Medical Office Strikes Back

› Southern Nevada’s medical office market registered its first positive net absorption in five quarters
› Vacancy dropped to 17 percent
› Asking rates also turned around, posting a moderate increase

After four quarters of mounting negative net absorption, Southern Nevada’s medical office market made an abrupt turn into positive territory. Net absorption rebounded in the third quarter of 2016, reaching 54,493 square feet. This brought vacancy down to 17 percent, a 0.7 point drop from one quarter ago, but still 0.7 points higher than one year ago. The weighted average asking rental rate increased to $2.16 per square foot (psf) on a full service gross (FSG) basis, a $0.02 increase over last quarter.

Historical Vacancy Rates and Rental Rates

“The third quarter of 2016 offered a pleasant change of course for the medical office market …”
According to the Nevada Department of Employment, Training and Rehabilitation, Southern Nevada’s medical office job market improved in July 2016 (the latest month of data available) compared with July 2015, adding approximately 4,500 jobs in the past twelve months. This does not include jobs at hospitals. Employment that directly impacted medical office projects increased by approximately 1,100 jobs. The medical sector has seen strong job growth for many quarters without that growth impacting demand for medical office space. This quarter, the medical office might have finally caught up with that job growth. Unemployment in the Las Vegas-Paradise MSA stood at 6.7 percent as of July 2016, down from 7.1 percent in July 2015. From July 2015 to July 2016, total employment in Southern Nevada has increased by 27,000 jobs.

According to the Nevada Department of Taxation, taxable spending on ambulatory health care services in Clark County in the second quarter of 2016 (the most recent quarter of data) totaled $21.1 million dollars. This represented a 22 percent year-over-year increase in spending. Spending on ambulatory health care appeared to be leveling off in late 2015 and early 2016 until the second quarter’s jump. On the downside, it is unclear how much of this increase in taxable spending is due to more healthcare being purchased versus how much that healthcare costs.

The last time medical office space was completed in Southern Nevada was during the second quarter of 2015, when 16,000 square feet was added to inventory. When the new Henderson Hospital at Union Village is completed, which should be very soon, development of 150,000 square feet of medical office and 190,000 square feet of retail space will follow, though this could still be 12-18 months away. A 211,000 square foot Class A medical office building is now under construction at Cimarron Road and Tenaya Way, and should be completed in 2017. Several new small hospitals for urgent or emergency care are planned in the valley, including the 100,000 square foot Southern Hills Emergency Hospital at Desert Inn & Fort Apache, and four small hospitals being developed by Dignity Health at Craig & Camino Al Norte, Blue Diamond & Decatur, Flamingo & I-215 and Decatur & Sahara.

Vacancy in medical office space decreased in the third quarter of 2016 to 17 percent, a decrease of 0.7 points from the second quarter of 2016, but an increase of 0.7 points from one year ago. This quarter’s decrease in vacancy was the first such decrease in four quarters, despite growth in health care-related jobs and spending, and hopefully signals a return to a more normal pattern of growth.

The highest vacancy rates in the third quarter of 2016 were in the Southwest (32.7 percent), North Las Vegas (20.9 percent) and Airport (20.2 percent) submarkets. The lowest vacancy rate is now in Downtown (10.4 percent), followed by East Las Vegas and Henderson at 14.7 percent. Vacancy decreased in Downtown, East Las Vegas and the Southwest, with the largest decrease occurring in the Downtown submarket. Vacancy increased in Henderson, West Central and Northwest, and remained stable in Airport and North Las Vegas.
Southern Nevada’s medical office market saw some positive growth in early 2015, but this growth turned negative during the four quarters between the third quarter of 2015 and the second quarter of 2016. This means that this quarter’s positive net absorption is the first growth the market has seen in a year. The 2015/2016 1.4-point increase in vacancy occurred at the same time the Valley added over 1,000 ambulatory healthcare jobs and ambulatory healthcare spending increased by 4.7 percent.

