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Auckland

Assessing the feasibility of IFHC property projects - Practice Managers Programme

Saturday, 30 July 2011 Start 4:00pm Duration: 60mins Scenic Room

The Health Planner Ltd

IFHC property development feasibility

GP CME South 2011

(Image sourced from Vital Healthcare Property Trust website “Eastmed Medical Centre”. June 2011.)

Your Presenters Today

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Overview

This workshop is structured to give a high level overview and practical examples of the planning process if you are considering an IFHC or medical property development project.

Idea	What do you want to create
What	Develop and articulate high level principles of MoC
Localities	Work out who are the key players in your area
Team	Carefully select your project team
Process	Understand the planning process and project life cycle
Motivation	What drives you and your potential shareholders
Financially viable	Assess the financial feasibility of a project
Resources	What resources are available to assist you

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Idea – The foundation for a strategic business case

Start the process of developing a vision by:

- Determining **what** services you want to deliver
- Work out **how** you want to deliver those services
- Work out **where** you want to deliver those services
- Decide **out of what** you want to deliver those services

What is an IFHC

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"The development of centres will provide the physical space required to support the delivery of the Government's priority for Better, Sooner, More Convenient health care in the community and are the key physical infrastructure to enable a generational change in the health system." (Ministry of Health, 2010).

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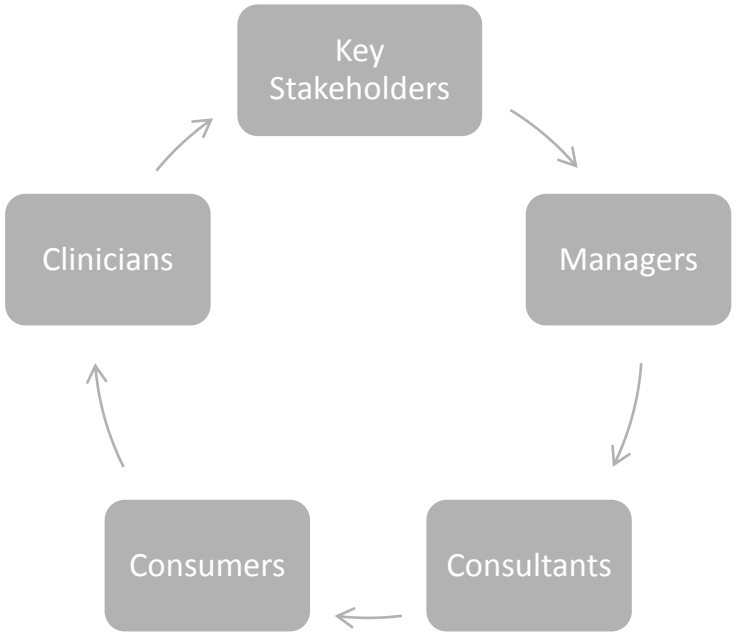
Understand your local environment

- Strategic intent of the DHB
- Who are the key players in your area
- What are other primary care practices planning in the area
- Do you have GPs with specialist interests in your area
- Strategic alliances
- What building stock is available and at what cost

