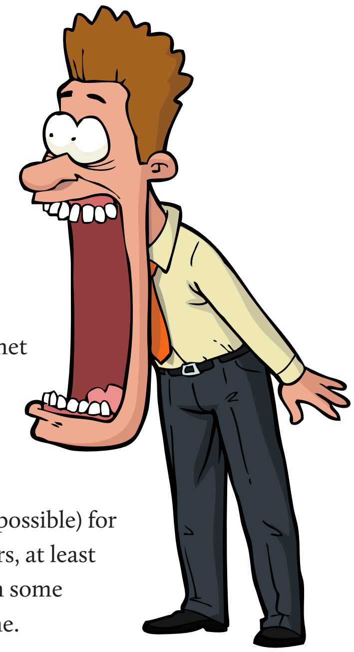
Surprise, Surprise …

I bet you didn’t see that one coming



My engineer friend Bob refers to them as “Show Stoppers.” By that he means, an event, circumstance or situation may arise unexpectedly that suddenly changes the planned course, or, in some cases, brings the proceedings to a halt. While there are always potential land mines in a practice sale and transition, we are going to focus this article on the ones that most often deliver an unexpected knockout punch, specifically for seller-owned real estate. If you own and want to sell the building the practice is located in, I can almost guarantee you that there will be problems associated with that sale. The problems may prove to be so serious that the buyer walks away or you find your practice to be virtually unsalable. In other words, the “show” will not go on. While clients are discovering new stumbling blocks every day, let’s look at a few challenges we have experienced in recent transitions.

THE BUILDING IS OBSOLETE. There was a time when a cozy, 1,000 sq. ft. office with three operatories was the standard. Doctors built those offices on the nicest corners in towns all over the country, but the 2016 reality is that the buyers want at least four and probably six operatories, and your building is of little interest to them. Throw in a dated design that has not yet reached historic registry designation, and it makes this a tough sell. We find that having this kind of real estate reduces the number of prospects for the practice by more than 50 percent. Insisting that the buyer simultaneously purchase the building and practice will result in some indigestion. Yes, you can offer to lease the new practice owner the building, but I can assure you they will likely be out of there as soon as possible, and you will be left with a property of questionable marketability.

THE BUILDING IS IN A BAD LOCATION. We will discuss Rural vs. Metro listings in a minute, but for now let’s go back to 1975 when the building was designed and built. Just like today, the area was probably picked because it was located in a growing part of the city with good access and parking. The office might have been in a quiet neighborhood somewhat centrally located to its anticipated patient base. Calendar ahead 40 years, and most of the city’s growth is now miles away, the intersection near your office is five lanes wide and the road development in 1990 took up 40 percent of your parking. Patients are now traveling several miles for their appointments, and the surrounding buildings have pawn shops and title loan offices as tenants. This too may be a tough sell unless the practice is discounted enough that the buyer can afford a new build-out in a more comfortable area. Hopefully the old building site can be sold to Taco Bell.

THE BUILDING IS PROBABLY OVERPRICED. To be frank, dental office space is not usable for many other purposes. Trying to get a premium price for a property that has a limited functional value, in addition to the sale of the practice, may find few takers. Yes, you spent a fortune in plumbing and leasehold improvements, but your equity position may not be as strong as you think. We find, too, that the Great Recession has left many building owners upside down on their mortgage, and buyers and their lenders are too savvy to offer to cure your problem. If you built a building in the last 15 years and took out a long-term mortgage, there is a good chance that the sale of your building will result in a net after-tax loss. Many have found that they are better off working (if possible) for a few more years, at least benefiting from some ordinary income.

YOUR KINDLY PARTNER SLITS YOUR THROAT. Building partnerships are a disaster waiting to happen. If you have a partner in the building housing your practice, let me assure you that partner has a say in the choice of a successor for your practice. They have veto power. While they might have been happy partnering and practicing with you, who’s to say that they will be OK with your buyer? One way or another, they will have to sign off on your sale, either as a landlord, partnership interest waiver or for some right of first refusal, and I have seen more than one case where they declined. Talk about a fun office Christmas party!

YOU BUILT IT IN THE WRONG CITY. While quality practices located in Metro areas across the country continue to be in strong demand, the plight of the rural practice remains an enigma. They are rewarding and, as a rule, more profitable, but they remain unattractive to most buyers. We can show prospects the financials and pictures of the office but their excitement wanes when we tell them that the office is located in a small town two hours away from the big city. We once asked a prospect “if money were no object, what would it take to get you and your family to move to (blank) and take over that practice?” His answer was, “an act of God”. Now that’s a show stopper.

A BONUS WORRY FOR THOSE WHO RENT THEIR SPACE. If you thought that renting your office space absolves you from any potential problems, let me put your mind at unease. The lender will almost always require the new doctor to have control of the office space for an amount of time equal to the term of the acquisition loan. Typically this is about 10 years and that control can be in the form of a single term lease or a lease with an initial term and a series of optional renewals. What landlords often realize at this point is that they are in the driver's seat and if the buyer wants to be the new tenant, that privilege will come at a premium. Sometimes that premium is such that the practice is no longer affordable at the agreed-to price. Likewise, while the landlord is very comfortable with the payment history of his long-time tenant, he knows virtually nothing about the buyer and may insist that the seller stay on the lease as a guarantor for a number of years. Selling doctors find that sort of long-term contingent liability distressing.

Let me leave you with one last uncomfortable thought. In the post Great Recession world of commercial real estate, buildings are financed on the basis of a formal, third party appraisal. The price the buyer and seller have agreed to can and will be overridden. Appraisals are time consuming and fairly expensive, a cost that may be subject to negotiation between buyer and seller. Waiting for that appraisal to "come in" is one more potential cause for the practice closing being delayed. We maintain a real estate license in our office under the management of a commercial broker to help keep us on top of these issues and how best to handle them. While we expect problems to occur, we like to think that market experience and a little prior planning can help ease the stress on both the buyer's and seller's side of a transition. *f*

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