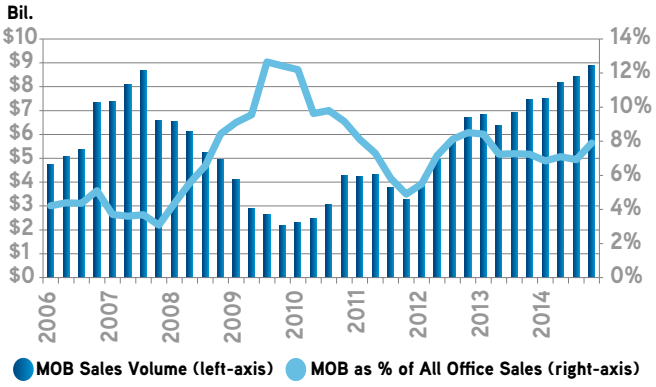


Sources: CoStar, Colliers International

Investment Climate

Despite uncertainty regarding the impact of the ACA on the healthcare industry and real estate market, medical office properties remain highly sought after by commercial real estate investors. The historical stability of the property type, coupled with favorable demographic trends, contributed to a smaller decline in transaction volume during the recession than the overall office market and a strong rebound in sales activity during the recovery. Also, low borrowing costs and a favorable capital-raising environment have been contributing to the flood of capital chasing healthcare properties with REITs in particular paying aggressive prices for top-tier assets. According to Real Capital Analytics (RCA), medical office sales transaction volume totaled $3.3 billion in Q4 2014, the highest quarterly total since Q4 2006. Total 12-month trailing transaction volume reached $8.9 billion in Q4 2014, exceeding the previous 12-month trailing peak of $8.7 billion in Q3 2007. In contrast, 12-month transaction volume in the overall office market reached $112.5 billion in Q4 2014, less than half the previous peak of $235.5 billion in Q3 2007.

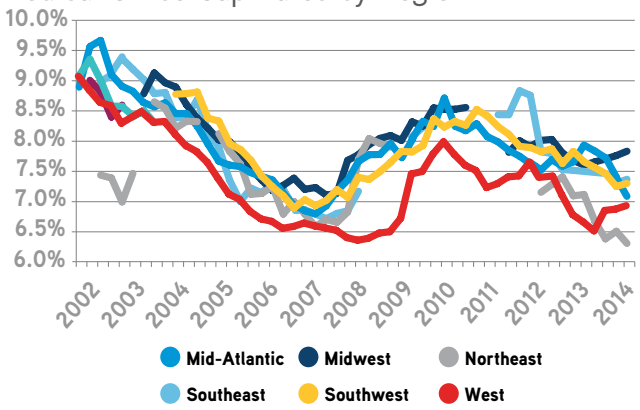
Medical Office Sales Volume



Note: All data are 12-month trailing
Sources: Real Capital Analytics, Colliers International

The bifurcation trend occurring in the medical office leasing market is also prevalent in the investment market. The highest-quality, institutional-grade assets are the most heavily pursued by investors, trading at cap rates at or below record low levels. Even at current, very low interest rates, investors are paying virtually no risk premium for top-tier assets. According to RCA, the average cap rate for the top quartile of assets trading during 2014 was just 2.5%. Reflecting this voracious demand, some properties under construction are being acquired and even closing before they are completed.

Medical Office Cap Rates by Region

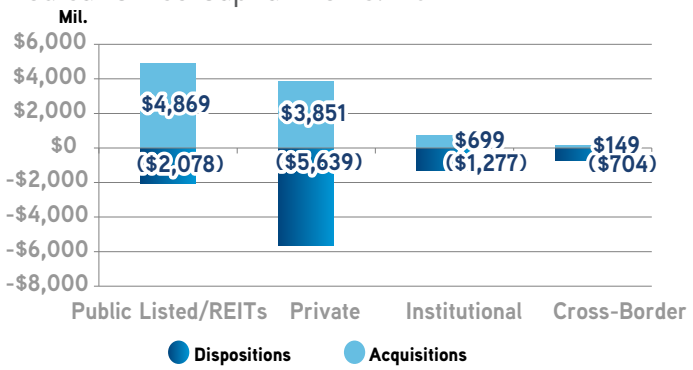


Note: Gaps in chart occur where there was insufficient data to calculate a cap rate
Sources: Real Capital Analytics, Colliers International

REITs seeking high-quality properties dominated the MOB acquisition market in 2014, accounting for 46% of buyer volume during the year, which is up from just 16% in 2013. Ventas, Griffin-American Healthcare REIT III and Healthcare Trust of America ranked among the top four acquirers of healthcare properties in 2013 and 2014. CNL Healthcare Properties closed out 2014 with the acquisition of a nine-building portfolio of Class A buildings in the Southeast. The portfolio was 92% leased to leading medical systems such as Novant Health and Duke LifePoint Healthcare. Private buyers were the second-largest MOB capital source, accounting for 36% of sales volume in 2014. Unlike traditional office properties, the medical office investment universe

is nearly entirely comprised of domestic buyers. Cross-border investors accounted for a mere 1% of sales volume in 2014 and just 2% of volume in each of the previous two years.

