

Healthcare providers look for ways to make patient care more convenient and cost effective

Lisa Bridges Director of Market Research | Houston

Healthcare Trends Commentary by Beth Young

It's a new year and a fitting time to look ahead. When it comes to healthcare and related real estate, you can expect providers and investors to look for ways to make your healthcare more convenient and cost effective while they are working on efficiency and consolidation.

In 2018, expect to see more of the trends that shaped last year such as more development of new outpatient facilities and little change in cap rates or pricing for MOB's. Further, there will be continued strong demand from investors for healthcare properties, particularly now that institutional and foreign investors have set their sights on the healthcare property sector.

Expansions and Contractions

Demonstrating the importance of providing healthcare in locations close to the consumer, numerous Houston-area hospitals expanded to the outer submarkets including The Woodlands, Katy, Pearland and Cypress. Although Houston health systems are increasing the size of their footprint on the Houston landscape with new hospitals in major markets, hospitals are reducing the number of beds while expanding other departments. For example, in 2007, Memorial Hermann (Houston's largest health system over the past ten years) had 10 acute care hospitals and more than 3,000 licensed beds. At the end of 2017, the system had approximately 50% more hospitals and one-third the number of beds. Meanwhile, the population data shows the greater Houston area has increased 20% during that time.

Driven by higher deductibles, better technology and drugs, shrinking reimbursement and patient demand for convenience and lower costs, health systems are incentivized to promote prevention and keep patients with chronic diseases out of the hospital, while providing care throughout Houston's major markets. Expect to see fewer overnight beds and growth in cardiac surgery, operating rooms, ICU beds and health system-sponsored clinics in locations citywide. Some hospitals are using available floors for hospice or rehab space, while others are doing a straight real estate deal, offering the floors for lease. The shift to outpatient care is well underway and accelerating.

Market Indicators <small>Relative to prior period</small>	Annual Change	Semi-Annual Change	Semi-Annual Forecast*
VACANCY	↑	↑	↓
NET ABSORPTION	↑	↓	↑
NEW CONSTRUCTION	↑	↓	↑
UNDER CONSTRUCTION	↓	↓	↓

*Projected

Summary Statistics <small>Houston Medical Office Market</small>	Q4 2016	Q2 2017	Q4 2017
Vacancy Rate	10.6%	11.1%	11.6%
Net Absorption <small>(Thousand Square Feet)</small>	-71.3	63.9	40.9
New Construction <small>(Thousand Square Feet)</small>	42.7	242.4	110.3
Under Construction* <small>(Thousand Square Feet)</small>	624.4	641.4	547.6
Asking Rents <small>Per Square Foot Per Year</small>			
Average	\$24.55	\$25.21	\$25.35
Class A	\$28.37	\$29.18	\$29.09
Class B	\$24.16	\$24.62	\$24.83

*Under Construction excludes hospitals, but includes the medical office buildings within the hospital complex.

Modern Medical Centers

Patients throughout Houston will choose where they go for care based on the customer experience. Retail settings near residential communities may include urgent care, free-standing emergency centers, MOBs, imaging centers, ambulatory surgery centers, oncology care, post-acute care facilities and perhaps senior-care properties. Some larger healthcare systems will provide multiple services in one location near homes, ranging from primary care visits, imaging, cardiology, gastroenterology and orthopedics to entertainment and exercise (to keep patients busy while waiting to see their doctors) and casual dining options in one building.

Not only do successful hospitals and health systems increase their locations, but successful physician groups and specialty services are also following the trend, opening locations in major submarkets around the city. Often, physicians share clinic space with compatible specialists in multiple locations so they can refer business to each other.

Hospital Design

A growing recognition of the need to treat behavioral and mental health (including addiction-management) is resulting in a demand to accommodate cognitively impaired patients more effectively and sensitively. In larger hospitals, emergency departments (ED) are being reconfigured to reduce risk while ensuring compassion and dignity for these patients. Since they often require longer stays in the ED, an emerging design practice is adding features like bathroom showers, storage areas for their belongings and decompression space. Occasionally smaller vacated hospitals are converted into behavioral and mental health treatment facilities and some of these buildings are used for substance abuse clinics for children, teens and adults.

Patients in smaller towns in 19 states are benefitting from micro-hospitals, where they provide services similar to larger hospitals, but on a smaller footprint, often 15,000 to 50,000 square feet with between 5 and 15 inpatient beds.

Another hospital trend is learned from the hospitality industry, says Noe Ramirez, a healthcare architect with RS&H Architects. Besides design changes that include a trend toward soothing interiors, immunocompromised patients, like those needing bone-marrow transplants, need a different type of hospital setting for extended care. After the surgery and Post-Op, these patients are vulnerable to infection and require monitoring for complications, but they don't need full hospital services. So the new design for this time in a patient's stay will feel more like a hotel than a hospital, with a more comfortable interior design including some suite-style rooms and possibly a skilled concierge rather than a nurse.

New MOBs

Nineteen new buildings were added to the list of CoStar's medical office properties in Houston in 2017. With that expansion came a 0.9% increase in direct vacancy, although sublease space remained

Job Growth & Unemployment

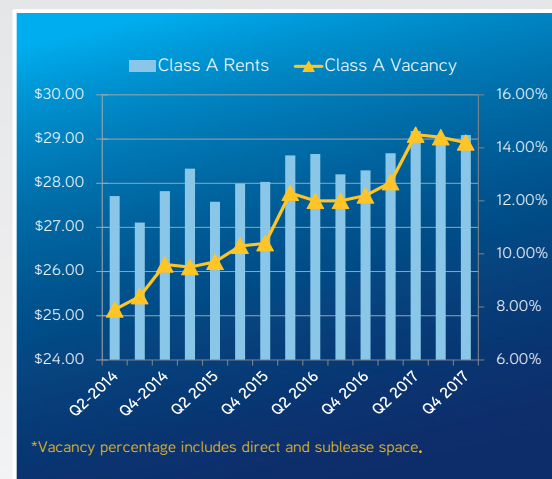
(not seasonally adjusted)

UNEMPLOYMENT	12/16	12/17
HOUSTON	5.3%	4.3%
TEXAS	4.5%	3.7%
U.S.	4.5%	3.9%

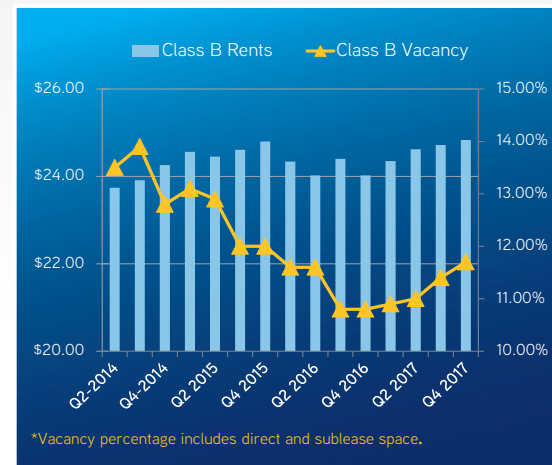
JOB GROWTH	Annual Change	# of Jobs Added
HOUSTON	1.5%	46.0K
TEXAS	2.5%	309.4K
U.S.	1.6%	2.28M

Medical Office

CLASS A RENTS AND VACANCY



CLASS B RENTS AND VACANCY



at the same 0.3% over the year. In 2016, 495K square feet of medical office space was absorbed, but as of December 2017 only 95K square feet was calculated by CoStar as the net absorption amount for the year. Further, 13 medical office buildings with over 700K square feet were under construction and expected to open in 2018.

Gross lease rates have increased about \$1.00/SF in the past year, and net rates have increased about \$0.43/SF. During that time, tenants offering sublease space paid attention to the difficulty in finding sublessees and have reduced sublease rates from \$22.52 to \$20.24 per SF.

Growth of Clinic Size

Because of the trend toward efficiency and consolidation in healthcare, the average clinic has grown in size. An average doctor's office was perhaps 2,500 square feet (SF) in the past; but now a single physician may lease closer to 5,000 SF. As technology improves, allowing for more outpatient procedures, physicians continue to locate offices with more services that include labs and imaging to provide more convenience for patients near their homes. It's not unusual for neighborhood clinics to average between 10,000 and 20,000 square feet.

The Effect of Baby Boomers

The growth of the senior population has spurred a new trend: the sale of many of their homes in exchange for apartments in denser urban areas. That presents the need for nearby modern and easily accessible medical offices, often in the form of urgent care facilities. They will be found in mixed-use centers that include a grocery store, retail shops, restaurants and perhaps a movie theatre and/or neighboring residential tower.

Although hospitals are reducing the number of beds due to the growth of outpatient facilities, remaining inpatients will be the sickest and most acute, requiring longer hospital stays. New designs will provide more private rooms and fewer shared rooms.

Investors and developers expect the senior housing sector to grow this year. Most aging baby boomers are still active in the workplace, but demand is expected to increase in the coming years which will encourage investors to add more senior living assets to their portfolios.

Healthcare Property Investments

Healthcare has changed from being an opportunistic investment to being a core investment. Most private investors and REITs hope to acquire off-market transactions. However, when it comes to dispositions of their own properties, investors prefer to use qualified brokers to fully market a property, saying they want to set up the competitive environment knowing they will usually achieve a better sale prices.

Healthcare real estate is still considered less expensive than some of the other asset types, but that is changing. Quality assets are very competitive. Value-add properties attract fewer investors because of the expertise, or disposition that is required to be successful.

Notable Houston Healthcare Property Sales

SECOND HALF 2017

Property	Size (SF)	Sale Price	Sale Date
Advanced Diagnostics Hospital and Clinic 12950 East Freeway	23,300	\$17.5M	November 2017
Red Oak Professional Building 17320 Red Oak Dr	40,315	\$2.3M	October 2017
Biolife Plasma 13320 Richmond	14,654	Undisclosed	N/A
St. Joseph Professional Building 2000 Crawford	138,586	Undisclosed	October 2017
Sugar Land Medical Pavilion	79,629	Undisclosed	N/A
Clear Lake I & II	132,800	Undisclosed	August 2017
Steeplechase Corner Professional Bldg 11301 Fallbrook	61,866	Undisclosed	August 2017

Houston Area Hospital Locations



Houston MSA Health Care

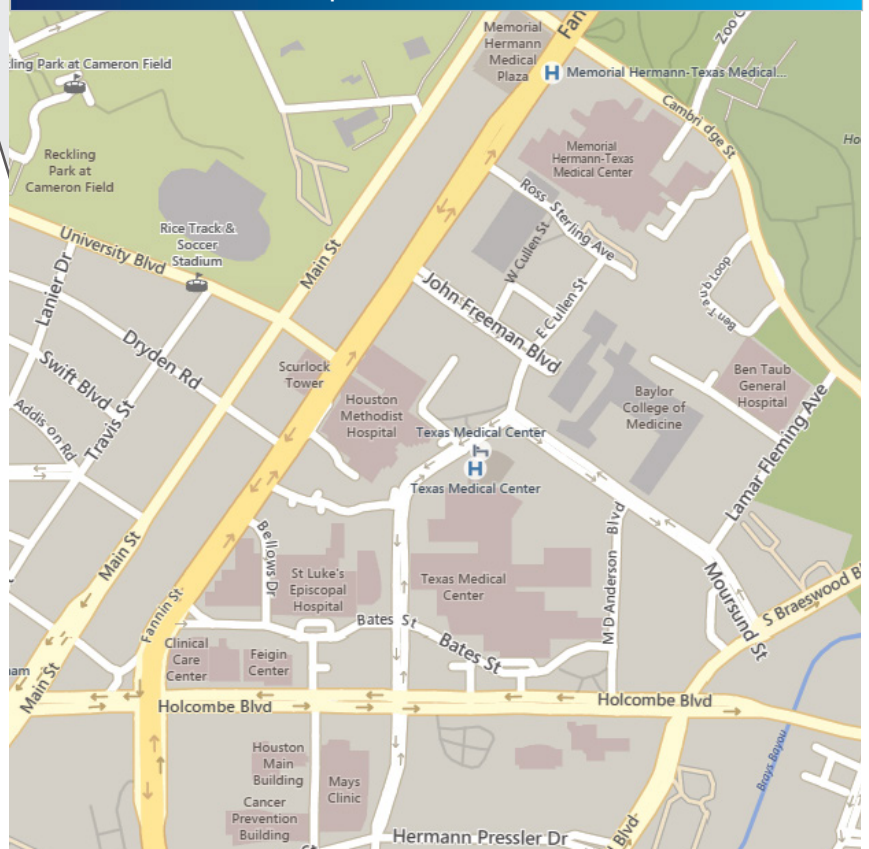
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Texas Medical Center

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Texas Medical Center Map



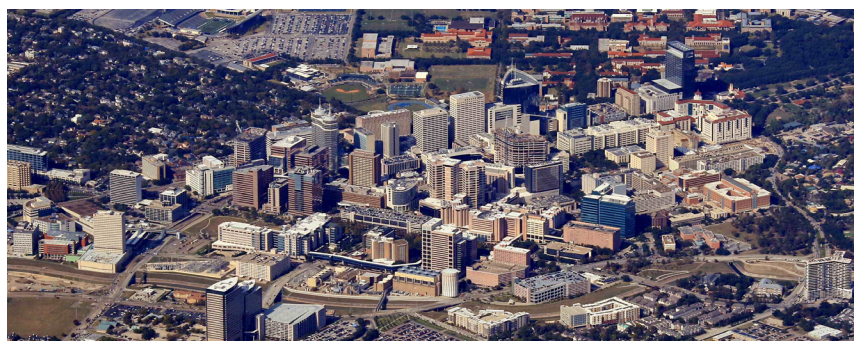
Texas Medical Center Update

When talking about healthcare property in Houston, we must provide an update of what is happening at the Texas Medical Center (TMC), the largest medical complex in the world. It is the eighth largest business district in the U.S. and continues to expand like an island built on an active volcano. In the last year, a new word has been used to describe what is happening in the TMC – collabitation. As the CEO of the TMC has told audiences recently, the institutional leaders of the TMC are now collaborating to compete with international medical centers rather than with each other. Three billion dollars in construction projects are underway and there is a clear passion about the determination to drive the next generation of life science advancements from Houston. The goal is to become the world leader by leveraging the collective power of TMC's renowned institutions in a shared, centrally managed environment. The result will be a research collaborative unlike anything healthcare has ever seen. With 1,345 total acres and \$25B in GDP, the TMC continues to expand, renovate and develop healthcare space for new accelerator programs that will drive innovation. Projects include incubation space to accelerate technology commercialization and a research park to co-locate early-stage companies alongside pharma, biotech and venture capital. In addition, a new 25-story, 550K square foot healthcare tower will break ground in the second or third quarter of 2018.

A major addition adjacent to the Texas Medical Center is planned by Medistar, scheduled to break ground in the second half of 2018. More details will be coming, but expect 32,000-SF floor plates in approximately 550,000 total SF with an oversized parking garage and retail at grade level.

Texas Medical Center Member Institutions

Baylor College of Medicine	Nora's Home
CHI St. Luke's Health	Prairie View A&M University
Children's Memorial Hermann	Rice University
City of Houston Department of Health and Human Services	Ronald McDonald House Houston
Coleman HCC College for Health Services	Sabin Vaccine Institute
DePelchin Children's Center	Shriners Hospital for Children – Galveston
Gulf Coast Regional Blood Center	Shriners Hospital for Children – Houston
Harris County Institute of Forensic Sciences	St. Dominic Village
Harris County Medical Society	Texas Children's Hospital - <i>Largest U.S. Children's Hospital</i>
Harris County Public Health and Environmental Services	Texas Heart Institute
Harris Health System	Texas Medical Center Hospital Laundry Cooperative Association
Health Science Center Texas A&M University	Texas Medical Center YMCA
Houston Academy of Medicine	Texas Southern University
Houston Hospice	Texas Women's University
Houston Methodist	The Health Museum: John P. McGovern Museum of Health and Medical Science
Institute for Spirituality and Health	The Texas Medical Center Library
LlfeGift	Thermal Energy Corporation (TECO)
MD Anderson Cancer Center - <i>World's Largest Cancer Hospital</i>	TIRR Memorial Hermann
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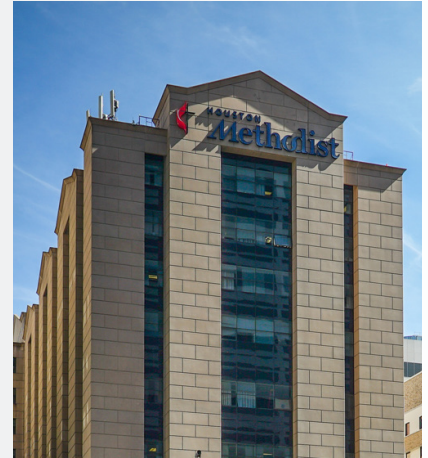


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Houston Healthcare Industry In The News

U.S. News & World Report's 2017-2018 ranked Houston Methodist Hospital in the Texas Medical Center No. 1 Hospital in Texas.

