Lincoln, Nebraska

# Medical Office Market Overview

Volume 5 | January 1, 2024

The Cushman & Wakefield / The 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 Lincoln, 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., Cushman & Wakefield/The Lund Company, a 41-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

Similar to 2022, the United States Economy continued to show resiliency during 2023 despite the Federal Reserve Bank's continued increases in the Federal Funds Rate, now ranging 5.25% - 5.5%. The Fed has been implementing these rate hikes as a means of achieving a 2% inflation rate target. This monetary policy tool seems to be working as inflation has dropped from 9.1% in June 2022 to 3.1% in November 2023.

Remarkably, the Fed has been able to effectively bring down inflation without creating a recession thus far. GDP remains strong with a projected 2.8% increase for the year and unemployment remains low at 3.7%. While Federal Funds rates have remained stable during the fourth quarter, the Fed has indicated that additional rate hikes during 2024 are not "off the table". However, as long as inflation remains moderate, it is anticipated that the rate might be reduced to 4.6% by year-end 2024 and 3.6% by year-end 2025. Wall Street is reacting very positively to the latest economic news. The Dow Jones Industrial Average ended the year at 37,690, a 13.7% increase over 2022. Moreover, NASDAQ ended the year at 15,011, a 43.4% increase over 2022.

While favorable statistics and emotions are running high at year end, there is concern of lagging effects of the Federal Reserve's Monetary Policy actions (principally its Federal Funds rate hikes) during 2024. GDP, for example, is forecasted to grow by just 0.7%. Unemployment is slated to increase to 4%. Inflation, while continuing to decrease, is forecasted to be 2.4%, a figure 20% higher than the Fed's 2% target.

The $550B in commercial real estate debt maturing during 2024 is a concern among borrowers and banks. Consumer spending is forecasted to slow down because of plateauing wage growth, savings depletion, student loan payment reactivations, personal loans and credit card debt servicing. Moreover, continuing geopolitical risk will affect the economy. Rising tensions with China, the Russo-Ukrainian War, Middle East conflict and upcoming United States Presidential election, no doubt will add degrees of instability that will impact the economy.

## HEALTHCARE

### *Healthcare Economy*

The emphasis of good health in all countries improves the quality of life for its citizens. Health is also an important determinant of economic development. A healthy population means higher productivity. It is a catalyst to economic growth, leading to higher income per capita and of course, affordability to meet financial obligations and/or to just live.

Rising medical supply/equipment and labor costs are pervasive in the healthcare industry. Insurers continue to increase rates to address rising healthcare costs. The average cost that U.S. employers pay for their employees' health care will increase 8.5% to more than $15,000 per employee in 2024. On average, employers subsidize about 81% of health plan costs, while employees fund the remainder.

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Healthcare systems continue to face inflation, labor shortages, high contract labor costs, reduction in positive margin procedures, increase in negative margin procedures and vanishing federal funding support. Operating margins are predominantly razor-thin and in some cases, negative. As a result, many hospital systems are cutting costs, and a major target is labor. For example, Hospitals are recognizing that paying high premiums for contract labor to address short-staffing, is no longer sustainable and are thus they are reducing this employment pool. Continued cost pressure on healthcare systems will likely drive continued agglomeration into 2024 as they can scale for controlling costs, negotiating contracts with payers and establish a diversified market footprint.

