

Medical Offices Provide Welcome Stability in a Shifting Healthcare Landscape

Property fundamentals remain steady. Medical offices were not as impacted by the pandemic as other facets of the health care system. Some patients opted to skip doctors' visits in 2020, but this trend has generally dissipated, returning demand to a more typical pattern. Over the last 20 years, medical office vacancy has stayed between 8 and 10 percent and, in June 2023, the rate was just 50 basis points above the long-term average. Operations are also aided by reduced supply-side pressure as development slows amid rising construction costs. As of September, medical office space accounted for just 10.7 percent of the total office pipeline. Therefore, the sector's main challenge is not supply, but rather a health care labor shortage. The pandemic exacerbated an existing worker shortage that may hinder practices seeking to match anticipated future medical care growth.

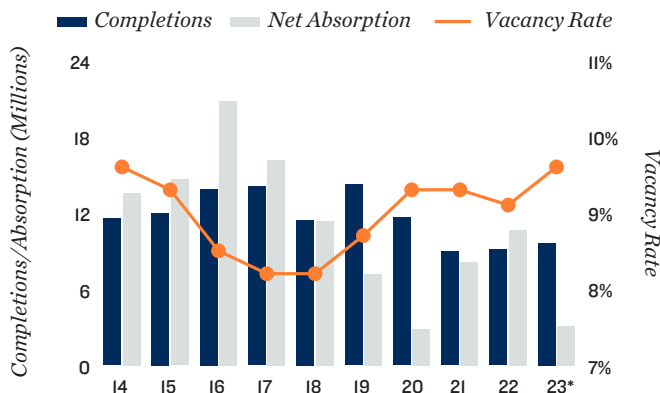
Spending on physician and clinical services rises. While health care spending surged at the onset of the pandemic, national health expenditures have been growing more in line with the pre-pandemic, long-run trend since 2021. Specifically, spending for physician and clinical services is estimated to have grown 2.4 percent in 2022, and is projected to accelerate further in 2023 by 5.1 percent. While some patients may forgo medical visits amid high inflation, the aging population and necessary nature of health care services for chronic conditions will fuel demand for medical space long-term. These factors largely insulate the sector from economic downturns, aiding property performance.

Medical Office Investment Highlights

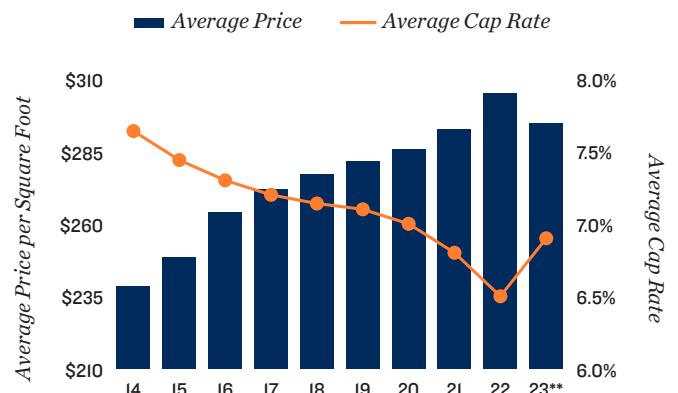
Deal flow impacted by high interest rate environment. Transaction velocity in the medical office sector fell by over 30 percent during the trailing 12 months ended in June. The average sale price has begun to recalibrate accordingly, dropping 3 percent from the high reached in 2022 to \$295 per square foot for the yearlong span ended in June. Still, a limited pool of transactions has largely hindered price discovery. Fewer assets priced over \$10 million changed hands, influencing the overall average amid the smaller deal pool of predominantly \$1 to \$10 million trades. Elevated lending rates are the primary driver impacting both transaction velocity and pricing. While rates may not come down in the near term, some of this pressure could abate as the Federal Reserve opted to hold the overnight lending rate between 5.25 and 5.50 percent in September. This could be an early indicator of financial markets stabilizing in the coming months, aiding deal flow.

