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H2C INDUSTRY INSIGHTS • REAL ESTATE

Medical Office Building Quarterly Update

Health Systems Make Strategic Moves in Second Full COVID-19-Impacted Quarter

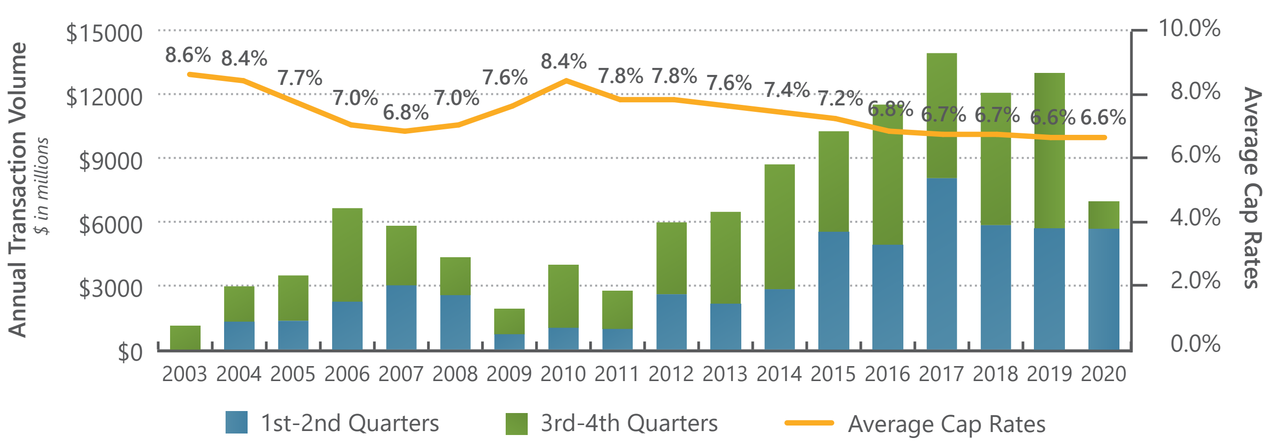
October 2020

Health systems lead third-quarter activity as cap rates show modest compression during a quarter that saw lower transaction volume.

This is H2C's second quarterly medical office building ("MOB") report reflecting the full impact of the COVID-19 pandemic. While COVID-19 continues to weigh on transaction volumes, with volumes totaling only $1.6 billion, marking the lowest quarterly transaction volume since Q1 2014, the MOB sector continues to show remarkable resilience in pricing. Average cap rates saw a slight decline of five basis points in Q3 2020, with the average cap rate for MOBs falling to 6.55 percent.

Health system-based activity made up over 25 percent of the transaction volume in the third quarter, with systems selling and acquiring MOBs. Publicly traded REITs continued to be net sellers, continuing a reversal that began in Q2, when REITs switched from transacting as net acquirers. This reversal is notable given that REITs had been net acquirers of MOBs for four years up until the impact of the COVID-19 pandemic. Select REITs continue to monetize non-core assets and have curtailed acquisitions due to depressed stock prices. While many healthcare REITs have seen improvement in stock prices since the depths of the market decline in March 2020, the majority still trade below their Q1 2020 peaks.

