

MARKET VOLATILITY AND DECLINES NOT AFFECTING HEALTHCARE REAL ESTATE AND M&A

Even with constant changing forces disrupting the healthcare industry, the medical office investment market and mergers and acquisitions activity continue to have a significant impact. In this report, healthcare real estate industry leaders Global Healthcare Services showcase the current U.S. healthcare real estate market, with special insight on how the Northeast market compares.

MEDICAL OFFICE INVESTMENT MARKET

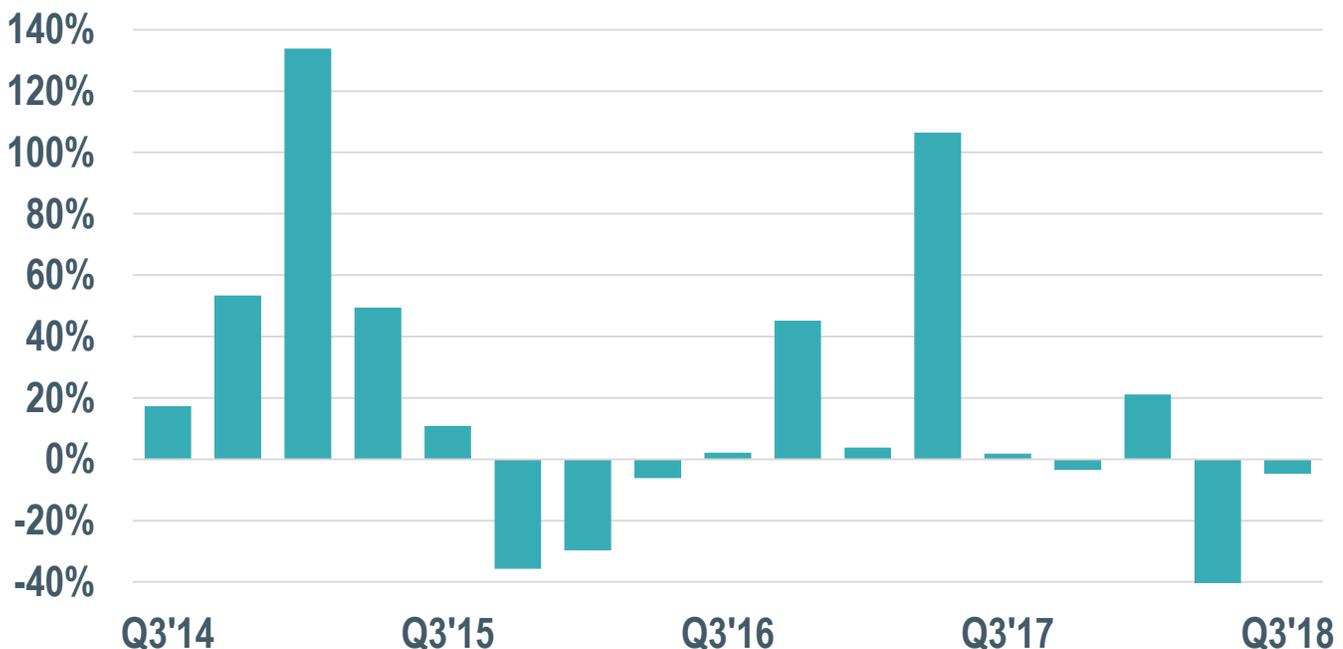
U.S. SALES VOLUME & PRICING

During 2017, medical office properties across the nation valued at \$13.3 billion changed ownership, well above the \$10.8 billion in 2016. 2018 has seen a decline in national sales volume with year over year total sales down by 17% (164 properties) and volume in terms of dollars down by -18% (\$1.8 billion).

Pricing hit an all-time high in 2017, with an average price of \$295/SF, an increase of 16% over 2016's average price of \$255/SF. Over the past 5 years, medical office assets have grown an average of 7% each year, with an overall increase of 55% since the recent lowest point in 2009.

2018 has seen the price per square foot of assets moving up since 2017, currently averaging \$299 psf. Cap rates hit an all-time low at 6.66% in 2017, finishing below 2016 cap rates of 6.74%. Cap rates have compressed at a rate of 22 basis points per year over the past five years. Given the increasing 10-year treasury rates in 2018, the days of cap rate growth are likely over, though cap rates have remained relatively stable in a rising interest rate environment; both 2017 and 2018 hovered around 6.6% for the same time period year over year. Likely, as further treasury rates increase, we will see cap rates beginning to move back toward 2016 levels.

