SkyView Advisors

THE ULTIMATE PHYSICIAN GUIDE TO SELLING YOUR MEDICAL OFFICE

TABLE OF CONTENTS:

1 Introduction

2 Should I sell my Healthcare Real Estate?

a. Macro-economic Conditions
- Demographics – Supply & Demand
- Interest Rates – Cost of Capital
- Monetary Policy - Inflation
- Labor Markets

b. Healthcare Real Estate Market Conditions
- Healthcare Industry Fundamentals
- Healthcare Real Estate Market Fundamentals
- Transaction Volumes
- Value Trends
- Are Physicians Selling?
- Financing – Availability and Cost of Capital
- What are the Trends?

c. Practice Operational Considerations
- Need for Growth Capital
- Reduction of Debt
- New Physician Partner Participation
- Physician Demographics - Retirement
- Physician Partner Alignment
- Sale of Practice to Third Parties/Employment Over Private Practice

d. Personal Financial and Lifestyle Issues and Goals
- Illness or Death of Physician Partners
- Lifestyle Changes (divorce, life-work balance, changing career paths)

3 Physician Sale Leasebacks
- Transaction Structure
- Economic Benefits of a Sale Leaseback
- Operational Benefits of a Sale Leaseback

4 How Medical Properties are Valued
- Valuation Methods
- Key Property Factors Impacting Value
- Unique Valuations

TABLE OF CONTENTS:

5 Types of Healthcare Real Estate Investors
- Health Systems
- Private Investors and Funds
- REITS
- Healthcare Providers

6 Private Equity in Healthcare

7 Maximizing the Sale

a. Preparing the Property for Sale
- Importance of Accurate Valuation and Market Analysis
- Optimizing Leases
- Physical Plant Considerations
- Key Legal and Financial Considerations on a Sale
- Due Diligence Preparation

b. Maximizing the Sale
- Market Assessment
- Determining the Right Time to Sell
- Underwriting
- Documentation
- Preparing the Property
- Hiring the Right Professionals
- Effective Marketing Strategy
- Offering Memorandum
- Buyer Competition
- Choosing the Right Buyer
- Negotiations and Closing

8 Tax Deferral Use of Proceeds
- Section 1031 Exchanges
- Section 721 Exchanges (UPREITS)
- Delaware Statutory Trusts

9 First Steps Towards a Sale
- About SkyView Advisors

THE ULTIMATE PHYSICIAN GUIDE TO SELLING YOUR MEDICAL PROPERTY

INTRODUCTION

This guide sets out the critical considerations and practices involved in a physician owner's sale of their healthcare real estate (HRE). While many of the issues discussed and information provided are applicable to any HRE owner, we will examine the process focusing on the perspective of the practicing physician or medical provider.

The importance of the decision to sell these assets and the implementation of best practices to maximize value cannot be underestimated. For many owners, their medical facility represents a substantial portion of the wealth they have spent a career building so the decision of when and how to sell is of paramount importance and consequences. We are pleased to offer this guide in the hope it will be a valuable roadmap in assessing all the aspects of such a transaction.

The guide is structured to address the two essential questions, should I sell my real estate and how to best maximize the value on sale. The following introductory comments outline the maters and issues which we will examine respecting each of these.

SHOULD I SELL MY HEALTHCARE REAL ESTATE?

As with most complex financial decisions, the answer to the question "Should I sell my medical building now?" is dependent on a varied number of factors.

These factors should include:
1. Macro-economic conditions.
2. Healthcare real estate market conditions.
3. Practice operational considerations.
4. Personal financial and lifestyle issues and goals.

MACRO-ECONOMIC CONDITIONS

The decision of whether to sell your asset(s) should, at an initial level, include an examination of the current macro-economic climate and an understanding of the professional economist's perception of trends and likely prevailing short (5 years) and medium (10-15 years) term economic conditions.

These considerations include:
1. Demographics – Supply & Demand
2. Interest Rates – Cost of Capital
3. Monetary Policy - Inflation
4. Labor Markets.

We will provide an overview and commentary on these general conditions and potential impacts on the current and future HRE market.

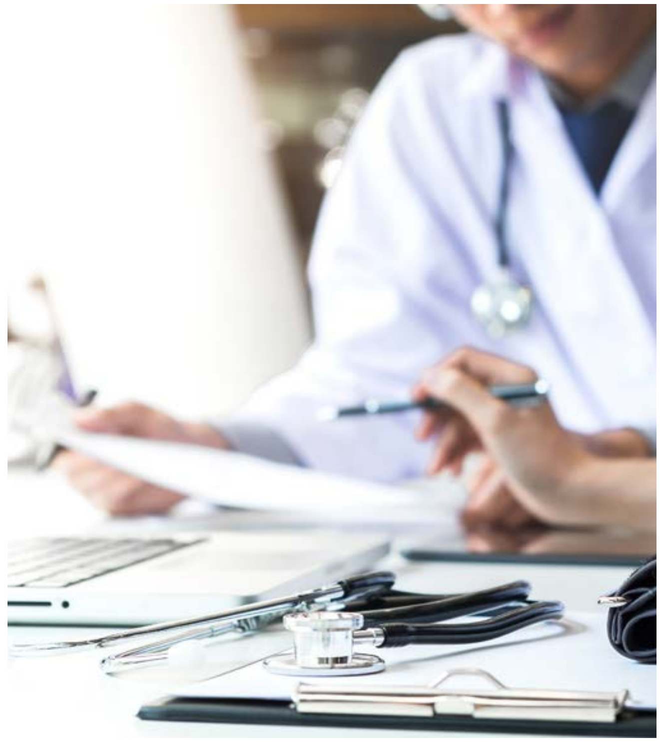
HRE MARKET CONDITIONS

The current and projected short term or medium term HRE market conditions will inform your decision to sell or hold your medical facility. Aside from business operational and personal considerations, these factors are the most determinative in assessing the situation.

While the HRE space has rightfully earned the title of resilient, especially in comparison to other sectors such as professional office and retail, all real estate markets are cyclical and repetitive so the timing of the decision to sell should account for the current andprojected cyclical path of the overall asset class market.

Our analysis of the HRE market conditions take account of the following market metrics:

1. Healthcare Industry Fundamentals
2. Healthcare Real Estate Market Fundamentals
3. Transaction Volumes
4. Value Trends
5. Are Physicians Selling?
6. Financing – Availability and Cost of Capital
7. What are the Trends?



We will look at the current and short-term projected market fundamentals (occupancy rates, rental rates), transaction volumes, pricing trends, availability of equity and debt and the growth or decline of the healthcare sector as a whole in assessing the state of the market relevant to a medical office building.

A word of caution, all real estate is local is an old truism but holds fast. A quality analysis of HRE market conditions must address not only the national and regional landscape but also the particulars of the sub-market the asset is located in. There are often particular market forces and factors that can directly impact the most beneficial timing of a sale. We will look at those sub-market factors which should be evaluated in contemplating a sale.

PRACTICE OPERATIONAL CONSIDERATIONS

Very often, it is one or more practice operational issues or goals that will drive the decision to sell a medical facility The most common operational situations are:

1. Need for growth capital
2. Reduction of debt
3. New physician partner participation
4. Physician demographics - retirement
5. Physician partner alignment
6. Sale of business operations to third parties/Employment over Private Practice

The physician partner alignment issue is often the greatest challenge involving the assessment of complex partnership agreements and the competing interests of various stakeholders. Innovative methods for ensuring an equitable result for all parties have been developed and will be discussed.

PERSONAL ISSUES & GOALS

Personal financial and lifestyle issues and goals are usually closely intertwined with the practice operational issues. This is most evident in the retiring partner scenario where partnership issues need to be realigned through the sale of the practice's real estate.

In addition to retirement, we will discuss other personal situations which can prompt a sale including:

1. Illness or death of physician partners
2. Lifestyle changes (divorce, life-work balance, changing career paths)

PHYSICIAN SALE LEASEBACKS

Regardless of personal or practice motivations, the most common real estate sale transaction by a medical practice is the sale leaseback. The doctors are motivated to monetize the real estate for a number of reasons, both operational and personal, but still wish to retain occupancy and control of the property to continue the practice.

A sale leaseback (SLB) is a real estate monetization transaction in which the owner-user of a property sells the asset to a third party and enters a lease of the property, or part of the property, with the buyer.

While not unique to the healthcare real estate, the technique is often employed in the retail, industrial and professional office spaces sectors, sale leasebacks are extremely well suited to the nuances of medical office properties owned by healthcare service providers.

We will examine the intricacies of this type of transaction and best practices in the execution of this transaction.

MAXIMIZING THE SALE

Once the decision to proceed with a sale of your medical facility is reached the challenge and goal now becomes how to maximize the proceeds of the sale, execute a smooth transaction and achieve the desired personal, business and financial results.

Selling your medical office building or other healthcare real estate requires careful planning and execution to ensure a successful sale. In this section of the guide, we will provide an overview of critical steps and key success factors to maximize the sale of your healthcare asset(s).

We outline the important factors and steps in executing a sale including the following elements:

- **Market Assessment**
- **Determining the Right Timing of a Sale**
- **Underwriting - Assessing Property Value**
- **Documentation and Records**
- **Preparing the Property**
- **Hiring the Right Professionals**
- **Effective Marketing Strategy**
- **Creating Buyer Competition**
- **Choosing the Right Buyer**
- **Negotiations and Closing**

As a physician looking to sell your healthcare real estate, having a robust and well-executed plan is crucial. By focusing on the critical factors and steps outlined here and enlisting the expertise of well qualified professionals, you can maximize the sale of your property.

BUILDING WEALTH THROUGH MEDICAL OFFICE RE

Physicians who own their medical office buildings own a valuable asset that has the potential to appreciate significantly over time. Rather than solely relying on the wealth accumulated from their clinical income for retirement, doctors can leverage their real estate investments to create a more diversified and sustainable wealth-building strategy. Owning the property where their medical office is located allows physicians to tap into the appreciated value of their real estate, and unlocking the capital that was invested in the development or purchase of the property and improvements.

A SPECIAL COMMENT ON PHYSICIAN RETIREMENT

Without question, the most common motivation for physicians to sell their medical building is their retirement or the retirement of members of the practice. So, a special introductory comment on that aspect is warranted.

Physicians dedicate their lives to building thriving medical practices, providing exceptional patient care, and making a positive impact in their communities. Many healthcare professionals with foresight have taken an additional step to secure their financial future by investing in the medical office real estate they conduct their practice in or other healthcare assets. These strategic investments, coupled with careful planning, can pave the way to retire in abundance. Physicians have the opportunity to leverage their medical office real estate as a core piece of their retirement strategy, so the importance of planning and capitalizing on real estate value and appreciation gains is critical.

IS THE TIME RIGHT FOR YOU?

The decision to retire is often difficult and involves many considerations. It cannot be stressed strongly enough that the sale of your medical facility needs to be planned well in advance of actual retirement. Physicians maximize the value of the real estate through committing to a long-term lease back of the property well in advance of retirement. Other strategies, integrated with the sale of the practice are available when earlier retirement is the goal. We will discuss, in detail, the best practices to maximize the value of the real estate through the lens of retirement.

It is vital to align the sale of the property with the retiring owner's overall financial objectives and retirement plan. Assessing the financial goals they wish to achieve, such as a desired retirement income or funding other investments, can provide a clear framework for determining how and when to sell.

Physicians who have the foresight to invest in medical office real estate have a significant advantage in building wealth and securing their retirement. By properly leveraging the appreciated value of their buildings, doctors can unlock the capital invested in property development or purchase. By incorporating these strategies into their retirement plans, physicians can ensure a prosperous and abundant future beyond their medical practices,

SHOULD I SELL MY HEALTHCARE REAL ESTATE?

This section of our guide examines the factors which should be brought into consideration when evaluating whether to monetize an MOB or other healthcare facility and if the timing is right to do so. We first analyze the broad economic and market factors involved in assessing the decision and then take a look into practice operational and personal issues which impact the decision to sell and the timing of a sale.

