

Before You Sign That Office Lease

Here's what to look for – and what to avoid.

If you build it, people will come. That may have been good advice for Kevin Costner in the 1989 film *Field of Dreams*, but building a new office, or even purchasing one, may not make sense for your particular practice at this particular time. (See “Leasing vs. buying” on page 19.) If leasing is the best choice for your practice, here's what you need to consider before you sign on the dotted line.

Location, location, location

We've all heard it before. Location is important. Data from the Future of Family Medicine Project affirmed this, noting that patients list “convenient location” as one of their top five criteria for selecting a primary care physician.¹

Choosing the right location for your practice can be tricky. You'll want to consider several important issues, including the following:

Demographics and competition. Are there enough potential patients in the area you're considering? One way to answer this is to use the Census Bureau's “population finder,” available at <http://www.census.gov>, which estimates the population within a ZIP code and provides demographic characteristics and trends. You should also consider whether there are other primary care offices in the vicinity, how many and whether they are busy. A simple way to begin gathering this information is to use Google maps, <http://maps.google.com>. Plug in the ZIP code or address you're considering, click on “search

nearby” and type “family practice” or a similar search term. The map will then display the practices in the area.

Patient convenience. Is the area you're considering convenient for your patients – for example, is it near a retail area or a pharmacy? Many physicians seem to prefer office space that is close to a hospital. This may be convenient for the physicians but often is not as convenient for patients. If you have an existing practice with a strong patient base, you might be able to get away with choosing a site that is not as convenient for the patient. However, a start-up practice with little or no patient base must be very careful in this area. We have seen young, energetic physicians whose practices could not thrive because their location was too far out of the way. Keep in mind that choosing a first-floor office space can also make the location more convenient.

Visibility. In most cases, a site with high visibility and traffic is optimal because your building becomes a billboard, in effect, and first-time patients will have an easier time finding your office.

Adequate parking. For newer buildings, parking isn't as much of an issue, but older facilities tend to have too few parking places for medical practices and provide only the minimum necessary ratio to meet city regulations. Practices with a high volume of patients should have access to five or six parking spaces per 1,000 square feet they occupy.

Good neighbors. We worked with a practice not long ago that had selected an office space with residen-

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tial dwellings on the second floor. Although the location was in close proximity to a large patient base, it was not optimal. The practice was restricted from using radiological equipment because of the residents living above the office space. Some locations may not allow hazardous materials on site. In addition, you may need to be concerned about neighboring businesses, such as restaurants whose cooking smells could permeate your office.

Negotiating the lease

Once you’ve found a space that you want to lease, you’ll need to negotiate a favorable contract. There are many opportunities – and opportunists – out there, so enter this process with caution, and be prepared.

You must get what you need from the lease. You don’t want to make real estate decisions that will negatively impact the profitability of your practice, so we recommend that you make a list of your deal-breakers. These could include the maximum price you’re willing to pay (more on that below), adequate parking, rights of expansion (such as the right of first refusal on adjacent space), hours of operation (so you can provide services outside of typical business hours if needed) and the ability to handle hazardous material and operate radiological equipment on site.

You also need to consider the following issues:

Base rent. Before you agree to a rental rate, check comparables in the area by going to <http://www.costar.com>. You can also hire a broker to gather this information, in addition to representing your interests during lease negotiations. (See “Building the right team” on page 20.)

Operating expenses. Monthly base rent is not the only financial variable your lease contract should spell out. It should also detail

how pass-through operating expenses (utilities, taxes, common area maintenance, etc.) will be handled. Brandon LaSala, commercial real estate broker at LaSala-Sonnenberg Commercial Realty Company in Overland Park, Kan., recommends familiarizing yourself with common commercial lease terms such as “expense stop” (or “operating stop”), that is, the amount per square foot that a landlord agrees to pay toward operating expenses, with any excess amounts billed to the tenant. This amount is often set following the first year of the lease – the “base year.”

