



ILLUSTRATIONS BY STEPHANIE CARTER

BY MARK TERRY

# To Landlord *or* Not to Landlord?

**Although it may not have the drama of Shakespeare, whether to rent or own your practice's facility depends—at least in part—on the philosophical question of how you see yourself.**

**D**ori Freeland, DDS, MS, an orthodontist in Lake Orion, Michigan, has a spacious lakefront office in a building designed to look like a lighthouse. Her own office and her patient chairs all face the lake, which is only a few yards from the floor-to-ceiling windows. Freeland, however, doesn't own her office, but leases it from the owners of the building. "When I bought the practice," she says, "they weren't selling the building, which has four owners. I sort of inherited the lease space with the practice."

Freeland notes that although she's pleased with the office and the space, "in the long run, if you know the area you're going to stay in, it's much better to buy as an investment."

## **Leasing: the fewest hassles**

The biggest problem with leasing for most physicians is the perception that they are throwing money away. Although you're acquiring a needed service for the money, it's not an investment. Freeland says, "Rent is not an investment. It is set, but it increases every year."

Freeland also notes that CAM costs—Common Area Maintenance charges like snow removal, restroom maintenance, and upkeep—typically are lumped into the rent, which can change every six months to a year.

Mike Crosby, CPA, MBA, the president of Provider Resources, a physician practice management company in Nashville, says, "The cons to leasing are that you can end up in a space that requires constant maintenance on a triple net lease. Triple net means essentially that the taxes, insurance, and minor repairs are all passed through to you. You pay the utilities; the taxes are all passed on to you as well as the association fees or general building fees; any general assessments are passed through to you, and then minor repairs are your responsibility as well."

There are advantages, though. "Leasing gives you a

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chance to get in and have some options, depending on the length of the lease. You may be entering an area where you're not sure you're committed to being in permanently," Crosby says.

Some of the advantages, of course, depend on timing. John Guiliana, DPM, a podiatrist in Hackettstown, New Jersey and a partner in SOS Healthcare Management Solutions, a practice management group, says, "Most of the people I give advice to I recommend that they lease for at least a year to be sure that this is the right marketplace for them, the right location for them. Then they can certainly restructure their lease so it's available for repurchase."

The most-cited reason for leasing instead of owning is just the hassle of dealing with maintenance issues, although many leases require you to take care of everything except external structural maintenance and repair problems. Shelly Klein, MD, a pediatrician in Prescott, Arizona, says, "I don't have a problem with leasing, but when I found out that the local leasing situation involved paying everything, I figured I might as well own the property and be my own landlord rather than pay all the expenses and have to follow somebody else's rules and not get

any benefit from it."

Guiliana has owned his own practice facility for almost 20 years. "Unless you're absolutely averse to having the necessity or responsibility of being a landlord, I would say there's no real downside to owning. Certainly it's a capital issue; you do need the capital available for down payment, and that capital that's tied up in real estate could be used for something else. I can't really see any other downsides," Guiliana says.

### Owning: the big commitment

Although the consensus seems to be that owning your facility is preferable to renting it, it's not a particularly simple decision. Many physicians acquire or build a building—either to host their practice or for multiple practices or multi-use with the intention of it being a good investment. Paul Angotti, who runs a practice management firm called Management Design in Monument, Colorado, says, "Fundamentally, I would ask, 'If it wasn't the building the physicians occupy, would they want to invest in it as a building anyway?' If it's not a good deal, but they want to buy it just because they occupy it and want to be able to exhibit some power or want to exhibit some influence over the

### An Insurance Dilemma.

Some physicians, especially surgeons, prefer to lease or own a medical office building that is adjacent to a hospital or surgical center. These facilities, due primarily to proximity, are expensive, but surgeons in particular, feel that it's worth the cost because that closeness allows them to perform one or two extra surgeries, thereby recouping the expense.

Paul Angotti runs a practice management firm in Colorado, and he offers a cautionary tale of what can go wrong in this situation. "We have a case in Colorado of several doctors who bought into a building adjacent to a hospital. There was a requirement by the association—these doctors are part of the as-

sociation—that owns the building that they perform 75 percent of their surgeries at that institution."

