Do's and Don'ts in Real Estate When Buying or Selling a Practice

Clint Herrema

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Realtors.

Approximately 50,000 licensed Realtors in Michigan. And of that, only approximately 6 or (…0.00012%) are what label themselves as dental specialists. And of those, we do not know of any that understand the bank appraisal regulations for valuations.

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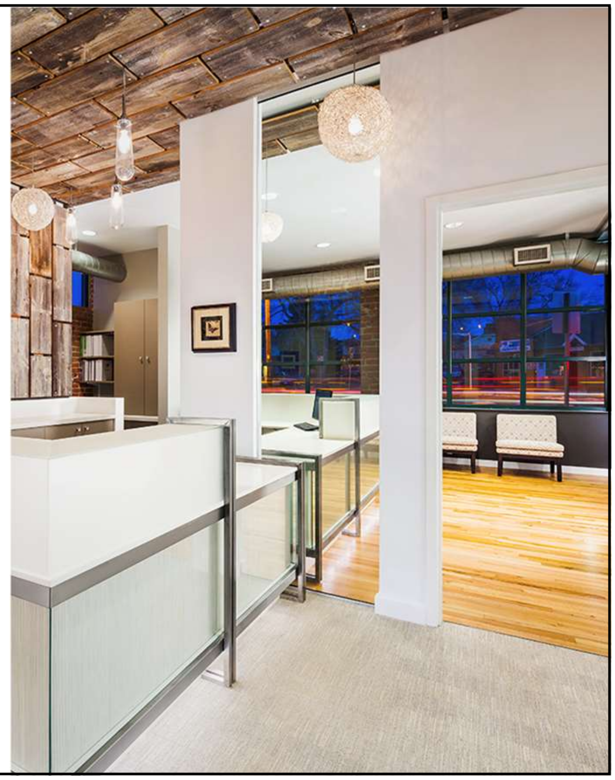
Who We Are and What We Do

- **Market Knowledge**
- **Purchase, Sale , Lease, Practice Transitions and Investment**
- **Strategic Planning**
  Complete cost analysis before you start looking at properties.
- **Appraisal Proficiency**



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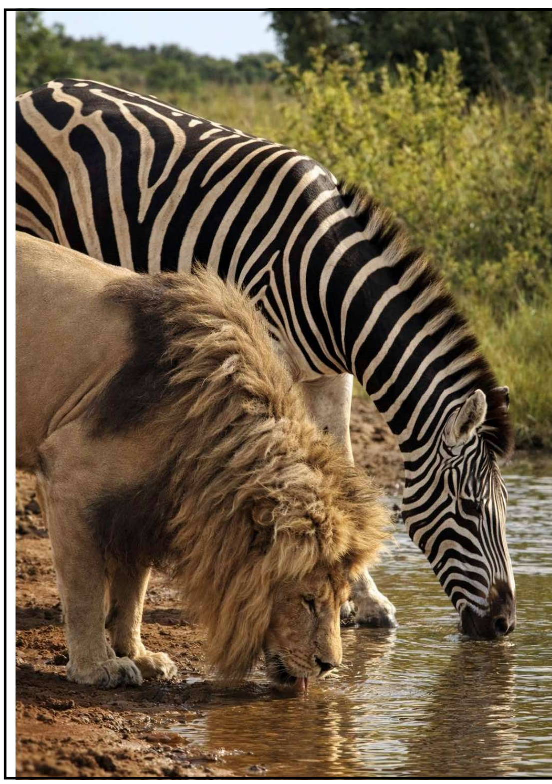

Presentation is Everything

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- People want to do business with those they like and trust
- Understand both Seller's and Buyer's expectations from one another

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Top Mistakes

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- **Having attorney or CPA negotiate purchase or lease value**
  Why?
  Ex. Malpractice.

- **Doing a short-term lease with option to purchase at end based on then appraised value.**
  Why?
  Examples..

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Top Mistakes – cont.

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- **Seller assuming value is worth what new construction value is**
  Why?

- **Buyer using a non-dental comps to assume value**
  Why?

