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PHYSICIAN-OWNED REAL ESTATE

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Presented By CMAC Partners

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Supplemental Equity Fund Established for Physician Real Estate Development

Nearly 100 Docs Make Millions Available

A collection of doctors representing a wide array of specialties has created the CPOMP Physicians' Equity Fund 2022A (PEF). This new fund is aimed at smoothing the path for other doctors to develop and acquire real estate. The PEF offers unique advantages and better economic outcomes to the doctors than other equity sources.

One significant difference is that the PEF stays in as a partner only for the time needed instead of being a "forever" partner like typical equity sources. This is because the PEF equity is contributed with an agreement in which the doctors buy-out the PEF partners at a future date at a predetermined value, which can usually be funded through a refinance after stabilization. In the case of a sale, the doctors are not forced to share proportionately with the PEF partners, but instead pay the predetermined price.

Two Big Differences: Dollars and Control

Until now, the most common source of supplemental equity when building an owner-occupied project is the developer. Usually, that equity comes with an agreement in which the developer shares all proceeds in proportion to its share of the total equity.

On the surface, that seems fair and reasonable, but it is not. With the signing of the lease by the practice group, the building value increases substantially. While that increase is caused solely by the practice group, the incremental lease value along with economic appreciation must be shared with a partner that had no part in its creation. The PEF is not entitled to share in those increases and looks only to the predetermined value that is typically a fraction of that leased value.

Andy Johnson, the Fund's Manager, provided the example of a large multi-specialty group that built a $40MM building with the developer as its 50% partner.

"The building was sold shortly after completion, based upon the practice group's lease, for a sum of $74MM, and the $34MM gain was shared equally with the development partner receiving $17 MM. Had the fund provided the equity, the doctors would have paid out $6.5MM instead, ending up with an additional $10.5MM. Whether the project is $50MM

or $5MM, the proportional differences when using the Fund are the same."

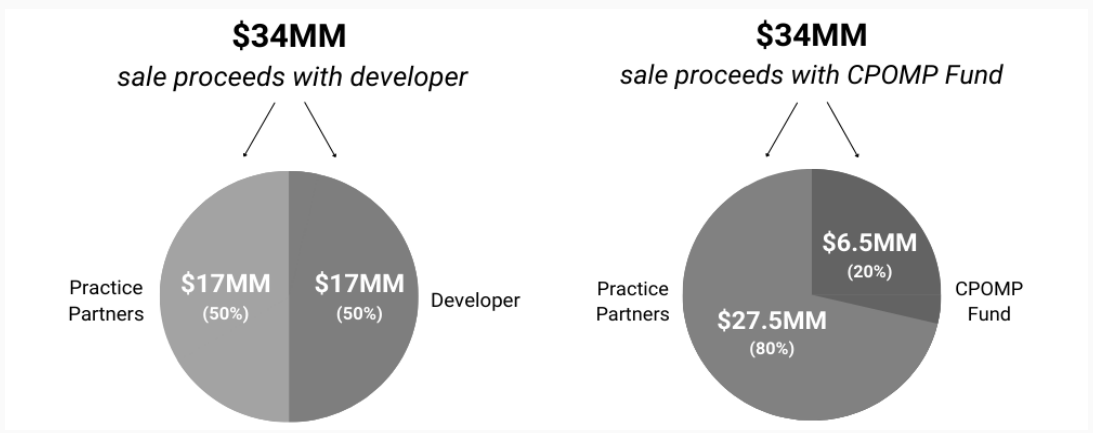
Johnson went on to point out that in the case where the building is held rather than sold, the difference remains, but over longer periods of time. That difference grows with every annual rental increase and the appreciation of the building. "The sooner the doctors can shed their equity partner, the sooner they start to see greater returns, and, in most cases, that is only possible with the PEF."

Beyond the dollar differences, the most frustrating and sometimes devastating issue in the traditional developer partnership is the loss of control. Johnson referred to several cases in which the non-physician partner blocked the physicians from taking action that may have been in the best interest of the practice, but not in line with the objectives of the developer. For example, Johnson spoke of a large orthopedic group with a 50% development partner who was intent on paying down debt. When the equity piece got so large that it prevented new doctors from buying in, the practice sought to refinance. This would provide cash out to the current partners, reduce the equity, and create affordable buy-ins. That refinance was blocked by the developer whose vote was required and who preferred to pay down debt.

"With the PEF, control on all major issues such as sale or refinance stays in the hands of the doctors subject to the take-out provisions of the agreement."

Johnson was quick to point out that the PEF is particularly unique because it is "By Doctors and For Doctors." According to Johnson, these are investors who understand their colleagues' needs and objectives and are on the same wavelength. "It makes for better outcomes." It really does seem that the emergence of the PEF may mark the dawning of a new age for physician development.

For further information on the Physicians' Equity Fund, go to www.CPOMP.org.



On the Bright Side: What's Good About Rising Rates?

Grant Blackhurst
Solutions Specialist

If you've been sleeping through 2022, here's what you missed: Actor Will Smith was banned from the Oscars; the LA Rams proved that their new stadium might be worth the money they shelled out for it; and Manchester City managed to choke yet again in the Champions League. Oh, and interest rates shot up.

The 10-year Treasury rate jumped from 1.51% at the close of 2021 to 3.29% by mid-June 2022. The last time it was that high was back in 2011 when the Netherlands were Baseball World Cup champions … and the Baseball World Cup still existed. The consensus among most economists is that rates will continue to climb throughout the year, as the Federal Reserve maintains its policy of hiking short term interest rates in an attempt to curb inflation.

But while rising rates are typically viewed in a negative light, it's possible to capitalize on the opportunities of the situation — and mitigate the impact on your practice — by using a few key strategies. The optimal course of action will vary from group to group depending how much debt you have, how it's structured, and how much risk you're comfortable with taking.

(Continued on page 10)

On the Inside...

The Sky's the Limit: Financing for a Louisiana Cardio Group in a High-Tech Medical World

Peter Kokins
Principal

You'd be forgiven for thinking you walked into a NASA launch control center — rather than a medical building — when you first visit the Cardiovascular Institute of the South (CIS) in Houma, LA.

With ceiling-to-floor monitors, the group's innovative "virtual care center" allows the physicians to provide round-the-clock access to patients and continually analyze the operational efficiency of each of their 22 locations in real time.

But while CIS has an eye for innovation, it also comes with a rich history: The group's original real estate operating plan dates to 1989, when it established an agreement that gave all current partners an opportunity to own the real estate.

Over the next three decades, CIS expanded operations to include eight owned properties across the southern United States. When those original partners began to retire, the body of real estate owners slowly diverged from the practice ownership .

After many years, the property's value had continued to increase and its debt continued to diminish, making it difficult to attract new shareholders who could afford the high cost of buying in.

At last, CIS decided it was time to bring its outdated financing up to speed with the modern needs and goals of its practice. The group contacted CMAC for help restructuring its real estate holdings, and our team got to work crafting a forward-looking financial solution.

After conducting a comprehensive, individualized analysis of the situation, CMAC laid out the best available options for re-syndicating the group's ownership. By making a few strategic changes to the financing structure, CIS could lower the equity of its real estate and allow new partners to enter as full shareholders at a fraction of the previous buy-in cost — and with over double the returns.

As the current partners had hoped, the new plan also brought a tide of new investment to the practice. Shortly after the deal was completed, ownership leaped from just 11 to almost 40 partners. At the same time, the new financing also allowed

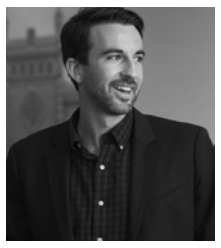
existing shareholders to take a significant amount of the investment value they had built up over the years and put it back in their pockets.

No matter what the future holds for CIS, their new financing will give them the foundation they need to be ready for it: fixed-rate security for the next 10 years at an interest rate significantly below 3%; no personal guarantees; and a 25-year repayment schedule.

Just as important, the change represents a big step closer toward the group's original vision of ownership parity between its physicians, its practice, and the real estate in which it operates.