U.S. News & World Report

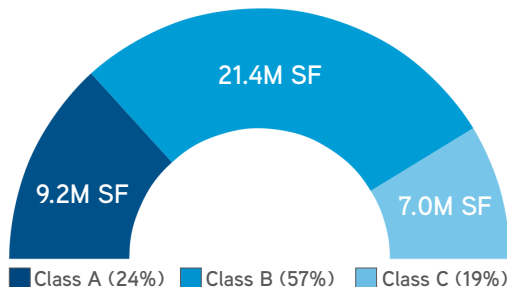


Q4 2017 Houston Medical Office Highlights



Houston's healthcare and social assistance job growth is very healthy **growing 9.4% in three years.**

12-Month Percent Change Dec - Dec
2016 - 2017 2.0%
2015 - 2016 3.1%
2014 - 2015 4.3%



37.7M SF
Total Inventory
40.9K SF
Net Absorption
11.6%
Vacancy



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Houston's aging population creates demand for healthcare professionals and the properties they occupy

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Healthcare Trends Commentary by Beth Young

When writing about the healthcare-property market in the greater Houston area, the first thing we must acknowledge is that Houston is home to the Texas Medical Center ("TMC"), the world's largest medical center and the eighth largest business district in the U.S. With that comes 50 million developed square feet in the TMC alone, plus additional hospitals and outpatient centers spread throughout the far-reaching suburbs that cater to nearly seven million people (as of last year). Currently the TMC is reporting \$3 billion in construction projects underway within their boundaries. Additional information about TMC can be found on pages 3-4 of this report. The following information focuses on a few of the high points in the suburbs of Houston's healthcare-property market.

Sublease and Direct Lease Space

Houston currently has a near-record amount of sublease office space available, and the sub-type of healthcare properties (including office buildings with some medical suites) has not escaped that trend. Vacant sublease space in healthcare buildings has increased from 98,647 square feet to 113,217 square feet since the first quarter of 2017. However, the amount that is available and yet still occupied, equals almost twice as much sublease space. Total medical office vacancy (including direct space) has increased from 10.9% at the end of 2016 to 12% according to CoStar, a national database of commercial real estate.

Interestingly, the gross lease rate for direct medical-office space and sublease space for medical office property is within two cents of each other across the city, at an average of \$25.28 per square foot per year. Knowing landlords can offer multiple incentives (free rent, construction allowance, parking options, flexible terms, etc.) to prospects, medical tenants who need to sublease their current office space may want to consider lowering the asking rent to compete with landlords for available prospects.

Market Indicators <small>Relative to prior period</small>	Annual Change	Semi-Annual Change	Semi-Annual Forecast*
VACANCY	↑	↑	↓
NET ABSORPTION	↓	↑	↑
NEW CONSTRUCTION	↑	↑	↓
UNDER CONSTRUCTION	↓	↓	↓

*Projected

Summary Statistics <small>Houston Medical Office Market</small>	Q2 2016	Q4 2016	Q2 2017
Vacancy Rate	11.2%	11.5%	12.1%
Net Absorption <small>(Thousand Square Feet)</small>	337.0	-101.2	61.7
New Construction <small>(Thousand Square Feet)</small>	160.7	21.9	234.8
Under Construction* <small>(Thousand Square Feet)</small>	613.9	573.3	547.2
Asking Rents <small>Per Square Foot Per Year</small>			
Average	\$24.68	\$25.08	\$25.38
Class A	\$28.66	\$28.22	\$29.07
Class B	\$24.02	\$24.02	\$24.43

*Under Construction excludes hospitals, but includes the medical office buildings within the hospital complex.

Development

Despite the recent increase in healthcare properties' vacancy, demand for new medical-office space has resulted in four properties being delivered in the first quarter, and five more delivered in the second quarter of this year. Currently, there are 11 more medical-office projects outside of the Texas Medical Center, adding up to 542,224 square foot currently under construction.

TierOne Development is building a speculative 38,600-square-foot project in Sugar Land, along Highway 59 South/I-69, centrally located between major hospitals. Completion is expected in the second quarter of 2018.

Memorial Medical Pavilion, a new five-story, 101,744 square foot medical office building with first-floor retail tenants and a freestanding parking garage in the Memorial Villages area is scheduled to break ground in December and open in the first quarter of 2019.

Medistar is working on their 70,000 square foot Integrated Medical Plaza in Webster. The Bay Area Regional Medical Center is finishing floors six through nine for a total square footage of 373,000 and 200 beds at an estimated investment of \$300 million.

Some additional healthcare construction in Houston includes plans by major health and hospital systems to position themselves closer to patients' residences. In March, after an accelerated 24-month construction period, Memorial Hermann, the largest health system in the Houston area, opened a new \$168 million hospital in the northwest suburb of Cypress to address the fast-growing community's health care needs from routine outpatient visits to inpatient procedures. The health system also recently started on a \$70 million, 123,000-square-foot, expansion to its Northeast Hospital's campus in Humble, TX. The five-story building is expected to open in December 2018. The campus currently houses more than 250 patient beds and is adding 90 new patient rooms. In addition, a second four-story medical office building in Pearland at 10907 Memorial Hermann Drive and Highway 288 near the new hospital is expected to open by September, and a 173,000 square foot Medical Plaza will open in November in The Woodlands.

Texas Children's Hospital, which was recently ranked by U.S. News & World Report as fourth in the country among the nearly 200 pediatric centers, opened a new 548,000 square foot facility in The Woodlands with 24 emergency rooms, and 30 acute-care beds. The system has plans to open more than two dozen new facilities including a 24 acute-care bed expansion on their campus in the suburb of Katy.

The Methodist Hospital's new 470,000-square-foot Woodlands hospital opened in July with 193 beds. In addition to building a 160,000-square-foot medical building in The Woodlands, they are also expanding in Katy with a new \$170 million, six-story, 228,700-square-foot hospital tower next to its West Campus facility. The health system continues to grow and needs more office space near the TMC, evidenced by a recent lease of 24,282 square feet

Job Growth & Unemployment

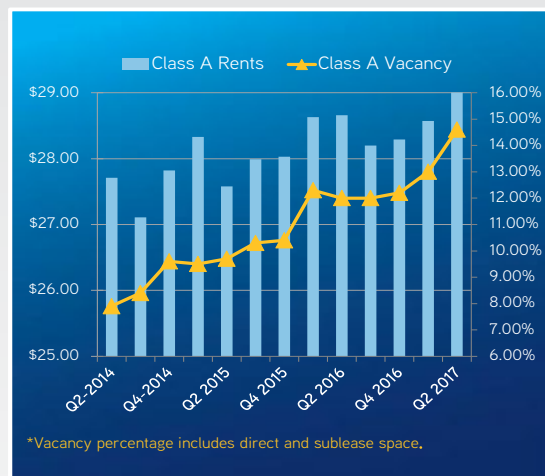
(not seasonally adjusted)

UNEMPLOYMENT	6/16	6/17
HOUSTON	5.6%	5.3%
TEXAS	5.0%	4.7%
U.S.	5.0%	4.5%

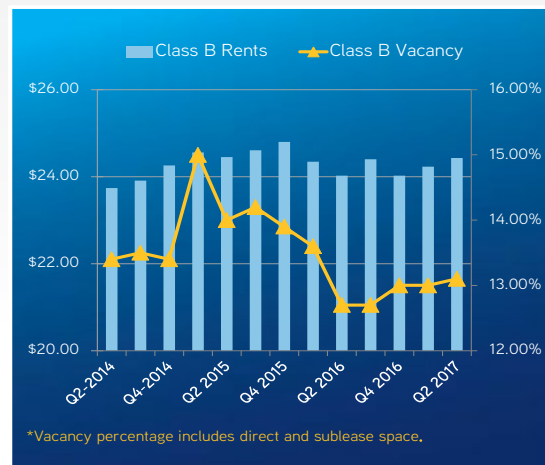
JOB GROWTH	Annual Change	# of Jobs Added
HOUSTON	1.9%	56.1K
TEXAS	2.6%	313.4K
U.S.	1.5%	2.2M

Medical Office

CLASS A RENTS AND VACANCY



CLASS B RENTS AND VACANCY



of office space at the Museum Medical Tower. (They are also currently expanding with a new 390-bed patient tower in the TMC.)

The University of Texas MD Anderson Cancer Center is building a new \$113.75 million outpatient center in Katy with a planned opening in 2018. The new 175,000 square foot facility will be their first free-standing clinical building constructed outside of the TMC. The new center is the first phase of a long-term plan to develop facilities on its 34.5 acre campus near I-10 and Dairy Ashford.

CHI St. Luke's Health will be the first tenant at Vivacity, a 186-acre medical district in New Caney at the intersection of Highway 59 and the Grand Parkway. The hospital system is still determining what size and scope of facility it will build in Vivacity. The medical district is being developed as part of the master-planned community Valley Ranch by The Woodlands-based real estate business the Signorelli Company. Vivacity will feature more than 2.5 million square feet of space, including a hospital and wellness and life science facilities.

Investment Transactions

Most healthcare real estate investors are primarily interested in pursuing medical office buildings ("MOB") this year. Advantages over non-medical office buildings include higher occupancies, lower tenant turnover and longer term leases. A steadily aging population creates demand for healthcare professionals and the properties they occupy. Investors see the sector as a safer place for their capital. Unfortunately for buyers, few owners of these property types have been quick to offer the properties for sale this year.

Ambulatory surgery centers are the second most desirable medical property sought by investors. Several surgical properties closed in Houston recently. The 34,600 square foot Houston Hospital for Specialized Surgery at 5445 La Branch Street, and the 37,000

square foot ambulatory surgery center at 8111 Southwest Freeway were purchased by an affiliate of Inland Real Estate Acquisitions, Inc. In June, the 100 percent-occupied South Shore Surgicenter in the suburb of League City was sold to an out-of-state private investor who specializes in the property type.

REITs and health systems have been active this year. Inland RE Group, a private REIT, closed on Memorial Hermann Acute Care Center at 1431 Studemont Street. It is a 100% occupied, 44,000 square foot single-tenant property. HCA Holdings Inc., the largest for-profit healthcare provider in the U.S., purchased three Houston hospitals from Tenet Healthcare Corp. for an estimated \$725 million in net proceeds. That transaction included the 423-bed Houston Northwest Medical Center, the 181-bed Cypress Fairbanks Medical Center Hospital and the 444-bed Park Plaza Hospital. HCA also committed to purchase two more hospitals from Community Health Systems including one in the northwest Houston area, the Tomball Regional Medical Center, a 350-bed hospital.

Private investors still hold the top spot nationally for being most active in the healthcare-property arena. Following are some recent purchases by private investors:

- Everest Medical Core Properties bought a medical office portfolio which included the UT Physicians 42,301 square foot building at 1517 Thompson Road in Richmond; the Memorial Hermann Surgical Hospital at 16902 Southwest Freeway; the Physicians Pavilion at 16906 Southwest Freeway; and the UT Physicians facility at 15035 SW Freeway, from Dr. Juliet Breeze, the developer of Next Level Urgent Care properties.
- Fercan E. Kalkan bought 11929 W. Airport Blvd in the southwest suburb of Stafford, also known as the Oasis Professional Building, is 206,474 square feet and nine stories.
- RoseRock purchased 8619 Broadway, a 19,760 square foot property in the south suburb of Pearland.

Recent Investment Sales

EVEREST MEDICAL CORE PROPERTIES MEDICAL OFFICE PORTFOLIO



1517 THOMPSON ROAD



16902 SOUTHWEST FREEWAY



16906 SOUTHWEST FREEWAY



15035 SOUTHWEST FREEWAY

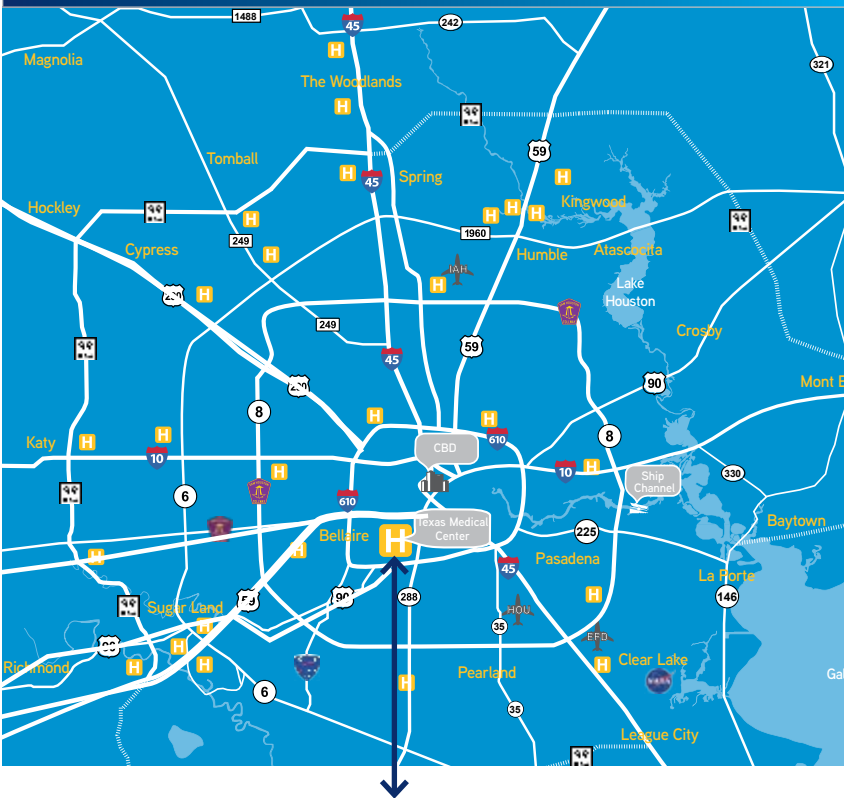
OASIS PROFESSIONAL BUILDING



8619 BROADWAY



Houston Area Hospital Locations



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Texas Medical Center Map



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Texas Medical Center

The Texas Medical Center (TMC) – the world’s largest medical center – represents one of Houston’s major economic drivers and core industries with an estimated regional annual economic impact of \$35 billion. TMC is also one of Houston’s largest employers with more than 106,000 employees, including physicians, scientists, researchers and other advanced degree professionals in the life sciences.

The internationally-renowned, 1,345-acre TMC is the world’s largest medical complex of member institutions, including leading medical, academic and research institutions, all of which are non-profit and dedicated to the highest standards of research, education and patient and preventive care. Over 50,000 students – including more than 20,000 international students – are affiliated with TMC, including high school, college and health profession graduate programs. More than 8.0 million patients visit TMC each year, including approximately 16,000 international patient visits.

In addition to the medical facilities and institutions of higher learning, TMC is also home to more than 290 professional buildings. Overall, the complex covers over 18 miles of public and private streets and roadways, with 50 million square feet of existing patient, education and research space. TMC has continued to grow and expand over the past several decades with the majority of growth occurring in the past ten years. The Center is located in the 110-acre University of Texas Research Park, a joint effort between the University of Texas Health Science Center, M.D. Anderson and General Electric Healthcare. TMC spends billions of dollars on research and charity care annually.

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Children’s Memorial Hermann	Rice University
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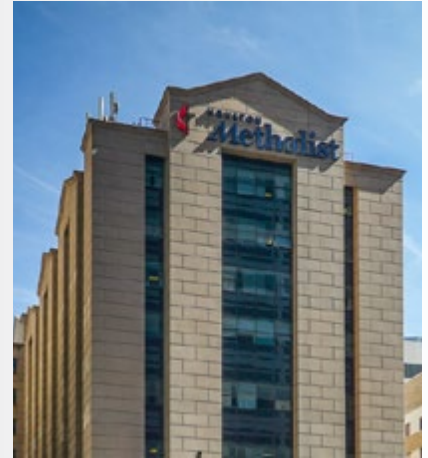


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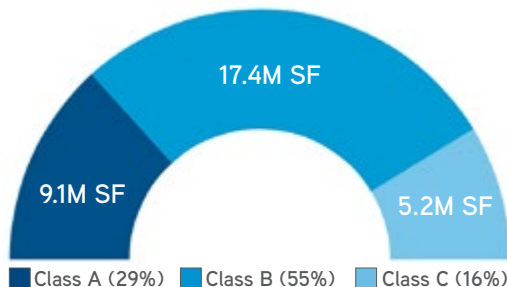


Q2 2017 Houston Medical Office Highlights



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2015 - 2016 5.2%
2014 - 2015 4.2%



34.9M SF
Total Inventory

61.7K SF
Net Absorption

12.1%
Vacancy



FOR MORE INFORMATION

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Accelerating success.

Houston's healthcare industry remains strong and continues to drive employment

Lisa Bridges Director of Market Research | Houston

Healthcare Trends Commentary by Coy Davidson

Houston's healthcare industry remains strong and continues to be a major driver of development and employment. More than 325,000 Houstonians work in healthcare, the city's second largest employment sector.