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Sale Comps Adjusted					
Address	Price per Sq Ft	Adjustment	Primary Reason(s) -	Primary Reason(s) +	Adjusted Price Per Sq Ft
[redacted] Grand Blanc, MI 48439	$188.70	5%		Age	$198.14
[redacted], Lapeer, MI 48446	$158.69	5%		Age	$166.62
[redacted]t Dr, Lapeer, MI 48446	$120.67	5%		Age	$126.70
[redacted] Rd, Flint, MI 48507	$119.80	5%		Age	$125.79
[redacted]Rd, Washington, MI 48094	$186.53	5%		Age	$195.86
Average	**$154.88**				**$162.62**

The sales comparison approach yields an approximate value of **$162.62** per SF for the subject property. This value can be used to calculate the sales comparison value for the property:

$162.62 per SF x 5,241 SF = **$852,291**

What NOT to Do Examples:

- Hiring Generic Realtor to assess value

All non-dental properties, improper adjustment for buildout

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Bridge's Comparable Properties

Comparable Properties SOLD in the market					
Address	**Size - SF**	**Date Sold**	**Price**	**Adjusted Price**	**Adj. Price / SF**
[redacted] Rockford	6,076	Sep/2022	$2,150,000 $353.85/SF	Dental Office Transition Add 3% Inflation / year over 3 years = $386.66/SF	**$2,150,000** $386.66/SF
[redacted] Portage	5,435	Aug/2022	$1,684,444 - $309.92/SF	Dental Office Transition Add 3% Inflation / year over 3 years = $338.65/SF	**$1,684,444 -** $338.65/SF
[redacted] Farmington Hills	3,362	Aug/2023	$950,000 - $282.57/SF	Dental Office Transition Add 3% Inflation / year over 2 years = $299.78/SF	**$950,000** $299.78/SF
[redacted] Plymouth	2,584	12/2022	$700,000 - $270.9/SF	Dental Transition Add 3% Inflation / year over 3 years = $296.01/SF	**$700,000** $296.01/SF
[redacted] Canton Twp	3,419	Aug/2024	$950,000 - $277.86/SF	Dental Office Transition Add 3% Inflation / year over 1 years = $286.19	**$978,483** $286.19
[redacted] Portage	2,719	Sep/2021	$750,000 - $275.84/SF	Dental Transition Add 3% Inflation / year over 4 years = $310.45/SF	**$844,113** $310.45/SF
			Average $319.62/SF		***Average $319.62***

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Comparable Properties Analysis

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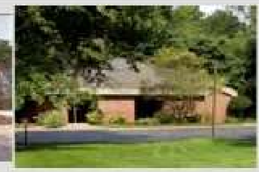
Comparable 1	Comparable 2	Comparable 3	Comparable 4	Comparable 5
				
[redacted]le Rd. Farmington Hills, MI	[redacted]h Rd Plymouth, MI	[redacted] Rd. Canton Twp., MI	[redacted]nd Dr. Portage, MI	[redacted]re Ave. Portage, MI
3,362 / 3,362	2,584 / 2,584	3,419 / 3,419	4,060 / 4,060	2,719 / 2,719
August 15, 2023	December 12, 2022	August 7, 2024	May 28, 2024	September 9, 2021
$950,000	$700,000	$950,000	$900,000	$750,000
$282.57	**$270.90**	**$277.86**	**$221.67**	**$275.84**
2004	1971, renovated 2007	1983/1996	2005	1985
Average	Good	Average	Average	Average

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Income Approach

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The income approach determines value by converting potential income derived from the property into a value. This approach utilizes lease information from the subject property to determine the expected income. A market lease rate for medical was used in this valuation.

Subject Property Income				
Address	Annual Rate / SF	NNN / SF	Sq Ft	Annual Rent
[redacted]h Rd – Main	$22.00	$7.03	5,241	$152,146

The income approach calculates income based on the expected lease rate for the subject property. The below calculation relies on the lease rates listed above. The capitalization rate (CAP rate) for most office properties in this area is around 8.4%, which is why 8% is used for the calculation below.

Calculation	
Square Footage	5,241 SF
Gross Lease Rate (Market)	$29.03 per SF
Annual Gross Income	$152,146
Operating Expenses (NNN) @ $7.03 per sq ft	$36,844
Net Operating Income	$115,302
CAP Rate	8%
Preliminary Value	**$1,441,275**
Depreciated Cost of Basement (per MVS) 4,097 SF x $118/SF x 50% Depreciation	$241,723
Final Market Value	**$1,682,998**

NOT To Do Examples cont:

- Improper use of investment real estate proformas. Cancelled out value to 3rd party buyer

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ADJUSTED CAP RATE	8.15%		AVERAGE LEASE RATE (PSF)	CASH ON CASH YEAR 1	IRR (10 YEAR EXIT)
DEBT SERVICE COVERAGE	1.46		$37.24	8.20%	15.26%

