

BentallGreenOak 

MEDICAL OFFICE &
LIFE SCIENCE

MEDICAL OFFICE

Thesis

- The growing 65+ population and shift to outpatient care are expected to accelerate demand for medical services. Aging demographics along with expanded insurance coverage provides a long-term tailwind for medical office fundamentals.
- Rare recession-resistant investment opportunity.
- Healthcare spending in the U.S. continues to rise, driving demand for medical office.
- Investor focus coupled with scarcity of product and rising replacement costs support long-term cap rate compression.
- Healthcare real estate sector continues to institutionalize with robust capital markets demand.
 - CBRE estimates that investors will deploy \$25Bn of equity into healthcare RE by 2022

Considerations

- Medical office is poised for growth following historically stable rents amidst an inflationary environment.
- Reliable cash flows, with high renewal rates and limited credit loss.
- Rising construction costs have limited the ability of tenants to relocate to newly constructed product, supporting rents.
- Medical office leasing growth has historically lagged relative to multifamily and industrial, positioning the asset class for outsized rent growth.
- Focus on the patient experience and cost-efficiencies are accelerating the shift to cheaper outpatient facilities.

Risks/Challenges

- Ground leases. Many of the medical office properties have ground leases owned by adjacent hospitals or by the city.
- Minimal historical rent growth. However, with the expectation that the medical office sector will become more institutionalized, it is expected that rents will get pushed.
- Longer term leases (sticky tenants) with lower fixed rate bumps causes risk of not keeping up with CPI growth and inflation.

LIFE SCIENCE

Thesis

- An ageing population, growing prevalence of lifestyle diseases, rising health care spending and increasing crossover with technology are strong structural growth drivers for the life sciences sector.
- Technological advances and an aging U.S. demographic are boosting demand for medical research and life science real estate space.
- Significant capital has flowed to biomedical companies and startups. The life sciences sector also receives research grants from the National Institute of Health (NIH), which budgeted in excess of \$30 billion to medical research in 2019. The increased investment amongst life science companies has naturally translated into a burgeoning need for Research & Development (R&D) and manufacturing space.

Considerations

- In Q4 2021, Lab/R&D vacancy rate decreased by 10 bps and asking rental rates rose by 7.8% quarter over quarter. Average asking rents are at \$67.05/sf net with about a 4.8% vacancy.
- Abundant capital: VC Funding grew from about \$2.0BN in 2016 to about \$8.0BN in 2021.
- Higher market rent than traditional office. Market rents for Life Science spaces range from \$65-\$100 NNN, whereas traditional office ranges from \$50-\$75 Gross.
- Life science is the leading source of U.S. employment growth.
- Demand continues to outpace supply of lab space.

Risks/Challenges

- Municipal legislation could stall growth. Local jurisdictions are starting to create significant roadblocks preventing future growth.
- Tenant credit concerns. Most tenants signing leases are pre-IPO early-to-mid stage R&D companies and do not have investment grade credit.
- High leasing costs. Currently, most leases are executed with a 10-year term, but tenants are only staying in the lease for 2-3 years on average. Tenants break their lease because they either 1) outgrow the space, or 2) go out of business.
- Obsolescence of space due to technological advancements. The timeline to convert office to lab or to construct a ground-up building is long. Space being designed today will need to meet the needs of tenants in 2 years, which is difficult to project.