

MOB Investments

The Off Campus Debate

Traditionally, healthcare has been delivered in a hospital setting or in a medical office building on a hospital campus, especially when it comes to complicated or specialized treatments. Historically, medical buildings away from the hospital campus have served lower acuity patients and typically in smaller, older buildings. Over the last decade, this long-established model has been shifting significantly in the other direction, with expanding care options available away from the hospital campus and closer to home. There are three main drivers of this shift:

- Technology is allowing more advanced procedures and treatments to be performed in an outpatient setting.
- It is more cost effective to move care away from the hospital campus to free up space for more intensive treatments and procedures.
- Patient preference is becoming ever more important as providers fight to retain and grow market share, and today’s patients prefer high quality care that is convenient.

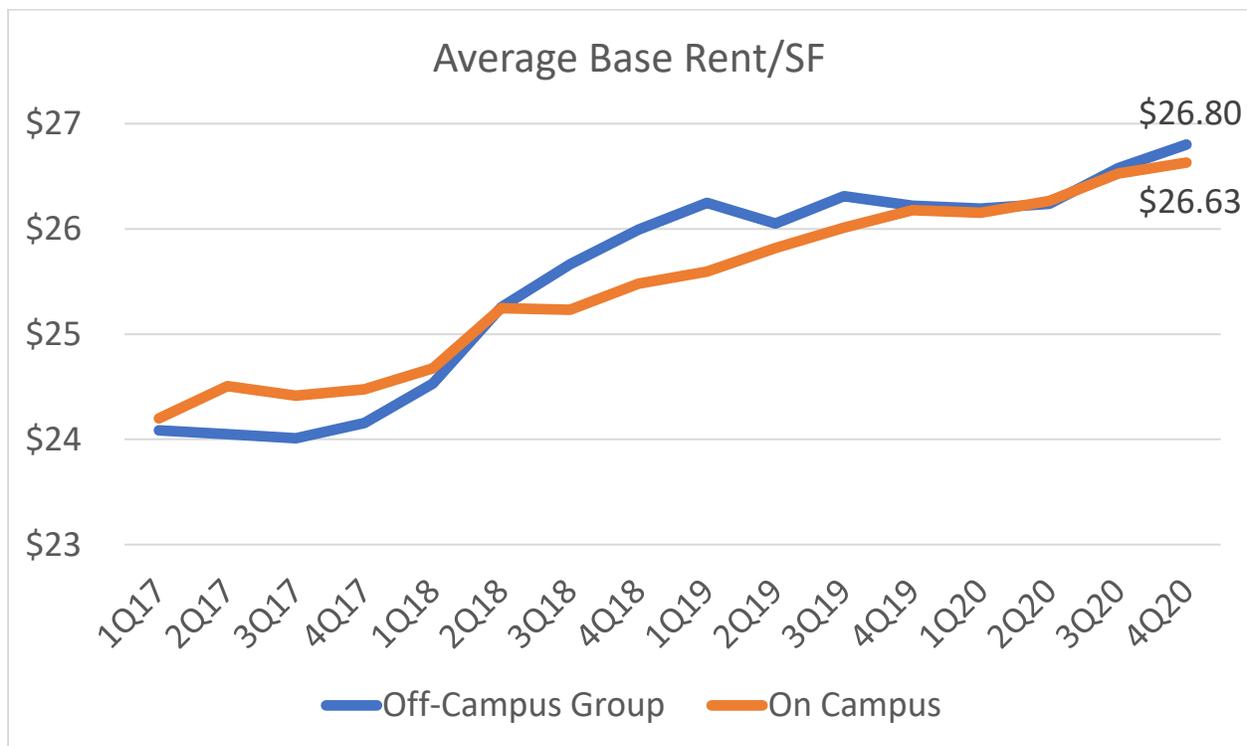
The discussion of these forces moving care away from the hospital setting is not new; it has been part of the industry conversation for years. For many investors however, this has not changed their perception of value and risk. Conventional thinking still suggests that medical office space on the campus of a hospital would be in greater demand by tenants than off-campus locations, generating more expensive leases, stickier tenants, and a better ability to increase rents. These factors in turn theoretically raise the value of the on-campus asset and lower the perceived risk, making this type of asset more appealing to many investors. But does this ring true in the data?

Certainly, if you look at all off-campus properties as compared to on-campus, you will see the previous assumptions play out. Much of the off-campus inventory is made up of those smaller buildings with individual physicians and non-core services. Since all on-campus properties are obviously hospital affiliated, let us refine the off-campus group to only affiliated locations and filter out those properties under 35,000 square feet. This group represents 429M square feet of MOB space and over 40% of the total off-campus universe. For the purpose of this report, we will look at metrics relating to these MOBs only in the top 50 metro areas.