Investors drawn to stable property performance. Since 2012, the medical office sector has enjoyed consistent year-over-year rent gains. Steady property cash flow is backstopped by favorable lease terms, benefiting both vacancy and rent trends with limited tenant turnover. Demand for health care services on a macro level is unlikely to decrease in any meaningful way, ensuring a stable tenant base, barring external challenges that arise from the tight health care labor market. This consistency proves to be especially appealing to many investors amid some macroeconomic uncertainty.

National Supply and Demand Trends



National Medical Office Sales Trends



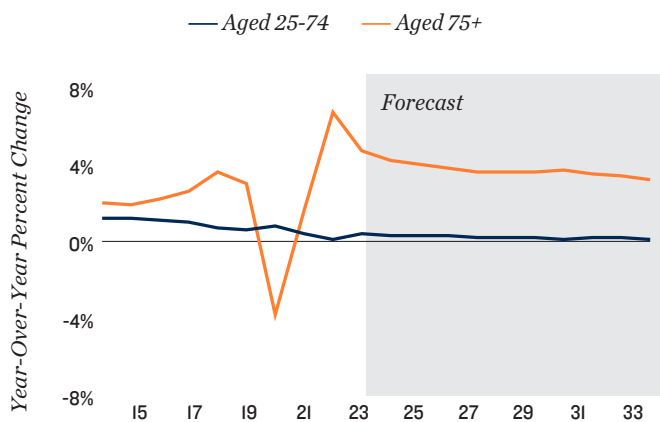
* Forecast; ** Trailing 12-months through 2Q

Sources: Marcus & Millichap Research Services; CoStar Group, Inc.; Centers for Medicare & Medicaid Services

Regional Performance

Region	2Q 2023 Vacancy	Y-0-Y Basis Point Change	2Q 2023 Average Asking Rent	Y-0-Y Percent Change
Mid-Atlantic	7.7%	-40	\$23.78	2.3%
Northeast	9.7%	0	\$23.21	4.6%
Midwest	10.8%	70	\$17.50	3.3%
Central Plains	8.2%	80	\$20.16	7.8%
Southeast	7.9%	40	\$24.25	4.5%
Southwest	12.6%	0	\$21.31	0.3%
Mountain	10.1%	-30	\$22.95	2.3%
Pacific	8.5%	90	\$32.74	-0.2%
United States	9.5%	20	\$22.99	2.1%

Aged 75+ Cohort Records Fastest Growth



Sources: Marcus & Millichap Research Services; Bureau of Labor Statistics; Federal Reserve; Centers for Medicare & Medicaid Services; Moody's

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Unprecedented Growth in 75-Plus Population Drives Health Service and Medical Office Demand

Aged 75-plus cohort expanding faster than other segments. In the last decade, the aged 75-plus group has grown at a remarkable pace, driving demand growth for health services as a result. By the end of 2023, this group will have inflated by nearly 30 percent compared to 10 years ago, the greatest increase of any single age segment and more than triple the overall pace across all ages. This has affected personal health care spending. Per capita, spending for retirement-age adults grew at an average rate of 4.5 percent from 2018-2020, faster than the 2.6 percent average growth from 2016-2018. Elderly populations are more likely to require health services. As such, demand for medical office space is likely to increase in areas with rapidly-growing elderly populations, subsequently compressing vacancy and facilitating rent gains long-term. This cohort will continue expanding over the next decade, albeit at a much slower pace.

Florida drives low vacancy in the Southeast. Sun Belt states have attracted a heightened number of elderly persons in recent years. Florida metros, in particular, are forecast to have nationally high expansion rates, claiming six of the top 15 slots for 65-plus year-over-year population growth. Strong tenant demand for space in southeastern metros can be partially attributed to the region's rapidly-expanding aging population. Notably, Mountain and Southwest metros claim the remaining top spaces, potentially driving down vacancy rates in these areas long-term. Physician and clinical services spending trends also contribute space demand. The mid-Atlantic has long claimed the lowest regional medical office vacancy rate. Four of the top five states with the highest per capita spending on physician and clinical services are in the mid-Atlantic region.

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Sources: Marcus & Millichap Research Services; Bureau of Labor Statistics; CoStar Group, Inc.; Federal Reserve Bank of St. Louis; Federal Reserve Bank of New York; Moody's Analytics; Real Capital Analytics; U.S. Census Bureau; Centers for Medicare & Medicaid Services