

MEDICAL OFFICE MARKET



Medical Office Ends Year on Positive Note

Year-to-Date Job Growth at All-Time High

OVERVIEW

Medical Office Remains in High Demand

Houston medical office metrics had a positive showing in the fourth quarter as absorption drove declines in direct vacancy, while rents and availability remained stable. Year-over-year direct vacancy increased marginally, up 10 basis points to 11.4%, and total availability remained stable at 14.6% over the same period. Although down slightly over the quarter, rental rate growth has been strong over the year, increasing 410 bps, ending the year at \$27.25 per SF gross. Absorption for the quarter recorded positive 38,832 SF with the Northeast submarket leading the way at 13,576 SF. Of note, Baylor St. Luke's Medical Group signed a lease for nearly 17,000 SF at 17350 St. Lukes Way in The Woodlands submarket. YTD job growth ending in November is at an all-time record high of 10,700 jobs created. Over 130,000 SF of new medical office space delivered to market this quarter, with more developments coming online in the near term. As such, developers remain interested in the potential Houston holds for MOB's. Investment activity slowed over the quarter with only one medical office building trading hands.

HEALTHCARE JOB GROWTH

Highest YTD Job Growth Ever Recorded

The Houston healthcare sector created 2,000 jobs over the fourth quarter. YTD job growth grew to 10,700 jobs ending in November, the highest YTD job growth ever recorded in the sector. Year-over-year job growth was 10,800 jobs for the 12-months ending in November, this is marked growth as compared to the -400 created over the same period last year. The sector has seemingly recovered from a slew of major-provider layoffs in 2017. Of note, UTMB signed a 15-year lease for the former Bay Area Regional Medical Center. As large occupiers continue to expand in Houston, job growth will continue to remain elevated. Given the strong socio-economic market fundamentals and notable population growth, continued job growth is expected in the period ahead.

TRENDLINES

5-YEAR TREND

CURRENT QUARTER

JOB GROWTH



2,000 JOBS

Healthcare jobs created Q4

ABSORPTION



38.8K SF

quarter-over-quarter

VACANCY



11.4%

Decreased 10 bps quarter-over-quarter

TOTAL AVAILABILITY



14.6%

No change quarter-over-quarter

UNDER CONSTRUCTION



285K SF

Medical Office under construction

RENTAL RATE



\$27.25 PSF

Decrease of 20 bps from previous quarter

VACANCY AND AVAILABILITY

Vacancy Declines While Availability Remains Stable

Vacancy rates for MOB’s declined over the fourth quarter, down 10 basis points to 11.4% at the end of the period. The Near North submarket recorded the highest direct vacancy at 24.2%, followed by Pasadena at 19.9%, and the Far West at 17.7%. Although up slightly over the quarter, the TMC continues to record the lowest direct vacancy at 5.1%. Conroe follows at 8.3%, and the Near West with 8.4%. Direct vacancy for on campus MOB’s remained the same at 9.1%, while direct vacancy for off campus MOB’s decreased by 30 basis points to 13.3%. Total availability remained unchanged over the quarter at 14.6%. On Campus recorded 10.1%, while off campus had 18.2% total availability.