The disconnect between job and spending growth and demand for medical office space can be tied to changes in which healthcare is being delivered, and these changes will continue to plague the market for years to come. In the first place, consolidation within the medical profession, coupled with more efficient space use, is decreasing the amount of space occupied by medical office users. Even when medical users are growing their practices, they may not be growing the size of their office. On top of that, medical practitioners have found it possible to use non-medical office space, such as in professional office buildings and retail centers, for their practices. Both of these factors have hurt demand for medical office space for the past decade. Since 2006, Southern Nevada’s medical office market has lost 151,000 square feet of occupancy, while at the same time adding 10,600 ambulatory healthcare jobs.

The lowest average asking rate for medical office space was in the West Central submarket, at $1.78 psf, followed by North Las Vegas at $1.80 psf. The Valley’s highest asking rate was in Northwest, at $2.41 psf, followed by Henderson at $2.34 psf. Lease rates increased this quarter in Downtown, East Las Vegas and West Central, and decreased in Henderson, North Las Vegas, Northwest and Southwest. It is worth noting that decreases in vacancy in Downtown and East Las Vegas were accompanied by increases in the weighted average asking rates in those submarkets; this suggests that the occupancy of less expensive space was indeed a factor in the increase of the Valley’s average asking rate in the third quarter.

Investment sales volume of medical office so far in 2016 amounted to $9.9 million in three sales totaling 90,000 square feet, with an average sales price of $110.12 per square foot. These buildings had an average cap rate of 6.8 percent. For comparison’s sake, investment sales volume in 2015 was almost $80 million.

Owner/user sales volume of medical office space so far in 2016 was $6.1 million in five sales totaling 23,893 square feet. The average sales price was $255.70. For comparison’s sake, owner/user sales volume in 2015 was $40.9 million in twelve sales totaling 120,543 square feet, with an average sales price of $339.03.

The third quarter of 2016 offered a pleasant change of course for the medical office market, replacing four quarters of negative net absorption with positive net absorption. While the four quarter slide was certainly not good for the market, it was fortunately not quite enough to erase the two strong growth quarters that occurred in early 2015, which means that the medical office market is in better shape now than it was two years ago. In medical office’s favor is the continued growth in healthcare employment and maybe the growth in healthcare spending in Southern Nevada. Even if not all of that growth is filtering into medical office buildings, this should help improve demand for medical office space in the long run.
Significant Medical Office Sales Activity

- **Windmill Medical Office Building**
  - 9,000 SF - $1,400,000
  - $161.98/SF
  - March 2016
  - Class C

- **Coronado Medical Center**
  - 3,000 SF - $600,000
  - $186.40/SF
  - May 2016
  - Class C

- **2650 North Tenaya Way**
  - 68,000 SF - $2,900,000
  - $42.61/SF
  - April 2016
  - Class B

- **Huffman Hualapai Pavilion Commons**
  - 5,500 SF - $2,500,000
  - $463.64/SF
  - July 2016
  - Class C

Significant Lease Activity

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<tr>
<th>Property Name</th>
<th>Lease Date</th>
<th>Lease Term</th>
<th>Size</th>
<th>Lease Rate</th>
<th>Tenant</th>
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<tr>
<td>1330 Valley View</td>
<td>Jul 2016</td>
<td>126 months</td>
<td>18,100 SF</td>
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<td>Durango Medical Plaza</td>
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## Market Comparisons - Las Vegas

### Medical Office Market

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<td>UNDER CONSTRUCTION SF</td>
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<td>PLANNED CONSTRUCTION SF</td>
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**Las Vegas Research & Forecast Report | Q3 2016 | Medical Office | Colliers International**
502 offices in 66 countries on 6 continents

- United States: 153
- Canada: 34
- Latin America: 24
- Asia Pacific: 231
- EMEA: 112

$2.5 billion in annual revenue*

2.0 billion square feet under management

16,000 professionals and staff

*All statistics are for 2015 and include affiliates.

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