Medical Office Capital Flows: 2014



Sources: Real Capital Analytics, Colliers International

On the flip side, properties that are below institutional grade are seeing little demand from investors. The average cap rate for the bottom quartile of MOBs was nearly 11.5% in 2014, according to RCA. Heavy demand for high-quality assets is prompting development of new space rather than driving investors further out on the risk spectrum to lower-quality properties and less desirable locations. The sluggish recovery in the traditional office market also is contributing to weak demand for these properties. In past cycles, some of these properties would have been attractive targets for repurposing for traditional office use. In the current cycle, however, tenant demand and rent levels, particularly in the suburban office market, have been insufficient to justify repositioning these assets.

Capitalizing on aggressive demand and pricing for MOBs, many owner-occupier independent physicians, practices and hospitals are disposing of their assets. A desire among physicians to focus on their core competencies and the high cost of compliance with the ACA are other, secondary factors driving this trend. The current low cap rate environment is encouraging practitioners to complete sale-leaseback transactions that allow them to monetize their assets while securing low lease payments. Physician practices that desire to acquire their buildings are struggling to compete on pricing, yet faced with few attractive alternative investment options. This disposition trend is likely to continue as long as interest rates remain low and robust demand for healthcare real estate persists.

Conclusion

Based on the data as presented, we expect the MOB and healthcare real estate sector to remain strong for the foreseeable future. Demographic trends will support continuing demand for the next 25+ years, driving increasing health care employment. Some constriction on development remains due to uncertainty surrounding the ACA and other changes, but these should ease as clarity regarding these regulations emerges. The recovery of the general economy will likely add fuel to these trends as employment recovers and the insured population increases.

Positive economic and demographic trends will likely continue to attract investors to the sector. However, a gap will persist between well-located, modern investment-grade properties and older product less suited for current tenant needs and preferences. Overall, the near-term outlook remains strong, and medical office will likely continue to be a leading sector in the real estate market.

