Lincoln, Nebraska

Medical Office Market Overview

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The Cushman & Wakefield / Lund Company Medical Office Report is produced annually for the benefit of owners, investors, owner-occupants, and tenants of medical office buildings throughout the metropolitan Omaha, NE area. Inventory as referenced in the Report includes traditional medical office buildings, owner-occupied community clinics, ambulatory surgery centers and specialized outpatient treatment facilities. If a property caters to both office and medical uses, at least one-half of building must be occupied by medical users to be included in the inventory.

The Report is prepared by Richard Secor, Jr., Associate, Cushman & Wakefield/Lund Company, a 39-year veteran of the commercial real estate industry and a member of Cushman & Wakefield's Healthcare Advisory Group. The Advisory Group is a national platform of real estate professionals with a focus on the sales, leasing, valuation, management, and financing of healthcare properties around the United States, including medical office, assisted living, skilled nursing, and hospital facilities.

The Economy

All countries, including the United States, continue to be impacted by COVID-19. Just when we thought we had the virus beaten, with the discovery and administration of the various vaccines, the reluctance among many citizens to take the vaccine and resulting mutations such as the Delta Variant and now the Omicron Variant, have prevented our ability to have herd immunity. Consequently, the virus will continue to be around for a while. COVID, to be sure, has redefined how we live, work and play.

Most of the world's office workers continue to work remotely. While we are experiencing positive Gross Domestic Product (GDP) growth (5.6%) and lower unemployment (4.2%) in the U.S., these promising signs of an economic recovery are being plagued now with a 6.8% inflation rate, the highest rate this country has seen since 1982. In hindsight, the inflation rate should not have been surprising recognizing the disruption in the supply chain due to the shutdown of manufacturing and transportation of goods during early 2020, when the Pandemic began to emerge rapidly. Although the production and movement of products is now back to pre-pandemic levels, receipt of many goods continues to be stalled at the ports due to the backlog of logistical support. Demand in the meantime has surged due to government relief checks, super-low interest rates and the roll-out of vaccines, that when combined, have given consumers the confidence and financial wherewithal to start spending again. We are currently experiencing a "goods-led inflation surge". In the labor market, employers are scrambling to meet this unexpected demand. Companies now complain that they can't find workers to fill job openings. Workers, finding themselves with bargaining clout for the first time in decades, are becoming choosier about jobs; a sign they have confidence in their ability to find something better. Although the inflation rate is believed to be just temporary, The Fed announced on December 15th two plans to combat inflation for the long term. It would accelerate its bond purchase reduction by $30 billion per month so that the program would end in March instead of June. In addition, there would be three interest rate increases during 2022.

The GDP growth and decline in unemployment, no doubt, was attributed to two major government spending bills, the Coronavirus Aid Relief and Economic Security Acts during 2020 and 2021 ("CARES ACT 1" and "CARES ACT 2"). The two combined bills amounted to nearly $3.1 trillion. More Government spending is forthcoming. The nearly $1 trillion Infrastructure Investment and Jobs Act ("IIJA") was recently passed by both the House and Senate. The result will be job creation and better infrastructure. Major allocations include funds for transportation, roads, bridges, freight and passenger rail, public transit systems, broadband expansion, and water system upgrades

As a matter of perspective, the three Acts, amount to nearly $4.1 trillion, which represents 18% of annual GDP or 14% of our national debt. This equates to approximately $33,000 per taxpayer or $13,000 per citizen. In the interim, all three bills are being funded by increasing our national debt.

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In addition, although the $1.75 trillion "Build Back Better Plan" bill, another spending act, which will focus on Universal Pre-K, Medicare Expansion, Renewable Energy Credits, Affordable Housing, Child Tax Credits and Obama Care Subsidies, is currently stalled in the Senate, it is believed that President Biden may be able to revive it by stripping out some of the programs and proposing them to be separate bills at a later date. Biden has proposed a new tax bill to pay for the proposed legislation, which is making the business community, including firms and higher wage earners, nervous, as these are the groups that will bear the brunt of the tax increases.

Political bickering continues to permeate all levels of government, local, state and national. Social unrest still exists either because of real or perceived systemic racism. All these issues make individuals and businesses more fearful of the future and thus uncertain about the economy. Regardless of all these issues, our economy appears resilient and it's future bright. The stock market continues to seem oblivious to all our troubles; the Dow Jones Industrial Average ("DJIA") reached an all-time high (36,338). This reflects an 18.7% increase year-over-year. In contrast, year-ending comparisons of 2019 and 2020 yielded a 7.2% increase.