Another key term is “gross up,” a provision used to establish an accurate base year for operating expenses. In a year where occupancy rates are low and variable expenses (such as utilities and janitorial services) drop accordingly, the gross-up provision increases variable expenses to the amount they would be if the building were 90-percent to 100-percent occupied. Applying the gross-up provision protects the tenant from having a base-year amount that is arbitrarily low (due to low occupancy when the base year was established) and from sharp increases in the base-year amount once the building becomes fully leased. Only certain operating costs (those that vary based on the building’s occupancy rate, such as electricity, utilities, trash removal, management fees and janitorial services) should be subject to the gross-up provision.

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■ Before negotiating the lease, make a list of any deal-breakers.

■ Your lease contract should spell out what your base rent will be and how operating expenses will be handled.

■ If you agree to a long lease term, make sure you get something in return from the landlord.



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Understanding the gross-up provision can help minimize variable expenses, particularly if the building is experiencing low occupancy rates at the time of leasing.

Lease term. A lease is a contract, and as with many other contracts, the term (or duration) of the contract determines what the other party is willing to give you. A longer term generally equals greater concessions by the landlord. Most medical leases are five years or longer if significant leasehold improvements are required. This is becoming more of an issue every year as construction costs increase. Markets may differ, but generally three-year terms are practical only when the space requires minimal, cosmetic changes. Howard Barewin, real estate attorney with Husch Blackwell Sanders law firm in Kansas City, Mo., suggests, “If you’re signing a 10-year lease, you should expect the landlord to give you something in exchange for the 10 years of security you’re providing them.”

For example, a medical practice in Olathe, Kan., worked with its broker to negotiate a six-year lease and, as a result, received six months of free rent. The deal was sweetened even further by including a \$50 per square foot tenant improvement allowance with an operating stop covering the practice from any pass-through expenses for the next four years! How much an individual landlord will be willing to give you will depend on the market and the building owner’s level of motivation to lease the space.

Exclusivity clauses. Some building owners will provide exclusive use rights to larger practices or tenants. For example, you may look at an office complex and request that your practice be the only family medicine clinic allowed. Exclusivity clauses such as these are usually only available to larger practices. If you want one, ask for it early on in discussions.

Personal guaranty. A personal guaranty allows the landlord to pursue repayment from the practice’s owners personally if the practice defaults on its rent, rather than seeking repayment via the practice’s assets, explains Barewin. A guaranty will be particularly important to a landlord that has fronted tenant improvement costs. Sometimes a landlord will agree to terminate the guaranty once the tenant improvement allowance has been amortized. This should be spelled out in the contract.

Tenant improvements. Most landlords

LEASING VS. BUYING

“The decision to lease or buy will vary by practice and will depend on your objectives,” says Brandon LaSala, commercial real estate broker at LaSala-Sonnenberg Commercial Realty Company in Overland Park, Kan. “It basically comes down to a financing decision, that is, your end cost to occupy.”

If after adding up the costs of financing the purchase of the property, making necessary building improvements and ongoing operating expenses, you end with a number that is within \$1 or \$2 of the market rate for leasing comparable space in the area, then ownership will make financial sense. Being a building owner will allow you to spread out the costs of building improvements over a longer period of time and build equity.

However, if you anticipate outgrowing your space over the next five or 10 years, leasing may be the more conservative option. Likewise, if yours is a brand-new practice, it may be more prudent to start out leasing for the first few years so you can spend your time focusing on building the patient base without having to worry about unforeseen building costs or repairs.

Some practices erroneously think that they can offset the cost of owning their office space by renting out parts of the building. Being a landlord, however, can turn out to be more headache than its worth. An office condominium, where you purchase only the part of the building that you’ll occupy, might be a good alternative. Another option is a medical office co-op, where a building “owner” has a 20-percent ownership stake and a group of doctors representing various practices has the other 80-percent ownership stake. The building is managed jointly, which lightens the load for any one physician.

offer tenants an allowance (e.g., \$30 per square foot) for build-out of the new space. This allowance is often not enough to cover the full cost of improvements to the space, and the tenant is stuck with any overages. For this reason, you need to ask a lot of questions about the build-out and its cost. Make sure you have the right to prepare, or at a minimum approve, the building plans, and find out whether the landlord gets to specify the general contractor or whether you can select your own with the landlord’s approval. “If the landlord insists on using a certain general contractor, this could be a red flag,” says John Pauley, facilities and relocation manager for Aegis Business Solutions in Kansas City, Mo. “You should ask if the landlord receives any kind of financial benefit by using that general contractor and make sure the bid amount is consistent with market values for your area.”