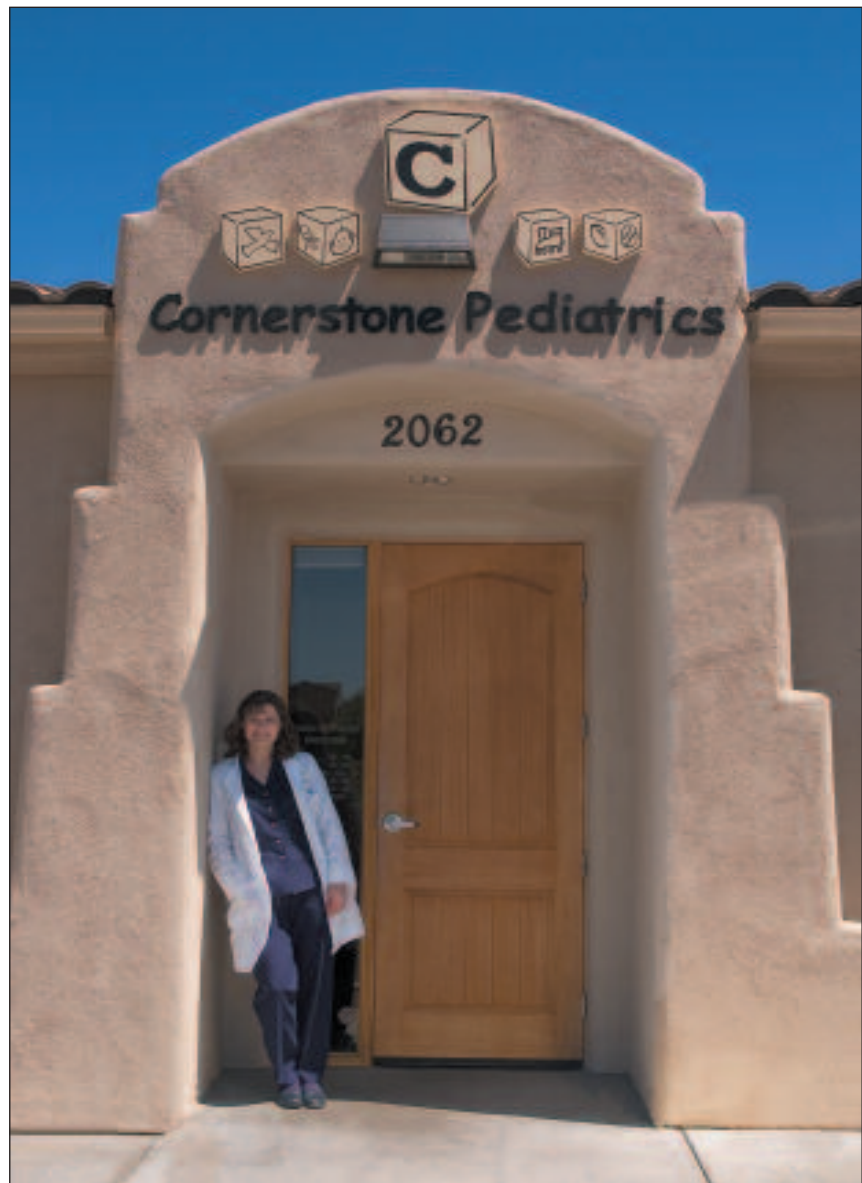
The problem appeared when several of the major insurance carriers insisted that the physicians do all of the surgeries for patients of those carriers at a different facility because the insurance companies didn't have a relationship with that hospital. At press time, this hadn't been resolved. Angotti says, "The surgeons have a conflict with their own building association that says they have to do 75 percent of their surgeries there, but their insurance carriers won't let them. They might wind up with an unsalable share of the building because other doctors won't want to move in there either."

Angotti says that there are aspects of the medical delivery system as a whole that influence the profitability of an investment. "You have to look at what you can control and what you can't control. On that basis, building in semi-rural areas and rural areas tends to be a surer deal because those conflicting situations don't usually occur," he says. "If you're in the suburbs away from most hospitals, it's unlikely those situations will change drastically. But if you're in a big city, and there are a number of competing hospitals and a number of competing insurance carriers trying to lock up the hospitals, that's going to lock up doctors into specific facilities. It's much more dynamic and much less in control for the doctors," Angotti says. ■

**Shelly Klein, MD, a pediatrician in Prescott, Arizona, decided ownership was preferable to leasing for her situation, and found an attractive deal. “In my case, I actually purchased land and built. There was a lack of available space in the community and I got the land on a bankruptcy deal.” Klein sublets several rooms of her 4,000-square-foot facility.**



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owners, then they probably shouldn't do it. If it were a shopping plaza or an office building downtown, would they want to invest in it? If the answer is no, then they shouldn't do it, because then it's going to be a bad deal.”

