

CBRE RESEARCH

2021 U.S. MEDICAL OFFICE TRENDS

Resilience Amid
Historic Change



CBRE

EXECUTIVE SUMMARY

- The U.S. health care industry was severely impacted by the COVID-19 pandemic in 2020 as patient visits declined by more than 50%. Health care employment fell by as much as 6.4% but rebounded much more rapidly than the broader job market.
- By contrast, medical office building sales fell by a relatively mild 12.7% in 2020, but are expected to see a strong rebound in demand this year once the COVID-19 virus recedes. Investors are sensing good growth opportunities with pricing and sales transaction levels more resilient than for most property types.
- While telehealth will clearly play a greater role in health care, its impact on medical offices likely will be negligible. Although COVID-19 has impacted the health care industry more broadly, we expect a potential return to pre-pandemic trends this year that will lead to new opportunities for owners and investors.





STABLE HEALTH CARE JOB GROWTH RESUMES IN 2021

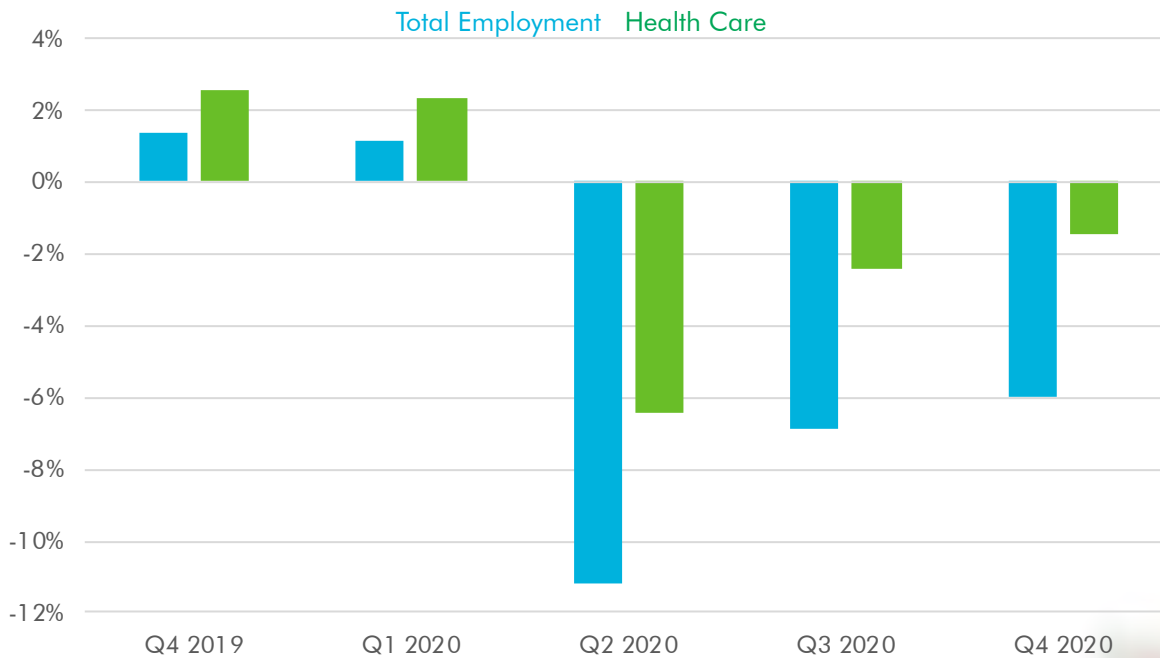
Very few industries have created as many jobs with such stability over the long term as the health care industry. In 2020, however, even health care suffered job losses, along with nearly every other sector of the economy. By the end of Q2 2020, U.S. health care employment had declined by 6.4% year-over-year, less than the 11.2% drop for the broader U.S. economy. The drop in health care employment was partially caused by patients' COVID-related reluctance to schedule routine visits and by government mandates limiting elective procedures.

Health care employment has been increasing since mid-2020 and by Q4

2020 was down by only 1.5% year-over-year versus a 6.0% decline in total U.S. employment. While job growth is expected to resume in 2021, uncertainty will prevail for the next several months as demonstrated by a mild drop in health care and social assistance employment in January 2021.

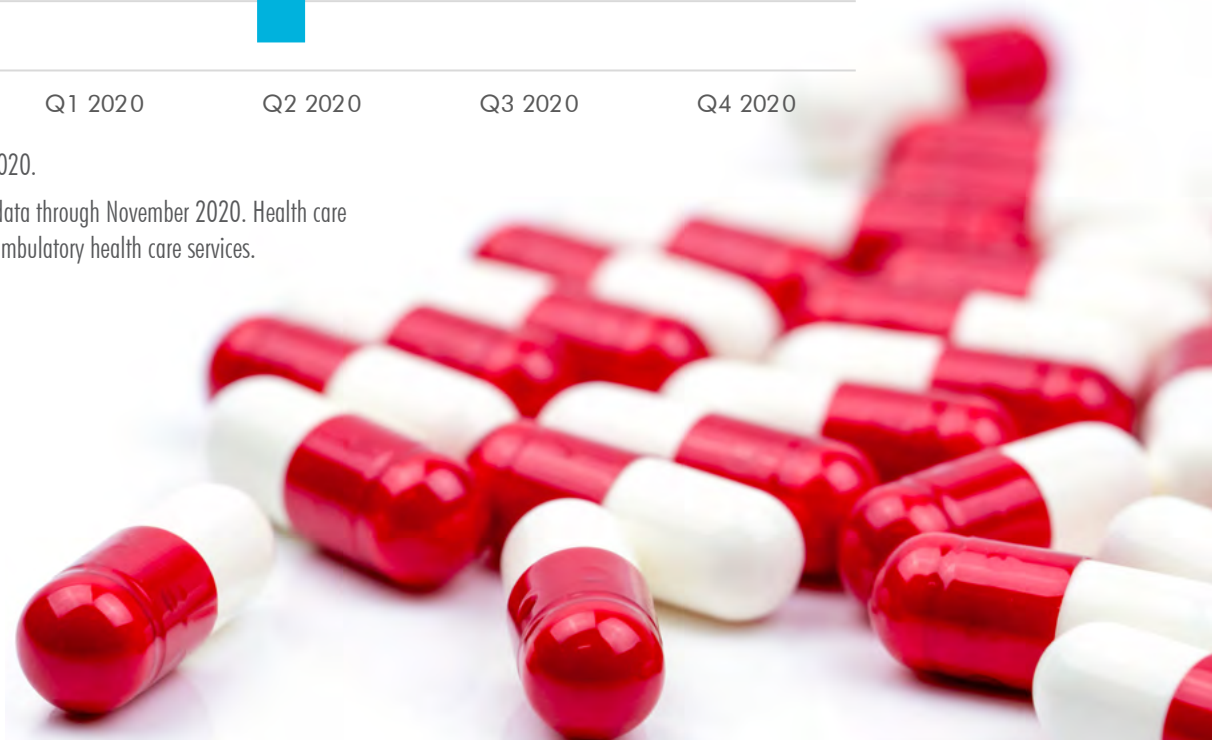
CBRE expects the long-term, outsized growth of U.S. health care to resume this year. The remarkable stability of U.S. health care employment (Figure 2) was briefly interrupted in 2020, but a return to secular, stable growth is expected over the next five years.