United States - Medical Office Market Statistics

MARKET	EXISTING INVENTORY (SF) JUN 30 2014	OVERALL VACANCY RATE JUN 30 2014	DIRECT VACANCY RATE JUN 30 2014	YTD ABSORPTION (SF) 1H 2014	YTD LEASING ACTIVITY (SF) 1H 2014	AVG. ANNUAL QUOTED RENT (USD PSF) JUN 30 2014	YEAR-TO-DATE NEW SUPPLY (SF) 1H 2014	UNDER CONSTRUCTION (SF) JUN 30 2014
Atlanta	16,827,446	13.1%	12.6%	252,097	273,276	22.12	177,000	233,000
Bakersfield	1,327,170	11.8%	11.2%	129,210	n/a	20.64	63,484	0
Baltimore	6,175,084	20.5%	20.4%	32,824	89,727	23.13	105,000	45,000
Birmingham	2,834,834	10.7%	10.7%	-8,174	45,169	20.08	0	240,648
Boise	13,621,692	4.1%	4.0%	n/a	n/a	13.75	n/a	70,971
Boston*	13,232,544	5.5%	5.3%	11,335	83,663	21.64	0	0
Charleston, SC*	2,859,867	2.8%	2.7%	-3,125	37,635	19.48	0	0
Charlotte	9,004,793	10.3%	10.2%	119,657	208,993	24.82	95,760	29,270
Chicago	24,165,105	14.0%	13.8%	164,683	367,469	20.89	51,500	0
Cincinnati	4,778,732	11.2%	11.2%	45,668	n/a	23.56	n/a	200,000
Columbia, SC	2,261,100	6.9%	6.9%	-8,927	24,193	17.56	0	0
Dallas-Fort Worth	19,915,025	12.6%	12.4%	-60,966	156,846	22.76	280,272	60,000
Denver	10,040,496	10.2%	10.0%	84,136	188,486	23.99	22,285	0
Detroit	13,104,393	13.6%	13.4%	-16,191	102,212	21.73	0	0
Fort Lauderdale	6,305,817	9.5%	9.5%	22,448	87,232	22.47	0	78,906
Grand Rapids	5,484,758	5.5%	5.5%	-76,818	n/a	14.96	0	99,369
Greenville, SC	4,091,639	4.4%	4.4%	2,096	38,608	13.36	0	0
Hawaii*	1,374,428	8.5%	8.5%	n/a	n/a	28.44	0	0
Houston	28,934,159	10.7%	10.6%	427,345	333,154	23.49	109,299	409,440
Indianapolis	5,204,940	9.1%	9.1%	22,921	36,348	17.90	0	274,000
Jacksonville	4,141,395	9.9%	9.6%	-10,784	6,036	19.80	13,000	0
Kansas City	8,414,130	7.8%	7.8%	49,999	40,692	19.55	75,000	23,000
Las Vegas	7,197,459	17.5%	17.3%	-28,879	309,851	25.80	0	0
Long Island	7,811,375	16.7%	16.5%	-67,872	103,934	27.00	0	0
Los Angeles	32,823,014	9.8%	9.7%	18,484	614,464	29.88	74,376	374,376
Miami	8,765,748	7.5%	7.5%	54,116	137,628	28.36	0	10,000
Milwaukee	6,115,997	9.0%	8.7%	67,469	152,506	17.04	95,000	42,000
Minneapolis	12,058,301	9.2%	8.9%	70,136	n/a	16.32	428,500	827,879
Nashville	8,278,942	6.1%	5.6%	13,858	78,545	21.08	36,000	0
NYC-Manhattan	4,813,447	14.2%	14.2%	-123,759	68,657	59.30	0	0
Omaha*	3,162,726	9.6%	9.6%	166,987	6,341	20.92	140,873	80,000
Orange County	13,661,170	10.0%	9.9%	47,654	266,904	30.12	0	70,000
Philadelphia	16,391,240	8.0%	7.9%	148,889	253,812	20.55	44,356	17,800
Phoenix	16,556,210	20.2%	19.8%	-93,435	447,947	22.62	0	22,716
Portland, OR*	7,195,586	7.2%	7.2%	81,982	39,036	24.31	45,521	0
Reno	1,757,058	8.8%	8.4%	2,099	49,214	21.06	0	0
Richmond	4,324,110	6.3%	6.2%	76,258	43,250	21.13	73,000	92,377
Sacramento*	9,322,726	12.7%	12.6%	5,281	197,233	20.86	0	0
San Diego County	12,958,645	11.2%	11.1%	-47,569	201,257	29.00	0	3,820
Savannah	1,554,905	2.7%	2.7%	0	0	18.59	0	0
Seattle	14,327,345	6.8%	6.2%	144,574	243,897	34.77	35,000	0
Tampa	3,482,733	10.7%	10.7%	32,546	57,673	18.93	0	0
Washington, DC	18,067,388	12.0%	11.7%	109,017	308,909	30.22	342,587	321,000
West Palm Beach	8,303,319	14.9%	14.9%	8,473	196,325	25.26	58,000	31,581
TOTALS	**423,028,991**	**10.9%**	**10.6%**	**1,865,743**	**5,897,122**	**23.97**	**2,365,813**	**3,657,153**

* New market added to 2015 report

United States - Medical Office Market Statistics

MARKET	SALES VOLUME 1H 2014	AVERAGE SALES PRICE (USD PSF) 1H 2014	CAP RATE 1H 2014
Atlanta	$92,373,212	$184	7.5%
Baltimore	$13,330,000	$169	n/a
Birmingham	$1,899,500	$87	n/a
Boston*	$275,536,101	$290	n/a
Charlotte	$11,550,049	$202	n/a
Chicago	$170,451,746	$237	7.1%
Dallas-Fort Worth	$174,400,000	$289	6.9%
Denver	$218,008,047	$105	8.4%
Detroit	$64,000,000	$137	6.8%
Fort Lauderdale	$13,125,000	$75	n/a
Houston	$46,476,187	$321	n/a
Indianapolis	$22,235,000	$117	8.3%
Kansas City	$3,000,779	$109	8.4%
Las Vegas	$43,775,278	$263	n/a
Los Angeles	$94,880,000	$226	6.6%
Miami	$113,553,000	$196	n/a
Milwaukee	$2,880,000	$60	7.5%
Minneapolis	$36,000,000	$135	6.9%
Nashville	$51,000,000	$107	8.0%
NYC—Manhattan	$145,000,000	$304	4.7%
Omaha*	$8,079,000	$159	8.2%
Orange County	$34,070,000	$181	6.0%
Philadelphia	$10,775,000	$81	10.0%
Phoenix	$76,698,447	$122	7.7%
Portland, OR*	$15,270,000	$269	7.3%
Reno	$19,500,000	$264	n/a
Richmond	$5,400,000	$180	n/a
Sacramento*	$56,430,000	$157	7.5%
San Diego County	$15,350,000	$127	6.0%
Seattle	$33,880,000	$312	6.6%
Tampa	$67,328,661	$187	8.5%
Washington, DC	$43,136,000	$157	8.0%
West Palm Beach	$46,598,000	$260	n/a

* New market added to 2015 report

FOR MORE INFORMATION

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