

## Medical Office Varieties By Mark Alexander, CCIM

If you want fresh baked bread, do you go to a plumber? Well you could, but if quality matters you are better off going to a baker. We seem to have evolved into a world full of specialists. The field of medicine is a prime example. If your tooth hurts, do you go to just any doctor like say...a Dermatologist? No silly, you go to a Dentist. All these different types of doctors spend years in school and training in hospitals for their chosen specialty just so they can be ready to help when your medical malady suddenly arrives. My daughter was five years old when she decided on the daycare playground one day to see just how far an acorn might fit up her nose. I rushed her to the doctor's office and later became grateful to the competent surgeon. You often never know what kind of doctor you are going to need...until that day arrives. But you can be sure of having many medical needs over your lifetime. No fortune teller is needed to predict we will all be driving to doctor offices more and more as we age.

All these different types of doctors need an office where we can visit them. Most of us have already spent too many hours sitting in doctor waiting rooms that tend to all look the same. So it might be easy to assume that all doctor offices are the same. They are not. The variety of different medical offices can vary as much as the specialties of medicine. The Psychologist for example just needs a room with a chair or proverbial couch so he can talk to you. Rarely are they as nice as the one Tony Soprano spilled his guts in. But their exam room walls and ceilings need good sound proofing so you can't overhear juicy gossip from the patient next door. The pediatrician will often have two separate waiting rooms: one for sick kids and one for well kids. When your child gets sick, you will often wish their exam room walls and ceilings had more sound-proofing as you listen to the wails of kids getting shots down the hall. Many doctors simply need exam rooms with a sink to wash their hands and cabinets to hold their goodies. Ophthalmologists and Optometrists on the other hand need longer exam rooms for that eye test. (Hint: It helps to memorize the chart beforehand.) Radiologists have strict electrical requirements (i.e. stabilized waves) to run their machines that resemble the star

ship enterprise from Star Trek days. While getting my last MRI, I nervously waited in that contraption wondering if the thing would explode and was half expecting to see Scotty rush into the control room and yell, "We need more power Captain!" Dentists need special lines run inside their exam room walls for things like compressed air, oxygen and laughing gas not to mention that Star Wars designed patient chair bolted to the floor in the middle of each exam room. General Dentists tend to prefer closed exam rooms while their brethren Orthodontists (who brace your teeth) often prefer open or semi-private exam rooms with exterior windows providing as much natural light as possible. I guess if kids can see each other, they tend to be less afraid and more embarrassed to scream out. You know that wouldn't work with adults. After dental offices, the most expensive medical office to construct is a Medicare approved Ambulatory Surgery Center. Peculiar things are required in surgery centers that drive up their cost like seamless floors so bacteria can't hide in the joints of floor tiles...and separate HVAC systems for OR's (operating rooms) that are vacuum balanced to insure air from the OR does not carry germs into non-OR areas of their office. Surgeons need wider procedure rooms with all kinds of specialty gadgets...like long needle nose pliers to pull acorns out of kid noses.

### **Own vs. Rent**

Some groups of doctors prefer to own their own surgery center rather than rent. Doctors receive higher reimbursements for their procedures if they own their own surgery center so financial incentives abound for them to own their own facility. This issue has become more important to doctors in recent years since their profit margins continue to erode due to Medicare cut-backs and capitation from the insurance industry while overhead expenses continue to rise. Doctors are trying to increase patient volume to off-set these continuous profit depletions by working longer and opening satellite offices. Many are using a sale/leaseback on their main facility and then using a 1031 exchange to roll their sale proceeds into buying a replacement property satellite office to self finance their expansion while enjoying tax benefits.

Big cities tend to have teaching hospitals where developers like to build high-rise medical office buildings nearby for doctors to rent. But

most of America has small towns with one or two hospitals and rarely does one see developers constructing medical office buildings on spec. This leaves most doctors to building their own special use facilities to match their brand of medicine and size of group. Small groups have 1-3 doctors; medium size groups have 4-10 doctors and larger groups have 11-30 doctors. There is a trend of smaller groups teaming up to form bigger groups to enjoy economy of scale through omission of redundant office tasks/personnel/equipment and to better secure larger contracts with health insurance firms. Many doctors in the USA live in fear that our federal government will socialize medicine and cause their wages to become more on par with truck drivers. Since more than a few Canadian Doctors migrate to the USA for this very same reason, there are many watchful MD eyes peering anxiously over our northern border as health care reform plays out over this next Presidential election.

For doctors that don't own their facility, the rest pay higher rent so that an office owner will convert his general office into the doctors' custom built medical facility. Doctors spend all their time studying and then practicing medicine. They don't usually have good business backgrounds. So doctors depend upon good business advisors to run their business. Their CPA's usually encourage them to build equity in their medical office buildings through ownership...as opposed to building lovely piles of rent receipts while renting their medical offices.

Having sold 63 medical office buildings in 5 states since 1991, I can tell you that ninety-five percent (95%) of the doctors that I meet for the first time do not know what a cap rate is...or more importantly...how to manipulate their cap rate through a proper lease structure to maximize the value of their multi-million dollar medical office building. If you research medical office sales in towns across America (like I have)...you will find a bell curve of sale prices per square foot (PSF) in each town from really low comps to really high comps with a bunch in the middle. Since most doctors don't have training in commercial valuation, they just don't realize that to create a top of market sales price, you simply need a long term triple net lease at top market rent to create your lowest cap rate which equals highest price. Medical office buildings sold vacant or with short term gross leases (so they are valued as though vacant) create the low

comps for medical office sales in each market. The Sale/Leaseback transaction utilized before a doctor retires is the most common tool used by doctors to separate building value from practice value to create top value for their medical office building. The Sale/Leaseback allows the doctor to create just about any price he wants for his building based on the rental terms he chooses to lease back. This self empowering Sale/Leaseback tool known as “off-balance sheet financing” provides wonderful financial benefits to the doctor while making it easier for her to sell her practice to a hospital and become an employee...or retire some day in the future and recruit new doctors to their on-going practice.

Since both McCain and Obama have publicly stated their intentions to raise the US capital gains tax rate from the current rate of 15% (which is our lowest rate since the 1940's), many doctors are opting to Sale/Leaseback their medical office building before the next President can raise capital gains taxes...in an effort to retain more of their medical office sale proceeds after tax. This is part of the reason why medical office sale transactions in the USA have increased by 30% from the first quarter of 2007 to the first quarter of 2008. Medical office investments are the darling of the industry right now because of their perceived stability. When is the last time your doctor moved his office?

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