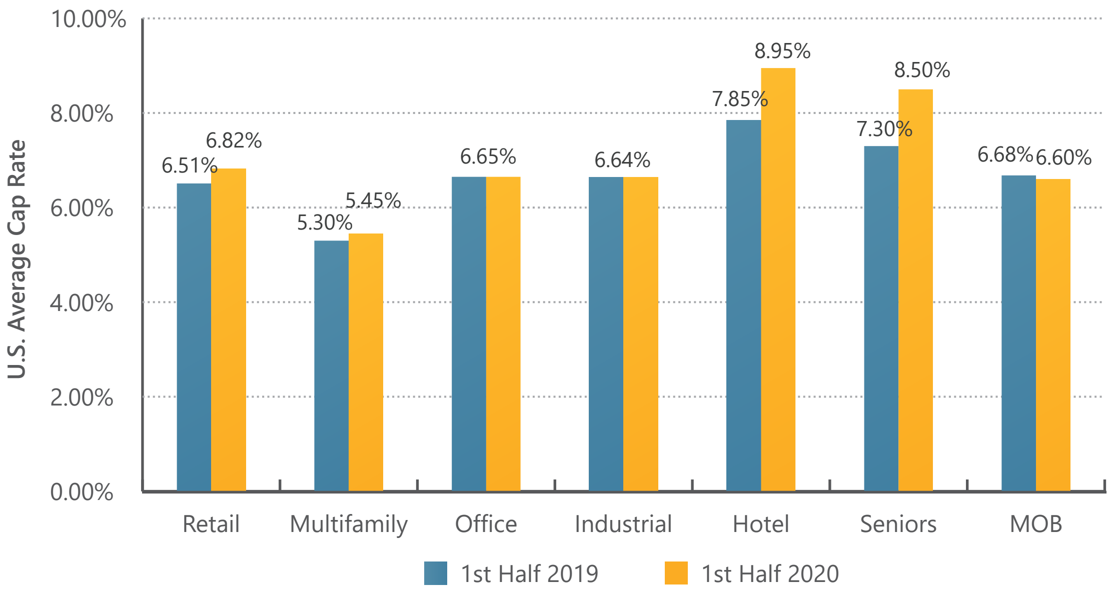
Figure 1: MOB Sales Volume and Cap Rate Trends[1] • *$ in millions*



[1]*Source: Real Capital Analytics*

Despite the limited transaction volume, MOB transaction pricing continues to hold steady, indicating a sustained level of market interest in the MOB space, particularly from private and institutional investors. As cited in previous H2C reports, investors view the MOB space as a "safe haven," where assets serve necessary and growing uses in the provision of healthcare. The uncertainty caused by the COVID-19 pandemic seen in other real estate asset classes, such as retail and hospitality, is increasing investor interest in the stability of the MOB space, which benefits from significant long-term tailwinds, such as an aging population and increased healthcare spending.

Figure 2: Year-over-Year Cap Rate Comparison Across Major Asset Classes[1]



[1]Source: Real Capital Analytics

Low interest rates, high demand, low supply, and capital availability will continue to support values in the MOB sector, despite the lower transaction volumes that are anticipated for 2020. It should be noted that a robust first half of 2020 ("H1 2020"), driven by an active Q1, was only 1.48 percent below H1 2019. This suggests that the sector may see increased transaction volume again as uncertainty due to the COVID-19 pandemic begins to fade and as investor interest in the sector remains strong.

MOB sellers continue to benefit from opportune market conditions, as evidenced by stability in transaction pricing. Current MOB owners considering a sale can potentially reallocate capital currently deployed in MOBs to alternative assets and other growth opportunities. MOB owners exploring alternative asset classes can achieve higher yields through the acquisition of real estate in other sectors that have seen price declines resulting from the COVID-19 pandemic.

As highlighted in H2C's Q2 2020 H2C MOB report, health systems continue to stand out as potential sellers of MOBs in 2020 and future quarters. According to the American Hospital Association ("AHA"), pandemic losses are expected to total $323.1 billion in 2020. Monetizing real estate is often a favorable way to bolster cash positions at attractive yields. Health systems considering MOB sales can potentially utilize the capital raised through asset sales toward new acquisitions, repayment of debt, or as a cash buffer to protect against further financial uncertainty. H2C is the leader in health system real estate monetization, having led the transaction of more health system sales than any other firm. We anticipate that more health systems will look to a potential transaction, often in the form of a sale/leaseback, in the next 12 months.

At the same time, some health systems have been acquiring real estate, often taking advantage of low interest rates and investor demand in the bond market to finance the acquisitions. In the third quarter, a health system advised by H2C acquired a 164,309-square-foot MOB in a Midwest suburb that it leased from a privately held investor at a purchase price of $54 million. By acquiring MOBs in which health systems lease the majority of space and/or look to expand, these systems can realize savings by avoiding paying rent and real estate taxes, in some cases. It is clear that there is "no one size fits all" when it comes to health systems optimizing real estate holdings.

