

Creating Long Term Private Practice Success Through Real Estate

A Presentation by:
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All Relevant Relationships have been mitigated.

Consulting/Speaking:

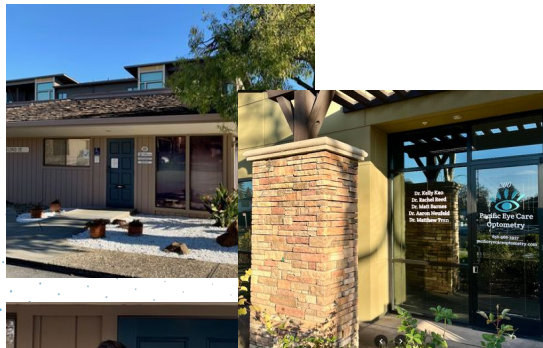
- Alcon - Speaker
- Coopervision - Speaker/Consultant
- Vyluma - Advisory Board/Consultant
- Movu - Consultant/KOL
- Aloha - Speaker/KOL
- Various VC/PE Funds - Consultant

Ownership/Equity:

- ODs on Finance LLC
- ODOF Ventures LLC
- EyeDock LLC

Bio

- Multi-Practice Owner
- RE/Angel Investor
- Consultant/Analyst



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Bio



WHO IS THIS GUY

AND WHY AM I STUCK WITH HIM FOR AN
HOUR?

DISCLAIMER

I am not an attorney, CPA, financial advisor or realtor

This presentation is for your information and entertainment only
and does not constitute formal, personalized financial,
accounting, or legal advice.

Cover
Your...





Objective

To educate private practice owners on ownership of practice real estate and its benefits by discussing the purchasing process and ownership implications through theory and case studies. This knowledge ultimately can help an owner enhance fiscal efficiency of their practice, which in turn, allows them to better serve their patients and run their practice more effectively.



Key Takeaways

1. Understand the benefits of owning commercial real estate for a private practice
2. Realize the pros/cons of being a commercial real estate owner
3. Understand the methods of obtaining commercial real estate
4. Understand the basic nuances of commercial real estate



Starting Exercise

Shout out the first thing that comes to mind when the next slide pops up...





What do we associate with McDs?

- Burgers
 - McNuggets
 - Ronald McDonald House
 - Broken Ice Cream Machine
 - Disgusting Play Area
-
- Real Estate?

A man with short, light-colored hair, wearing a white dress shirt and a red patterned tie, is sitting in an office chair. He has a serious expression and is looking slightly to the left of the camera. The background shows office windows with blinds and some office supplies on a desk.


**MOVIE
CLIP**

F HD

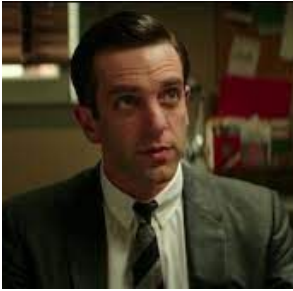


McDonald's is the Ultimate Commercial Real Estate Company

- McDonald's only owns about 15% of its storefronts; 85% are franchised
- **McDonald's** has **more** than \$30 billion in **real estate** assets, and annual profits that float around \$4.5 billion from real estate alone
- Food and drink serve as revenue to help franchisees pay rent



“You don’t build an empire off a 1.4% cut of a 15 cent hamburger, you build it by owning the land on which that burger is cooked.”



“You don’t build a **thriving private practice legacy** off **poor VCP reimbursements**, you build it by owning the land on which you provide **excellent eye care.**”





Why is ownership of Real Estate important for a practice owner and the success of their practice?