MACRO-ECONOMIC CONDITIONS

While it is beyond the scope of this guide to present a comprehensive discussion of macro-economic conditions, we would like to set forth those economic factors and trends which have an overall impact on the commercial real estate markets in general and healthcare real estate markets in particular.

The macro-economic landscape is ever changing and evolving but we can identify the following factors as having a substantial impact on commercial real estate market cycles thus informing a decision as to the timing of a sale relative to the general economy:

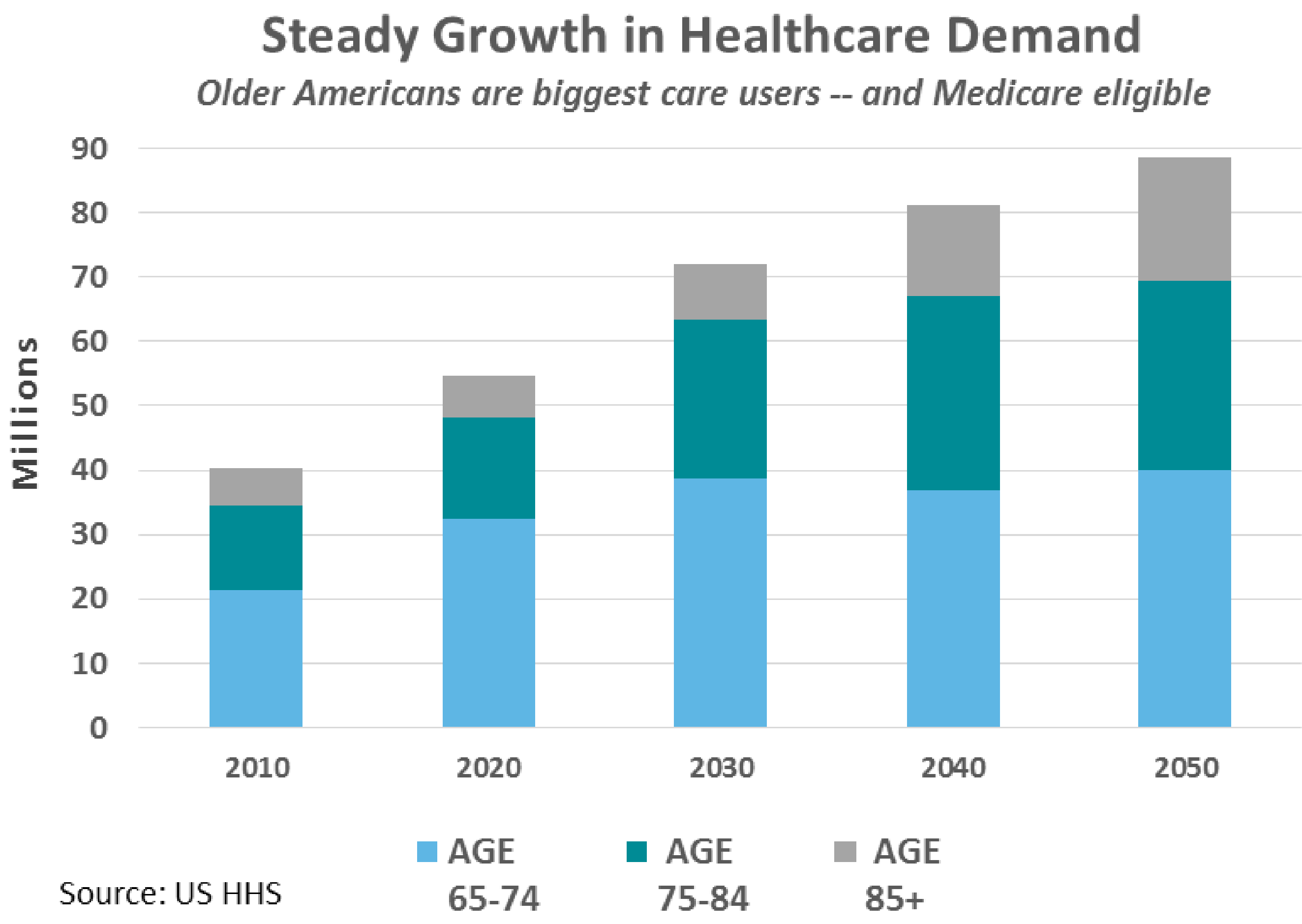
1. Demographics – Supply & Demand
2. Interest Rates – Cost of Capital
3. Monetary Policy - Inflation
4. Labor Markets.

DEMOGRAPHICS – SUPPLY & DEMAND

The dominant macro-economic factor impacting the healthcare real estate market is clearly demographics. The accelerating trend of the "graying" of America continues to propel the overall healthcare sector of the economy. By the end of 2023, the number of persons aged seventy-five and over will have grown by 30% over the last 10 years. This is the greatest increase of any single age segment and more than triple the overall pace across all ages.

The U.S. Census Bureau has forecasted that by 2040, the number of Americans over the age of 75 would increase by approximately 93%. Further, the number of Americans over the age of eighty would increase by approximately 115%. The large increase in the elderly population is often referred to as the "Silver Tsunami."

Naturally, the elderly require more medical care, leading to an increased demand for more healthcare services and hence healthcare real estate. Currently, patients sixty-five and older make up 13.5% of the U.S. population yet consume more than 45% of all healthcare services.

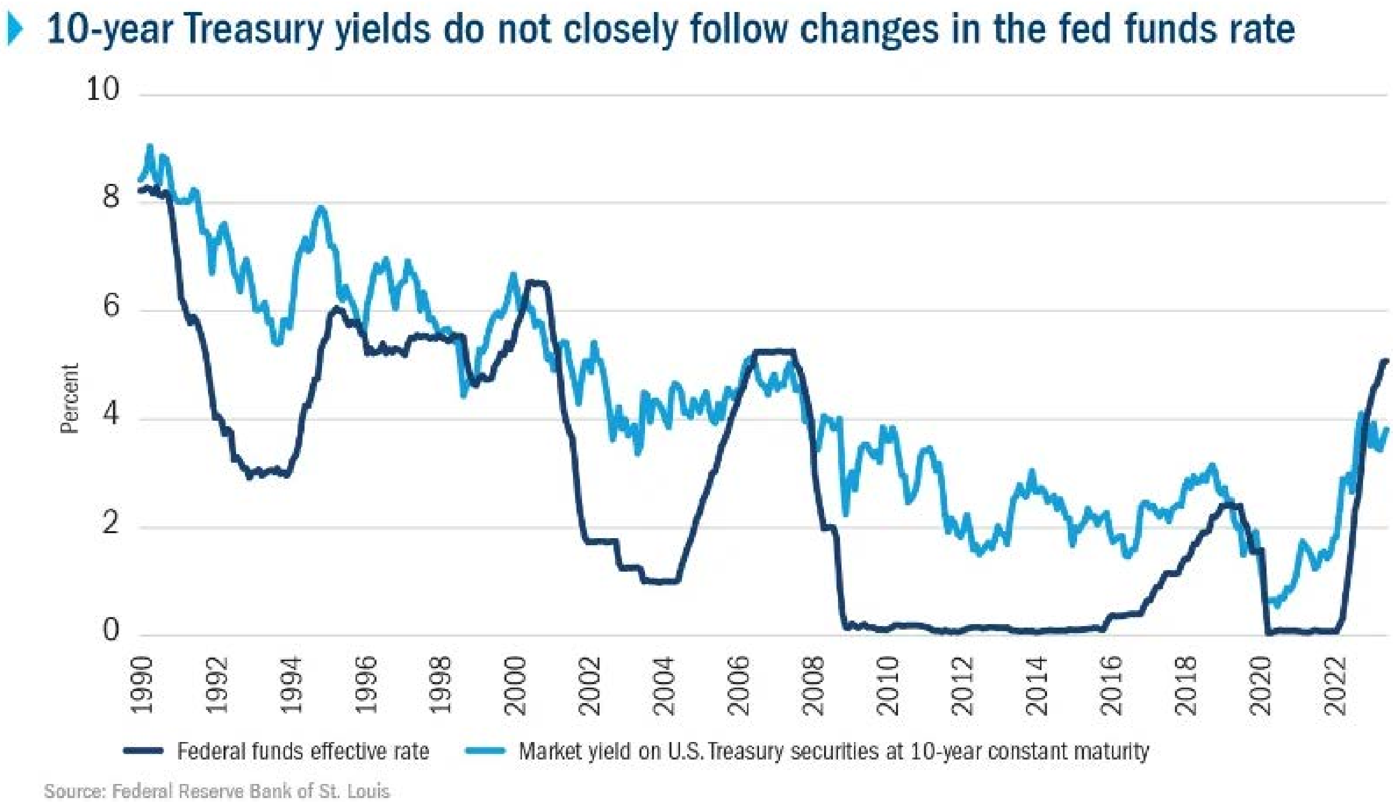


INTEREST RATES – COST OF CAPITAL

Commercial real estate is a very capital-intensive industry. The large sums of capital required to construct, acquire, operate and maintain the assets necessiatates the use of financing and leverage; hence, the cost of such financing has a substantial impact on valuation and is an important timing issue.

The unprecedented monetary policy of the Federal Reserve over the last decade has resulted in many years of the lowest cost capital and the subsequent fastest increase in the cost of capital in the last 40 years. While current interest rates appear astronomically high in comparison to the prior 5 years, historically, they are at a midrange rate if viewed in the context of the last 30 years.

In addition to government monetary policy, the markets also have a say in the cost of capital. Commercial real estate lending rates are directly correlated with the cost of "risk free" returns, most usually the Ten-Year Treasury Bill. The yield of this instrument does not necessarily follow the rates set by the Federal Reserve, sometimes getting out of step and creating either higher or lower lending rates than anticipated but generally speaking the expansion of treasury rates has been very aggressive in step with the Fed 's monetary policy over the last two years.



FED FUNDS RATE VS. 10-YEAR TREASURY RATE

Although the federal funds rate remains below the historical average, the rapid upward adjustment seen since March 2022 has complicated the financing and acquisition process across commercial real estate sectors. Many investors have remained sidelined as pricing continued to absorb the impact of elevated lending rates. The current hiatus, however, could translate to a more stable interest rate environment, which should facilitate transaction velocity moving forward and increase the pool of active buyers in the market.

MONETARY POLICY - INFLATION

As the Federal Reserve has as its two prime directives the control of inflation and full employment, the future cost of CRE debt will come down to inflation. Historically, if the Fed resists further rate hikes and inflation returns to target, historical data shows that CRE lending rates will stabilize and return to low-normal thus benefiting CRE valuations. Historically, once the Fed ceased raising rates, commercial real estate yields rebounded cautiously at first but gained significant momentum after only a couple of quarters. Many see the same scenario playing out in this this cycle and with the Fed having raised rates so aggressively, returns could veer toward the higher side of that historical experience, especially with so much available capital siting on the sideline.

LABOR MARKETS

Whether or not the economy avoids a recession is also substantially dependent on the performance of the labor markets. While the press and public tend to focus on GDP as the arbiter of recessions, the labor market consistently provides a bell weather indicator of the prognosis for a downturn.

Surprisingly, labor markets have shown resilience in the face of first elevated inflation and then rising interest rates over the last couple of years. Though loosening somewhat, the markets remained constrained. The structural, demographics-based labor shortage is causing employers to hoard workers, even in some interest-rate-sensitive industries that would have otherwise seen significant job losses at this juncture. Although the labor market likely cannot remain this tight, it should experience far less deterioration than during a typical slowdown, which would bode well for avoiding a rapid deceleration in economic growth. Monthly hiring is accelerating above the year-to-date monthly averages. Employment growth is occurring in many sectors, led by the onboarding, notably leisure and hospitality, government, education, professional and business services and healthcare. Strong job creation is holding the unemployment rate flat, sustaining a tight sub-4 percent for the 20th consecutive month. How resilient the labor market can remain will largely come down to the Fed and monetary policy. Thus far, interest rate hikes have slowed down the labor market without throwing it into reverse. If hiking has truly ended, the labor market seems as if it can endure the lagged impact of previous hikes. If the Fed resists raising rates unless inflation meaningfully rebounds, then labor tightening may have ended.