The best practices stay up to date, embracing and managing change in all areas, including the real estate which provides a lucrative ancillary cash flow to the partners. Kudos to CIS for tackling this project and bringing in the expertise needed to allow so many partners to tap into the real estate partnership.

Perfection is the Enemy of Progress



James Winchester
Principal

"Perfection is the enemy of progress." – James Winchester

I have profoundly blurted out that quote a few times in recent meetings and have since claimed it as my own. Being a quintessential British man, I can get away with stuff like that. Some may not know that it was at one time said, allegedly, by Winston Churchill. Nonetheless, it is quite fitting when talking about physician-owned real estate.

Sometimes, to consummate a transaction, an unfamiliar word touches everyone's lips: Compromise. (Shocking, I know.) This was the case for one orthopedic group in the Southeast U.S.

As a relative newbie to real estate ownership, the group naturally wanted to drive partner participation by making the investment as enticing as possible. To achieve that, they offered all physicians an ownership interest in perpetuity, with the caveat that each owner would be relieved of voting rights when they retired from the practice. For a few years, their plan was seemingly going well, and, as the group expanded, it was able to replicate the same ownership structure for their new buildings.

Before long, the partners noticed a problem:

Several new doctors had joined the practice and were eager to get involved in the real estate investment. But which property? And to what extent? And how would those shares be valued? To make matters worse, some of the original partners had retired, causing the real estate's ownership to diverge from that of the underlying practice. Challenges began to emerge:

1. Divergent Decisions.

Lease renegotiations, tenant improvement, and general building upkeep became contentious. Every transaction ended in a disagreement, making it harder to make decisions which were in the best interests of both groups of stakeholders.

2. Unbalanced Liability.

The practice guaranteed the debt obligation, but that only benefited the real estate ownership group that was growing less and less reflective of the practice.

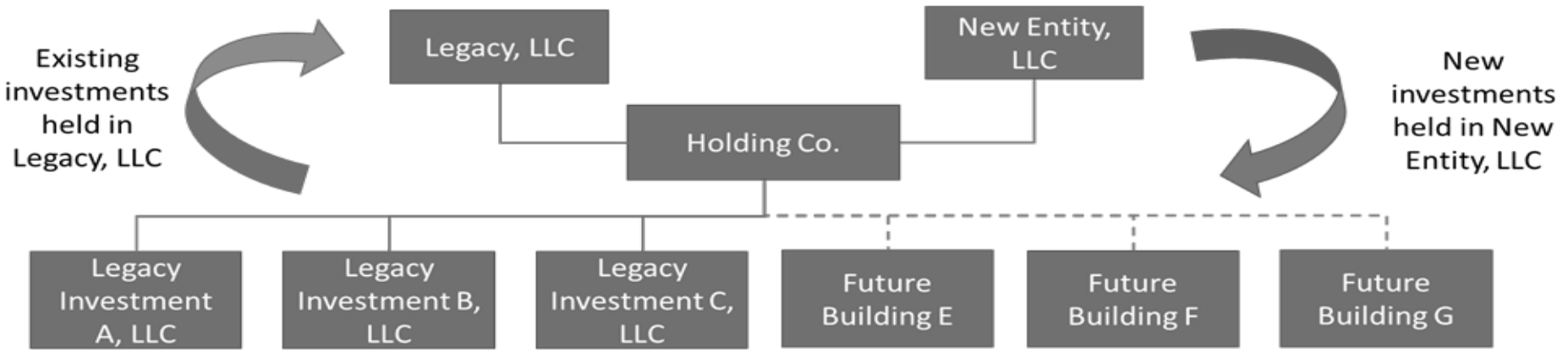
3. Where is the Value Coming From?

Because most of the real estate value is dictated by the practice lease, non-real estate owners in the practice started to raise questions as to why that value was given away.

With these issues in mind, the orthopedic group was in a quandary. How could they attract new partners while honoring the initial offer that had been afforded to the legacy owners? After consulting with CMAC, they learned that a restructuring could create an attractive proposition for stakeholders on both sides.

As outlined in the diagram, the orthopedic group rolled its ownership interest into a holding company. No more picking and choosing investments by the partners. By splitting the ownership interests between the new entity and the legacy owners, the partnership allowed the legacy owners to maintain the equity and the investment they had been promised. Meanwhile, any new investment would be made through the New Entity, LLC. In essence, this allowed the group to create ownership parameters in the new LLC that mitigated any divergence from the practice, while not adversely impacting what had already been agreed upon. What a great **compromise.**

So back to good ol' Churchill. This may not have been what he had in mind when he coined that phrase long ago, but it certainly is representative of the challenges many groups face with their real estate investments today. By striving for perfection and to entice partners, groups sometimes enter into operating agreements which are unsustainable in the long run. Not every group has the option to start fresh, and there can be some good reasons that certain provisions were established. If you can find ways that appease existing owners and enhance the sustainability of the investment, perhaps perfection isn't what is needed anyway.



The Crucial Importance of Maintaining Debt in Physician-Owned Real Estate

Debt = Leverage = Sustainable Investment

When members of a practice group decide to become investors in the practice real estate, there are two primary questions they need to ask:

- Can I AFFORD the investment?
- Will the investment produce an ATTRACTIVE return?

The single, essential element that will provide positive answers to both questions is leverage. Investopedia defines leverage as "the use of debt (borrowed funds) to amplify returns from an investment or project. Investors use leverage to multiply their buying power in the market."

For independent physician groups investing in a new owner-occupied project, debt typically accounts for at least 80% of the total investment. The table below assumes a $10MM investment by a 10-partner group and demonstrates that, without leverage, this investment is probably not affordable and is certainly less attractive.

(see Table 1)

While virtually all groups leverage their investments from the outset, opinions vary on the ongoing leverage that should be applied as the investment matures. If your group is dynamic and reflects the practice ownership in that new doctors are looking to buy in and retiring doctors are expecting to be bought out, the answer becomes quite clear. You need to be able to bring in the new partners by keeping the investment both **affordable and attractive.** Groups often make things more difficult for themselves, however, by treating the building investment as if each doctor were the sole owner paying down debt. This practice makes it harder for the group to attract new doctors.

Now, let's look at the same investment, but assume that it's paid down to where the debt is 50% of the value. Table 2 depicts the investment the new doctors are expected to make. It is over three times more expensive, with a cash return that is only about half of what the senior doctors received. The investment is no longer affordable or attractive.

(see Table 2)

Yet if you asked that same group of senior doctors what amount of financing they would take out if they were buying that same building again, invariably, it would be the same amount of financing as they applied originally. A comparable investment opportunity, achieved through a comparable amount of leverage, should be made available to those incoming doctors if the investment is to remain sustainable.

Variable	Unleveraged Return	Leveraged Return
Project Cost	$10,000,000	$10,000,000
Starting NOI (Triple Net Rent)	$750,000	$750,000
Initial LTV / Loan Amount	0%	85% / $8.5MM
Equity Requirement per Partner	**$1,000,000**	**$150,000**
Annual Debt Payment	$0	($515,729)
Annual Cash Flow Received	$750,000	$234,271
Annual Cash on Cash Return	**7.50%**	**15.62%**
Affordable and Attractive	👎	👍

Table 1

Other Important Considerations of Debt

The "Whom Should I Owe" Conundrum

"If your bank loan is paid off, are you debt-free?"

Variable	Under-leveraged Return	Leveraged Return
Project Cost	$10,000,000	$10,000,000
Starting NOI (Triple Net Rent)	$750,000	$750,000
Initial LTV / Loan Amount	50%	85% / $8.5MM
Equity Requirement per Partner	**$500,000**	**$150,000**
Annual Debt Payment	$318,000	($515,729)
Annual Cash Flow Received	$432,000	$234,271
Annual Cash on Cash Return	**8.64%**	**15.62%**
Affordable and Attractive	👎	👍

Table 2

Counterintuitive as it may seem, the answer is "no." Why? Upon a physician's retirement and buyout of the real estate, their equity is converted to a note payable debt obligation.

