

HOUSTON HEALTHCARE MARKET

YEAR END 2017

Healthcare Fundamentals Continue to Shine

6,400 Jobs created over 2017

OVERVIEW

Mergers and Acquisitions Reshaping Healthcare

The healthcare market continued to evolve and adapt over the fourth quarter as merger and acquisition (M&A) activity remained prevalent. M&A's have increased in frequency as healthcare providers work to secure profitability by gaining efficiencies of scale. Amongst the most notable M&A's this quarter was Catholic Health Initiatives announcement of a merger with Dignity Health. The combined entity will represent one of the nation's largest not-for-profit hospital systems with a total of 839 locations nationwide. Also announced during the quarter was CVS' pending acquisition of Aetna for \$69 Billion. The move is seen as a way to improve CVS' bargaining power while hedging against a potential entry into the market from Amazon. Finally, Amazon, Berkshire Hathaway, and JPMorgan announced a major joint partnership delving into the healthcare realm to form an independent healthcare company in a move to reduce costs by leveraging technology. The primary theme in each of these transactions are efforts to reduce costs by increasing buying power. As the healthcare market continues to evolve, M&A activity is expected to remain elevated.

JOB GROWTH

2,500 Jobs Created in Q4

Although job growth has slowed moderately, the healthcare sector is still one of the primary drivers of growth in the city. The Houston healthcare sector created 6,400 jobs year-over-year through December 2017, an increase of 2% year-over-year. This growth occurred in spite of several major health systems announcing job cuts throughout the year due to budget constraints. Job growth picked up over the quarter as 2,500 jobs were created. Growth in the sector looks to remain steady over the course of 2018 as providers look to keep pace with the growing population.

MEDICAL OFFICE STATISTICS

Asking Rents

Asking rental rates for Houston medical office buildings (MOB's) increased throughout the fourth quarter. The average asking rental rate in Houston rose 0.6% over the quarter, to end the year at \$26.30 per SF

Medical Office Building Stats

	MOB COUNT	TOTAL MOB SF
All MOB's	397	29,681,498
Construction	7	454,844
Off Campus	305	16,306,322
On Campus	92	13,375,176
Sold Past 12 Mos.	39	2,630,733

SOURCES: Transwestern, Revista, CoStar

Largest Healthcare Systems

Houston Metro Area | 2017

HEALTHCARE SYSTEM	BEDS	LOCAL HOSPITALS
HCA Gulf Coast Division	4,110	15
Memorial Hermann	3,750	15
Houston Methodist	2,765	8
CHI St. Luke's Health	1,563	7
St. Joseph Medical Center	790	2
Harris Health System	770	3
Kindred Healthcare Inc.	736	9
Texas Children's Hospital	713	4
UT MD Anderson Cancer Center	674	1
UT Medical Branch	666	4
Total	16,537	68

SOURCE: Houston Business Journal

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MEDICAL OFFICE STATISTICS (CONT.)

gross. Asking rental rates increased 5.4% year-over-year, up from \$24.95 at the end of 2016. At year's end, 12 out of the 17 submarkets recorded an overall increase in asking rental rates, with the Texas Medical Center recording the highest average rate at \$31.57 per SF gross.

Vacancy and Availability

Vacancy rates for MOB's declined by 0.3% to 11.6% over the fourth quarter, while year-over-year vacancy rose 0.8% from the end of 2016. The Near North submarket recorded the highest direct vacancy with 25.4%, while the TMC recorded the lowest vacancy at 4.4%. Total availability for the market recorded 15.1%, down 0.4% from the third quarter, but up 1.1% year-over-year. Vacancy should continue to decline throughout 2018 as health systems require more space to meet the demands of the growing population.

Sales Activity

Medical office properties have become blue chip investments, regardless of uncertainties of the ACA. Over the quarter, several medical offices changed hands, highlighted by Texas A&M's purchase of the 270,000 SF MOB at 1020 Holcombe Boulevard in the TMC, for use by their EnMed program. Also of note, Boxer Property acquired the 135,586 SF St. Joseph Professional Building in the Inner Loop. The Near North submarket also had activity with the 54,111 SF Cypress Station Medical Center selling to SMB Cypress Station Properties, and the 48,750 SF Lantern Bend Medical Plaza selling to AccuBuild Companies for an undisclosed price.