Investment Sales and Trends

In the third quarter's largest transaction, Healthcare Realty Trust (NYSE: HR) sold one property that was 100 percent occupied by Mercy St. Louis (Aa3/A+/NR) to the health system. The property consisted of a 200,000-square-foot comprehensive outpatient care facility in Oklahoma City, Okla. The transaction placed Mercy Health as the largest acquirer of MOBs in Q3. The disposition is one of two scheduled between Healthcare Realty Trust and Mercy Health, with the combined sales proceeds of the two transactions anticipated to be approximately $244.5 million.

After Mercy Health, Israel-based W-D Group was the second largest acquirer of MOBs in Q3, having closed on one $103 million MOB acquisition, followed by Kayne Anderson, which acquired three properties for $92.4 million, and Oak Street Real Estate Capital LLC, which closed on the second and final tranche of a 23-property portfolio acquisition for $88.7 million, a transaction led by H2C.

Figure 3 : Cap Rate Trends[1]

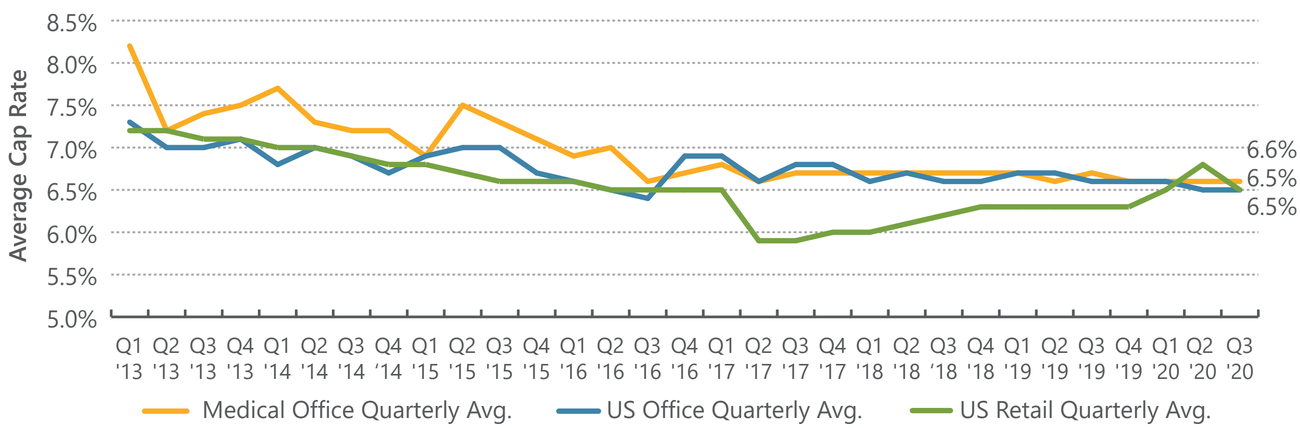
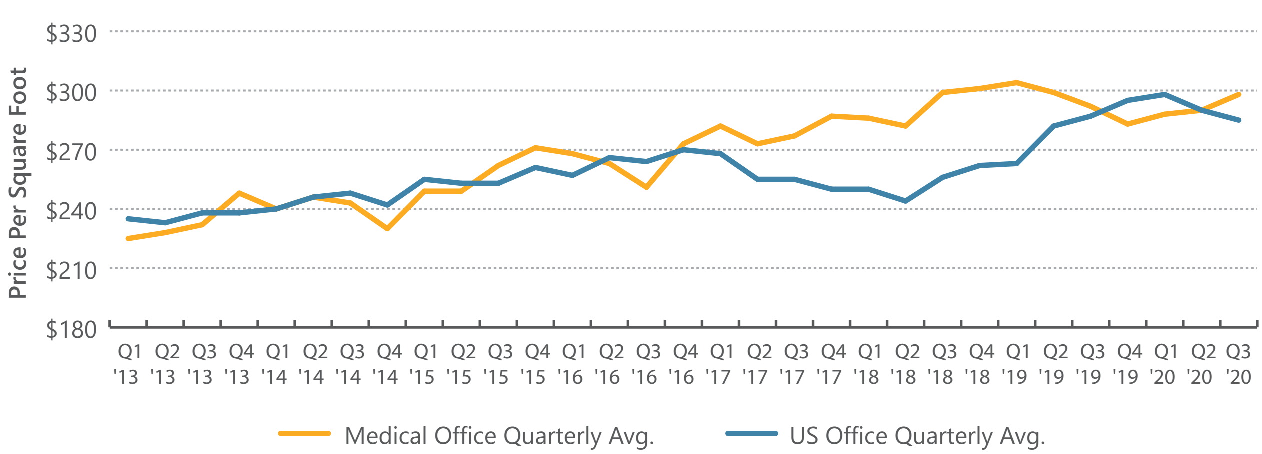