MACRO-ECONOMIC CONCLUSIONS

With inflation appearing to be waning and labor markets showing resilience, the overall economic conditions remain largely supportive for commercial real estate. While adjustments in valuations have occurred in some sectors, most notably professional office, given the totality of the economic landscape, CRE markets will likely continue to stabilize and avoid large resets.

In the HRE sector, the dominant macro-economic factor continues to be demographics. The juggernaut of the “graying of America” continues, in the main, to limit the effect of any negative economic landscape and propel the asset class forward as a resilient choice. With the macro-economic landscape improving and the pent-up equity and demand prevailing, the forward-looking prospects for the HRE market are encouraging.

We will look next at the specific market conditions of healthcare real estate with the intent to convey the overall market context for a decision to sell or hold current HRE assets.

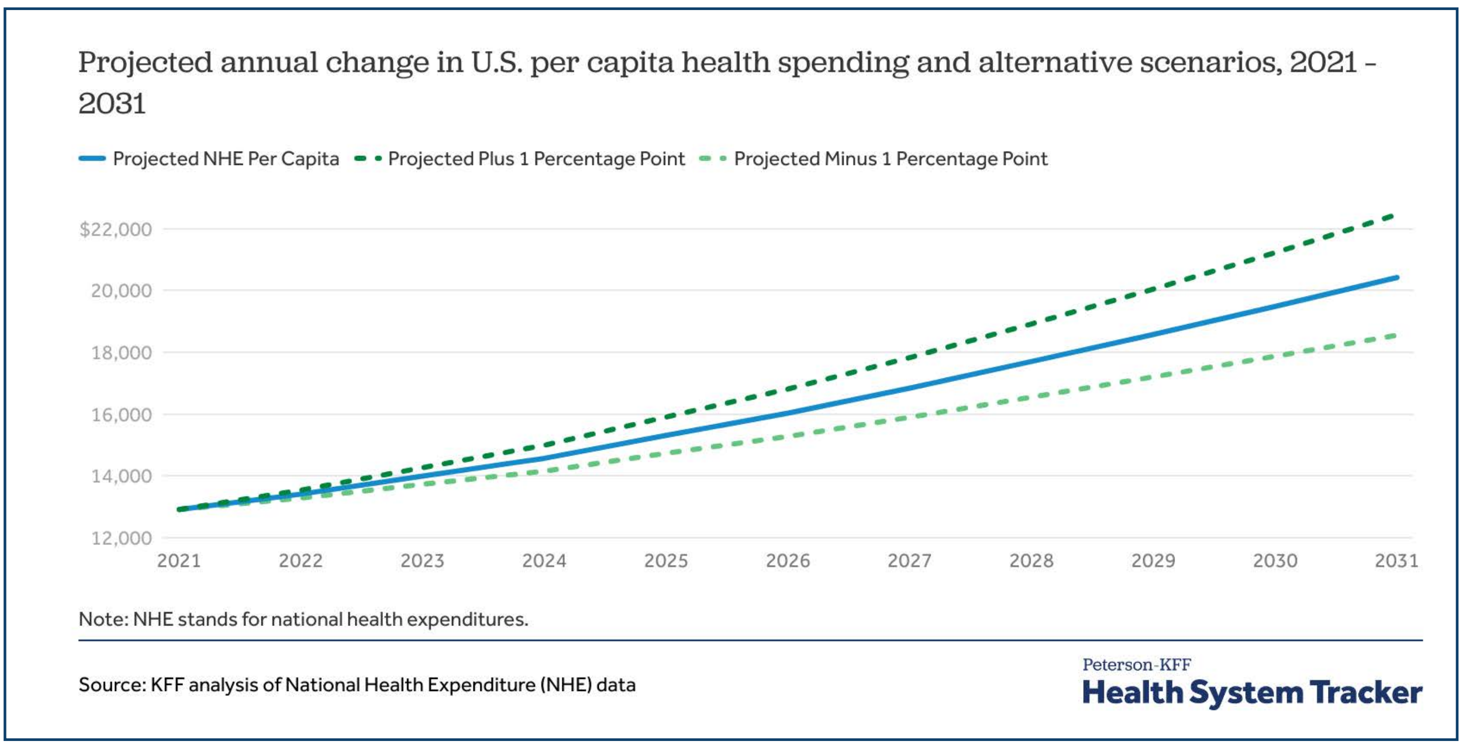
HEALTHCARE REAL ESTATE MARKET CONDITIONS

The specific conditions and trends in the healthcare real estate market sector should play a significant role in any decision to monetize your medical property. While difficult to predict future markets, a thoughtful analysis of historical conditions, current state of the market and likely future trends can help to inform the decision and timing of monetization.

Here we present a brief overview of the fundamentals of the healthcare industry and an analysis of the current and projected future state of the HRE market.

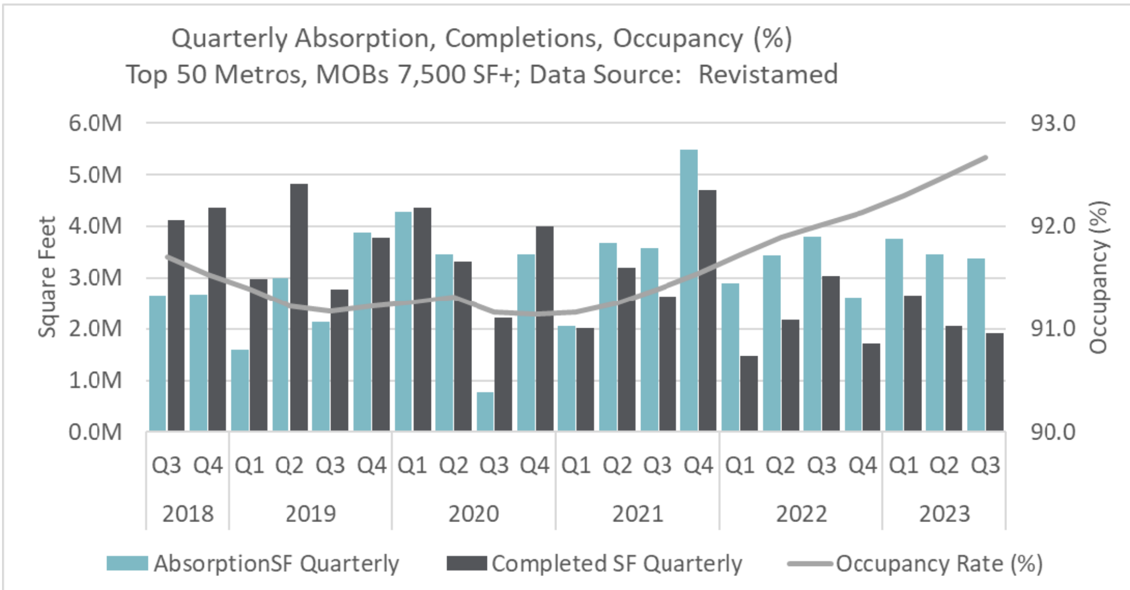
HEALTHCARE INDUSTRY FUNDAMENTALS

Fueled by the graying of America and the rise in the insured population, the healthcare industry has grown from 13% of the national GDP to over 20% in the last ten years. U.S. national healthcare expenditures are expected to reach $6.2 trillion by 2028 per the Centers for Medicare and Medicaid Services. If the current trajectory continues, health care spending will triple by 2040 to $12 trillion, over 26% of the national GDP. Per capita health expenditures are projected to grow to $20,425 in 2031, which is an average annual growth rate of 4.3%. This tremendous growth will continue to drive the demand for medical office space and facilities. This is particularly the case in areas with rapidly growing elderly populations. Accordingly, this growth will facilitate the rise in rental rates and compressed vacancies, long term.

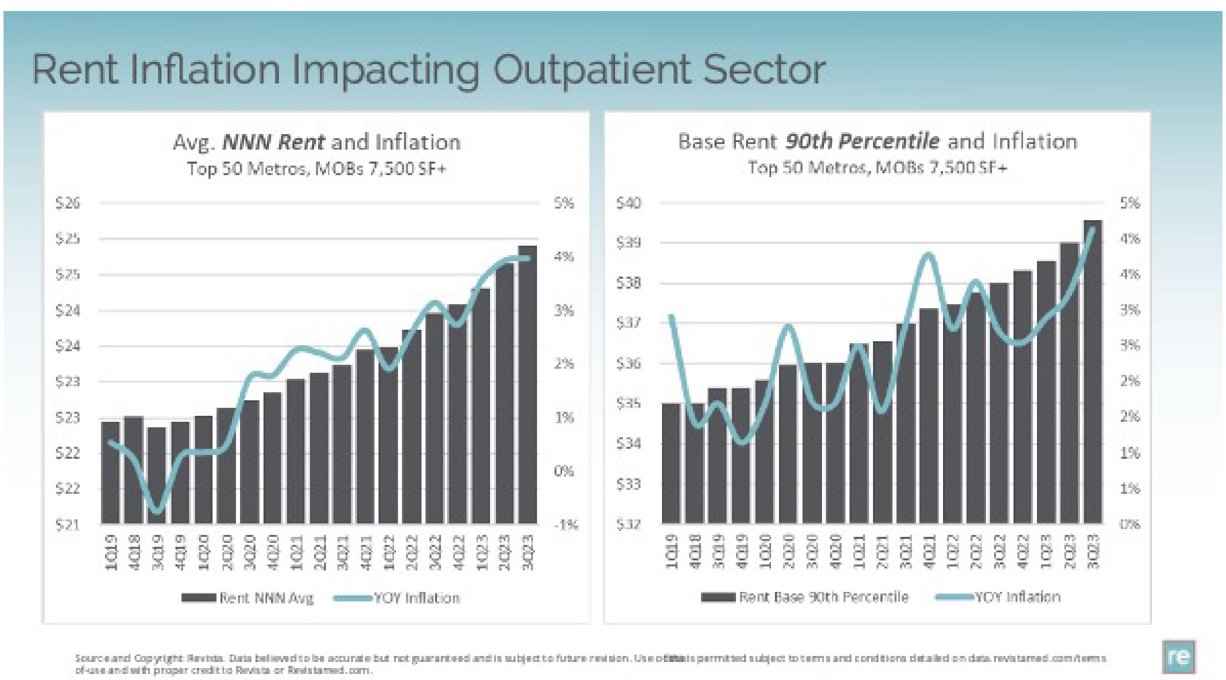


HRE FUNDAMENTALS

As an alternative commercial real estate asset class, healthcare real estate continues to exhibit very strong fundamentals and outshine the core sector assets, notably professional office and retail. Both occupancy expansion and rental rate growth continue a solid upward, years-long trend. The national occupancy rate in Q3 2023 was 92.7% continuing the rise commencing in Q1 2021 and up .7% year over year from Q3 of 2022. On a same store basis, the median occupancy rate change was up five basis points.



Rental rates also continue their growth trend, which has prevailed sicne 2019 began. In the top 50 metros, rates are increasing at almost 4% per annum and natoinal same store growth is trending over 3%.



Occupancy and rental rate expansion can significantly be attributed to tenants looking to occupy existing stock and being more selective in choosing new developments due to the inability to afford the new construction rents.