SUPPLY & DEVELOPMENT

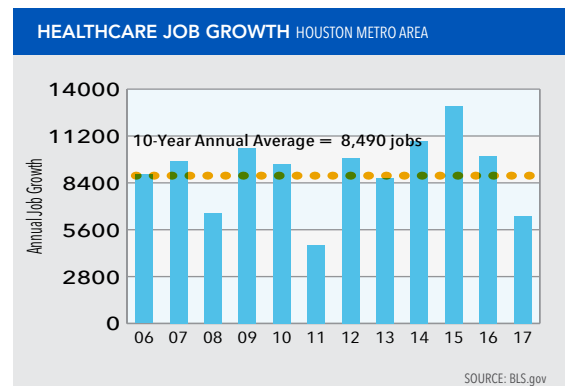
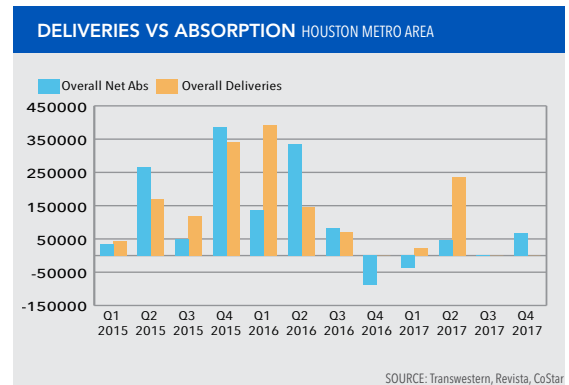
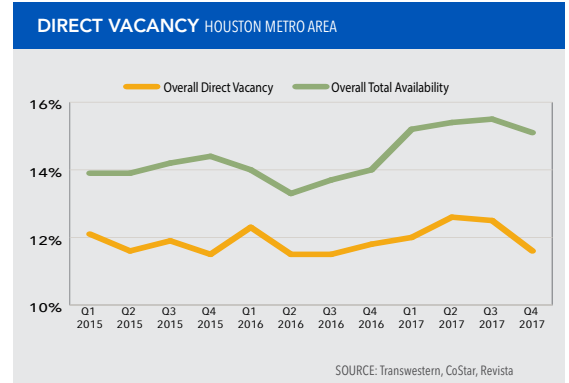
Construction Pipeline Remains Robust

Currently, 4.7 MSF of healthcare projects are being developed in Houston, with hospital construction making up 4.3 MSF of the pipeline. In total, 7 medical office buildings are under construction, comprising of over 454,000 SF. The construction pipeline has begun to reduce as large suburban expansions have delivered over the past two years. However, with the continued population growth and retailization of the healthcare sector, new projects will continue to enter the pipeline.

OUTLOOK

Healthcare To Remain Stable

The healthcare sector looks to remain strong through the course of 2018. Strong population growth and a large base at both ends of the age distribution (medical using cohorts) curve will push job growth and medical real estate expansions.



Notable MOB Sales Transactions (4Q 2017)

PROPERTY	SUBMARKET	RBA	BUYER	SELLER
1020 Holcombe Boulevard	TMC	270,227	Texas A&M	Norvin Partners
St. Joseph Professional Building	Inner Loop	137,296	Boxer Property	Mission Equities, Inc.
Cypress Station Medical	Near North	54,111	SMB Cypress Station Properties	Cypress Station Medical Plaza II
Lantern Bend Medical	Near North	48,750	AccuBuild Companies	CWCapital Asset Mgmt & Wachovia joint venture

SOURCE: Real Capital Analytics, Revista, Transwestern

Notable MOB's Under Construction

BUILDING	SUBMARKET	RBA	EXPECTED DELIVERY
1439 Highway 6	Sugar Land	20,225	1/1/2018
8520 Broadway St	South	47,500	2/2/2018
Houston Methodist The Woodlands MOB 2	The Woodlands	160,000	3/1/2018
12002 S Highway 6	Sugar Land	23,520	3/1/2018
7619 Branford Place	Sugar Land	38,600	5/1/2018
Vital Heart & Vein	Northeast	65,000	7/1/2018
Memorial Hermann Northeast MOB II	Northeast	100,000	4/1/2019
Total		454,844	