Shelly Klein says that when she built her facility, the deal was hard to pass up. “In my case, I actually purchased land and built. There was a lack of available space in the community and I got the land on a bankruptcy deal.” Klein's facility is 4,000 square feet and

she sublets several of the rooms.

If leasing is like dating, then buying a facility is like a marriage—and significantly harder to undo. According to Crosby, “The biggest issue is the commitment to the geographic area and location. The second is, once you've made the commitment, how long is it for? Most people will say, ‘I'm going there and I don't plan on leaving.’ But doing the right studies to determine that that's the right area for your practice is vital.”

Guiliana agrees, saying that if you're a new practitioner who is just coming into the market, it's much safer to test the waters by renting. For new practices, Guiliana is a big proponent of spending the available capital and time on building the practice. “Obviously you're investing capital up front, especially capital that can be used for other things. If you're buying and it's not the right location for you, or even if it's the right location and you need to expand

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down the road, you're locked in."

Crosby says it's a philosophical question as much as practical. "This gets into a personal philosophy on how you want to spend your investment dollars. From a planning perspective, however, owning is often a very good thing to do."

### **Condos: Not just residential**

There are a number of options when choosing to buy—or lease—a facility. Will it be a large facility where you can rent out rooms or suites to other businesses or other practices? Will it be a facility solely for your practice's use? Will it be a multi-use facility for tenants other than medical practices?

One option that often appeals to physicians is a condominium-style facility, where you buy your unit, but the exterior and physical plant and common areas are maintained by the condo association. Guiliana's office, for instance, is a condominium. Klein's is a larger facility that was built for three medical providers and she sublets two of them, but it's not a condo. A condominium would seem to have the benefit of appreciation and the added bonus of limiting the maintenance involved—seemingly the best of both worlds.

Thomas Tift III, the CEO and founder of HealthAmerica Realty Group in Atlanta, a real estate company that specializes in medical office buildings in the southeast, as well as Houston and southern California, isn't as enthusiastic about condominiums. "There's recently been big, big interest from physicians in owning condominiums for medical office space. It's primarily driven by really low interest rates. From a real estate perspective, we don't think it's a good idea for physicians. It limits their expansion opportunities. Also, if they

want to shrink their space size it limits that as well."

Tift also says that condominiums for medical practices generally are overpriced. "It's a very high per square foot price and when he goes to sell it at some point, it's usually very difficult to make a profit on it. He is really kind of put in a position where it's more like a forced savings, paying down on a mortgage."

That said, Guiliana is very pleased with his condo situation. "I basically take care of the 3,500 square feet I own, but we have a management company as part of the association that does all of the exterior maintenance and common areas. For a single doctor to handle all that would be a lot, and I do think you'd need a management company for that," he says.

A condominium will typically have a condo board of some sort that you, as an owner, will have to work with. Tift says, "You may or may not be involved with that board and you have limited control. If you're in a multi-tenant situation and a partnership in that building, typically there will be a general partner who will be the developer, and his interests should be aligned with yours in order to maximize the profitability of that building."

That, of course, could be a pretty nebulous issue. Angotti says, "Sometimes the management companies and condo organizations don't know anything about running a facility."

### **Multi-tenant buildings: Know thy neighbor**

If you plan to own your own facility, should you invest in a facility solely for your own practice, or purchase a larger facility so you can lease out some of the space? There are some good reasons to

want to have tenants, especially other medical practitioners, all in one building. Synergy is the predominant one—a healthy and convenient source of referrals all under one roof. This, of course, can become a very complicated issue and run afoul of the Stark amendments, federal laws that prohibit certain types of referrals for Medicare and Medicaid patients. They read:

*The Stark I Amendment is a federal law that prohibits physicians from referring a Medicare patient to an entity for the furnishing of laboratory services if the physician or an immediate family member of the physician has a direct or indirect financial interest in the entity providing such services. The Stark II Amendment extends this prohibition by prohibiting physicians from referring Medicare and Medicaid patients for certain types of services known as 'designated health services.' A financial interest includes an ownership interest or a compensation arrangement (the latter includes both the giving and receiving of compensation).*

Interpretation of the Stark amendments is well outside the scope of this article, so when in doubt, consult with an attorney familiar with these laws.