- 1) Allows for evolution of structure in tandem with evolution of practice
- 2) Room for expansion
- 3) Creates Fiscal Efficiency
- 4) Tax Benefits



Pros: Evolution of Structure in Tandem with Practice

Can update office based upon patient trends and specialization demands

- i) Ex: Contact lens specialty grows and office needs more area for contact lens training - can convert storage space or exam room
- ii) Ex: Medical dry eye patient base increases - can convert space into a dedicated room for dry eye treatment procedures



Pros: Room for Expansion

Growth through addition of staff and doctors

- a) Creating additional exam rooms
- b) Expanding work space for staff
- c) Special Equipment Spaces/Rooms
- d) Stock/Storage Areas





Pros: Room for Expansion

Methods of expansion

- a) Horizontal Addition (more room)
- b) Vertical Addition (less room)
 - i) Structural considerations
 - ii) Patient accessibility considerations
- c) Internal Expansion



Pros: Creates Fiscal Efficiency

Freedom from lease restrictions/landlords

- 1) Rent increases can drastically affect cash flow
 - a) Prevent over-leveraging after buildout
- 2) Impervious to situations that tenant cannot control



Pros: Creates Fiscal Efficiency

Expenses are Investments

- Staff Payroll → Service/Revenue
- COGs → Revenue
- Equipment → Revenue
- Utilities → Comfort
- ~~Rent~~ Mortgage → Equity



Pros: Creates Fiscal Efficiency

Equity Building

- 1) Commercial real estate tends to appreciate
- 2) Opportunities for creation of future passive income for practice



Opportunities for creation of future passive income for practice

- a) Utilize strategic build out for rental
 - i) Commercial or residential
- b) Utilize space for like-kind business
 - i) Ex: Doctor gives lectures or workshops after hours
- c) Shared space agreement
 - i) Ex: Another OD with own business entity can rent space
- d) MD/surgery center
 - i) Increase foot traffic and possible referrals based on proximity



Pros: Creates Fiscal Efficiency

Section Sell-Off if downsized in future

- a) Create condominiums or separate buildings
- b) Allows for additional cash flow, especially if practice volume decreases

Line of Credit can be obtained after equity is built

- c) Useful for buying equipment such as OCT, fundus camera, etc.
- d) Can use for build outs
(Healthy practices can normally get a LoC regardless)



Pros: Creates Fiscal Efficiency

Off The Record... The “R” Word



Pros: Creates Fiscal Efficiency

Remember for build outs!

- 1) Permitting
- 2) Costs to create

The Cons - When can ownership of real estate be a detriment to a practice owner?





The Cons - When can ownership of real estate be a detriment to a practice owner?

Monthly mortgage may* be more expensive than renting

- 1) Analysis of practice cash flow is important
 - a) Plan for known “cash flow crunch” periods
 - b) Make sure cash flow can handle mortgage *and additional expenses* without affecting efficiency of practice

*Area dependent



The Cons - When can ownership of real estate be a detriment to a practice owner?

May be saddled with previous liabilities if buying an existing building

- 1) Non-permitted additions or sections that are not up to code
- 2) Disrepair of plumbing/electrical/foundation
 - a) Get an inspection!



The Cons - When can ownership of real estate be a detriment to a practice owner?

If Creating a new building

- 1) Architect/design costs
- 2) Permitting
- 3) Electrical/water/sewage lines
- 4) Foundation

The Cons - When can ownership of real estate be a detriment to a practice owner?

Maintenance Costs

- Interior
- Exterior



Finding Real Estate for Your Practice



Pearls and Pitfalls



Finding Real Estate for Your Practice



Pearls and Pitfalls



Due Diligence is VITAL!

Finding Real Estate for Your Practice

Examine location

- Visibility for capturing walk-in patients



Finding Real Estate for Your Practice

Examine location

- a) Accessibility
 - i) Parking lot or structure - spaces
 - ii) Access restrictions for patients (gates, locked doors, etc.)