	Off-Campus Group	On Campus	ALL MOBS
Number of Properties	5,970	5,976	36,462
Square Feet	429M	441M	1.5B

Base Rent

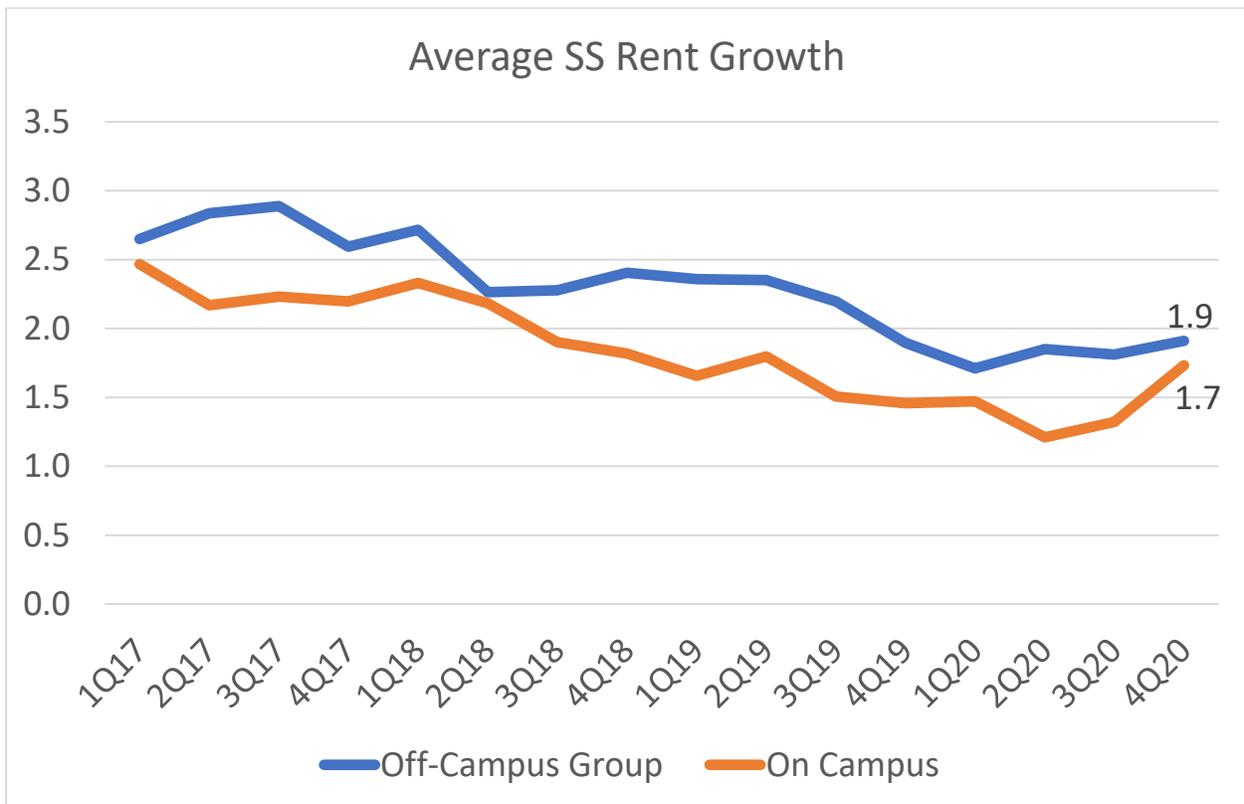
One might expect medical office space on the campus of a hospital to garner a higher rent than space off the campus. Aside from assuming increased value due to proximity to a hospital/potential referral source, simple supply constraints would suggest a premium, as only so much space can be made available on-campus. When comparing to our refined off-campus group however, that thinking does not play out in the data. Throughout the last few years, hospital affiliated off-campus MOB's greater than 35K square feet have trended similarly to on-campus, often commanding a greater base rent. The current 4Q20 average base rent for the off-campus group was \$26.80 PSF compared to \$26.63 for on-campus. Both groups trend far above the overall MOB average of \$22.50/SF.



* Revista researches rents on a quarterly basis. Most of the rents captured are asking rents from brokers marketing space. Therefore, many of these rents are representative of MOB's with multiple tenants. Base rent, as shown here, is the average of all rents regardless off type. (NNN, Full Service, Modified Gross etc.)

