DO'S AND DON'TS with REAL ESTATE in a PRACTICE TRANSITION

WHAT MAKES FOR A SUCCESSFUL PRACTICE TRANSITION IS A DEAL WHERE BOTH SELLER AND BUYER FEEL TREATED FAIRLY.

What is open for translation is what "treated fairly" defines. For two parties approaching from opposite ends of the spectrum, it is quite rare for both parties to walk away not only feeling the Transition was a success, but knowing it was a success without strategically approaching the deal.

When a doctor owns the real estate, the expectations and considerations for the real estate are rarely well evaluated often resulting in a one-sided windfall for either the seller or the buyer. Sellers, Buyers, and practice brokers usually defer to an appraisal, or broker opinion of value to identify the sale or lease value. This sounds like common sense, however in a *Practice Transition* this approach can be an incredibly costly mistake.

MISTAKE OF HIRING AN APPRAISER TO DETERMINE VALUE.

Appraisers do not set a real estate's value, they are hired by a bank to mitigate risk for the bank. Appraisals are subjective, not objective, they can be read to find the subjective interpretation, and often evaluate a property as if it was for sale in the open market. This metric weighs heavily on the comps in the market for other like properties that were listed and sold. The problem with this is that such properties were sold without consideration of the interior build out.

Why? Because the real estate in practice transition is not listed on the MLS and therefore not readily available in databases for appraisers to find other like sale values.

If an appraiser does factor in the interior build out value, we must know what depreciation they factored in and what storage space was not part of the build out expenses. For example, we have seen these hyper inflated, in which the doctor buying the practice plans to buy the charts but then purchases a neighboring building to build out because the Seller's price was beyond reasonable.

WHAT WE DISCOVERED

was the appraiser factored in the lower level of unfinished space 3,000 SF as if it was finished built out dental space. This threw off the value by over $400,000 above what the real estate should have been, causing the deal to die. Because of our involvement, we successfully saved this deal for the Seller.

We have also seen a Buyer and Seller purchase separate appraisals on the same building to find as high as a 40% difference in valuation. This goes to show how subjective appraisals can be.

COMMON MISTAKES MADE BY A BUYER

Relying on an appraiser to determine value

I recently had a practice owner who purchased her practice one year prior asking me about selling the real estate. It turned out the Seller used an appraiser to identify the valuation and was over $300,000 below its actual value. We were able to find a new 3rd party Buyer who gladly paid the proper price as the value was without question the best deal even with the price being nearly $300,000 more than she had purchased it for.

Structuring a poor lease

Sellers often allow their attorney, practice broker, or consultant to identify what the lease rate and terms should be. This is one of the worst mistakes I have seen in the industry. It sounds reasonable to sign a 5-year lease with (4) 3-year renewal options; however, when throwing in first right of refusal, purchase options, etc., the issue is that no one is educating the Seller on how each item affects the value of the real estate. Sellers also are not taught how to structure a lease so that the value is preserved regardless of what the future holds with the tenant. What if the Buyer does not want to purchase the real estate in the future? What if the tenant moves out at the end of 5 years? Just like that, the Seller in this scenario has lost hundreds of thousands in value.

You can structure leases that accomplish both protecting the Seller's value and providing very fair lease rates and terms to the tenant. No one needs to be greedy to accomplish protection for both parties. Typically, it is the Seller that draws the short stick when using their attorney, practice broker, or consultant to come up with terms for the lease.

> As an example of this, we helped an oncology practice sell to a hospital. In the real estate negotiations, we were able to increase the Seller's real estate value from $20MM up to $30MM in value without raising lease rates. The structuring of the lease achieved high levels of satisfaction for both parties with the lease's terms and outcome. These same metrics in a hospital acquisition also apply to a standalone dental transition.

Trying to save money by not having proper representation for the real estate

Finding value must ALWAYS start with the Seller. Why? It's based on who owns the asset and has control. Sellers are in the driver's seat of decision-making on what they own. It is imperative that a Seller understands how and why values work and what the margin of value is.

If you ask for too much on the price the broker will not be able to justify the price to the appraiser, causing a shortfall and possibly a failed deal. However, if a Seller wants to be generous to a Buyer on the real estate, they need to know where the lower end of that margin is. A good real estate representative of the Transition can properly evaluate all three metrics used in an appraisal.