FIGURE 1:
U.S. EMPLOYMENT GROWTH



Source: Oxford Economics, December 2020.

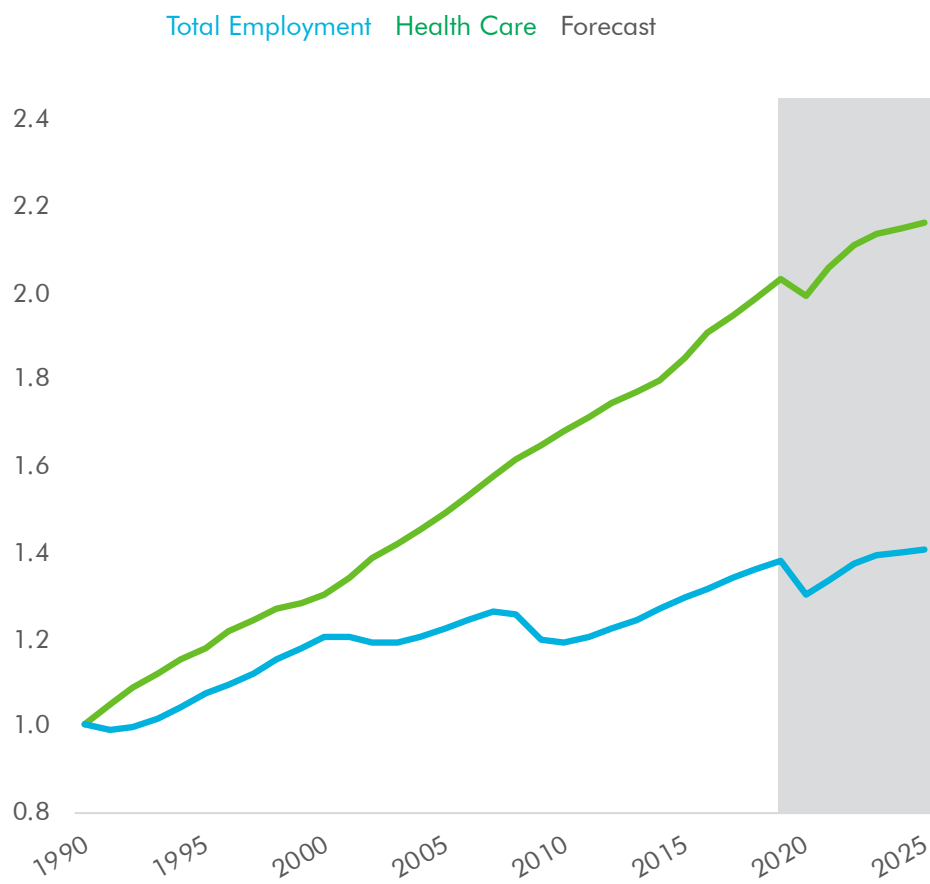
Notes: Q4 forecast based on historical data through November 2020. Health care employment consists of hospitals and ambulatory health care services.





CBRE expects the long-term, outsized growth of U.S. health care to resume this year.

FIGURE 2:
U.S. EMPLOYMENT LEVELS INDEXED TO 1.0 IN 1990



Source: Oxford Economics, December 2020.

Notes: Q4 forecast based on historical data through November 2020. Health care employment consists of hospitals and ambulatory health care services.



DURABLE AND GROWING INVESTOR DEMAND FOR MEDICAL OFFICE BUILDINGS

The resilience of medical office buildings was evident in investment activity through most of 2020. Annual investment volume declined by 12.7%, the least of any major property type and investor sentiment for the sector appeared to grow.

The relative resilience of medical office investment activity should endure, based on evidence from the last downturn. Figure 4 compares investment volumes during the current recession with those during the Global Financial Crisis. Medical office sales transactions have not only held up better in the current downturn, but also were not as severely affected as during the Global Financial Crisis. Notably, medical office sales returned to their 2006 peak faster than all other property types following the Global Financial Crisis.

Pricing resilience of medical offices also is evident when comparing current trends in the price per square foot achieved in sales transactions during the current

recession with those of other property types during the Global Financial Crisis. In Q4 2020, the average price per square foot of medical office transactions (based on a rolling four-quarter average) was 3.7% higher than in Q4 2019, a resilience demonstrated in previous cycles as well.