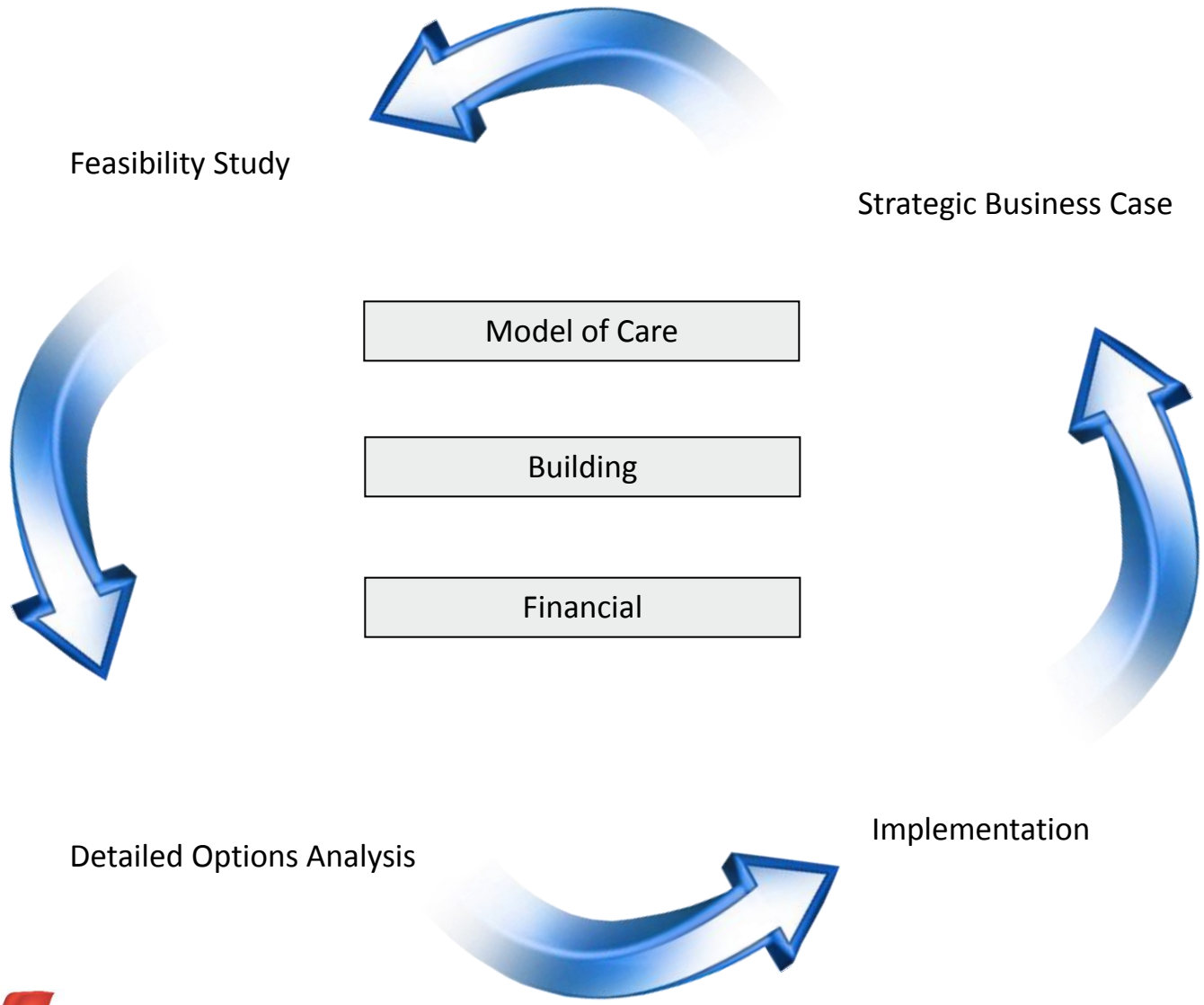
Project Team

Core Team

- Carefully select and hand pick your team
- The team should include key stakeholders
- Small and diverse
- Expand to take on new temporary members as required
- Team members attributes



The project life cycle



Project milestones / considerations

Project Phase	Strategic	Feasibility	Detailed Options Analysis	Implementation
Model of Care	•MoC priorities and outcomes •Scope of services current and estimate future demand •Population served and demographics •Workforce availability •IT options / potentials •Developing strategic alliances	• Define MoC •Determine volumes and explore funding channels •Workforce – roles / supply for both clinical / practice •IT options / restrictions •SWOT / risk analysis •High level business case	•Finalise the MoC •Finalise volume and revenue streams •Establish measurable outcomes linked to assumptions in business plan and financial model •Assess sensitivities •Finalise business case including projected capex and opex •Appoint a clinical project manager	•Corporate / clinical governance in place •Project build team •Design, commissioning and decanting plan •Communication strategy •Marketing plan •Engage and train personnel •Full equipment schedules •Finalise costs