From December '14 to October '16, a period when mining and logging lost nearly 25,000 jobs due to the energy downturn, health care created nearly 23,000 new jobs. Houston can expect to see more health care growth and more jobs, according to the Greater Houston Partnership's 2017 Houston Employment Forecast.

Recent job cuts announced by one of Houston's major hospital systems, M.D. Anderson, are not reflective of the overall strength of the local healthcare market. Despite the uncertainty surrounding the Affordable Care Act and rising costs in every facet of the industry, healthcare real estate fundamentals remain solid and the industry will likely remain buoyed by consumer demand.

There are more than 5 million square feet of new hospitals and expansions and medical office buildings currently under construction in the Greater Houston area. These include major expansions in the Texas Medical Center and a wave of new development in the suburbs. Healthcare tends to follow population growth similar to retailers and as Houston's population has moved to the suburbs, healthcare providers have followed.

Houston Methodist Hospital will deliver a 1 million square foot expansion in the Texas Medical Center and a 470,000 SF hospital in The Woodlands in 2017. In addition, Memorial Hermann will complete the 321,000 SF Cypress Medical Center in 2017. These are just a few examples of the multiple hospital construction projects underway around the Houston metro.

On the leasing front Houston Healthcare Systems are continuing to expand services and market share in suburban locations establishing clinical locations in new medical office buildings and highly visible retail locations with attractive demographics.

Market Indicators

Relative to prior period

Annual
Change

Semi-Annual
Change

Semi-Annual
Forecast*

VACANCY



NET ABSORPTION



NEW CONSTRUCTION



UNDER CONSTRUCTION



*Projected

Summary Statistics

Houston Medical Office Market

Q4 2015

Q2 2016

Q4 2016

Vacancy Rate

11.7%

12.2%

12.4%

Net Absorption
(Thousand Square Feet)

624.5

159.5

20.3

New Construction
(Thousand Square Feet)

600.0

155.0

39.0

Under Construction*
(Thousand Square Feet)

734.9

622.9

599.3

Asking Rents

Per Square Foot Per Year

Average

\$24.96

\$24.67

\$24.74

Class A

\$28.03

\$28.66

\$28.29

Class B

\$24.80

\$24.29

\$24.39

*Under Construction excludes hospitals, but includes the medical office buildings within the hospital complex.

Vacancy & Availability

Houston's medical office market occupancy decreased slightly during the second half of 2016 with the citywide average vacancy rate increasing 20 basis points to 12.4% from 12.2% in Q2 2016.

Sublease space has not had a significant impact on current vacancy rates. Of the 4.3M SF of vacant space on the market, only 117,127 SF or 0.3% is sublease space.

Disciplined healthcare development activity has helped prevent major upheavals in current vacancy levels. There were six new buildings (SF) added to the market during the second half of 2016. Currently, there are twelve buildings totaling 599,285 SF under construction.

The largest medical office building currently under construction is the 172,000-SF Class A Memorial Hermann The Woodlands Medical Plaza 4 located in The Woodlands submarket on Pinecroft Dr. The 6-story building is expected to deliver in August 2017.

Absorption & Demand

Houston's medical office market recorded 43,787 SF of positive net absorption in the second half of 2016, bringing the year-end 2016 total to 372,979 SF.

By property class, Class B posted the largest amount of positive net absorption in the second half of 2016, posting 58,893 SF of positive net absorption while Class A posted negative net absorption.

Leasing Activity

Houston's medical office leasing activity, which includes renewals, reached 464,903 SF in the second half of 2016, pushing the year-end 2016 total to 949,736 SF.

Sales Activity

Houston's healthcare investment sales activity included 28 transactions, with an average price per square foot of \$247 and an average cap rate of 6.7%. Listed below are a few transactions that closed in the second half of 2016.

The Rotunda Building



Colliers International represented both the buyer and seller of the 51,179-SF Rotunda medical office building located in the E Fort Bend Co/Sugar Land Submarket. The sale occurred in August 2016.

Coastal Surgical Group



Colliers International represented the seller in the sale of a 12,300-SF medical office building located at 150 FM 1959 in the NASA/Clear Lake submarket. The property traded for \$2.2M or \$178 per SF in October 2016.

Job Growth & Unemployment

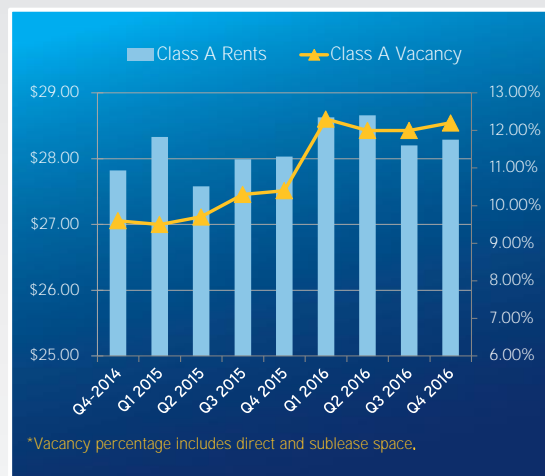
(not seasonally adjusted)

UNEMPLOYMENT	12/15	12/16
HOUSTON	4.6%	5.3%
TEXAS	4.2%	4.6%
U.S.	4.8%	4.5%

JOB GROWTH	Annual Change	# of Jobs Added
HOUSTON	0.5%	14.8K
TEXAS	1.8%	213.5K
U.S.	1.7%	2.5M

Medical Office

CLASS A RENTS AND VACANCY



CLASS B RENTS AND VACANCY



A map of the Houston area showing hospital locations. The map is centered on the Houston CBD (Central Business District) and the Texas Medical Center. Major highways (Interstates 10, 25, 45, 59, 67, 610, 288, 290, 249, 240, 241, 242, 243, 244, 245, 246, 247, 248, 249, 250, 251, 252, 253, 254, 255, 256, 257, 258, 259, 260, 261, 262, 263, 264, 265, 266, 267, 268, 269, 270, 271, 272, 273, 274, 275, 276, 277, 278, 279, 280, 281, 282, 283, 284, 285, 286, 287, 288, 289, 290, 291, 292, 293, 294, 295, 296, 297, 298, 299, 300, 301, 302, 303, 304, 305, 306, 307, 308, 309, 310, 311, 312, 313, 314, 315, 316, 317, 318, 319, 320, 321, 322, 323, 324, 325, 326, 327, 328, 329, 330, 331, 332, 333, 334, 335, 336, 337, 338, 339, 340, 341, 342, 343, 344, 345, 346, 347, 348, 349, 350, 351, 352, 353, 354, 355, 356, 357, 358, 359, 360, 361, 362, 363, 364, 365, 366, 367, 368, 369, 370, 371, 372, 373, 374, 375, 376, 377, 378, 379, 380, 381, 382, 383, 384, 385, 386, 387, 388, 389, 390, 391, 392, 393, 394, 395, 396, 397, 398, 399, 400, 401, 402, 403, 404, 405, 406, 407, 408, 409, 410, 411, 412, 413, 414, 415, 416, 417, 418, 419, 420, 421, 422, 423, 424, 425, 426, 427, 428, 429, 430, 431, 432, 433, 434, 435, 436, 437, 438, 439, 440, 441, 442, 443, 444, 445, 446, 447, 448, 449, 450, 451, 452, 453, 454, 455, 456, 457, 458, 459, 460, 461, 462, 463, 464, 465, 466, 467, 468, 469, 470, 471, 472, 473, 474, 475, 476, 477, 478, 479, 480, 481, 482, 483, 484, 485, 486, 487, 488, 489, 490, 491, 492, 493, 494, 495, 496, 497, 498, 499, 500, 501, 502, 503, 504, 505, 506, 507, 508, 509, 510, 511, 512, 513, 514, 515, 516, 517, 518, 519, 520, 521, 522, 523, 524, 525, 526, 527, 528, 529, 530, 531, 532, 533, 534, 535, 536, 537, 538, 539, 540, 541, 542, 543, 544, 545, 546, 547, 548, 549, 550, 551, 552, 553, 554, 555, 556, 557, 558, 559, 560, 561, 562, 563, 564, 565, 566, 567, 568, 569, 570, 571, 572, 573, 574, 575, 576, 577, 578, 579, 580, 581, 582, 583, 584, 585, 586, 587, 588, 589, 590, 591, 592, 593, 594, 595, 596, 597, 598, 599, 600, 601, 602, 603, 604, 605, 606, 607, 608, 609, 610, 611, 612, 613, 614, 615, 616, 617, 618, 619, 620, 621, 622, 623, 624, 625, 626, 627, 628, 629, 630, 631, 632, 633, 634, 635, 636, 637, 638, 639, 640, 641, 642, 643, 644, 645, 646, 647, 648, 649, 650, 651, 652, 653, 654, 655, 656, 657, 658, 659, 660, 661, 662, 663, 664, 665, 666, 667, 668, 669, 670, 671, 672, 673, 674, 675, 676, 677, 678, 679, 680, 681, 682, 683, 684, 685, 686, 687, 688, 689, 690, 691, 692, 693, 694, 695, 696, 697, 698, 699, 700, 701, 702, 703, 704, 705, 706, 707, 708, 709, 710, 711, 712, 713, 714, 715, 716, 717, 718, 719, 720, 721, 722, 723, 724, 725, 726, 727, 728, 729, 730, 731, 732, 733, 734, 735, 736, 737, 738, 739, 740, 741, 742, 743, 744, 745, 746, 747, 748, 749, 750, 751, 752, 753, 754, 755, 756, 757, 758, 759, 760, 761, 762, 763, 764, 765, 766, 767, 768, 769, 770, 771, 772, 773, 774, 775, 776, 777, 778, 779, 780, 781, 782, 783, 784, 785, 786, 787, 788, 789, 790, 791, 792, 793, 794, 795, 796, 797, 798, 799, 800, 801, 802, 803, 804, 805, 806, 807, 808, 809, 810, 811, 812, 813, 814, 815, 816, 817, 818, 819, 820, 821, 822, 823, 824, 825, 826, 827, 828, 829, 830, 831, 832, 833, 834, 835, 836, 837, 838, 839, 840, 841, 842, 843, 844, 845, 846, 847, 848, 849, 850, 851, 852, 853, 854, 855, 856, 857, 858, 859, 860, 861, 862, 863, 864, 865, 866, 867, 868, 869, 870, 871, 872, 873, 874, 875, 876, 877, 878, 879, 880, 881, 882, 883, 884, 885, 886, 887, 888, 889, 890, 891, 892, 893, 894, 895, 896, 897, 898, 899, 900, 901, 902, 903, 904, 905, 906, 907, 908, 909, 910, 911, 912, 913, 914, 915, 916, 917, 918, 919, 920, 921, 922, 923, 924, 925, 926, 927, 928, 929, 930, 931, 932, 933, 934, 935, 936, 937, 938, 939, 940, 941, 942, 943, 944, 945, 946, 947, 948, 949, 950, 951, 952, 953, 954, 955, 956, 957, 958, 959, 960, 961, 962, 963, 964, 965, 966, 967, 968, 969, 970, 971, 972, 973, 974, 975, 976, 977, 978, 979, 980, 981, 982, 983, 984, 985, 986, 987, 988, 989, 990, 991, 992, 993, 994, 995, 996, 997, 998, 999, 1000) are shown as white lines. Major highways (Interstates 10, 25, 45, 59, 67, 610, 288, 290, 249, 240, 241, 242, 243, 244, 245, 246, 247, 248, 249, 250, 251, 252, 253, 254, 255, 256, 257, 258, 259, 260, 261, 262, 263, 264, 265, 266, 267, 268, 269, 27



- 128 Hospitals
- 18,681 Hospital Beds
- 16,070 Licensed Physicians
- 299,600 Health Care & Social Assistance Jobs
- 3.6% Annual Employment Growth

Texas Medical Center Map

The map displays the Texas Medical Center area in Houston, Texas. Major roads shown include Loop 281, Main St, John Freeman Blvd, University Blvd, Dryden Rd, Swift Blvd, Travis St, Fannin St, Bellows Dr, Bates St, Holcombe Blvd, and Hermann Pressler Dr. Key medical facilities and landmarks labeled include Memorial Hermann Medical Plaza, Memorial Hermann-Texas Medical Center, Houston Methodist Hospital, Texas Medical Center, Baylor College of Medicine, Ben Taub General Hospital, St Luke's Episcopal Hospital, Clinical Care Center, Feigin Center, Houston Main Building, Cancer Prevention Building, Mays Clinic, Scurlock Tower, Rice Track & Soccer Stadium, and Reckling Park at Cameron Field. A blue arrow points to the intersection of Main St and John Freeman Blvd, indicating the location of the Texas Medical Center.



- › World's Largest Medical Complex (1,300 Acres)
- › 54 Member Institutions
- › 7.2M Patients Annually
- › 106,000 Employees
- › 5,000 Physicians
- › 49,000 Life Science Students
- › \$960 Million in Charity Care

Texas Medical Center

The Texas Medical Center (TMC) – the world’s largest medical center – represents one of Houston’s major economic drivers and core industries with an estimated regional annual economic impact of \$20 billion. TMC is also one of Houston’s largest employers with more than 106,000 employees, including physicians, scientists, researchers and other advanced degree professionals in the life sciences.

The internationally-renowned, 1,345-acre TMC is the world’s largest medical complex of member institutions, including leading medical, academic and research institutions, all of which are non-profit and dedicated to the highest standards of research, education and patient and preventive care. Over 50,000 students – including more than 20,000 international students – are affiliated with TMC, including high school, college and health profession graduate programs. More than 8.0 million patients visit TMC each year, including approximately 16,000 international patient visits.

In addition to the medical facilities and institutions of higher learning, TMC is also home to more than 290 professional buildings. Overall, the complex covers over 18 miles of public and private streets and roadways, with 50 million square feet of existing patient, education and research space. TMC has continued to grow and expand over the past several decades with the majority of growth occurring in the past ten years. The Center is located in the 110-acre University of Texas Research Park, a joint effort between the University of Texas Health Science Center, M.D. Anderson and General Electric Healthcare. TMC spends billions of dollars on research and charity care annually.

Texas Medical Center Member Institutions

Baylor College of Medicine	Nora’s Home
CHI St. Luke’s Health	Prairie View A&M University
Children’s Memorial Hermann	Rice University
City of Houston Department of Health and Human Services	Ronald McDonald House Houston
Coleman HCC College for Health Services	Sabin Vaccine Institute
DePelchin Children’s Center	Shriners Hospital for Children – Galveston
Gulf Coast Regional Blood Center	Shriners Hospital for Children – Houston
Harris County Institute of Forensic Sciences	St. Dominic Village
Harris County Medical Society	Texas Children’s Hospital - Largest U.S. Children’s Hospital
Harris County Public Health and Environmental Services	Texas Heart Institute
Harris Health System	Texas Medical Center Hospital Laundry Cooperative Association
Health Science Center Texas A&M University	Texas Medical Center YMCA
Houston Academy of Medicine	Texas Southern University
Houston Hospice	Texas Women’s University
Houston Methodist	The Health Museum: John P. McGovern Museum of Health and Medical Science
Institute for Spirituality and Health	The Texas Medical Center Library
LlfeGift	Thermal Energy Corporation (TECO)
MD Anderson Cancer Center - World’s Largest Cancer Hospital	TIRR Memorial Hermann
Memorial Hermann	University of Houston
Menninger Clinic	University of St. Thomas
Michael E. Debakey High School for Health Professions	UT Health
Michael E. Debakey Veterans Affairs Medical Center	UTMB Health



The University of Texas M.D. Anderson Cancer Center in the Texas Medical Center, ranked #1 in U.S. News & World Reports “Americas Best Hospitals 2016-2017” for cancer care.

Houston Healthcare Industry In The News

The Texas Medical Center's TMCx accelerator program announced in February 2017 that 24 companies have joined the program, the largest cohort since TMCx launched in early 2015. This cohort will focus on digital health while the previous class was dedicated toward medical devices. The TMCx accelerator advances the development of health and medical technology companies by connecting visionary entrepreneurs to the abundant resources of the Texas Medical Center.

Houston Business Journal

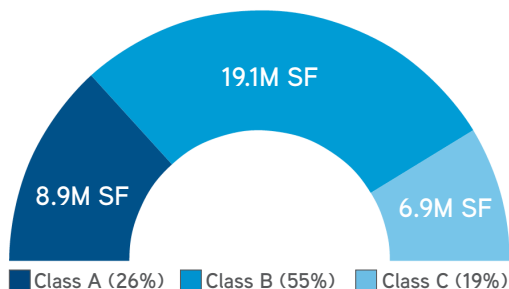


Q4 2016 Houston Medical Office Highlights



Houston's healthcare and social assistance job growth is extremely healthy **growing 16.3% in three years.**

12-Month Percent Change December - December
2015 - 2016 3.6%
2014 - 2015 5.5%
2013 - 2014 7.2%



34.9M SF
Total Inventory

20.3K SF
Net Absorption

12.4%
Vacancy



FOR MORE INFORMATION

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Accelerating success.

