

# Spotlight On: Selling the Real Estate to Enhance the Surgery Business

An interview with Lt. Col. Bruce Bright

**Stephanie Wasek:** What is the property management model you follow?

**Bruce Bright:** Our business is to be a long-term holding company; our only focus is to develop, acquire and manage medical offices buildings and ASCs. We buy the real estate — the physical building and land — at full market value and lease it back to the ASC business entity on a long-term basis. Essentially, we become the landlords.

**SW:** For background, can you speak briefly about types of leases and how they work?

**BB:** On one end of the lease spectrum there's the triple-net lease. In that model, the tenants are responsible for everything. They pay a rent check each month to their landlord, and everything inside is their responsibility. The tenant manages electric, water, maintenance; they're in control and can keep expenses to a minimum.

On the other end is the full-service lease, where the tenant pays one rent check at the end of the month, but the landlord is responsible for everything. This may sound as if it's better, but the landlord has to

charge in order to prepare for the worst-case scenario. As a result, the rent will be much higher, because the landlord is charging what he thinks the overall cost might be for all issues, major and minor. This arrangement is not typical in a single-tenant ASC building.

We prefer triple-net leasing, letting the tenant better control costs, even though we get a smaller rent check. There are a million ways to modify any part of a given lease to fit a group's specific preferences and needs.

**SW:** Isn't real estate ownership preferable?

**BB:** Well, there are pros and cons to both sides. While pride of ownership can be a rallying point and there is some appreciation in real estate, many issues in commercial building ownership overshadow those advantages. So, in most cases, I'd advise physicians to lease their building.

First of all, there is a risk in real estate ownership: Physician-owners have to ask themselves whether they're willing to put personal capital at risk on bricks and mortar, whether they're willing to sign a

personal guarantee on a mortgage and be liable for that money.

They also have to ask whether real estate provides a better return on investment than other similar-risk ventures. ROI on real estate is about 8 percent, but you get more than that back on a surgery business itself; it's never that low. Physician-owners might, therefore, prefer to put that money into the higher-margin asset, the ASC business. Real estate ownership isn't essential to the delivery of health-care; surgeon-owners might rather reinvest the money in higher-margin, mission-critical activity, such as MRI or other equipment.

Even if they have that capital and are willing to take the risk on bricks and mortar, there's also the matter of whether they're willing to tie it up long-term on an ill-liquid investment.

**SW:** What are the advantages to leasing?

**BB:** You eliminate long-term, personal guarantees on debt, which frees up cash flow and allows higher returns on the surgery center business.

You also eliminate the dissonance between real

estate owners and the non-participating practicing physicians. Over time, as the surgery center takes on junior physicians, they become tenants, and there can be resentment between surgeons when some feel as if they are simply paying the rent to the senior physicians, who are making more money as a result.

There are also issues of maintenance and upkeep — if you get into ownership of a building and mismanage it, it will depreciate. Most physicians are not familiar with how to build a building, and they shouldn't be; it's a separate profession. Further, does an orthopedic surgeon really want to be in charge of upkeep? A surgery center is a house on steroids, all the issues are magnified — we can step in as landlord and take care of that.

The last huge advantage, as I mentioned, is that a physician group that leases a building from us is in complete control of the building. We will manage it if they would like us to, though if they want to, that's fine with us, too. How they conduct their surgery business is, of course, still up to them.

**SW:** How can physicians decide which route to go down — owning or leasing?

**BB:** I would tell a physician group thinking about purchasing or building a building to do a few things. First, they should talk to a banker to

find out how much they need to put down on the real estate in addition to the surgery business.

I'd also recommend that they consult with a commercial real estate lawyer, not a realtor from another part of their lives, and get information on all the ins and outs of the building process. There are Stark laws, the lease has to be at fair market value — all those factors should come into play in the decision to own the real estate.

Another good action would be to talk to their peers, doctors who have bought or built or sold office space or a surgery center, and ask how they handled their real estate and why. A good market search looking at the area where they want to buy build or lease is also necessary.

For a lot of ASCs we see, it's a matter of the timing and the situation. Normally, there are two separate entities: One owns the real estate, one owns the surgery business. Many times, physicians will come to us because 10 physicians bought a building, but it's time for some of them to retire and they want to cash out of both. It's tough to sell two-tenths of a building; so the group might decide to sell and take the liquid cash, even if not all are ready to retire.

**SW:** How much capital can be freed up as a result?

**BB:** Well, it's very typical for a group to have up to 30 to 50 percent of its capital in real estate. At start-up, on the other hand, you can take that amount the bank would want down on the mortgage, or the amount of the building costs and take that right off the top.

You could certainly build and hold for five or 10 years — but that's a long time to have nothing happen with that money. Look at it this way: If I gave you two options and said, OK, you can take investment A, or you can take investment B and get a higher rate of return, you'd have a tough time justifying taking option A and the lower return.

Surgeons are in the unique position of being able to take option B, because of their profession, and get the higher return. Surgeons are smart, but there are some things that go along with managing, filling, leasing and locating buildings that might not be in their purview, whereas that's all we do. By selling, they can concentrate on doing surgery, and let us concentrate on managing the bricks and mortar for them. ■

*Lt. Col. Bright is the director of business development for The Sanders Trust, an Alabama-based healthcare real estate investment company that operates nationwide.*