

Practice Management

Buy or Lease Your Next Urgent Care Site?

Urgent message: After location, how to pay for an urgent care site is crucial to your success. Here's how to think it through.

MICHAEL ZELNIK, CCIM

Introduction

Once you've found the right location for your next urgent care (see *An Urgent Care Site That Maximizes Revenue*, JUCM, September 2011), your focus can turn to analyzing the risks and benefits of leasing or purchasing property in the trade area you've identified. This analysis should be more than just a financial calculation. Each choice has a unique set of benefits and risks that could restrict or accelerate profit and expansion possibilities.

Leasing Benefits

Leasing is an option available to the largest number of potential tenants. Although credit is an issue, the criteria are not as demanding as those for securing a loan to purchase a building. Leasing space, therefore, can be good choice for start-up urgent care centers with limited capital to invest, whereas an established urgent care center may prefer to preserve capital for future expansion.

Benefit 1: Flexible Size Choices

Why purchase space if you are uncertain about the number of patients who you will see on a regular basis? Starting small and growing when

Michael Zelnik, a real estate professional for more than 30 years, is president and founder of the Zelnik Realty Group and the National UC Realty division (www.nationalucr.com) in Columbus, Ohio. He is a Certified Commercial Investment Member (CCIM). He can be reached at (614) 309-3288, mike@nationalucr.com.



patient count and cash flow warrant an expansion can be an effective strategy.

Example

An urgent care leased 4,000 square feet of space for 5 years. Their patient counts increased to a level that warranted leasing additional space. The landlord agreed

to extend the term of the lease and allow the practice to expand into the adjacent space.

Benefit to the Urgent Care Practice

The business was not disrupted by relocation or having to add space to an existing building. The other advantage was being able to grow into a space without having to pay the cost of extra space during the early years of the practice.

Benefit 2: Faster Start-Up Time

Leasing space typically involves locating an existing building. Buildings that have never been occupied are called first-generation or “shell” buildings. Second-generation spaces are locations that have had a previous tenant. In each case, the space needs to be customized for use by an urgent care practice. The time required to build out the interior of the space typically ranges from 60 to 90 days.

Example

An urgent care operator wanted to be open by the end of December to capture a large percentage of patients needing flu vaccination before the end of the flu season. Negotiations to lease a space in a shopping center started at the beginning of October. Terms were agreed to and a lease was executed by the middle of October. Once the lease was signed, construction commenced and the clinic was completed by the end of December.

Benefit to the Urgent Care Practice

Within 90 days, the provider was able to find a building, negotiate the lease, complete construction, and be open for business in time to serve patients need flu vaccination.

Benefit 3: An Exit Strategy

No one can predict what factors will influence the viability of a location over a period of 5 to 10 years. A lease agreement has a specific termination date that gives an urgent care center the flexibility to close or relocate to a better location if the current site is no longer profitable.

Example

An urgent care leased space for 5 years. The location was in the back of a shopping center and did not have sufficient signage or visibility. Because of these issues, the patient counts never reached the anticipated level of profitability. Once the current lease expired, the

provider was able to move to a new location with improved visibility and signage, which helped to increase the number of patient visits.

Benefit to the Urgent Care Practice

The fact that this lease had a specific termination date enabled the provider to find a new location without having any uncertainty about when he could relocate.

Leasing Risks

Not all aspects of leasing are beneficial. Leasing has risks that can seriously impact a business operation.

Risk 1: Property Foreclosure

Your lease agreement is typically subject to an existing mortgage agreement. If your landlord is having financial difficulty, the property could go into foreclosure and your lease could be terminated.

Example

The building occupied by an urgent care practice is under foreclosure by the lender. If the lease agreement did not provide for a “subordination and non-disturbance” (SNDA) clause, the tenants may run the risk that the lender will terminate all lease agreements and force the tenants to relocate.

Risk to the Urgent Care Practice

The financial problems of the landlord could result in loss of time and money spent building the urgent care practice at a leased location.

Risk 2: Other Tenants

A leased space may provide all the desired benefits of signage, visibility, and access. But the surrounding tenants may have a negative impact on the operations of the other tenants in the shopping center.

Example

An urgent care provider shared a parking lot with all of the tenants in a shopping center. A new restaurant moved into the center and was open for lunch and dinner times. The restaurant was so successful success, that the common parking lot was at full capacity during lunch and dinner hours.

Risk to the Urgent Care Practice

The lack of parking could make the location undesirable to potential patients, which could decrease the number of daily visits.

In considering leasing vs buying, there is no intrinsically right or wrong choice. Each option has its own set of risks and benefits.

