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# Marketing Medical Office Space



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## By Steve Bergsman

Over the past decade, the number of companies seeking pure office space has waxed and waned greatly depending on which bubble seems to be expanding or bursting at any given time. However, the number of organizations seeking medical offices never seems to diminish. Doctors, clinics, HMOs, and hospitals always seem to be on the move, always wanting more space.

While that's a good thing, the average space need for a medical office lease is generally much less than that of an accounting firm. For example, specialists in medical office real estate are happy to see a 12,000- to 15,000-square-foot lease. Even a moderately-sized accounting or attorney group can easily require a minimum of 50,000 square feet of general office space.

**Mark Warlick, SIOR**, a Senior Vice President for S.L. Nusbaum Realty Co. in Norfolk, Virginia,



runs his company's industrial and office group. He spends about 50 percent of his time brokering medical office buildings and he has been doing it for more than 20 years.

Warlick has tracked a few trend lines in this niche product. First, doctors have been consolidating into larger practices so there aren't as many one- or two-doctor medical offices as in the past. The good news on consolidation is that the larger groups require more space—in the 15,000- to 30,000-square-foot range.

Secondly, medical groups tend to fall into two categories. Specialists, like surgeons, need to be near hospitals, because their patients are there and a lot of back and forth travel is required. These groups are willing to

pay more to be near a particular hospital. The second group, which includes clinics, family practice groups, and some specialists like OB/GYNs want to be near population centers.

The third trend Warlick sees is escalating costs for build-out of pure medical office buildings. Unfortunately for medical offices that depend primarily on payments from insurance companies, reimbursements can cause a financial squeeze; therefore, these doctor groups have a difficult time paying higher rents.

## Steady Growth in Tennessee



“This is a great business,” exclaims **John Speropulos, CCIM, SIOR**, with Mitch Cox Development Group in Johnson City, Tennessee. “Medical office real estate is consistent, it grows steady at two to three percent per year, and there are no 20 percent swings in transaction volume as there can be in general office.”

Speropulos has an advantage most brokers don’t. He was the CFO of a physician management company before he came into real estate. “I have a good working relationship with physicians. I understand how they think. It was a great segue into this business.”

The population of Johnson City continues to climb and as Speropulos notes, “as this market continues to grow, there will be a great need for medical space.”

## Merits of Medical Space Brokerage

Brokers who work the medical office market along with their office specialist field, like to do so for two important reasons: the lease rates on medical office space are typically 15 percent higher

(mostly because the build-outs are very expensive) and the leases are generally for a longer term.



On Long Island, office build-outs may cost about \$25 per square foot, but medical build-outs would be closer to \$45 per square foot, notes **Jack J. Britvan, SIOR**, President of Britvan Commercial Realty Services of Long Island. This results in a higher commission.

## Doctors Like to Stay Put and to Cluster

Medical deals generally have a lease term of 10 to 15 years plus options, Britvan says. “Once medical space is built out, doctors don’t like to move because a relocation and new installation is so costly. Also, their patients know where they are and are comfortable with the present location. Changing locations often results in the loss of some patients,” stated Britvan.

The other good thing about working with



medical groups is that these partnerships are financially solvent. You know when you get hired that credit is not going to be an issue, adds **Timothy K. O'Brien, CCIM, SIOR**, President and Principal of RESOURCE Commercial Real

Estate LLC in Indianapolis.

One person who feels very lucky to be working in the medical office field is



**Richard Meginnis, SIOR**, an Executive Vice President with NAI FMA Realty in Lincoln, Nebraska. For the past seven years, his office has been doing the management and leasing for a regional hospital

that has been building a lot of medical office space in the local market. Including the hospital's space, Meginnis estimates that his firm manages and leases more than 380,000 square feet of medical office space in the Lincoln metro area.

What makes medical office space work, says Meginnis, is that physicians like to be near other

physicians and prefer to be in a medical office building. Doctor groups also prefer to have on-site ancillary services such as lab and radiology areas.

In Lincoln, lease rates for medical office space run about 50 percent higher than general office, he adds.

These are the good things about working the medical office market, but there are downsides and differences of opinion. For every specialist in this field who works with medical groups and enjoys doing so, there are probably three or four who would rather work with just about any other organization, even attorneys.

## Some Markets Are Limited



**Gerald Surprenant, SIOR**, an Executive Vice President with MG Commercial Real Estate in Providence, Rhode Island, has been executing medical office deals along with general office transactions for the past seven years. "It is not an easy market," he relates

Unlike Johnson City, Providence is not a growing market, so there is not a lot of expansion in the medical office field. "It is a steady business," says Surprenant, which is a good thing, but in the region there are a limited number of pure medical buildings and the market is concentrated."

