MedicalOffice
RESEARCH REPORT

Marcus & Millichap

Midyear 2007

FAVORABLE DEMOGRAPHICS PUT MEDICAL OFFICE IN SPOTLIGHT

The long-term outlook for the medical office market remains bright, supported by strong tenant demand generated by the healthcare needs of the nation's aging population. Over the next 10 years, the 55-plus population is expected to increase 25 percent, or by 15 million individuals, a trend not lost on investors or developers. In nearly every major market in the United States, construction of medical office space remains at peak levels, supported by demand from all facets of the healthcare industry. Total square footage slated for delivery in 2007 is anticipated to surpass last year's level and will be well above the annual average over the past five years. As a result, medical office vacancy is expected to rise temporarily as new inventory is delivered, though the long-term need for medical office space will keep supply and demand in line. Average asking rents, meanwhile, are forecast to increase at a moderate pace.

Investor demand for medical office properties will remain elevated, and heightened competition among investors has caused recent cap rate compression. Cap rates currently average in the low-7 percent range, and while demand will remain strong for medical office properties, recent increases in the cost of capital could cause cap rates to rise subtly in the near term. Once viewed as a higher-risk specialty asset, medical office properties have clearly become mainstream for private and institutional investors. Long-term leases and low tenant turnover, combined with a stable market outlook and advancing medical technology, point to a positive future.

Job Growth 2007 Forecast 1.3% Increase

Economy: Nationwide, employers are on pace to create 1.7 million new jobs by year end, a 1.3 percent gain. The educational and health services sector, which encompasses most medical professions, is expected to lead growth, increasing by approximately 500,000 new positions, or 2.8 percent.

55+ Population 2007 - 2017 Average 2.3% Increase

Demographics: Over the past 10 years, the 55-plus population has expanded at an average annual rate of 1.8 percent, making this segment the fastest-growing age group nationwide. Growth is expected to accelerate to 2.3 percent annually over the next 10 years, which is nearly three times the rate of the next fastest-growing age cohort.

Construction 2007 Forecast 14.5 Million Square Feet

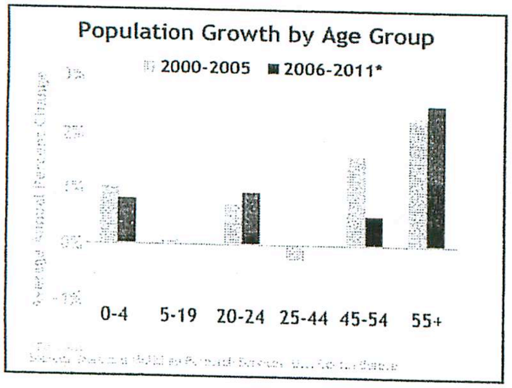
Construction: Developers are slated to add 14.5 million square feet of medical office space in 2007. This year's deliveries will represent an increase of 9.5 percent from 2006, and current construction levels remain significantly higher than the average of nearly 8.6 million square feet brought online annually since 2000. The Mountain/Southwest region will receive 3.8 million square feet, or 26 percent of all new space nationally.

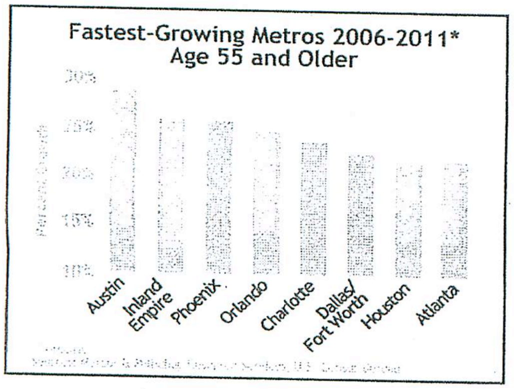
Vacancy 2007 Forecast Up 10 Basis Points

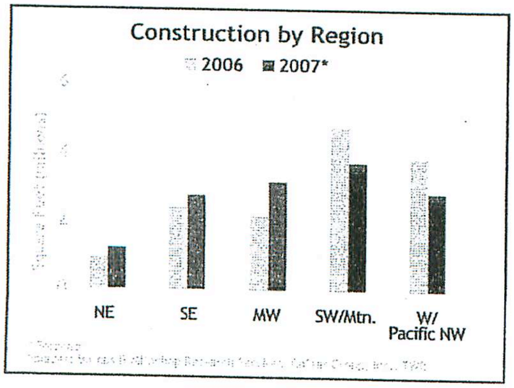
Vacancy Trends: Deliveries in the Northeast and Midwest regions have pushed the nationwide vacancy rate higher over the past 12 months. Looking forward, elevated construction activity will nudge vacancy up 10 basis points by year end to 9.7 percent.