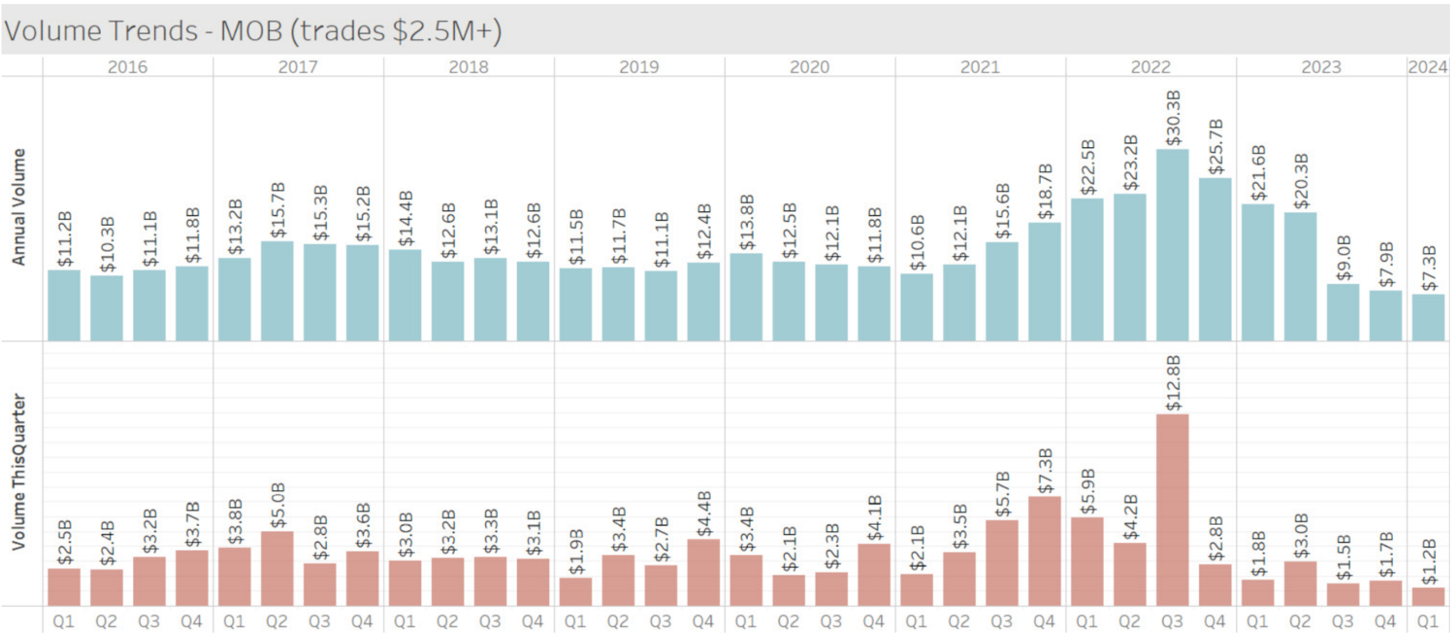
These strong fundamentals have played a significant role in supporting the value of MOB assets in the current macro-economic environment. Medical office building fundamentals have proven to be less volatile than other CRE asset classes, notably professional office post pandemic, offering investors a more secure and reliable investment option in an uncertain market. MOBs are enjoying their time in the sun as a very resilient alternative real estate asset.

Overall, the fundamentals of the healthcare real estate sector remain strong as the need for MOBs, Hospitals, and various alternative healthcare properties continues to increase. We anticipate more investors to allocate capital to traditional healthcare real estate (MOBs and Hospitals) and to the various alternative healthcare assets based on these strong fundamentals.

TRANSACTION VOLUMES

Nationally, the quarterly dollar value of transactions, greater than $2.5MM, for healthcare properties has been on a declining trajectory since the start of 2022. This is primarily due to the tightening of credit in the commercial real estate space based on higher interest rates and stricter lending criteria. However, quality HRE, backed by credit worthy tenants and long-term leases continues to have considerable favored status with lenders.

Notably, there is a serious scarcity of quality opportunities coming to market and an abundance of pent-up equity capital in the HRE sector ready to be deployed. Competition for quality assets has never been greater which serves those coming to market in this economic environment very well.



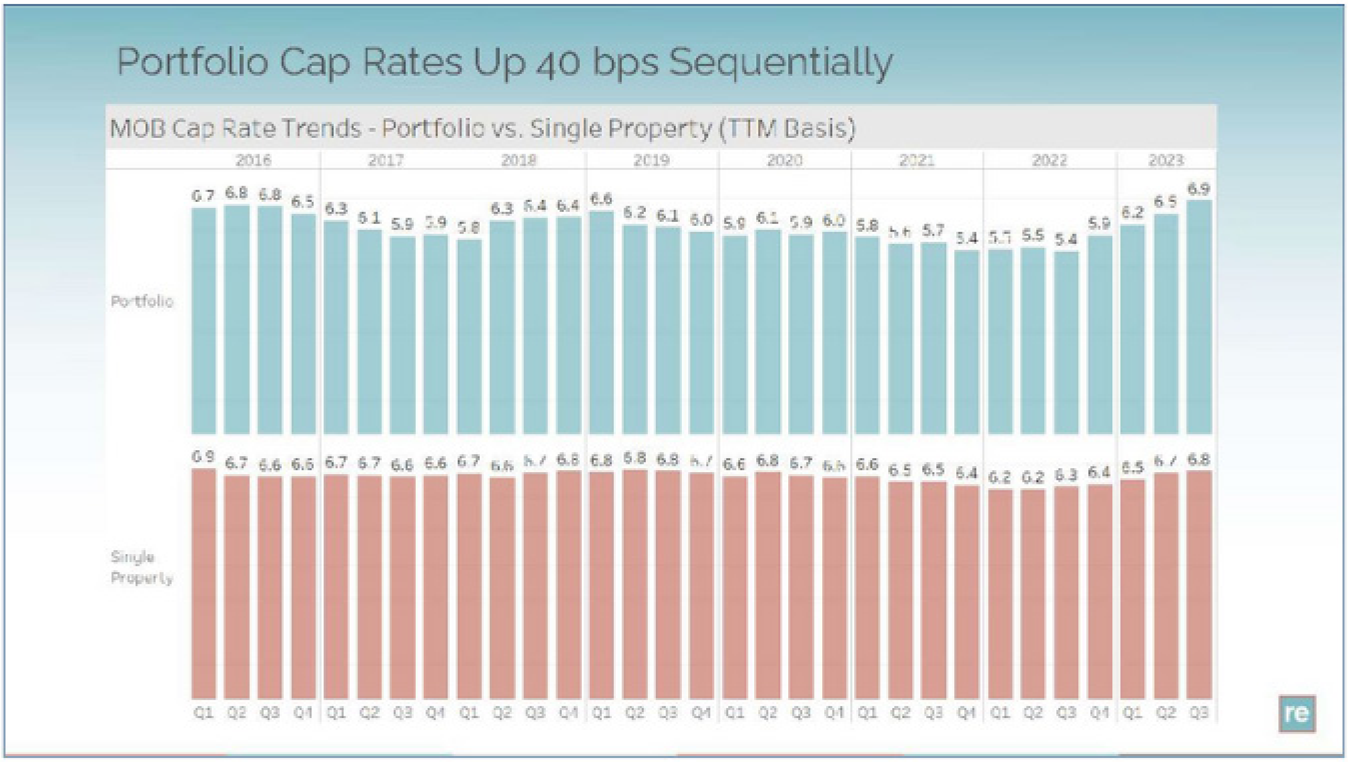
VALUE TRENDS

While demand in the sector remains strong among a wide range of investors relative to other commercial real estate sectors, 2023 has seen some expansion of capitalization rates. While there is ample equity capital available in the space, many would-be investors are currently hindered from making purchases due to the cost of debt, which has been fueled by interest rate hikes by the U.S. Federal Reserve Bank and a subsequent pullback by many lenders. In addition, current market conditions have led to a disconnect on pricing between sellers and buyers – the so-called “bid-ask gap.”

It is notable that the rise in cap rates in the HRE sector is minimal when viewed in terms of the rise in the cost of capital. Such a delta speaks to opportunity in HRE. Investors are clearly taking note of this and the strong fundamentals in the space and we have seen over $2.5B of equity capital enter the sector, 50% of which is from “new” investors. Much of this capital is from the reallocation of “dry powder” from other CRE sectors, primarily professional office and retail.

With the Federal Reserve pausing on interest rates increases and signaling the potential for easing in 2024 we anticipate cap rates to stabilize through 2024 and potentially see some decline, resulting in a normalization of pricing and leading to greater volumes.

CONNECT WITH US



ARE PHYSICIANS SELLING?

While overall transaction volume has declined, a very active cohort in the sector is the monetization of assets by medical providers, particularly independent physician groups. Undoubtedly, the pervasive trend of private physician groups selling their practices to opt for employment and the aging of the doctor workforce plays a key role in this. There are several other reasons private groups are electing to sell into this market including loan maturities, succession planning or capital requirements for operations and expansion as further discussed in later sections.

Provider seller activity peaked in 2022 with an annual run rate of $3.3B and came down somewhat in 2023, however, is still significantly above the typical activity we've seen in previous years and is certainly not showing the impact seen across other seller types. It is highly likely this trend will continue.

As the data shows, by far the most active current buyers in the sector are private investors. These investors are focused on acquiring from providers, usually on a sale leaseback basis. Much of this activity is being generated by the expansion of private equity funds into the healthcare space over the last 5 years. The sale of physician groups to private equity often results in the follow along sale of the physician owned real estate to capitalize on the increased creditworthiness of the PE tenant and the long-term lease which accompanies the practice buyout.

Who is Actively Buying?

Key Stats by Buyer Type (MOBs, Past 12 Months)

BuyerType (group)	Number of Properties	Total Price	Square Feet	Price Per SF	Avg. Cap Rate/Yield
Hospital/Health System	52	$605M	2,076,162	$306	7.2
Investor/Private	531	$5,448M	16,308,887	$365	6.2
Provider Owner	62	$347M	1,388,408	$325	6.6
REIT	158	$2,218M	6,580,205	$331	7.7
Grand Total	**803**	**$8,618M**	**26,353,662**	**$352**	**6.8**

FINANCING – AVAILABILITY AND COST OF CAPITAL

The capital markets hold the key to value metrics and the ability to HRE sell assets.

While there are plenty of lenders willing to provide financing, primarily for high quality assets, across the sector there have been substantial debt pricing increases and tightening of risk tolerance. As goes with transaction volume, the financing levels have declined. While the increase in debt costs have fortunately have not directly correlated to cap rate expansion, the decline in available financing for deals with shorter lease terms and weaker tenant credit is substantial. Adding to the debt issue is the uncertainty of pricing. With less transaction volume the cost of debt is hard to predict thus making underwriting more challenging for investors.

The market is currently in a state of discovery. Credit is gradually loosening, cap rates are resetting slightly higher and the Fed's rate hiking campaign may be near the end, which collectively could pave the way for an uptick in deal volume in 2024. Throughout the HRE markets, access to capital has been reduced and become more expensive. Almost all lenders lowered their loan-to-value thresholds, limiting the amount of capital available to an investor from traditional financing sources. However, many investors are now looking for alternative financing to help achieve additional leverage. These typically include private money lenders and mezzanine financing. While each capital source has its pros and cons, there is no debate that investors are now seeking alternative funding sources to keep their leverage at a level required to meet their yield expectations.

WHAT ARE THE TRENDS?

Investors have come to appreciate the resiliency offered by healthcare real estate. Different from other sectors, throughout and post COVID pandemic, healthcare real estate has shown impressive fundamentals. Estimates are that over $2.5 billion of new capital has entered the space over the last couple of years, poised to invest in quality HRE assets.

Even though transaction volume has slowed, the sector continues to attract record amounts of capital, especially from the private equity space. The predictable, steady returns offered by the healthcare sector resulted in increased competition for healthcare acquisitions in the last 10 years. Since 2020 and prior to the recent rate increases from the Federal Reserve Board (the Fed), there was continual compression of capitalization rates in the MOB s e c t o r. As investment competition for MOBs, ASCs and other HRE facilities increased, the returns realized by investors compressed. Returns were further reduced as the Fed began to raise interest rates, causing an increase in the cost of capital. As we return to a more normalized interest rate and inflation environment, we anticipate a corresponding increase in transaction volume and cap rate compression. The fundamentals and growth story of the healthcare real estate market remain strong, which is attracting new investors who have traditionally only invested in office, retail, multi-family, or industrial sectors.