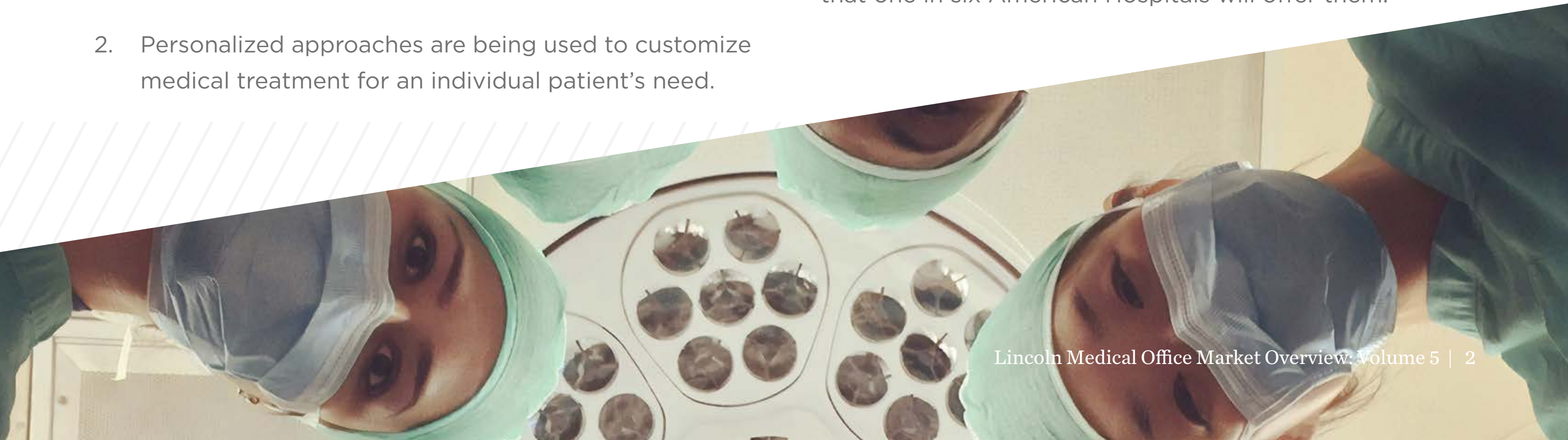
Healthcare, to be sure, is not only vital to living but is a large part of our economy. U.S. national healthcare expenditures approximate $4 trillion. Healthcare spending is estimated to reach $6 trillion by 2027, at which time healthcare will represent approximately 20% of the U.S. GDP. The rapid growth in healthcare spending is attributed to the aging U.S. population and the higher-than-average inflation on the price of health-care goods and services. By 2030, one in every five people in the U.S. will be 65 or over. Interestingly, today people over 65 account 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 ten people employed in the economy have jobs in healthcare and that ratio is expected to rise in the future.

***Eight trends continue to emerge:***

1. Artificial intelligence is being used to assist clinicians in their practices.
2. Personalized approaches are being used to customize medical treatment for an individual patient's need.
3. Patient wearable devices enable consumers the ability to monitor their health and habits.
4. Virtual patient experiences are emerging for a more efficient and more hygienic mode of treatment. In addition, remote patient monitoring programs are reducing the need for continued hospitalization or new admissions.
5. Social determinants of health are becoming more and more recognized in understanding how non-medical factors influence people's health.
6. Mental health is becoming a priority since many of today's chronic conditions are primarily caused by behavior.
7. Employers are setting up direct-to-employer arrangements with healthcare providers.
8. Unbundling of coverage allows consumers to choose specific levels of coverage from a large menu of options.

In addition to the above, major retail institutions are making significant investments in health services and products. Amazon, for example, recently spent $4B to acquire primary care chain, One Medical. CVS has acquired Oak Street Health. Walmart will have doubled the size of its in-store clinics (Walmart Health) by the end of 2024.

Finally, the trend of hospital-level care at home continues to emerge with approximately 300 programs currently in place throughout the country. By 2030, it is anticipated that one in six American Hospitals will offer them.



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## SPACE AVAILABILITY

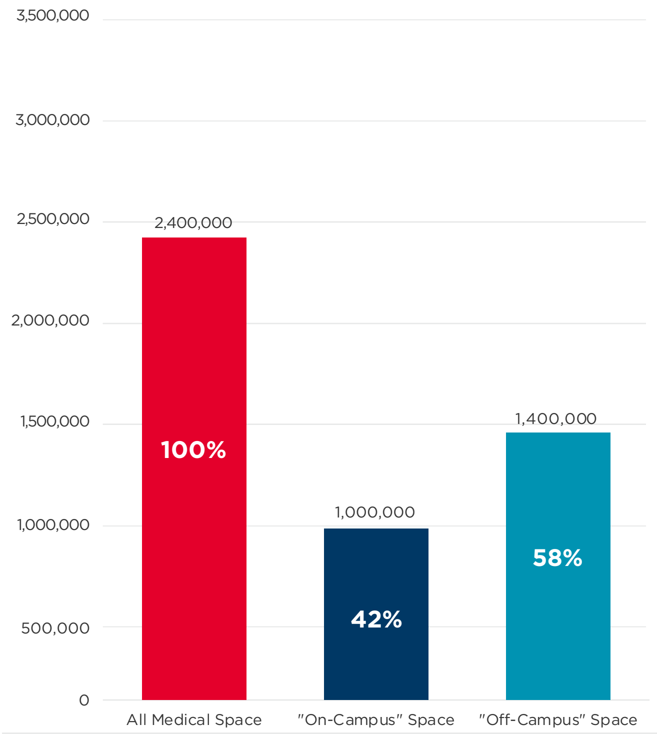
***Current Medical Office Building ("MOB") Statistics***