Healthcare

Post COVID-19

The Pandemic will influence forever how and where care will be provided in the future. Fundamental shifts are occurring in the areas of design and construction of facilities, training of healthcare workers and the sourcing and management of critical care equipment and personal property equipment and optimal settings for care. For example, there is an increasing trend for hospitals to care for only the critically ill and consequently many can readily convert some of their regular beds to critical care beds. COVID patients are separated from regular critical care patients. Virtual Intensive Care Units are being established outside of the hospital setting. Nurses, managed by specialists at the hospitals, are administering critical care to patients at home. Physical care at ambulatory facilities and at home are flourishing as patients avoid hospital admission because of COVID concerns. On-line health and telehealth will continue to emerge as alternative sources of care, reducing the number of physical meetings with a physician in an office/hospital setting, and in some cases, eliminating a visit.

Currently, facilities delivering healthcare whether it be hospitals, ambulatory centers or physician offices within a medical office building or traditional building, have set up protocols for all visitors and occupants. Policies for masks and pre-screening at building entrances and suite entrances are required with requests or mandates for social distancing in common areas and suite open areas. Hand sanitizer stations have been strategically placed throughout common areas of facilities and physician offices to accommodate patients. Janitorial services in medical buildings have increased both in frequency and scope of work, including the use of stronger disinfectants on surfaces. Existing HVAC systems are being adapted with more filtration and fresh-air intake. Finally, touchless technology is being addressed to provide sanitary ways to access entrance/exit doors, elevators, plumbing and lighting.

Healthcare Trends

Healthcare, to be sure, is not only vital to living but is a large part of our economy. U.S. national healthcare expenditures approximate $4 trillion. Healthcare spending is estimated to increase at an average annual rate of 5.5% through 2027, reaching nearly $6 trillion by 2027, at which time healthcare will represent approximately 20% of the U.S. GDP. The rapid growth in healthcare spending is attributed to the aging U.S. population and the higher-than-average inflation on the price of healthcare goods and services. By 2030, one in every five people in the U.S. will be 65 or over. Interestingly, people over 65 accounted for 36% of all healthcare spending, yet they only represent 16% of the population. The healthcare industry is a large employment sector. Nearly one in every 10 people employed in the economy have jobs in healthcare and that ratio is expected to rise in the future.

Three major trends are occurring: 1) The shift toward care in the home; 2) the shift from fee-for-service to value-based care; and 3) the ongoing professionalization and investment in behavioral healthcare.

Moreover, “retailization” of healthcare continues to evolve. Medical practitioners are establishing facilities closer to the patients in more accessible suburban locations. In addition to single-purpose medical office properties, we continue to see a proliferation of co-location facilities where primary care physicians, for example, occupy space within supermarkets and drugstores.

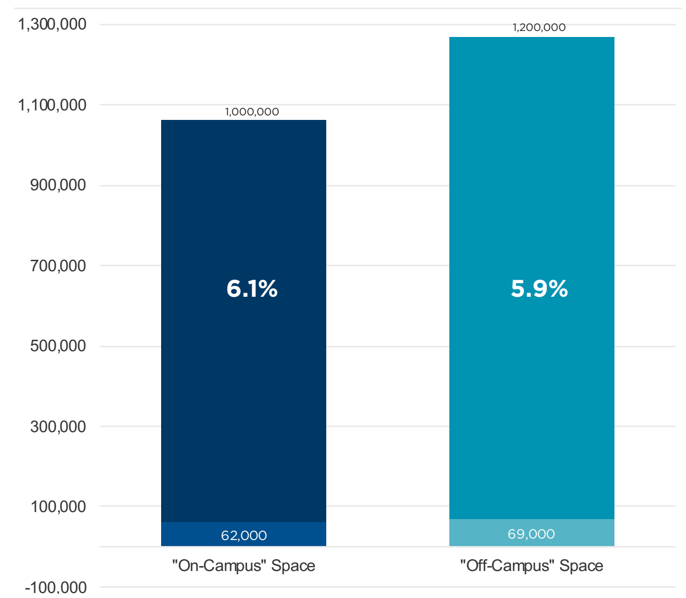
Current Medical Office Building Statistics | *Lincoln, Nebraska*