	Year 1	Year 2	Year 3	Year 4	Year 5	Year 6	Year 7	Year 8	Year 9	Year 10
INCOME:										
Rental Income	$96,000	$98,400	$100,860	$103,382	$105,966	$108,615	$111,331	$114,114	$116,967	$119,891
Other Income	$0	$0	$0	$0	$0	$0	$0	$0	$0	$0
Reimbursement Revenue (NNN)	$40,576	$40,779	$40,983	$41,188	$41,394	$41,601	$41,809	$42,018	$42,228	$42,439
Occupancy Rate	100%	100%	100%	100%	100%	100%	100%	100%	100%	100%
CAPITAL EXPENDITURES:										
Capital Reserves	($1,289)	($1,289)	($1,289)	($1,289)	($1,289)	($1,289)	($1,289)	($1,289)	($1,289)	($1,289)
DEBT SERVICE:										
Interest Expense	($51,693)	($50,782)	($49,812)	($48,779)	($47,679)	($46,508)	($45,260)	($43,931)	($42,516)	($41,009)
Principal	$14,010	$14,921	$15,891	$16,924	$18,024	$19,196	$20,443	$21,772	$23,187	$24,694
EXPENSES:										
Operating Expenses	($40,576)	($40,779)	($40,983)	($41,188)	($41,394)	($41,601)	($41,809)	($42,018)	($42,228)	($42,439)
CASH FLOW BEFORE TAX:										
Cash Flow Before Tax ($)	$29,008	$31,408	$33,868	$36,389	$38,974	$41,623	$44,338	$47,122	$49,974	$52,899
Before Tax Cash on Cash (%)	8.20%	8.88%	9.58%	10.29%	11.02%	11.77%	12.54%	13.33%	14.13%	14.96%
Cash on Cash Return Plus Equity ($)	$43,018	$46,329	$49,759	$53,313	$56,998	$60,819	$64,782	$68,894	$73,162	$77,593
Cash on Cash Return Plus Equity (%)	15.50%	16.43%	17.43%	18.47%	19.54%	20.66%	21.81%	23.01%	24.25%	25.54%
TAX DEDUCTIONS:										
Depreciation	($26,853)	($26,853)	($26,853)	($26,853)	($26,853)	($26,853)	($26,853)	($26,853)	($26,853)	($26,853)
Non-Reimbursed Operating Expenses	$0	$0	$0	$0	$0	$0	$0	$0	$0	$0
Taxable Income	$2,155	$4,555	$7,015	$9,536	$12,121	$14,770	$17,485	$20,268	$23,121	$26,045
Income Tax	$754	$1,594	$2,455	$3,338	$4,242	$5,169	$6,120	$7,094	$8,092	$9,116
CASH FLOW AFTER TAX:										
Cash Flow After Tax ($)	$28,254	$29,814	$31,413	$33,052	$34,732	$36,453	$38,218	$40,028	$41,882	$43,783

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in Turnkey condition in comparison like The Subject Property.

Comparable Properties SOLD in the market

Address	Size - SF	Date Sold	Price	Adjusted Price	Adj. Price / SF
[redacted] St Schoolcraft	2,748	Mar/2022	$181,000 - $65.87/SF	$494,640 - $180/SF Dental Buildout	$675,640 $245.87/SF
[redacted]e Rd Portage	2,376	Oct/2021	$153,000 - $64.40/SF	$427,680 - $180/SF	$580,680 $244.40/SF
[redacted]idge Portage	5,435	Aug/2022	$1,684,444 - $309.92/SF	Orthodontic Office	$1,684,444 - $309.92/SF
[redacted] Ave Portage	3,536	Sep/2021	$750,000 - $212.10/SF	Dental Office Transition	$750,000 $212.10/SF
[redacted] Schoolcraft	2,982	Under Contract	***~$275,000 ~$92.22/SF	Restaurant + Business $656,040 - $220/SF	$931,040 $312.22/SF
SUBJECT PROP.	2,085	-			**$552,320 - $264.90/SF**

Properties FOR LEASE in the market

Address	Size – SF	Asking	Adjusted for Build Out	Adjusted Price / SF TOTAL VALUE
[redacted]d Portage	3,130	$11.00/SF + NNN *~$12.38 Avg / 3% escalations* **$394,701 base rent**	$160/SF $500,800 *Incl. LL contribution of $20/sf*	~ $25.30/SF/YR – 10yr **$791,780 Total**
[redacted]y 131 Schoolcraft	3,520	$10.00/SF + NNN *~$11.26 Avg / 3% escalations* **403,528 base rent**	$160/SF $563,200 *Incl. LL contribution of $20/sf*	~$27.46/SF/Yr – 10yr **$966,728 Total**
SUBJECT PROP. Lease Scenario	2,085	Current: $24.17/SF + NNN *~$27.20 Avg / 3% escalations* **$577,715 base rent**		**$577,715 TOTAL $27.71/SF/Yr – 10yr**

