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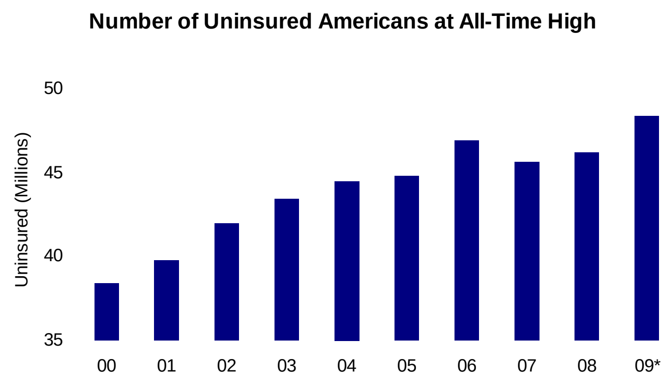
THE OUTLOOK

Healthcare Reform:
A Winning Prognosis for Medical Office Investments

Healthcare reform has emerged as a top priority for the new administration, and opportunities within medical office investments bear close monitoring as a result. At present, rising medical costs, a lack of access and quality concerns are preventing many Americans from seeking regular care. Compounding these problems are economic uncertainty, extreme job losses and corporate benefit cuts. In spite of the issues, the medical office sector is outperforming traditional office properties, and demand should increase considerably as a growing share of the population is covered by health insurance.

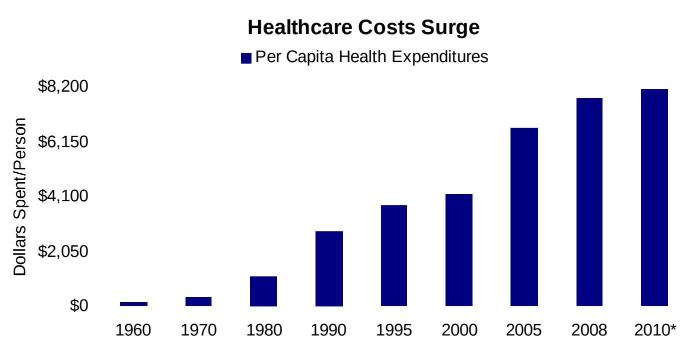
Healthcare Cost-Prohibitive for Many Americans. When managed care became prevalent in the 1980s, healthcare costs constituted roughly 9 percent of GDP; costs have since surged to almost 17 percent. Likewise, annual per capita costs jumped from $1,100 in 1980 to almost $7,800 last year. On average, Americans spend 5 percent of their pre-tax income on healthcare, with those in lower income brackets paying 15 percent or more, leading many lower-income families to forgo care and/or insurance coverage.



* Forecast
Sources: Marcus & Millichap Research Services, CDC, Economy.com

Lower Costs, Accessibility to Drive Surge. Despite higher costs, doctors' office visits have increased 13.2 percent over the past 10 years. The administration is hoping to reduce costs, saving a typical family up to $2,500 per year as reforms are implemented. Proposals include a new public insurance plan based on benefits available to members of Congress that would allow individuals and small businesses to purchase affordable healthcare coverage. If costs decline as projected, insured and uninsured alike are expected to increase their utilization of primary and specialty care physicians. The resulting surge will intensify demand for physicians and nurses, which will, in turn, heighten the need for medical office space.

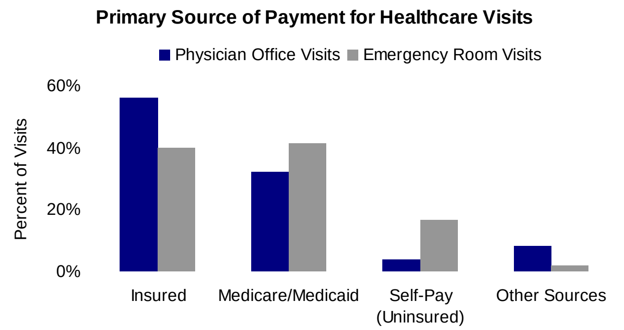
Goals of Healthcare System Overhaul: Access, Quality and Affordability. The aim of the new administration is to eventually cover all Americans and reduce costs. More than 46 million Americans do not have health insurance. While the nation has been on the verge of reform several times since the 1930s, a broad coalition of healthcare and doctor associations, insurance companies, and pharmaceutical companies is converging to support this initiative. The group believes it can shave 1.5 percentage points from the growth rate of U.S. healthcare costs over the next 10 years, a savings of approximately $2 trillion. Inroads have been made previously with the passage of Medicare and Medicaid in 1965. These programs made healthcare available to the elderly and the poor, but even these plans are in



* Forecast
Sources: Marcus & Millichap Research Services, BEA, CDC, OMB, U.S. Census Bureau

need of an overhaul, as the trust funds set aside to finance them are dwindling at an accelerated pace due to the recession.