Next question: *"Would you rather have more bank debt or more partner debt?"*

This question is even trickier. Generally, the terms of bank debt are superior to partner debt. While a bank can typically amortize debt on a 20- or 25-year schedule at interest rates of Prime or below, partner buyouts typically follow an accelerated repayment schedule over five to seven years at a rate greater than Prime. This often becomes problematic from a cash flow perspective, as the balance of long-term debt shifts to shorter-term debt at higher interest rates.

Asset Protection

Groups that can secure bank debt without personal guarantees often view stripping equity out through a cash-out distribution as a way to secure at-risk equity. To learn how, read the case study "Reducing Personal Risk While Increasing Real Estate Debt" found at CMACPartners.com.

Impact of Stripping Out Equity

Re-leveraging the investment typically involves cash distributed to the partners. With a quick back-of-the-envelope calculation, we can see that if the return received on the funds extracted is higher than the interest rate on the bank debt, the partner's economic position will improve by extracting the funds.

Banks are among the most risk-averse lending institutions. For a low-risk investment, such as a secured mortgage loan to a strong medical client, they typically accept a low return on that capital. Therefore, a mixture of diversified investments should yield a higher annual interest return to the physician-investor than the interest rate paid on the bank debt. Furthermore, cash-out refinance distributions are often tax-deferred transactions, which allows the partner to earn interest on proceeds extracted today to manage the taxable impact upon the sale of shares that trigger that tax event*.

Leverage: Your Tool for Growth

Despite the conflicting interests and timelines that impact physician-owners in an independent medical practice, leverage can help your practice maintain a consistent and sustainable investment appealing to the interest of new owners, as well as perpetuating the financial health of the existing shareholders. Balancing debt and equity is essential for managing stakeholders and supporting your practice's long-term success. To learn more about finding the right level of leverage for your investment, contact solutions@cmacpartners.com.

**CMAC is not a certified CPA firm and will not be held liable as a tax advisor. This article is not intended to provide tax recommendations associated with a cash-out event.*

How the Harried CEO Can Optimize Real Estate Performance

CEOs and CFOs of independent medical groups will generally agree on one thing: it is a full-time job to run a profitable practice.

That said, physicians are investing millions of dollars in their medical buildings and expecting those same executives to manage and coordinate not only the operation of the practice, but also the property. And not just items impacting the practice as tenant, but also all the issues related to ownership and even new construction. When those executives are faced with a decision as to where their attention is needed most, it correctly turns to the practice. After all, that's what brings in the money and pays the rent.

Subsequently, the real estate investment often does not get all the attention it deserves and, for any number of reasons, underperforms. That's not to say it doesn't make money, but it could provide a greater return on the doctors' money and do better at establishing important intangible benefits such as the creation of practice glue and improved recruitment. The bottom line is that with millions of dollars being invested in the real estate by the doctors, they cannot afford to let that happen. Particularly given these investments can act as a source of phenomenal wealth generation for the owners and may be regarded as one of the best potential perks afforded to independent physicians.

That said, C-Level executives have only so much bandwidth which must first be devoted to the practice; the engine that is driving the train. Is acceptance of the status quo an acceptable solution? Focusing on what makes you the most money might be the best management decision.

Let's look at Amazon for a possible solution. Despite its extraordinarily high employee turnover, it is often listed as one of the best managed companies in the world. Just because its online stores are the greatest revenue source – totaling ~$66 billion in Q4 of 2021 – doesn't mean it neglects its subscription services which totaled just a measly ~$8 billion in the same quarter. Amazon has managed this segment to its optimal capacity. The fact is, there are intricacies between the ownership of the practice and its real estate facility that will directly impact the practice performance and must be managed as much as the practice itself.

It takes not only time but also expertise to devise a strategically engineered entity and operating agreement to function for the maximum benefit of the practice, generating attractive returns and sustaining itself through properly planned and funded buy-ins and buyouts. So, while it's possible to let these investments keep ticking along in the background, why receive a 5% return on your equity when you could be receiving 15%? Why build up equity if there's no way of easily accessing it upon retirement?

Yet executives generally don't have the excess capacity to analyze and implement the corrective actions necessary to enhance these investments for the physician-owners. This is where outsourcing items that aren't your core competency can come into play. Many groups have the misconception that working with an outside expert advisor, such as CMAC, will take a substantial amount of time. The reality is that a good advisor understands that their role, in part, is to make sure that the executives don't take extra time away from their practice, while bringing the added bandwidth that's needed, in this case to the real estate.

CMAC has found that practices that are willing and want to ensure their real estate investments are the highest performing assets only need to invest a relatively small amount of time to provide us enough information. We take it from there, providing and implementing a set of solutions unique to the practice.

After working with hundreds of practices from across the country, we have developed solutions to challenges that many practices face, avoiding the need for groups to reinvent the wheel. It really is no different than bringing on a new employee.

While it may initially take time to bring them up to speed, it shouldn't take long before they're reducing your workload and improving your output. When you work with CMAC, you get the extra bandwidth to enhance your practice's real estate investments.

Bank Empowerment: Helping Your Bank to the Absolute Best Rates and Terms

Liz Allport
Executive Vice President

"I sit on the Board of our local bank, and I know for a fact that they give our group the absolute best terms that they can offer. They just can't do any better!" OR CAN THEY?

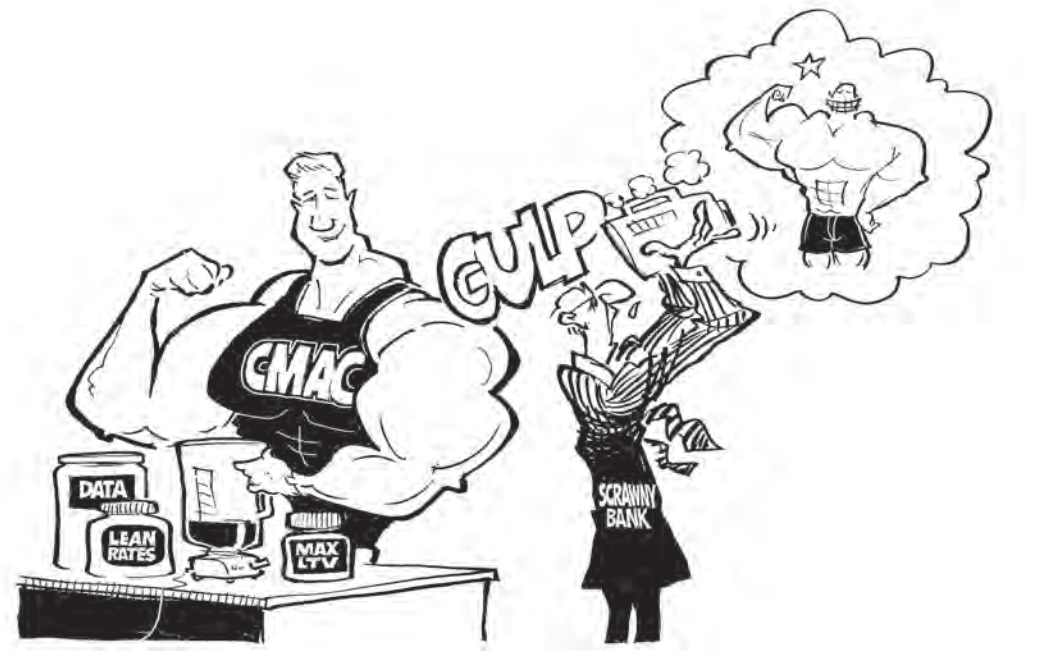
In Missouri, a physician served on the bank's Board and was witness to his bank proposing pricing to his group that was lower than they (or any other client) had ever seen from that bank. It was the same story in Pennsylvania where the group's CEO sat on the bank's Board.

How and why does this happen when doctors and executives who serve as Board members at their group's bank already receive favorable treatment in return for volunteering their time and expertise to serve on the Board? The answer is pretty simple. When local banks are provided with knowledge and understand what they need to do in order to retain a good client, they will go to places they've never been and good things will happen for the physician groups.

