

*A Newsletter by Budd Larner, P.C.*

## Lease or Buy Medical Office Space?

*By Henry A. Larner, Esq.*

*The decision whether to lease or to buy office space is a complicated issue. Physicians need to weigh a variety of factors when making that important decision, including:*

- *The availability of rental office space in the area and the current rental rates.*
- *The length of time you plan to practice in that area.*
- *Whether the capital earmarked for a building down payment will be needed for other business expenses.*

*There are numerous other considerations as are discussed herein.*

**W**hether leasing or owning office space is right for you and your practice is dependent upon a number of considerations. Either through the purchase of an existing building or the construction of a new one, this article will discuss the pros and cons of leasing versus owning depending upon your facts and circumstances.

### The “Pros” of Ownership

**Design Control.** Building from scratch allows you to design your office layout as you envision it as opposed to the confines presented by existing leased space. Of course, as a tenant, you may have the opportunity to have “build outs” constructed within existing space of your building assuming they are compatible with the building’s infrastructure.

**Space Control.** As an owner, you have the flexibility to control not only the layout, but also the future additional space for yourself and sublets. As a tenant, you may be able to achieve that luxury through a lease option, but unless you are a major tenant, you are at the whim of the landlord.

**Overhead Cost Control.** You can expect leases to allow for annual increases in a landlord’s operating expenses, which



can increase the cost of leased space by 15% or more. Owning a building gives you the ability to control your occupancy-related overhead costs. As a tenant, you can negotiate exclusions from operating expenses, but you may not possess the bargaining leverage to achieve such a result. As an aside, auditing a landlord’s records is possible to make certain that, for example, capital improvements and other excluded items are not improperly billed to a tenant.

**Financial Aspects.** As a tenant, you most likely will encounter lease renewals at higher rates. As an owner, you could charge whatever makes the most economic sense.

**Return on Investment (ROI).** To building owners, a real estate acquisition can build substantial equity as the property increases in value over time while the mortgage decreases.

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**Tax Issues.** The opportunity to reduce income taxes through ownership may favor ownership over leasing. Investing in a property that makes economic sense should be considered in discussions with your attorney or tax advisor.

**Buy-Out Funding.** In certain situations, the ownership interests in a building can be a mechanism for funding the buy-out of a retiring principal.

### The “Cons” of Ownership

**Property management.** To achieve the advantages of ownership mentioned above, you must undertake landlord responsibilities, which are a full-time job. You will be responsible for building maintenance, utilities, capital improvements, local taxes and ordinance compliance, just to name a few. Daily complaints of leaking ceilings, snow covered sidewalks, plumbing and lighting problems fall upon you.

**Financial risk.** The economic dangers are real. Foremost, most building op-

erating budgets require at least a 90 percent occupancy rate to cover the cost of debt service, maintenance, real estate taxes, etc. As such, any initial investment decision will necessarily be, in part, a function of your region’s commercial real estate market.

Similarly, the real estate market for an existing building could take a downturn. Market rentals even at the prevailing rates and at full occupancy might not be sufficient to keep the property profitable without an added infusion of capital. Moreover, a decline in market value of the property can affect refinancing or sale opportunities.

### Conclusion

The decision whether to lease or buy office space must be made on an individual basis for any particular physician or practice group. As with any other significant decision involving a medical practice, the ability to evaluate these pros and cons and to determine what effect they will have upon your bottom line requires thorough investigation and expertise.



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