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Building	•Schedule of accommodation - determine space requirements •Explore possible integration with other providers •Property options •Market •Identify key consultants	•Identify range of property options •Stock take of existing facilities and their potential for reuse •Architect - prelim plans / specs •Clinical design consultant •Tenancy mix and lease profile •Preliminary QS review eg cost; compliance; practical advice	•Commence the design process •Apply for council consent and contributions •Agreement to lease in principle from tenants •Detailed QS costing including professional fees •Select preferred site and secure land or building (eg RoR)	•Finalise design •Resource and building consent application •RFP / Tender construction •Appoint a building project manager •Construction contract details – fixed price preferable •Formal leases signed •Terms of property settlement

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Building	•Schedule of accommodation - determine space requirements •Explore possible integration with other providers •Property options •Market	•Identify range of property options •Stock take of existing facilities and their potential for reuse •Architect - prelim plans / specs •Clinical design consultant •Provider mix and lease profile •Preliminary QS review eg cost; compliance; practical advice	•Commence the design process •Apply for council consent and contributions •Agreement to lease in principle from tenants •Detailed QS costing including professional fees •Chose preferred site and secure land or building	•Finalise design •Resource and building consent obtained •Lead contractor appointed on fixed price •Appoint a building project manager •Construction contract – fixed price •Binding lease from tenants •Property settlement
Financial	•Ownership options •Separate practice and property •Estimate total project cost •Lease review - $ sqm / demand •Estimate value vs total cost •Identify revenue streams •Identify sources of capital •Decide practice return required •Evaluate future property value and property cashflows	•Cost / revenue assumptions MOC •Capital structure •Prepare PL and BS forecasts & timeline for practice and property •Estimate cost vs value •Compare lease vs debt servicing •Assess impact on practice profitability	•Finetune financial model for practice using operational assumptions •Update property financial model •What is the MRA – maximum reasonable adversity •Run MRA scenarios for property and practice •Seek indicative / conditional bank funding	•Develop financial model for practice using operational assumptions •Propco financial feasibility •Negotiate contracts •Tenders for project partners •Formal bank approval and loan facilities established •Start writing cheques!

Motivation

- What return are you looking for on your investment in this project?
- How much risk are you taking on, and what is the appropriate return?

Increase the value of my practice

Make my practice easier to sell

Increase the profits from my practice

- Retain and grow patients
- Create economy of scale
- Create referral networks

- Better Sooner More Convenient healthcare
- Improve services for patients
- Clinical networks
- Professional development

- Profit on the property upon completion
- An attractive income stream e.g. return on investment
- A capital gain on sale

Financial Snapshot

How do you decide if a property development project will be financially viable ?

