



# Houston's Future Medical Market

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## HOUSTON'S FUTURE MEDICAL MARKET

Houston is among the nation's fastest-growing metropolitan areas. According to the CCIM Institute's Site To Do Business, Houston's ten-county greater metropolitan area is projected to expand by almost one million residents every ten years. The largest demographic age group is 25-34; however, the age group entering the retirement age of 65-74 will increase from 4.8% today to 6.1% by 2015, representing the largest change for any demographic group. During the same period, households will increase by another 150,000.

With Texas currently leading the nation in uninsured residents, the demand for medical office and facilities space is expected to increase as a result of the national healthcare reform bill. Costar classifies 254 Houston buildings as medical office buildings (MOB's) covering 17,423,342 square feet in the Houston area. Many of these are more office building than medical, but all have at least some medical tenants. Healthcare service providers, many in 3,000, 5,000, and 10,000 square foot medical office spaces are placing strategically-located offices throughout the Houston metropolitan area.

Grubb & Ellis tracks medical properties and reports average full-service gross rental rates for class "A" space at \$29.78 per square foot and \$22.13 per square foot for class "B" buildings. However, some class "A" MOB's in strong locations may demand triple-net rates that start in the low \$30s. Houston's MOB market retained its stance as one of the top markets in the nation by weathering the economic downturn and outperforming traditional office properties. The local medical office leasing market ended the year on a strong note by recording 104,963 square feet of positive net absorption during the fourth quarter, driving the annual growth tally to nearly half-a-million square feet. As a result of the sustained growth, overall vacancy fell by 30 basis points to 11 percent

to end the quarter.

The harmony that is evident in the Houston business community is apparent in the healthcare sector also. Houston's major health institutions joined forces to create the world's largest medical center, the obvious focal point of health care and one of the largest employers in the city. The Texas Medical Center (TMC) is staggering in its scope, encompassing 49 institutions, including 13 hospitals, 21 academic institutions, and 15 support services organizations. In 2010, U.S. News & World Report published their best-of edition, with the TMC's University of Texas M.D. Anderson Cancer Center listed as the nation's No. 1 cancer center and five other TMC institutions making the 2010 "America's Best Hospitals" list.

The Greater Houston Partnership reports that The Texas Medical Center will grow to 41 million square feet as a result of \$7.1 billion in capital investment planned through 2014. Projects include new hospitals, clinics, research labs and office space for member institutions. The additional health-related activities in this space could increase Texas Medical Center employment by some 30,000. Currently, the complex consists of 6,500 licensed beds and 600 bassinets.

### **TMC construction underway or projects that should be completed by 2014 include:**

- \$158 million facilities expansion and renovation and land acquisition program for the Harris County Hospital District
- Baylor College of Medicine's \$40 million Michael E. DeBakey Center for Biomedical Education and Research. The center will serve as a resource for physicians and scholars who wish to study advances in a range of medical areas, from cardiovascular surgery pioneered



by Dr. DeBakey to the contemporary innovations made possible by breakthroughs in genomic medicine discovered in BCM's Human Genome Sequencing Center.

- M.D. Anderson's addition of nine floors atop its 12-story Albert B. and Margaret M. Alkek Hospital. Expected cost: about \$293 million. This expansion will add 478,000 square feet to the hospital's current 755,764 square feet.
- Memorial Hermann Medical Plaza, the largest medical office building in the Texas Medical Center, with a 1.5 million square foot, 30-story tower representing a capital investment of \$157.5 million.
- The Methodist Hospital will build a \$300 million patient tower and a \$70 million adult outpatient clinic to consolidate services.
- St. Luke's Episcopal Hospital is undertaking a \$200 million expansion project that
- includes demolishing its original 50-year-old hospital and erecting a 10-story patient care center.
- Memorial Hermann Healthcare System is undergoing a five-year, \$420 million project to expand all nine of its acute care hospitals.
- HCA is undertaking seven construction projects, including a \$50 million investment in a medical office building, parking deck and surgery center at the Woman's Hospital of Texas.
- Near the Texas Medical Center, The University of Texas Research Park — a joint project of The University of Texas M.D. Anderson Cancer Center and The University of Texas Health Science Center — Houston — offers a master planned campus with laboratory and office

space for both academic and commercial biomedical and biotechnology research facilities. Here, collaboration between scientific and business professionals will accelerate commercialization of new biotechnologies developed in the Texas Medical Center and the Research Park and lead to new businesses, products and services. The M.D. Anderson portion of the Research Park is planned to provide parcels for as many