Here's an industry secret: Banks don't always know as much as you think they do. In fact, when I was working on Wall Street as a commercial lender, I only had information about the terms my own bank was offering. In fact, most of the time, banks will only share knowledge on a local level to take advantage of market disparity.

That's why I love working at CMAC. With detailed information about lending terms at a wide spectrum of banks and a database of thousands of term sheets from nearly every region in the country, that information can be strategically shared with banks to let them understand what they need to do to compete. It can also be shared to let a single banking center understand what its own bank is offering in other markets. With that knowledge these banks receive a "bird's-eye view" of the real market pricing for a loan, giving them ammunition to offer it to their best clients.

You (and your banker) might think your current deal provides the best possible terms – but that doesn't mean CMAC can't empower your bank to go even further. Let's look at what happened in those instances in Pennsylvania and Missouri:



Nailing down precedent for each bank's best rates.

In Pennsylvania, with a $34 million refinance on the horizon, the practice felt certain the loan terms offered by their regional bank were the best they could hope for. After all, their CEO sat on the bank's Board of Directors, so it was in everyone's interest to provide advantageous terms.

CMAC, however, had recently closed financing of over $75 million with that same bank at a lower credit spread (the bank's cut of profits from the interest rate) for a different orthopedic practice. While it's common for banks to offer more aggressive rates for larger deals, CMAC successfully lobbied the bank to match its own pricing for the Pennsylvania practice, despite the smaller size.

Lesson learned:

Each geographic market has its own competitive environment. By showing the local banker what his own bank colleagues in another territory were offering their clients, CMAC enabled him to get more competitive. After all costs, the improved pricing saved the doctors over $700,000.

Matching market rates nationwide.

A Missouri practice faced a similar situation: their Acting President sat on the Board of their bank and received very attractive terms for the refinance and expansion of the practice's real estate. He was told they were "the best available" … but he decided to work with CMAC to make sure his group wasn't leaving anything on the table.

CMAC provided the local Missouri bank with data showing the all-in spreads and rates quoted by banks nationwide on our most recent closings. With more information about what offers other banks might make to take over the business, the local banker was able to lower her own bank's rate and keep a valued client. The doctors were delighted to stay, but with savings of over $800,000.

Lesson learned:

Bankers need to know how their rates and terms stack up in the wider market, and CMAC can help them access that information. While maintaining lender confidentiality, CMAC provides recent and accurate data about similar loan closings, giving the bidding bank a complete picture of the market – minus the guesswork.

There's no question that supporting your bank is a "win-win-win" for your practice, your bank, and the community – but when it comes to finding the best lending terms, it's not the bottom line. By working with CMAC to connect your bank to the right market information, you can empower them to set you up for financial success.

Appraisal Valuation Crisis

Overcoming Low Appraisals in a Market of Rising Costs

Ha Tran
Finance Project Manager

With the onset of the COVID-19 pandemic, the world rapidly changed. Lockdowns, travel restrictions, and general unease gripped the public, causing disruptions in every facet of the economy.

Drastic changes in supply and demand, the Suez Canal blockage, the war in Ukraine and a $3 trillion relief package have given rise to the worst inflation in 40 years. The Federal Reserve is fighting inflation with the few tools it has, but will it be enough, and what will be the lasting consequences?

The traditional method to combat inflation is to raise interest rates. However, some believe the rising prices of raw materials is partly due to price gouging and profiteering. Medical practices across the country continue to build and expand their practice facilities, but uncertain and increasing construction costs are wreaking havoc on budgets.

General contractors are unable to lock in guaranteed maximum prices, creating mismatch between appraisal values and final budgets, which leads to challenges for groups looking to finance their building.

Some groups have recently received a nasty surprise when their banker reports a low appraised value compared to actual costs, which can result in additional equity needed. Here are some tips to keep your project going:

Understanding the Scope

It can be helpful to know the types of values which an appraiser could be told to use by the bank as it could drastically impact the concluded value on which the bank will lend. There are three basic values:

1. The "fee-simple" fire sale value (value of the property without a tenant),

2. The market value (value of the property based on comparable sales in the area, and

3. The leased-fee value (value based on the cash flows the building will generate).

The first two approaches tend to be conservative, while the third can paint a more representative picture from the borrower's perspective. The value of the lease should equal the value of the property.

Be Proactive

Once the bank engages the appraisal firm, it should reach out to you to request detailed information on the property. Have the information ready and in an organized format. This allows the appraiser to understand the current building status and assists with the fact-finding. Another key piece of information is the current lease. This will help the appraiser identify comparable sales ("comps") and, more importantly, it will denote a value based on cash flows.

The lease becomes more important for new construction deals as it proves that there is a tenant who is willing to lease the property for X years at a rate of $Y/SF. If an official lease has not been executed, a letter of interest ("LOI") or an income statement proforma would also be helpful. Ideally, the appraiser will conclude a leased-fee value (value based on cash flows of the building) rather than a fee-simple value (value of the property in a fire sale). Your information should also include any comps that have recently been sold or leased that reflect a desirable market value.

React to an Adverse Appraisal Valuation

If you have an appraisal valuation that comes up short of expectations, what do you do? First, don't panic; then seek to understand the scope. Most commercial real estate properties "should" be evaluated on a leased-fee basis (arm's length transaction between a landlord and tenant documented by a lease). The key here is that the bank will almost always want to look at the property value from a "fire-sale" perspective (e.g., fee-simple valuation). The trick will be convincing the bank or the appraiser to believe the lease would survive in the event of a sale. The base case scenario here is a sale-leaseback. Make sure you include any offers and LOIs you might have recently received.

► Request the Bank to Challenge –

The bank can also challenge the appraiser from their internal real estate valuation department but keep in mind that this is the same team that provided the appraiser with the set of instructions in the first place. That being said, mistakes do happen, and the bank may agree with you.

• ***Challenge the Concluded Value*** **–**

Banking is a highly regulated industry and when it comes to appraisals, there is a certain set of guidelines that each bank follows (FIREA). The bank's size will dictate their "flexibility" (larger banks are more heavily regulated and monitored than smaller banks), and almost all banks will say they have an external department that deals exclusively with appraisals. Your relationship manager may only garner so much influence when dealing with appraisal inquiries. Therefore, when appealing an appraisal valuation, you will likely only get one shot. To help form a strong argument for an appeal, focus on:

► Fee Simple versus Leased Fee –

This relates to the first point about understanding the scope. Most commercial real estate properties "should" be evaluated on a leased-fee basis (arm's length transaction between a landlord and tenant documented by a lease). The key here is that the bank will almost always want to look at the property value from a "fire-sale" perspective (e.g., fee-simple valuation). The trick will be convincing the bank or the appraiser to believe the lease would survive in the event of a sale. The base case scenario here is a sale-leaseback. Make sure you include any offers and LOIs you might have recently received.

• ***Alternative Options*** **–**

If you have exhausted your appeal options and still do not receive the value to support your project, there are two choices:

► Pivot to another lender and get a new appraisal. This has worked for several of our clients.

► Borrow more from the bank (usually a second lien or stub note). Keep in mind these notes will not amortize as slowly as a primary real estate loan and can adversely impact cash flow and returns.