You should also ask to see a detailed bud-

■ If your contract includes a personal guaranty, see if it can be terminated once the landlord has recouped any improvement costs.

■ Ask lots of questions about any build-outs; don’t entrust this to the landlord.

get of the build-out. General contractors frequently use preferred subcontractors, and there could be financial benefits included in these relationships as well. It's best to have a competitive bid process in place so you can see the range of costs for each aspect of the project and make the most economical decisions. If you can lower the tenant improvements costs, your rent will go down as well.

If you can't afford to front any money toward construction, you may want to negotiate a "turn key" deal with the owner. Under this arrangement, the landlord would cover the build-out costs in full, usually in exchange for a higher monthly rent payment.

Construction. The construction process needs to be monitored frequently – sometimes daily – which is why you need a good general contractor. In some cases, landlords have in-house staff who obtain competitive bids, monitor subcontractors and report progress to the tenants, but the tenant (you) should not be responsible for the day-to-day monitoring of the construction process.

Construction of new office space frequently takes longer than anticipated, so be prepared for delays. For example, if your practice is currently in building A and moving to building B, don't let your first lease expire too early. Holdover rent for lease A can be extremely expensive unless you negotiate it on the front end. One option is to negotiate a delivery date provision that makes the new landlord

responsible for the cost of holdover rent if the delivery date is missed.

Early access. Most tenants require access to the space two weeks prior to the date on which the agreement takes effect. This is for the purposes of moving furniture and wiring the space for telephones and computer. The landlord should provide this at no cost as long as the tenant is not conducting business in the new space before the commencement date.

Restoration costs. Exit strategies are important to consider even before you sign the lease. If you add something specific to your leased space that is of no value to future tenants, such as a lead shield in a wall, then the landlord may ask you to restore the practice when you move out. Tenants aren't usually responsible for ordinary wear and tear, but determining what is "ordinary" versus what is real damage is almost always subjective. It's a good idea to put some parameters around this in your lease agreement.

Renewal options. Some landlords are reluctant to offer renewal options because doing so limits their ability to rent the space to prospective tenants down the road. "That's no reason to avoid asking," instructs Barewin. You can't get what you don't ask for. Try to get a pre-determined rental price for renewing written into the lease rather than settling for a "fair market" rental rate to be calculated later. The financial certainty will prove beneficial.

When it comes time to renew, be sure to allow sufficient time (six to nine months) to negotiate all the details of your new lease if you intend to stay. This time frame will give you more leverage.

Getting what you need

Don't feel apologetic about broaching difficult subjects or asking tough questions during the lease negotiation. In the end, it's your money and your office space. If you pay close attention to the deals going on around you, take your time and seek good counsel, you can end up with a favorable lease that makes it easier for you to practice medicine. 

Send comments to fpmedit@aafp.org.

1. Future of Family Medicine Project Leadership Committee. The future of family medicine: a collaborative project of the family medicine community. *Ann Fam Med*. 2004;2:S3-S32.

■ Construction often takes longer than expected, so don't let your former lease expire too early.

■ If possible, get a rental rate for renewing your lease written into your initial contract.

BUILDING THE RIGHT TEAM

Here are some team members you might want to involve to help you navigate your way to a successful office space arrangement:

Brokers. A broker representing your interests is often able to negotiate a much more favorable deal than you could achieve on your own. This person will also have knowledge of market rates and recommended contractors, which can be invaluable. In a lease situation, the landlord usually pays the broker fee or it is amortized into the lease.

Insurance agent. This person will help you secure business and liability insurance coverage prior to occupying the space. The agent will need a copy of your lease in order to cater coverage to your practice's needs.

Real estate attorney. It's always a good idea to hire a real estate attorney to look over the lease. This might cost you fees on the front end, but it can save you dollars down the road.