RENTAL RATES

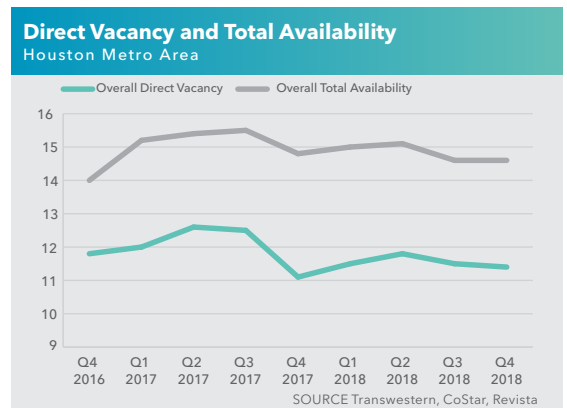
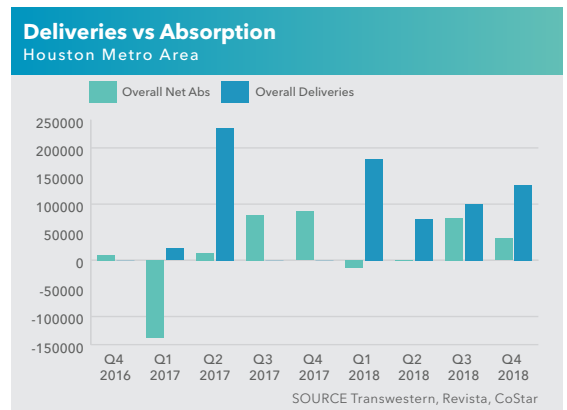
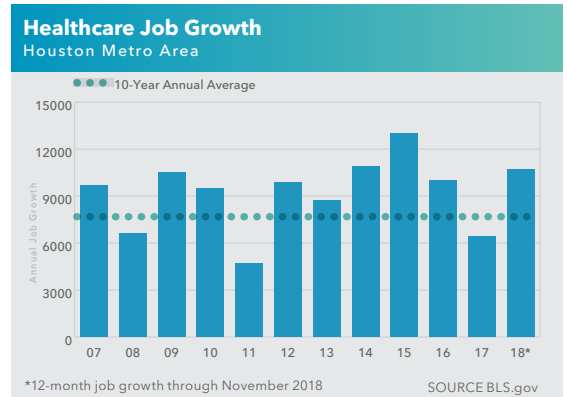
Rental Rates Steady

Weighted average rental rates for MOB’s decreased by a marginal 20 basis points over the quarter to \$27.25 PSF gross. Although rates were down over the quarter, year-over-year rental rates have increased by 410 basis points from the \$27.25 PSF gross recorded in the same period last year. Over the quarter, 9 out of 17 submarkets recorded an increase with the Near Southwest submarket increasing the most, up 550 bps to \$21.99 PSF gross. Pasadena followed with a 440 bps increase to \$22.58 PSF gross, and Sugar Land with a 250 bps increase to \$30.18 PSF gross. The most value friendly submarkets are the Near North submarket at \$21.70 PSF gross, Near Southwest at \$21.99 PSF gross, and Pasadena at \$22.58 PSF gross. Both on and off campus rates declined over the quarter, on campus by 30 basis points to \$29.57 and off campus by 20 basis points to \$26.32 PSF gross. While weighted average rental rates stayed relatively stable, same store rents are continually increasing. As quality space gets leased up, weighted average rental rates come down with the lower rates of less desirable spaces.

SUPPLY AND DEVELOPMENT

Deliveries Drive Q4 Activity

The development pipeline remains robust with 285,000 SF of medical office space and 2.3M SF of hospital space under construction. In addition, Kelsey-Seybold announced plans to build a standalone 4-story multispecialty care center in Cypress. This new state-of-the-art clinic will be around 72,000 SF, nearly tripling their current Cypress clinic. Over the quarter, three medical office buildings delivered including two in the Sugar Land submarket. The 30K SF Egret’s Landing building and 7619 Branford Place, a 38.6K SF medical office building. The Vital Heart and Vein build-to-suit in Park Air 59 also delivered. The 65,000 SF building will be fully occupied by Vital Heart and Vein in February. In the TMC, Texas Children’s Hospitals Lester and Sue Smith Legacy Tower became fully operational.



SUPPLY AND DEVELOPMENT CONT.

The 640,000 SF tower consists of six operating rooms for orthopedics, neurosurgery, plastic surgery, transplant and pediatric surgery, one equipped with intraoperative MRI. In addition to the OR's there are 84 intensive care beds with dedicated surgical, neurological and transitional ICU rooms. The tower is also the new home of Texas Children's Heart Center, and a helistop on the roof.

INVESTMENT SALES

Major Portfolio Sale Shows Investor Faith in MOB's

Over the quarter only one medical office building traded hands in Houston. Inland Group purchased the 60,584 SF Memorial Hermann Convenient Care Center at 4251 Kingwood Dr from Lovett Commercial for an undisclosed price. In national news, MOB's continue to gain favor as an investment vehicle. As highlighted by Welltower Inc.'s \$1.25B deal to acquire CNL Healthcare Properties Class A MOB portfolio consisting of 55 medical office and outpatient facilities. The 3.3 MSF portfolio is spread across 16 states and is currently 94% occupied. The deal is expected to close in the first half of 2019.