Asking Rents 2007 Forecast 4.0% Increase

Rent Trends: Increasing tenant demand for medical office space, coupled with the prevalence of new, high-end Class A space, has pushed nationwide rents higher. Average asking rents are forecast to advance 4 percent to $23.73 per square foot full service by year end.







Regional definitions available on page four.

National Trends

- **Demographic Trends:** Positive demographic trends will continue to support an optimistic outlook for the medical office market and will remain one of the leading drivers for both new development and investment activity. The population of individuals entering the 55-plus age group will skyrocket over the next 10 years, fueling expansion in the medical services industry. The investment outlook and asset performance of medical office properties will remain strong in high population growth areas, specifically the Mountain/Southwest region, which is expected to lead the nation in population growth in the 55-plus age cohort over the next five years.

- **Construction Trends:** Developers are expected to deliver 14.5 million square feet of space by year-end 2007, up from 13.2 million square feet in 2006 and above the annual average of 8.6 million square feet since 2000. An increasingly popular trend in medical office construction is the development of medical office buildings anchored by ambulatory surgery centers, often in joint ventures with hospitals and physicians. These ventures are perceived as mutually beneficial, as they provide an ownership stake for the physician, while keeping the income stream generated by the surgery center on the hospital's books.

- **Rent and Vacancy Trends:** Over the past 12 months, vacancy has increased 70 basis points to 9.6 percent. Elevated construction will keep vacancy within the mid- to high-9 percent range over the next year, as new space is absorbed in the coming quarters. Nationwide vacancy is forecast to end 2007 at 9.7 percent, up 10 basis points for the year. Elevated construction and the prevalence of premium Class A space has driven asking rents 4 percent higher over the past year to $23.36 per square foot. By year end, rents are expected to reach $23.73 per square foot full service, an increase of 4 percent from year-end 2006.

- **Investment Trends:** Confidence in the future of the medical office market is fueling robust investor demand, and more institutions are becoming active buyers. Over the past year, transaction velocity has increased 9 percent, and the median sales price has risen 6.4 percent to $200 per square foot. Cap rates are averaging in the high-6 to low-7 percent range, down nearly 40 basis points over the past year.

Northeast

- **Construction Trends:** Builders are expected to deliver 1.1 million square feet in 2007, up from 860,000 square feet last year. Developers are focusing on Northern New Jersey and Manhattan. These two areas are experiencing the fastest growth in the 55-plus age cohort in the Northeast.

- **Rent and Vacancy Trends:** Construction activity has exceeded tenant demand over the past 12 months, pushing vacancy up 170 basis points to 10.3 percent. As new supply comes online through year end, vacancy is forecast to rise modestly to the mid-10 percent range. Higher vacancy has led to a slight 1.8 percent decline in asking rents to $24.15 per square foot full service over the past year. Rents are expected to stabilize during the second half of 2007.

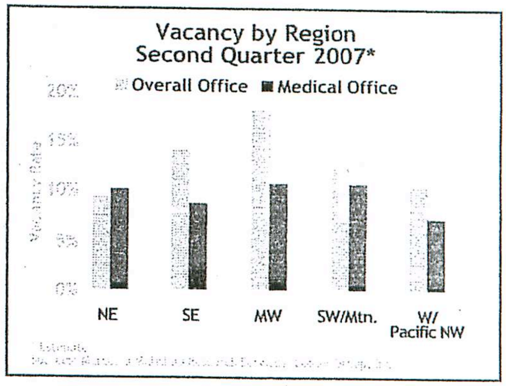
- **Investment Trends:** The stable economic environment and projected positive demographics of the Northeast have kept investor demand for properties elevated. As a result, transaction velocity has increased 10 percent over the past year. In addition, the median sales price is currently $179 per square foot, up 6 percent year over year, as competition among investors has driven prices higher. Cap rates are averaging in the high-6 percent range, down from the mid-7 percent range one year ago.