Space Availability

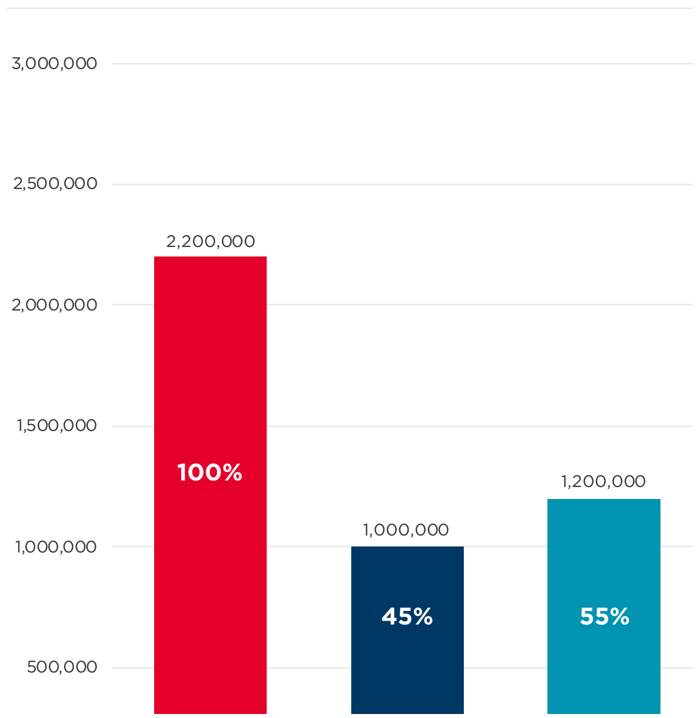
Among 87 buildings recently surveyed, there is approximately 2.2M square feet (SF) of Medical Office Building (MOB) inventory in the metropolitan area. Available space reflects approximately 131K SF or approximately 6% of all medical space. In contrast, nationwide, average medical office space vacancy approximates 8.6%. Lincoln, to be sure, has a healthy Medical Office Building market.

Approximately 45% (1M SF) of total MOB space reflects “on-campus” space, square footage located on Hospital campuses; while the remaining 55% (1.2 M SF) “off-campus” space. Space availability in each category reflects approximately 62K SF (6.1%) and 69K SF (5.9%), respectfully.

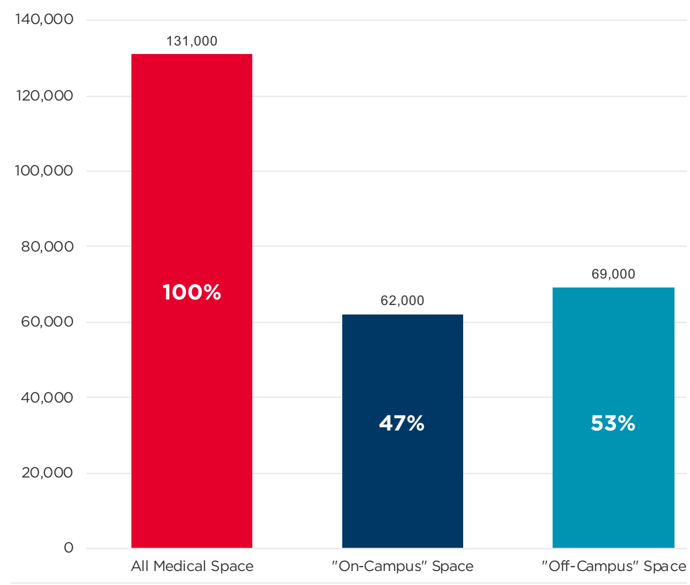
Campus Available SF
Lincoln, Nebraska



Market SF
Lincoln, Nebraska



Market Available SF
Lincoln, Nebraska



Note: All numbers have been rounded.

Investment Activity & Pricing

MOBs are still considered a favored asset class among all commercial real estate sectors given the strong demand for office space due to principally an aging population needing healthcare services. By 2030, all baby boomers will be older than 65, representing 20% of the U.S. population. This 65-and-older age segment is expected to live longer than ever before, which will undoubtedly result in a rise in healthcare related services. As a result, there remains a strong appetite for “cycle-resilient” real estate investment that medical and healthcare real estate offers. Moreover, Investor recognition of the “retailization” of healthcare, a location emphasis of MOBs in affluent suburban markets that are closer to the patients and creditworthiness of tenants, continues to drive premium pricing for off-campus medical products.