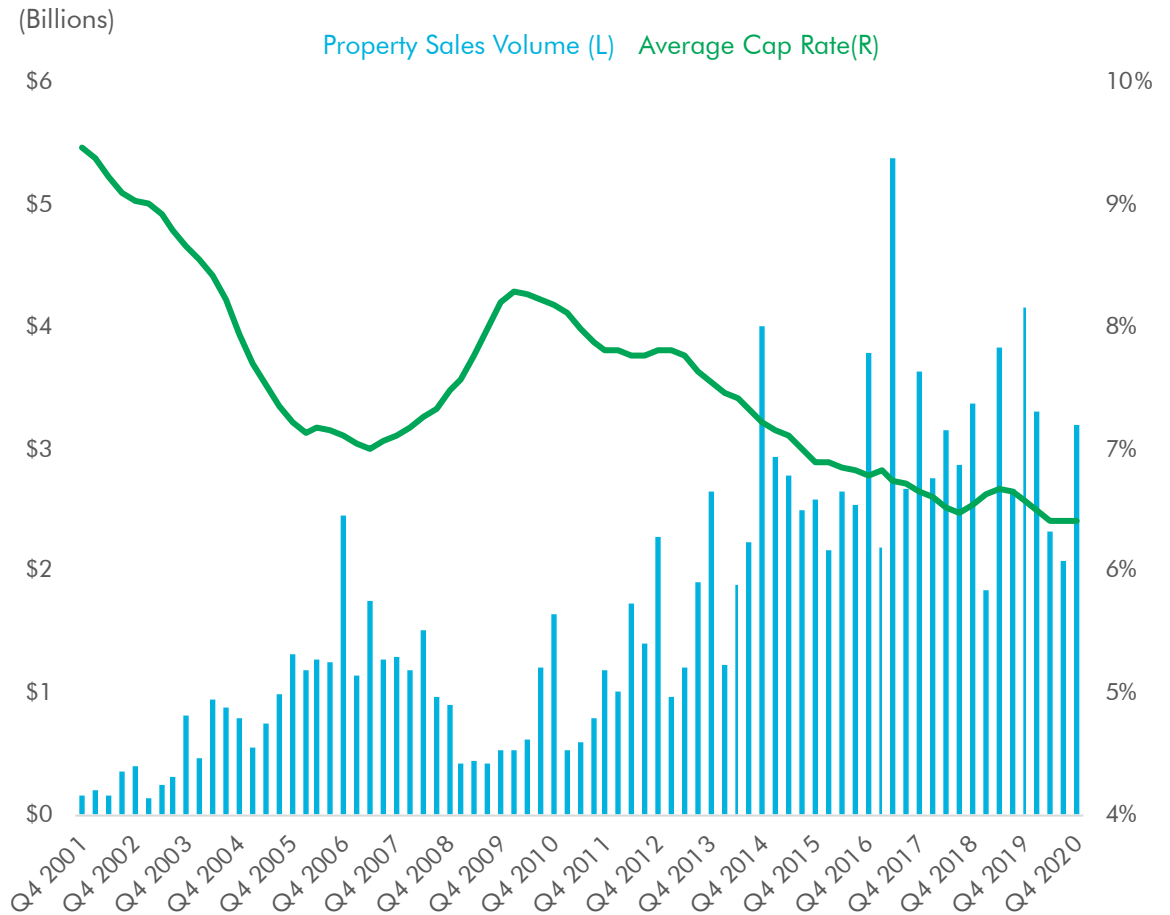
The sector's proven resilience and outperformance has sparked renewed interest from investors. Potentially accelerating interest has been amplified by the notable challenges facing conventional offices and some other property types. Net acquisitions of medical office buildings by institutional investors reached a record in 2020.

Results from the 2021 Emerging Trends in Real Estate® survey by PwC and the Urban Land Institute (ULI) show evidence of increased investor demand for medical offices subsequent to the downturn that began in February 2020. Figure 6 shows the survey results of “buy” recommendations for various property types in 2020 and 2021. Not only are

medical offices one of the most sought-after property types for purchases in 2021, but the sentiment from investors increased year-over-year. PwC and ULI highlighted medical offices as one of their “Expected Best Bets in 2021.”



**FIGURE 3:
U.S. MEDICAL OFFICE PROPERTY SALES VOLUME**



Source: Real Capital Analytics, February 2021. Based on independent reports of properties and portfolios \$2.5 million and greater.

**FIGURE 4:
CHANGES IN INVESTMENT VOLUME**

	Medical Offices	Conventional Offices	Multifamily	Retail	Industrial
1-year Change (Q4 2019-Q4 2020)	-12.7%	-40.2%	-27.6%	-42.8%	-15.9%
Change during Global Finan- cial Crisis (Q4 2006-Trough)	-70.8%	-87.5%	-82.6%	-78.3%	-80.1%

Source: Real Capital Analytics, February 2021. Based on independent reports of properties and portfolios \$2.5 million and greater.

Note: Based on four-quarter sum of transactions.

**FIGURE 5:
CHANGES IN PRICE PER SQ. FT.**

	Medical Offices	Conventional Offices*	Apartment	Retail	Industrial
1-year Change (Q4 2019-Q4 2020)	3.7%	4.1%	7.5%	-3.0%	6.1%
Change during Global Finan- cial Crisis (Q4 2006-Trough)	-7.4%	-21.8%	-16.2%	-17.0%	-16.7%

Source: Real Capital Analytics, February 2021. Based on independent reports of properties and portfolios \$2.5 million and greater.

Apartment data reflects change in price per unit.

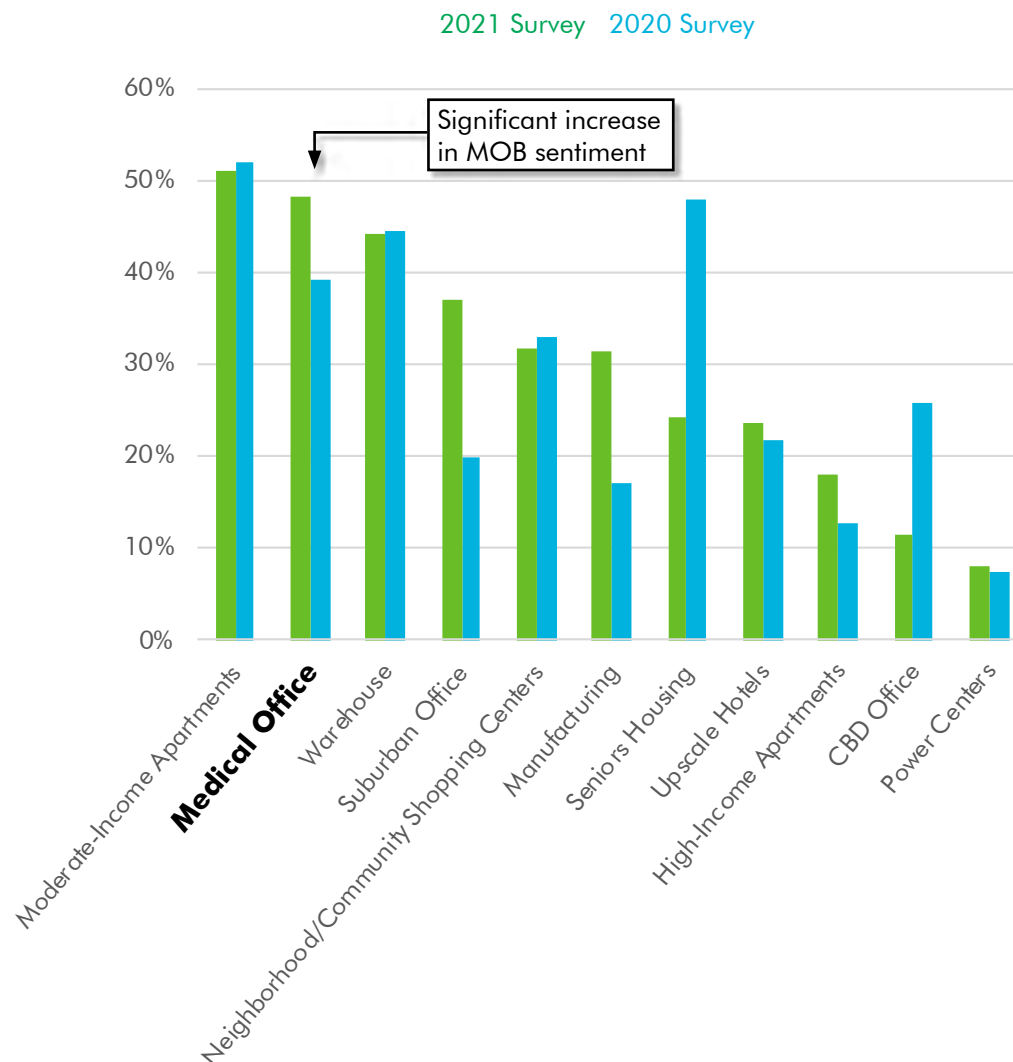
Note: Based on four-quarter averages.

