



Phoenix medical market poised for a turnaround in the coming years

Medical market change spurs growth

At first glance, the Phoenix medical market seems to be scraping along the bottom. Negative absorption, increasing vacancy and falling rental rates point to a flattening market. This would be true if not for several fundamental changes in today's medical office marketplace. In the past, physicians sought space in traditional medical office buildings that were close to hospitals, supported specialized build-outs and specific demographics. Since the recession, medical tenants have expanded their scope to include retail strip centers and traditional office buildings. The fact that economic conditions, most notably the housing market, have yet to gain traction towards recovery has prevented a more robust rebound for the medical market. Despite uncertainty and unanswered questions regarding healthcare reform, the fact remains that there will be more patients creating more demand for physicians, and this increased demand for service will continue to spawn growth in the healthcare industry.

ECONOMY

Economy still searching for a breath of life

Economic sentiment has been mixed since the beginning of 2010 and most can agree there has been very little sustained momentum towards a recovery. Initial estimates showed positive job growth in 2010; however, revised statistics now indicate a slight loss. 2011 has shown the same uneven growth, as the Phoenix market has gained only 300 jobs thus far through May. The good news is we're not losing jobs, and unemployment is declining, albeit at a very slow descent. A bright spot in the economy is retail sales. Sales are up 13.7% for 2011 year-to-date over 2010 levels. This, combined with increases in personal income, shows that residents are loosening their belts and are starting to spend more, which will help aid economic growth.

SUPPLY AND DEVELOPMENT

Increased MOB development on the horizon

While there are currently no medical developments under construction in the Phoenix area, the lack of new development will not last long. Major healthcare companies are in expansion mode, looking for land to build on or breaking ground on new hospitals and specialty centers. Nationally, it is estimated there will be a 19% increase in demand for MOB's by 2019, which equates to roughly 64 million square feet of new product. In addition, owner/user activity for small-to mid-size practices (3,000-10,000 sf) is expected to climb as more opportunities come to market.