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- Must prove out if we are in fact The Best deal in the market.
- This is NOT about setting price as much as proving equity to the Buyer

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Item	Size	Replacement Cost
Land	.77 Acres (*$4/SF)	$134,164
Entitlements, Sitework, Core, & Shell -	2,085 SF (*225/SF)	$469,125
Interior Finish	2,085 SF (*180/SF)	$375,300
Total Estimated Replacement Cost - $978,589 ($469.35/SF)		
Factored Depreciation	Effective Age 25 (42%) Based on 60 years of economic life	$567,581 ($272.22/SF)

3. **Capitalization Rate (CAP)** – The average CAP rate for investors in today's market for dental real estate is typically around 8% - 8.50%. For example, based on the current lease in place with subject property a **Net Operating Income of $50,400** in 2022 (*lease rate of $24.17/SF OR; $50,400 / year, NNN, 10 year lease*), the corresponding value at a **CAP rate of 8.0%** would be ~ **$630,000; ($302.16/SF)**. A **CAP of 8.50%** would be ~ **$592,941.17; $284.38/SF.**

Conclusion: The primary applicable metric for Valuation is the Comparable Cost Approach Combined with the Capitalization Cost CAP. The Reproduction Approach is still applicable because of the lack of inventory options. All of the Cost Approach Metrics are supporting of one another with similar market values.

The Value to purchasing comparable real estate, and then having to do a customized build out for the office needs are showing that the convenience and practicality of purchasing or leasing the current office is a much better value per the equity and the ability to expand as the demand from growth continues.

Sale price of $495,000 ($237.41/SF).

Lease Option 1: Lease Rate of $20/SF NNN – 10 Year lease, with 3% escalators, with first right of refusal to purchase for $495,000 and option to purchase during term of the lease.

Lease Option 2: Graduated Step-up 12-Year Lease; Year 1 @ $15/SF NNN; Year 2 @ $18/SF NNN; and Year 3 @ $20/SF NNN with 3% escalators ensuing, with first right of refusal to purchase for $495,000 and option to purchase during term of the lease.

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- Proper Depreciation is a must, or appraisers cannot take your work seriously
- Sale price is below the metrics showing respect to the buyer and mitigating risk for bank appraisal.

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The Cash Flow Metric

"Can the practice afford the purchase price of the real estate?"

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	YEAR 1			YEAR 1		
	Purchase			**Lease**		
Total Monthly Costs			**$12,639**			**$12,699**
Total Monthly Costs after Taxes			**$8,717**			**$8,255**
Total Monthly Costs after Principal Reduction			**$4,028**			**$8,255**
Net Equity			**$408,398**			

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	Rate		Total	Rate		Total
Total Space Size (Square Feet)			7,088			7,088
Space Occupied by Purchaser (Square Feet)			7,088			7,088
Land Size (Square Feet)			46,017			
Tenant Income (*Tenant Base Rent + NNN*)			$0			
DEAL TYPE: Purchase Existing Building						
Existing Building						
Total Purchase Price	$215.00	per SF	$1,523,920			
Land Value (*Tax Purposes*)	$0.00	per SF	$0			
Landlord TI Allowance	$0.00		$0	$0.00	per SF	$0
Exterior Build Out	$0.00	per SF	$0	$0.00	per SF	$0
Interior Build Out	$0.00	per SF	$0	$0.00	per SF	$0
Architect and Engineering	$0.00	per SF	$0	$0.00	per SF	$0
Soft Costs	$1.00	per SF	$7,088	$1.00	per SF	$7,088
Total Initial Cost			**$1,531,008**			**$7,088**
Cost per square foot	**$216**	**per SF**				
Down payment	20%	of total	$306,202	100%		$7,088
Amount Financed	80%	of total	$1,224,806	0%	of total	$0