As a broker, Surprenant sometimes finds himself competing against the local hospitals and large medical groups that often decide not to use brokers. To make matters worse, a good portion of the medical industry is getting the profitability squeezed away by insurance reimbursement formulas, so doctor groups, especially family practitioners, are watching expenses.

Even Meginnis would agree this is becoming a

problem. “Over the past five to seven years the market in Lincoln has been good because a lot of groups were undersized to the amount of business they were handling. So, we saw groups that grew internally needing more space. This has slowed down drastically because of changes in federal government reimbursements. A lot of doctor groups have become cost-conscious.”

## Diagnosis: Doctors Can Be Difficult

A final concern, Surprenant says, is that doctors are not the easiest group with which to deal.

“They are intelligent, Type A personalities, who don’t like to take outside advice.”

Like Surprenant, O’Brien works in an older city, Indianapolis, where there is not a lot of population growth, so the medical office market is not “significant.” Nevertheless, O’Brien has worked with doctor and medical groups for many years. When working with doctors, challenges to consider include:

—The need for coordinating schedules. Doctors work a different day from the rest of the private sector, so meetings are generally before the workday or at lunch in the break room.

—Building a consensus. Doctor groups are made up of a lot strong personalities, so there are always differences of opinions within the organization.

—Obtaining personal guarantees that the landlord may require. Leasehold improvements are so extensive and expensive that landlords may require a personal guarantee. No one enjoys having to go that route.

Because individual doctors have such strong personalities, complications on deals generally arise. Britvan gives this example of a recent transaction with a small cardiologist group, actually a single practitioner sharing an office with two other cardiologists:

When Britvan started brokering space for the group in its present building, the single practitioner suddenly decided he didn’t want to be with the other doctors,

but he wanted to be in that same building. Britvan called the landlord, who was willing to find him space, but after a lease was negotiated, it turned out a medical group that leased three-fourths of the building’s space also had first right of refusal. So, the lone practitioner asked the other medical group if he could be part of their organization but still practice by himself. The medical group thought it was a good idea and subleased space to the sole practitioner.

## Queen of Medical Office Space



Considering the number of health-care organizations she has helped place, one is tempted to name **Jill K. Rasmussen, CCIM, SIOR**, a Senior Vice President for Northstar Partners/Cushman & Wakefield Alliance in Eden Prairie, Minnesota, the queen of medical office space. Her

count is now just under 60 different organizations, from Adson Plastic Surgery to Minnesota Heart Clinic, from Hearing Care Specialists to Southdale Family Physicians, and from Urology Associates to Consulting Radiology Ltd.

She says her firm is currently working with a children's physical therapy group, a dermatology group, a cardiology organization, and a national dialysis company. That doesn't take into account dental groups. "Lots of dental," Rasmussen says.

The good thing about medical, she notes, is that it is a steady business with about the same level of absorption every year. The difficulty with this piece of the office market pie is that it is not very big. If there are 70 million square feet of general office space in the Minneapolis area, there are only about five million in medical office.

As can be expected, medical office deals are not very large and they are often slow to close, says Rasmussen.

Nevertheless, she likes this part of the brokerage business. "I have always found it interesting to assist doctors through their financial decision making, helping them with market research, demographics,

and helping them strategically determine the best place for them to locate," she says. "Real estate is a big component of what they are trying to do, but it is a challenge for the doctor groups. We really can provide a lot of assistance to them, whether they are looking at long-term leases or figuring the capital costs to build-out space."

## Marketing—Groundwork and Good Works



About 12 years ago, **William P. O'Brien, SIOR**, a Vice President of M.C. O'Brien Inc., Brooklyn, New York, saw the handwriting on the medical office wall. With the changes going on in managed care and HMOs, O'Brien knew there was going to be a big push into the borough's various communities to expand medical services, so he began courting several local hospitals.

"HMOs and hospitals were almost mandated to go and create clinics because new arrivals to the United States tended to flood the hospital emergency rooms for minor medical problems such as a cough or cold" explains O'Brien. "There was a need to bring clinics into the neighborhoods."

To this day, all that groundwork a dozen years ago is paying dividends. "I know every hospital administrator in the borough and they know me," says O'Brien. "I don't do a lot of cold calling, because we are often sought out. They come to me."