Member institutions also take the lead on the research front. For example, Texas Children's Hospital started building a Neurological Research Institute, which will be the first facility in the U.S. entirely dedicated to researching and developing treatments for pediatric cognitive developmental and neurological disorders.

Baylor College of Medicine has built the shell of the \$1 billion Baylor Clinic and Hospital on a 35-acre tract of land located in the Texas Medical Center's mid-campus. They completed the exterior of the building in 2010 and have put the construction of the interior on hold while they increase funds for the project. Another possibility for the building would be to sell it to an investor or user that can construct the interior to meet their specific needs.



*BAYLOR CLINIC AND HOSPITAL (INTERIOR CONSTRUCTION ON HOLD)*



When the \$7 billion worth of projects now underway at Texas Medical Center are completed in 2014, the center will rank as the country's seventh-largest business district – larger than downtown Los Angeles. That's just the main campus near downtown. It doesn't include satellite projects throughout the Houston metro area and beyond, or hospital and clinic complexes like the western campus in the suburb of Katy, headed up by Texas Children's Hospital and Methodist Hospital. Currently, west Houston, extending from Beltway 8 west past Katy, is home to more than one million residents. Research conducted by the West Houston Association predicts continued growth for the greater west Houston area through 2025, with an almost 50 percent increase in residents,



*THE NEW TEXAS CHILDREN'S HOSPITAL WEST CAMPUS, TOP, AND METHODIST WEST HOUSTON HOSPITAL*

bringing the total number of west Houston residents to more than 1.4 million.

Other strong submarkets where healthcare campuses are being developed or grown include Kingwood and Humble on the northeast, Cypress in the northwest, and Sugarland in the southwest.

Clear Lake, the south Houston suburban area of more than 1.5 million residents and home to NASA, is also home to the HCA affiliated Clear Lake Regional Medical Center (CLRMC) which employs more than 2,000 people.

The CLRMC will have completed a \$17 million expansion in March 2011 for its Heart and Vascular Hospital with 72 additional private rooms; and a \$92 million expansion and renovation is planned between now and the summer of 2013. The expansion will include a new 154,470-square-foot patient tower which will house pre-operating, operating and recovery rooms as well as a 30-bed adult intensive care unit.



*CLEAR LAKE REGIONAL MEDICAL CENTER*



## INVESTMENTS

Despite much uncertainty in the healthcare sector concerning the impact of health insurance reform and the condition of the general economy, the core-like profile of high quality medical real estate is proving attractive to investors. Medical office buildings remained a popular investment choice in 2010 offering several advantages over traditional office properties such as lower volatility, higher occupancies, and longer term leases that lead to stable cash flows and strong valuations. According to Real Capital Analytics (RCA), transaction volume in Houston nearly doubled in 2010 compared to the prior year as investors spent an estimated \$84.3 million. The largest transaction during the fourth quarter of 2010 involved Grubb & Ellis Healthcare REIT II which paid \$13.1 million for the Humble Surgical Hospital located at 1475 FM 1960 Bypass.

Looking ahead, MOB's are positioned to have another solid year in 2011.

Cap rates for MOB's are continuing to compress for a number of reasons including large pools of equity aggressively searching for assets to acquire. Cap rates for Class "A" on-campus healthcare properties have fallen into the low 7% range and sometimes below 7%. Off-campus properties are trading slightly higher at 8-9% for good quality properties with a strong tenant base. It is expected that the continuation of low interest rates combined with the positive change with debt markets will help fuel this compression of cap rates. Ask-to-offer differentials will continue to shrink as investors get more aggressive due to pent up demand and available capital.