Healthcare systems continue to expand into the suburbs as population grows

Lisa Bridges Director of Market Research | Houston

Healthcare Trends Commentary by Beth H. Young

At least two facts come together to make a very healthy medical real estate market: (1) Houston leads the nation in population growth, and (2) the Accountable Care Act requires health care providers to improve care while reducing expenses. The Greater Houston Partnership says healthcare payroll employment grew between June 2015 and June 2016 by 25,000 people. With Houston being home to the world's largest medical center - Texas Medical Center - taking advantage of the economies of scale leads to a strategy for many local health systems to proceed with mergers, acquisitions and expansions.

In spite of low oil prices and related layoffs, Houston's healthcare real estate market continues to expand as it responds to the city's irrepressible growth. Although Houston's office sublease space has increased to over eleven million square feet (as of early August 2016), medical office space being offered for sublease is only about one (1%) percent of that category. Hoping to have an advantage over office buildings with lots of sublease space, some office buildings that were previously considered strictly office properties have started advertising their available space as medical-office buildings (MOB's), particularly if it is located near a hospital or medical campus. Demonstrating why landlords may want to call their property "medical," in the first quarter of 2016, over 116,000 square feet of medical office space was absorbed - and because of the need for that kind of space, over two million square feet of medical office space is currently under construction in Houston.

Although MOB vacancy rates have increased from 11.8 to 12.4 percent in the last year, one must take into consideration new medical office facilities in the market, soon-to-be occupied. A perfect example is the newly opened Spring Valley Medical Plaza, a 68,000 square foot MOB and surgery center along I-10/Katy Freeway near the Memorial Hermann campus. Four of the five floors are leased at opening. The landlord quotes lease rates at \$31.00/NNN per rentable square foot (RSF) per year. Having clinic space plus the ability to provide outpatient procedures that were previously only available in an inpatient setting provides lower cost for patients at a much more convenient location.

Market Indicators

Relative to prior period

	Annual Change	Semi-Annual Change	Semi-Annual Forecast*
VACANCY	↑	↑	↓
NET ABSORPTION	↓	↓	↑
NEW CONSTRUCTION	↓	↓	—
UNDER CONSTRUCTION	↓	↓	↓

*Projected

Summary Statistics

Houston Medical Office Market

	Q2 2015	Q4 2015	Q2 2016
Vacancy Rate	11.8%	11.7%	12.4%
Net Absorption (Thousand Square Feet)	313.9	629.6	116.7
New Construction (Thousand Square Feet)	335.1	821.8	276.2
Under Construction (Thousand Square Feet)	2,762.4	2,760.0	2,070.8

Asking Rents

Per Square Foot Per Year

Average	\$25.11	\$25.42	\$25.02
Class A	\$27.64	\$28.11	\$28.23
Class B	\$24.78	\$25.16	\$24.68

Healthcare Trends - continued

Some MOB's may become less important as a place to treat illnesses and become more relevant as a place for preventive care and wellness. With the goal being to provide an enhanced patient experience and better care, numerous MOB's are being developed within the Inner Loop of Houston and the suburban areas including The Woodlands, along the Highway 290 corridor, in Clear Lake, Sugar Land, Katy, Humble, Kingwood and Tomball. In addition, several rehabilitation and assisted living facilities are under construction in Conroe, Katy, League City (Clear Lake area) and Inner-Loop Houston.

Class A advertised lease rates for medical office space are slightly higher than a year ago, increasing from \$27.64 to \$28.23/gross per RSF per year, while Class B product has decreased by ten cents to \$24.68 per RSF, according to our data provider, CoStar Property. However, recently constructed MOB's are priced near a lease-rate range of \$27.00 - \$32.00/NNN (rather than gross), plus operating expenses ranging somewhere between \$12.00 and \$14.00 per RSF per year.

Notable Expansions/New Developments

Adding to the new development of medical office space, most of the major hospital systems in Houston are building, remodeling and expanding their campuses, particularly in the suburbs. Memorial Hermann Health System acquired the Houston Orthopedic and Spine Hospital, located near the Galleria, adding to its three Ironman Sports Medicine Institutes and seven joint centers around Houston. Memorial Hermann opened a 64-bed hospital in Pearland (south Houston), completed its 100,000 square foot Medical Plaza II (MOB) on the Memorial Hermann Katy Hospital campus, plans to build a five-story patient tower with 90 more patient rooms at their campus in Humble (northeast Houston), is building a 176,000 square foot, six-story medical office building (MOB) in The Woodlands and has a \$14 million expansion project scheduled for completion in 2018 in Houston's southeast region. Late last year, a 23-bed Clinical Decision Unit opened in the Southeast hospital's emergency center; now another 3,000 square feet are being added to accommodate the busy emergency center which sees an estimated 200 patients daily. Memorial Hermann approved plans to invest \$25 million in its Woodlands hospital location for expansion, adding 36 surgical beds, 10 intensive-care unit beds, one cardiac catheterization lab and renovation to the main entrance.

Near The Woodlands, CHI St. Luke's opened its Springwoods Village Hospital on the south side of The Woodlands where ExxonMobil has practically created a new submarket all its own. CHI St. Luke's has also expanded into Lake Jackson (south of Houston on the gulf coast) through Brazosport Regional Health System, one of the area's largest health systems as of early February. CHI St. Luke's added 24/7 emergency locations to its system this year and moved forward with construction on the second phase of its \$1.1 billion McNair campus in the Texas Medical Center. The facility will also house two of their affiliated health brands – the Texas Heart Institute and Baylor College of Medicine.

Job Growth & Unemployment

(not seasonally adjusted)

UNEMPLOYMENT	5/15	5/16
HOUSTON	4.4%	4.8%
TEXAS	4.3%	4.2%
U.S.	5.3%	4.5%

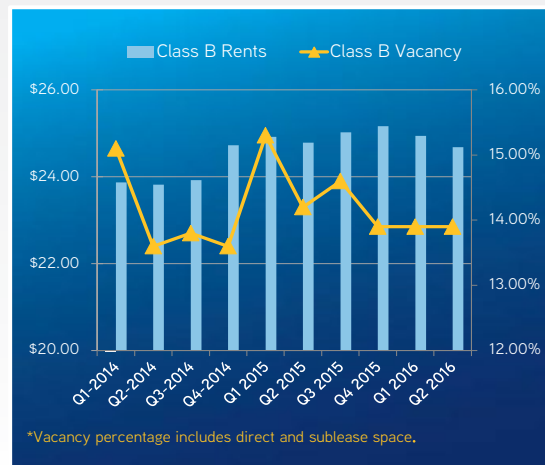
JOB GROWTH	Annual Change	# of Jobs Added
HOUSTON	0.2%	5.1K
TEXAS	1.4%	169.4K
U.S.	1.7%	2.4M

Medical Office

CLASS A RENTS AND VACANCY



CLASS B RENTS AND VACANCY



Notable Expansions/New Developments - continued

Texas Children's Hospital has a new 548,000 square foot facility that will open in The Woodlands in 2017, being the first in the area to offer services exclusively for children and adolescents. Also opening there in 2017 is Houston Methodist's 470,000 square foot hospital. Plans include 187 beds and 600 employees, however, may expand to have as many as 400 beds upon opening.

M.D. Anderson will start construction on a 170,000 square foot facility on 35 acres in Houston's Energy Corridor this year, merging three West Houston operations. Plans include clinical offices, lab/imaging and supportive care, which will begin moving into the new center between 2018 and 2022 as the current leases expire. A little further west in the suburb of Katy, Houston Methodist is expanding the west hospital campus by adding a six-story, 228,000 square foot building with additional beds, OR's, imaging and emergency department.

The University of Texas Medical Branch (UTMB), the largest employer in Galveston county (one of five counties in the greater Houston area and located south of Houston) opened a new 142,000 square foot hospital in League City. On Galveston Island, UTMB opened the new Jennie Sealy Hospital, a 765,000 square foot facility, in April

In the next five years, the Galveston-Brazoria population is expected to exceed 800,000 people; so UTMB is also expanding in Alvin, Angleton and Galveston itself. Clinics in Alvin, Angleton, Dickinson, Friendswood, Lake Jackson, League City, Texas City and Webster are all part of an extensive network of care offered on the south side of Houston, but the system estimates that they need an additional 1,000 doctors to service the area. Bay Area Regional Medical Center opened a Heart and Vascular Center in its Webster hospital, housing some of the latest tools and technology available. The hospital is pursuing a Level III Trauma Designation. By the end of the year, three more floors of private patient rooms will open including medical, surgical and ICU beds. Sacred Oak Medical Center, an 80-bed specialty behavioral hospital, is under construction at Clearpoint Crossing on Space Center Boulevard. Phase one is expected to open in October 2016. The 40,000 square foot building is being renovated from restaurant to medical, and will be expanded to 60,000 square feet once it's open. And in the first partnership of its kind, M.D. Anderson Cancer Center will lease space from UTMB for a treatment center away from the Texas Medical Center.

Sales Activity

Houston's healthcare investment sales activity included 19 transactions, with an average price per square foot of \$227 and an average cap rate of 7.43%. Listed below are a few transactions that closed in the first half of 2016.

Significant Sales Transactions - Q1 & Q2 2016								
BUILDING NAME	SUBMARKET	RBA (SF)	YEAR BUILT	BUYER	SELLER	SALE PRICE	\$/SF	CLOSED
Copperfield Professional Plaza 7825 N Hwy 6	FM 1960/Hwy 249	25,480	1991	DBI Investments, LLC	Terramark	\$3.36M	\$132	Apr-16
Woodlands Medical Arts Center I 17198 St Lukes Way	Conroe/Outlying Montgomery Co	96,199	2001	Physicians Realty Trust	Catholic Health Initiatives	\$21.7M	\$226	Jun-16
¹ Mid-town Surgical Center 2105 Jackson St	Midtown	8,936	1979	Jackson Street Surgical Center, LLC	Mid-Town Surgical Center, LLP	Undisclosed	N/A	Jan-16

¹Colliers International transaction

Sources: CoStar and Real Capital Analytics

Monetization and Acquisitions

Healthcare providers have many reasons to need more capital and consider monetization of some properties. A few of the factors that will have an effect on their books include new government regulations requiring the implementation of EHR's, construction of modern facilities and the requirement for advanced medical devices and additional personnel. Some systems may want to take advantage of the favorable market conditions, have the ability to reinvest the money, enhance the care provided to the communities they serve or simply strengthen their operational and financial performance. With that in mind, monetization is a popular subject. Memorial Hermann Health System demonstrated how to do it by selling a portfolio of 11 MOB's for \$225 million to HCP Inc., a REIT specializing in healthcare properties, including properties in The Woodlands, the southeast, southwest and northwest campuses in Houston. Memorial Hermann, the largest not-for-profit healthcare system in southeast Texas, will lease back the buildings on initial 10-year terms with four 5-year renewals.

The rationale for mergers and acquisitions is to create economies of scale, providing more negotiating leverage and ultimately stronger



Monetization and Acquisitions - continued

balance sheets. 3,144 hospitals are now part of health systems nationwide, an increase of 18 percent in the past decade. Foundation HealthCare Inc. out of Oklahoma City acquired Houston's University General Hospital, which filed for bankruptcy protection in 2015. The newly named Foundation Surgical Hospital of Houston was purchased for \$33 million and is a 69-bed hospital located at 7501 Fannin Street on the south side of the Texas Medical Center (TMC).

Healthcare Trust of America acquired seven properties located on-campus including the 251,000 square foot building next to Tenet Healthcare's Park Plaza hospital on the north side of the TMC. This acquisition increased HTA's investment in the TMC to 425,000 square feet.

Hospital Prices

Revista, a website that specializes in healthcare real estate, published a graph demonstrating the increasing price per square foot for hospital transactions in 2014 and 2015. Covering many specialties of hospitals including acute care, rehab and long-term, the trend showed a continuous quarterly price climb from as low as \$262 per square foot in early 2014 to \$316 per square foot in late 2015.

There have been a handful of old and obsolete hospitals close in the last few years. Vacant hospitals are popular property types for renovations and re-use. Some investors plan to turn them into clinical and ASC locations, while other investors will be operators of safe houses for homeless juveniles, churches and rehabilitation facilities including state-backed penal-system locations to treat drug and alcohol-dependent residents. Prices for older, closed hospitals are usually under 70 dollars per square foot, and it's even more common to see them being offered at purchase prices closer to annual lease rates.

Physician Tenants

Independent physicians are being stressed on renewals based on how much they can afford to pay. Not all doctors can handle rising lease rates. There will be more shared space for clinics or multiple doctors. Some

will want timeshare, co-locating or merging of their businesses. However, many physicians are expanding with second and third office locations from the medical center to the suburbs.

We're being contacted by doctors who signed leases and then learned the quality of property management is not what they had expected. They won't settle for it and are finding ways to break their leases and move to better buildings.

In Houston, some owners of office buildings that are located near hospitals have signed non-compete agreements with the nearby health systems, forcing some medical specialists and medical tenants into the hospitals' adjacent MOB's if they want to be located near the hospitals.

Primary care providers are learning that easy access for patients is key; so many former retail centers near residential areas have become well-leased with medical users, especially if they have emergency departments, urgent care facilities or a large drug store in the project.

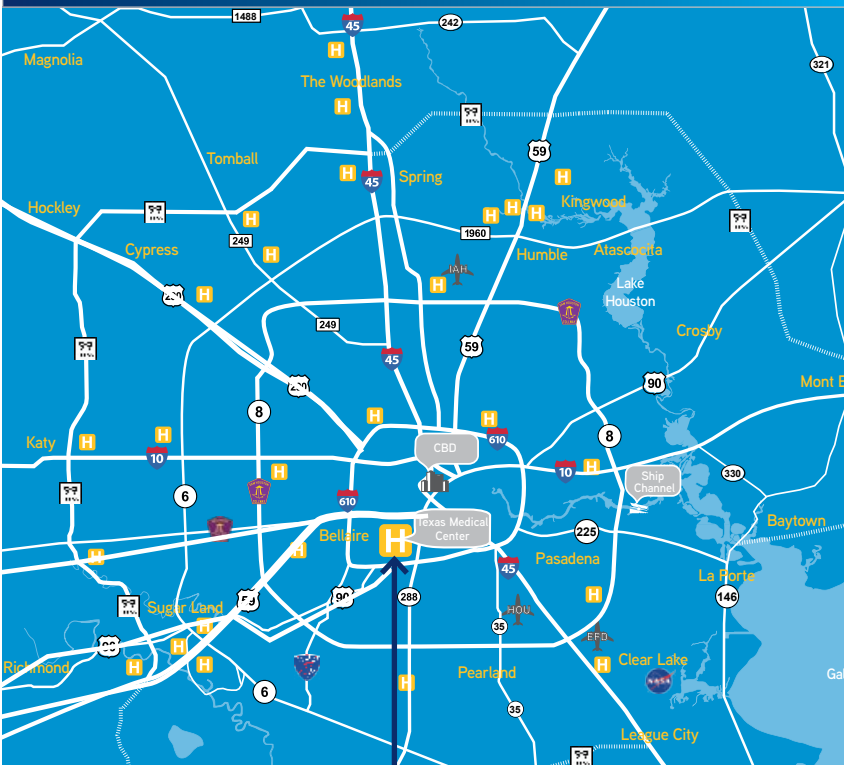
Summary

The outlook for the Houston healthcare market is bright. The plan for better access to higher quality healthcare at a lower cost is happening throughout this giant city. Health systems are building well-equipped hospitals and medical properties in the Texas Medical Center as well as the larger suburbs. They are well planned, flexible, and efficiently modern layouts for multiple specialties, levels of treatment and entertainment. It's not surprising that investors want to own these properties, and medical tenants (and patients) are benefitting from the trends.

Beth H. Young CCIM, LEED AP

A handwritten signature in black ink that reads "Beth H. Young". The signature is fluid and cursive, with the first letters of the first and last names being capitalized and prominent.

Houston Area Hospital Locations



Houston MSA Health Care

- > 128 Hospitals
- > 18,681 Hospital Beds
- > 16,070 Licensed Physicians
- > 299,600 Health Care & Social Assistance Jobs
- > 5.2% Annual Employment Growth (June 2015 - June 2016)

Texas Medical Center Map



Texas Medical Center

- > World's Largest Medical Complex (1,300 Acres)
- > 54 Member Institutions
- > 7.2M Patients Annually
- > 106,000 Employees
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- > 49,000 Life Science Students
- > \$960 Million in Charity Care

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In addition to the medical facilities and institutions of higher learning, TMC is also home to more than 290 professional buildings. Overall, the complex covers over 18 miles of public and private streets and roadways, with 50 million square feet of existing patient, education and research space. TMC has continued to grow and expand over the past several decades with the majority of growth occurring in the past ten years. The Center is located in the 110-acre University of Texas Research Park, a joint effort between the University of Texas Health Science Center, M.D. Anderson and General Electric Healthcare. TMC spends billions of dollars on research and charity care annually.