CHANGE IN SALES
(Medical Office Y/Y)



MEDICAL OFFICE INVESTMENT MARKET

U.S. INVESTOR PROFILE

Private investors were the largest sellers of medical office assets in 2017, accounting for 47% of dispositions and 35% of purchases by dollar volume. Users/others, including healthcare systems and other providers, accounted for 12% of dispositions and 9% of acquisitions. 2018 has seen a number of hospitals purchasing back buildings, and it is possible that we will see this trend continue if rental rates continue to increase along with construction costs and changes in accounting regulations. Publicly traded REITs were the largest buyers of medical office assets in 2017, accounting for acquisitions of \$4.8 billion, or 36% of all acquisitions.

NORTHEAST SALES VOLUME & PRICING

Much like the U.S. trends, the Northeast is experiencing a drop in the total number of buildings sold from 119 in 3Q 2017 to 106 through 3Q 2018. However, overall volume in terms of purchase price has increased in the Northeast, bucking the national trend through 3Q 2018. Volume in terms of dollars has moved up for the same time period from \$1.285 billion in 2017 to \$1.943 billion in 2018. With 4Q historically seeing some of the highest volumes, the Northeast is on pace to have one of its better years in terms of total volume by price.

The Northeast has seen similar national sales trends with sales-to-date trading above the national average at \$320 PSF, up from \$305 in 2017. Cap rate trends in the Northeast are also in line with national trends, as 2018 cap rates remain unchanged hovering around 6.9% for non-portfolio sales.

NORTHEAST REGION DEAL HIGHLIGHT *Lancaster General Health*

Lancaster General Health is a member of the University of Pennsylvania Health System (Penn Med), a not-for-profit health system with 786 licensed beds. In late September, Lancaster closed on a property located at 950 Octorara Trail in Parkesburg, PA. While the deal is not notable for its size or its value, it is notable because of what it represents. There has been a trend emerging in 2017 and 2018 where hospitals are purchasing buildings or purchasing back buildings that have sold. With changes to FASB and how leases will be treated, as well as the rising cost of lease rates and construction costs, an emerging trend has formed where hospitals are choosing to own rather than capitalize their assets. Lancaster General purchased the ~41,000 SF building for \$230 psf.



HEALTHCARE M&A ACTIVITY

Last year, we saw the beginning stages of major consolidation and change. Large health systems are merging together to enter new markets and/or increase market share in existing markets to grow scale and leverage operations for economic efficiency. Smaller health systems are joining larger health systems that have capital and resources to achieve economies of scale. Similar trends are taking place in 2018, as 30 health system and hospital deals were made in the first quarter of 2018, which is 11% higher than 2017 according to a report by Kaufman Hall & Associates. The overall themes of these health

system mergers are fueled by lower reimbursements, decreasing patient admissions and readmissions while providing a lower cost of care in the community. The impact of these mergers will see an effect in the real estate market in a variety of ways. More capital and scale could result in more development opportunities, on the other side redundancy of space could see consolidation efforts to optimize the outpatient footprint in the market. Data around each health system's locations will be critical in understanding what real estate initiatives will be a catalyst for contributing to success of the merger.