Figure 4: Price per Square Foot Trends[1]

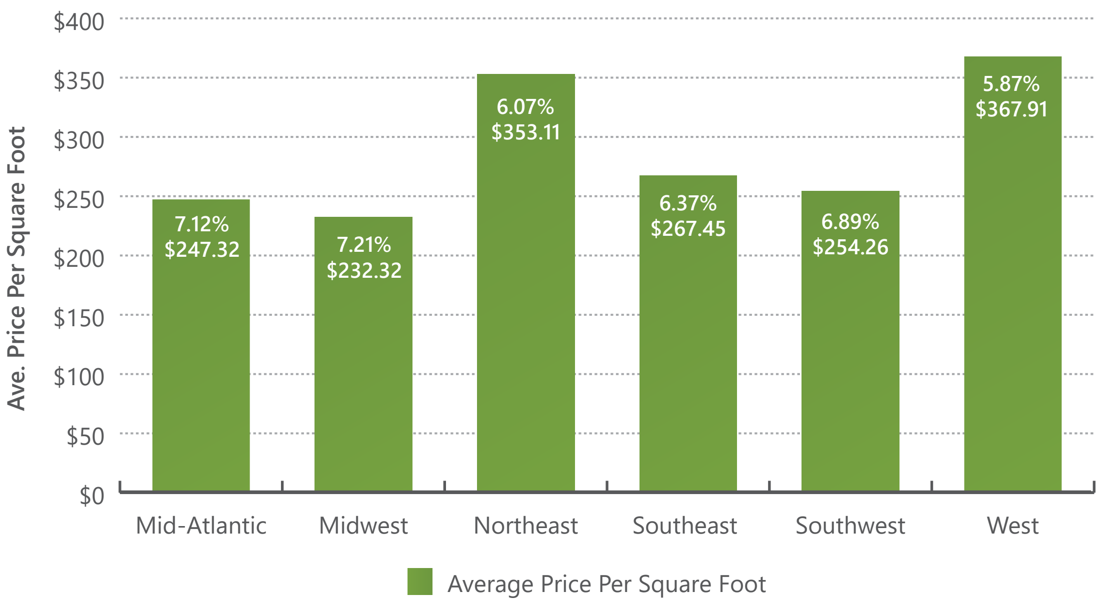


[1]*Source: Real Capital Analytics*

Regional Review

The West region had the greatest transaction volume compared with other RCA-tracked regions, at $410.9 million. Notably, Q3 saw cap rates fall modestly across most regions, with the strongest cap rate compression seen in the Northeast, where cap rates fell 18 basis points to an average transaction cap rate of 6.07 percent. This marks the lowest average cap rates in the Northeast since Q1 2017. Cap rates in the West were the lowest of any region in Q3, with an average transaction cap rate of 5.87 percent. The West also saw the highest average price per square foot among all RCA-tracked regions, with an average price per square foot of $389. This marks a return to the outperformance of the West, which last had the strongest metrics in all three categories of cap rates, transaction volumes, and price per square foot in Q3 and Q4 of 2019.