Among 93 buildings recently surveyed, there is approximately 2.4M SF of MOB inventory in the metropolitan area. Available space reflects approximately 129K SF or approximately 5.4% of all medical space. In contrast, nationwide, the average medical office space vacancy approximates 7.6%. Lincoln, to be sure, has a healthy Medical Office Building market.

Approximately 42% (1M SF) of total MOB space reflects "On-Campus" space, square footage located on Hospital campuses; while the remaining 58% (1.4 M SF) "Off-Campus" space. Space availability in each category reflects approximately 67K SF (6.7%) and 62K SF (4.5%), respectfully.

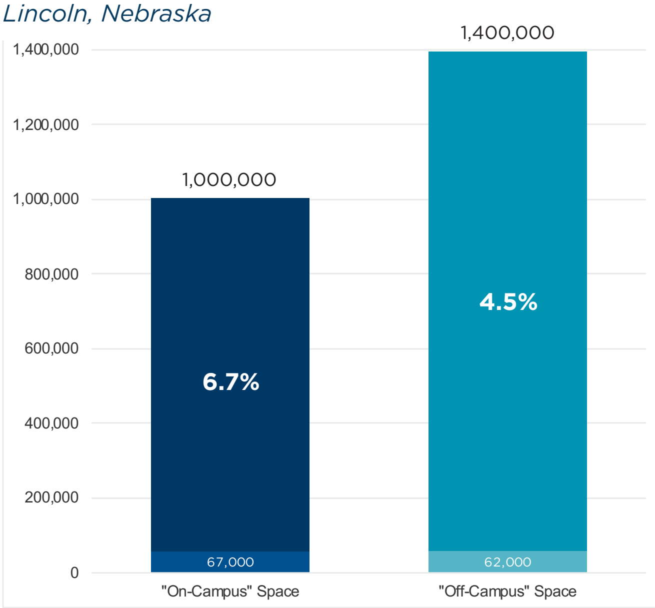
**Market SF**

*Lincoln, Nebraska*



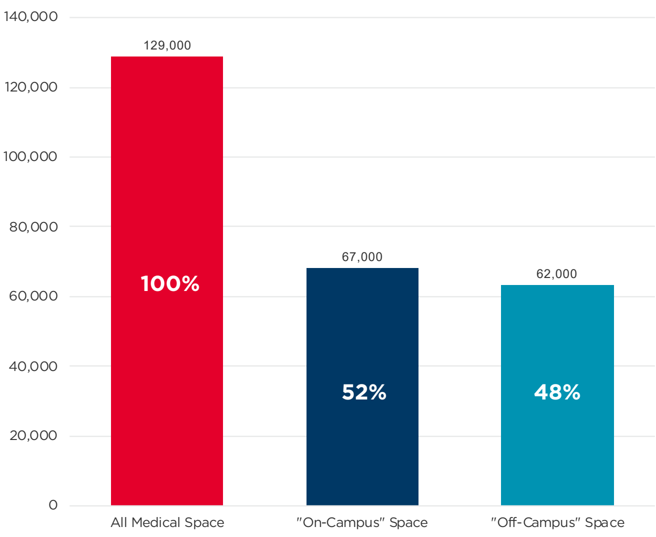

**Campus Available SF**

*Lincoln, Nebraska*




**Market Available SF**

*Lincoln, Nebraska*




*Note: Numbers for all data tables have been rounded.*

## NATIONAL INVESTMENT ACTIVITY, TRENDS & PRICING

*National 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 principally to 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 consequence , there remains a strong appetite for “cycle-resilient” real estate investment that medical and healthcare real estate offers. The industry has more favorable occupancy than in any other real estate sector, 92%. In contrast the general office market is 84%. Investors are moreover attracted to the “retailization of healthcare”, a location emphasis of MOBs in affluent suburban markets that are closer to the patients and to the creditworthiness of tenants. These two attributes continue to drive premium pricing for “off-campus” medical buildings.