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Harris Health System	Texas Medical Center Hospital Laundry Cooperative Association
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Houston Healthcare Industry In The News

One of the most iconic medical office towers in the South Main/Medical Center submarket is available for sale in a 3-property portfolio. The 506,000-SF O'Quinn Medical Tower at St. Luke's sits just outside of the Texas Medical Center campus and has 323,000 square feet of medical office space, 100,000 square feet of out-patient and laboratory facilities and 22,000 square feet of retail space.

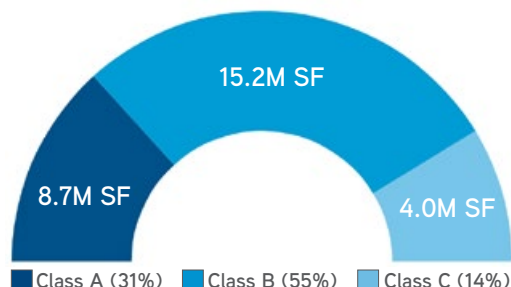


Q2 2016 Houston Medical Office Highlights



Houston's healthcare and social assistance job growth is extremely healthy **growing 12.7% in three years.**

12-Month Percent Change June - June
2015 - 2016 5.2%
2014 - 2015 4.8%
2013 - 2014 2.7%



27.9M SF
Total Inventory

116.7K SF
Net Absorption

12.4%
Vacancy



FOR MORE INFORMATION

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Houston's Texas Medical Center announces expansion plans for new life science hub

Lisa Bridges Director of Market Research | Houston

Healthcare Trends Commentary by Elena Bakina

Houston's population continues to grow despite low oil prices. Hospitals are trying to keep up with this trend by building new facilities and renovating older ones.

Texas medical construction volume of \$7.7 Billion is the second largest in the nation. There is nearly \$5 Billion in development underway or planned for Houston's healthcare sector. A big portion of that is the \$1.5 Billion development of the 30-acre research campus in the Texas Medical Center. The TMC's goal is to establish Houston as a new life science hub and a leader in human health.

Baylor College of Medicine and CHI St. Luke's Hospital announced plans to develop \$1.1 billion medical campus featuring one of the country's top medical schools, a world-renowned cardiovascular research institute, and a nationally recognized hospital that cares for the most complex cases. The campus will feature two bed towers, a medical office building and ambulatory care complex, and new facilities for basic science and translational research. Hospital completion is expected in early 2019.

The Affordable Care Act and aging Baby Boomer population continue to shift ambulatory facilities to off campus locations. Hospitals are building new healthcare facilities to expand access and make those locations more affordable. The retail trend has continued to accelerate. Practices and hospitals are leasing space in retail centers, which are more convenient for many consumers.

The trend of physician owned developments continues, but often times development companies are no longer equity partners. Instead, they act as consultants.

Mergers, acquisitions and other types of partnerships are critical as hospitals focus on providing coordinated, cost-effective care. The most notable consolidation over the last six months was the joining of twelve orthopedic surgeons from the Bone

Market Indicators <small>Relative to prior period</small>	Annual Change	Quarterly Change	Quarterly Forecast*
VACANCY	↑	↓	↑
NET ABSORPTION	↑	↑	↓
NEW CONSTRUCTION	↑	↑	↓
UNDER CONSTRUCTION	↓	↓	↓

*Projected

Summary Statistics <small>Houston Medical Office Market</small>	Q4 2014	Q2 2015	Q4 2015
Vacancy Rate	11.4%	11.9%	11.7%
Net Absorption <small>(Thousand Square Feet)</small>	220.8	292.0	482.4
New Construction <small>(Thousand Square Feet)</small>	203.0	216.1	411.8
Under Construction <small>(Thousand Square Feet)</small>	899.5	794.2	458.6
Asking Rents <small>Per Square Foot Per Year</small>			
Average	\$24.75	\$24.85	\$24.82
Class A	\$27.82	\$27.05	\$26.35
Class B	\$24.69	\$24.76	\$25.09

Healthcare Trends - continued

Joint Clinic of Houston to Houston Methodist Hospital. CHI St. Luke's Health formed joint venture with The Larkin Group and will rebrand five PhysicianER facilities as CHI St. Luke's Health-Baylor St. Luke's Emergency Centers.

The MOB properties are getting larger as smaller physician groups, not able to compete as easily due to the new ACA standards, are consolidating and joining the larger systems. There was a strong growth of neighborhood MOB's in 2015. However it may change this year as a result of new government regulations. The Bipartisan Budget Act of 2015, passed in November, placed restrictions on medical care reimbursements for new off-campus, provider-based properties. Demand for on-campus or campus-adjacent MOB's might increase because that would allow hospitals to continue receiving reimbursements at their current level.

Vacancy & Availability

Houston's medical office market occupancy increased slightly during the second half of 2015 with the citywide average vacancy rate decreasing 20 basis points to 11.7% from 11.9% in Q2 2015.

Sublease space has not had a significant impact on current vacancy rates. Of the 3.1M SF of vacant space on the market, only 80,537 SF or 0.3% is sublease space.

Disciplined medical office development activity has helped prevent major upheavals in current vacancy levels. There were six new buildings (525,114 SF) added to the market during the second half of 2015. Currently, there are ten medical office buildings totaling 458,600 SF under construction.

The largest medical office building currently under construction is the 165,750-SF Class A Memorial Hermann Cypress Medical Office Building located in the Northwest Outlier submarket on Hwy 290 in Fairfield. The 5-story building is 26.7% pre-leased and is expected to deliver in April 2016.

Absorption & Demand

Houston's medical office market recorded 519,775 SF of positive net absorption in the second half of 2015, bringing the year-end 2015 total to 577,850 SF.

By property class, Class B posted the largest amount of positive net absorption in the second half of 2015, posting 483,875 SF of positive net absorption.

Leasing Activity

Houston's medical office leasing activity, which includes renewals, reached 391,646 SF in the second half of 2015, pushing the year-end 2015 total to 846,200 SF.

Job Growth & Unemployment

(not seasonally adjusted)

UNEMPLOYMENT	11/14	11/15
HOUSTON	4.3%	4.9%
TEXAS	4.5%	4.5%
U.S.	5.5%	4.8%

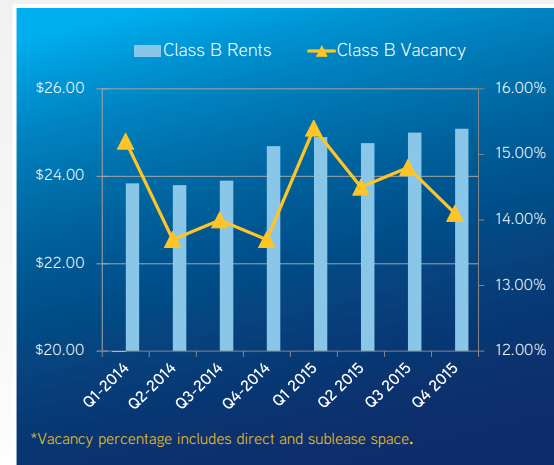
JOB GROWTH	Annual Change	# of Jobs Added
HOUSTON	0.8%	23.7K
TEXAS	1.5%	180.4K
U.S.	1.9%	2.7M

Medical Office

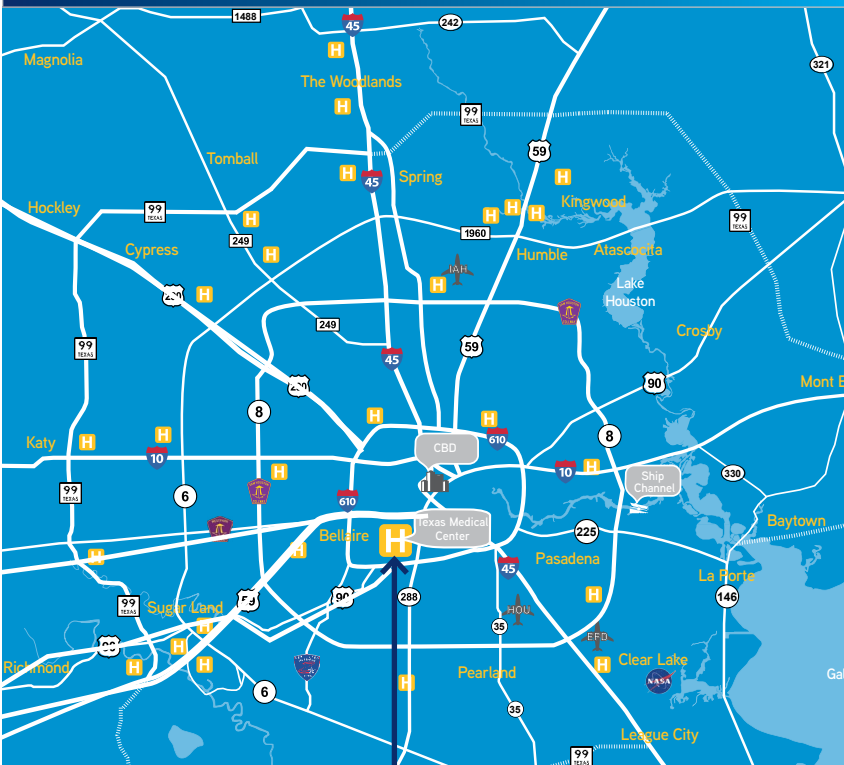
CLASS A RENTS AND VACANCY



CLASS B RENTS AND VACANCY



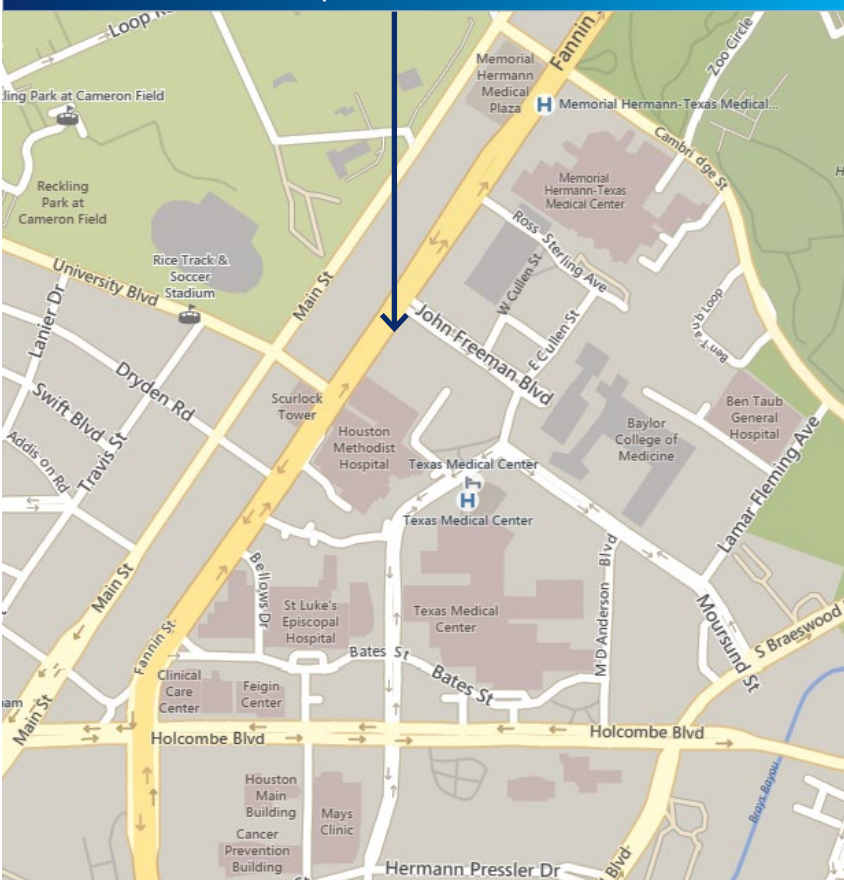
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Sales Activity

Houston's healthcare investment sales activity included 15 transactions, with an average price per square foot of \$232 and an average cap rate of 6.83%. Listed below are a few transactions that closed in the second half of 2015.

Significant Sales Transactions - Q3 and Q4 2015

BUILDING NAME	SUBMARKET	RBA (SF)	YEAR BUILT	BUYER	SELLER	SALE PRICE	\$/SF	CLOSED
1501 River Pointe Dr	Conroe	68,832	2004	Healthcare Trust Inc	Clarion Partners	\$17.3M	\$252	Jul-15
21700-21720 Kingsland Blvd	Katy/Grand Parkway West	107,737	2005	Physicians Realty Trust	Nimble Development, LLC	\$40.4M	\$375	Sep-15
Tomball Medical Center	Northwest Outlier	40,000	2014	Inland Real Estate Acquisitions, Inc.	RoseRock Capital Group	\$15.2M	\$380	Jul-15
Red Oak Plaza	North	50,085	1985	Physicians Realty Trust	Usp Houston Inc	\$6.3M approx.	\$126	Dec-15

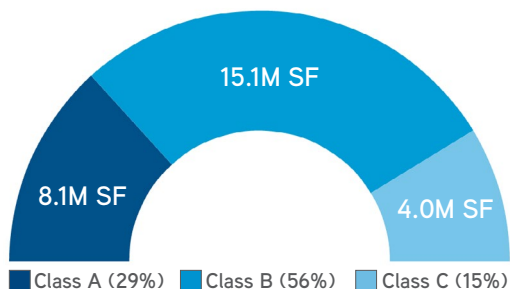
Sources: CoStar and Real Capital Analytics

Q4 2015 Houston Medical Office Highlights



Houston's healthcare and social assistance and ambulatory health care services job growth is extremely healthy **growing 12.1% in three years.**

2014 – 2015 5.5%
2013 – 2014 3.5%
2012 – 2013 3.1%



27.2M SF
Total Inventory
482,400 SF
Net Absorption
11.7%
Vacancy



FOR MORE INFORMATION

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Accelerating success.

Houston's robust healthcare/medical office market drives new development

Lisa Bridges Director of Market Research | Houston

Healthcare Trends

Commentary by Elena Bakina, PhD and Coy Davidson

While low oil prices have negatively affected jobs and growth in Houston's oil industry in the first half of 2015, the health care industry has continued to flourish. Positive changes in the industry due to the Affordable Care Act, and the continued increase of the city's population keep developers busy building additional space for hospitals and clinics.

Hospitals are adding more primary care clinics in retail centers, free standing emergency departments and acute care centers. Hospitals are looking for lease exit opportunities to leave room for flexibility and creativity in lease structure on 10-15 year terms that would allow them to keep expenses off the balance sheets.

A growing number of U.S. doctors are leaving private practice for hospital employment and Houston's major hospital systems are aggressively recruiting physicians, driving leasing activity particularly in suburban submarkets.

Health systems and providers are spending more than \$3 billion to expand and construct hospitals, medical office buildings and specialized medical facilities throughout the Houston area.

Here are some highlights of the most recent healthcare developments in Houston metro area:

- > Houston Methodist Hospital has several expansion projects underway including the construction of a 390-bed In-patient Tower in the Texas Medical Center, the 470,000 square hospital campus in the The Woodlands as well as expansion of both the Sugar Land and West Houston Campus.
- > Kelsey-Seybold Clinic's Main Campus is undergoing a \$30 million expansion and renovation. It's a part of the clinic's \$200 million capital investment across the Houston area in 2015. The clinic will add a 48,000 square-foot wing that will host new cancer treatment services.
- > Tomball Regional Medical Center invested approximately \$3 million in the new 11,000 square-foot freestanding emergency

Market Indicators

Relative to prior period

Annual
Change

Quarterly
Change

Quarterly
Forecast*

VACANCY



NET ABSORPTION



NEW CONSTRUCTION



UNDER CONSTRUCTION



*Projected

Summary Statistics

Houston Medical Office Market

Q2 2014

Q1 2015

Q2 2015

Vacancy Rate

10.6%

11.9%

11.5%

Net Absorption
(Thousand Square Feet)

255.2

-275.5

275.4

New Construction
(Thousand Square Feet)

0

0

216.1

Under Construction
(Thousand Square Feet)

649.7

236.1

794.2

Asking Rents

Per Square Foot Per Year

Average

\$23.99

\$24.99

\$24.82

Class A

\$27.93

\$28.10

\$26.91

Class B

\$23.81

\$25.04

\$24.90

Healthcare Trends - continued

department in Magnolia.

- › Texas Children's Hospital currently has 50 Texas Children's Pediatrics at retail locations and five community healthcare centers and has announced plans to add more. Texas Children's Hospital continues development of their 548,000 square-foot facility in The Woodlands that is expected to open in 2017. The facility is located on a 22 acre lot next to St. Luke's The Woodlands Hospital at Interstate 45 and State Highway 242. The new facility will have 24 emergency center rooms and 74 outpatient exam rooms, 30 acute care beds and 4 operating rooms. Texas Children's Hospital's West Campus is undergoing a \$50 million expansion. The project will happen in phases over the next several years. The first phase, building out the shelled fifth floor, is expected to be opened by the first of October 2015.
- › Memorial Hermann Convenient Care Center in Katy is set to open in June 2015. It offers one-stop access to a vast array of services in a single location with flexible hours and walk-in options. Medical Plaza II in Sugar Land should be completed by December 2015. Memorial Hermann Sugar Land Hospital has already completed several expansion projects and broke ground in January on a medical campus in Cypress. Phase I of the project, which is scheduled to open in early 2016, will include a six-story, 125,000 square-foot medical office building and emergency room. Convenient Care Center will occupy 45,000 square feet in the building.
- › Memorial Hermann Health System recently approved a \$25 million expansion of The Woodlands Hospital's East Tower in addition to a \$17.4 million renovation and expansion of the emergency department. The East Tower expansion is scheduled to be completed by summer 2016, and the emergency department by summer 2017.