Most importantly, they can show and articulate to a Buyer the equity of why a lease or sale of real estate is truly the best option for them, and how much equity they are achieving from the day of sale. If a Buyer does not understand how and why the values work, they, too, will struggle in feeling treated fairly. By effectively being able to break down the values of real estate for the Seller first, the Seller can then decide with confidence on the appropriate price to present to the Buyer.

The presentation to the Buyer shows the metrics used and how the Seller decided on the price and terms. This is what mitigates emotion and negotiation!

How does a seller know who to hire?

The litmus test of a real estate advisor's value that prompts a Seller to hire incorporates four components: a representative's understanding of your practice, build out values, third-party values (if you sold real estate to a separate party from the Buyer of the practice), and lastly, if they can interpret the subjectivity of an appraisal. These four components will assure you have someone who can effectively evaluate your situation.

COMMON MISTAKES MADE BY A SELLER

Having a real estate agent barter with seller based on "Market Comps"

Market comps are not the issue. It's the Buyer's real estate friend, or Buyer's rep who advises them they can get a better deal when they present comps that have been sold in the 'open market' to a different type of user that does not value the interior build out. This happens often. Buyers send a Seller a list of comps only to find out all the comps are buildings completely irrelevant without factoring in interior build out.

A Buyer should have someone guide them in what the market is for real estate options and what the build out costs would be if they did not purchase or lease the Seller's office. This should be done by whoever is facilitating the practice transition's real estate transparently. Otherwise, you are comparing apples to oranges.

Emotional Negotiations

Buyers are willing to pay fair value and even a premium for a good practice and real estate. However, they don't want that willingness to be taken advantage of. We always inform Buyers that they are welcome to make a counter offer as long as it is not an emotional one. Sellers are almost always willing to listen to reason. Making an offer for the sake of feeling like you got a good deal will hurt and can even kill the deal. A Buyer must have reasoning for the offers being made.

Not utilizing the real estate professional to speak with appraiser

If the deal is being facilitated professionally, the Seller will have a transactional coordinator involved. Buyers can run ahead with their lender thinking the Seller's representative is only working for the Seller. This is not true. The Transactional Coordinator is working for the success of the deal; however, they do not negotiate prices. They are there to provide transparency and articulate the values in place for both Seller and Buyer.

Buyers that do not utilize this service put themselves at higher risk of an appraisal shortfall on the real estate. If they cannot purchase the real estate, they often lose it or the deal altogether. In a Transactional Coordinator role, our job is to prepare a report for the Buyer's bank.

The Buyer's lender should have the appraiser use the Transactional Coordinator as the point of contact and share with the appraiser our work and how the values were established. This is significant to the appraiser. Many times, a lender does not send the appraiser to us, and they appraised with poor comps resulting in a shortfall. However, when a Buyer switches to another bank as a point of contact, magically the appraisal tends to come through with no shortfall on the same deal.

Many times, one lender did not send the appraiser to us, and they appraised with poor comps resulting in a shortfall. The buyer then switched to another bank, and with that new bank using us as point of contact, magically the appraisal came through with no shortfall on the same deal.

CONCLUSION: WHY HIRE A TRANSITION REAL ESTATE SPECIALIST?

Professional and Objective Evaluations

Mitigate Emotions and Negotiations

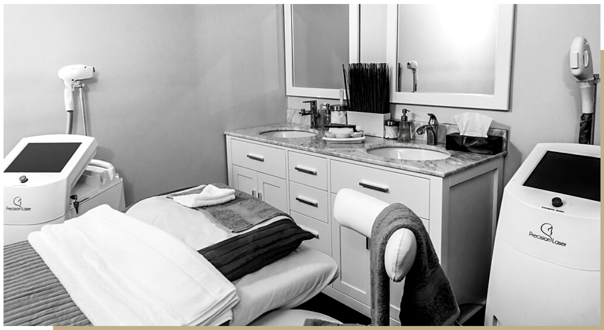
Knowing your options

- Lease vs. Purchase vs. 3rd Party Values

Strategic lease structuring to protect and preserve value

Key components that prepare for a successful transition:

- Transparency
- Simplicity
- Fairness



CONTACT US

800-373-5306

contact@bridgecommercialrealty.com

bridgecommercialrealty.com/mda