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	Rate		Purchase	Rate		Lease
Down payment	20%	of total	$306,202	100%		$7,088
Amount Financed	80%	of total	$1,224,806	0%	of total	$0
Annual Costs						
Interest Rate	5.0%	per year		5.0%	per year	
Amortization Term	15	years		10	years	
Principal & Interest Payment			$116,228			$0
Base Lease Rate				$15.00	per SF	$106,320
Operating Expenses *NNN's*	$5.00	per SF	$35,440	$6.50	per SF	$46,072
Annual Income						
Total Annual Pretax Costs			$151,668			$152,392
Total Monthly Pretax Costs			$12,639			$12,699
Tax Deductions						
Operating Expenses + *Base Lease*			$35,440			$152,392
Mortgage Interest Expense			59,963			$0
Depreciation of Structure	39	years	$39,075			
Depreciation of Interior Build-out	15	years	$0	15	years	$0
Total Deductions			$134,477			$152,392
Annual Tax Benefit	35%	bracket	$47,067	35%	bracket	$53,337
Total Annual Costs after Taxes			$104,601			$99,055
Total Monthly Costs after Taxes			$8,717			$8,255
Mortgage Principal Reduction			$56,266			
Total Annual Costs			**$48,335**			**$99,055**
Total Monthly Costs			$4,028			$8,255
Estimated Market / Equity Value after 10 Years						
Annual Appreciation	3%	per year				
Market Value (*Less Interior Depreciation*)	7%		$1,576,938			
Loan Balance			$1,168,541			
Net Equity			$408,398			

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Practice Brokers

The most overlooked question when interviewing
Who to hire for listing.

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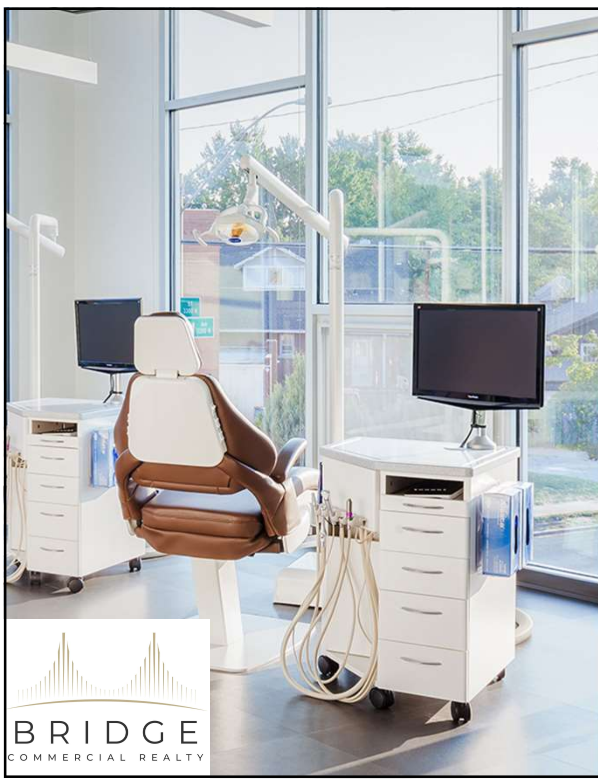

"Do you Co-broker with other Brokers?"

WHY?

- **Limited Exposure**
- **Buyer's may want representation separately**
- **Examples**

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Free Property Value Analysis for MDA Members:

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50[redacted]IDS MI

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PURCHASE PRICE	TOTAL NOI	LEASE $ PSF	LEASE TERM	LEASE STRUCTURE
$1,163,636	$96,000	$37.24	10.00 Years	NNN

GROSS LEASEABLE AREA	CAP RATE	IRR	CASH ON CASH (YEAR 1)	DEBT SERVICE COVERAGE
2,578 Sqft	8.25%	15.26%	8.20%	1.46

SALES RANGE - $37.24/SF

	LIST	OPTOMISTIC	PROBABLE	CONSERVATIVE
Cap Rate	8.00%	8.25%	8.50%	8.75%
Sales Price	$1,200,000	$1,163,636	$1,129,412	$1,097,143

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Purchase Price

Lease Rate	$1,200,000	$1,163,636	$1,129,412	$1,097,143
$30.00	2.28%	2.93%	3.57%	4.21%
$32.00	3.70%	4.38%	5.07%	5.76%
$34.00	5.11%	5.84%	6.57%	7.30%
$36.00	6.53%	7.30%	8.08%	8.85%
$38.00	7.94%	8.76%	9.58%	10.39%

CASH ON CASH YEAR 1

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ADJUSTED CAP RATE	8.15%									
DEBT SERVICE COVERAGE	1.46									

AVERAGE LEASE RATE (PSF)	CASH ON CASH YEAR 1	IRR (10 YEAR EXIT)
$37.24	8.20%	15.26%

	Year 1	Year 2	Year 3	Year 4	Year 5	Year 6	Year 7	Year 8	Year 9	Year 10
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