

# COMPASS



## Impact Of COVID-19 Accelerates Occupier Right-Sizing

The arrival of COVID-19 in the first half of 2020 caused significant disruption across the healthcare industry, which had long been perceived to be recession-proof. Since the onset of the pandemic, lost revenue due to depressed patient volume for elective procedures has forced systems and other users to accelerate changes to their business models. Some notable changes played out in the Twin Cities medical office market during the second half of the year as occupiers began to right-size their footprints.

Fairview Health announced the closure of two hospitals in St. Paul, Bethesda and St. Joseph's, each has been repurposed in the short term for public housing and other community support services. Additionally, Fairview will close 16 of its clinics in the Twin Cities and western Wisconsin. HealthPartners also announced the closure of seven clinic locations in the Twin Cities market as well as a larger space in Sartell, Minnesota. These locations and others followed a common pattern of temporarily closing due to pandemic-related restrictions before ultimately never reopening as systems quickly pivoted their businesses, in part driven by the incorporation of telehealth practices.

An increase of sublease availability represented a symptom of right-sizing steps taken by medical office building (MOB) occupiers in the second half. More than 50,000 square feet (sf) of sublease space was available in the off-campus universe at year-end, which more than doubled the total recorded in the first half. Tenants largely slowed new leasing decisions, focusing instead on shorter-term extensions of critical leases, and year-to-date direct absorption in the market was virtually flat.

The more measured pace of development has been a trademark of the off-campus market in the Twin Cities, and the second half of 2020 continued this historical trend. Davis began construction on the ±78,000-sf Xchange Medical project in St. Louis Park with lease commitments in place from Ear Nose & Throat Specialty Care and Surgical Care Affiliates. In the Northeast submarket, the Roseville Health MOB, also by Davis,

**MEDICAL HISTORICAL RENTAL RATES (AVG NET)**

Source: Cushman & Wakefield





completed in the second half with Tareen Dermatology occupying half of the ±40,000-sf project. Twin Cities Orthopedics broke ground on its latest single-tenant facility in Oak Park Heights.

Growing demand for Twin Cities medical office product, from established ownership groups as well as new capital entering the market, made for steady investment sales activity in the second half. Stabilized assets cleared the market with strong pricing support. Notables deals included:

- **The Excelsior Group** sold Mercy Health Care Center in Coon Rapids to Healthcare Realty Trust after a successful renovation of the on-campus asset, capped off by recent new lease commitments from groups within the Allina Health system that totaled nearly 40,000 sf.
- **Montecito Medical Real Estate** purchased the 100%-leased Ridges Pondview in Burnsville for the group’s first acquisition in the Twin Cities market.
- **Healthcare Realty Trust** also acquired City Center Professional Building in Plymouth just before year-end at a price of \$322 per square foot (psf). This 48,594-sf, Class A project was 100% leased at the time of the sale. The seller was an entity controlled by Sidal Realty Company.
- **Cornerstone Medical Specialty Centre** in Woodbury traded for almost \$475 psf. The 52,767-sf property is also 100% leased.
- **Medcraft Healthcare Real Estate** purchased an ±11,400-sf MOB in Otsego for nearly \$400 psf. The property was occupied and sold by Twin Cities Orthopedics.

MEDICAL VACANCY & ABSORPTION					Source: Cushman & Wakefield			
SUBMARKET	TOTAL # BLDGS	NRA	VACANT SPACE	% VACANT	% VACANT W/SUBLEASE	1ST HALF 20 ABSORPTION	2ND HALF 20 ABSORPTION	2020 ABSORPTION
Off Campus	82	3,544,216	528,876	14.90%	16.40%	20,349	-23,118	-2,769
On Campus	40	3,205,650	274,404	8.60%	8.70%	5,151	10,650	15,801
<b>Total Market</b>	<b>122</b>	<b>6,749,866</b>	<b>803,280</b>	<b>11.90%</b>	<b>12.80%</b>	<b>25,500</b>	<b>-12,468</b>	<b>13,032</b>

**OUTLOOK**

Long-term fundamentals, such as the increasingly aging population and corresponding consumer spending on healthcare, continue to support employment levels in the industry and demand for medical office space. More measured demand, however, is expected in the short term as occupiers continue to evaluate and execute right-sizing plans.

**THE COMPASS REPORT**

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