* The increase in the sales price per square foot was likely skewed by a historic dearth of transactions as well as a disproportionate composition of single-tenant and high-occupancy core office trades.



The relative resilience of medical office investment activity thus far should endure, based on evidence from the last downturn.

FIGURE 6:
“BUY” RECOMMENDATIONS FOR SELECT PROPERTY TYPES



Source: PwC and the Urban Land Institute: Emerging Trends in Real Estate® 2021. Based on responses from survey participants.

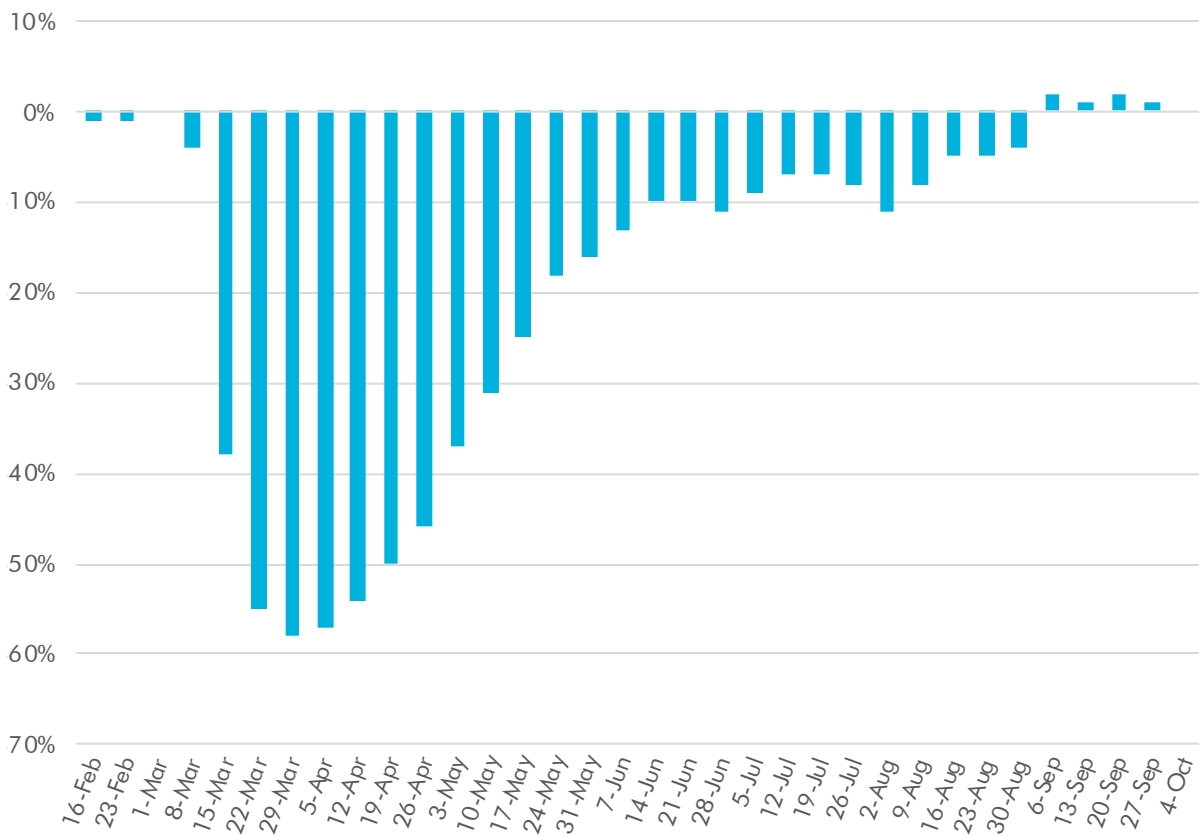


BIG REBOUND IN ACTIVITY EXPECTED FROM BACKLOG OF MEDICAL PROCEDURES

According to the Centers for Disease Control and Prevention (CDC) in Q2 2020, an estimated 41% of U.S. adults had delayed or avoided medical care, including urgent or emergency care (12%) and routine care (32%), due to concerns over COVID-19. However, ambulatory visits had reached pre-crisis levels by October, albeit with more telehealth visits comprising that share.

Elevated COVID-19 case rates this winter likely have reduced ambulatory visits once again, causing a backlog of elective procedures and routine visits. In early December, 106 U.S. hospitals postponed or canceled elective procedures to free up space and protective gear to care for COVID-19 patients. With expectations for the COVID-19 virus to gradually be controlled in 2021, a significant uptick in demand for health care services is expected.

**FIGURE 7:
PERCENT CHANGE IN VISITS TO AMBULATORY PROVIDERS
FROM BASELINE**



Source: Ateev Mehrotra et. al., "The Impact of the COVID-19 Pandemic on Outpatient Care: Visits Return to Prepandemic Levels, but Not for All Providers and Patients" (Commonwealth Fund, Oct. 2020).

Note: Data presented as a percentage change in the number of visits in a given week from the baseline week (March 1–7).