Finding Real Estate for Your Practice

Examine location

- a) Boutique Storefront appearance vs. medical office appearance
- b) Security measures needed

Finding Real Estate for Your Practice



Buy Existing vs. Developing



Finding Real Estate for Your Practice

Buying Existing

- a) Lookout for Liens and other liabilities
- b) Pre-existing/underlying conditions
- c) Project Long Term
 - i) What needs fixing in 5-10 yrs?
- d) Environmental factors (weather)



Finding Real Estate for Your Practice

Developing Real Estate

- a) Make sure land plot does not have zoning restrictions
- b) Ensure construction lives up to long term goals
- c) Keeping Costs Low - contractors, plumbing, electricians + getting permits
- d) Location selection
 - i) Design and Approach for target demographic





How to Value Commercial Real Estate





How to Value Commercial Real Estate

- Different than valuing residential real estate
- Based on **ROI**, **potential** and **comparable analysis**



How to Value Commercial Real Estate

- a) Gross Rent Multiplier Approach (GRM)
- b) Sales Comparison Approach (SCA)
- c) Capital Asset Pricing Model (CAPM)
- d) The Cost Approach



How to Value Commercial Real Estate

Gross Rent Multiplier Approach (GRM)

GRM = Property Price/Gross Rental Income

***Lower GRMs are better**

****GRMs between 4-7 considered healthy**



How to Value Commercial Real Estate

Gross Rent Multiplier Approach (GRM) - Example

Property Price = \$1,000,000

Annual Rent (Gross Rental Income) = \$250,000

GRM = \$1,000,000/\$250,000 = 4



How to Value Commercial Real Estate

Gross Rent Multiplier Approach (GRM)

Harder to apply to purely owner occupied since you're setting your own rent rate



How to Value Commercial Real Estate

Sales Comparison Approach (SCA)

Determines the value of a property by comparing it to similar properties in the vicinity based on the principle of substitution



How to Value Commercial Real Estate

Sales Comparison Approach (SCA)

Determines the value of a property by comparing it to similar properties in the vicinity based on the principle of substitution

Four Comparables used:

1. Term of sale
2. Time of sale
3. Location
4. Physical Elements



How to Value Commercial Real Estate

Capital Asset Pricing Model (CAPM)

**View your property in terms of expected
future returns**



How to Value Commercial Real Estate

Capital Asset Pricing Model (CAPM)

$$\text{ERI} = \text{RF} + \beta \times (\text{ERM} - \text{RF})$$

ERI = Expected Return of Investment

RF = Risk-Free Rate

β = Risk of investment*

ERM = Expected Return in Market



How to Value Commercial Real Estate

Capital Asset Pricing Model (CAPM)



Primarily used in the stock market, a bit over our heads!



How to Value Commercial Real Estate

The Cost Approach

Property Value = Land Value + (Cost of New Structure – Accumulated Depreciation)

The **cost approach** is based on the economic belief that informed buyers will not pay any more for a product than they would for the **cost** of producing a *similar product that has the same level of utility*.



How to Value Commercial Real Estate

- a) Gross Rent Multiplier Approach (GRM)
- b) Sales Comparison Approach (SCA)**
- c) Capital Asset Pricing Model (CAPM)
- d) The Cost Approach**

Paying for Real Estate





Paying for Real Estate

Cash Purchase

- Fine if you have the funds!
- A favorable interest rate can help with cash flow





Paying for Real Estate

Financing





Paying for Real Estate

General Loan Criteria

- 1) Loan-to-value ratio (LTV) that does not exceed 80%
- 2) Debt-service-coverage ratio (DSCR) of at least 1.20x
- 3) History of the business's *profitable* operating performance
- 4) Business's stable and *recurring* cash flows
- 5) Guaranty or recourse clause from the borrower
- 6) 51% occupancy requirement



Paying for Real Estate

Information often required by banks and lenders

- Business tax returns
- Your books, records and financial reports
- Last three months or more of bank statements
- Details regarding collateral
- Third-party appraisal of the property
- Business plan



Paying for Real Estate

Methods to Boost Your Chance of Loan Approval

- Paying off existing debt and taking other steps to improve your credit scores
- Pledging additional collateral if you have it
- Adding an investor or cosigner
- Agreeing to pay a larger down payment and/or higher interest rate
- Selecting a less expensive property



Paying for Real Estate

Types of Loans

- Bank Loan (conventional mortgage)
- Commercial Lender Loan
- Hard Money Loan
- SBA
 - 7(a)
 - 504
- Conduit Lender



Paying for Real Estate

What are the terms?

