

Questions from September Webinar:

1. Do you know what percentage of physician practices own their building vs. lease it?

If we're only considering main facilities for practices that don't have to be on a hospital campus, then I'd estimate 50-60%.

For all types of practices and all their offices, I'd estimate 30 – 40%. It's lower because satellite office participation could range from timeshare to full ownership. Also, some practices need to be on campus, and leasing a hospital building may be their only option. Private practice ownership in an on-campus building does exist, but it's not as common as leasing campus buildings from hospitals.

2. Is it more difficult today to find an investor than 2 years ago?

In Columbus, investors purchased nearly \$20 million of medical office buildings over the last 6 months. This is compared to virtually zero for the 12 months prior, so things are picking up.

Still, there are *fewer* investors than a couple of years ago, but most of the ones that washed out were less experienced and less capable. The lending environment is more difficult than a couple of years ago, but the activity noted in the paragraph above indicates it's possible to find solid investors who can close.

3. Refinancing -- I know that interest rates are really low for personal homes. Does the same apply for commercial real estate? Is this a prime time to buy a building?

It is a great time to buy a building if the building meets the long term needs of your practice because:

- 1) Many properties available are at a substantially lower price than their construction costs.
- 2) The costs for renovations and improvements are low as contractors are aggressively competing for work.
- 3) Loan rates are good, although the underwriting process is more difficult than a couple of years ago.

That being said, it's not prudent to buy a building just because the price is great or because rates are low. If the building constrains your practice (physically or financially), then it's not a good buy despite what the spreadsheets say.

4. Is it difficult for a physician practice to get financing to buy a building? Who are some people to talk to if the practice isn't in Columbus?

It is less difficult for physician practices than for most businesses... Like everyone else, however, it is more difficult than it was a few years ago. Lately, we've found that community banks have had more of an appetite to lend than some of the larger banks.

On the second question, if the question is related to assistance on the real estate, I can be an initial contact for anyone throughout Ohio. I'm on my firm's national healthcare services group, and we coordinate with offices throughout the state and country to help healthcare clients.

If the question is related to lending, I would recommend using your local banking relationships and also reaching out to some new contacts, especially community banks and possibly credit unions.

5. Does a broker charge for his/her services? Who pays the broker? Are the rates negotiable or is it a standard rate?

For practices that purchase or lease space and hire a real estate broker, their broker's fee is usually paid by the owner / seller, which means there is no charge to the practice leasing or buying.

For practices that want to sell their building, their broker's fee is normally paid from the sales proceeds at closing which means there is usually a charge to the practice selling their building, but only upon closing.

Brokers are actually precluded from setting standard rates as it's considered an anti-trust violation. I have seen rates from 2% to 10%. The lower rates are for *exceptionally* large transactions, and the higher rates are usually offered by unusually aggressive or desperate owners. The norm, as you might have guessed, would be somewhere in between.

6. The Market determines the cap rate. Who is the "market"?

The cap rate is the relationship between how much income a building generates and how much someone is willing to pay. Our presentation leaned heavily on the concept of average cap rates as determined by the market.

The "market" is the aggregate of the activities of hundreds of medical building buyers that bought a medical office building during the previous quarter.

So, we can't tune into CNBC to find out what today's cap rates are... we only know by looking at previous transactions and the ratio between building incomes and sales prices.

The strength of understanding cap rates is that it gives us a broad based measure to see whether buyers are becoming more or less aggressive. Cap rate is impacted by supply and demand, loan rates, downpayment requirements, strength of the practice, strength of the leaseback lease document, and many other factors.

7. Given the state of the economy, have you seen instances where landlords are willing to re-negotiate standing lease/terms?

Yes, especially in instances where practices can provide something of value. For example, if a practice has 3 years left on the lease and the space is a great fit for their long term needs, I'd advise putting together a strategy to discuss a lease extension in exchange for reduced rent, paint, or whatever else would help your practice moving forward. Crafting a solid strategy in advance of those discussions can help lead to a very positive outcome and reduce rent expenses immediately.

8. Is there a checklist on criteria looked at for "Strength of Practice"?

Although there is no checklist, common considerations include the history of the practice (startup versus longevity), other properties owned by the practice, and financial wherewithal. Buyers and lenders will almost always ask for practice financials. Buyers and lenders who work with medical are savvy enough to understand that a practice may not have a highly profitable practice because many of the profits are distributed and/or placed into initiatives to boost practice efficiency and productivity. For practices that want to sell their building via sales-leaseback, personal guarantees will increase the sales price of the building (less risk to investor allows them to pay more) However, it's important to note that personal guarantees are not always required in order to accomplish a sales-leaseback (The Orthopedic building I sold a few months ago had no personal guarantees, but did have a corporate guarantee from that extremely strong practice)

9. What are commercial loan interest rates? Are they fixed and for how long?

They vary, with the most aggressive rates being in the 5-6% range and higher rates being between 6-7%. This is impacted by the loan structure

(fixed long term versus fixed 3-5 years), down payment, credit of the borrower, risk of the building (a building fully utilized by a practice is less risky than a building that will have quite a bit of vacancy even after the practice moves in).

Many practices are considering SBA loans, which may be applicable if the practice is going to occupy > 50% of the building. This is advantageous because it may only require 10% down, and from the lender's perspective there is additional security because the loan is backed by SBA.

10. What do you expect for security if Drs. buy building themselves?

Personal Guarantees on the loan are common. Additionally, they will require a down payment, which can be as low as 10% (SBA) or substantially higher depending on the risk.

11. How does one pick a broker to help the medical practice decide what to do in the future?

Many commercial brokers have begun dabbling in medical real estate over the last year. It's important to pick a broker who has a significant amount of experience working with medical practices. I'd recommend asking for medical references, or an overview of medical projects completed.

When you meet a potential broker, hopefully he / she asks questions that help clarify your vision, or even expands the possibilities for you. As you talk about the requirements of your practice, if they seem lost as you discuss pods, patient flow, or referral patterns, then they're probably not a good choice. The medical broker should be able to talk comfortably about what other practices in the area are doing, or have recently done. In short, the broker should be able to add value to the process from the beginning and throughout. On a final note, you should feel that the approach of the broker is in alignment with your practice's goals and approach.