TELEHEALTH'S GROWTH WILL HAVE A NEGLIGIBLE IMPACT ON MEDICAL OFFICES

Though more use of telehealth is here to stay, its effect on clinical space in medical offices likely will be negligible, especially as COVID-19 dissipates. As an early indication of this, Figure 9 shows that nearly a third of health care providers never offered telehealth services during this crisis. Between April and September, most providers reverted to minimal use of telehealth after the virus's initial surge.

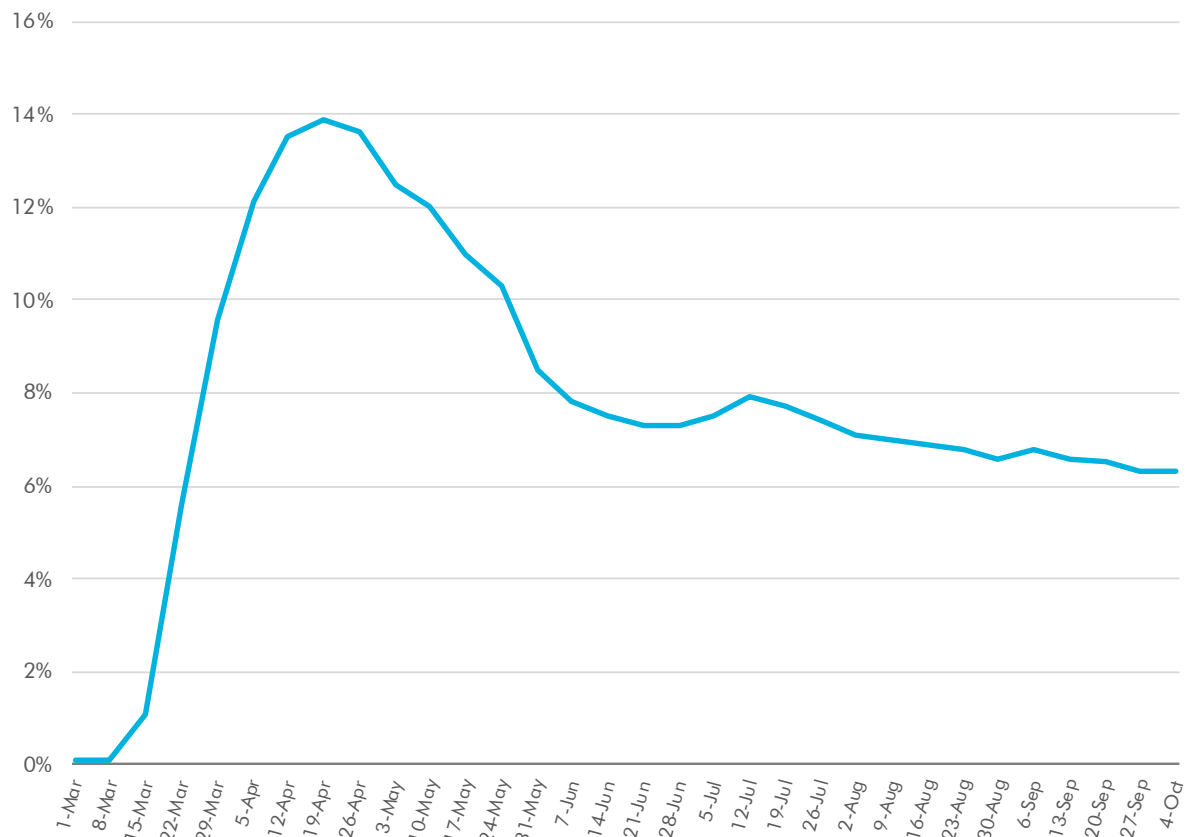
Ultimately, telehealth cannot substitute for in-person procedures and diagnoses, despite its advantageous role in early consults and follow-up visits. Telehealth may even result in greater need for medical offices by offering more opportunities for

patient interaction and consults that lead to in-person visits. It also allows health providers to reach a larger pool of new office patients (e.g., rural residents).

The configuration of medical office spaces likely will change with little impact on total square footage. New sanitation procedures will persist, as well as other operational and behavioral changes such as visitors entering and exiting via different doorways or more use and integration of internal stairwells rather than elevators to maintain social distancing. Furthermore, one or more exam rooms may be temporarily used for telehealth visits but still have all the necessary equipment for in-person visits.