- 10% or 20% down, ZERO down exists!
- 10, 15, 20 years terms
- Owner occupied much easier than CRE investment
- Rates just lowered...



Paying for Real Estate

Bank Loan (conventional mortgage)

Pros:

- Good rates
- Convenience, possible discounts as an existing bank customer
- Long-term financing options

Cons:

- Requires extensive documentation
- Slow process
- Only for borrowers with good or excellent credit



Paying for Real Estate

Commercial Lenders

Pros:

- Less rigid underwriting standards
- Faster approval than banks
- Lower fees and closing costs

Cons:

- Interest rates are often higher than with banks
- May require a balloon payment in 5 to 10 years
- Many are short-term loans



Paying for Real Estate

SBA 504 Loan - 50% from bank, 40% Certified Dvlpmt Co., 10% you

Pros:

- Below-market interest rates
- Terms of 20 or 25 years
- Low down payment

Cons:

- Must meet SBA size standards
- Slow funding process



Paying for Real Estate

SBA 7(a) - SBA flagship, up to \$5 million from affiliate lender

Pros:

- Competitive interest rates (sometimes)
- Terms of up to 25 years
- Most loans are fully amortized

Cons:

- Limits on company size
- Requires satisfactory credit score
- Lengthy approval time



Paying for Real Estate

SBA 7(a) - SBA flagship, up to \$5 million from affiliate lender

Note that:

- SBA-guaranteed loans require at least **51% owner occupancy for existing** buildings and **60% owner occupancy for new construction**
- Based on prime rate plus a small margin

Paying for Real Estate

Hard Money Lender - short term loan from private party

Pros:

- Doesn't evaluate borrower's credit rating
- Fast approval
- Easier to qualify for

Cons:

- Higher interest rates
- Average LTV ratio is 60% to 80%
- Short-term financing





Paying for Real Estate

Conduit Loan - commercial loans pooled together and sold to investors

Pros:

- Low interest rates
- Amortization period longer than loan term
- Non-recourse loan doesn't require personal guarantee

Cons:

- Balloon payment after 5- to 10-year term
- Significant prepayment penalties



Creating a Holding Company

Why do I need a holding company?

Protect Yourself and limit your liability!





Creating a Holding Company

Structuring a Holding Company

- LLC is most common due to simplicity and protection offered
- Have a qualified professional do it
- Rent to Yourself



Tax Implications

- Depreciation
 - Taken over 39 year time period
 - Only on building, not land
 - Use depreciation to offset any profits on taxes
 - Cost Segregation
 - Strategy to ACCELERATE depreciation
- Deductible expenses
 - Mortgage interest
 - Property taxes
 - Maintenance + Capital Expenditures (CapEx)
 - Travel between buildings



Y'all still with me?





Other Considerations

ADA Accessibility

- Ramps
- Minimum bathroom sq ft + grab bars
- Minimum hallway widths



Other Considerations

Renting Space to Colleagues

- Lucrative, but make sure all parties have full understanding
- Types
 - Fellow Optometrist (shared space)
 - Ophthalmologist
 - Vision Therapist/Orthoptist/Ocularist
 - Esthetician
- How does this fit into your practice IDENTITY?



Other Considerations

Renting Other Sections of Real Estate

- a) Have a qualified professional draw up a lease agreement
- b) Be wary of any restrictions
 - i) Occupancy requirements from loan
 - ii) City/county restrictions



Other Considerations

- Landscaping
- External Utilities
 - Keep the lights on
 - Cracks in pavement lead to cracked bones which result in cracked bank accounts



Other Considerations

Insurance

- Liability



Other Considerations

Renting Other Sections of Real Estate

- 1) Single Net (N) - includes property taxes in addition to rent.
- 2) Double Net (NN) - includes property taxes and property insurance in addition to rent.
- 3) ***Triple Net (NNN) - includes property expenses such as real estate taxes, building insurance, and Common Area Maintenance (CAM) fees in addition to rent and utilities.***
 - a) Lower rent charge due to additional fees
 - b) Most Popular - allows for low risk cash flow
 - i) Remember rent equates to equity built