OUTLOOK

Medical Office Poised for Continued Growth

Coming off the heels of a strong year, the medical office market is poised for continued growth in 2019. With continued user demand and piqued developer interest the outlook for the healthcare sector looks bright. As demand in suburban markets remain strong developer activity is anticipated to increase. Nearly 300,000 SF of medical office space is set to deliver throughout 2019, at 43.4% preleased. A slight rise in vacancy and availability is to be expected, while other metrics remain strong. The healthcare market is poised for growth as Houston remains one of the top national destinations for innovation and care in the nation.

Largest Healthcare Systems

Houston Metro Area | 2018

HEALTHCARE SYSTEM	BEDS	LOCAL HOSPITALS
HCA Houston Healthcare	4,231	15
Memorial Hermann	4,156	14
Houston Methodist	3,031	8
CHI St. Luke's Health	1,574	8
Kindred Healthcare Inc.	906	9
St. Joseph Medical Center	790	2
Texas Children's Hospital	767	4
Harris Health System	700	3
UT Medical Branch	665	4
UT MD Anderson	658	1
Total	17,478	68

SOURCE: Houston Business Journal

DEVELOPMENT OVERVIEW

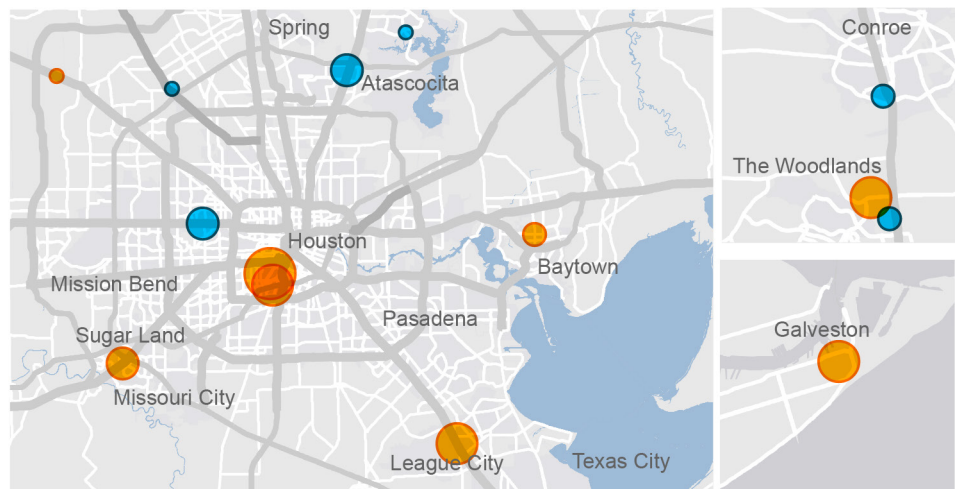
Construction Activity

Hospital SF Range U/C

- 30000 - 45000
- 45001 - 60000
- 60001 - 138000
- 138001 - 300000
- 300001 - 1340000

MOB SF Range U/C

- 30000 - 45000
- 45001 - 60000
- 60001 - 138000
- 138001 - 300000
- 300001 - 1340000



SOURCE Transwestern, Revista, Costar

Notable MOB's Under Construction

BUILDING	SUBMARKET	SF	EXPECTED DELIVERY
13219 Dotson	Tomball	30,000	2/1/2019
1020 Riverwood	Conroe	50,000	3/1/2019
Hedwig Place	Near West	102,474	3/1/2019
Vision Park Medical	The Woodlands	58,000	5/1/2019
Memorial Hermann Convenient Care Center	Northeast	45,000	11/1/2019
Total		285,474	

