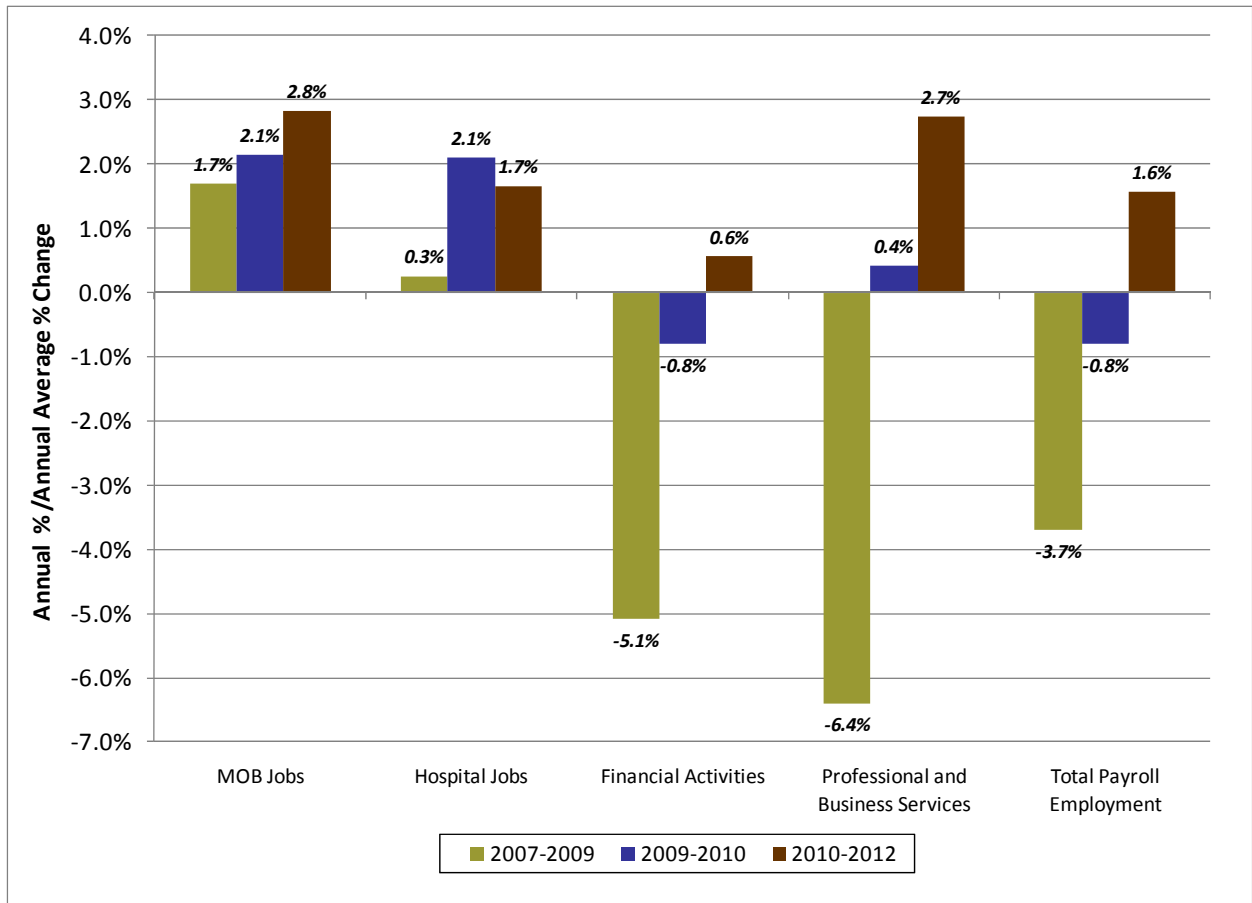


THE WORST IS OVER FOR THE MOB MARKET IN CHICAGO

During 2008, 2009 and 2010, the deep recession caused mainstream office tenants in the metro Chicago market to retrench and the overall amount of occupied office space declined by over 3.0 million square feet in 2009. Negative absorption in Chicago’s mainstream office market was attributable to dramatic job declines, especially in two sectors – the Financial Activities and Professional and Business Services sectors. Between the 4th quarter 2007 and the 4th quarter 2009, *Financial Activities* jobs declined by over 5% per year and Professional and Business Services jobs declined by nearly 6.5% per year over that two year period. In contrast to the substantial declines in these two employment sectors, Hospital jobs merely flattened (to 0.26% per year, on average) and Medical Office Building (MOB) employment growth slowed to about 1.7% per year. These trends suggest that the MOB space market should not have been impacted by the recession as severely as the broader mainstream office space market. An indeed that was true.

ANNUAL %/ANNUAL AVERAGE % CHANGE IN METRO CHICAGO EMPLOYMENT BY JOB SECTOR: 2007-2009, 2009-2010 AND 2010-2012



Source: Moody’s Economy.com

Note: MOB jobs are defined to include Ambulatory Health Care Services, Offices of Physicians, Outpatient Care Centers, Offices of Other Health Practitioners and Medical and Diagnostic Laboratories.

Substantial evidence indicates that the downturn in MOB space demand has not been nearly as deep and as prolonged as has been demand across the mainstream office market. Still, MOB property managers and brokers we spoke with throughout 2010 pointed to the general slowdown in MOB space leasing activity that resulted from slower growth in healthcare employment. We attribute slower healthcare job growth to four factors: (1) physicians and hospitals witnessed a slowdown in healthcare visits as the national recession worsened in 2009; (2) increase in hospital network acquisition of physician practices; (3) what appears to be slower growth in healthcare practice start-ups resulting from the uncertainty of national healthcare reform (and many private practice physicians opting for simply one-year lease renewals); and (4) other structural trends such as the increasing number of baby boom age physicians moving to or planning for retirement.