CMAC Partners

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Bayside Orthopedics
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Carolina Orthopedics & Sports Medicine Center, Inc.
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Coastal Orthopedic & Sports Medicine of Southwest Florida
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Lowcountry Orthopaedics & Sports Medicine
Charleston, SC

Michigan Orthopaedic Surgeons
Southfield, MI

Missoula Bone & Joint
Missoula, MT

Moore Orthopedic Clinic
Lexington, SC

Northwest Orthopaedic Specialists
Spokane, WA

OAK Orthopedics
Bradley, IL

Olympia Orthopaedic Associates*
Olympia, WA

ORA Orthopedics
Moline, IL

OrthoArkansas*
Little Rock, AR

OrthoCarolina*
Charlotte, NC

OrthoIllinois
Rockford, IL

OrthoMontana
Billings, MT

Orthopaedic Associates
Albany, GA

Orthopaedic Associates*
Fort Walton Beach, FL

Orthopaedic Associates of Central Maryland
Baltimore, MD

Orthopaedic Associates of Michigan
Grand Rapids, MI

Orthopaedic Associates of Muskegon
Muskegon, MI

Orthopedic Associates of Lancaster
Lancaster, PA

Orthopaedic Associates of Wisconsin
Pewaukee, WI

Orthopaedic Associates USA
Plantation, FL

Orthopaedic Specialists of the Carolinas
Winston-Salem, NC

Orthopedic Associates
St. Louis, MO

Orthopedics Center of Florida
Fort Myers, FL

OrthoAlaska*
Anchorage, AK

Orthopaedic Specialists of Southwest Florida
Fort Myers, FL

OrthoTennessee*
Knoxville, TN

OrthoTexas
Plano, TX

OSS Orthopaedic Hospital*
York, PA

Palm Beach Orthopaedic Institute
Palm Beach, FL

Presicion Bone & Joint Surgery Center
Stuart, FL

Premier Bone & Joint Centers
Laramie, WY

Princeton Orthopaedic Associates
Princeton, NJ

Puget Sound Orthopaedics
Tacoma, WA

Raleigh Orthopaedic Clinic*
Raleigh, NC

Reno Orthopedic Clinic
Reno, NV

Rothman Orthopaedic Institute
Philadelphia, PA

Sierra Pacific Orthopedics
Fresno, CA

Slocum Center for Orthopedics
Eugene, OR

South Florida Orthopedics & Sports Medicine
Stuart, FL

Southern Oregon Orthopedics*
Medford, OR

Spectrum Healthcare Partners - Orthopaedics Division
Portland, ME

Syracuse Orthopedic Specialists
Liverpool, NY

Tallahassee Orthopaedic Clinic*
Tallahassee, FL

Tampa Bay Orthopaedics
St. Petersburg, FL

Tennessee Orthopaedic Alliance
Nashville, TN

Texas Orthopedics
Austin, TX

The Bone and Joint Group*
Clarksville, TN

The Orthopedic Clinic Association
Tempe, AZ

The Orthopedic Clinic
Daytona Beach, FL

The San Antonio Orthopaedic Group
San Antonio, TX

Tri-State Orthopaedics
Evansville, IN

Tulsa Bone and Joint*
Tulsa, OK

Wooster Orthopedics & Sports Medicine Center
Wooster, OH

*** Returning Clients**

Orthopedic Associates of Southwest Florida

Fort Myers, Florida

Orthopedics

$27,500,000

Cardiovascular Institute of the South

Houma, Louisiana

Cardiology

$31,200,000

Southern Oregon Orthopedics

Medford, Oregon

Orthopedics

$17,300,000

Augusta Orthopedic Specialists

Augusta, Georgia

Orthopedics

$11,790,000

Orthopaedic Associates of Muskegon

Muskegon, Michigan

Orthopedics

$18,000,000

OSS Orthopaedic Hospital

York, Pennsylvania

Orthopedics

$92,000,000

Ohio ENT & Allergy Specialists

Columbus, Ohio

ENT

$18,600,000

Spectrum Healthcare Partners

Portland, Maine

Orthopedics

$13,800,000

CMAC Partners

WE KNOW MEDICAL

Urology

Arkansas Urology* Little Rock, AR
Central Ohio Urology Group Gahanna, OH
Idaho Urologic Institute, PA* Meridian, ID
Southeastern Urological Center, PA Tallahassee, FL
Urology Associates, P.C. Nashville, TN

Urology Associates of Southern Arizona Tucson, AZ
UroPartners Westchester, IL
Urology Nevada Reno, NV
Urology San Antonio San Antonio, TX
Wisconsin Institute of Urology Neenah, WI

Ophthalmology

Bay Eyes Cataract and Laser Center Fairhope, AL
California Eye Institute* Fresno, CA
Emerald Coast Eye Institute* Fort Walton Beach, FL
Eye Associates of Boca Raton Boca Raton, FL

Eye Associates of Colorado Springs Colorado Springs, CO
Eye Surgeons Associates* Bettendorf, IA
Eye Center of North Florida Panama City, FL
Eye Institute of West Florida* Largo, FL

Eye Specialists of Mid-Florida* Winter Haven, FL
Huntsville Laser Center Huntsville, AL
Laser & Surgery Center of the Palm Beaches Palm Beach Gardens, FL
LaserVue* Orlando, FL
Medical Eye Specialists Bozeman, MT

Ocala Eye Ocala, FL
Ophthalmology Consultants St. Louis, MO
Pacific Cataract & Laster Institute Chehalis, WA
Retina Consultants of Southern Colorado Colorado Springs, CO

St. Louis Eye Surgery and Laser Center St. Louis, MO
The Eye Clinic of Florida Zephyrhills, FL
Triad Eye Institute Tulsa, OK
Virginia Eye Institute* Richmond, VA
Visual Health Lake Worth, FL

Hospitals

Arkansas Surgical Hospital Little Rock, AR
Ascension St. Vincent Orthopedic Hospital Evansville, IN
Catholic Health/St. Francis Hospital Colorado Springs, CO
Heritage Park Surgical Hospital Sherman, TX

Lafayette Surgical Specialty Hospital Lafayette, LA
North Carolina Specialty Hospital Durham, NC
Springhill Medical Center Mobile, AL

The Spine Hospital of Louisiana at the NeuroMedical Center Baton Rouge, LA
The Breast Cancer Center at Physicians Medical Center Houma, LA
Western Reserve Hospital* Cuyahoga Falls, OH

Cardiology

Abilene Cardiology Abilene, TX
Alabama Heart & Vascular Medicine Tuscaloosa, AL
Cardiovascular Associates* Birmingham, AL
Cardiovascular Institute of the South Houma, LA

Clearwater Cardiovascular Clearwater, FL
Florida Heart Group* Orlando, FL
Fort Worth Heart Fort Worth, TX
Northeast Georgia Heart Gainesville, GA
Orlando Heart Orlando, FL

Pima Heart Tucson, AZ
Savannah Cardiology Savannah, GA
South Denver Cardiology Littleton, CO
Southern Cardiovascular Gadsden, AL
Sutherland Cardiology Clinic Memphis, TN

Other Specialties

Alyeska Vascular Surgery Anchorage, AK
Audubon Medical Office Building Colorado Springs, CO
Austin Diagnostic Clinic Austin, TX
Austin Regional Clinic Austin, TX

Black Warrior Medical Center Tuscaloosa, AL
Cancer Specialists of North Florida* Jacksonville, FL
Canyon View Medical Group Springville, UT
Cascade Brain & Spine Bellingham, WA

Central Park Ear, Nose & Throat Arlington, TX
Dallas Nephrology Associates Dallas, TX
Endoscopy Center of Ocala Ocala, FL
ENT & Allergy Associates Charleston, SC
ENT Center of Utah Salt Lake City, UT

Northeast Georgia Diagnostic Clinic Gainesville, GA
Granger Medical Clinic West Valley City, UT
The Doctors' Clinic Salem, OR
The Lexington Clinic Lexington, KY
The Oregon Clinic Portland, OR

Valley Medical Center Lewiston, ID
Medical Care PLLC Elizabethton, TN
Metrolina Nephrology Associates Charlotte, NC
Nephrology Associates Nashville, TN
North Carolina Eye, Ear, Nose & Throat* Durham, NC

Orlando Aesthetic Institute Orlando, FL
Ohio ENT & Allergy Physicians Columbus, OH
Phoenixville Birth Center Phoenixville, PA
Premier Family Medical Pleasant Grove, UT
Signature Medical Group St. Louis, MO

Tanner Clinic Layton, UT
The Iowa Clinic West Des Moines, IA
The Oregon Clinic Portland, OR
Willamette ENT Salem, OR
Women's Healthcare Associates Portland, OR

Surgery Centers

Bend Surgery Center Bend, OR
Blue Water Surgery Center* Port St. Lucie, FL
Carolinas Center for Surgery* Morehead City, NC
Coral Ridge Outpatient Center Oakland Park, FL

Hilton Head Surgical Hilton Head, SC
Hollywood Surgical Center* Hollywood, FL
Palmetto Surgery Center* Columbia, SC
Same Day Surgery Center Zephyrhills, FL
Southpoint Surgery Center Jacksonville, FL

Surgery Center of Southern Oregon Medford, OR
Surgical Solutions Covington, LA
TLC Outpatient Surgery Lady Lake, FL

*** Returning Clients**

CMAC Supports a Growing Georgia Orthopedic Group For Nearly 10 Years

Mariela Araujo
Solutions Specialist

Twenty years ago, a small orthopedic practice in Georgia launched with a handful of partners. Then the practice grew, opening a new office upstate …and then a new surgery center … and then merging with another group. All the while, appreciating real estate values and routine debt payments caused the equity in the real estate portfolio to skyrocket – making it more expensive for new partners to buy in and harder for existing partners to cash out their own shares.