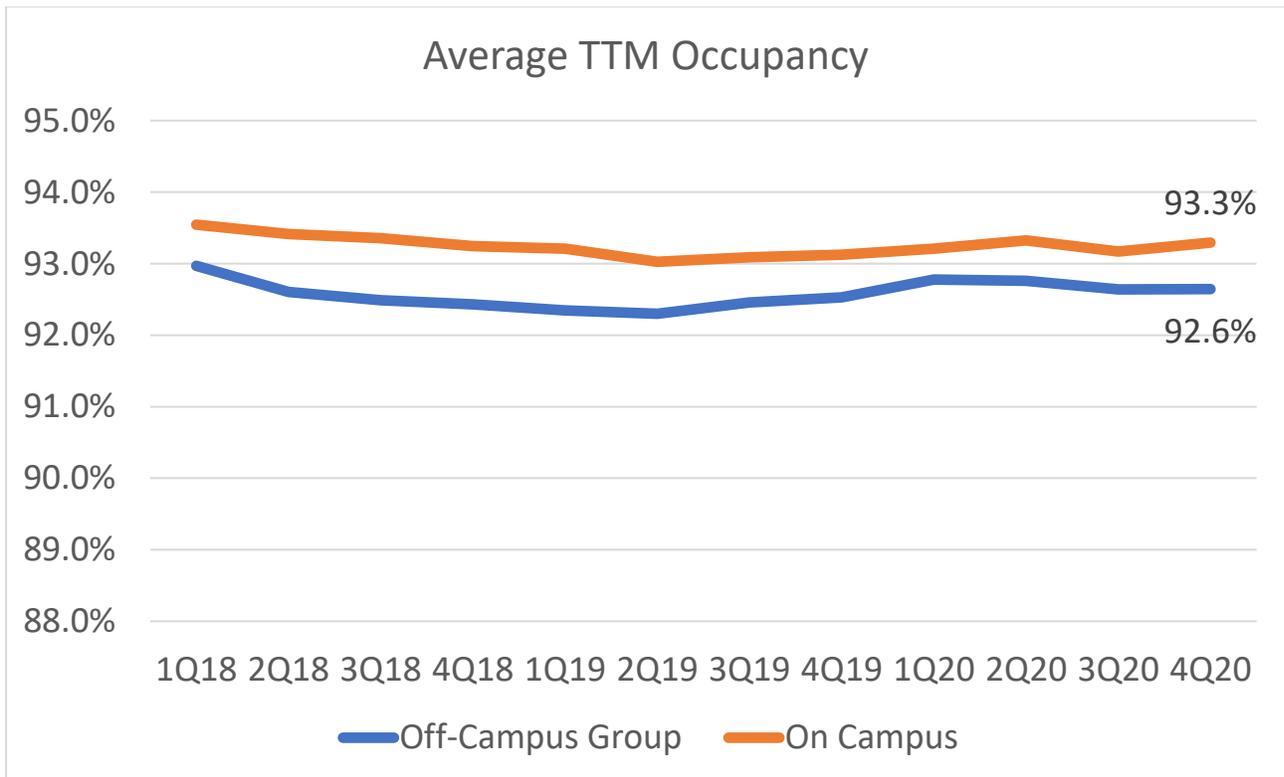
Rent Growth

Rent growth has a similar story to base rents. In 4Q20, same store YOY rent growth is 1.9% for hospital affiliated off-campus MOBs greater than 35K square feet, compared to 1.7% for on-campus MOBs. Since 1Q17 the off-campus group have had a running average YOY rent growth of 2.3% compared to 1.8% on-campus, suggesting a similar picture on ability to raise rents on both groups, with off-campus trending slightly higher.



