Creating Long Term Private Practice Success through Real Estate

Objective: To educate private practice owners on ownership of practice real estate and its benefits by discussing the purchasing process and ownership implications through theory and case studies. This knowledge ultimately can help an owner enhance fiscal efficiency of their practice, which in turn, allows them to better serve their patients and run their practice more effectively.

1) The Pros - Why is ownership of Real Estate important for a practice owner and the success of their practice?
    a) Allows for the structure to evolve as the practice evolves
        i) Can update office based upon patient trends and specialization demands
            (1) Ex: Contact lens specialty grows and office needs more area for contact lens training - can convert storage space or exam room
            (2) Ex: Medical dry eye patient base increases - can convert space into a dedicated room for dry eye treatment procedures
        ii) Can revise layout in order to promote new materials or equipment
            (1) Ex: New frame line - can restructure walls and floor design to account for a new display of frames/lenses
        iii) Creating a blueprint that enhances efficiency - an exact design of building layout in synergy with practice philosophy can drastically improve patient flow
    b) Room for expansion
        i) Growth through addition of staff members and doctors
            (1) Creating additional exam rooms
            (2) Expanding work space for staff (such as edging labs, admin. rooms, etc.)
            (3) Special Equipment Spaces/Rooms
            (4) Stock/Storage Areas
        ii) Methods of expansion
            (1) Horizontal Addition
            (2) Vertical Addition
                (a) Structural considerations
                (b) Patient accessibility considerations
    c) Creates Fiscal Efficiency
        i) Freedom from lease restrictions
            (1) Rent increases can drastically affect cash flow
            (2) Impervious to situations that tenant cannot control
        ii) Equity Building
            (1) Commercial real estate tends to appreciate
            (2) Opportunities for creation of future passive income for practice, which in turn can help build practice and serve more patients
                (a) Utilize strategic build out for rental
                    (i) Commercial or residential

(b) Utilize space for like-kind business
(i) Ex: Doctor gives lectures or workshops after hours
(c) Shared space agreement
(i) Ex: Another OD with own business entity can rent space
(d) MD/surgery center
(i) Increase foot traffic and possible referrals based on proximity

iii) Section Sell-Off if downsized in future
(1) Create condominiums or separate buildings
(2) Allows for additional cash flow, especially if practice volume decreases

iv) Line of Credit can be obtained after equity is built
(1) Useful for buying equipment such as OCT, fundus camera, etc.
(2) Can use for build outs or expansion of practice as well

v) Considerations for I-IV
(1) Permitting
(2) Costs to create

d) Tax Benefits
i) Can Depreciate the Asset
ii) Write off the Yearly Mortgage
iii) Tax Deductions
iv) Cost Segregation - depreciate building components over 39 years
v) Section 179 - deduct furnishings/equipment same year purchased
vi) 1031 Exchange - moving practice to different location or purchasing a different facility under fixed budget

2) The Cons - When can ownership of real estate be a detriment to a practice owner?
a) Monthly mortgage will almost always be more expensive than renting
i) Analysis of practice cash flow is important
(1) Look at past trends and plan for known “cash flow crunch” periods
(2) Make sure cash flow can handle mortgage and additional expenses without affecting efficiency of practice

b) May be saddled with previous liabilities if buying an existing building
i) Non-permitted additions or sections that are not up to code
ii) Disrepair of plumbing/electrical/foundation

c) Maintenance cost overview - exterior & interior

3) Finding Real Estate for your Practice - Pearls and Pitfalls
a) Due Diligence is Vital!
b) Examine location
i) Visibility for capturing walk-in patients
ii) Accessibility
(1) Parking lot or structure
(2) Access restrictions for patients (gates, locked doors, etc.)

iii) Boutique Storefront appearance vs. medical office appearance
iv) Security measures needed

- c) Buying vs. Developing
  - i) Buying Existing
    - (1) Lookout for Liens and other liabilities
    - (2) Pre-existing/underlying conditions
    - (3) Environmental factors
    - (4) Natural Disasters/weather conditions
  - ii) Developing Real Estate
    - (1) Make sure land plot does not have zoning restrictions
    - (2) Ensure construction lives up to long term goals
    - (3) Keeping Costs Low - contractors, plumbing, electricians + getting permits
    - (4) Location selection
      - (a) Design and Approach for target demographic

4) How to value Commercial Real Estate
   - a) Gross Rent Multiplier Approach (GRM)
   - b) Sales Comparison Approach (SCA)
   - c) Capital Asset Pricing Model (CAPM)
   - d) The Cost Approach
5) Paying for Commercial Real Estate
   - a) Cash Purchase
   - b) Financing
     - i) Loan Criteria
       - (1) Loan-to-value ratio that does not exceed 80 percent.
       - (2) Debt-service-coverage ratio of at least 1.20x.
       - (3) History of the business's profitable operating performance.
       - (4) Business's stable and recurring cash flows.
       - (5) Guaranty or recourse clause from the borrower.
     - ii) Loan Types
       - (1) Conventional Mortgage Loan
       - (2) Bridge Loan
       - (3) Hard Money Loan
       - (4) SBA Loan
         - (a) 7(a) Loan
         - (b) 504 Loan
       - (5) Mezzanine Loan
     - iii) Pros/Cons of each loan type
6) Creating a Holding Company
   - a) Liability and Insurance Considerations
   - b) LLC vs S-Corp vs Sole Proprietor
   - c) Structuring Holding Companies
7) Tax Implications
   - a) Depreciation - can depreciate over 31 years
   - b) deduction for improvements
8) Other Considerations

a) ADA Accessibility
b) Geometric Layouts for larger instrumentation or work space
c) Surgery Room Codes and Permits
   i) Working with Ophthalmology, including renting space
d) Landscaping and External Utilities
e) Renting Other Sections of Real Estate
   i) Triple Net & CAM Fees
   ii) Lease Agreements
   iii) Build outs and restrictions

9) Case Studies
   a) Purchasing an Existing Building in a High Priced/Volatile Location (Los Altos, CA)
      i) Key Takeaways:
         (1) Combination of a volatile no-rent-control environment and highly appreciating property value can yield piece of mind for practice
         (2) Existing Property in a fixed area can still be developed vertically
   b) Developing Land in an Area with Limited Parcels (Austin, TX)
      i) Key Takeaways:
         (1) Acquiring land early may be advantageous based on future plans
         (2) Consider what other landowners will utilize their parcels for
   c) Purchasing a Business Condo with a Shared Space Agreement (Collierville, TN)
      i) Key Takeaways:
         (1) Creativity in choosing tenants can be beneficial for all involved
         (2) Condo Association Special Assessments must be planned/budgeted for
   d) Developing Land for Both Practice and Rental to Other Businesses (Shenandoah, TX)
      i) Key Takeaways:
         (1) Larger spaces with portions leased to other businesses can drastically help with cash flow - but can also hurt if a tenant is lacking
         (2) Projections on surrounding area growth can be a “crystal ball” for future patient growth
   e) Purchasing a Practice and the Building with Previous Owner Financing (Decatur, GA)
      i) Key Takeaways:
         (1) Private financing (in this case, with previous OD owner) can be beneficial if correctly negotiated
         (2) Capital Expenditures must always be planned for

10) Conclusion