Alternative HRE property types are garnering a lot of attention. Over the last few years there has been a substantial increase in interest from all types of investors in ambulatory surgery centers, behavioral health clinics (especially post-pandemic), cancer centers and other specialized facilities.

The capital the private equity funds are bringing into the sector, on the operational side, is also fueling the rise of the asset class. Approximately $500 billion of private equity is active in the healthcare space. Much of this is a result of institutional investors, such as pension funds, insurance companies and university endowments, allocating much more capital to private equity ventures. Private equity has expanded, growing from 3,000 to 14,000 funds over the last ten years and to $7 trillion globally. Similarly, PE interest in healthcare has grown with almost all US firms now having a presence in the space and even specialized funds focusing only on healthcare. This huge influx of capital into healthcare provider space has resulted in the greater institutionalization of healthcare provider operations and led to increased credit worthiness of the providers as the tenants of healthcare real estate.

PRACTICE OPERATIONAL CONSIDERATIONS

Physicians operate in a very complex business and regulatory environment. There are a myriad of issues and challenges that arise through the lifespan of a medical practice. Focusing on the real estate component of the practice, we see a number of operational matters that provide motivation to consider the sale of the practice owned real estate. We will examine the primary situations where this occurs and discuss aspects which should be taken into account and best practices for executing solutions to these challenges.

NEED FOR GROWTH CAPITAL

A primary motivation for a practice's sale leaseback is the need for growth capital. Medicine is a capital- intensive business. The ability of a practice to adopt new technologies, upgrade workforce, expand services or add new services is often limited by the shortage of investment capital. The sale leaseback of the real estate can unlock "trapped equity" in the facility for deployment into operations improvement or expansion without incurring further debt or having to sell equity in the operations. Normally, the return on investment from the medical practice operations is significantly greater than that of the real estate so unlocking this equity, while still retaining long term control of the facility, can have substantial economic advantages.

REDUCTION OF DEBT

Due to the historically low interest rate environment over the last 10 years, the reduction of mortgage debt on the practice's facility has not been a major issue for most providers. Times have changed. Re-financings now are priced significantly higher thus making the mortgage debt an important consideration for the overall financial health of the practice. Elimination of this debt can relieve the practice of a large financial obligation and unlock capital for alternative uses. Additionally, the reduction of mortgage debt often results in elimination of personal liability as often the members of the practice have personally guaranteed the obligation. Elimination of this personal liability not only mitigates future risk but can also facilitate other business initiatives by improving the balance sheet and credit of the guarantors.

NEW PHYSICIAN PARTNER PARTICIPATION

When recruiting new physicians for the practice, they are often not interested in buying into the real estate component due to the increased value of the asset(s), lack of financial resources or other reasons. In larger physician groups, the problem often arises when there are older physicians retiring or planning their retirement and newer physicians coming into the practice. This can create misalignment between the two groups. When it comes to retiring physicians, their concerns are likely over return on the investment in the real estate or a desire to be bought out of the asset. The younger physicians are concerned with potential rising occupancy costs for the practice. This makes it difficult to align the various partner's economic interests. Using the proper strategies to monetize the asset and lease it back to the practice, can align those interests.

PHYSICIAN DEMOGRAPHICS - RETIREMENT

Forty-seven percent o f all physicians in the U.S. are over 55 years o f age! The average age o f a U.S. physician is 53.2 years! Fifty-five percent of physicians fifty-five and older are in private practice. Only 30% of physicians under the age of forty work in private practice!

These demographics speak volumes as to why practice groups are liquidating their real estate. America's private medical practices are, in the main, owned by physicians 5-15 years from retirement age. This is the sale leaseback window. This is the optimum age for doctors to sell and lease back their property (assuming a retirement age of 60-70 years). The sale of the real estate is often the best vehicle for funding the retiring partner's buy-out as it maintains control of the practice with the partners and avoids incurring debt or an equity partner.

PHYSICIAN PARTNER ALIGNMENT

The misalignment of ownership interests between the practice's operations and the real estate is common and constitutes a good reason to do a sale leaseback in order to eliminate this conflict. Also, any misalignment in the ownership stakes of individual physicians is resolved by the SLB and is an operational benefit.

Practice ownership of the real estate and the necessity for new partners to buy into the real estate can get in the way of expanding a practice. Often when recruiting new physicians for the practice they are not interested in buying into the real estate component due to the high value of the asset(s), lack of financial resources or other reasons. Disposition of the asset effectively eliminates this issue.

The alignment problem also often arises when the practice has older physicians retiring and newer/younger physicians in the practice. This can create misalignment between the two groups, when it comes to retiring physician's concern over return on the investment in the real estate and maximizing value vs. the younger physician's concern about ongoing occupancy costs under the lease. This makes it difficult to align the various partners' economic interests. Monetizing the building and leasing it back to the practice, properly structured, can align those interests.

The strategy of a partial sale leaseback is also utilized to address partnership misalignment and the problems with younger partners buying into the practice assets. The practice can monetize less than 100% of the asset and retain ownership in the balance thus reducing the burden of the buy in and unlocking capital to address the requirement of buying out retiring partners or those who wish to exit the ownership.

SALE OF PRACTICE TO THIRD PARTIES EMPLOYMENT OVER PRIVATE PRACTICE

There are approximately 1.1 million physicians in the U.S. Approximately 49% of those physicians are in private practice. A private practice is defined as a practice wholly owned by physicians. It should be noted that included in the number of employed physicians are physicians employed by a private practice. As a result, the actual cohort of "employee" physicians is much higher than 50%.

This marks the first time employed physicians outnumbered those in private practice exhibiting the dominant and accelerating trend towards employment over private practice in the healthcare space. Opting for employment often results in the sale of the practice to a well-capitalized buyer such as a health system, larger practice or private equity platform. Each of these situations usually results in the creation of an entity with stronger financial credit, thus creating the best time to execute a sale when combined with a long-term leaseback.

The trend of physicians opting for health system or corporate employment over operating their own practice continues unabated. A recent study found the number of physicians employed by health systems increased from 290,000 to 341,000 between July 2020 and January 2022.

The pandemic certainly played a central role in this substantial change. The pressures of the pandemic drove physicians to leave private practice for employment at a more rapid pace than seen in previous years, however, the data indicates that this trend continues to accelerate, despite the end of the pandemic.

Reasons for opting for employment also include the difficulty of operating a profitable private practice as the healthcare industry evolves. Escalating expenses, insurance costs, liability exposure and declining reimbursement rates all contribute to this trend. May doctors also find health system employment creates a better life/work balance and is less stressful. They can focus on practicing medicine and without the burden of also operating a complex business.

From January 2019 to January 2022 the percentage of physicians employed by corporate entities increased 15.3% and there was an 86% increase in the percentage of corporate owned physician practices in the same period rising from 14.6% to 27.25%

Private equity continues to extend its reach into the medical field. The "roll up" of individual private practices, especially in the high acuity specialties such as orthopedics and cardiology into a larger entity continues to expand. In more cases than not the PE firm does not wish to purchase the practice's real estate. They are only interested in the operations.

The sale of a profitable on-going private practice to a corporate entity, such as a private equity group, is a transaction that usually enhances the option of the sale leaseback. The large, well-capitalized entity with highly professional management now becomes the tenant offering the physicians an opportunity to sell the real estate with greatly enhanced tenant credit thus maximizing values. Such a transaction also relieves the landlord physicians of the potential conflict of interest with their employer/tenant.

PERSONAL FINANCIAL & LIFESTYLE ISSUES & GOALS

Personal issues and goals can greatly contribute to the motivation to monetize the practice's real estate. Unlocking the equity in the asset can solve financial issues caused by catastrophic events or fuel partners personal goals. In circumstances where the practice continues on and even flourishes, a sale leaseback of the real estate is often a perfect solution.

ILLNESS OR DEATH OF PHYSICIAN PARTNERS

In the event of incapacitating illness or untimely passing of a physician partner who is a stakeholder in the real estate, practice or both, funding is usually required to fund their personal expenses or estate. Sale leaseback of the real estate is usually a financially beneficial way to accomplish their goals where the alternative is either payment of cash on hand or incurring debt.

Succession planning to address these events should be incorporated into partnership agreements, however this is often not the case. In most cases the buy-out is substantially less than the equity in the real estate. As an alternative to a complete sale of the asset with a leaseback, the transaction can be structured to derive the equity required while keeping the partners who wish to continue to hold the real estate intact.

PHYSICIAN DEMOGRAPHICS - RETIREMENT

Forty-seven percent of all physicians in the U.S. are over 55 years o f age! The average age o f a U.S. physician is 53.2 years! Fifty-five percent of physicians fifty-five and older are in private practice. Only 30% of physicians under the age of forty work in private practice!

These demographics speak volumes as to why practice groups are liquidating their real estate. America's private medical practices are, in the main, owned by physicians 5-15 years from retirement age. This is the sale leaseback window. This is the optimum age for doctors to sell and lease back their property (assuming a retirement age of 60-70 years). The sale of the real estate is often the best vehicle for funding the retiring partner's buy-out as it maintains control of the practice with the partners and avoids incurring debt or an equity partner.

LIFESTYLE CHANGES

The sale or partial sale and leaseback of the real estate can also address the lifestyle changes that arise over the life of a practice. These are situations where the partner physician desires to continue working but requires funding to address life events such as divorce, working less to achieve a work-life balance or even fund personal endeavors such as additional residences, travel or recreation. The partial sale leaseback functions to fulfill these goals and leave the remaining partners intact.

PHYSICIAN SALE LEASEBACKS

TRANSACTION STRUCTURE

The basic structure of a sale-leaseback is straight forward. The healthcare provider-owner sells the building to an investor buyer and then leases back all or part of the building back, pursuant to a long-term lease (usually 10 years or more). The credit of the new tenant combined with a new long-term lease is a powerful combination which truly maximizes the value of the asset.
In the event some of the ownership group does not want to sell, Skyview can structure a partial sale- leaseback where those owners who choose can remain in an ownership position with the buyer investor are able to do so. This is particularly attractive to buyers as a vested interest in the property stays with the tenant resulting in enhanced tenant retention. Tenants who have a partial ownership interest in the facility are highly unlikely to default on their lease or vacate.

A sale-leaseback allows the seller medical practice to recover the capital that was spent on the development or purchase of the property and improvements while maintaining the ability to occupy the property and continue practice operations without having to relocate. This is an important strategy to unlock capital which may be required or better positioned in the operation of the practice and likely earn a greater return on investment than the real estate. The strategy can also provide tax advantages in contrast with conventional mortgage financing of the property. As discussed, the sale-leaseback strategy is also a good way to realign practice dynamics and facilitate recruitment of new physicians.

The timing of the SLB transaction is of paramount importance as a long-term leaseback is necessary to create maximum property value. While there is a market for 5-year and 7-year leasebacks, a practice that is prepared to commit to at least a 10-year lease term, or more, is best suited for this monetization transaction.

The sale leaseback strategy is also available where the practice occupies only a portion (usually more than 50%) of the property it owns. A look at the economic and operational benefits of a sale-leaseback will help determine if such a transaction is right for you.

ECONOMIC BENEFITS OF A SALE LEASEBACK

REALIZATION OF 100% OF THE REAL ESTATE EQUITY

The sale or partial sale and leaseback of the real estate can also address the lifestyle changes that arise over the life of a practice. These are situations where the partner physician desires to continue working but requires funding to address life events such as divorce, working less to achieve a work-life balance or even fund personal endeavors such as additional residences, travel or recreation. The partial sale leaseback functions to fulfill these goals and leave the remaining partners intact.