SOURCE Transwestern, Revista, Costar

Notable Hospitals Under Construction

BUILDING	SUBMARKET	SF	EXPECTED DELIVERY
Memorial Hermann Texas Medical Center	Texas Medical Center	1,340,000	3/1/2019
University of Texas MD Anderson Cancer Center	The Woodlands	208,000	5/1/2019
Memorial Hermann Cypress Medical Center	290 Corridor	40,000	8/1/2019
Houston Methodist San Jacinto Hospital	Baytown/Channelview	60,000	11/1/2019
UTMB League City	Clear Lake	300,000	4/1/2020
Houston Methodist Sugar Land Hospital	Sugar Land	138,000	5/1/2020
University of Texas Medical Branch John Sealy Hospital	Galveston	200,000	10/1/2020
Total		2,286,000	

SOURCE Transwestern, Revista, Costar

Q4 2018 | HOUSTON | MEDICAL OFFICE MARKET

Houston Medical Office Market Indicators

Submarket	Inventory	SF Available Immediately	Direct Vacancy Q3 2018	Direct Vacancy Q4 2018	Total Availability Q4 2018	Under Construction	Net Absorption Q4 2018	FS Rental Rates Q4	Rent Change Q-Q
On Campus	13,506,401	1,160,723	9.1%	9.1%	10.1%	-	(8,528)	\$29.57	-0.3%
Off Campus	16,218,855	2,152,347	13.6%	13.3%	18.2%	285,474	47,360	\$26.32	-0.2%

Houston Medical Office Market Indicators

Submarket	Inventory	SF Available Immediately	Direct Vacancy Q3 2018	Direct Vacancy Q4 2018	Total Availability Q4 2018	Under Construction	Net Absorption Q4 2018	FS Rental Rates Q4	Rent Change Q-Q
290 Corridor	938,629	121,045	12.8%	12.9%	17.1%	-	(948)	\$27.67	-0.7%
Baytown/Channelview	531,552	82,787	14.9%	15.6%	16.0%	-	(3,398)	\$24.28	-17.1%
Bellaire	1,164,920	115,514	8.8%	9.9%	18.2%	-	(13,392)	\$27.12	1.0%
Clear Lake	1,676,060	191,269	10.7%	11.4%	13.1%	-	(11,901)	\$26.46	-6.2%
Conroe	946,534	78,797	8.8%	8.3%	8.6%	50,000	4,672	\$25.97	-1.8%
Far West	1,446,403	255,548	17.6%	17.7%	19.8%	-	(700)	\$29.54	0.1%
Inner Loop	2,094,649	274,438	13.6%	13.1%	14.0%	-	10,485	\$26.75	0.3%
Near North	1,564,153	378,413	25.9%	24.2%	31.8%	-	12,791	\$21.70	-0.2%
Near Southwest	1,254,388	145,730	12.7%	11.6%	22.2%	-	13,015	\$21.99	5.5%
Near West	3,619,020	305,362	8.8%	8.4%	12.2%	102,474	12,539	\$26.08	0.9%
Northeast	1,219,608	185,045	17.2%	15.2%	9.6%	45,000	13,576	\$26.62	-3.5%
Pasadena	722,007	143,670	20.3%	19.9%	22.3%	-	2,783	\$22.58	4.4%
South	836,592	138,058	16.2%	16.5%	17.1%	-	(2,248)	\$29.96	-2.0%
Sugar Land	1,739,028	269,292	14.6%	15.5%	18.9%	-	(2,969)	\$30.18	2.5%
The Woodlands	2,186,489	267,210	12.7%	12.2%	17.1%	58,000	9,901	\$31.15	-0.1%
TMC	6,681,083	341,603	4.9%	5.1%	7.9%	-	(12,756)	\$32.55	1.2%
Tomball	1,104,141	94,289	9.2%	8.5%	11.5%	30,000	7,382	\$29.49	0.9%
Total - Houston	29,725,256	3,388,070	11.5%	11.4%	14.6%	285,474	38,832	\$27.25	-0.2%

SOURCE Transwestern, Revista, CoStar

NOTE Includes buildings 20,000 SF RBA and greater; does not include buildings owned by the government

NOTE Total availability includes under construction projects

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METHODOLOGY

The information in this report is the result of a compilation of information on office, industrial, retail, multifamily and healthcare properties located in the Houston metropolitan area. This report includes single-tenant, multi-tenant and owner-user properties and excludes properties owned and occupied by a government agency.

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