MOB  REPORT

By John Mugford

During the past few years, selling medical office buildings (MOBs) was a seemingly simple task of tossing a portfolio of properties out to the market and watching the price soar like a rare antique on eBay.

But as commercial credit became more expensive and underwriting standards became more restrictive in the latter half of 2007, sale prices for MOBs began to level off after several years of remarkable, and by most accounts somewhat unexpected, growth.

The skyrocketing prices of recent years were fueled, in large part, by an influx of cash from new buyers of medical real estate, such as large real estate investment trusts (REITs), pension funds, and other institutional investors. On top of that, many commercial real estate experts say that credit had become very cheap and easy to get, sometimes with no money down.

Here's an example of what happened when medical office pricing soared: Back in mid-2003, the 12-month rolling average price per square foot (PSF) for MOBs was hovering around $140.

By the fourth quarter (4Q) of 2006, the rolling 12-month average was about $230. That's a 61 percent increase in three years or so.

The statistics presented in this article were provided to **Healthcare Real Estate Insights**™ by Real Capital Analytics (RCA) Inc., a New York-based firm that specializes in gathering and distributing data concerning commercial real estate transactions.

RCA provides **HREI**™ with quarterly data concerning nationwide, as well as regional, MOB sales.

Now, back to today's leveling off of MOB prices. Industry veterans say that while the credit crunch is having an ancillary effect on MOB sales, in no way does this stabilization of prices reflect on the long-term prospects for healthcare real estate.

That's because the fundamentals of healthcare in general remain strong– namely that demand will continue for years to come as more and more baby boomers enter retirement age.

The latest stats

The most recent statistics distributed by RCA indicate that the 12-month rolling average PSF for nationwide MOB sales was $224.40 at the end of Q3 2007.

That represented a slight decrease from the end of Q2, when the 12-month average PSF was $232.

Dan Fasulo, managing director with RCA, says that it makes sense for MOB prices to level off in light of turmoil in the commercial credit industry.

"It does make sense … with what's going on in the debt markets," Mr. Fasulo says.

"If buyers have to pay more for debt, as they currently are, they're not going to be willing to pay as much for an asset."

Even though prices have leveled, however, many healthcare real estate veterans say now is still a fine time to sell MOBs.

In fact, total nationwide MOB sales volume – on a 12-month basis – increased from Q2 to Q3 in 2007.

By the end of Q3 there were a total of 339 MOB sales in the prior 12 months, for a total volume of $5.16 billion. At the end of Q2 there were 308 sales in the previous 12 months for a total sales volume of $4.7 billion.

Mr. Fasulo says that even with the upheaval in the lending industry, "deals that make sense are still going to get done … Deals are taking place."

As prices have stabilized, so have average capitalization (cap) rates, which are used to calculate a buyer's expected annual return on investment by dividing projected annual net operating income (NOI) by the sale price.

As prices have risen steadily in recent years, cap rates for MOBs have fallen. Back in 2001, the average cap rate was 9.9 percent. But by 2005, the average cap rate had fallen to about 7.3 percent.

Since then, the average cap, on a 12-month rolling average, has hovered around 7 percent, according to RCA's stats.

For Q3 2007, the 12 month weighted average cap rate was 6.9 percent – the same as at the end of Q2.

Top photo: Aventura (Fla.) Medical Arts Building. Photo courtesy of Ventas Inc.

Region by region

RCA's statistics also show how much MOB sales prices vary from region to region.

According to RCA, the Northeast has the highest priced MOBs in the country, at least for the 12 months ending in Q3. There, the 12-month rolling average PSF was $277, with an average cap rate of 6.8 percent.

On the other end of the spectrum, the average PSF in the Midwest during the 12-month period ending with Q3 was $165. The cap rate in the Midwest was 7.7 percent.

The second priciest region was the Mid-Atlantic with a PSF of $263 and an average cap rate of 6.9 percent.

Other regions are as follows; West with a PSF of $253 and a cap rate of 6.7 percent; Southwest with a PSF of $200 and a cap rate of 7.1 percent; and Southeast with a PSF of $178 and a cap rate of 7.3 percent.

As for metropolitan markets, Boston led the way in MOB sales volume during the 12 months that ended with Q3. Sales in Boston totaled $730 million and included the September sale of the Biewend and Tupper buildings on the campus of Tufts-New England Medical Center.

The buildings have a total of 154,000 square feet and were sold for $116 million by NEMC Real Estate Co. Inc. The buyer was Santa Ana, Calif.-based Triple Net Properties LLC, which has since been acquired by Grubb & Ellis Co. (NYSE: GBE).

The PSF for the acquisition was $460 – well above the national average.

Other markets experiencing plenty of activity included Seattle, where MOB sales volume was $350 million for the 12 months ending with Q3; San Diego with $350 million in volume; Los Angeles with $250 million; and Phoenix with $230 million.

Who's buying, selling?

RCA's statistics also breaks down the composition of buyers and sellers. For example, the main category buyers of MOBs for the 12 months ending with Q3 were private, in-state entities, gobbling up 23 percent of all MOBs sold during that time. Other big buyers included institutional investors at 16 percent, publicly owned REITs at 16 percent, and private out-of-state entities at 14 percent.

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In terms of specific companies, RCA found that some of the biggest buyers were Triple Net Properties, Health Care REIT Inc. (NYSE: HCN), Washington Real Estate Investment Trust Inc. (NYSE: WRE), Montecito Property Co., and the ProMed Properties unit of Gazit-Globe Ltd.

Another big MOB buyer was LaSalle Investment Management, which bought for one of its funds a nine-property, 398,000 square foot MOB portfolio in New York's Hudson Valley region for $99.7 million.

The largest category of sellers was private in-state entities, which sold 45 percent of all MOBs changing hands. That category includes hospitals and health systems. The next biggest sellers were private out-of-state entities and miscellaneous investment funds, each accounting for 14 percent.

Some of the top sellers were Rendina Cos.; Tufts New England Medical Center, by virtue of the Boston deal mentioned above; and First Columbia LLC, which was the seller in the LaSalle Investment Management transaction described above. ❑

Condell Imaging Center and Condell Medical Building, Gurnee, Ill. Photo courtesy of Shattuck Hammond Partners.