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 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.

Buyer profile continues to transition from a market dominated by institutional and Public/REIT buyers (27%) to one with non-traditional private equity and private investors (60%). The balance of the investor pool for medical office buildings is users (13%).

There’s been an approximate 65% drop in sale transaction volume due to limited product availability, mainly driven by high price “hangover” expectations (sellers unwillingness to sell relative to current market conditions), and the cost of debt financing. For some larger institutions to grow their portfolio, mergers with or acquisitions of competitors are an opportunistic way to expand. Physicians Realty Trust (aka DOC REIT) and Healthpeak Properties, for example, just announced their merger. The value of the combined entity will approximate $21B and will involve 52M SF. The transaction is expected to close Q1 2024.

Capitalization rates are on the rise as the cost of capital increases. Class A and Class B “On Campus” product universally experienced a 35-basis point increase, while Class A and Class B “Off Campus” property had a 30-basis point increase, versus a year ago. Current national averages are 5.85% and 6.1% for Class A product “On” and “Off campus”, respectively; 7.55% and 8.2% for Class B product, correspondingly.

Despite rising capitalization rates, the demand for medical office buildings is expected to remain strong as additional capital rotates from the more volatile office/retail/hospitality sectors to medical office.

## RENTAL RATES & TRENDS

Of the reported rents, “on-campus” MOB full-service rental rates range from $23.50 PSF to $29.50 PSF with “off-campus” $17.50 PSF to $38.00 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.

**“Nationally, Class A and Class B on-campus and off-campus capitalization rates experienced an average 32.5% - basis point increase versus a year ago.”**

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## COMPLETED PROJECTS

- ***Lincoln Pediatric Group*** has completed construction of its 27K SF facility, at ***Black Forest Estates, 5625 South 62nd Street.*** The practice occupies approximately 20K SF. The remaining 7K SF is for lease. The Group relocated from Elizabeth Park Medical Center, 70th & Pioneers Boulevard.


Lincoln Pediatric Group

## PROJECTS UNDER CONSTRUCTION

- ***Bryan Health*** is creating a new angiography suite and a new inpatient dialysis center at its **West Campus.**

- Construction is nearing completion on the $45M Bryan Health – Southeast Nebraska Cancer Center ***(April Sampson Cancer Center, 40th & Rokeby Streets).*** The 140K SF comprehensive community cancer center will provide treatment, care, and counseling for cancer patients. 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 additional development ground that someday will contain 180 residential units and commercial space. The entire development area is known as “Grandale South”. Completion is scheduled to occur in Q1 2024.

April Sampson Cancer Center

## ANNOUNCEMENTS

- ***CHI*** has announced plans for a new ***Women’s Health Center*** in the medical office plaza space at St. Elizabeth, where the current mammography center is. The new center will offer mammography, ultrasound and bone density screenings and will house the multidisciplinary breast clinic, which offers genetic testing and a team-based approach to

CHI St. Elizabeth Hospital

*Market Report Sources: The Omaha World Herald, Lincoln Journal-Star, U.S. Bureau of Labor Statistics, The Federal Reserve, Peterson-KFF health System Tracker: Health Spending. “An early look at what is driving health costs in 2023 ACA markets” (July 18, 2022), SHRM: Benefits. “Medical Plan Costs expected to see bigger rise in 2023” (August 16, 2022), Exploding Topics: “8 Healthcare Trends (2023-2025)” (July 13, 2022), Cushman & Wakefield Webinar: “The State of Healthcare” (September 8, 2022, David Porter, Executive Partner, Advisory Board), CNN Business (October 2, 2022, Allison Morrow), The Conference Board (November 9, 2022), Bankrate (November 11, 2022, Sarah Foster), Cushman & Wakefield Vital Signs 2023: Healthcare Sector Outlook, Cushman & Wakefield 2022 Medical Office Investor Survey, Heartland Real Estate Business (December 2022), AARP Bulletin (September 2023), SHRM Report, Kathryn Mayer (August 17, 2023), Medical Economic Publication, Todd Shryock (august 25, 2023), Heartland Real Estate Business (November 2023), CoStar Analytics (December 13, 2023), J.P. Morgan 2024 Economic Outlook: 10 Considerations for the U.S. Economy (December 6, 2023)*