Sound familiar? Adapting a practice's financing to meet its current needs is a conundrum faced by many of our clients as they expand and acquire new properties. Fortunately, CMAC is there to help you find the ideal financing solution to make your model work.

This group, Augusta Orthopedic Specialists (AOS), has worked with CMAC for nearly a decade. Through expansions and mergers, transitions and market shifts, our team has helped the group structure its financing, overcome challenges, and expand to serve a growing community of patients.

2014: The Start of a Successful Partnership

Initially, AOS sought to refinance its existing medical office building and finance the construction of a new ambulatory surgery center. CMAC stepped in to request offers from a wide range of lenders – and the group's incumbent lender responded by lowering their interest rate, offering an improvement of 1%.

2019: Cashing Out and Buying In

Five years later, AOS encountered a new challenge: As existing partners repaid debt, the practice equity ballooned and the cost of buying in as a new partner became unfeasibly high. Once again, they came to CMAC in search of help.

Leveraging our market expertise, CMAC worked with local, regional, and national bankers to secure 13 loan proposals for the practice. The best term sheet that was offered allowed existing partners to lower the interest rate, take cash out of over $3 million, while also allowing new partners to buy in at an affordable price. As an added benefit, CMAC helped consolidate debt under one loan and removed the physicians from personal liability.

2020: Taking Advantage of Market Conditions

During the height of the COVID-19 pandemic, with interest rates dropping precipitously, CMAC saw an opportunity to secure a better rate for AOS. With the doctors' permission, we reached out to the current lender to request options.

The group elected to accept a rate improvement of nearly 1%, generating over $400,000 in interest savings over the remaining term of the loan. The bank also allowed the loan to be re-amortized to stretch out the repayment, which improved monthly cash flow by about $5,000 per month. The lower loan payment was especially welcomed with the uncertainty caused by the pandemic.

Later that same year, the doctors purchased an adjacent vacant lot with the goal of constructing a Rehabilitation and Physical Therapy location and alleviating parking constraints. CMAC coordinated with the bank to secure the loan required for the construction project.

2021: A Bright Future Ahead

In an exciting step forward, AOS announced a planned merger with Carolina Musculoskeletal Institute which would combine four owner-occupied properties between the two groups. Faced with the prospect of consolidating and equalizing the ownership of the combined real estate portfolio, the group once again turned to CMAC for guidance.

Not only did CMAC refinance the debt of all properties at a rate of 2.5% fixed for ten-years, but it also facilitated structural changes by ensuring all physician-owners held an equal share in the property. In the end, both groups were successfully integrated with no out-of-pocket expenses.

2022: Wrapping up a Loose End

During the merger, AOS was drawing on the construction loan for its planned Rehabilitation facility. Now that the property has been completed and occupied, CMAC was able to have the bank commit to offering the same 2.5% fixed rate on the conversion to the permanent financing, even though market rates had increased to over 4%.

As your practice grows and changes, so do its financing needs. By securing the most advantageous terms for our clients' debt – and using that debt strategically to adapt to new market conditions – CMAC is more than a one-stop service provider. We're a long-term partner for your evolving real estate portfolio.

What CMAC Clients Have to Say...

Probably the biggest impact from CMAC was their expertise with a resyndication effort. They ran multiple models, probably 40 to 50 total, between different options that we could consider.

Dr. David Morris
Urology Associates, P.C.

CMAC's connections in the banking and financing world are far more extensive than we could develop on our own. They really cast a much wider net. They made us feel as if they were partnering with us on the project and we really appreciated that.

Dr. Arthur Valadie
Coastal Orthopedics

I think that one of the most important things about CMAC is they were very clear to let me know that they were always there for us, even after we had closed the deal.

Brenda Hulbert, former CEO
South Denver Cardiology Associates

There's always things that come up that are unexpected or unforseen, and in dealing with CMAC, I have always felt a partnership. So, I've never hesitated to text or call, and they've always been very prompt to return my call.

Dr. Steven Meek
Tanner Clinic

The CMAC team members are specialists - they are experts at what they do. They freed us up to do the day-to-day tasks that we needed to do. Partnering with someone that can take that burden off myself and my team brought great value to our transaction.
E. Scot Davis, CEO
Arkansas Urology

We were very pleased with the experience. CMAC was very easy to work with and made our lives easier as physicians as well as my administrators.

Dr. Check Kam
South Florida Orthopedics & Sports Medicine

One of the most beneficial things we received from CMAC is that we understood some mistakes we made in our first joint venture and that will help us as we move forward with future joint ventures.

Rob Condie, CFO
Granger Medical Clinic

Would we use CMAC again? Absolutely. Would I recommend them? Absolutely. If you want a process that's truthful and transparent, a team that listens to their clients and delivers, then this is really the best way to go.

Dr. Ashish Soni
Nephrology Associates

As the hospital CEO, with CMAC I was able to take a step back and really just hand off the entire financial renegotiation to CMAC, and they executed the entire project all the way through.

Buffy Domingue, CEO
Lafayette Surgical Specialty Hospital

One of the things we liked best, and that several of my doctors took full advantage of, was being able to call CMAC and just ask a question, or get their opinion on something. And that was invaluable.

Lynn Wolff, former CEO
Georgia Hand, Shoulder & Elbow, P.C.

On the Bright Side: What's Good About Rising Rates?

(Continued from front page)

The Upside: Groups With Swaps and Conduit Loans

Your time in the spotlight has come! When rates go up, groups that have existing swaps or insurance/conduit loans in place are in luck. Depending on your situation, you're either a ***"Winner"*** or a ***"Big Winner."***

The ***"Winners"*** are those who had swaps or conduit loans that were heavily "out of the money," meaning that these groups would have had to pay their lenders a hefty amount to prepay their loans. These borrowers were effectively blocked from refinancing or making other moves that may have been desirable, such as further leveraging the real estate investment to enable more affordable buy-ins for partners.

The recent rise in interest rates, however, means that many of these groups are no longer saddled with this contingent liability, and it may be an opportune time to revisit changes that could positively impact the sustainability of the group's investment.

The ***"Big Winners"*** are those groups that entered swaps in the last two to three years; those swaps now have a substantial positive value, meaning that the bank will pay the doctors to terminate that swap early. There are several ways that groups can take advantage of these positive swaps, including:

1. Terminating the interest rate swap to provide cash-out to partners.
2. Improving cash flow by blending the positive value into a new swap and re-amortizing the debt.
3. Using the positive swap value to pay down principal on the loan.

If you have an interest rate swap, it is worth finding out what the mark-to-market (also known as termination value or swap unwind) is on that swap so the group can understand its available options. This value can be provided by CMAC or any independent swap advisor. Banks can also provide the information but may skew the unwind value in their own favor.

The Downside: Groups With New Real Estate Projects

We certainly understand the sleepless nights caused by the rising interest rate environment, and the impact it's likely to have on new real estate projects. Those concerns are not without merit, as interest rates will play a significant role in a group's return on investment. For those groups that are willing to assume a little more risk, however, a floating rate option could be an attractive proposition.