Case Studies

***Actual Stories From Actual ODs on
How Real Estate Purchasing Changed
Their Practice for the Better!***





Case Studies

Developing Land for Both Practice and Rental - Mike Gerdts, OD (Shenandoah, TX)





Case Studies

Developing Land for Both Practice and Rental - Mike Gerdts, OD (Shenandoah, TX)

The Process

- Bought a 1 acre undeveloped lot and built a 10,000 sq foot office building
- Had to be within a mile of 2 previous locations after patient survey
- Retained 85% of patient base and have grown about 7% over the last 2 years
- Traditional loan - 15 year practice history at the time



Case Studies

Developing Land for Both Practice and Rental - Mike Gerdts, OD (Shenandoah, TX)

The Plan

- Utilize 4500 sq ft for growing practice (~2M gross on 2 FT ODs)
- Rent out remaining ~5000 sq ft



Case Studies

Developing Land for Both Practice and Rental - Mike Gerdts, OD (Shenandoah, TX)

Pros

- No more increases in rent based on CAM, triple net. No more negotiating with landlords.
- Already values at 25% more than cost to build 3 years later.
- Easier to sell practice without pending lease negotiations/terms being unknown beyond the current lease for the new owner. Can negotiate the lease with the buyer directly.
- Building is located in the middle of the fastest growing county in Texas, so value will go up.
- New lot availability was scarce in community when purchased 6 years ago, no viable lots for a small business owner now.



Case Studies

Developing Land for Both Practice and Rental - Mike Gerdts, OD (Shenandoah, TX)

Cons

- Delays (3 years to develop) and cost overruns (\$27K above budget due to missed items during the land development feasibility study) would have put him out of business had he not been dealing with a good financial cushion and willing to work 6 days a week
- No tenant means 'big occupancy cost' for the owner when you are not at 100%, but he's still paying less as a mortgage than the combined triple net rent for two 2250 foot offices



Case Studies

Developing Land for Both Practice and Rental - Mike Gerds, OD (Shenandoah, TX)

Key Takeaways:

- 1) Larger spaces with portions leased to other businesses can drastically help with cash flow - but can also hurt if a tenant is lacking
- 2) Appreciation pushed by scarcity
- 3) Projections on surrounding area growth can be a “crystal ball” for future patient growth



Case Studies

Thanks Mike!





Case Studies

Purchasing an Existing Building in a High Priced/Volatile Location - California





Case Studies

Purchasing an Existing Building in a High Priced/Volatile Location

The Process

- Purchased Practice in 2016
- Building owner offered building in 2018 - 2 condo complex
 - Bought half (roughly ~1600 sq ft)
- Obtained SBA 7(a) loan - 20 year term with 20% down



Case Studies

Purchasing an Existing Building in a High Priced/Volatile Location

The Plan

- Renovated entire office + replaced signage
- Converted storage area into office space
 - Part used for side business
 - Part for rent



Case Studies

Purchasing an Existing Building in a High Priced/Volatile Location

Pros

- Avoid rent increases due to area volatility
 - Neighbor's rent increased 3x when lease was renewed
- Building assessed for 1.4x purchase price - instant equity
- Future plans
 - Other half of building will be sold in next few years
 - Will develop into a multi-story building with condos on top
 - Private equity buyout - 4 x 5 year lease agreements
 - 3% increase each year



Case Studies

Purchasing an Existing Building in a High Priced/Volatile Location

Cons

- Monthly mortgage about double what rent was
- Down payment was costly - had to use personal money to prevent cash flow crunch
- Capital Expenditures on landscaping, flooring and barriers
 - Also roof depending on development schedule



Case Studies

Purchasing an Existing Building in a High Priced/Volatile Location - California





Conclusion

- Owning Real Estate allows for opportunities in practice growth, creativity and fiscal security
- Understanding the value of real estate both in terms of your professional career as well as your practice's wellbeing is paramount
 - The math + fine details are boring, but important!
- If the chance occurs and the cards align, buy real estate

THANK YOU!



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