Beacon of Light: Medical Office Sector

By Mark Alexander, CCIM

Tired of depressing news about the economy and our real estate market? There may be a glimmer of sunlight starting to peak through these dark days of real estate. The medical office market continues to be strong across the country including Southwest Florida. But this statement can be a tad misleading because not the entire medical office sector is doing well at the moment. A small part of the medical real estate market includes vacant medical buildings that need tenants.

Vacant Medical Buildings

This vacant medical sub-segment is painfully slow now for a few reasons. First, we are not seeing new doctors moving to Florida at the same rate we had in the past. An orthopedic surgeon client of mine recently moved his practice from Melbourne, FL to Knoxville, TN. He gleefully learned upon arrival that his Medicare reimbursement rate for the same procedures in TN were 40% higher than FL because of supply and demand. There were 27 Orthopedics in Melbourne where the floor was flooded with surgeons compared to much fewer surgeons in his new Tennessee town were Medicare paid a higher rate to attract the surgery procedures needed. Rural areas in lower cost of living states are becoming a good choice for doctors just starting out or those simply looking for greener pastures.

Secondly, existing medical office practices today are not expanding as they were just a few years ago. The slow economy has paralyzed many medical office expansion and relocation plans as too many doctors sit on the beach waiting for an indication from the economic lifeguard that it is safe to go back in the water. Many doctors have pension plans that include large holdings in the stock market so their loss of paper wealth due to Wall Street woes has them feeling less than enthusiastic about expansion plans right now. It is easier for doctors to “hold-do nothing” as they lick their “paper-loss” wounds in sullen stoicism for the time being.

But long-term forecasts are good for vacant medical offices since demographics provide good support for future medical business growth. In one of many such reports, a “Health Affairs” analysis last spring predicted that population growth and aging will increase demand for primary care physicians by 29% over the next 17 years.

That's good growth for any business. Once the economy stabilizes, the vacant medical office space will get absorbed and then the medical office market will start expanding again to support the future growing medical demand. The future for vacant medical space looks bright...we just have to get there. But it won’t happen as quickly as owners of vacant medical offices prefer, due to the current down economy.

Leased Medical Buildings

The majority of the medical office sector consists of fully occupied medical office buildings. This fully leased segment of the medical office market is the shining star of today’s real estate investment market. Demand is so strong for triple-net leased medical office buildings today that some buildings are actually selling at prices higher than original list prices after bidding wars that are more reminiscent of the heady days of 2005. Here are some 2008 medical office closing examples that I personally sold as a representative of the Seller:

A 30,000 square foot cardiology building was listed at $7,500,000 at 25097 Olympia Avenue, Punta Gorda, FL. This is located across from the hospital. Dr. Terry Connelly and Dr. Mario Lopez personally guaranteed a 10-year term, NNN leaseback. This three year old property created such a stir that a national bidding war ensued. The winning bidder was a North Carolina firm that closed the deal on April 11, 2008 for $7,850,000, or $262 per square foot. This sale garnered a closing price of $350,000 higher than original list price during one of the worst economic downturns since the Great Depression. How’s that for a beacon of light in a dismal market!

On May 2nd, 2008 I closed a medical Sale/5-Year term leaseback for a group of 9 OB/GYN MD’s lead by Dr. John Phillips and Dr. Stephen Bale at 200 S. Herlong Avenue, Rock Hill, SC, which is a 25 minute ride south of Charlotte, NC. Their 7,980 SF medical office condo on a hospital campus was originally listed at $1,414,000 and it closed at $1,400,000, which is $175 psf or 99% of list price.

On May 29th, 2008 I closed a medical Sale/5-Year leaseback for a group of three Ophthalmologists lead by Dr. Kurt Heitman (2008 President of the SC Ophthalmology Society) on their 2,400 SF optic lab at 1201 W. Faris Street, Greenville, SC for full list price of $439,000, or $183 psf. (We sold their main clinic next door in 2007 for full list price of $1,400,000, or $205 psf.)

On June 20th, 2008 I closed a medical Sale/5-Year leaseback for Dr. Larry Castillo on his Asthma Center located at 8461 Cypress Lake Drive, Ft. Myers, FL for $854,200, or $262 per square foot. This building is 19 years old and he paid $520,000 for the building in April 2000. Leased medical office product is appreciating nicely in spite of the dreadful economy.

On August 22, 2008 I closed a medical Sale/7-Year leaseback for Dr. Carl Reed and Dr. Oscar Alea on their beautiful "Children's Specialists" medical building seen just south of the intersection of Cypress Lake Boulevard and Summerlin Road, located at 7970 Summerlin Lakes Road. It was originally listed at $3,494,000 and we again created a national bidding war. It closed at $3,600,000, or a record setting $276 per square foot. The closing price was $106,000 higher than original list price. The winning bidder was a 1031 exchange investor from Cupertino, CA which is the heart of Silicon Valley.

The key to these top market 2008 medical office closings was their triple-net leases with personal guarantees by the seller MD's. Financing was no problem whatsoever. We always start the quest for new financing with the bank that the seller/doctors had been using for years. The lender gets to keep the same doctors as a guarantor on the new triple-net lease for the building they already know quite well, plus the bank gets a new investor/buyer to provide his personal guarantee on the mortgage. But if you don't have good triple-net leases with strong tenants in today's market, you can expect much poorer results in sale prices per square foot. Here's a good recent example:

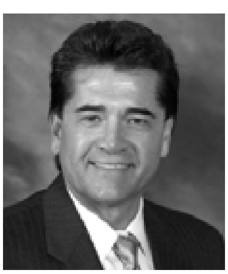
On September 15, 2008 I sold the 9,097 SF office building (which had one medical tenant space) located at 6360 Presidential Court, Ft. Myers. This "Sperry Van Ness" building used to house my personal office for the past two decades fronting College Parkway. It is just 200 feet west of the Summerlin/College intersection and across the street from Edison College. Even though this College Parkway building had a better location than Dr. Castillo's building on Cypress Lake Drive (that sold for $262 psf just three months earlier) and was built around the same time as Dr. Castillo's building, it only sold this fall for $162 per square foot, or $1,475,000.

The reason this College Parkway building sold for $100 per square foot less than Dr. Castillo’s building this year was because the College Parkway building had short-term gross leases with 30% vacancy. Dr. Castillo’s building was 100% leased and had a 5-year term, triple-net lease with an MD personal guarantee.

The status of your commercial leases at time of sale determines how high or how low your sales price will be…regardless of location. In commercial income real estate, it is not so much “Location, Location, Location” as it is “Quality of NNN lease, Quality of NNN lease, Quality of NNN lease”. Investor flight to quality in this country continues unabated during this economic downturn, as evidence in part by these above 2008 medical office sales.

I have two more medical office Sale/Leaseback transactions (Neurosurgeons and Neurologists) under contract totaling in excess of $6.5 million that are due to close at full list prices before the end of this year in Pine Bluff, Arkansas and Goldsboro, North Carolina.

Yes, I think there is a light at the end of this long, dark economic tunnel…and I do not believe for a moment that it is the headlight of an on-coming train. The beacon of light through this foggy economic malaise in real estate has begun with our vibrant and dependable medical office market.



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