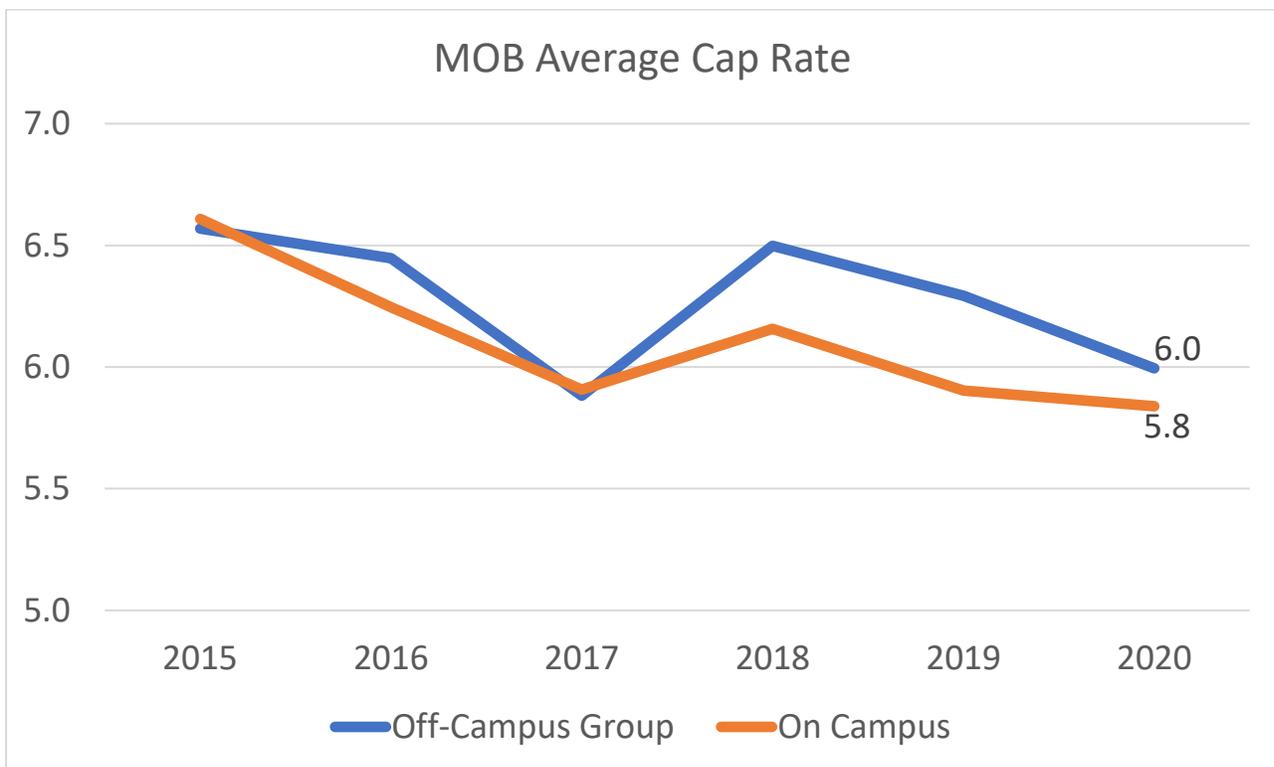
Occupancy

Occupancy is indeed higher for MOB's on-campus. The 4Q20 average occupancy rate for on-campus MOB's is 93.3% compared to 92.6% for hospital affiliated off-campus MOB's greater than 35K square feet. The current spread between the two occupancy rates is 65 basis points and has averaged 67 basis points since 1Q18. Occupancy for both groups have a very steady trend and again, both groups trend well above the top 50 market aggregate which is currently 91.4% as of 4Q20.



Cap Rate Trends

It has been commonly accepted that medical office buildings on a hospital campus command a premium over their off-campus counterparts and historically have been the preference for investors due to a perceived lower risk income stream. Yet with higher rents, rent growth and comparable occupancy, are investors still placing this premium on hospital-based MOB's? Although very close, the cap rate trend for the two groups suggests yes, a premium still exists. This graph measures the average capitalization rate (Cap Rate) for on-campus MOB's compared to hospital affiliated off-campus MOB's greater than 35K square feet. As of 4Q20, on-campus MOB's are at a 16-basis points premium to the off-campus group. The average cap rate for all MOB's in the top 50 markets is 6.2.





Summary

It is understood that individual properties and acquisitions will be different and contain varying attributes that will raise or lower the risk profile. However, from a 30,000-foot view, it appears a carte blanche premium for on-campus assets may eventually become a thing of the past. With many high quality off-campus buildings providing the same superior care in state-of-the-art buildings close to the patient, the performance divide is dwindling and the distance to a hospital hub becoming less significant. As we continue to discuss as an industry the shift to off-campus and the drivers affecting this change, here at Revista we will continue to monitor how performance, valuation and appetite is affected.

Glossary

Medical Office Building MOB: Any building where all tenants and services are involved in the delivery of care on an outpatient basis.

Off-Campus Group: Off-campus MOB's 35,000 square feet or greater and affiliated with a hospital or hospital system.

On Campus: Buildings that fall within the hospital's defined campus and are not separated from the hospital building by a major road or thoroughfare without a walkway or covered bridge.

Affiliated: Any building where a hospital or health system delivers care, regardless of how much space they occupy or whether they own the building.

Base Rent: Any rent collected regardless of what expenses are included (NNN, Full Service, Modified Gross etc.)

Rent Growth: Year over year same store change in rent. Rent growth includes all rent types (NNN, Full Service, Modified Gross etc.)