REDUCE DEBT AND PERSONAL GUARANTEES

The disposition of the practice's real estate allows the practice to eliminate the mortgage debt and improve their balance sheet (perhaps to facilitate other borrowing for operational or other uses). It will also eliminate any personal guarantees the physicians may have on the mortgage thus improving their personal financial circumstances.

In the current interest rate environment, for the first time in many years, the alternative of sale-leaseback is more advantageous to the practice than the option to borrow. The effective borrowing rate on a sale leaseback, the capitalization rate, can be substantially less than the loan rate the practice has available from banks and other lenders. This renders the sale leaseback a more beneficial method for the business to "borrow" to fulfil its obligations and goals than borrowing at higher rates against their balance sheet where the real estate is usually the most valuable asset.

GET EXPERT INSIGHTS

REDEPLOYMENT OF CAPITAL

Practices can use capital from a sale to reinvest back into their core operations, facilitate expansion to grow the practice or make partnership distributions. The return on investment in the practice is usually greater than that of the real estate so redeployment of capital to operations may be very beneficial.

CREATE HIGH VALUATION & CONTROL COSTS THROUGH LONG-TERM LEASE

The economic terms and structure of the lease will substantially determine the value of the property. While it is advisable for the rental rates to be in line with market ranges, the practice has the luxury of determining whether to capitalize on the higher property value on sale or the benefit of below market rental rates over the long term.

ELIMINATE REAL ESTATE AND PERSONAL RISK

Commercial real estate is a cyclical market and subject to macro-economic trends and influences. Ownership of your building entails assuming the risks inherent in the asset class. Converting building ownership to a leasehold interest effectively eliminates this risk.

OPERATIONAL BENEFITS OF A SALE LEASEBACK

PRACTICE FOCUS

Relief of the burden of owning and maintaining the facility can enhance focus on the core mission of the practice of high-quality medicine.

ALIGNING PHYSICIAN PARTNERSHIP INTERESTS

Often when recruiting new physicians for the practice they are not interested in buying into the real estate component due to the increased value of the asset(s), lack of financial resources or other reasons. In larger physician groups, the problem often arises when there are older physicians retiring and newer physicians coming into the practice. This can create misalignment between the two groups, when it comes to retiring physicians' concern over return on the investment in the real estate vs. the younger physician's concern about rising occupancy costs. This makes it difficult to align the various partners' economic interests. Monetizing the building and leasing it back to the practice, properly structured, can align those interests. Even when real estate partnership stakes are perfectly aligned between practice and real estate ownership stakes, which is rare, the situation where a senior partner(s) is planning retirement prior to the full term of the proposed leaseback raises the alignment problem.

Junior partners perceive that they are being left with the lease obligation for a longer term than the retiring partner(s) who have "cashed out" and received a greater benefit from the sale.Formulas have been developed to account for this economic discrepancy based upon the term each partner will contribute to the lease obligation. Ultimately, the resolution of the alignment of interests comes down to a good faith negotiation between the partner stakeholders and every party being satisfied that they are receiving their fair share of the proceeds and future lease obligation.

NON-ALIGNED STAKEHOLDER INTERESTS

More often than not the physicians own the real estate and the practice in unequal shares and the ownership of each between individuals is also misaligned.

This naturally occurs as new partners are admitted to the practice and acquire a share in the practice or the real estate at a later date than inception on the basis of a "buy in" or "work for equity" model.

This misalignment of real estate and practice stakes is most acute in the negotiation of the rental rate to be paid under the lease. Partners with the highest real estate equity stake and shortest remaining career(s) will look to maximize the rental rate and increase the value of the property at sale. Conversely, junior partners want to see long-term low occupancy costs for the practice.

Despite complex financial formulas purporting to solve the issue, as an advisor, our value add is to bring the parties and their advisors together, in good faith, to reach an equitable solution for all.

INADEQUATE PARTNERSHIP AGREEMENTS

While it is prudent and most advantageous to address real estate disposition procedures and interests in the practice's partnership agreement, very often the issues are not addressed or not adequately addressed in the agreement. The partnership agreement may help to clarify the issues however these can also be lacking in enough specificity to solve the problems of misaligned real estate ownership.

There is no one size fits all solution for this problem. Again, as advisors, our goal is to engage and advise all the stakeholders and their professional advisors to work to an equitable solution with economic terms satisfactory to all.

CONTROL OF OFFICE SPACE

With a sale-leaseback transaction and a long-term lease with options, the practice retains long-term control over the offices and defined long-term occupancy costs. Also, these leases can give greater rights for alterations, operations and change of use/occupancy and sub-leasing flexibility.

ABILITY TO STRUCTURE ADVANTAGEOUS LEASE TERMS

The practice is very much in the "driver's seat" when executing a sale leaseback. Terms of the lease can be determined as a condition of the sale of the property. This allows the practice to structure a lease which conforms to its long-term business plan. Leases can be structured long term with successive options giving control over the office space well into the future at the option of the tenant.

HOW MEDICAL PROPERTIES ARE VALUED

VALUATION METHODS

Not unlike other sectors of commercial real estate, standard appraisal methodologies are used to value MOBs:

1. Replacement Cost
2. Market Comparables
3. Income Capitalization

Discounted Cash Flow (DCF) and Internal Rate of Return (IRR) models are also used to value MOBs over a projected ownership period.

REPLACEMENT COST

Replacement Cost is the cost to construct or replace, at a given time, an entire building of equal quality and utility, using prices for labor, materials, overhead, profit and fees in effect at the current time. This method usually distills cost to a price per square foot. While a useful metric in the appraisal context, as buyers are purchasing an existing and potential future stream of income, replacement cost is not a factor usually a primary consideration in the sales context.

MARKET COMPARABLES

The Market Comparables (Comps) method compares the price paid for like or similar properties, adjusted for time of sale, age of properties, quality, location, use and other factors, to the subject property. These factors are adjusted in relation to the subject property to establish a current market value. Sale Market Comps are useful in determining market rents to assess potential future rents on vacancies and upon lease rollover and to arrive at capitalization rates under the income capitalization approach.

In rapidly changing markets, comps become less valid as they are always backward looking. As macro- economic forces, such as the cost of capital, impact the market, the conditions of a sale that took place even in the recent past can vary substantially and affect capitalization rates thus value.

INCOME CAPITALIZATION

Capitalization Rate (cap rate) is the current rate of return generated by a property relative to the value or pricing. Cap rate is computed by dividing the annual Net Operating Income (NOI) of a property by the value or pricing. The method is used to establish value/pricing by applying a market rate cap rate for recent sales of like and similar properties to other subject property's NOI.

As MOB buyers are primarily focused on investing in a stream of income, this is the primary method used to value medical facilities. While the cap rate is useful for comparing the value of similar real estate investments in the market and determining price ranges, it should not be used as the sole indicator of an investment's strength because it does not account for leverage, the time value of money and future cash flows from property improvements, among other factors.

The Discounted Cash Flow Model and Internal Rate of Return are models used by more sophisticated investors to estimate the Return on Investment (ROI) over a projected period of time. These models account for the time value of money (Discount Rate) and apply a projected future Cap Rate to a projected future income stream to determine future value.

KEY PROPERTY FACTORS IMPACTING VALUE

Aside from macro-economic and market influences, as previously discussed, there are specific property level factors which can increase or decrease valuations from the prevailing market capitalization rates and comparables.

LOCATION

The impact of location on asset value cannot be overstated. Trade areas to be considered are usually a 3- mile radius with reference to a general 10-mile general market profile. All the supply and demand factors are determined by specific sub-market location, especially demographic factors, population health insurance profiles and competition. This is narrowed in scope in more densely populated areas.

Proximity to a hospital or within a significant medical node is very impactful. However, the trend over the last decade is to remove ambulatory services from the hospital campus and place them closer to “the customer” in the community. The proliferation in community centered MOBs with health system sponsorship, notably urgent care centers, exemplifies this dominant trend.

Access and visibility are a minor concern as healthcare is not an impulse buy. Patients are “fed” through the healthcare system by insurance dynamics. Typically, patients will go to the nearest in-network physician without regard to access or visibility but certain services, such as urgent care, clearly benefit from high visibility and easy access.

BUILDING AGE

The chronological age of a building can be very determinative of the prospective buyer universe and valuation. Institutional grade investors greatly prefer newer assets and some have strict mandates prohibiting investing in assets older than a certain age, usually 15-20 years. Similarly, older assets will be downgraded in value based solely on age regardless of condition. The presumption towards deferred maintenance and obsolescence is prevalent.

As building age is usually indicative and accompanied by deferred maintenance and the need for capital repairs and replacements, building age can severely reduce valuations. The importance of maintaining the physical plant cannot be underestimated when seeking to maximize value. Consideration of timing the monetization of the real estate before it is perceived as “old” is a recommended strategy.

TENANT PROFILES

Like all professional use buildings, the type and quality of the tenants and the terms of the leases is integral to the performance and value of the asset. MOB tenants include the full spectrum of outpatient services. Generally, higher specialty tenants (imaging, surgery, cardiology, orthopedics) are regarded as more economically valuable tenants.

The tenant(s) lease and the quality of the rent roll are the foundational valuation documents. There is no standardization when it comes to MOB leases. Standard rules of thumb are applied by all HRE investors when evaluating lease quality.

POSITIVE LEASE TERMS:

- Longer the term the better
- Aggressive rental rate escalations
- Minimal landlord expense responsibility (NNN leases)

NEGATIVE LEASE TERMS:

- Gross leases (maximum landlord expense responsibility)
- Early termination rights
- Exclusive use provisions
- Long term fixed rents

Tenant credit also plays a key role in valuation, especially in the single tenant market. Health system and public company credit is the most coveted in the sector with community hospital, national and regional practices second. National urgent care, behavioral health and imaging practices are also establishing investment grade credit and private equity owned practices are valued as enhanced creditworthiness.

In the case of multi-tenant MOBs, tenant mix is a key metric in valuation. On campus buildings offer the opportunity to add value for the hospital with the right mix due to proximity and in turn ensure tenants prosper. It should be noted that almost all on campus MOBs are subject to restrictive covenants respecting the allowed uses. For example, imaging and surgery are rarely permitted as they would compete with the hospital services.

Other factors to consider in evaluating a building's tenancy include general demographics of the market, market gap for specific healthcare services, tenants with potential competing locations, tenant's health system affiliations/sponsorship and the sub-market demand for the particular tenant's services.

TENANT CREDIT/HOSPITAL AFFILIATION

The presence or lack of quality tenant credit can have a dramatic impact on valuation. Large, stable practices with a history of consistent earnings and established credit, private equity backed practices and health system owned or affiliated practices, all with solid credit profiles, increase the valuation of the real estate assets.

Significant health system tenancy in a multi-tenant MOB is a major impactful factor in the success of the property and the valuation of same. The health system credit is a significant value creator, and their tenancy almost always attracts specialists and ancillary services to a medical office building. This is becoming a more dominant factor as health systems move services from the campus to the community.

PROVIDER COMPETITION

Provider competition relates directly to supply and demand and location. Fine-tuned metrics exist and are readily available for any location based on data produced by the Center for Medicare/Medicaid Services. This data shows the current market gap for a given medical specialty and projected future demand. While a medical facility may be located in a sub-market with solid demographics and good growth, an oversupply of specific competition is impactful on a property's valuation.

USE RESTRICTIONS

While on-campus medical buildings have the advantage of proximity to the hospital, such locations often come with extensive use restrictions which can significantly restrict the pool of potential tenants thus having an impact on performance and valuation. These restrictions are generally related to specialized services provided in the hospital itself such as radiology and surgery.

LEASE TERMS

While it is obvious that the basic economic terms of the lease or leases such as term remaining, rental rate, rental rate escalations, tenant's responsibility for operating expenses impacts the value of a medical property, there are other lease provisions which can have a varying effect on valuation.

CORPORATE/PERSONAL GUARANTEES

Guarantees go to the issue of tenant credit. These provisions can have an extensive effect on valuation. Most physician practices are owned as limited liability companies. Absent personal guarantees, such a tenant has minimal accountability for financial obligations and can opt to default on the lease obligation.

