

Houston's healthcare sector takes a pause, but for how long?

BY MATT BAKER



Mason Creek MOB in Katy, Texas, recently acquired by Montecito Medical.

The Houston healthcare sector, like the overall market itself, witnessed incredible growth over the past decade. That activity came to a skid, however, leaving owners and occupiers attempting to navigate the choppy waters brought about by the pandemic.

All market metrics—from absorption to vacancy to investment activity—either remained relatively stable or trended in discouraging directions, according to Q3 research compiled by Transwestern. For example, absorption during the quarter was less than that of a typical dialysis center, totaling just 456 square feet.

Granted, just barely positive absorption is better than negative, but that figure is tempered even further by the 70 bps quarter-over-quarter vacancy rate increase to 13.1 percent. One contributing factor to this rise in vacancy is the approximately 252,000 square feet of new healthcare space that came online, less than half of which was pre-leased.

The largest delivery during the third quarter was Bissonnet Medical Plaza, a 53,000-square-foot MOB in the Bellaire submarket. All across Houston, multiple projects are in the pipeline that will add additional healthcare supply.

In or near the TMC alone there are three hospital facilities now under construction, totaling more than 733,000 square feet. The largest of these is the 427,000-square-foot O'Quinn Medical Tower going up on the Baylor St. Luke's McNair campus, scheduled for completion in early 2024. The two-building UTHealth Public Education Mental Health Hospital will comprise 220,000 square feet when it wraps construction this December. Slated to deliver in the fourth quarter of 2023, the MD Anderson Cancer Center Proton Therapy Center will occupy 86,500 square feet.

A pair of developments in The Woodlands—both scheduled for completion early next year—will bring over 592,000 square feet of healthcare space to

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that submarket. The Memorial Hermann Woodlands tower expansion will be over 332,500 and the Houston Methodist Woodlands project will add another 260,000 square feet.

Looking across the Houston area, 14 out of the 17 submarkets that Transwestern tracked saw a rise in vacancy. The most dramatic quarterly increases were in Bellaire and Conroe which rose, respectively, 220 bps to 10.6 percent and 200 bps to 15.8 percent. Though the Near North didn't see much additional vacancy this quarter, it still has the highest availability with a 24.7 percent vacancy rate. The Texas Medical Center (TMC) and Clear Lake scored the lowest vacancies across the metro with 8.1 and 8.3 percent, respectively.

The metro's \$27.24 per square foot average asking rent during the third quarter represents a 90 bps drop from the previous quarter and is down 120 bps year-over-year. More than half of all submarkets saw asking rents reduce; the Near North commanded the lowest rent at \$20.76 per square foot but the Inner Loop saw the most precipitous fall, dropping 1,140 bps quarter-over-quarter to \$27.44 per square foot. Asking rents are highest in the 290 Corridor, The Woodlands and the South submarkets, all of which were just north of \$30 per square foot.

Given overall capital hesitancy at the height of the pandemic late last year, and the performance of Houston's healthcare sector, investor activity was subdued in the third quarter. The most notable transaction saw Montecito Medical acquire Mason Creek MOB from Read King Commercial. The 30,000-square-foot building, located in Katy, Texas in the Far West submarket, is fully leased to Village Medical and Memorial MRI & Diagnostics.

While the pandemic certainly cooled transaction velocity, investors continue to have interest in healthcare assets, especially those that are well-leased to tenants with good credit. And with continued job growth in the sector, this interest is sure to pick back up.

Houston added 2,500 healthcare jobs in the third quarter, rising to 6,600 from one year prior—before the start of the pandemic. There were nearly 8,000 new jobs during that time in the ambulatory health care services subsector, which includes offices of physicians, dentists and practitioners, among others.

This job growth is projected to continue for years to come. A study by Center for Houston's Future found that healthcare—which currently accounts for 12 percent of employment across the region—will see an explosion over the next 17 years, with one in four newly created jobs being in the healthcare sector.

Houston is currently facing more hurdles than most other U.S. markets as the pandemic has also led to a collapse in the energy sector. This will only

compound the recessionary forces brought about by COVID-19. Add to that the incredible growth that the market witnessed in the previous decade—spurred on, in part, by healthcare expansion—and there are going to be near-term increases in vacancy across sectors.

The long-term outlook is far more bullish. Healthcare is an always-in-demand sector to a degree, so high-quality properties should continue to attract credit-worthy tenants and investor interest. The wider asset class will have to wait until after widespread vaccine rollout, and for the supply-demand landscape to return to balance. Assuming the vaccines prove to be effective and are distributed quickly (and no variants of the virus create new issues), pent up demand for Houston-area healthcare space could begin to have an impact as soon as late 2021.

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