



Medical office space seen as bright spot in battered commercial real estate market

Health care helping prop up medical office space

By Alex Veiga, AP
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LOS ANGELES — The health care sector is one of the few bright spots in an otherwise dismal market for office space.

While the recession has left entire floors barren in many high-rise office buildings, demand for space in buildings near hospitals is competitive and that has propped up rents and kept vacancies in check.

Doctors and other medical tenants have weathered the economic slowdown better than retailers and other office tenants. And for landlords, these tenants tend to stay in the same location longer than other office renters and have lower default rates.

Overall office sales are down this year, but the proportion of deals for medical buildings was up almost 11 percent, according to Chris Bodnar, vice president of CB Richard Ellis' Health Care Capital Markets Group. And the vacancy rate for these buildings is a mere 10 percent, compared to 16 for overall office buildings.

And that could go even lower in the next few years as the economy improves and baby boomers continue to age.

“The health care industry has been really the largest contributor to the economy for the past two years,” Bodnar said. “As the population gets older, there should be a requirement for more medical services and in turn an increased need for medical office space.”

Still, some real estate experts aren't as optimistic about the sector.

Poe Corn, head of Jones Lang LaSalle's Healthcare and Real Estate Finance group, notes that while some medical tenants continue to sign leases, the space they leave behind isn't getting filled.

“The demand is not growing, it’s just moving around,” said Corn. “There is a fairly decent amount of vacancy on medical office space that’s not close to a hospital.”

The vacancy rate for these types of buildings has risen to between 15 percent and 18 percent, Corn said.

While better off, even office buildings near hospitals are seeing some weakness in demand from tenants because many hospitals are operating under increasingly constrained budgets.

“The bottom line is, when the hospitals cut, doctors are not going to continue to expand,” Corn said.

Nevertheless, the health care industry continues to be a major contributor to the economy and one of the few sectors that continues to add jobs. And sales for private practice physicians, as well as optometrists, podiatrists and physical therapists, among others, are up this year from 2008, according to Sageworks Inc.

That’s made medical office buildings more attractive to investors looking for better returns.

In September, Healthcare Trust of America Inc. bought 16 medical office buildings in South Carolina from Greenville Hospital System for about \$163 million.

In June, Healthcare Trust acquired two out-patient surgery centers in Milwaukee from Aurora Health Care.

In many cases, when hospitals sell office buildings they lease them back from the new owner. The Greenville hospital system plans to lease the majority of its space for at least five years.

“We’re definitely seeing that trend there,” said Richard Taylor, head of Cushman & Wakefield’s Healthcare Practice Group.

Another growing trend: dentists and physical therapists, which don’t need to be near hospitals, are setting up shop in shopping centers.

“A lot of those types of services are going where the patients are and that’s why you’re seeing more retail product becoming more attractive to medical services,” Bodnar said.

One company, Aspen Dental, has opened 41 offices so far this year in retail centers in states such as Oregon, Washington, Kentucky and Florida.

The dental practice management firm, which is based in Syracuse, N.Y., typically leases between 3,200 and 3,600 square-feet of space in new shopping centers or still-busy, established ones where it can expect high traffic.

It plans to open 55 new locations next year, said Todd Phillips, Aspen's vice president of real estate construction.

"There's a little less growth or expansion from the cell phone stores — AT&T and Verizon — that's actually opened up a couple of spots for us," Phillips said.