According to JP Conklin, Founder & President of Pensford, an independent swap advisor, there has yet to be a time in history where a 10-year fixed swap rate has outperformed the comparable floating rate option. Assuming we don't break from the historical norm, a floating option could save borrowers a significant amount of interest expense over the term of the loan.

It's also worth noting that there's nothing precluding a group from utilizing an interest rate swap to fix the rate in the future. In fact, this could be a very effective strategy employed by groups to take some of the risk off the table later, when interest rates may be more favorable.

Economists expect rates to continue rising in the short term, but most also agree that a recession could be right around the corner — along with the expected decrease in rates that comes along with it.

This expectation is reflected in current rate projections, which have short term interest rates priced higher than long term rates, otherwise known as an inverted yield curve. So, for those groups that are willing to take an educated gamble, floating rate options could provide an attractive avenue in the current higher rate environment.

The SPREAD, the whole SPREAD, and nothing but the SPREAD!

While there's nothing a borrower can do to control market interest rates, or "the cost of funds," the profit a bank adds to that cost (the SPREAD) is completely negotiable. The importance is the same in either a floating rate loan or with a loan fixed via an interest rate swap. Every basis point (.01%) added to the spread can have a significant impact on the returns of a borrower's investment.

For example, a single 0.01% to the rate of a $20MM loan is valued in the range of $16,000. Therefore, just 25 bps (0.25%) in additional spread results in a present value cost to the borrower of roughly $400,000. Banks also add a profit to the cost of a swap, and generally do not disclose that additional spread to the borrower. For this reason, it is wise to work with a company such as Pensford whenever entering into a swap.

It's said "everyone wins in a rising tide" — and while the same may not be true for rising rates, there are still plenty of opportunities for savvy medical practices to capitalize on the advantages of this unique real estate market, while mitigating the downside. If you'd like help exploring the options that may be available to your group, reach out to solutions@cmacpartners.com.

CMAC Secures Debt for Docs to Purchase Stake in Practice

Not Quite Real Estate – But a Proven Process That Works

Chris Tollinchi
Principal

As the great philosopher Bruce Lee once said, "There are no limits. There are only plateaus, and you must not stay there. You must go beyond them." The same can be true when it comes to financing your debt.

Here at CMAC, medical owner-occupied real estate financing is our bread and butter. But as the years go by, we've increasingly been asked to go beyond our core capabilities to bring the same results to other types of financing, such as debt to purchase equity ownership shares of surgery centers.

While every medical practice we work with comes with a unique set of circumstances and obstacles, obtaining loans for the purchase of equity presents a particular challenge. Bank underwriting for equity loans is quite different than for real estate mortgage loans. That's because most banks don't consider ownership shares to be appropriate collateral. Nevertheless, CMAC's tried-and-true RFP process has been shown to produce excellent results in all cases.

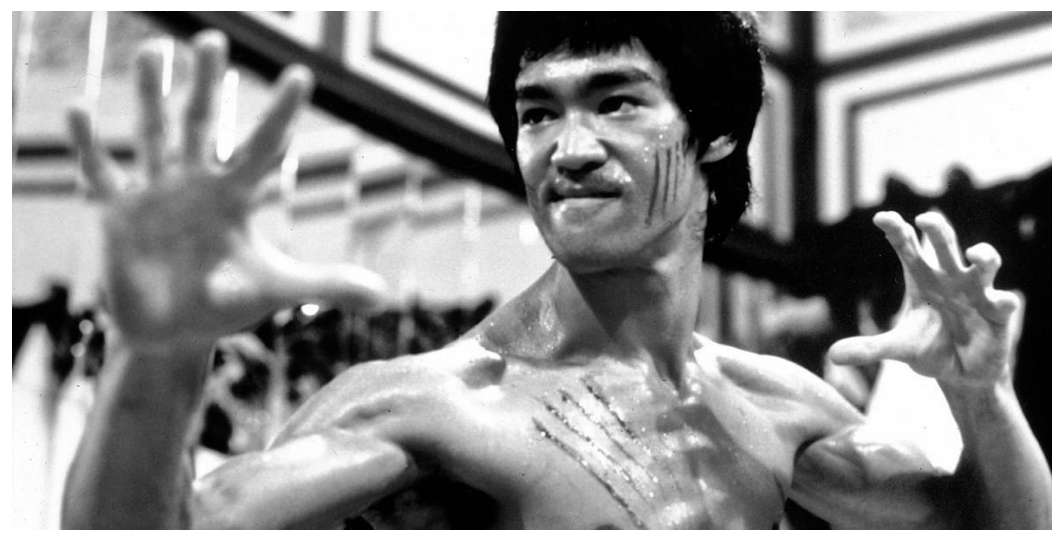
Recently, we put that process into practice for a prominent Nephrology group in middle Tennessee. ***Nephrology Associates*** was hoping to improve the terms of its equity loan used to finance a joint venture with Fresenius. The group already had solid financing with its local lender and wanted to keep some business with that bank. The doctors asked if CMAC could apply the same RFP process we use for real estate debt to their equity loan: pre-underwriting the credit; custom crafting a loan structure; explaining the request to a dozen or more of the most likely lenders; and negotiating all the terms to the doctors' best advantage.

Our team decided to accept the challenge, and the results speak for themselves. We secured a loan proposal which improved the group's annual cash flows by over $500,000, reduced individual personal liability of the physician-owners by 25%, and lowered the interest rate by 75 basis points (0.75%). While the incumbent lender was disappointed to lose the equity loan from its balance sheet (nothing a good bottle of smooth Tennessee Whiskey between two old colleagues couldn't ease), they were pleased to retain the operating accounts of the practice.

We faced a different kind of challenge with ***First Settlement Orthopedics*** of southeast Ohio. The doctors held shares of a surgery center individually but wanted to transfer that ownership to the practice for tax-advantage purposes. To complicate the challenge, the practice wanted to secure financing that would cover the entire cost of the share purchase with no personal liability to the doctors. On top of it all, this needed to be completed by year end to avoid tax consequences for the group.

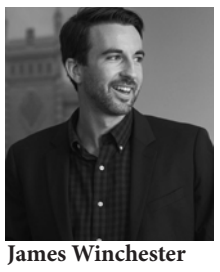
It was a tricky request, and one we knew banks would be reluctant to entertain. After all, 100% of the loan proceeds would go into the doctors' pockets while the practice (the borrower) went into debt. But we felt confident that by applying our expertise and market knowledge, we could get the job done quickly. And indeed, on December 30, we closed on ten-year financing with a rate just over 3% and no personal guarantees.

In an ever-changing market, CMAC is continually adapting its competencies to expertly provide the services clients need today and take on the challenges of tomorrow.



The Three Key Elements of an Operating Agreement

For a Physician-Owned Real Estate Portfolio (As Seen Through the Eyes of a British Bachelor)



James Winchester
Principal

As a ~~failed~~ repurposed engineer, I like to consider complex problems either as open-loop or closed-loop systems. Obviously, this makes me eminently qualified to opine on what it takes to create a proper operating agreement, right? What do you mean, you don't see the connection? Well, let me elaborate...

If you're not familiar with open-loop and closed-loop systems, consider a saucepan simmering on a stove. When you remove the lid, it becomes an open-loop system where mass and energy can escape in the form of steam. When you replace the lid, it becomes a closed-loop system, where all the steam and heat stay inside the pan. (Are you starting to understand why I'm still single?)

What on earth has this got to do with real estate operating agreements, you ask? Well, humor me a moment while I stretch this comparison even further. Most physician groups who own their real estate will unknowingly participate in an open-loop system. Just like steam won't stay in an open saucepan, partners aren't going to stay put throughout the life of the investment. Instead, some will retire and others will join the practice to replace them.

Of course, a real estate operating agreement is a little more complicated than a saucepan. So let's look at a more apt example, using every American's pride and joy: the automobile. (You guys really do love cars. ESPECIALLY big ones.)