Figure 5: Average Price Per Square Foot and Cap Rate by Region *(Trailing 12-Month Average)* [1]



[1]*Source: Real Capital Analytics*

Northeast Region

In August, Kayne Anderson acquired 385 Southbridge St. in Auburn, Mass., which is a suburb of Worcester, Mass. The two-story, 98,700-square-foot property is located at the Auburn Mall, and the asset consists of a newly converted department store. Kayne Anderson acquired the asset from Simon Property Group. The MOB was 100 percent leased to Reliant Medical Group, which is part of the OptumCare network and a subsidiary of UnitedHealth Group. The redeveloped facility offers primary care and specialty care services. The $50.3 million purchase price equated to $509 per square foot.

In September, West Concord, Mass.-based Winstanley Enterprises purchased Temple Medical Center, located at 40 Temple St. in New Haven, Conn. The property was previously home to Yale New Haven Health, which provided outpatient services at the location but since relocated the services to its campus. The nine-story building, which was acquired with an adjacent parking garage for $21 million, is expected to be redeveloped in life science and biotech space.

West Region

In September, Israel-based W-D Group acquired 19000 Homestead Rd. in Cupertino, Calif. The two-story, 100,352-square-foot property is 100 percent occupied by Kaiser Permanente (NR/AA-/AA-), which has a lease term until February 2023. The seller was a joint venture between Thor Equities and Harbor Group International. Services provided at the property include behavioral health and psychiatry health. The purchase price of $103 million equated to $1,026 per square foot, nearly a record in the MOB space.

In July, Healthcare Realty Trust acquired a 49,785-square-foot MOB located at 630 S. Raymond Avenue in Pasadena, Calif., for $35 million. The multi-tenant MOB was developed in 2007 and is majority-leased to Huntington Hospital and affiliated practices, with its campus adjacent to the property. Notably, Huntington Hospital is currently under definitive agreement to join Cedars-Sinai Health System (Aa3/NR/AA-) and within close proximity to two other MOBs HRT acquired in 2019 near the hospital campus. The cap rate was reported at 5.4 percent.

Southwest Region

In July, Chicago-based MBRE (since renamed to Remedy Medical Properties) acquired 535 North Wilmont Rd. in Tucson, Ariz. The 40,000-square-foot MOB is fully leased to Banner Health (NR/AA-/AA-), which operates combined primary and specialist care at the facility, including primary care services, psychiatric services, and lab and pharmacy services. The $11.5 million purchase price equated to $291 per square foot.

In September, Rancho Santa Margarita, Calif.-based Cypress West Realty Partners acquired 26224 N. Tatum Blvd. Located in Phoenix, Ariz., Cypress West acquired the property from Healthpeak Properties (NYSE: PEAK). Among the tenants at the facility is HonorHealth (A2/NR/A), which operates a primary care facility at the location. Other tenants include Tatum Highlands Dentistry and Premier Orthodontics of North Phoenix. The purchase price of $5.9 million equated to $219 per square foot.

Midwest Region

In September, a joint venture between MBRE (since renamed Remedy Medical Properties) and Kayne Anderson acquired the MOB portfolio known as the Salt Creek Medical Campus Portfolio. Located at 12 Salt Creek Ln. in Hinsdale, Ill., the portfolio consists of four outpatient MOBs on a single campus encompassing 156,660 square feet. The properties are 85 percent leased to healthcare providers including Edward-Elmhurst Health, AMITA Health, UChicago Medicine, Rogers Memorial Hospital, and the Hinsdale Surgical Center. The purchase price of $51 million equated to $326 per square foot.

In July, Bethesda, M.D.-based Global Medical REIT (NYSE: GMRE) acquired 1 Old Hwy 5 in Centerville, Iowa. The 16,000-square-foot building is 100 percent occupied by MercyOne, and services provided at the facility include family medicine, general surgery, pediatrics, pulmonology, imaging, and radiology. The purchase price of $5 million equated to $318 per square foot. The cap rate reported was 7 percent.