New master planned communities in the Houston area have spurred additional medical construction including Signorelli Co.'s construction of a 100-acre medical district on the southern border of Valley Ranch in northwest Houston. Two acute care hospitals and half a million square feet of medical office buildings in the district will serve this 1,400-acre master-planned community upon their completion in late 2016 or early 2017.

In The Heights, Pennsylvania-based Select Medical Holdings Corp. is closing its long term acute care hospital. St Joseph Medical Center currently occupies space in the 191,000 square-foot building.

Another factor driving the healthcare demand upward is the growth in the local baby boomer population. Among the largest metropolitan areas in the nation, Harris County's forecast has the highest percentage of population aged 65+ and the highest absolute change over the next five years. Houston metro area has 208 senior housing facilities and two additional assisted living facilities are currently under construction in Houston area including a 120,000 square-foot facility in The Heights and a 63,000 square-foot facility in Cypress. At The Vision Park in the Woodlands, a 38,000 square-foot congregate senior housing facility is also newly

under construction. Additionally, there are two proposed projects in the pipeline; a 63,000 square-foot assisted living facility in Clear Lake and a 38,000 square-foot congregate senior housing facility in Cypress.

Despite the continued growth of health care facilities, national tendencies in hospital consolidations and bankruptcies are continuing to take place in Houston as well. Houston-based Nobilis Health Corp. has acquired Victory Medical Center Houston, a surgical hospital close to the Texas Medical Center. Nobilis acquired a controlling stake in the hospital for \$1.5 million in cash and leases valued at \$2.4 million. Another Houston-based group, University General Health System, has filed for bankruptcy to restructure its operations and finances. Houston University General Hospital is the company's flagship facility. Last year the company closed its hospital in Dallas and began the sale of its senior-living segment.



Healthcare Trends commentary by
Elena Bakina, PhD Vice President | The Woodlands
Coy Davidson Senior Vice President | Houston



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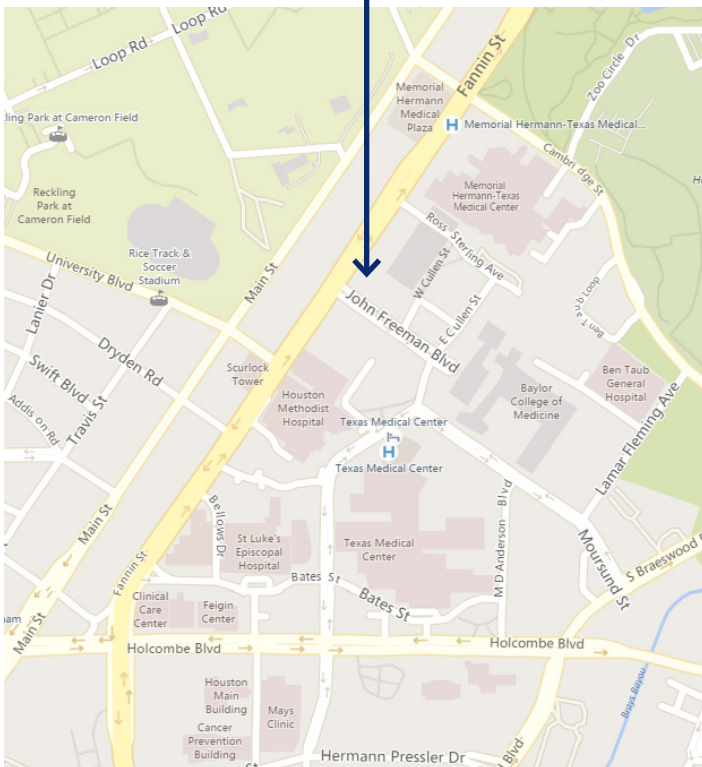
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Houston Area Hospital Locations



Texas Medical Center Map



Job Growth & Unemployment

(not seasonally adjusted)

UNEMPLOYMENT

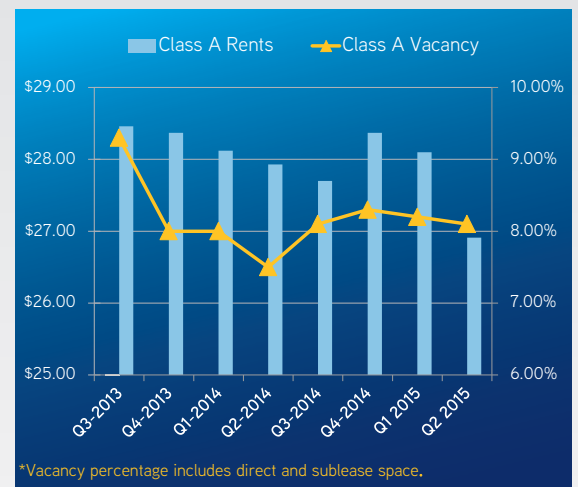
	05/14	05/15
HOUSTON	4.9%	4.2%
TEXAS	5.0%	4.1%
U.S.	6.1%	5.3%

JOB GROWTH

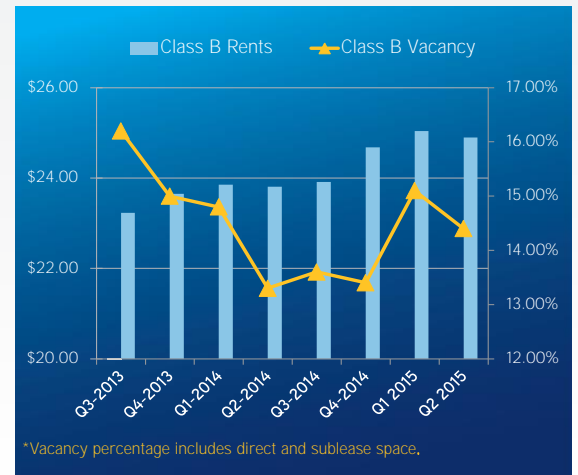
	Annual Change	# of Jobs Added
HOUSTON	2.1%	62.3K
TEXAS	2.5%	287K
U.S.	2.2%	3.1M

Medical Office

CLASS A RENTS AND VACANCY



CLASS B RENTS AND VACANCY



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Sales Activity

Houston's healthcare investment sales activity included 5 transactions, with an average price per square foot of \$132 and an average cap rate of 6.5%. Listed below are a few transactions that closed in the first half of 2015.

Q1 and Q2 2015 Significant Sales Transactions

BUILDING NAME	SUBMARKET	RBA (SF)	YEAR BUILT	BUYER	SELLER	SALE PRICE	\$/SF	CLOSED
22710-22730 Professional Dr	Kingwood/Humble	43,000	2005	Griffin-American Healthcare REIT III, Inc	CKO Properties	\$14.9M	\$348	Mar-15
Friendswood Medical Center	NASA/Clear Lake	14,000	2007	Griffin-American Healthcare REIT III, Inc	Caddis Healthcare Real Estate	\$5.6M	\$205	Feb-15
Bayside Medical Center	Gulf Freeway/Pasadena	51,316	1992/2000	Community Healthcare Trust	Groen Realty Partners	\$6.5M	\$127	Jun-15
Northwest Surgery Center	Northwest	11,200	1979/2004	Community Healthcare Trust	Adrian & Kathleen Varni	\$4.6M	\$411	May-15
Spring Creek Medical Plaza	Northwest Outlier	22,345	2005	Ventas	ARC Healthcare Trust	\$7.0M	\$316	Jan-15

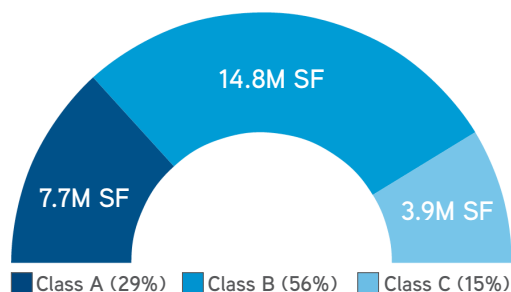
Sources: CoStar and Real Capital Analytics

Q2 2015 Houston Medical Office Highlights



Houston's healthcare and social assistance job growth is extremely healthy **growing 11.9% in three years.**

June 2014 – 2015 4.2%
2013 – 2014 3.4%
2012 – 2013 4.3%



26.5M SF
Total Inventory
275,445 SF
Net Absorption
11.5%
Vacancy



FOR MORE INFORMATION

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HEALTHCARE MARKET COMMENTARY



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Leasing and Investment Trends

BY BETH YOUNG

Everything is bigger in Texas, including healthcare, and the Houston area will continue leading those statistics. Harris County, home of Houston, has 80 hospitals – and it appears that isn't enough. We need more medical real estate.

Several health systems are expanding their hospitals and constructing in additional locations. Houston Methodist, CHI St. Luke's and Texas Children's Hospital ("TCH") are some that have purchased prime land for the expansions. The Texas Medical Center ("TMC") is working on an expansion of 640,000 square feet. Memorial Hermann is expanding with a \$650 million project in the TMC and its hospitals are expanding in Katy and Sugarland. They have purchased a 32-acre site in the Cypress area for an 80-bed acute care hospital, community care medical office building ("MOB") and an emergency center. They are also opening a new 100K SF MOB in Pearland the first quarter of 2015.

Texas has 375 primary care Health Professional Shortage Area designations, demonstrating a serious need for primary care physicians. Because of the long wait to see primary care physicians, and because emergency rooms are so expensive and overcrowded, urgent care centers are rapidly growing. Late in 2014, there were 26 UCAA-certified urgent care centers in Texas – not enough.

Suburban office and retail properties are filling up with general practitioners and family practice providers, while more specialists stay on or closer to the hospital campuses. Multi-specialty properties are continuing to be a trend where a patient can see a primary care provider or be admitted into an emergency department, then go down the hall to a specialist, an imaging center, or a pharmacy, and then have a bite to eat at a restaurant or deli in the building while waiting for x-rays or a

prescription. Efficiency and economy are the guiding forces behind the current trends.

Houston still has the same challenge for investors that other cities do. There are more investors for healthcare real estate than there are properties for sale. No matter what type of healthcare property goes on the market, if it is well leased with good-credit tenants on reasonably long-term leases, the competition is fierce. Cap rates are holding at low levels for better properties.

Property investors and opportunities are clearly divided into categories. For each opportunity, it seems like a small and specialized world. Most investors are very specific about the types of properties they want to purchase. Medical office buildings, surgery centers, dialysis clinics, hospitals, etc. each have their own set of investors. Some buyers are guided by location and specific submarkets. The Woodlands couldn't get much hotter, and just a few miles south, the FM-1960 submarket is still struggling. REITs seemed to control the class A purchases in past years, but more recently, they have lost opportunities to bigger investors – the institutional buyers. High-quality opportunities like on-campus, MOB portfolios being offered by health systems that would lease the properties back are rarely even seen by private investors. Even REITs have found it difficult to compete for those trophies recently.

Private investors still have the largest piece of the pie when you look at healthcare property sales statistics for 2014. In Houston, most purchases over 10,000 square feet were made by private investors. However, a notable sale involved CNL Healthcare Properties, a real estate investment trust (REIT) focused on senior housing and healthcare facilities, which purchased the Houston Orthopedic and Spine Hospital and the attached MOB for an

estimated \$76 million, making it the largest single-property investment in its portfolio.

Other hospital sales included the Humble Surgical Hospital, a 30,000 square foot property, built in 2000 and renovated in 2012, sold for just under \$12 million or \$399 per square foot. The 23,300 square foot Victory Surgical Hospital in East Houston, and the 105,000 square foot Pristine Hospital in Pasadena (also the east side of Houston) represented the extreme differences in values of hospitals with the former selling for around \$500 per square foot, and the latter selling for less than \$50 per square foot.

The Berkeley Eye Center, a 100% occupied, 16,250 SF single-tenant facility was sold for \$357 per square foot and leased back to the seller. 9551 Fannin, one of two buildings sold in a portfolio, was also 100% occupied and is estimated to have brought \$471 per square foot.

At the time of this writing, Memorial Hermann Health System has decided to market for sale an 11-building, one-million square foot, on-campus medical office portfolio totaling more than one million square feet of net rentable area throughout the Greater Houston area. It will be interesting to see who is given the opportunity to be their new landlord. With a portfolio like that, the health system can practically choose whom they want for a landlord.

Overall, the largest individual owners of healthcare real estate are hospitals and healthcare systems, not REITs. Public REITs own about 12 to 15 percent of the real estate. So 85 to 88 percent is owned by other owners and investors, including the hospitals, health systems and private investors.



Healthcare System Real Estate Trends

BY COY DAVIDSON

Houston is known as the energy capital of the world and its reputation as an oil and gas town is well documented. What many outside of the region don't know is that Houston is a major healthcare hub and home to one of the largest medical complexes in the world, The Texas Medical Center.

While the energy industry has been primarily responsible for Houston's stellar job growth, robust economy and hot commercial real estate market, healthcare expansion and job growth was more than significant in Houston in 2014.

While the recent plummet of energy prices is expected to halt job growth in the energy sector and cool off the Houston commercial real estate market, the healthcare sector in Houston is showing no signs of slowing down as hospital systems implement strategies to respond to the Affordable Care Act and meet demand in Houston's rapidly expanding population. All you have to do is scan the recent headlines of the Houston Chronicle or Houston Business Journal and you will see many headlines detailing major hospital system expansions, new construction and merger and acquisition activity.

Here is a look back at recent trends and highlights in Houston Healthcare real estate for 2014.

The Continued Push into the Suburbs

Several of Houston's major health systems implemented aggressive strategies of expanding their reach out to suburban Houston to expand market share and respond to an increase in healthcare services demand for Houston's rapidly growing population.

Houston Methodist Hospital, Memorial Hermann Health System, CHI St. Luke's and Texas Children's Hospital all acquired land for new facilities or initiated expansion of existing facilities in suburban areas such as The Woodlands,

Sugar Land and Cypress in 2014.

In addition, Houston Methodist entered the Clear Lake market and expanded its West Houston footprint with the acquisition of the Christus-St John Hospital in Nassau Bay and the Christus-St. Catherine campus in Katy.

Construction Accelerates in the Texas Medical Center

As the largest medical complex in the world, the Texas Medical Center (TMC) is an internationally recognized community of healing, learning and discovery. Several of the TMC institutions initiated major capital improvement and expansion projects in the Texas Medical Center in 2014.

Some of the projects announced, underway or completed in 2014 include:

The Methodist Hospital will build a \$300 million patient tower and a \$70 million adult outpatient clinic to consolidate services.

Memorial Hermann Medical Plaza, the largest medical office building in the Texas Medical Center, is a 1.5 million square foot, 30-story tower representing a capital investment of \$157.5 million.

CHI-St. Luke's Episcopal Hospital is undertaking a \$200 million expansion project that includes demolishing its original 50-year-old hospital and erecting a 10-story patient care center.

Baylor College of Medicine is building the \$1 billion Baylor Clinic and Hospital on a 35-acre tract of land located in the Texas Medical Center's mid-campus.

M.D. Anderson's addition of nine floors atop its 12-story Albert B. and Margaret M. Alkek Hospital is expected to cost about \$293 million. This expansion will add 478,000 square feet to the hospital's current 755,764 square feet.

Texas Children's Hospital's approved plans to build a 19-story tower on top of

a six-story facility next to the Texas Children's Pavilion for Women in the Texas Medical Center. The 25-floor tower is expected to be complete in 2018.

The Proliferation of Free-Standing Emergency Facilities

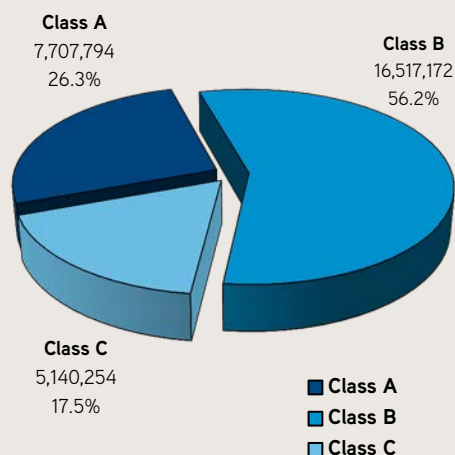
The Affordable Care Act has spurred an initiative among health systems to extend their reach beyond the hospital campus and more health systems are turning to a satellite network of freestanding emergency departments (FEDs) to provide enhanced services in the outlying suburbs to capture additional market share, reduce ER overcrowding and wait times.