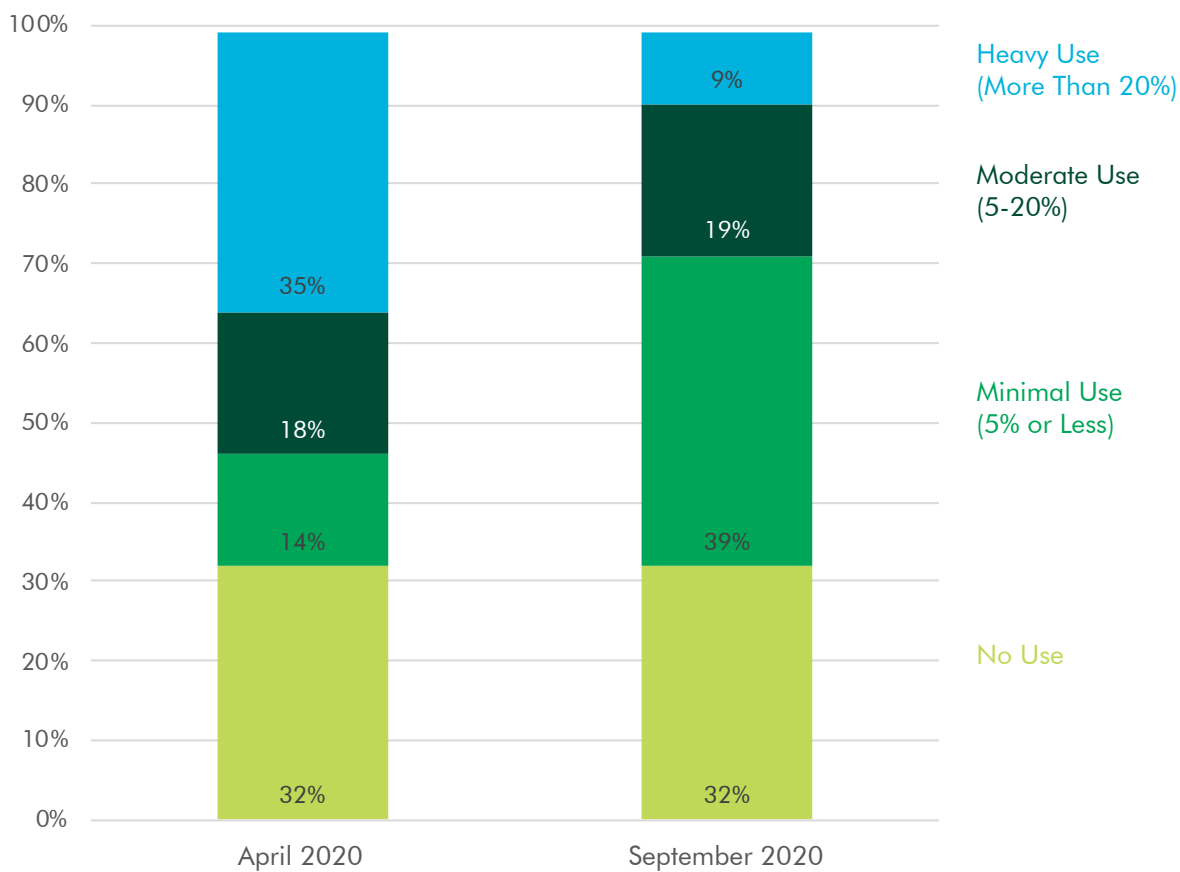
**FIGURE 8:
WEEKLY TELEHEALTH VISITS AS A PERCENT
OF BASELINE TOTAL VISITS**



Source: Ateev Mehrotra et. al., “The Impact of the COVID-19 Pandemic on Outpatient Care: Visits Return to Prepandemic Levels, but Not for All Providers and Patients” (Commonwealth Fund, Oct. 2020).

Note: Data is the percentage of telemedicine visits in a given week as a share of the number of visits in the baseline week (March 1–7). Telemedicine includes both telephone and video visits.

FIGURE 9:
TELEHEALTH USE (PERCENT OF ALL HEALTH PROVIDERS)



Source: Ateev Mehrotra et. al., "The Impact of the COVID-19 Pandemic on Outpatient Care: Visits Return to Prepandemic Levels, but Not for All Providers and Patients" (Commonwealth Fund, Oct. 2020).



MORE CONSOLIDATION AMONG HEALTH PROVIDERS IS EXPECTED

Upheaval to the health system in 2020 stressed many health care providers financially. Additional pressure from a challenging winter of record cases of COVID-19 could lead to more consolidation by health providers in 2021.

As of November 2020, hospital operating margins were down by 5.1 percentage points year-over-year, not accounting for federal CARES funding, according to consulting firm Kaufman Hall. Currently stressed health systems, as well as newly

merged organizations, will be forced to reevaluate their real estate in order to reduce cash expenses. Not only may a divestment strategy be an option, but so may buybacks of currently leased space, depending on the needs of the organization. In short, we expect more reorganization of health care systems this year, with real estate being a major focus.

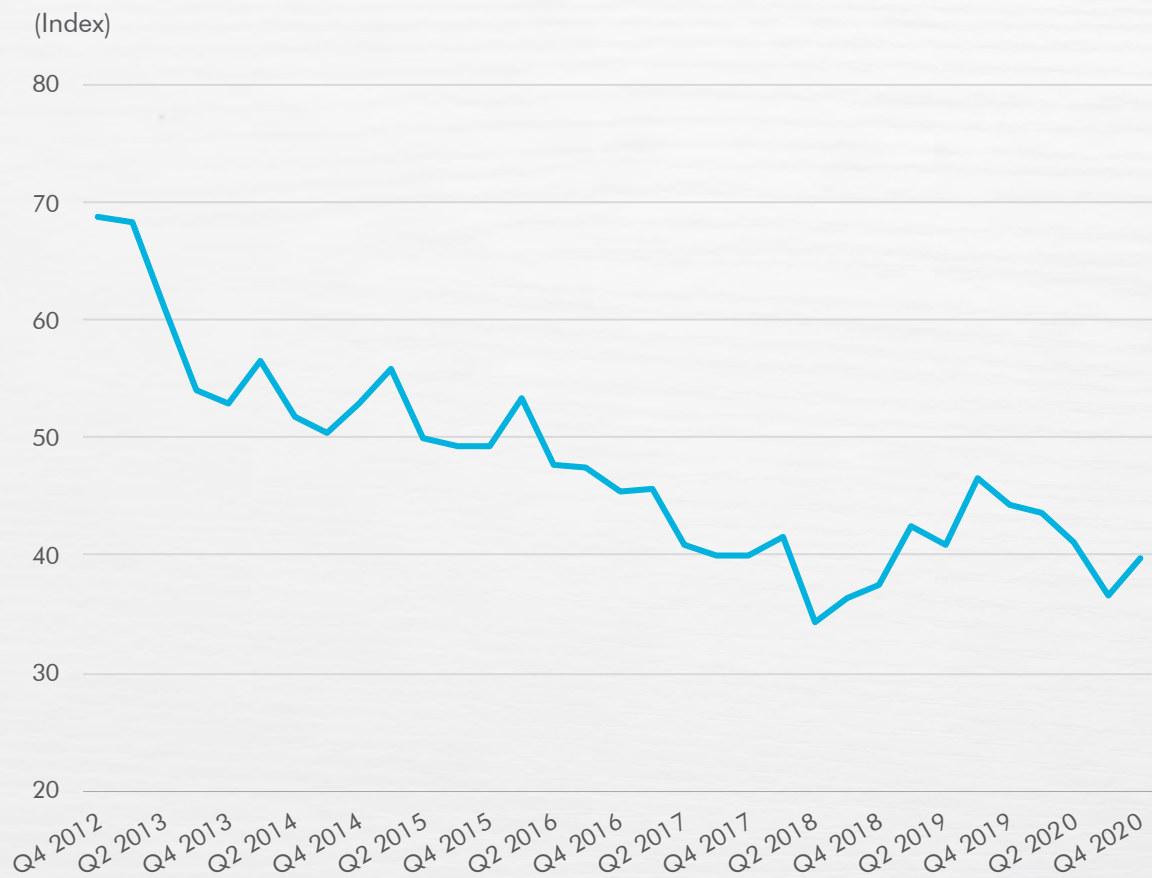


DIVERSIFICATION OF HOSPITAL CAMPUSES WILL ACCELERATE

Hospitals will diversify their space use for several reasons, including financial constraints and technological advancements. Greater technological capabilities are leading to an increasing share of procedures being performed in off-campus locations. Ridesharing services and the prospect of driverless cars are leading hospitals to reconsider onsite parking

capacities. This presents a generational opportunity to diversify and integrate new uses for hospital campuses. There also is a growing need for affordable housing to accommodate hospital staff who are increasingly burdened by longer commutes due to rising home prices, particularly in high-cost metros like Seattle as illustrated in Figure 10.