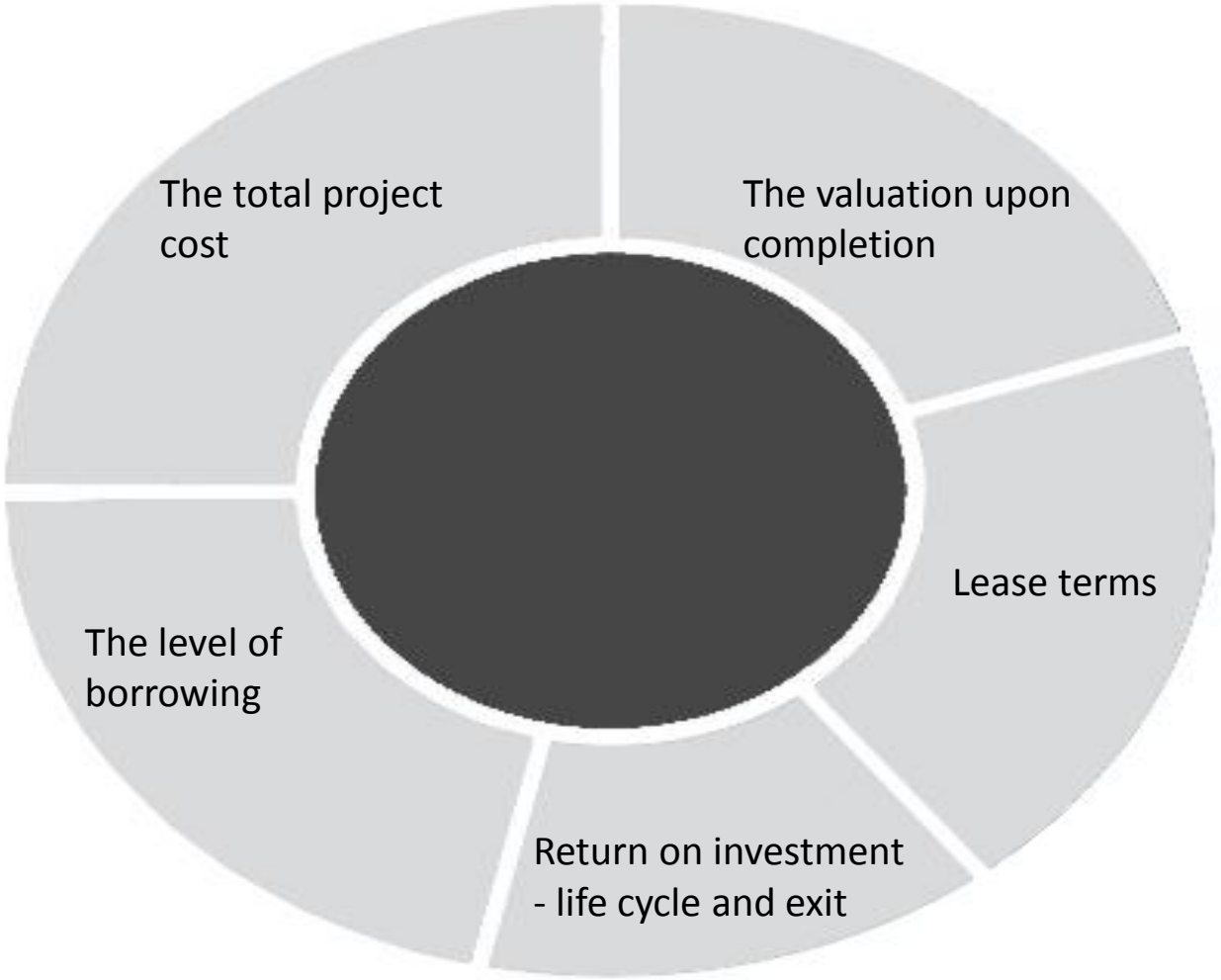
Financial Scorecard

- The property is valued at more than Total Project Cost to reward investors for the risk
- The property is fully leased on market terms with scope for future uplift in value
- The lease income can comfortably service the borrowing
- The annual cash surplus is sufficient to meet shareholder dividend expectations
- The level of borrowing allows for future revaluation / devaluation or future capital requirements
- The property could be sold easily at a profit

Financial Scorecard – Medical

- As an owner occupier, the practice profitability compensates for lack of profit on the development
- As an owner occupier, the shares in the practice increase in value or liquidity

Financial Feasibility



Total Project Cost - Budget

A quantity surveyor ("QS") is the best source of advice for estimating total project cost.