Our benchmark survey of Class A/B hospital-affiliated city and suburban MOB's indicated that though free rent and higher levels of tenant improvement allowances were being offered, asking rents showed little downward movement, especially at on-campus MOB's. The statistical data and anecdotal information we collected in 2010 indicate that though asking rents remained flat, effective rents (i.e., average contract rent after deducting free rent and above-standard tenant improvement allowances) did decline in 2009 and 2010 from the levels of 2008. However, for a select group of on-campus, high occupancy MOB's, there has been no significant decline in rents, even on an effective basis.

Other noteworthy trends we identified in 2010 include:

- MOB's (mainly off-campus MOB'S) with high vacancy and those that suffer from inferior locations offered significant asking rent reductions to retain and attract tenants.
- There was significant downward pressure on those rents that were at the upper limit of the metro market MOB rent structure.
- Suburban new construction MOB rents were somewhat depressed in the face of slower growing metro MOB space demand.
- Some MOB submarkets have continued to exhibit strong growth in MOB space demand since the mid 2000s (e.g., Near North/Streeterville area - Northwestern University Hospital), despite the recession.

Nationally, in the face of health care reform, hospitals will continue to implement organizational changes that range from modifying intake procedures based on severity of care needed; more efficient use of bed space; and, lowering re-admission rates. This evolution is apparent in Chicago - area hospitals are expanding their outpatient services and adding MOB space in Elmhurst (Elmhurst Memorial Hospital), Glenview (Glenbrook Hospital) and Joliet (Silver Cross Hospital) to name just a few campuses. In fact, we expect several MOB developments that were on hold throughout the financial and credit crisis of the last two years to move forward in 2011 as hospitals continue with their expansion plans and as the impact of the health-care law becomes more definitive to market participants.

Now that the Great Recession is behind us, we expect metro Chicago MOB space demand to increase in 2011 and 2012, favorably impacting leasing activity and occupancy and rent levels. Between the 4th quarter 2010 and the 4th quarter 2012, metro area *Hospital* jobs are forecast to increase by an estimated 1.7% per year, but *MOB* jobs are forecast to grow at 2.8% per year.

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