US M&A ACTIVITY TRENDS ⁽¹⁾

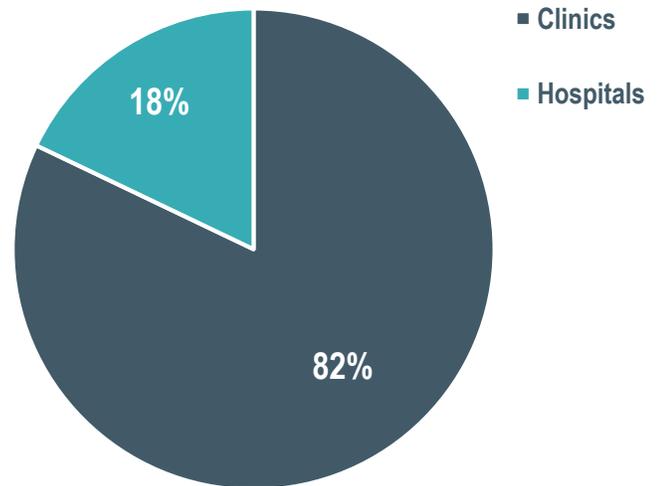


HEALTHCARE M&A ACTIVITY

MEGA DEALS

The two mega-deals in process, CVS-Aetna and Cigna-Express Scripts, and increased private equity investments will continue to shape and transform how healthcare is delivered to the market. For example, The CVS-Aetna merger will provide a new model for the healthcare industry with CVS offering primary-care services and medical follow-ups directly from the drugstore. The merger is also a strategic move for CVS to stay competitive with Amazon, which is increasing its presence in the healthcare industry. Also, many health systems are partnering with CVS and Walgreens in their markets to provide primary care and urgent care clinics close to their patient's homes.

US M&A ACTIVITY ⁽¹⁾



NORTHEAST SALES VOLUME & PRICING

As for clinics and physician groups, 2017 saw a 37% increase in physician-owned practices transactions compared with 2016. Similar trends are apparent in 2018 activity. Many physician practice transactions are backed by private equity firms. Having access to capital for operational and technology needs allows practices to position themselves for future growth. Some physicians find it more appealing to sell their practice to a private equity firm versus selling to a hospital. A part of the appeal is that physicians don't lose complete ownership/control and there are attractive economic benefits. Attractive economic benefits include ownership of the management services organization as well as potential disposition of real estate assets to REITs or other institutional investors if owned by the practice group.



NORTHEAST REGION M&A HIGHLIGHTS

The northeast region is following similar healthcare M&A trends as the entire United States. The majority of the activity are in the states of Pennsylvania (17 transactions), New York (13), New Jersey (13) and Massachusetts (10).

BETH ISRAEL DEACONESS MEDICAL CENTER & LAHEY HEALTH MASSACHUSETTS

The merger was announced in 2017 and is currently in the regulatory approval phase. The new proposed health system would include 13 hospitals, over 800 primary care physicians and more than 3,500 specialists across the state. The system would represent a competitor to Partners HealthCare which is the biggest health system in the state with 10 hospitals and \$12 billion in annual revenue. The intention of the merger will improve patient care in the community while also containing rising healthcare costs the consumers are experiencing. Real estate activity could play a role in the effort to reduce cost by shifting care to lower cost settings, as well as evaluating overlapping or redundant point of care and making the health system footprint more optimal.

NEW MAINSTREAM CAPITAL INVESTS IN OMNI EYE SERVICES

New MainStream Capital (NMS) is a private equity firm that specializes in strategic investments and leveraged buyouts. NMS invested in Omni Eye Services which is based in Iselin, NJ in 2017. The investment in Omni Eye services will provide additional capital to grow organically and through acquisition as well as expanding resources and capabilities to patients. Growth will include de novo office openings, provider recruitment and new acquisitions. In 2018, Omni Eye Services acquired Phillips Eye Center (Elmwood Park, NJ) and Kremer Eye Center (King of Prussia, PA) to continue expanding their service offering and referral optometric practice in the Northeast.



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Newmark Knight Frank is one of the world's leading commercial real estate advisory firms. Together with London-based partner Knight Frank and independently-owned offices, NKF's 16,000 professionals operate from more than 430 offices in established and emerging property markets on six continents. With roots dating back to 1929, NKF's strong foundation makes it one of the most trusted names in commercial real estate. NKF's full-service platform comprises BGC Partners, Inc., a real estate services segment, Cantor Fitzgerald, one of the oldest and most established franchises in the financial intermediary industry, CCRE, a commercial real estate finance company, and Berkeley Point Capital, one of the nation's leading multifamily capital solutions providers. For further information, please visit www.ngkf.com.

ABOUT GLOBAL HEALTHCARE SERVICES

Newmark Knight Frank's Global Healthcare Services team is one of the largest and most experienced healthcare real estate teams in the country, advising healthcare clients seeking to maximize value on assets and implement long-term business strategies. The Global Healthcare Services team provides clients with a single-source solution for every phase of acquiring, financing, developing, and disposing healthcare real estate. The team comprises real estate transaction and consulting professionals with more than 25 years of experience serving hospitals, health systems, and medical office building owners throughout the U.S. and across the globe. For further information, please visit www.ngkfglobalhealthcare.com.

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