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## Medical real estate a challenge for retiring doctors

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When doctors finally retire after a career of helping their patients, two numbers will become important to them. They are the value of their medical practice and the value of their medical office property.

The first number is their practice value. Unfortunately today, most doctors believe there is little if any value in their medical practices. Most view their medical practice simply as a vehicle to earn their living. After all, what's to stop a young doctor just out of residency from renting or buying a medical office located across the street from that long-term practice being offered for sale by the retiring doctor?

The next important number to doctors as they near retirement is their medical office property value. Unfortunately, more than half of the doctors in each town in America do not own their medical office where they practice medicine. So, most doctors spend a decade or two building up lovely piles of rent receipts instead of building up equity in their medical office property. For those doctors who do own their medical office property, they have a few different choices on how they can sell their property prior to retirement. Which option they choose to sell their property will determine whether they lose or gain as much as a 30 percent in sales price. Making an educated decision at this point in their careers will certainly put more money in their pockets as they sail off into their retirement sunset.

But making an educated decision on how to best sell their medical office building is not always an easy thing. You see, they don't teach this stuff in medical school. I have had many doctor friends and clients tell me that after all their many thousands of hours of school training to earn the right to put "M.D." after their name, they only had a maximum of 30 hours of business training ... or less. Yes, we have all heard the jokes that doctors are not always the best business people. But you see ... it is not their fault. You are hard pressed to find anyone with more education than a doctor, but their training and focus is on medicine, not business.

Yes, there are exceptions to every rule and I have met a few doctors who are also exceptional business people. But they are the exception and not the norm.

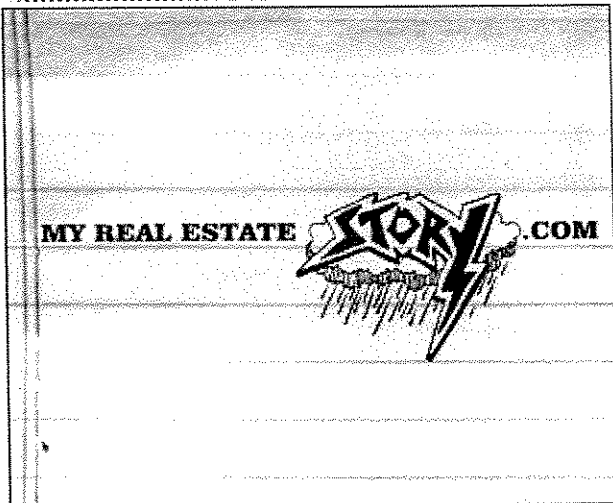
Having witnessed the good and the bad after selling 54 medical office properties for doctors in five different states since 1991, here is a partial list of "Do's" and "Don'ts" for doctors:

- Don't sell your practice and retain ownership of the medical building. You give up control and negotiating leverage to maintain top rent (and hence top value) for the property. More than one doctor has tried to convince me otherwise that this route will easily give him or her safe cash flow for many years after they retire. But here is just one example of many why a doctor should not do this: Near the end of the 1990s, a Fort Myers doctor sold his practice to a Lee County hospital. The hospital did not want to own his building and instead rented the building back from the doctor on a one-year term lease which they could renew in one-year term increments. Like most doctors, this one did not have training in commercial valuations. He was not aware that he needed a minimum of a five-year term, triple net lease to create a top sales price (i.e. lowest cap rate) should he ever want to sell the property later to an investor or refinance it for top dollar.

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After a few years of renting this doctors' office, the hospital suddenly gave notice to the doctor that they were not renewing the lease and the hospital was moving him (their employee) to another location that they preferred. His idyllic views of long-term cash flows suddenly vanished with the cruel reality from a poorly structured lease. This doctor got mad, called me and asked me to sell his vacant medical building. I explained we could get the best price by renting it first to another doctor on a five-year term lease and then selling the property based on the income approach to valuation using the cap rate formula to create a top price, just like a developer does when he develops a property from raw land.

The doctor said he was just so upset that he didn't even want to look at the property and just to sell it as-is. I carried out my orders and sold it vacant in early 2000 for \$78 per square foot. At that time, my average sales price for leased medical office building sales in Fort Myers ranged from \$110 to \$130 per square foot. He left a lot of money on the table. Lessons learned: Fully leased properties with top market rent with minimum five-year term leases will yield top market sales prices. The same properties sold vacant will sell for less.

- Do a sale/leaseback with your medical building to an investor when you get within five to seven years of retirement to create your highest sales price. This option typically creates a sales price that is often higher than appraised value. Example: I have helped doctors in Wilson, N.C., sell and leaseback three separate medical buildings since 2005. Before I came to Wilson and showed doctors how to use a sale/leaseback to their financial advantage, the highest comparable sale in Wilson had been a surgery center that sold for \$145 a square foot in 2004. My three medical office sale/leasebacks since then have ranged from a low of \$175 to a high of \$213 a square foot.

- Don't sell your building together with your practice. Or you will lose between 20 percent and 30 percent of property value compared to what you could get by separating practice value from property value. This is accomplished by doing a sale/leaseback on the building sometime before you retire.

If you sell the building and practice together, here is the sort of scenario that you can expect: You will both come to a quick agreement on the practice value. Then you are locked into negotiating the big number or sale of the building only with this one doctor (or company/hospital) that is buying the practice. You can't shop the building to get a higher price from someone else.

The practice buyer has the advantage over the building owner in this situation. And guess who buys medical practices? If it is not a hospital, then usually, it is young doctors who are fresh out of residency and who have lots of school debt and not a lot of cash at that point in their careers.

Lessons: Investors will almost always pay you a higher price for the medical building using a sale/leaseback than a hospital or incoming/remaining partners will pay.

- Don't depend upon someone else to do what is right for you. While you have control in your practice to structure your rent to whatever works best for you, that is the time to do the sale/leaseback. As an example, a doctor I have known for a decade called me up a few years ago to say that he was in his late 60s and finally ready to retire. He owned a nice \$2 million medical building by himself and his partner in the medical practice (not in the building) was going to buy the practice and sign a new lease for the building.

I extended my congratulations and quickly sent him a listing agreement. A short time later this doctor client called me back to say that his practice partner would only sign a one-year term lease and not a five-year term lease like I suggested. I said, "Sorry doc, but he just shot you in the foot. You can't get that top price now." He said, "Why not?" I replied, "Well, let's pretend for a moment that your partner is not an M.D. and instead he is Dell Computers. What is the bank going to say when a buyer for your property asks them to finance this acquisition?" The bank will say, "Dell Computers is a great tenant, but my worse-case scenario is I could have a vacant building in 12 months so we have high risk. We will need a higher interest rate and more cash down to mitigate this risk."

I explained that a buyer will have the same reasoning for not paying you top dollar (or lowest cap rate). Interestingly, a short time later, these two doctors had a big fight and split up with the younger practice partner going to work for a competitor which forced the senior partner to put his retirement plans on hold.

Lessons: While you have the control to set rental terms to maximize property value, use it to your advantage. If you have practice partners who do not have property equity along with you, allow them to buy into the building equity or you can expect heated disputes since they will always vote for lower rent and shorter term leases to maximize profit from the practice. Such real estate disputes in split-equity practices are the No. 1 cause of doctors splitting up. It is better to get everyone in the same boat, rowing together, to help facilitate long-term harmony. A sale/leaseback can put split equity partners back in the same boat together again as fellow tenants.

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