SOUTHEAST

- **Construction Trends:** Developers are expected to deliver 2.8 million square feet this year, slightly more than the 2.4 million square feet added in 2006. The largest increase will occur in South Florida, where 1.3 million square feet is scheduled for completion, compared with 800,000 square feet last year. The rise in construction is due to the abundance of retirees in South Florida.

- **Rent and Vacancy Trends:** The long-term outlook for the Southeast remains promising, as the region continues to attract retirees, supporting demand for medical office space. Over the past year, however, elevated construction has pushed vacancy up 90 basis points to 8 percent. Vacancy is expected to record a 20 basis point gain for the year, as new space continues to lease up. New Class A space has stimulated asking rent growth of 4.2 percent over the past year to $22.24 per square foot full service. Asking rents are expected to reach $22.36 per square foot in 2007, a gain of 4 percent.

- **Investment Trends:** Increasing tenant demand and solid long-term fundamentals continue to boost property prices. While transaction velocity has declined 22 percent over the past year, prices have appreciated 8.6 percent to $191 per square foot. In turn, cap rates have compressed 10 basis points to the high-7 percent range.

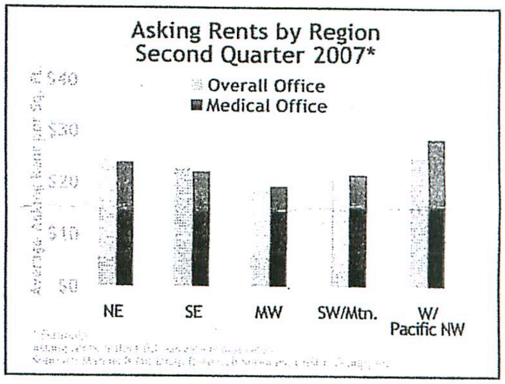


MIDWEST

- **Construction Trends:** Developers are scheduled to deliver 3.1 million square feet of medical office space this year, up 41 percent from 2006 and well above the annual average of 2 million square feet since 2000. Construction in Indianapolis accounts for 16 percent of new deliveries in the Midwest, as developers continue to target residential expansion north of the metro.

- **Rent and Vacancy Trends:** Vacancy has increased 190 basis points over the past 12 months to 11.9 percent, primarily due to the delivery of new space. Given the modest population growth projected for the next year, vacancy will likely remain in the mid- to high-11 percent range in 2007. Average asking rents in the region are currently $19.40 per square foot full service, a 4.8 percent increase from one year ago. By year end, asking rents are expected to reach $20.08 per square foot, a gain of 4.1 percent for 2007.

- **Investment Trends:** Transaction velocity has increased 8 percent over the past 12 months, but the median price has remained unchanged at $139 per square foot. Over the same period, cap rates in the region have held firm in the high-7 percent range.

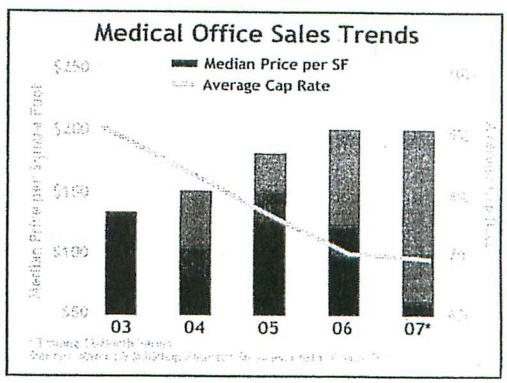


SOUTHWEST/MOUNTAIN

- **Construction Trends:** After completing 4.7 million square feet in 2006, sustained economic expansion and population growth will drive another healthy year of construction as an estimated 3.8 million square feet of medical office space will be added to the Mountain/Southwest region in 2007.

- **Rent and Vacancy Trends:** Despite another year of strong employment and population growth, vacancy has increased 60 basis points over the past 12 months to 11.7 percent, but will likely fall to 11.3 percent by year end as new deliveries fall short of demand. Asking rents have gained 3.2 percent year over year to $22.18 per square foot full service. Strong demand is expected to result in accelerating rent growth of nearly 4 percent to just over $23.00 per square foot in 2007.

