Medical Office Draws More Investors Post Pandemic

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By **Les Shaver** | July 06, 2021

The medical office sector was considered a solid asset class before the pandemic. But during the COVID-19 crisis, it proved to be surprisingly durable and these newfound growth drivers are expected to continue this year.

The overall strong fundamentals before the pandemic and the resiliency during the economic downturn have attracted a broader range of investors to the medical office, according to Marcus and Millichap. In addition, it says that the rise in population aged 65 and older and a rise in elective procedures and routine appointments could increase the number of buyers of sub-$10 million on- and off-campus assets this year.

This year, Marcus & Millichap projects that a 20 point rise in vacancy to 9.7% and an increase in newly built space should push the national asking rate 1.6% to an average of $21.85 per square foot. This gain represents a ninth consecutive year of positive marketed rent growth for the sector.

That growth will partially be driven by 1.7 million more people becoming 65 this year. That 3.0% growth will outpace last year's 2.9% rate of growth.

On the other hand, supply will increase medical office inventory by 1.0% as delivery volume surpasses the 9.9 million square feet finalized last year. Showing the demand in the sector, 70% of the space slated for completion this year had lease commitments as of mid-May.

The flood of investor interest in medical office has led to record trading, according to M&M. In the 12 months ending March 2020, medical office closings accounted for nearly 30 percent of all U.S. office sales. From 2015 to 2019, they comprised 21 percent of all office trades. And, from October 2020 through March 2021, the number of closings represented the strongest six-month stretch for deal flow in more than 20 years. M&M says this increased sales velocity suggests capital allocated for other property types may be finding its way into medical office as 2021 progresses.

While medical office may be more resilient than other CRE sectors, its highest-performing markets are in the sunbelt, consistent with what has been performing for other property types. M&M says that major metros in the Southwest, Southeast and California that are attracting in-migration or have large cohorts of retirees should drive medical office sales activity in 2021. For example, Riverside-San Bernardino, Miami, Fort Worth, Los Angeles and Orange County posted year-over-year gains in sales activity during the 12-month span that ended in March. Phoenix also registered 15 percent of all secondary market trades.

"Moving forward, tenant quality and income durability will be key to pricing in these locales, with institutional buyers willing to pursue deals at or below $7 million," according to M&M.

A recent report from Colliers also shows that **medical office space remains a hot target for institutional investors** (https://www.globest.com/2021/06/18/institutional-interest-in-these-specialized-assets-is-here-to-stay/), which accounted for about 35% of buyers in the early part of this year (compared to 31% in 2020). In addition, Colliers predicts aging baby boomers will be pivotal in growing demand for this sector, as that demographic will be 65 or older by the year 2030.