Risk 3: Lack of Options

A lease agreement will have a specific termination date. If the lease does not provide an option for the tenant to extend the term, the tenant could be forced to leave a profitable location.

Example

An urgent care practice leased space for 5 years in a location that generated a considerable number of daily patient visits. The practice wanted to remain at that location but a competitor approached the landlord and offered a higher rent than the current tenant was willing to pay, so the landlord leased the space to the competitor.

Risk to the Urgent Care Practice

All the time and money spent promoting this location will now benefit the competing urgent care practice, which was able to take over the space without spending any of the typical costs associated with starting a new center.

Buying Benefits

Owning a property rather than merely renting a location offers benefits that cannot be achieved by tenants. The results of these benefits are not automatic, however, and are subject to risks that in many instances are out of the owner's control.

Benefit 1: Value Creation

The value of real estate is influenced by the length of a lease, quality of the tenant's credit, and use of the space. In today's market, investors are aggressively pursuing medical buildings with long-term leases in place. In many instances, this has caused sales values to increase.

Example

An urgent care practice agreed to lease a 5,000-square-foot building for 15 years. In return, an investor was willing to purchase the property for a value that was 8.5 times annual net income.

Benefit to the Urgent Care Practice

The value of this property would only have been \$500,000 if the property did not have a long-term lease in place. Because the tenant was willing to commit to a long-term lease, the value of the property more than doubled to \$1,050,000. The owner then sold the building and leased back the property for 15 years. The profit from the sale provided the capital to build a new building and open a new clinic.

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JOHN SHUFELDT, MD, JD, MBA, FACEP

FOUNDER AND FORMER CEO AND CHAIRMAN OF NEXTCARE URGENT CARE

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JSHUFELDT@SHUFELDTCONSULTING.COM

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Benefit 2: Custom Design

As the owner of a property, you will have the ability to design the space to meet your needs and desires.

Example

The owner of an urgent care practice wanted a reception area that was comfortable and homey. His design included a functional fireplace in the waiting area.

Benefit to the Urgent Care Practice

The owner was able to have a specific finish, which would have been impossible in a traditional shopping center with multiple tenants.

Benefit 3: Management Decisions

As the owner of the property, you will be able to make all the decisions regarding how the interior and exterior of your building should be managed. This would include signage, landscaping, and snow removal.

Example

An urgent care leased a building in a town that permitted digital signage. The landlord did not want to have any digital displays on his property, so the practice was unable to take full advantage of enhanced signage.

Benefit to the Urgent Care Practice

If the property was owned by the urgent care provider, it would be in a position to take full advantage of all signage that was acceptable under local zoning regulations.

Buying Risks

There is a downside to ownership. The fact that you are the owner means you have total control of your property. Unfortunately there are numerous factors that are totally out of your control.

Risk 1: Market Area Changes

Picture a former shopping center, once the focal point of an area for shopping, offices and entertainment, now reduced to a group of lifeless vacant buildings.

Example

A major grocery store anchor ceases operations. The other tenants in the shopping center who relied on the grocery store for a steady flow of customers must now also close their doors. Outparcel buildings that once sold for over \$1 million are now selling at a 30% to 40% discount.

Risk to the Urgent Care Practice

The owner of this type of property has no control over other retail traffic generators. When a major retail anchor closes, the ability to sell a property for more than your original cost could be compromised.

Risk 2: Lending Risk

Most loans require repayment in 5 to 7 years, many with what is known as a balloon payment. A balloon payment protects the lender from having money tied up for long periods of time at unfavorable rates.

Example

The current terms of a loan are favorable to the owner. The loan had a balloon payment due when interest rates were at a higher rate than that currently being paid on the loan. The owner must refinance the property, pay all the costs associated with refinancing, and accept the current interest rate.

Risk to the Urgent Care Practice

The increase in the cost of the loan could reduce the practice's profitability.

Risk 3: Aging Building

Roofs, parking lots, and the exterior of buildings have a limited useful life. As the owner of the property, you would need to make a capital investment to replace aging building components.

Example

The useful life of a roof is 15 to 20 years. The useful life of a parking lot is 10 to 15 years. The exterior of a building may require maintenance every 10 to 15 years.

Risk to the Urgent Care Practice

The condition of your building's components will affect the value of the property and you may need to make additional capital investments during slow income periods.

Conclusion

In considering leasing vs buying, there is no intrinsically right or wrong choice. Each option has its own set of risks and benefits. Your first priority should be to pick the right location for your urgent care practice. Once you have selected a location, you should devote time and attention to evaluating the benefits and risks of leasing and buying and select the option that best fits the long-term plan for your business. ■