LONG TERM FIXED RENTS

Leases with long-term fixed rates are detrimental to value. All investors seek cash flows which increase over time and an expense obligation structure where future inflation is accommodated, preferably by the tenant(s).

GROSS LEASES

Gross leases are leases in which the tenant pays a specified rental amount and all property expenses are the responsibility of the landlord. This is in contrast with a NNN (triple net) lease in which expense obligations are those of the tenant(s). Due to the risk inherent in assuming expense obligations, investors prefer NNN leases, especially in a volatile or inflationary macro- economic market.

EXCLUSIVE USE

Many MOB leases contain a provision granting exclusive rights to practice a specific specialty in the building. While not having a large detrimental effect on value it will restrict future leasing options and can result in a minor reduction of perceived value.

EARLY TERMINATION

Clauses permitting a tenant to terminate their lease prior to stated expiration result in buyers regarding the lease term as ending when the right is exercisable. The shorter remaining lease term can reduce value and such clauses signal to the buyer a lack of commitment to the space by the tenant.

RENEWAL OPTIONS

Renewal options which provide for a specific future rental rate can benefit a landlord in a down trend market. However, many tenants will opt to move if the stated option rate is too far above the current market. Buyers tend to like to see renewal options provided the rental rate escalations state are in line with the market and future projected economic conditions.

RIGHTS OF FIRST REFUSAL (ROFR)

Where a tenant has a right of first refusal to purchase the building, it can result in some buyers not being willing to engage in the purchase process and at the least can cause a detrimental delay in the transaction.

UNIQUE VALUATIONS

REDEVELOPMENT AND REPURPOSING

Certain properties have increased inherent value due to the potential to redevelop, expand or repurpose the asset. This is often the case with older assets in dense urban infill locations. Excess land can add value in its potential to expand the square footage of the building or build an additional facility.

The potential for repurposing a building is commonly found in situations where the property is being under-utilized by the current tenants, for example, conversion of low-end clinical space to a high acuity uses or surgery center.The opportunity to redevelop and modernize an older facility can increase value to a buyer however the process of redevelopment with tenants in place is very complex and costly.

ASSEMBLAGE

An assemblage is the combining together of several contiguous land parcels, owned by different owners, thus creating a parcel with greater development potential. This is the “last piece needed” scenario where the building is a crucial part of the proposed new development that is necessary for the project and all the other parcels have been acquired. This scenario most often occurs in dense urban locations with older properties. Such a situation can garner a unique valuation for the assembler.

USER BUYERS

Physician practice buyers have unique valuation metrics. A medical user can perceive value inherent in a property relevant to the profitability of the services which can be provided in the location, synergies with its other locations or other practices and the suitability of the property for the desired services that a purely financial investor will not have. As a result, strategic acquisitions of medical real estate by providers can result in higher valuations. The provider buyer pool should be addressed in evolution of the asset and the marketing efforts as well.

TYPES OF HEALTHCARE REAL ESTATE INVESTORS

The national medical real estate market constitutes 1.5 billion square feet of properties valued at $460B. Ownership cohorts are broken down as follows:

- Health Systems 52%
- Private Investors & Funds - 24%
- REITs 13%
- Provider Owners 11%

HEALTH SYSTEMS

Health Systems are far and away tops in the HRE ownership landscape. Major health systems such as Kaiser Permenante, Acension Health, Hospital Corporation of America and Advent Health control a dominant portion of the medical real estate market. While some health systems are potential buyers in select situations, usually dependent on practice acquisition dynamics, they are most active in the market as developers of their own facilities and occasional sellers. Acquisition of a practice by a health system often does not include the purchase of the physician's real estate however, great benefit is often derived from the increase in the tenant credit where the health system assumes the existing lease or implements a new long-term lease. This scenario provides an excellent opportunity to execute a sale leaseback and maximize the value of the asset.

REAL ESTATE INVESTMENT TRUSTS (REITS)

An HRE Real Estate Investment Trust owns and operates HRE properties. Many REITs own all types of assets in the HRE sector with some focusing strictly on medical office buildings and ancillary medical facilities. In the MOB space there are both publicly listed REITs and private non-listed REITS. These owners traditionally focus on institutional grade core assets with a preference for larger (40,000 SF+) MOBs, preferably with some health system sponsorship of form of tenant credit. These REITs range from $500MM to $30B in assets under ownership. There are sixteen public healthcare REITS as well as many private REITs. REITS are a target market for physician owned sales as their cost of capital is lower than the competing buyers, such as private investors, hence they are often able to pay the most for an asset.

PRIVATE INVESTORS & FUNDS

Private investors make up the second largest segment of MOB ownership. These investors are typically private equity funds, high net worth individuals, family offices, structured limited partnerships, aggregators and more recently crowdfunding. Over the past several years private equity groups have been net buyers of MOBs and account for about 60% of the total transaction volume. Traditionally, these owners acquire off-campus, smaller (10K SF – 50K SF) properties with lower tenant credit. Due to cost of capital, it is difficult for the private investors to compete with the institutional investors and REITs for the core, on-campus, larger trophy MOBs.

HEALTHCARE PROVIDERS

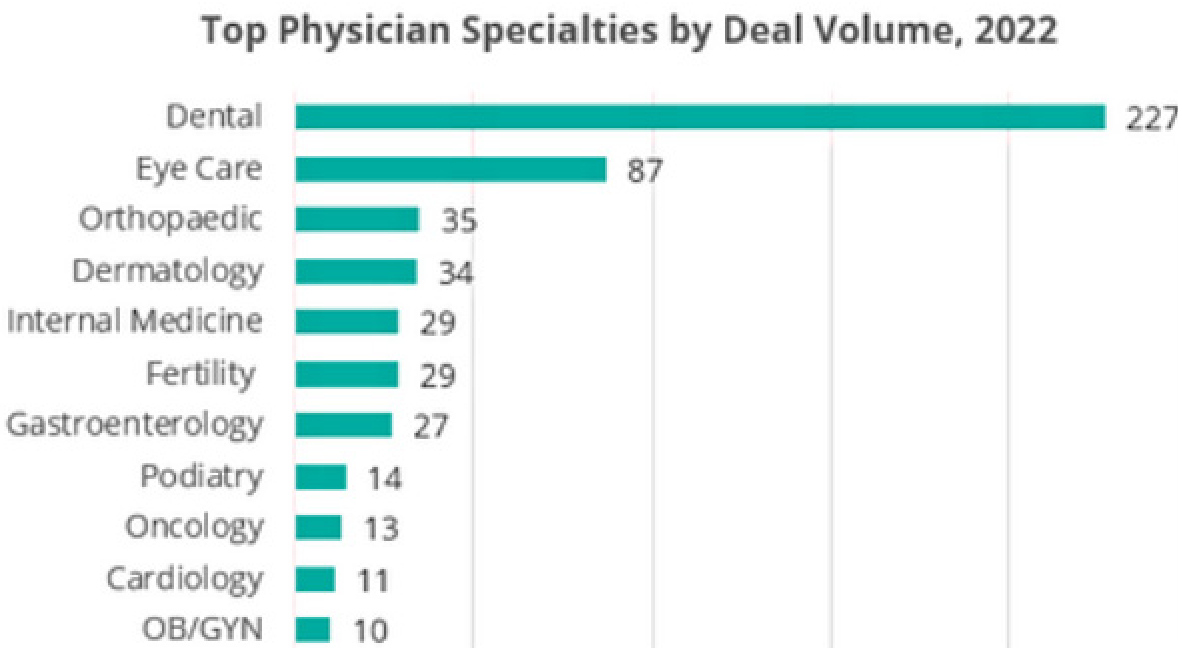
Providers make up the smallest cohort of medical real estate ownership. This cohort has been net sellers of properties over the last few years as they liquidate assets to deal with the costs of the Covid pandemic and rising expenses or to expand their practice footprints.

As previously discussed, provider buyers sometimes have a unique valuation of a HRE asset based upon their business operations. The real estate may strategically fit into their operational growth plans either currently or in the future. If there is an expansion or redevelopment capability for the property this may also add considerable value to a user buyer. Provider owners can be the buyer of choice in situations where there is vacancy in the property that can be immediately occupied by the buyer.

PRIVATE EQUITY IN HEALTHCARE

Over the last 20 years the allocation by institutional investors (insurance companies, pension funds, educational endowments) toward private equity has grown from 5% of their portfolios to over 20%. This significant growth in allocation has fueled tremendous growth in the private equity sector so it now represents globally over $7 trillion of capital. Similarly, private equity funds have grown from about 3,000 to over 13,000 over the last 20 years with approximately 5,000 firms in the U.S. The majority of these firms have a healthcare services investment thesis and are active in acquiring and managing medical providers.

DATA REVEALS WHERE THE PE SECTOR IS DEPLOYING THEIR CAPITAL IN THE HEALTHCARE SECTOR.



Source: LevinPro HC, Healthcare Acquisition Report 2023

The explosion of PE in healthcare has had a substantial effect on healthcare real estate dynamics. While very few PE firms acquire real estate along with their investment in healthcare providers, the sale of a practice to PE can have very beneficial results where the practice also owns the facilities used to provide the services. Such a transaction increases the credit of the tenant, provides capital for expansion and management services for greater profitability and is often accompanied by the implementation of a long-term lease. All these factors, both individually and combined, can greatly increase the value of the real estate and make a sale of the asset very timely.

The best PE firms, while not interested in purchasing the real estate, will understand and account for the value impact of the real estate assets and engage a HRE specialist firm to assist in the transaction in order to best achieve the overall financial and operation goals of the practice on the sale.

MAXIMIZING THE SALE OF YOUR HEALTHCARE REAL ESTATE

Once the decision to proceed with a sale is reached, the challenge and goal now becomes how to maximize the proceeds of the sale, execute a smooth transaction and achieve the desired personal, business and financial results.

Selling your medical office building or other healthcare real estate requires careful planning and execution to ensure a successful sale. In this section, we explore the importance of having a great plan in place and how to achieve optimal results.

MARKET ASSESSMENT

It is essential to begin by conducting a thorough analysis of the local healthcare real estate market, including recent transactions of similar properties and market fundamentals such as vacancy rates, rental rate growth and new construction. Qualified HRE professionals can provide all the data and insight required. This analysis will help you understand the current market conditions and how your property is currently positioned in the market. Intelligence respecting the overall HRE market and the current and projected impacts of macro-economic forces on the market which can affect the sale should also be considered.

DETERMINING THE RIGHT TIME TO SELL

The timing of the sale involves many factors including market conditions, practice operational plans, partnership obligations, retirement plans and personal financial goals, all of which must be considered. As discussed, the primary factor respecting the timing of a sale is usually the operational goals of the practice. Advance planning is crucial in order to maximize value. Consulting with a market expert with extensive experience in the process is beneficial at any stage in the lifespan of the practice.

UNDERWRITING - ASSESSING PROPERTY VALUE

A qualified advisor will analyze the specifics of your asset(s) and determine a fair market range of value. The extensive expertise and proprietary data which can be provided by an experienced HRE advisor will be invaluable in determining the fair market value of your real estate, considering all relevant factors such as location, healthcare demographics, condition, size, age, use, and specialties.

While no advisor can truly pinpoint what value your property will trade at, highly skilled professionals can provide a range of values most likely achieved in the current market thus enabling you to assess whether you are a seller in that range.

Before bringing your property to market, it may be critical to invest in necessary repairs, upgrades, and aesthetic improvements to enhance its appeal. Good advisors are experts at identifying what physical plant conditions could have an impact on pricing and the steps necessary to remedy the issues before going to market.

Structuring the lease or leases to maximize value is also imperative. This is especially a consideration in the sale leaseback situations. An advisor's knowledge of market rate dynamics and how to best structure the leaseback to obtain the best valuation is critical.