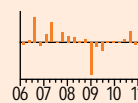
VACANCY



20.7%

Up 20 basis points from last quarter

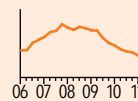
ABSORPTION



-24,577 SF

Class B accounted for all vacated space

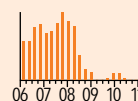
LEASE RATES



\$23.12 PSF

Less than a percent decrease

UNDER CONSTRUCTION



0 SF

Currently no new construction

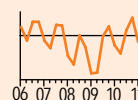
AVERAGE MEDICAL SALE PRICE



\$0.00 PSF

No medical office sales during second quarter

JOB GROWTH

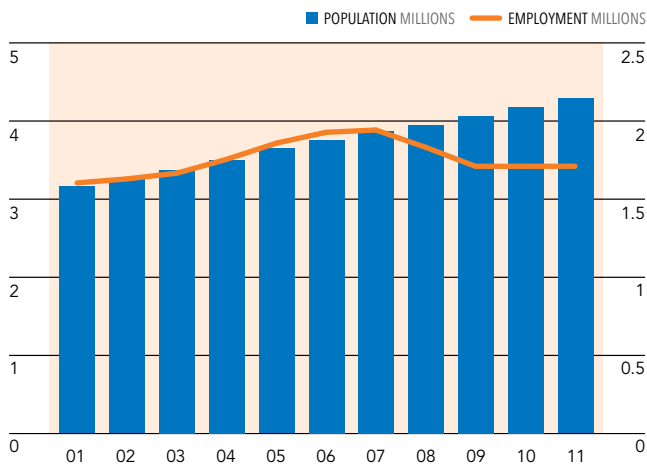


9,900 jobs

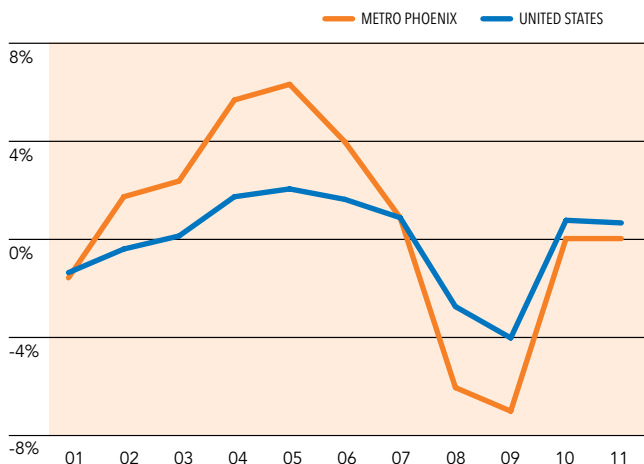
gained during the second quarter



METRO PHOENIX POPULATION AND EMPLOYMENT



PAYROLL JOB GROWTH



DEMAND

Demand for medical office remains flat

Demand for traditional medical office space has been up and down over the past two years. While current numbers show very little demand, it is becoming more difficult to measure market velocity and how much space is being absorbed as healthcare tenants are now occupying many different product types, most notably traditional office buildings and retail strip centers. Second quarter net absorption was slightly negative as 24,577 sq. ft. of space was given back to the market. In a market that is relatively flat, a single occupied or vacated space can have an impact resulting in a positive or negative quarter. As the number of insured individuals increases, both demand and supply factors point to rapid growth in spending on medical services and MOB's for many years.

VACANCY

Ten quarters of flat vacancy valley wide

Vacancy in the Phoenix medical market has been virtually unchanged since the beginning of 2009. Considering tenants once needed to occupy the vacant space have been bleeding off into other property types, this is a positive sign. Even with tenants executing deals at non-traditional locations, there is enough movement and expansion to keep vacancy rates level. With vacancy hovering near the 21% mark, medical office is faring better than regular office product. Two of the four market areas saw a decline in vacancy. The Northeast market, which makes up 21% of the total Valley-wide base, boasts the highest vacancy in the Valley at 26.1%. This is not surprising as it also boasts the highest rental rates due to the availability of high-end amenities.

METRO PHOENIX MEDICAL OFFICE MARKET INDICATORS

MARKET	INVENTORY	UNDER CONSTRUCTION	Q2 NET ABSORPTION	YTD NET ABSORPTION	DIRECT VACANCY	SUBLEASE SPACE	TOTAL VACANCY	AVERAGE RATE PSF
Central	3,062,974	-	-12,099	3,160	13.3%	0.5%	13.8%	\$21.84
Northeast	3,135,251	-	5,323	-4,129	24.8%	1.3%	26.1%	\$24.93
Southeast	3,769,568	-	-24,587	-27,127	20.8%	0.1%	20.9%	\$22.43
West	4,685,973	-	6,786	-19,306	21.3%	0.1%	21.4%	\$22.74
Metro Phoenix Total	14,653,766	-	-24,577	-47,402	20.2%	0.4%	20.7%	\$23.12



RENTAL RATES

Rates dip as vacancy remains unchanged

Overall average asking rates have been steadily declining since the beginning of 2008 and will continue to fall as vacancy remains high. As demand returns and vacancy begins to fall again, landlords will be in a position to start increasing rates. Current overall Phoenix rates sit at \$23.12 per sq. ft., which is down over 13% from the high at the end of 2007. Due to the high-end perception and quality of local amenities, the Northeast market commands the highest overall average asking rate of \$24.93 per sq. ft.