The strategy of locating in highly visible, well traveled and convenient locations with attractive demographics where potential patients already frequent retail establishments, these free-standing emergency facilities provide a convenient alternative to hospital emergency rooms.

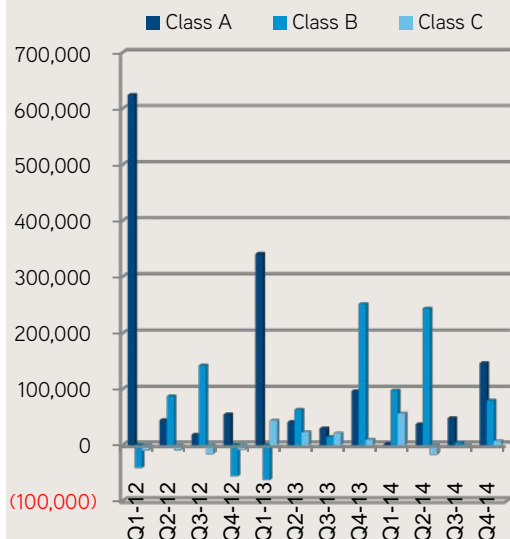
Free-standing emergency departments are staffed by emergency physicians and nurses and operate round-the-clock. They are capable of handling most emergencies as well as stabilizing patients who need to be transferred to a hospital.



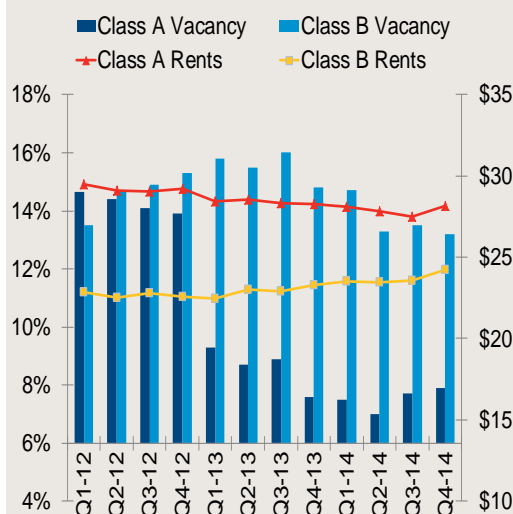
MEDICAL OFFICE EXISTING INVENTORY BY CLASS



MEDICAL OFFICE NET ABSORPTION BY CLASS



MEDICAL OFFICE CLASS A & B VACANCY VS. RENTS



VACANCY & AVAILABILITY

Houston's medical office market occupancy decreased slightly during the second half of 2014 with the citywide average vacancy rate increasing 10 basis points to 11.0% from 10.9% in Q2 2014.

Sublease space has not had a significant impact on current vacancy rates, remaining at 0.2%. Of the 3.2M SF of vacant space on the market, only 52,500 SF is sublease space.

Disciplined medical office development activity has helped prevent major upheavals in current vacancy levels. There were nine new buildings (353,315 SF) added to the market during the second half of 2014. Currently, there are six medical office buildings totaling 371,797 SF under construction.

The largest medical office building currently under construction is the 150,000-SF Class A Springwoods Village Medical Office Building located in The Woodlands submarket. The 6-story building is 33.3% pre-leased and is expected to deliver in September 2015.

ABSORPTION & DEMAND

Houston's medical office market recorded 284,394 SF of positive net absorption in the second half of 2014, bringing the year-end 2014 total to 705,775 SF.

By property class, Class A posted the largest amount of positive net absorption in the second half of 2014, with 194,670 SF, followed by

Class B properties posting 84,000 SF of positive net absorption.

RENTAL RATES

Quoted full-service rental rates for all medical office property classes averaged \$24.29 per SF in Q4 2014, an increase of 3.1% from \$23.57 per SF in Q2 2014.

By property class, on a bi-annual basis, the average Class A rental rate increased by 1.2% from \$27.82 per SF in Q2 2014 to \$28.15 per SF, Class B increased 3.4% from \$23.45 per SF to \$24.25 per SF, and the average Class C rental rate increased 3.1% from \$17.77 per SF to \$18.32 per SF.

SALES ACTIVITY

Transaction activity remained steady between mid-year and year-end 2014, with 13 properties changing hands since July 1, 2014. The majority of the sales that occurred were patient medical centers and the average sales price was \$340 per SF and the average cap rate was 5.95%.

Currently, there are 64 properties listed for sale and 3 pending transactions.

LEASING ACTIVITY

Houston's medical office leasing activity, which includes renewals, reached 378,675 SF in the second half of 2014. By property class, Class B product led the market with 256,175 SF leased.

TEXAS MEDICAL CENTER

The Texas Medical Center (TMC) – the world’s largest medical center – represents one of Houston’s major economic drivers and core industries with an estimated regional annual economic impact of \$15 billion. TMC is also one of Houston’s largest employers with 106,000 employees, including physicians, scientists, researchers and other advanced degree professionals in the life sciences.

The internationally-renowned, 1,345-acre TMC is the world’s largest medical complex with 54 member institutions, including leading medical, academic and research institutions, all of which are non-profit and dedicated to the highest standards of research, education and patient and preventive care. Over 50,000 students – including more than 20,000 international students – are affiliated with TMC, including high school, college and health profession graduate programs. More than 7.2 million patients visit TMC each year, including approximately 16,000 international patient visits.

In addition to the medical facilities and institutions of higher learning, TMC is also home to more than 290 professional buildings. Overall, the complex covers over 18 miles of public and private streets and roadways, with 45.8M SF of existing patient, education, and research space. TMC has continued to grow and expand over the past several decades with the majority of growth occurring in the past ten years. The Center is located in the 110-acre University of Texas Research Park, a joint effort between the University of Texas Health Science Center, M.D. Anderson and General Electric Healthcare. TMC spends billions of dollars on research and charity care annually.

The University of Texas M.D. Anderson Cancer Center in the Texas Medical Center, ranked #2 in U.S. News & World Reports “Americas Best Hospitals 2014-2015” for cancer care.

TMC PATIENT CARE INSTITUTIONS

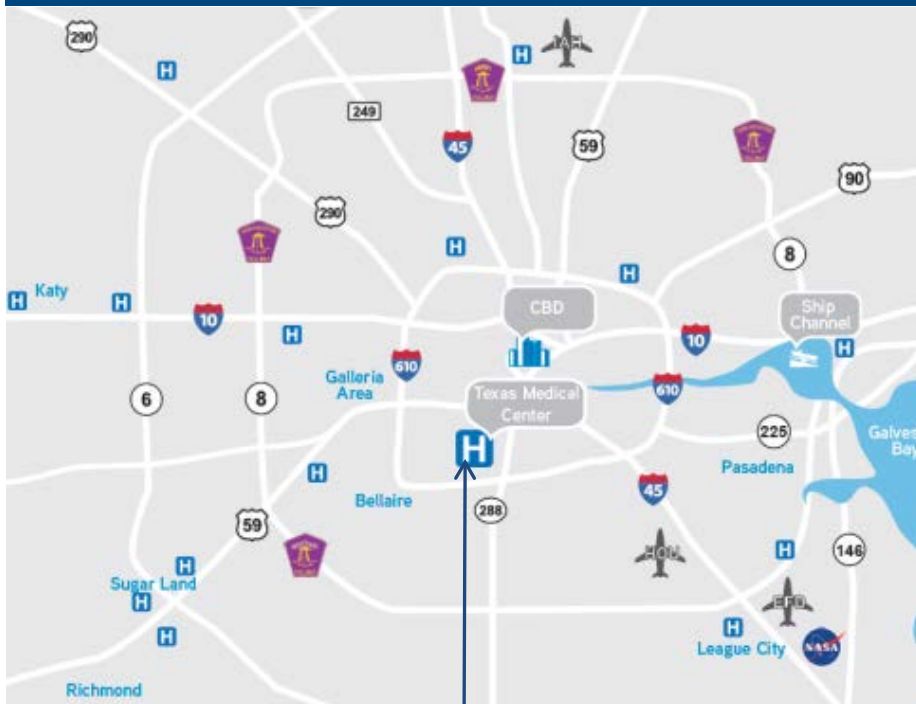


DePelchin Children’s Center
The Menninger Clinic
The University of Texas M.D. Anderson Cancer Center
Texas Children’s Hospital
Memorial Hermann Hospital System
The Methodist Hospital
St. Luke’s Episcopal Hospital
Lyndon B. Johnson General Hospital
Quentin Mease Community Hospital
Ben Taub General Hospital
The Institute for Rehabilitation and Research
The Hospice at the Texas Medical Center
Texas Heart Institute
Shriners Hospitals for Children – Houston
Veterans Affairs Medical Center in Houston

TMC ACADEMIC AND RESEARCH INSTITUTIONS

Sabin Vaccine Institute
The University of Houston – Victoria School of Nursing
Texas Children’s Hospital Neurological Research Institute
Baylor College of Medicine
The University of Texas Health Science Center at Houston
The University of Texas M.D. Anderson Cancer Center
University of Houston College of Pharmacy
Rice University
Texas A&M University Health Science Center
Prairie View A&M University College of Nursing
Texas Woman’s University Institute of Health Sciences
Texas Southern University College of Pharmacy and Health Sciences
Harris County Psychiatric Center
Houston Academy of Medicine

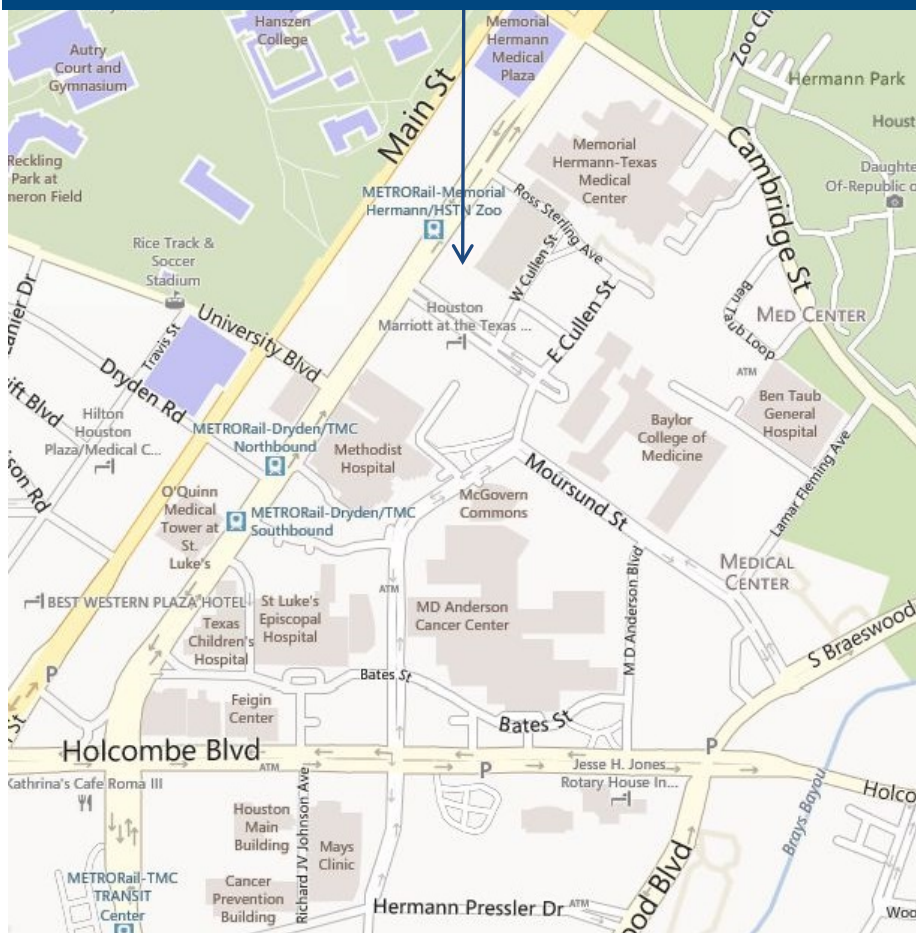
HOUSTON AREA HOSPITAL LOCATIONS



Houston MSA Health Care

115 Hospitals
19,830 Hospital Beds
13,360 Physicians
299,600 Health Care
& Social Assistance Jobs
3.5% Annual Employment Growth

TEXAS MEDICAL CENTER MAP



Texas Medical Center

World's Largest Medical Complex
(1,345 Acres)
54 Member Institutions
7.2M Visits Per Year
106,000 Employees
5,000 Physicians
50,000 Life Science Students
\$960M in Charity Care

The Colliers Advantage

ENTERPRISING CULTURE

Colliers International is a leader in global real estate services, defined by our spirit of enterprise. Through a culture of service excellence and a shared sense of initiative, we integrate the resources of real estate specialists worldwide to accelerate the success of our partners.

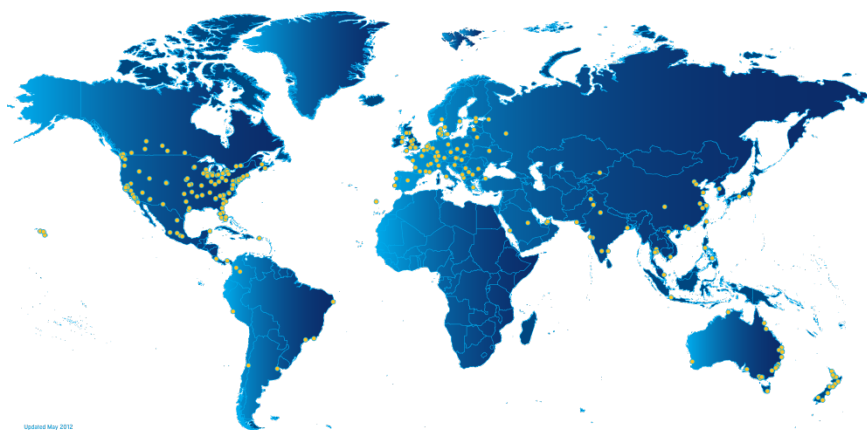
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**Information herein has been obtained from sources deemed reliable, however its accuracy cannot be guaranteed.*



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\$2.1 billion in Annual Revenue

15,800 Professionals | 63 Countries | 485 Offices

\$75 billion in over **80,000** Lease/Sale Transactions

5,800 Advisors | 1.46 billion | Square Feet Managed

Based on 2013 results. Square footage includes office, industrial and retail property under management. Residential property is excluded from this total.



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Trends in Healthcare Real Estate

LEASING AND INVESTMENTS

By Beth Young

For medical office space, the increased emphasis is on smarter decisions to reduce costs and enhance the patient's experience. Changes in the way medical care is provided, suburban location of facilities, and types of buildings are hot topics in healthcare real estate.

Private investors have dominated the purchases in the past year in Houston. New equity has entered the healthcare real estate market. Some non-traded REITs are raising a million dollars per day to invest in medical properties. There is little supply of available investments compared to the money that is chasing the properties.

The competitive environment, given the scarcity of properties and the availability of capital, has kept cap rates low; and they are expected to stay flat for a while.

Some medical office buildings are being master-leased by health systems to accommodate the need for office space by doctors who have made a choice to leave private practice for employment with the hospitals, although the trend of doctors consolidating with hospitals has sharply declined in the last two years. Older properties owned by health systems are facing disposition, renovations, or repurposing. Some of the repurposing options include skilled nursing facilities, post-acute and long-term care, and hospice. Off-campus locations are leasing up twice as fast as traditional on-campus buildings. This is good news for doctors who own a medical office building, but must vacate it in order

to go to work for a healthcare system.

An important trend is the single destination for multiple types of medical care. Kelsey Seybold was a trail-blazer with this trend. Multi-specialty locations will often include emergency departments, ambulatory surgery centers, radiology, pediatrics, orthopedics, common waiting areas, plus snack areas or restaurants, and perhaps even a workout facility. The purpose is to make it convenient and more pleasant for the customer – and health systems are competing ferociously for customers.

Any building with appropriate improvements can be used for medical purposes, and one of the biggest trends for medical office space is in retail centers located close to patients' homes for their convenience. Free-standing emergency and urgent care centers are being developed in all suburbs, frequently in retail centers, which are further leased by doctors of different specialties and dentists.

High-end retail in the stronger submarkets is currently more expensive to lease than Class A office buildings. The convenience of easy access for patients and high visibility for the medical office places retail/medical space in high demand. In addition to the higher rental rate, the cost of improvements to the retail space is often more expensive for the medical tenant because it is usually slab space rather than built-out office space that would only require a renovation or minor changes in an office building.



DEVELOPMENT

By Coy Davidson

Bay Area Regional Medical Center (Webster, Texas), opened to patients in July 2014. The facility is designed and engineered to accommodate 275 patient rooms on 11 floors when it is fully built out.

CHI St. Luke's has begun construction in Springwoods Village on a new medical campus. The first building will be approximately 150,000 SF and will house two floors of ambulatory medical center and four floors of medical office space. It is expected to be completed in late 2015.