Investors are now considering a broader range of healthcare users and tenant types, including behavioral health.

Although telehealth has enjoyed a recent surge in popularity, the widespread adoption and use has not substantially altered the demand for medical office space. Telemedicine is a great supplement, but not a replacement for traditional medical practice. Physicians will still require medical office space to perform traditional office visits.

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Buyer profile continues to transition from a market dominated by institutional and Public/REIT buyers (27%) to the current market that is dominated by more non-traditional private equity and private investors (59%). The balance of the investor pool for medical office buildings are users (14%).

As in 2020, 2021 saw nominal changes in capitalization rates. There was no change in Class A on-campus or off-campus product. Class B on-campus and off-campus product had slight increases (each, 10 basis points). Current national averages are 5.7% and 6.0% for Class A product on and off campus, respectively; 7.4% and 8.1% for Class B product, correspondingly

Although capitalization rates have been relatively flat the past couple of years, they are expected to compress in the future as more capital rotates from the more volatile office/retail/hospitality sectors to medical office. It is projected that the decline will be 50 – 150 BPS.

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Rental Rates & Trend

Of the reported rents, on-campus MOB full-service rental rates range from $22.00 PSF to $28.25 PSF with off-campus $17.25 PSF to $28.50 PSF. The surveyed rents generally do not reflect specialty medical space (i.e., surgical, dialysis, etc.) as this space commands a higher full-service rent due to improvement costs. Local rental rates have generally followed national rental rate increases of 2-3%/year.

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Project Activity | *Lincoln, Nebraska*

Projects Under Construction

- Madonna Rehabilitation Hospitals continues its $57 million expansion/renovation project at its main campus, 5401 South Street. The project will include the addition of an approximate 112 K-SF, three-story patient wing that will replace 59 patient rooms, creation of a new front entry to the existing buildings, exterior gardens for additional daily therapy and renovation of 50K SF of existing space. Completion is expected January 2023.

- CHI Health has broken ground on its approximate 40K-SF primary care clinic, 40th & Yankee Hill Road. Completion is slated for fall 2022. Services will include: priority care with walk-in access, available seven days a week, full-time behavioral health with a psychiatrist on-site, diagnostics services including X-Ray, mammography, ultrasound, DEXA, and more, lab, physical & occupational therapy, pharmacy, and virtual & drive-up care for picking up prescriptions, COVID-19 testing, etc.

- Bryan Health, in partnership with Southeast Nebraska Cancer Center, has broken ground on its $45 million, 140K-SF Comprehensive Community Cancer Center located on approximately 10 acres at 40th & Rokeby Streets. The Center will provide treatment, care, and counseling for cancer patients. The building delivery date is mid to late 2023. The 10-acre site is part of the 29-acre Bryan Hospital controlled area that may also contain approximately 180K SF of future medical office space. The site area will evolve to become "Bryan Health South Campus". The site abuts other development ground that someday will contain 180 residential units and commercial space. The entire development area is known as "Grandale South".

- Nebraska Neurosurgery Group is finishing up its Health Plaza, 27th & Old Cheney Road, Project. The two-story 22K-SF medical office building will contain a 13K SF Ambulatory Surgical Center on the upper level and 8K-SF of clinic space on lower level.

Bryan Health South Campus: Comprehensive Community Cancer Center

Madonna Rehabilitation Hospitals

CHI Health; 40th & Yankee Hill Road

Market Report Sources: Lincoln Journal Star, The Conference Board Economic Forecast of the U.S. Economy, U.S. Bureau of Labor Statistics, The Federal Reserve, Cushman & Wakefield 2021 Medical Office Investor Survey, Cushman & Wakefield "Fall 2021 Vital Signs Healthcare and Medical Office Report", The Conference Board Economic Forecast for the U.S. Economy (November 10, 2021), Goldman Sachs/Economic Research/Global Economics Analysist, GS Macro Outlook 2022: The Long Road to Higher Interest Rates (November 8, 2021), U.S. News & World Report, U.S. Jobless Claims Hit Record 52-Year Low After Seasonal Adjustments (November 24, 2021), U.S. Inflation Calculator, National Conference of State Legislators (October 22, 2021), Shopping Center Business (July 2021), Healthcare in a Post-Covid-19 World: Three Trends to Watch, Andrew Kadar June 8, 2021, Webinar, U.S. Debt Clock.org