DISCOVER MY PROPERTY VALUE

DOCUMENTATION AND RECORDS

The timely delivery of quality property records and accurate accounting can make the difference between an efficient and painless sale and one that can drag on for months or potentially falter. Maintaining and marshalling meticulous records of your real estate operations, including accurate and detailed financial statements, lease agreements, licenses, permits, and any other pertinent documentation is necessary. A good advisor will ensure that all documents are organized, up-to-date, and readily accessible during the sales process.

PREPARING THE PROPERTY

It is essential to correctly position every property prior to sale to maximize value. There are beneficial steps to be taken such as deferred physical plant maintenance and improvements, lease structuring, and accounting and documentation production and organization. Buyers complete very thorough inspections, often engaging engineers and other consultants. Physical plant deficiencies are always best addressed prior to coming to market rather than during contract negotiations.

HIRING THE RIGHT PROFESSIONALS

Medicine is a very complex business and healthcare real estate is highly specialized. Enlisting the services of a skilled commercial real estate broker or agent with experience and specialization in healthcare property sales is essential. Professional HRE brokers will oversee all aspects of the sale process including marketing the property, identifying potential buyers, negotiating favorable terms, and ensuring a smooth transaction through closing. Firms with a national footprint and advisors with decades of experience, such as SkyView, provide invaluable advisory services and buyer relationships that do not exist in firms which do not specialize in medical real estate and have only a local presence.

The advantages of partnering with an experienced specialist in the field are numerous. SkyView Advisors has an extensive database of national HRE investors, utilizes the industry specific platforms and can leverage professional relationships to best market your HRE property. We know how to identify and target not only the most likely buyers for a particular asset but also those most likely to pay the highest price.

EFFECTIVE MARKETING STRATEGY

Due to the specialty of medical real estate, developing a custom marketing strategy for each asset to attract the most and best potential buyers is key. Certain HRE properties, for example ambulatory surgery centers, behavioral health facilities and imaging centers often require a different marketing approach than an average medical office building. Experience in selling these types of assets and the knowledge of how best to market and position them for sale is critical in maximizing value.

PREPARATION OF THE OFFERING MEMORANDUM

A high-quality offering documentation is critical to an effective sale process. The experience of understanding exactly the information the best potential buyers want to see in an offering document and how to best present that information is highly advantageous to any seller. Institutional grade investors are inundated with offerings. Quality marketing materials which cogently present the facts and tell the story of the asset can result in the opportunity standing out among the competing opportunities. Detailed market analysis, obtained from proprietary data, can go a long way to emphasizing unique features of your healthcare real estate that make it appealing to potential buyers. Factors such as patient demographics, insured patient populations, relationships with other and competing providers and specific local market knowledge can make a difference and can only be obtained through a partnership with a national HRE specialist firm, such as SkyView.

CREATING BUYER COMPETITION

Creating competition amongst buyers and choosing the right buyer is an essential value-add service a quality HRE advisor provides. Maximum value is obtained when qualified buyers are placed in competition against each other. This process requires a structured and nuanced approach. SkyView's track record of achieving superior results based upon its proprietary offering process is well documented.

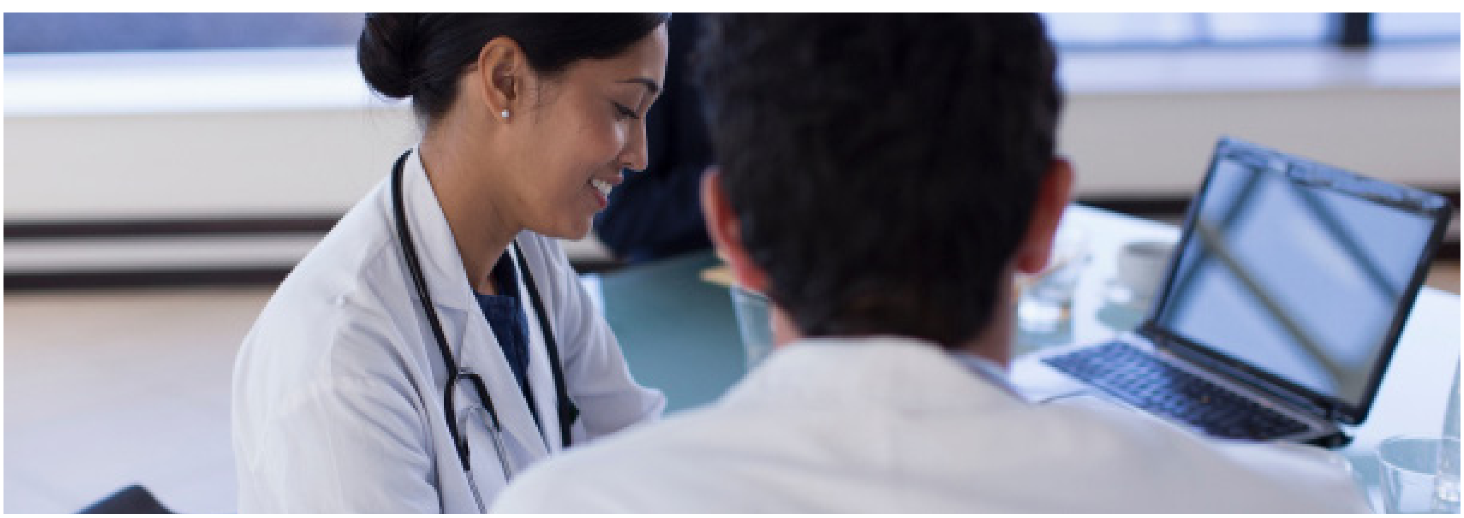
CHOOSING THE RIGHT BUYER

The buyer offering the highest price is not always the best buyer. The importance of timing, conditions of an offering and the ability of the investor to close all need to be considered in the evaluation of the competing offerings. Experienced HRE brokers, who have a history of working with and closing with the buyer pool, offer valuable insight into each buyer in assessing all these factors.

NEGOTIATIONS AND CLOSING

Once offers are received, a careful evaluation of them with the guidance of your real estate professional is necessary. Advisors identify the most favorable terms and quality of each buyer and negotiate accordingly. Experienced advisors work with legal professionals to ensure a smooth closing process, adhering to all legal requirements. Atention to detail, creativity and preparedness are brought to the table by expert HRE advisors.

As a physician looking to sell your healthcare real estate, having a robust and well-executed plan is crucial. By understanding your perspective, focusing on critical steps, and delivering value through experience and expertise we can maximize the sale of your property. With good timing, some patience, and the right professional assistance, you will be well on your way to achieving a successful sale that optimizes your investment.



USE OF PROCEEDS

As discussed, there are many personal and practice operational reasons to monetize the practice's real estate. Use of proceeds to fund practice expansion and reduction of debt account for the allocation of funds received on sale however, many of the motivations such as retirement, reduction of a real estate sale risk and partner alignment result in the owners facing the issue of what to do with the proceeds.

There are many strategies for reinvestment of proceeds of real estate sale with the primary concern being the deferral of taxable capital gains. Receiving the counsel of qualified experts, tax accountants and tax attorneys is highly recommended as these tax deferral strategies come with very strict regulations which if not followed can disallow the deferral.

There are many strategies for reinvestment of proceeds of real estate sale with the primary concern being the deferral of taxable capital gains. Receiving the counsel of qualified experts, tax accountants and tax atorneys is highly recommended as these tax deferral strategies come with very strict regulations which if not followed can disallow the deferral.

SECTION 1031 EXCHANGES

A 1031 Exchange, so named after the section of the IRS Code, is a transaction where seller transfers Net Sales Proceeds (NSP) of relinquished property into one or several replacement properties of like-kind nature. The transfer between seller and buyer(s) is executed by Qualified Intermediary (known as QI). Non-like-kind property received in exchange for relinquished property, known as boot, is subject to normal taxation. IRS Form 8824 sets out the full guidelines for this process, which is very time sensitive in order to be tax deferral compliant.

The use of a 1031 exchange is for investors seeking to defer capital gains taxes and depreciation recapture taxes on the relinquished property. This method is frequently used by physicians to redeploy funds into an alternative real estate investment to achieve less risk, a better yielding investment and tax deferral.

SECTION 721 EXCHANGES (UPREITS)

Similar to a 1031 Exchange, a Section 721 Exchange (also known as an UPREIT) is a tax deferment strategy in which sellers can redeploy capital into shares in REITs in exchange for their property. This allows sellers to avoid capital gains taxes and recapture some of the depreciation value created by their asset. This also allows for broad diversification within a seller's portfolio by investing in different asset classes of REITs. This diversification further mitigates opportunity costs and risks by spreading risk over many assets and possibly several asset classes.

Many public and private REITs have programs in place to accommodate a 721 exchange. The use of this method can also increase the valuation of the relinquished property as the cost of capital and the transaction is reduced for the REIT buyer.

THE BENEFITS OF A 721 EXCHANGE ARE NUMEROUS

- Provides a tax deferral exit strategy to property owners facing significant capital gain tax liabilities on the sale of appreciated property with a low tax basis
- Diversification of real estate holdings. Investors have an interest in a portfolio of properties
- Potential to convert liquid, long-term real estate assets into more liquid saleable securities
- No property management responsibilities or concerns
- Quarterly income distributions
- Potential to recognize unrealized gains as earnings

DELAWARE STATUTORY TRUSTS

A Delaware Statutory Trust (DST), so named atier the state that created the vehicle, is a passive investment in real estate which can be used to defer capital gains tax. The capital is deployed into certain assets sponsored by the DST sponsor pursuant to a preconstructed offering. The purchase, financing, management and eventual sale of the property is the responsibility of the DST sponsor, which allows the investor to enjoy the benefits of owning property without the hassle of day-to-day management. The DSP is very similar to a 1031 exchange but can avoid the strict timing requirements and uncertainty of close which can derail a 1031 exchange.

With a DST, the sponsor performs due diligence, purchases the property and arranges financing, allowing the investor to seamlessly transition from the sale of their property into the DST(s). The DST gives the buyer access to institutional grade real estate with no management responsibilities and can provide excellent diversification to mitigate risk. DSTs also can provide a good estate planning tool where heirs are not inclined to be active real estate investors. A DST can be a powerful estate planning tool since DST interests can be divided among beneficiaries leaving each to decide what to do with their own portion, and the basis on the property steps up to fair market value upon the original owner’s death.

DSTs usually have flexible minimum investment amounts enabling investors to exchange into multiple offerings or deploy only part of their gains. Investors who are not able to buy a property on their own, or do not own existing property to swap, may still enjoy the advantages of a 1031 exchange by investing cash into a DST. In some cases, a cash investment can be made into a DST for as litle as $50,000. Investors receive any income paid out by the DST along with any pass-through depreciation, take part in any appreciation of the property over time and when the DST is sold, may complete a 1031 exchange.

FIRST STEPS TOWARDS A SALE

With the myriad of issues and factors involved in the decision to sell the practices real estate and the execution of the sale, the importance of engaging with highly qualified and experienced experts in the field cannot be understated. The SkyView HRE team has decades of experience advising physicians on the sale of their real estate and addressing all the complexities involved.

We encourage you to consult with us to evaluate your situation. We are first and foremost advisors and take pride in providing unbiased advisory to our clients and being a partner in fulfilling their goals.

ABOUT SKYVIEW ADVISORS

SkyView Advisors is a national commercial real estate brokerage firm built on the values of innovation, accountability, preparation, resilience & attention to detail. SkyView Advisors' revolutionary new model is the most salesperson-centric platform in the industry, ensuring elite execution on every transaction through its proprietary 252-point process and modern technology-based platform.

With a relentless commitment to innovation, SkyView Advisors harnesses technology to create efficiency in everything it does, leading to a more frictionless experience and delivering better results for clients.

FOR MORE INFORMATION, PLEASE CONTACT:

Robert King, Director Healthcare Real Estate rking@skyviewadvisors.com
Scott Schoettlin, Managing Director sschoettlin@skyviewadvisors.com

SkyView® Advisors

Process. Execution. Results.