

HOUSTON HEALTHCARE MARKET

FIRST QUARTER 2017

Systems Continue to Struggle to Adapt Financially Healthcare Demand Remains Strong

OVERVIEW

2017 Off to a Tepid Start

The Houston Healthcare sector has started slowly in 2017 with financial concerns impacting several healthcare systems as they attempt to adapt to a changing marketplace. Industry challenges, such as increasing technology costs, changes in payer mixes, and reimbursement rates have impacted organizations operating models as a whole. While the majority of organization's have effectively adjusted or are adapting to the change, companies such as CHI St. Luke's, Adeptus Health, and Foundation Healthcare have not fared as well, resulting in a tepid start to the year.

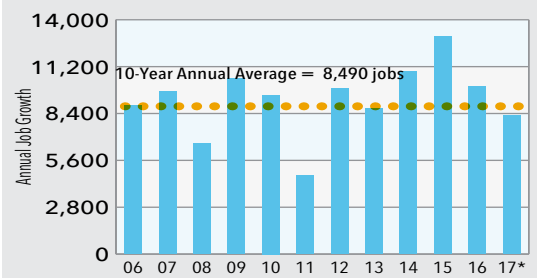
In late March, CHI St. Luke's Health System announced yet another round of layoffs, stating that it would eliminate more than 459 jobs and an additional 161 vacant positions statewide. This is the fourth round of layoffs CHI has announced over the previous two years as the company continues to struggle with lower patient volumes, reduced reimbursement via Medicaid and Medicare, and increased technology-related operating costs. Adeptus Health, a freestanding emergency room operator with over 29 Houston-area locations, appears to be headed for bankruptcy, having announced in March that it would be hiring a restructuring chief. Adeptus has grown rapidly over the past several years, initially opening facilities that lacked hospital network affiliations. This operating model led to problems for both Adeptus and its consumers, as patients were met with exorbitant bills not covered by insurance, and Adeptus faced difficulties with collecting fees directly from patients. Finally, the quarter's largest negative absorption event stemmed from the recent bankruptcy of Foundation Healthcare, which just one year prior, purchased University General Hospital, a 69-bed hospital at 7501 Fannin, for \$33 million.

Medical Office Building Stats

	MOB COUNT	TOTAL MOB SF
All MOBs	565	37,359,495
Construction	12	796,440
Off Campus	433	18,835,634
On Campus	132	18,523,861
Sold Past 12 Mos.	13	1,378,500

SOURCE: Revista, Transwestern

HEALTHCARE JOB GROWTH HOUSTON METRO AREA



*12-month job growth through February 2017 SOURCE: Bureau of Labor Statistics

Notable Q1 Leases

TENANT	SQUARE FEET	LEASE TYPE	BUILDING	SUBMARKET
Trilliant Surgical LTD	44,866 SF	New Lease	Corporate Center Shepherd	Inner Loop
Northwest Diagnostic Clinic	25,007 SF	New Lease	Springwoods Village MOB	The Woodlands
Houston Methodist	24,762 SF	New Lease	Museum Medical Tower	TMC

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After operating the hospital for less than a year, Foundation was forced to file for bankruptcy, placing 109,000 SF at the Fannin hospital back on the market. Despite the issues surrounding these companies, overall demand in the sector remains healthy as it is fueled by a rapidly growing and aging population base. Healthcare networks will continue to look to increase market share by expanding services to where end-users reside, especially in growing, but underserved, suburban markets.

MARKET INDICATORS

Stable Leasing Activity Pushes Rents

Activity for the quarter remained robust as healthcare providers continue to seek out locations that align with the population growth and an effective insurance payer mix. Early this quarter, TexPharma announced that it will begin construction on a 210,000 SF building situated on 19 acres in Rosenberg, TX. On the leasing side, continued demand for medical office space has resulted in a rapid appreciation of rental rates. For Class A medical office buildings, average NNN asking rents increased by 3.5% annually, and over 1.6% over the quarter, ending at \$24.30 per SF.