FIGURE 10:
AFFORDABLE HOUSING NEEDS GROW FOR HOSPITAL STAFF
Share of Seattle Metro Homes Affordable to a Family Earning Local Median Income



Source: NAHB/Wells Fargo Housing Opportunity Index, March 2021.

Note:: Defined as the share of homes sold in the area that would have been affordable to a family earning the local median income, based on standard mortgage underwriting criteria.

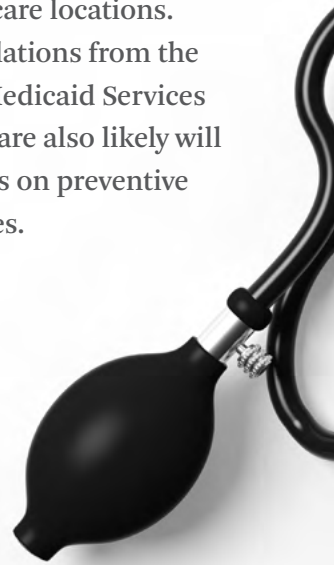
THERE WILL BE MORE DISPERSION AND DECENTRALIZATION OF CARE

Demand will grow for medical office space in lower-cost, off-campus facilities that are convenient and closer to the patient. Amplifying this trend has been the historic shift to more remote work, allowing more people to live farther away from central urban cores.

Longer-term demographic trends bode well for more growth in suburban areas as the millennial generation transitions to homeownership. The COVID-19 crisis has accelerated the flight from central cities, sparking more demand for suburban residences. Occupancy in suburban, garden-style apartments grew by 20 basis points (bps) between Q4 2019 and Q4 2020 to 95.9% (Figure 11). In contrast,

occupancy in urban high-rise apartments fell by 1.3 percentage points to 93.9% over the same period. Many residents likely will stay in the suburbs and seek health care services closer to home.

Telehealth, in which patients have more convenient interaction with their health care providers, may boost the need for more convenient health care locations. New legislation and regulations from the Centers for Medicare & Medicaid Services supporting value-based care also likely will cause increased emphasis on preventive care in lower-cost facilities.



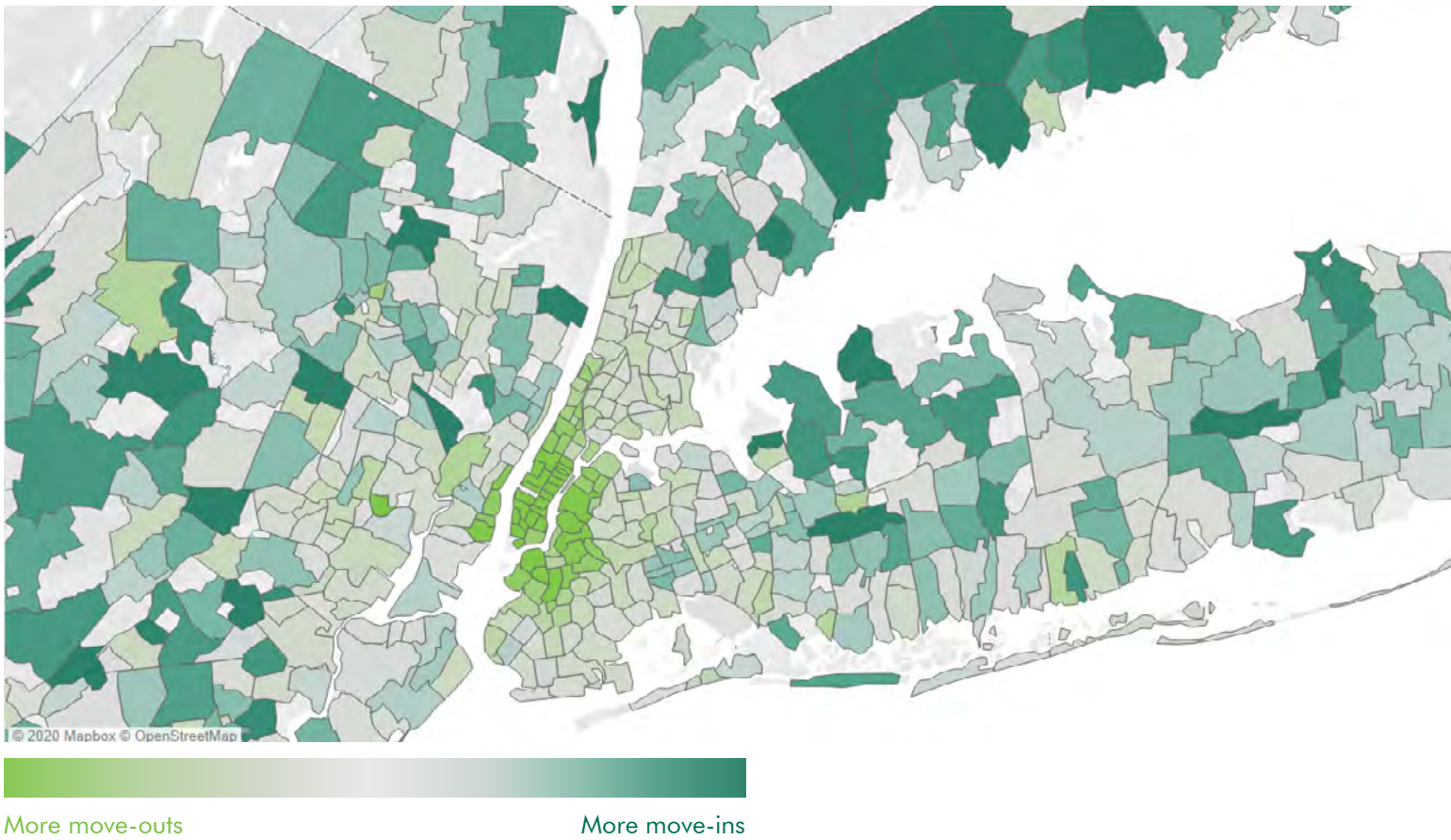


**FIGURE 11:
MULTIFAMILY OCCUPANCY BY TYPE**



Source: CBRE Econometric Advisors, Q4 2020.

