

views you can use



Commercial Real Estate

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Healthcare Professionals: Essential Insights When Leasing or Buying Office Space

Regardless of their specialty, most healthcare professionals (unknowingly) overpay for their office space. I surmise that the reason for this is because real estate decisions are typically made every three to five years, and few healthcare providers can devote adequate time to becoming proficient at a task that occurs so infrequently. This makes them vulnerable to exploitation at the hands of those whose core business is commercial real estate, i.e., property owners, property managers, and the agents that market buildings for lease or sale.

The insights presented below are intended to increase awareness of some

buy property. In fact, every transaction is unique; tenants and buyers not only pay different rates but receive a wide range of concessions. Base the amount you are willing to pay on the lowest price and best terms available for suitable space in similar buildings elsewhere. Note that this reasoning applies equally to lease renewals, new leases, and purchases.

INSIGHT 2: Time can be your ally, or your enemy. It generally takes five to 18 months to complete most medical transactions. This includes the due diligence period during which comparable properties are identified, negotiations

INSIGHT 3: The negotiation process is, by definition, adversarial. That's because people with opposing interests square off against each other – the landlord trying to determine the greatest amount the tenant will pay, and the tenant seeking the lowest amount the landlord will accept. Generally speaking, the side that is best prepared prevails. In commercial real estate, "preparation" means discovering all of the available spaces suitable for your practice, identifying the property owners who have the greatest needs, and understanding what rates and concessions can likely be achieved (based on ever-changing market conditions).

INSIGHT 4: Say less – save more. Property managers and real estate agents are the eyes and ears of the property owner. Their tools-in-trade include a friendly manner and the ability to gather revealing information through the guise of innocuous banter. As it's the seemingly innocent disclosures that can adversely affect your negotiating leverage the most, instruct your entire staff that all questions regarding your current space or future requirements are to be referred to you or your real estate advisor.

INSIGHT 5: The "asking" rate is seldom the "getting" rate. Listing agents, property managers and property owners commonly refer to their "asking" rate as the "market," "going" or "standard" rate – I call it the sticker price...the amount only an uninformed person would pay. Because the asking rate does not reflect any of the discounts or concessions that

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seldom-discussed nuances of the commercial real estate industry and help physicians, dentists, and the managers of their practices make better-informed leasing and buying decisions.

INSIGHT 1: It pays to shop around. Claims that "everyone else pays this amount" (besides being unverifiable) are irrelevant when deciding how much you are willing to pay to lease space or

are conducted and, if buying a building, financing is arranged. Waiting until there are just two or three months remaining on your lease to strategize can limit your alternatives and significantly dilute your negotiating leverage, resulting in higher pricing and fewer concessions. Astute practitioners plan well in advance and are continually looking for ways to reduce, or at least control, their operating overhead.

purposeful negotiating can achieve, it is merely the starting point of the process.

INSIGHT 6: Arm's length or strong arm? The modern real estate industry is founded on the concept of the arm's length transaction, where the parties deal from equal bargaining positions. The operative words in this definition are "equal," meaning that each party conducts business in a formal manner without trusting the other's fairness or integrity and without being under the other's control or dominant influence, and "bargaining," meaning that the terms and conditions of the lease or purchase contract are based on informed negotiations. When the parties are unevenly matched in experience and access to information, exploitation can occur. To level the playing field, do as property owners do: hire your own skilled real estate advisor to educate and insulate you throughout the search and negotiation process.

INSIGHT 7: Commercial leases are more complex than purchases. When leasing space, the medical tenant's focus should be two-fold: first, on the condition and utility of the space, and second, on the costs of occupancy throughout the lease term. In addition to the leasable size (which should be confirmed by a field-measurement), some of the variables that affect the overall cost of occupancy include: term, contract rate, rental escalations, free rent period, tenant improvement allowance, fixturing period, cost and availability of parking, excess operating expenses, the base year, the expense stop, janitorial costs, and warranties on the air conditioning, plumbing, electrical, roof and structure. Additional considerations include: permitted and exclusive uses, options to extend, caps on management fees, holdover provisions, expansion rights, assignment rights, relocation provisions, cotenants, signage rights, and many others. *Whew!*

Note that all terms and conditions must be identified, addressed and negotiated *before* the contract is signed.

INSIGHT 8: Leasing space provides flexibility, while owning property provides stability. Property owners typically seek annual rental rate increases of three to five percent, and have been known to increase rates significantly when extending lease terms. However, it is unlikely that most medical practices can increase their

rates to cover these additional costs. In order to control the costs of occupancy, it makes good economic sense to purchase the space that houses your practice as soon as your mid- to long-term space needs are established. Because well-located buildings tend to increase in value, owning commercial property should be viewed as an important part of a balanced financial portfolio.

INSIGHT 9: Get value from the commission. Almost every real estate transaction includes a commission that is typically split between the agents/brokers or advisors representing each party. In most new leases and sales, the commission equals five to eight percent of the value of the transaction. To illustrate: the value of a five-year lease with monthly rental payments averaging \$5,000 is \$300,000, and yields a commission between \$15,000 and \$24,000. *Although the property owner writes the commission check, it's the tenant or buyer who ultimately pays the tab.* Make certain you receive value from your portion of the commission by selecting an experienced, licensed

advisor to protect your interests; after all, you're paying for it.

INSIGHT 10: Choose your real estate advisor wisely. Your choice of advisors determines which properties you are shown and how much you will pay. Query potential candidates as you would when selecting an attorney or accountant, making certain they have significant and verifiable experience in solving your problems. Because you

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seek objective advice, eliminate any agents/brokers who also list properties, as they have inherent and insurmountable conflicts-of-interest.

CLOSING COMMENTS. Because healthcare professionals are healers, they tend to trust that those with whom they do business are motivated by the same altruistic desire help their fellow man. The reality of commercial real estate, however, is that property owners are speculators whose primary objective is to lease or sell their investments for the highest prices possible.

I urge all medical and dental professionals to heed their own advice, and schedule *annual real estate checkups*. In the final analysis, adequate preparation, unbiased information, and tenacious representation are the antidotes to overpaying. ■

Stephen Cross owns CROSS Commercial Realty Advisors and counsels business owners, healthcare professionals and corporate decision-makers on ways to acquire or lease property at the lowest cost and most favorable terms. Please contact him at (480) 998-7998 or steve@crossrealty.com.