INVESTMENT MARKET

Sale market slow but future demand is expected

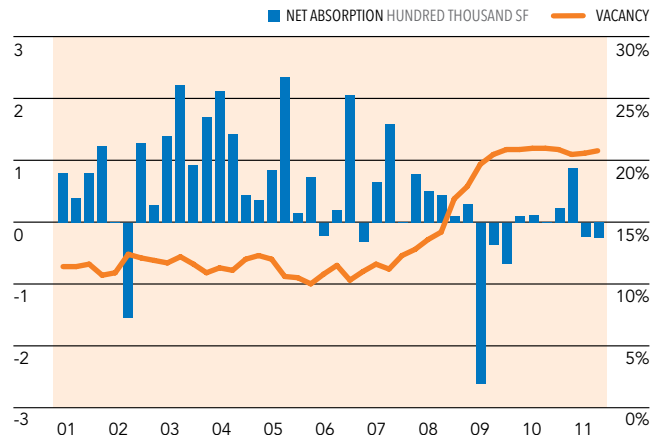
After a modest increase in sales volume during the previous quarter, the investment market sputtered during the second quarter, though this is likely an anomaly. New groups continue to express interest in the Phoenix market, bringing more dollars, which will result in more property changing hands. More companies are consolidating as bigger REITs are buying or merging with smaller trust companies. Phoenix is not void of activity, as a handful of smaller properties have changed hands but the totals still represent a slowdown in the second quarter. Owner/user deals in the Phoenix area will start to gain momentum in the upcoming years. The Phoenix investment market should get a boost as there are several large MOB sales currently in the pipeline which will close by year-end at substantially higher prices than in recent past.

OUTLOOK

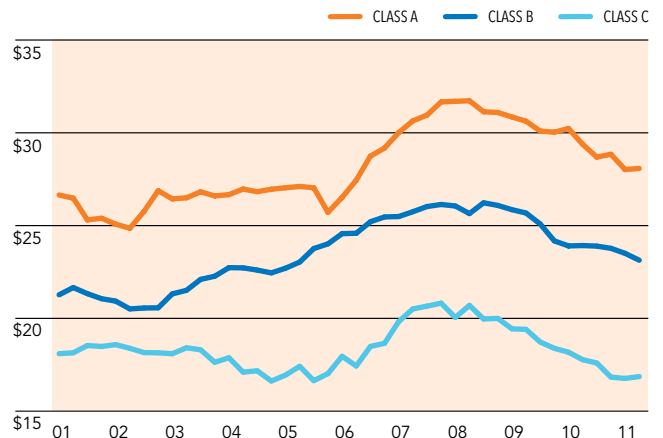
High demand upcoming for medical market

The next few years will be an interesting time for the Phoenix medical market. Some general practice and primary care physicians are being bought by hospitals or closing their doors all together, while the specialty niches are starting to explode. There will be substantial demand for MOB, as many small physician offices will be replaced by larger hospital-related facilities. With the estimated 32 million individuals expected to gain medical insurance under the federal government's healthcare law, demand for physicians and physician assistants will increase not only in hospitals but in private practices as well. In the near term, all eyes will be on government budget cuts and how they will impact the current Medicare system; mainly, the uncertainty of reimbursements to physicians for services rendered. ■

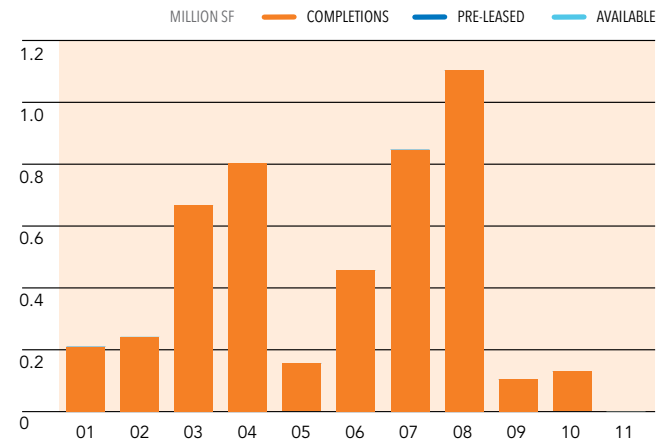
METRO PHOENIX NET ABSORPTION AND VACANCY