Reform at the Start of a Long Journey. In the latest version of the administration's budget, $630 billion has been earmarked over the next 10 years for financing reforms to the healthcare system. Furthermore, the American Recovery and Reinvestment Act of 2009 (ARRA) includes an allocation for prevention and wellness intervention that places a stronger focus on primary care physicians. In the near term, this will generate increased demand for medical services in offices while reducing pressure on emergency rooms. The uninsured and underinsured presently comprise nearly 17 percent of emergency room visits but only 4 percent of physician office appointments.

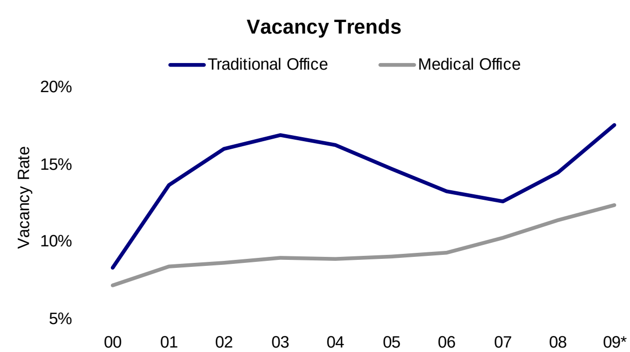


Sources: Marcus & Millichap Research Services, CDC, U.S. Census Bureau

Medical Sector Constantly Evolving. Technology, innovation, and research and development will play crucial roles in medical reform, providing yet another potential demand driver for office space. The medical landscape is changing rapidly as new treatments, drugs and devices become available. To facilitate continued research and development, the ARRA contains a $1.1 billion provision for medical research, including investments in studies into the comparative effectiveness of drugs and treatments. This will generate demand for R&D and traditional medical office space.

Impact on Medical Office Property Sector

Medical Office Outperforming. Despite the recession, medical office properties have performed favorably, and demand is set to accelerate as medical reform is phased in over the next several years. Unlike other asset types, medical office properties continue to garner investors' demand by exhibiting considerable resistance to the economic downturn. Medical office vacancy is currently 11.6 percent, up only 100 basis points from one year ago; traditional office vacancy, by comparison, is 15.2 percent, a 240 basis point increase over the same period.



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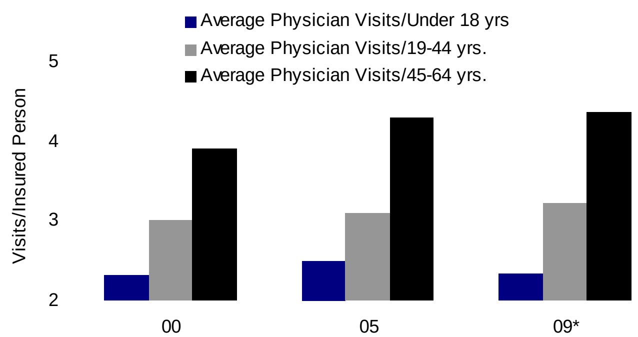
Sources: Marcus & Millichap Research Services, CoStar Group, Inc., Reis

Changes Under Way to Buoy Space Demand Through Downturn. The ARRA included a temporary provision to make insurance more affordable for unemployed individuals. This group will receive a tax credit to continue their health insurance through COBRA, which will benefit an estimated 7 million Americans. Healthcare demand will be supported further by the reauthorization of the Children's Health Insurance Program (CHIP) for the next 4.5 years. The $33 billion legislation broadened coverage by 57 percent, or 4 million children. The result is a forecast 5 percent increase in patient office visits for those under 18 years of age, or almost 10 million additional office visits per year.

Demographic Trends, Scientific Advancements Support Positive Outlook for Medical Office. The medical office sector's resilience can be attributed to a combination of variables, including technological advances and medical innovations that continue to extend life spans, as well as the aging baby boomer generation. At present, baby boomers account for 29 percent of the total uninsured yet represent almost one-third of all physician office visits. Proposed changes to the healthcare system will dramatically increase demand for medical services among this group. Per person office visits for 45- to 64-year-olds have expanded by 7 percent over the past decade. Insuring 95 percent of this cohort could elevate physician office visits by 12 percent, or 34 million visits, annually. At the current average of 120 visits per week for primary care physicians, approximately 5,400 new general practitioners will be needed to handle the additional workload from this age group alone. The resulting demand for office space from these doctors would total nearly 10 million square feet.