A second reason to have other tenants is to offset your own mortgage costs through rents. Tift says that the best way for a physician to own a facility is through some form of partnership on a multi-tenant building. "It's a much broader market to sell those and typically in that situation you would be partnering with a developer. The developer comes in and puts together a partnership with the doctors to own a multi-tenant building. That way the physician gets the expertise of a real estate developer (hopefully one with experience in medical real estate) to set up that kind of partnership."

Such a facility is typically much larg-

er—perhaps a 50,000-square-foot building—so that when the physician decides to sell the building, there is a much larger potential market.

### A taxing decision

If you own the building you practice out of, it's a good idea to charge your practice rent. Guiliana says rental income to a doctor who owns the real estate is taxed at a different rate than ordinary income. "Most doctors should do that," says Guiliana. "Even if they own, they should pay rent to themselves, simply because it shifts some of the compensation to rental income rather than ordinary income."

That can be a double-edged sword, of course. If you own the building, you're paying individual property taxes on the property. The taxation issue is further complicated because it varies from state to state, but in general, Angotti says, "There tend to be more tax advantages if you're an owner."

### The "M" word

Although it makes good fiscal sense to own your own facility, some people just might not want to wear the management hat. When considering the possibility of owning a multi-use and multi-tenant facility, it's important to remember the time issue. One of the primary arguments for physicians not to invest in real estate is that they're unlikely to make as much income from it as they would from practicing medicine.

Even with a sole-use facility, there are going to be issues of upkeep and maintenance that will suck time away from a practice. Klein agrees. "The big thing is, if you're going to own, can you handle it? Financially it's one thing, but you have to shovel sidewalks if it snows; you have to

have the trash taken care of; if the lights burn out, you have to have bulbs. Can you handle it? Do you want to handle it?" she says.

A supportive, available, and handy spouse might help. Klein says that she's fairly handy herself, "but I know a lot of people who wouldn't know the first thing to do with a plugged up toilet. It's like home ownership. You've got to be comfortable, not just financially, but you've got to know you can keep up the yard and the facility. And sometimes with a medical facility there are additional things you've got to stay on top of to keep in code." (See "Accessibility for Patients," page 24.)

Crosby says that whether you can handle the management yourself depends greatly on the size and complexity of the building. "If you're a sole tenant, then you can manage it. But if you have multiple tenants, you're probably going to be much better off having a management company do it for you."

Tift agrees, emphasizing that if you're looking for a real estate management company, look for one that specializes in medical office buildings. "It's a different business. It's all we do, but if I owned a shopping center, I wouldn't manage it myself and I wouldn't go to an office manager. I'd go to a retail company. I also believe physicians should have someone else manage it because physicians' expertise is in running a practice and being a physician. It is not in running real estate, and it's going to take time away from their business to handle real estate and those unique problems."

Crosby is also a fan of having a professional management company run the building, and he urges shopping around for the right one. "As an accountant, an attorney, a doctor, or any professional,

you should do what you do well, and in this case, it means a doctor being a doctor. Having a professional management firm will allow you to get a greater return on your investment," he says.

Although it would seem to be a good business decision to own your practice facility, there are a tremendous number of variables involved in making it work. Many physicians will simply want to focus on medicine and not get into the headaches of investing in real estate or the upkeep and management of a facility, whether or not they have tenants. There are, after all, plenty of people who choose not to own homes, but rent apartments. Sometimes that's an economic decision, but often it's a personal decision having to do with lifestyle choices. It may also be a decision having to do with where you are in your life. If you're undecided about where to practice or how long to stay in one area, leasing may be the way to go. If you're closing out your practice for retirement in the near future, that's also a consideration, but ultimately the decision may not be economic. ■

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Mark Terry is a free-lance writer and novelist. His next book, *The Serpent's Kiss* (Midnight Ink), is due in July. This is his first article for *UO*. He can be reached at [www.markterrybooks.com](http://www.markterrybooks.com).