For example, in a couple of recent deals, O'Brien represented the State University of New York which took 11,000-square-foot of medical office space in a building that was originally an old movie theatre. The remainder of the space in the 29,000-square-foot structure was taken by a dialysis center. The clincher on that deal was that the property controlled 65 parking spaces. Parking is hard to find in Brooklyn, and it is extremely important for medical offices.

O'Brien also represented a Staten Island hospital that was expanding in Brooklyn, placing it on the second floor of a building (above a drugstore) near a busy subway station. The clincher there was a rental rate of

\$40 per square foot, and it was leased “as is.”

For Speropulos in Johnson City, marketing is an on-going process. He gets to know the medical community by getting involved in different organizations. For example, he chairs a foundation for the largest healthcare system in the region, as well as being a volunteer with other associations and doing work with the finance and investment committee of the local hospital. This means that he interacts with a lot of physicians.

In a similar vein, O’Brien recommends that becoming known as a recognized expert in medical real estate opens the door to getting invited to speak at trade shows or becoming associated with state and local medical associations.

Rasmussen goes the same route. “Our office is a member of the Minnesota Medical Group Management Association,” she says. “We spend a lot of time in these kinds of medical group arenas, going directly to users.”

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One of Speropulos’ most effective marketing tools is the collegial lunch, where he’ll meet with the members of the law firm or accounting firm that often represents the medical professions. He explains that, when medical groups consider making a big move or buying something, they talk with their accountants and lawyers.

## Office Condos Appeal to Medical Groups

In a number of cities such as Phoenix and Atlanta, the concept of the office condo has become firmly established. As the name implies, this is office space that is acquired like a residential condominium and not leased. For a number of reasons, the office condo has become very popular space for the medical profession.



In Tucson, another city with a growing base of office condos, most of the space recently taken up by medical groups has been in this type of product. “About half of the office condo space being built, whether designed for medical or not, has been taken by medical organizations,” says David A. Volk, SIOR, a Vice President with CB Richard Ellis in Tucson.

A typical office condo development runs 40,000 to 100,000 square feet, but they are campuses made up of smaller buildings ranging from 2,500 to 10,000 square feet. Acquisition costs are from \$175 to \$195 per square foot for shell space, then another \$60 to \$90 per square foot to finish out the investment.

“Doctors like the concept because their accountant probably tells them it’s a good investment, something to cash in later on for their retirement,” says Volk, “but the principal reason these work is that medical offices have to put so much money—\$30,000 to \$40,000—into custom build-outs, they figure they might as well own that building.”

This type of structure doesn’t work for everyone, but if the doctor group expects steady business without much growth over the next 15 years, it makes sense, says Volk.

## Medical Offices Join Green Building Movement

One unique turn in medical offices is to Green buildings. O, R&L Construction Corporation, a Branford, Connecticut-based construction firm and sister company to O, R&L Commercial, a real estate brokerage and management firm can now



boast that **F. Todd Renz**, the President, is a LEED-Accredited professional. The company recently signed a contract to build a 30,000-square-foot facility that will be the first privately held LEED-certified medical office

building.

(LEED stands for Leadership in Energy and Environmental Design, a designation developed by the U.S. Green Building Council that provides a suite of standards for environmentally sustainable construction.)

“There are a number of institutional medical buildings and clinics, including one in New Haven, that are LEED certified, but this will be the first privately owned medical office that we are aware of,” says Renz.

LEED-certified buildings generally cost more to build, but because they create operational costs savings, the extra cost is won back over time.

“Everyone is catching on to this,” says Renz. “Let’s say you are in the market looking for 50,000 square feet of space and it costs \$3.25 a square foot for electricity. But if that same space in a Green building across the street costs \$2.25 a square foot for electricity because it is energy efficient, then if you choose the second building it saves you \$50,000 a year.”

Medical organizations such as doctor groups tend to have a longer lease curve



and can see the long-term benefit of a Green building, adds **Frank Hird**, SIOR, a Vice President at O, R&L Commercial. “When we put doctors into a building, they don’t go in it for three or five years; they always look for a 10- to 15-year

lease term. Or if they are buying, they have the ability to look long-term. That is why Todd (Renz) was able to make that sale to upgrade the building to LEED certified. The doctors saw the payback.”

There is one other benefit to going Green, Hird says. “LEED certified buildings sell for a 10 percent premium over a standard office building.”

“In Connecticut, as well as in the rest of the nation,” Hird says, “there are a lot of tenants who have leases without clauses to pay for the rising costs of electricity or heating. Landlords are scrambling, trying to find ways to mitigate their losses. It costs a lot to retrofit for energy efficiency.”