Insured Baby Boomers Seek More Medical Care



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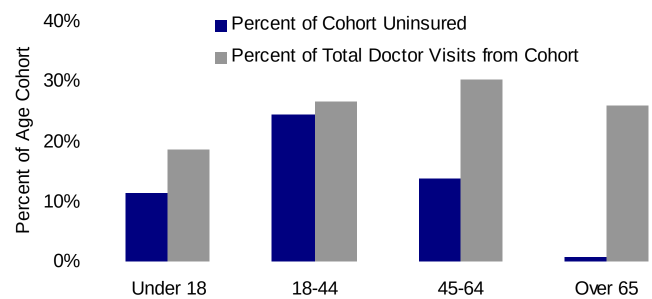
Sources: Marcus & Millichap Research Services, CDC, OMB

Significant Share of Younger Population, Baby Boomers Uninsured



Sources: Marcus & Millichap Research Services, CDC

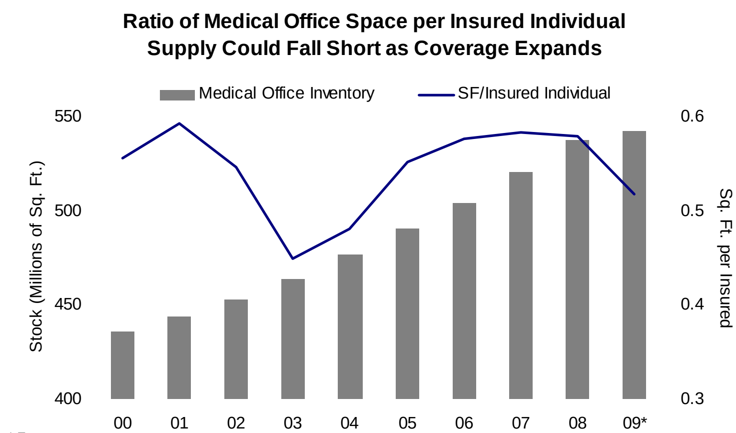
Healthcare Reform Beneficial to Medical Office Investment. For insights into how the implementation of a national healthcare plan could affect the overall medical office market, we looked to Massachusetts, which implemented reform in 2006. So far, medical reform in Massachusetts has been a boon for the state's medical office sector. Massachusetts' version of universal healthcare has resulted in 97 percent coverage. Higher demand for healthcare, however, has been met with a shortage of providers. Nonetheless, the impact on medical office in the state has been significant.

- Since passage of the plan in 2006, developers have added 1.8 million square feet of new medical office space in Massachusetts, a roughly 14 percent increase to inventory. Absorption has been robust, with 85 percent of the space already occupied and statewide vacancy holding firm in the low-9 percent range, one of the lowest rates in the country.

- Within the investment arena, sales of medical office properties in Massachusetts increased during each of the past three years. Institutions dominated the local market in 2006 and early 2007, but private investors have expanded their presence recently, purchasing smaller assets. Transaction velocity in the state was up 32 percent in 2008, while dollar volume and transaction velocity for properties under $10 million rose 55 percent and 40 percent, respectively. In contrast, dollar volume and transaction velocity for similar assets nationwide fell 5.2 percent and 4.8 percent, respectively, last year.

Medical Office Demand Set to Rise. There are still unknowns regarding the methods that will be used to achieve nationwide coverage; however, if reform is even partially successful, demand for medical professionals and facilities will increase.

- It is estimated that a net addition of more than 8,000 primary care physicians will be needed to care for the newly insured. While it will take time for the healthcare community to catch up with the increase in demand for services, the addition of even half of these new doctors in the near term would generate demand for another 7 million square feet medical office space, based on the current U.S. average of 1,780 square feet per primary care doctor.



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Sources: Marcus & Millichap Research Services, CDC, CoStar Group, Inc., TWR

- The outlook is even more optimistic when viewed from the perspective of office space required per covered individual. Increasing the health insurance coverage rate to 95 percent of the population, up from 84 percent at present, would require an additional 21.4 million square feet of medical office space, based on the current ratio of approximately 0.5 square feet per insured individual.

Healthcare Reform a Slow Process but Gaining Momentum. Healthcare reform will continue to evolve on Capitol Hill, but changes are becoming increasingly probable, which bodes well for the long-term health of the medical office sector. Overall, the task of insuring the uninsured and underinsured could result in 56 million extra patients, or roughly 20 percent of the population. This significant increase will not only generate greater demand for physicians and nursing but also require additional record processing and enrollment personnel, further driving demand for healthcare space and even nearby office properties. One major caveat is the potential shortage of physicians and skilled nurses. Recognizing this fact, however, several members of Congress have introduced legislation aimed at attracting and retaining healthcare professionals and direct-care workers.

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