FIGURE 12:
NEW YORK CITY AREA RESIDENTIAL ADDRESS CHANGES
(OCTOBER 2020 VS. OCTOBER 2019)



Source: CBRE Research; U.S. Postal Service.



THE DECADES-LONG SHIFT TO THE SUN BELT AND LOWER-COST MARKETS WILL ACCELERATE

The COVID-19 crisis has only accelerated a decades-long population shift to the Sun Belt and lower-cost markets. Under financial and operational pressure in high-cost dense markets, some companies have migrated to Texas and Florida from California and New York. This is partly due to companies shifting to a more dispersed workforce and congregating less in one headquarter market. Conventional office leasing data shows the most negative demand for office space generally in the nation's largest, highest cost and densest markets.

Data from the U.S. Postal Service indicates households making more moves out of high-cost coastal markets as well.

Certainly, after the COVID-19 crisis fades, there will be a rebound for high-cost markets like New York and San Francisco. But the long-term demographics still favor the Sun Belt and lower-cost markets (Figure 13).

FIGURE 13:
FIVE-YEAR FORECAST FOR TOTAL POPULATION GROWTH
(2020-2025)

Market	Growth (%)	Market	Growth (%)
Austin-Round Rock, TX	11.1%	Tampa-St. Petersburg-Clearwater, FL	6.0%
Phoenix-Mesa-Scottsdale, AZ	10.1%	Seattle-Tacoma-Bellevue, WA	6.0%
Houston-The Woodlands-Sugar Land, TX	8.8%	Riverside-San Bernardino-Ontario, CA	5.9%
Charlotte-Concord-Gastonia, NC-SC	8.4%	Denver-Aurora-Lakewood, CO	5.7%
Las Vegas-Henderson-Paradise, NV	8.2%	Salt Lake City, UT	5.3%
Raleigh, NC	7.9%	Washington-Arlington-Alexandria, DC-VA	4.9%
Dallas-Ft. Worth-Arlington, TX	7.8%	Portland-Vancouver-Hillsboro, OR-WA	4.8%
San Antonio-New Braunfels, TX	6.8%	Miami-Fort Lauderdale-West Palm Beach, FL	4.6%
Atlanta-Sandy Springs-Roswell, GA	6.2%	Columbus, OH	4.3%
Nashville-Davidson-Murfreesboro-Franklin, TN	6.1%	Sacramento-Roseville-Arden-Arcade, CA	3.6%

Source: Oxford Economics, December 2020.



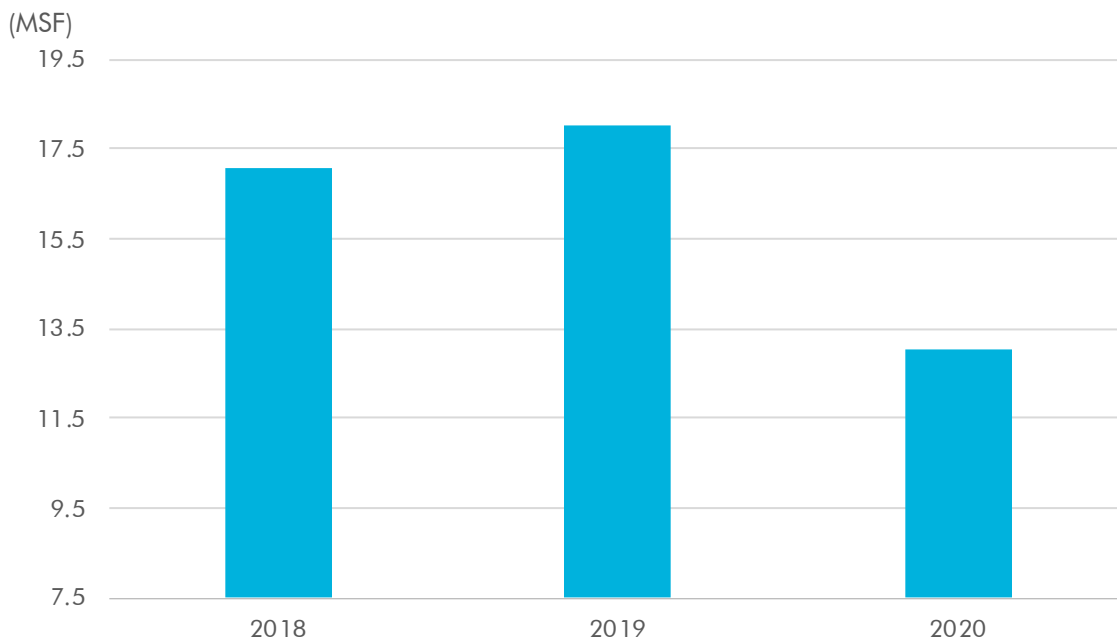
THE SHIFT TO MORE REMOTE WORK WILL MOSTLY AFFECT ADMINISTRATIVE OFFICE USE BY HEALTH CARE PROVIDERS

The need for conventional office space is under a generational reassessment. All industries are reconsidering their current utilization of offices, especially since many employees are expected to work remotely more often. The surprising success of remote work during the COVID-19 crisis has established a new norm for how office space is used. Leasing of conventional office space by the health care and education industries totaled 10.3 million sq. ft. in 2020, a 28% decrease from 2019.

Although the health care industry's demand for conventional office space likely will rebound in 2021, recent CBRE analysis suggests remote working could cut the overall need for office space by 15% across all industries. However, it is still too soon to know what the impact of remote working will be on overall demand for space until more companies return to the office.



FIGURE 14:
U.S. CONVENTIONAL OFFICE LEASING BY THE HEALTH CARE AND EDUCATION INDUSTRIES



Source: CBRE Research Q4 2020.





RECOVERY EXPECTED TO STRENGTHEN IN 2021

Medical office properties endured a very challenging year in 2020 but are well positioned for a relatively sharp rebound in 2021. Health care employment is already recovering and a backlog of patient demand is building. The increasing use of telehealth is not expected to materially impact medical office space. Furthermore, the traditional resilience of medical office market fundamentals and investment trends has held up in this downturn, which may result in a more rapid recovery than most other property types. Some of the broader impacts from COVID-19 on society have also created a host of new opportunities for health care providers to better meet the needs of their patients.



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