SOURCE: Transwestern, Revista

Notable Hospital Expansions/Under Construction

BUILDING	SUBMARKET	SF	EXPECTED DELIVERY
Ben Taub General Hospital	Texas Medical Center	140,000	3/1/2018
Houston Methodist North Tower	Texas Medical Center	960,000	4/1/2018
Houston Methodist West Hospital	Far West	228,700	7/1/2018
Memorial Hermann Northeast	Northeast	123,000	12/1/2018
Texas Children's Hospital	Texas Medical Center	640,000	12/1/2018
University of Texas MD Anderson Cancer Center	Texas Medical Center	185,000	1/1/2019
Memorial Hermann Texas Medical Center	Texas Medical Center	1,340,000	3/1/2019
Baylor St Luke's Medical Center McNair Campus	Texas Medical Center	185,000	3/1/2019
Houston Methodist Sugar Land Hospital	Sugar Land	138,000	5/1/2019
University of Texas MD Anderson Cancer Center	The Woodlands	108,000	5/1/2019
Houston Methodist San Jacinto Hospital	Baytown/Channelview	60,000	11/1/2019
University of Texas Medical Branch John Sealy Hospital	Galveston	200,000	10/1/2020
Total		4,307,700	

SOURCE: Transwestern, Revista

Houston Medical Office Market Indicators

SUBMARKET	INVENTORY	SF AVAILABLE IMMEDIATELY	DIRECT VACANCY Q3 2017	DIRECT VACANCY Q4 2017	TOTAL AVAILABILITY Q4 2017	UNDER CONSTRUCTION	NET ABSORPTION Q4 2017	Q4 RENTAL RATES	RENT CHANGE Q-O-Q
On Campus	13,375,176	1,192,467	9.1%	8.9%	10.4%	160,000	7,999	\$28.45	0.0%
Off Campus	16,306,322	2,238,206	14.2%	13.7%	19.1%	194,844	60,344	\$25.41	0.7%

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290 Corridor	944,306	155,707	17.5%	16.5%	17.5%	-	9,983	\$28.51	-0.8%
Baytown/Channelview	577,320	68,425	10.0%	11.9%	20.1%	-	(10,980)	\$31.12	8.0%
Bellaire	1,159,328	105,351	9.0%	9.1%	17.4%	-	(1,344)	\$26.43	4.7%
Clear Lake	1,642,992	248,906	16.1%	15.1%	15.6%	-	15,100	\$28.38	-4.7%
Conroe	1,031,534	95,934	9.5%	9.3%	9.9%	-	2,258	\$26.33	3.3%
Far West	1,420,594	277,374	19.9%	19.5%	20.6%	-	5,476	\$29.56	-0.1%
Inner Loop	2,096,359	314,868	13.2%	15.0%	16.8%	-	(38,134)	\$25.43	5.4%
Near North	1,633,208	415,164	25.9%	25.4%	33.1%	-	7,951	\$19.54	0.3%
Near Southwest	1,251,661	199,459	15.4%	15.9%	23.6%	-	(6,488)	\$20.23	0.1%
Near West	3,662,639	324,070	10.9%	8.8%	12.3%	-	73,410	\$26.05	0.1%
Northeast	1,141,019	73,793	6.8%	6.5%	12.2%	165,000	(1,064)	\$24.17	-1.3%
Pasadena	723,420	182,407	22.7%	25.2%	26.9%	-	(18,473)	\$22.81	-3.8%
South	855,140	92,965	11.2%	10.9%	19.6%	47,500	2,693	\$31.43	0.2%
Sugar Land	1,736,410	250,541	14.7%	14.4%	19.5%	82,344	4,893	\$28.92	0.7%
The Woodlands	2,156,240	269,931	13.4%	12.5%	15.9%	160,000	(2,347)	\$30.06	-1.6%
TMC	6,553,112	290,436	4.5%	4.4%	6.9%	-	3,964	\$32.39	-0.5%
Tomball	1,096,216	65,342	7.9%	6.0%	7.8%	-	21,445	\$27.30	5.6%
Total - Houston	29,681,498	3,430,673	11.9%	11.6%	15.1%	454,844	68,343	\$26.30	0.6%

NOTE Includes medical office buildings 20,000 SF RBA and greater

SOURCE Inventory and vacancy from analysis of CoStar data, net absorption computed by Transwestern

TOTAL AVAILABILITY reflects all space currently being marketed as available for lease. This includes direct, sublet and under construction properties set to deliver within 12 months.

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METHODOLOGY

The information in this report is the result of a compilation of information on office, retail, and healthcare properties over 20k RSF, 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.