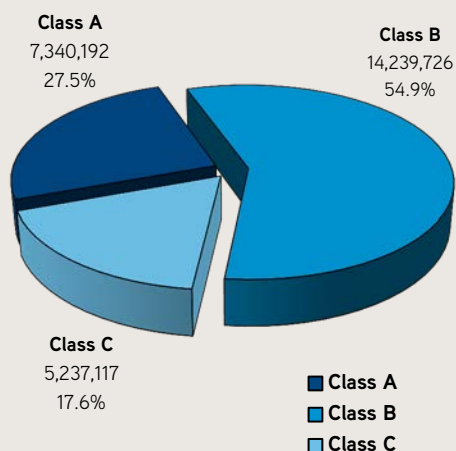
Houston Methodist has acquired 58 acres at Interstate 45 and SH 242 in The Woodlands for development of a new medical campus; and announced plans to build a new 193-bed hospital. Groundbreaking on the new 470,000 square foot hospital is planned for early 2015, with the hospital expected to be completed in 2017. In addition, Houston Methodist has opened two 8,500 square foot free-standing emergency facilities in the suburbs of Pearland and Missouri City.

Memorial Hermann Health System has purchased a 32-acre site in the Cypress area.

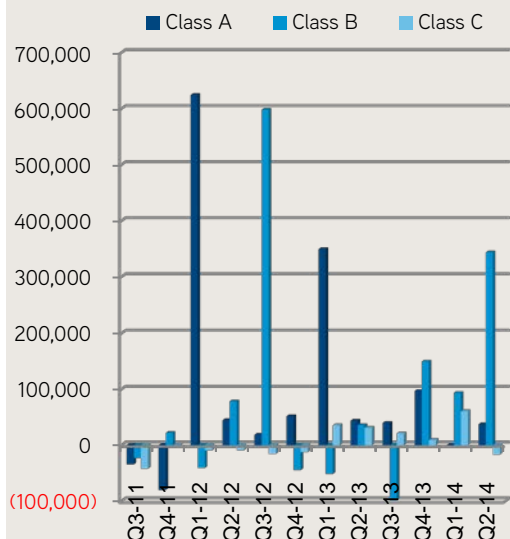
HCP, a publicly-traded health care real estate investment trust, broke ground on a 100,000-square-foot building on the Memorial Hermann Pearland campus in June.



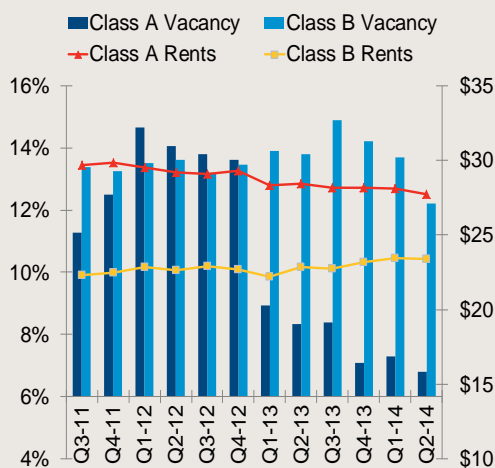
MEDICAL OFFICE EXISTING INVENTORY BY CLASS



MEDICAL OFFICE NET ABSORPTION BY CLASS



MEDICAL OFFICE CLASS A & B VACANCY VS. RENTS



VACANCY & AVAILABILITY

Houston's medical office market occupancy increased during the first half of 2014 with the citywide average vacancy rate decreasing 120 basis points to 10.3% from 11.5% in Q4 2013.

By property class, Class B vacancy rates posted the largest decrease during the first half of 2014, dropping 160 basis points to 12.2% from 13.8% in Q4 2013. Class C vacancy rates decreased 80 bps to 9.3% from 10.1%, while Class A vacancy rates fell 50 basis points to 6.8% from 7.3%.

Sublease space has not had a significant impact on current vacancy rates, remaining at 0.2%. Of the 3.1M SF of vacant space on the market, only 52,000 SF is sublease space.

Disciplined medical office development activity has helped prevent major upheavals in current vacancy levels. There were only five new buildings (201,200 SF) added to the market during the first half of 2014. Currently, there are eight medical office buildings under construction.

Kingwood Medical Centers expansion is almost completed. The 155,400-SF, 3-story tower will house the Kingwood Women's Center. The project is expected to be open July 2014.

CHI St. Luke's has begun construction on the first phase of a new medical center in

Springwoods Village, a 150,000-SF medical office building which is expected to be completed in late 2015.

ABSORPTION & DEMAND

Houston's medical office market recorded 516,778 SF of positive net absorption in the first half of 2014.

By property class, Class B posted the largest amount of positive net absorption in the first half of 2014, with 436,881 SF, followed by Class C properties posting 43,927 SF of positive net absorption and then Class A posting 35,970 SF.

RENTAL RATES

Quoted full-service rental rates for all medical office property classes averaged \$23.36 per SF in Q2 2014, an increase of 0.7% from \$23.19 per SF in Q4 2013. Medical office building landlords continued to offer lease concessions including free rent to credit worthy tenants, but have decreased the amount of tenant improvement packages.

By property class, on a bi-annual basis, the average Class A rental rate decreased from \$28.26 per SF in Q4 2013 to \$27.73 per SF, Class B increased to \$23.40 per SF from \$23.14 per SF, and the average Class C rate decreased from \$18.08 per SF to \$17.54 per SF.

SALES TRANSACTIONS

The Houston Orthopedic & Spine Hospital and Foundation Medical Tower

Bellaire Submarket



RBA: 226,714 SF
Built: 2005
Buyer: CNL Healthcare Properties, Inc.
Seller: Health Care REIT, Inc.
Sale Date: May 2013

*Colliers International Houston Transaction

South Shore Surgicenter

NASA/Clear Lake Submarket



RBA: 7,365 SF
Built: 2009
Buyer: LAIT Texas, LLC/DDIT Texas, LLC
Seller: South Shore Surgicenter
Sale Date: February 2014

*Colliers International Houston Transaction

Humble Medical Office Building

Kingwood Humble Submarket



RBA: 45,000 SF
Built: 2012
Buyer: Griffin-American Healthcare REIT II, Inc.
Seller: K & S Consulting ASC, LP
Sale Date: April 2014
Sale Price: \$13.7M

SALES ACTIVITY

Transaction activity slowed slightly between year-end 2013 and mid-year 2014, with 12 properties changing hands compared to 16 sales in the second half of 2013. According to CoStar Comps, Houston medical building sales transactions in the first half of 2014 had a total sales transaction volume of \$91.5M.

Several of the transactions were multi-property portfolio sales, however, there were several single property transactions that occurred.

Currently, there are 51 properties listed for sale and 1 pending transaction.

LEASING ACTIVITY

Houston's medical office leasing activity reached 305,158 SF in the first half of 2014. By property class,

Class B product led the market with 191,229 SF leased, followed by Class A at 84,456 SF, then Class C at 29,473 SF.

Although the majority of leases signed in the first half of the year were in the 1,000 - 5,000 SF range, there were a few larger lease transactions.

Houston Methodist leased 26,352 SF in the Fannin Medical Plaza located at 7505 Fannin St. in the South Main/Medical Center submarket.

Bio-Medical Applications of Texas, Inc. renewed its lease for 11,150 SF at 8303 Creekbend Dr. in the Southwest submarket.

The bulk of medical office leasing activity has come from Hospital Systems as they aggressively recruit physicians into their organizations.



TEXAS MEDICAL CENTER

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In addition to the medical facilities and institutions of higher learning, TMC is also home to more than 290 professional buildings. Overall, the complex covers over 18 miles of public and private streets and roadways, with 45.8M SF of existing patient, education, and research space. TMC has continued to grow and expand over the past several decades with the majority of growth occurring in the past ten years. The Center is located in the 110-acre University of Texas Research Park, a joint effort between the University of Texas Health Science Center, M.D. Anderson and General Electric Healthcare. TMC spends billions of dollars on research and charity care annually.

The University of Texas M.D. Anderson Cancer Center in the Texas Medical Center, ranked #2 in U.S. News & World Reports “Americas Best Hospitals 2014-2015” for cancer care.

TMC PATIENT CARE INSTITUTIONS

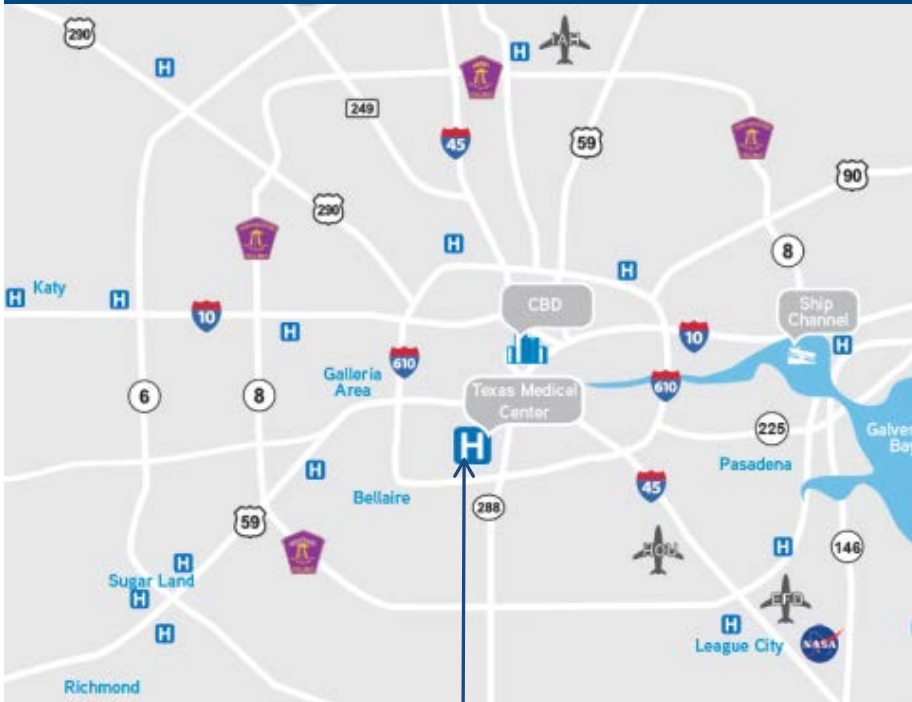


DePelchin Children’s Center
 The Menninger Clinic
 The University of Texas M.D. Anderson Cancer Center
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 Memorial Hermann Hospital System
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 The Institute for Rehabilitation and Research
 The Hospice at the Texas Medical Center
 Texas Heart Institute
 Shriners Hospitals for Children – Houston
 Veterans Affairs Medical Center in Houston

TMC ACADEMIC AND RESEARCH INSTITUTIONS

Sabin Vaccine Institute
 The University of Houston – Victoria School of Nursing
 Texas Children’s Hospital Neurological Research Institute
 Baylor College of Medicine
 The University of Texas Health Science Center at Houston
 The University of Texas M.D. Anderson Cancer Center
 University of Houston College of Pharmacy
 Rice University
 Texas A&M University Health Science Center
 Prairie View A&M University College of Nursing
 Texas Woman’s University Institute of Health Sciences
 Texas Southern University College of Pharmacy and Health Sciences
 Harris County Psychiatric Center
 Houston Academy of Medicine

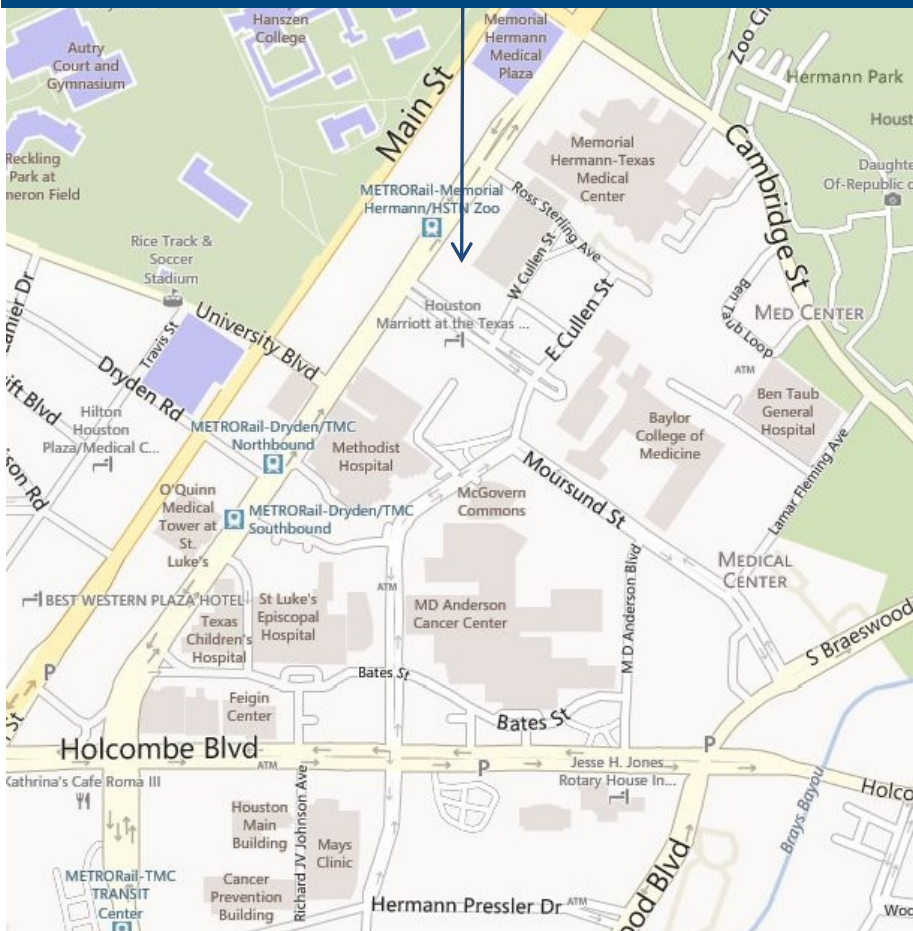
HOUSTON AREA HOSPITAL LOCATIONS



Houston MSA Health Care

115 Hospitals
 19,830 Hospital Beds
 13,360 Physicians
 299,600 Health Care
 & Social Assistance jobs
 3.5% annual employment growth

TEXAS MEDICAL CENTER MAP



Texas Medical Center

World's Largest Medical Complex
 (1,300 Acres)
 54 Member Institutions
 7.2M Patients in 2012
 106,000 Employees
 5,000 Physicians
 49,000 Life Science Students
 \$960 million in Charity Care

The Colliers Advantage

ENTERPRISING CULTURE

Colliers International is a leader in global real estate services, defined by our spirit of enterprise. Through a culture of service excellence and a shared sense of initiative, we integrate the resources of real estate specialists worldwide to accelerate the success of our partners.

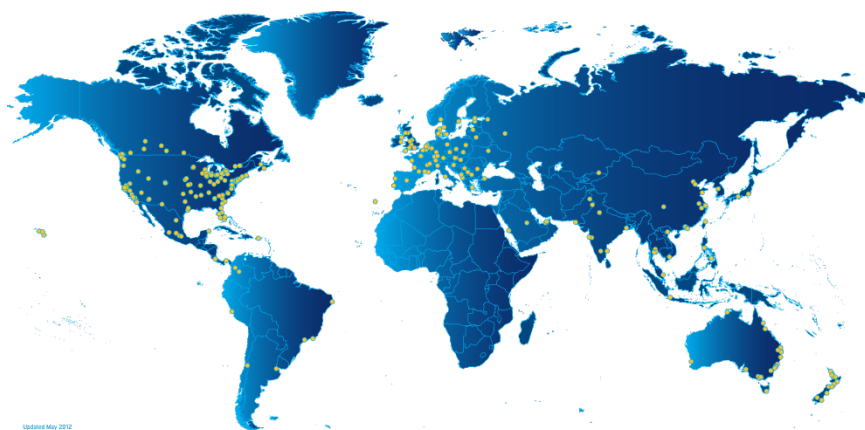
When you choose to work with Colliers, you choose to work with the best. In addition to being highly skilled experts in their field, our people are passionate about what they do. And they know we are invested in their success just as much as we are in our clients' success.

This is evident throughout our platform—from Colliers University, our proprietary education and professional development platform, to our client engagement strategy that encourages cross-functional service integration, to our culture of caring.

We connect through a shared set of values that shape a collaborative environment throughout our organization that is unsurpassed in the industry. That's why we attract top recruits and have one of the highest retention rates in the industry. Colliers International has also been recognized as one of the "best places to work" by top business organizations in many of our markets across the globe.

Colliers International offers a comprehensive portfolio of real estate services to occupiers, owners and investors on a local, regional, national and international basis.

**Information herein has been obtained from sources deemed reliable, however its accuracy cannot be guaranteed.*



COLLIERS INTERNATIONAL AT A GLANCE*

\$2.1 billion in Annual Revenue

15,800 Professionals | 63 Countries | 485 Offices

\$75 billion in over **80,000** Lease/Sale Transactions

5,800 Advisors | 1.46 billion | Square Feet Managed

Based on 2013 results. Square footage includes office, industrial and retail property under management. Residential property is excluded from this total.



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Accelerating success.