What the Doctor Ordered: Medical Property Shines

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Investors are pouring money into buying and developing senior housing, medical-office buildings and other health-care-related properties, a class of commercial real estate that has been outperforming almost all others since the recession.

The country’s aging population and recovering economy, as well as major changes taking place in the economics of health care, are fueling demand for more space.

Investors are gravitating to health-care real estate in part because it held up well during the downturn. Since 2007, health-care real-estate investment trusts have outperformed all other property types except for manufactured homes and self-storage facilities, according to the National Association of Real Estate Investment Trusts.

Investors also are betting the Affordable Care Act will translate into millions more visits to doctors by patients who are getting insurance for the first time. Last year, health-care-focused REIT shares produced total returns of 35.5%, including dividends, Nareit said.

The strong performance and new money flowing into the sector are signs that many investors want to stick to properties that are more recession-resistant.

Health-care property “has a stability factor that’s very attractive,” says John Sweet, chief investment officer of Physicians Realty Trust, a real-estate investment trust that went public in 2013 at $11.50 a share. It traded recently at about $17.25.

Sales and construction activity have been surging. In all, about $5 billion in medical-office buildings were sold last year in the U.S., a record, up from $4.3 billion in 2013, according to John Smelter of the real-estate firm Marcus & Millichap. About 8 million square feet of new medical-office buildings were delivered, up from 7 million in 2013, but short of the more than 26.5 million square feet delivered in 2008, Mr. Smelter said.

Medical-related housing—ranging from apartment complexes that exclude younger people to nursing facilities with 24-hour-a-day care—also is experiencing a boom. Sales transactions involving senior housing and nursing facilities rose to $17.4 billion in 2014 from $14.8 billion in 2013, according to the National Investment Center for Seniors Housing & Care, a Maryland nonprofit organization that tracks investment in the senior-housing real-estate sector.

Investors, meanwhile, have been flocking to health-care REITs—both those traded on stock exchanges and those that aren’t. Last year, nontraded REITs focused on health-care property raised a record $5.22 billion, up from $4.11 billion in 2013, according to Robert A. Stanger & Co.

Pension funds and other institutional investors also are buying more—either directly or through investment companies such as Harrison Street Capital LLC of Chicago and Boston-based AEW Capital Management. AEW last year closed its second fund devoted to health-care property, which raised $370 million.

Veteran investors in the sector caution that health-care-related real estate can be riskier than more conventional commercial property like office buildings and stores. Some property types, such as nursing homes that accept Medicaid and Medicare patients, are vulnerable to changes in federal reimbursement rates.

Still, the sector proved resilient during the downturn. While shopping centers and office parks saw vacancies spike and rents decline, demand for doctors' offices and senior living facilities stayed relatively steady or fell only slightly. Regular office vacancy rose as high as 13.7% nationwide during the downturn. By comparison the highest vacancy reached by medical office buildings was 10.5%, according to Marcus & Millichap.

Now, demand is improving as the economy rebounds and changes take place in the health-care sector. For example, rising housing prices in many parts of the country are enabling more seniors to sell their homes and move. Occupancy of housing complexes limited to healthy seniors hit 91.3% in the fourth quarter of 2014, the highest level since the fourth quarter of 2007.

Developers, meanwhile, are cranking up production of new health-care properties that respond to the changing needs of doctors and hospitals. For example, as hospitals try to become more profitable, many are acquiring physicians' practices and developing new office buildings designed to make the delivery of services more efficient.

One of these new facilities opened in 2013 in Tacoma, Wash., developed by Minneapolis-based developer Frauenshuh HealthCare Real Estate Solutions for St. Joseph Medical Center. The 130,000 square-foot medical-office building has very little space devoted to waiting rooms or doctor's offices, says Eric Carmichael, a Frauenshuh principal.

Rather, doctors have modular work spaces and patients are assigned to examination rooms as soon as they enter the facility.