- **Investment Trends:** Over the past 12 months, transaction velocity has decreased 3 percent, while the median sales price has climbed 19 percent to $179 per square foot. Cap rates are averaging in the mid- to high-7 percent range, down approximately 40 basis points from 12 months ago.



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HEALTHCARE REAL ESTATE GROUP

Marcus & Millichap's Healthcare Real Estate Group is comprised of real estate investment professionals who specialize in healthcare properties nationwide. In addition to offering specialized market knowledge, members of the Healthcare Real Estate Group are able to the leverage the firm's network of more than 1,300 investment professionals to help clients meet their investment objectives.

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West/Pacific Northwest

- **Construction Trends:** After delivering 3.9 million square feet of medical office space to the region over the last 12 months, an increase of 79 percent over the same period one year earlier, developers are projected to add 2.9 million square feet in 2007. San Diego will lead the region in new medical office stock, with completions estimated at 550,000 square feet.

- **Rent and Vacancy Trends:** Following the substantial additions to inventory over the past year, medical office vacancy has increased 60 basis points to 7.4 percent. Tenant demand will remain strong, pushing vacancy down 30 basis points to 7.1 percent by year end. Average asking rents have gained 3.8 percent over the past 12 months to $29.06 per square foot full service. By year end, rents are expected to reach $29.43 per square foot, a gain of 3.7 percent.

- **Investment Trends:** Transaction velocity has declined 9 percent over the past year, primarily due to a decrease in available for-sale inventory. While deal flow has eased, prices continue to appreciate. Regionally, cap rates are currently in the mid-6 percent range, virtually unchanged over the past year. The median sales price has advanced 4.3 percent over the past 12 months to $245 per square foot. Strong investor demand in Portland has pushed the median sales price up nearly 18 percent to $214 per square foot, leading the region in price appreciation over the past year.

Sales Highlights

Property Name	City, State	Sales Price	Square Feet	Price/SF
Wilshire-Spalding Building	Beverly Hills, CA	$41,850,000	63,286	$661
Newport Superior Medical Plaza	Newport Beach, CA	$15,400,000	35,825	$430
Paradise Valley Medical Plaza	Scottsdale, AZ	$21,450,000	50,695	$423
Tonopah Medical Building	Las Vegas, NV	$8,125,000	19,566	$415
Laguna Hills Square	Laguna Hills, CA	$20,725,000	51,683	$401
Medico-Dental Building	San Francisco, CA	$45,290,000	129,000	$351
Scottsdale Medical & Professional Building	Scottsdale, AZ	$12,000,000	36,700	$327
Suburban Wellness Center	Germantown, MD	$19,402,500	63,210	$307
University Medical Plaza	Sugar Land, TX	$6,900,000	22,772	$303
Toluca Lake Center	Burbank, CA	$12,200,000	41,388	$295
Bedminster Medical Plaza	Bedminster, NJ	$10,625,000	38,004	$280
Eastridge Medical Center	Highlands Ranch, CO	$7,325,000	30,000	$244
Alexandria Professional Center	Alexandria, VA	$26,900,000	113,048	$238
Monterey Professional Center	Boynton Beach, FL	$10,100,000	50,000	$202
Wallingford Plaza	Seattle, WA	$6,000,000	31,774	$189
Heritage II Office Center	Maywood, NJ	$4,800,000	30,000	$160
Prudential Centre	Indianapolis, IN	$9,435,000	66,000	$143
Thunderbird Medical Plaza II	Glendale, AZ	$8,372,000	59,167	$142
St. Vincent Medical Office Building	Cleveland, OH	$5,610,000	51,385	$109

Regional Definitions:
Midwest: Chicago, Cincinnati, Cleveland, Columbus, Detroit, Indianapolis, Milwaukee, Minneapolis
Northeast: Boston, New York City, Northern New Jersey, Philadelphia, Washington, D.C., metro area
Southeast: Atlanta, Charlotte, Orlando, South Florida, Tampa
Mountain/Southwest: Austin, Dallas/Fort Worth, Denver, Houston, Phoenix, Tucson
West/Pacific Northwest: Inland Empire, Las Vegas, Los Angeles, Oakland, Orange County, Portland, Sacramento, San Diego, San Francisco, San Jose, Seattle

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