Medical Real Estate Challenges for Retiring Doctors
By Mark Alexander, CCIM

When doctors finally retire after a career of helping their patients, two numbers suddenly 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 second important number to doctors as they near retirement is their medical office property value. Unfortunately, more than 50% of 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 that do own their own medical office property, they have a few different choices on how they can sell their medical office property prior to retirement. Depending upon which option they choose to sell their medical office building equity, they can lose or gain as much as a 30% difference in sales price. Making an educated decision at this point in their career will certainly put more money in their pocket as they sail off into their retirement sunset.

But making an educated decision on how to 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 & clients tell me that after all their many hours of school training to earn the right to put "MD" after their name, they only had a maximum of 30 hours of business training. 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 good number of doctors who are also exceptional business people. But they are the exception and not the norm. Most doctors understand they are not experts in every field and will seek qualified advisors to help them navigate unfamiliar waters.

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 that I recommend:

Don’t sell your practice and retain ownership of the medical building. You give up control and negotiating leverage to maintain a top value for the property. Many a doctor has told me that if he goes this route, it will give him cash flow in retirement. Here is one example why you should not do this: At the end the last decade, a Ft. Myers doctor sold his practice to Lee Memorial 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. This doctor was not aware that he needed a minimum of a five year term lease to create a good sales price should he want to sell the property later to an investor or refinance it for top dollar. After a few years of renting this doctors’ office, they 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. This doctor got mad, called me and asked me to sell his medical building vacant. 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 sold it vacant at the beginning of the 1990’s for $78 per square foot. At that time, my average sales price for leased medical office building sales in south Ft. Myers ranged from $100 to $120 PSF. He left a lot of money on the table. **Lessons:** 100% 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. When doctors don’t have their own financial advisors and they negotiate business transactions with a hospital that has a team of MBA’s on staff, don’t be surprised who comes out on top.

Do a Sale/Leaseback with your medical building to an investor when you get within 5-7 years of retirement to create your highest sales price. This option traditionally creates a sales price higher than appraised value. Example: I helped doctors in Wilson, NC sell/leaseback three medical buildings since 2005. Before I came to town and showed doctors how to use a Sale/Leaseback to their advantage, the highest comparable sale in Wilson had been a surgery center that sold for $145 PSF in 2004. My three medical office sale/leasebacks ranged from $175 to $213 PSF and none of them were a surgery center. You may call oral surgeon Chip Satterly, DDS to confirm since he is the proud record holder in Wilson, NC with the $213 PSF sales price. Chip attended a physician seminar I spoke at in Raleigh a few years ago.

Don't sell your medical building together with your practice. Otherwise, you will lose between 20% and 30% on building value compared to what you could get by simply 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 to be expected. You will both come to a quick agreement on the smaller number which is practice value. Then you are locked into negotiating the big number (i.e. Building value) with just this one doctor (or hospital) who 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 is this situation. And guess who buys medical practices? If it is not a hospital, then usually it is a young doctor fresh out or residency with piles of school debt and not much cash at that point in their career.

Lesson: Investors will almost always pay a higher price for the medical building using a Sale/Leaseback than a hospital or incoming/remaining partner.

Don't depend upon someone else to do what is best for you. The best time to pick rental terms that will maximize your sales price on a Sale/Leaseback is while you still have control in your medical practice. For example, a doctor in Florida that I have known for a decade called me a few years ago to say he was in his late 60's and finally ready to retire. He owned a nice $2 million medical building by himself. But he had a partner in the practice who did not have equity in the building. We call this a “Split-Equity” group. He said his non-equity partner was going to take over his practice and sign a new lease for the medical building. I congratulated him and submitted my listing agreement to sell the building as a “Sale/Leaseback” which included a five year term, triple net lease back. A short time later, this doctor client called me to say his non-equity practice partner would only agree to a one year term leaseback. I replied, “Sorry doc, but he just shot you in the foot. You can’t get that top price now.” Astonished, he said, “Why not?” I said, “Well, let’s pretend this is not an MD but it is Dell Computers instead. What is a bank going to say when a buyer for your property asks them to finance this property?” The bank will say, “Dell Computers is a great tenant but my worst case scenario is that we 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 further explained that a buyer will have the same reasoning for not paying you top dollar (or lowest cap rate). Sadly, a short time later these two doctors had a big fight and split up with the younger partner going to work for a competitor. This caused the senior doctor to put his retirement plans on hold.

Lessons: While you have control to set rental terms to maximize property value, use it to your advantage. If you have practice partners who do not own medical office property equity with you, allow them to buy into the building or you can expect heated disputes since they will always vote for the lowest rent and shortest lease term 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 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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