METRO PHOENIX AVERAGE ASKING RENTAL RATES

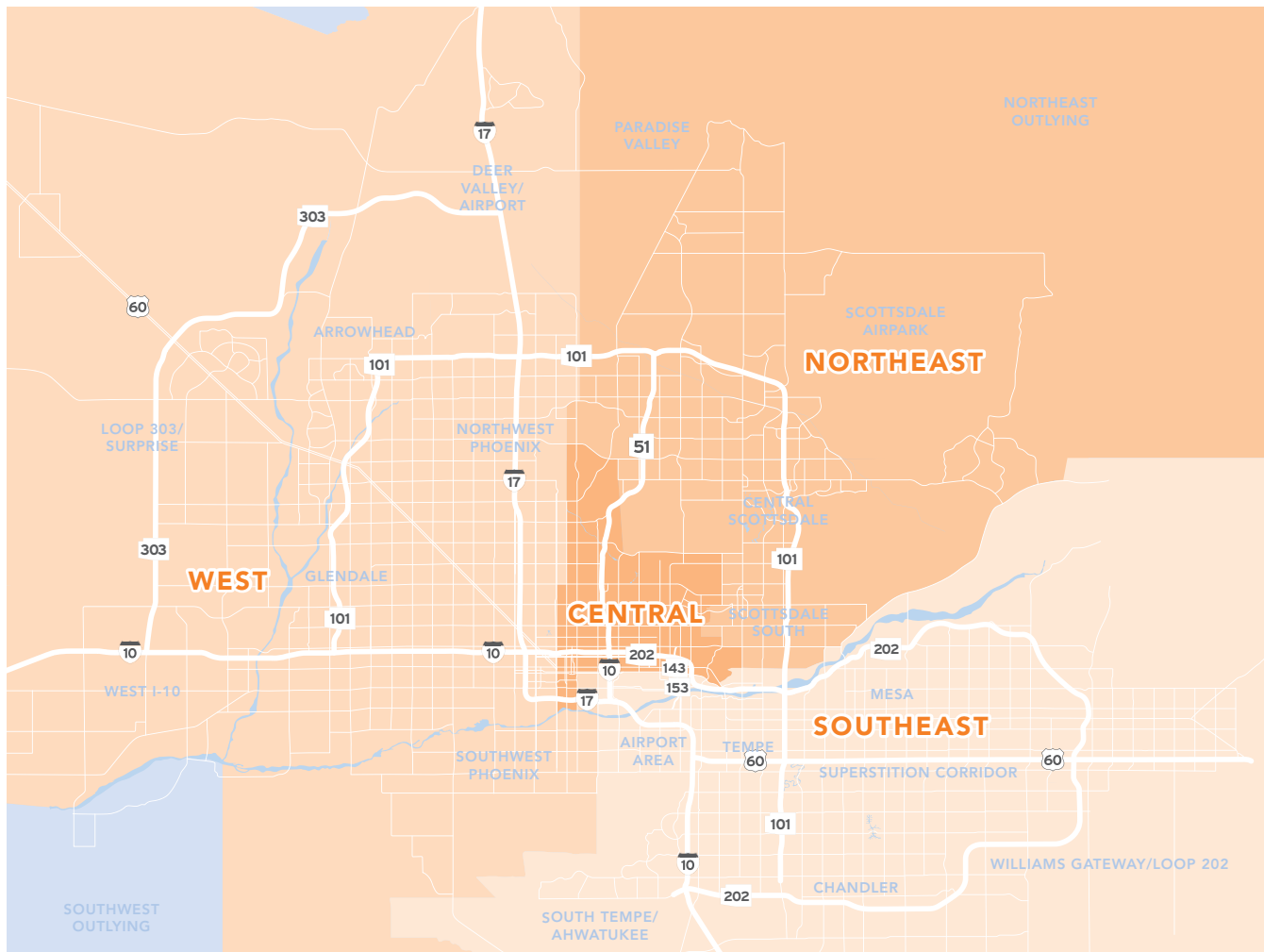


METRO PHOENIX DEVELOPMENT PIPELINE





METRO PHOENIX MARKET AREAS



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METHODOLOGY

The information in this report is the result of a compilation of information on medical office properties located in the Phoenix metropolitan area. Transwestern obtained the information from a variety of primary and secondary sources, including CoStar.

This report includes medical office properties 10,000 SF and larger, excluding hospitals and in-patient and out-patient facilities.



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