Mid-Atlantic

In September, a joint venture between Washington, D.C.-based Municipal Acquisitions and Children's National Health System (A1/NR/A+) acquired the newly built Children's National Prince George's County from Heritage Partners. The 60,000-square-foot property is 100 percent occupied by Children's National Health System and was developed as a build-to-suit for the health system. The facility includes a pediatric ambulatory surgery center and includes space for pediatric medical offices. The purchase price of $39.2 million equated to $653 per square foot.

In July, Nashville, Tenn.-based Montecito Medical acquired 2321 Atherholt Rd. in Lynchburg, Va. Built in 1975, the 17,000-square-foot MOB is leased to Blue Ridge Ear, Nose, Throat & Plastic Surgery. The purchase price of $4.6 million equated to $274 per square foot.

Southeast

In August, Wilmington, D.E.-based Anchor Health Properties acquired 3929 Peachtree Rd. NE in Atlanta. Known as Brookhaven Medical Center II and built in 2020, the 51,429-square-foot property is 100 percent occupied by Piedmont Physicians of Brookhaven. Specialties provided at the location include ENT, dermatology, orthopedic, ophthalmology, and pulmonary services. The property is located 10 miles northeast from downtown Atlanta. The purchase price of $29.8 million equated to $579 per square foot.

In July, Healthcare Realty Trust acquired 400 Tower Rd. in Marietta, Ga. The 48,145-square-foot property spans three stories and is adjacent to the Wellstar Kennestone Hospital. Fully occupied at the time of sale, tenants at the facility include Georgia Lung Associates and PainSolutions. The purchase price of $20.5 million equated to $422 per square foot. The cap rate reported was 6.2 percent.

About Hammond Hanlon Camp LLC

HAMMOND HANLON CAMP LLC (H2C) is an independent strategic advisory and investment banking firm with a singular focus on healthcare. Our commitment to exceed our clients' expectations begins with senior leadership on every engagement and continues with independent and objective strategic advice. Our belief in the markets and in the power of competition has resulted in loyal clients and long-term relationships.

The experienced professionals at H2C are well positioned to serve as your trusted advisors. We have the expertise to understand the unique complexities of the healthcare industry and an in-depth knowledge of the range of potential alternatives essential to designing and implementing highly successful business and financial strategies. We bring in-depth knowledge and experience across the full continuum of care and across a wide range of healthcare-related businesses.

H2C offers services in the following areas:

- Strategy design, development, and execution
- Mergers, acquisitions, and divestitures
- Capital planning and management
- Capital markets financial advisory and private placements
- Real estate advisory and transaction execution services
- Bankruptcy and restructuring

Real Estate Investment Banking Practice

For more than 20 years, the real estate investment banking professionals at H2C have successfully served as advisors on real estate transactions in excess of $12.5 billion nationwide. For more information on our real estate advisory group, please contact one of the following H2C professionals or visit our website at h2c.com.

Philip J. Camp
Principal
212 257 4505
pcamp@h2c.com

Brady R. Stern
Director
312 508 4203
bstern@h2c.com

Matthew T. Tarpley
Vice President
212 257 4516
mtarpley@h2c.com

Mitchell J. Levine
Associate
212 257 4519
mlevine@h2c.com

E. Chris Byrns
Associate
212 257 4518
cbyrns@h2c.com

Stuart L. Gilbert
Analyst
212 257 4506
sgilbert@h2c.com

Evan T. Gaines
Analyst
212 257 4534
egaines@h2c.com

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H2C Offices

ATLANTA
3333 Piedmont Road
Suite 725
Atlanta, GA 30305
402 937 1350

CHICAGO
311 S. Wacker Drive
Suite 5425
Chicago, IL 60606
312 508 4200

NEW YORK
623 Fifth Avenue
29th Floor
New York, NY 10022
212 257 4500

SAN DIEGO
4655 Executive Drive
Suite 280
San Diego, CA 92121
858 242 4800