JOB GROWTH

Strong Fundamentals Despite Losses

Year-over-year job numbers continue to paint the Houston healthcare sector as one of the primary drivers of growth in the city (8,300 jobs created through February 2017). However, the first two months of 2017 show losses in the sector of 1,900 jobs, occurring primarily in ambulatory and healthcare services. Considering the recent layoffs announced by CHI St. Luke's, the short-term prognosis is for slow to no job growth as the market absorbs the additional losses. That said, the underlying fundamentals of the market are positioned well for long-term growth.

SUPPLY & DEVELOPMENT

Robust Construction Pipeline

At just over 5.1 million SF of hospital and MOB construction underway across the Houston metro, the development pipeline remains highly active. However, there will likely be a significant reduction as several large projects are set to deliver throughout the balance of the year. Additional construction activity over the year will be focused on smaller facilities with negligible impact on the overall pipeline.

Largest Healthcare Systems

Houston Metro Area | 2016

HEALTHCARE SYSTEM	BEDS	LOCAL HOSPITALS
Memorial Hermann	3,613	12
HCA Gulf Coast Division	2,721	12
Houston Methodist	2,545	7
CHI St. Luke's Health	1,557	7
Tenet Healthcare Corp.	1,113	4
Harris Health System	963	3
Kindred Healthcare Inc.	950	11
St. Joseph Medical Center	792	2
Texas Children's Hospital	683	3
UT MD Anderson Cancer Center	654	1
Total	15,591	62

SOURCE Houston Business Journal

Notable Q1 Transactions

PROPERTY	SUBMARKET	RBA	SALES PRICE	SELLER	BUYER
San Jacinto Professional Building	Baytown/Channelview	71,760 SF	Undisclosed	TMH Medical Office Building	Houston Methodist Hospital
1431 Studemont	Inner Loop	44,000 SF	Undisclosed	Studemont Venture LP	Inland RE Group

SOURCE Real Capital Analytics, Revista, Transwestern

Notable MOBs Under Construction

BUILDING	SUBMARKET	SF	EXPECTED DELIVERY
Memorial Hermann - Medical Plaza 4	The Woodlands	173,000	May-17
Memorial Hermann Convenient Care Center	Northeast	45,000	Jun-17
Houston Methodist - MOB 2	The Woodlands	160,000	Mar-18
Integrated Medical Plaza	Clear Lake	75,000	Jun-17
7619 Branford Place	Sugar Land	38,599	Sep-17
700 E. Medical Center Blvd.	Clear Lake	30,000	Mar-18
Heritage Place II	Conroe	20,000	May-17
Altus Surgical Hospital	Near Southwest	15,000	May-17
Total		556,599	

SOURCE Revista, Transwestern

Notable Hospitals Under Construction

BUILDING	SUBMARKET	SF	EXPECTED DELIVERY
Memorial Hermann Texas Medical Center	Texas Medical Center	1,340,000	Mar-19
Memorial Hermann Northeast	Northeast	123,000	Feb-19
Memorial Hermann The Woodlands	The Woodlands	34,000	Sep-17
Houston Methodist	Texas Medical Center	1,000,000	Dec-17
Houston Methodist The Woodlands	The Woodlands	470,000	Jul-17
Houston Methodist West Campus	Far West	228,700	Jul-18
Houston Methodist Sugar Land	Sugar Land	138,000	Jul-18
Baylor St. Luke's Medical Center McNair Campus	Texas Medical Center	900,000	Mar-19
Baylor St. Luke's Medical Center McNair Campus	Texas Medical Center	100,000	Mar-19
University of Texas MD Anderson Cancer Center	Texas Medical Center	185,000	Jan-18
Ben Taub General Hospital	Texas Medical Center	140,000	Mar-18
Houston VA Medical Center	Texas Medical Center	140,100	Sep-17
Bay Area Regional Medical Center	Clear Lake	100,000	May-17
Texas Children's West Campus	Far West	75,000	Jun-17
Total		4,973,800	

SOURCE Revista, Transwestern

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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.

