Finding a Medical Home

Here are five tips to navigating the real estate market to lease or buy office space.

Medical office space options are evolving as fast as anything in medicine. Simply put, you're a good credit risk, and the developers and the money people behind them are looking for your business and, better yet, your input. But buying an office—or even an office building—isn't for everyone. Here are five tips to help you find the professional home that suits you best.

1 UNDERSTAND YOUR OPTIONS.

The two big ones: lease or buy. Leasing is more flexible from a tenant standpoint, because you can negotiate the length of the contract and you can adjust the amount of leased space by simply moving, says John Wadsworth, vice president for office and healthcare properties in the Irvine office of Colliers International, a global commercial real estate services firm. Thus, a lease is ideal for practices and providers with uncertain growth plans. "[Leasing works] if, for example, your practice scales back or expands or a partnership opportunity arises—or doesn't go as planned," Wadsworth says.

As any apartment dweller can tell you, though, the big downside to a lease is that your costs are not fixed from year to year, Wadsworth says. Lease payments change, and landlords handle rent increases in different ways. Some peg it to the Consumer Price Index, he notes, and some simply raise it as much as they choose to, subject to applicable regulations. Right now, rents per square foot in medical buildings are very high and may climb even more.

Another downside of leasing is that you're paying somebody else for space. If you own an office condo or entire building, on the other hand, "you're paying down a loan and building equity in a property," Wadsworth says. The benefits of that are pretty obvious, including fixed costs and, often, enhanced tax incentives. The downside? It's tougher to expand, contract or move to a new neighborhood if you're tied down by a mortgage.

2 EXAMINE THE TAX INCENTIVES FOR OWNERSHIP.

This tip is especially valuable if you're starting to plan for retirement. "Doctors in that position who own their office space can sell their practices at a higher value with the real estate or sell the practice only while retaining the real estate and simply collect an annuity in the form of rent as part of their retirement," explains James Ruiz, who handles finance and sales at Huffman West, an Aliso Viejo-based network of owner-operated medical and professional offices throughout the West. "Another option would be for the doctor to combine the two and sell the practice for a premium with a lease-option to purchase." That, he says, is the proverbial best of both worlds, because it allows you to "spread the favorable tax implications over time."

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> —Steve Delson, DBN Development LLC

3 GET IN ON THE GROUND FLOOR.

"There are always market advantages to being early to a project," says Steve Delson, president at Laguna Hills-based DBN Development LLC, a commercial developer of retail, mixed-use residential and office space in Southern California. "Pricing, space selection and any needed utility or structural upgrades are more limited after a building is completed."

DBN just broke ground on Parkside Medical Center, a multiphase, state-of-the-art medical office complex in San Jacinto. When such a project is being developed, Delson adds, companies like his seek advice from design specialists and prospective tenants, and they check with other developers and property managers to study trends—and to understand things that have worked and not worked on recent projects. "We include specialty equipment manufacturers in our information search as well," Delson says, so the offices can accommodate particular space or power requirements.

Getting involved early gives buyers more flexibility. "The spaces are not divided until a purchaser is identified. On medical condo projects such as the initial Parkside building, we map the structure into small slices so our buyers can buy as much of the loaf as they will need," Delson says. In addition, ground floor space is usually set aside for say, a physical therapy practice, a pharmacy or an MRI center.

4 BASK IN YOUR CREDIT-WORTHINESS AND YOUR SOUGHT-AFTER SPENDING HABITS.

"The healthcare industry is a great area to be part of as a lender," says Brian Harrison, vice president and senior relationship manager in Alliance Bank's Irvine-based Orange County Regional Banking Center. "Doctors may prefer to own their own medical buildings or condos, and they have continual needs for equipment and leaseholds along with other real estate investments. ... They also tend to be somewhat recession-proof."

Indeed, Alliance Bank has established a Healthcare Division with lending products tailored to the medical field. "We offer construction loans for the developer or for the doctors to acquire space once the project is completed," Harrison says, "or we can lend directly to doctors themselves." Often, a group of doctors will form an LLC, which Alliance Bank then lends to. "We financed First Street Medical Office Building in Tustin and Anaheim Medical Office off Beach Boulevard," he reports. And he's now working with CBRE on financing for medical condos at Von Karman Medical

Center and with Uni-Med Realty for the Irvine Medical Arts Building.

5 CHART THE COURSE THAT'S RIGHT FOR YOU.

Overall, doctors have to sift through their medical real estate options and do what makes sense for them.

For example, James Strebig, MD, an internist in Irvine, subleases half an office, and Orange-based St. Joseph Hospital holds the master lease. "I have never seriously considered owning my office," he says. "I am a solo practicing internist. When I work, I want to focus on my patients. When I have free time, I want to spend it with my family. … Owning an office is an investment. I prefer to invest my money in other ways."

Tim Pietro, MD, a urologist based in Riverside, finds that leasing works for him, too. "I lease the space I work in, primarily due to its location near the hospital that I use in performing surgery and for providing consultations. And most of our referring physician offices are nearby as well," he says. Leasing is a better option, he adds, because his practice "could not afford to buy or build any building with a similar proximity."

Not so at Riverside Medical Clinic, a service corporation with 85 shareholders that has had a real estate partnership since 1992, according to Steven Larson, MD, MPH, FACP, chairman and CEO. Shareholders in RMC are required to be partners in the real estate partnership, which has prevented a small group of senior partners from controlling the real estate and reaping all the benefit. "The result is that it is an excellent investment for all the shareholders, and all are owner-tenants," he says. There's a sell arrangement in place for when a shareholder retires or leaves the practice, under which the remaining partners buy that person out over time.

"Everyone is happy with the arrangement thus far," Dr. Larson adds. "The investment is liquid and is valued every two years by certified appraisers. Owning our own real estate promotes collegiality and long-term service, puts us in control, and provides a terrific investment."

—*Russell A. Jackson*

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