Cars are also open-loop systems, but they're much more complicated. Air and fuel enter the system through intakes and create combustion. Combustion drives pistons that, in turn, create torque. The byproduct of that combustion is filtered and cleaned before leaving the system. Are you seeing the link yet? The similarities are clearly undeniable.

The three key economic elements of the real estate operating agreement are similar to those of a car's open-loop system:

1. Air and Fuel Intakes – Affordable and Attractive New Partner Buy-ins

A car isn't going to move without fuel and air creating combustion. So how do we move our real estate engine? By creating a sustainable mechanism – the operating agreement – that allows shareholders into the real estate investment partnership.

To make sure this mechanism is successful, you need to create a structure that is both AFFORDABLE and ATTRACTIVE to new shareholders. Without new practice partners entering the investment, the practice starts to stall, potentially even coming to a standstill.

Many real estate operating agreements are uncommunicative about how and when new partners should enter. That's why a more thoughtful and forward-looking methodology allows for a steady intake of new shareholders throughout the life of the investment. And just like different types of fuel work best for different cars, it may take some testing and fine-tuning to get the right combination of affordability and attractiveness to appeal to new partners.

2. Throttle – Valuation Methodology

The harder you put your foot down, the faster the car goes. (Unless you're driving the Fiat Punto I was when I passed my driver's test. That "washing machine of a car" barely made it out of second gear.)

Using a lever to consistently control a car's speed makes it easy for the average (non-Floridian) driver to effectively navigate from place to place. But when you look at real estate operating agreements, it's easy to see the issue: Too many have had their "throttle" removed. With no basis for measuring the investment, it is difficult to tell "how fast" the real estate investment is going.

Most agreements stipulate that the building should be valued at "fair market value," or FMV. But depending on the calculation method used, that value can change significantly. When a practice relies on an outside party to determine how much their real estate is worth, are they truly in control?

There are other valuation methods that may be utilized, and many groups are now opting for these alternatives. For example, some practices predetermine their real estate value based on the value created by their leases. In doing so, they strike the right balance when they're "putting their foot on the gas," making buyouts manageable and creating an attractive return for the existing owners.

3. Exhaust – Forecast and Manage Buyouts

Thirty years ago, the conversation about curbing vehicle emissions was just getting started; it wasn't until 1990 that the Federal Clean Air Act was amended in an effort to greatly reduce air pollution. Part of the problem was that, back when cars were popularized, we understood very little about the environmental implications. It took companies a long time to seek out sustainable alternatives, such as the electric vehicle.

Likewise, it's taken a long time for operating agreements to develop sustainable mechanisms for buying out physicians. Twenty years ago, it was more common for operating agreements to be silent or unclear on the methodology for buying out retired partners. The few methods that were in place generally didn't use appropriate modeling, making them unsustainable over the long term. The implications of this are significant; it becomes a Pandora's Box that, once opened, or executed, is hard to close, or fix.

Nowadays, the exhaust is generally the most expensive part of the car. Its most important component is the catalytic converter, which reacts with pollutants to convert them into less harmful gasses. When you look at an operating agreement, the partner succession model is our version of a catalytic converter: it allows groups to forecast and manage physician buyouts such that the real estate entity is properly capitalized to sustain those obligations. Without it, the entity is likely to cause more harm to the practice than good!

It takes an experienced engineer to design a modern, reliable, and sustainable vehicle that reflects all the evolutions that have occurred. Likewise, it takes a specialized team – with knowledge of the nuances, challenges, and evolution of real estate financing – to craft a real estate operating agreement that can serve your practice for the long term. If you're looking for a specialist to help your practice, get in touch with CMAC at solutions@cmacpartners.com.

Physicians Optimizing Real Estate Outcomes

CPOMP 2023 Annual Meeting – Limited Availability!

The Congress of Physician-Owned Medical Properties (CPOMP) will convene for its 6th Annual Meeting November 2-4, 2023 at the Ponte Vedra Inn & Club near Jacksonville, FL.

Join physician-owners and C-level executives from independent medical groups around the country to discuss the optimization of Members' physician-owned medical real estate. Register at CPOMP.org.

NEW! Peer-to-Peer Discussion Forum

A new initiative that further enhances exclusive networking for CPOMP Members includes:

- Private online forum for CPOMP Members only
- Discussions focused exclusively on physician-owned medical real estate
- Filters to send your question to a specific group of physicians or executives

Find how to access this platform and other initiatives at www.CPOMP.org.

Maintaining Practice Glue in a Sale-Leaseback

Greg Warren
Managing Partner

Sale-leasebacks can be beneficial under the right conditions, but they can also unknowingly bring pitfalls.

What many practices don't realize is that, in a typical sale-leaseback structure, the doctors who remain in the practice during the term of the new lease realize disproportional benefits than the doctors who retire during the term. And, the sooner a doctor retires, the more they benefit. The real estate, which once helped unify the practice, instead becomes a divisive force that incentivizes early retirement and damages the practice's long-term productivity and revenue.

Fortunately, there are methods of executing your sale-leaseback AND creating equitable benefits, encouraging continued partner participation in the practice. To learn how, you first need to understand how the inequity occurs.

In a sale-leaseback with a triple-net lease, the selling partners receive a multiple of the annual rent to be paid. The multiple is determined by several factors, but generally, it is the rent income produced over the term of the lease.

Let's look at a basic example of a sale-leaseback deal:

- A 10-doctor practice agrees to pay annual rent starting at $2MM, with annual escalations of 2% for 12 years, totaling $26.8MM over the lease term.
- The buyer agrees to pay 16 times the starting rent to the sellers. That amounts to $32MM, a cap rate of 6.25.
- There is $14.8MM of debt to be paid off, leaving $12MM in income after the $26.8MM rent payments. Each of the doctors receives their 10% portion, or $1.2MM each.

Assuming all the partners remain in the practice, each one will be responsible for paying 10% of the $26.8MM total rent payments, or $2.68MM each. That's not, however, what happens in the real world. Rather than having all partners remain for the term of the loan, some doctors will naturally retire and be replaced by newcomers joining the practice.

Imagine two of the doctors retire one year after the real estate sale, another after two years, and another after the third year. With each retirement, the remaining doctors will be left to pick up the retired doctors' shares of the rent obligation.

This situation causes inequity because the **remaining doctors will pay more in rent to get the same benefit as those who paid less.** The sooner a doctor retires after a sale-leaseback, the more they profit.

Let's look at the outcomes:

Dr.	Rent Paid	% of Rent Paid
1	$200,000	0.75%
2	$200,000	0.75%
3	$455,000	1.70%
4	$752,257	2.80%
5	$4,202,820	15.67%
6	$4,202,820	15.67%
7	$4,202,820	15.67%
8	$4,202,820	15.67%
9	$4,202,820	15.67%
10	$4,202,820	15.67%
	$26,824,177	

While each doctor received 10% of the proceeds and should have been responsible for paying 10% of the rent obligation, it didn't turn out that way after doctors began to retire. Instead, Doctors 1 and 2 received 10% ($1.2MM) of the profits but paid only 0.75% of the rent, while the doctors who remained for the full term paid 15.67% of the rent instead of the expected 10%. The doctors who left soonest – Doctors 1 and 2 – received more than 20 times the return compared to those who stayed with the practice.

Although some of that burden will be offset by new doctors joining the practice, it will never be fully "equal." Those doctors who stayed will always pay more than those who left early. Meanwhile, the new doctors will bear the burden of escalating rent, without any compensation from the original sale.

Saving the Sale-Leaseback – The Answer

Fortunately, for groups interested in moving forward with a sale-leaseback, newly developed models are now available that can provide an equitable solution. All doctors who pay the lease can secure their fair share of the benefits.

These models can be applied to any practice, regardless of the unknown factors such as the number of new or retiring partners or the timing of retirement. These solutions will encourage doctors to continue practicing, rather than taking an early retirement.

To learn more about the models available and find out how they can benefit your practice, email our team at solutions@cmacpartners.com.

The CMAC Team would like to thank its readers and contributers. We hope this newspaper serves as a valuable resource to you and your physician-owned practice.

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