DEAL OF THE WEEK

# The Health-Care Law's Real Beneficiary

*Owners of Medical Office Space Are Benefiting*

ByDAWN WOTAPKA

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Harrison Street paid more than $500 million for medical-office buildings in the Washington area. *James Oesch*

As the Affordable Care Act alters the nation's health-care landscape, business groups are closely watching to see who gets helped or hurt by the new law. In the real-estate world, one group appears to be emerging a clear winner: owners of medical-office space.

Earlier this month, Harrison Street Real Estate Capital LLC paid Washington Real Estate Investment Trust more than $500 million for 22 medical-office buildings containing 1.5 million square feet of space in the Washington area. The rich purchase price translates to $320 a square foot, well above the sector's average price of $179 a square foot and close to what it would cost to replace the buildings.

The sale of Washington REIT's buildings was part of a flurry of medical-office deals in the past year. In the fourth quarter of 2013, investors spent $2.5 billion to acquire medical-office space, up 18% from a year earlier, according to Real Capital Analytics. The average price per square foot, meanwhile, climbed 13% in the same period. Buyers include REITs, private-equity firms and hedge funds.

Brokerage Newmark Grubb Knight Frank, which says it has several medical-office transactions in the pipeline totaling about half a billion dollars, expects to see its sales volume double this year from 2013. "We're seeing a voracious appetite for the product," said Todd Perman, an executive managing director of NGKF Global Healthcare Services.

Even before the Affordable Care Act became law, investors were betting that medical-office space would be a safe bet due to the large number of aging boomers who will require a high level of medical services. The demographic trends meant that medical-office space "was somewhat seen as a safe haven over the last few years," said Dan Fasulo, a managing director with Real Capital.

But the Affordable Care Act means that millions more Americans are gaining access to health care and will seek out services. These trends come as hospitals have been moving nonemergency services into office space near their campuses to reduce costs.

Supply, meanwhile, has risen modestly. After several years of little supply growth, the market added about 7.5 million square feet of medical office space last year and a similar amount should hit the market his year, according to Marcus & Millichap's Healthcare Real Estate Group. Still, oversupply currently isn't a concern because little of this new space is speculative, or built without a user in place, said Alan Pontius, the group's national director.

"New supply will not damage the supply-demand balance," he said, adding that vacancy rates should fall in 2014.

To be sure, the high prices some buyers currently are paying exposes them to risk. Medical-office space can take longer than other types of real estate to re-lease because the user base is limited and rental growth has been relatively flat in recent years.

Christopher N. Merrill, co-founder of Chicago-based Harrison Street, which has about $6 billion of assets under management, said he isn't worried about the high prices his company paid because the buildings it acquired are 90% occupied and the average lease terms are between five and 10 years. The retention rate, or tenants who re-sign leases, is between 85% and 90%.

"We think it's a very good nonvolatile investment. That's what we look for," he said. "Long term, medical office is a very attractive sector."

Mr. Merrill said his company was attracted to the wealthy patient base in and around Washington, as well as locations within walking distance of respected medical institutions including MedStar Health.

Seller Washington REIT said it decided to exit the medical office business to focus on its other businesses, which include apartments, office space and shopping centers.

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