Land
- Acquisition cost, legal, real estate, valuation, holding costs
- Market rates

Contingency
5% to 10% of construction cost

Council fees
Resource consent, building consent, development contributions

Construction
- Siteworks, carparking, base build, hard fitout, soft fitout
- Market rates

Professional fees
- Architect, health planners, engineers, traffic management, design consultant, QS, project manager, legal, finance

Capitalised interest
6 to 18 months build time

Total Project Cost - Examples

Building Cost per SQM	Auck	Wgtn	Chch	Dun
Group practice surgery.	$1800-$2000	$1750-$1950	$1725-1925	$1650-1850
Private hospital. 40 bed. Ex-aircon. Op Theatre.	$2700-$3000	$2600-$2900	$2650-2950	$2600-2900

Source: Rawlinsons QS Construction Handbook 2010

Case Study Scenarios	Low rent 65% LVR ($000)	100% debt ($000)	High rent 65% LVR ($000)
Land (2,400 sqm) *Per sqm*	$1,085 $452 per sqm	$1,085 $452 per sqm	$960 $400 per sqm
Construction (750smq floor plan) *Per sqm*	$1,725 *$2,300 per sqm*	$1,725 *$2,300 per sqm*	$1,500 *2,000 per sqm*
Professional	$225	$225	$225
Council (10% of land)	$109	$109	$96
Contingency (10% of cost)	$173	$173	$150
Capitalised Interest	$75	$120	$86
Total Project Cost	**$3,391**	**$3,436**	**$3,017**

Lease Considerations

The lease terms have a major impact on valuation and project feasibility so consult a registered valuer or leasing specialist for advice on current market rentals.

Rental Income

- Per sqm rates depend on location, demand, building quality, tenant feasibility
- Ensure that lease assumptions are at market
- Property management / maintenance / occupancy costs
- Carparks included?
- Common areas included for all tenants

Tenancy Mix

- The clinical model of care critical to create demand from tenants
- Referral tenancy rates often higher eg pharmacy, pathology, specialist , radiology

Basic Lease Considerations

- Use the latest Auckland District Law Society Format
- Term should be for at least 5 years
- Termination clauses - related party leases
- Assignment

Valuation

The value of a commercial property will generally be determined by how much investors will pay for the quality of the future lease income, and the potential for capital gain.

Capitalisation of Earnings or "Cap Rate"

- What the market has paid for similar income streams / properties
- A low cap rate indicates low risk, higher demand and higher value
- A higher cap rate indicates more risk, less demand, and lower value

- Medical property valued at approx 7.5% - 8.5% capitalisation rate

Case Study Scenarios	Low rent 65% LVR ($000)	100% debt ($000)	High rent 65% LVR ($000)
Lease Income (750 sqm) *Per sqm*	$280 *$373 per sqm*	$321 *$428 per sqm*	$321 *$428 per sqm*
Capitalisation Rate	8.5%	9.0%	*8.5%*
Valuation Upon Completion	**$3,291**	**$3,567**	**$3,776**
Total Project Cost	**$3,391**	**$3,436**	**$3,017**
Profit	**-(100)**	**+130**	**+760**

Valuation

Cap Rate Influencers

Market forces and **economic conditions**
will dictate required returns for investors e.g. surplus commercial space (supply), tenancy default risk

Recent **sale prices / yields** of comparable properties

Lease terms
longer term with regular rent reviews increases value

Quality of tenant
government, blue chip, medical are stable, low risk tenancies

At market
above market rental dilutes future capital gain so value is lower

Location, building condition

Below market
depending on lease expiry can increase or decrease value

Level of Borrowing

The level of gearing impacts the risk and investment profile of the project

Vested interest
Gain share / pain share: Do shareholders have skin in the game?

Fluctuating property values, construction costs or future investment
Is there a safety net to protect against shifting asset values and potential changes in shareholder circumstances?

Volatility of interest rates
High gearing magnifies interest rate increases

How do you subsidise shortfall in market lease?
- Are equity top ups tax efficient?
- Can all shareholders meet their obligations?

The impact of creditor disputes and meeting solvency test
- Does your property company pass the solvency test?
- Think about legal costs in resolving disputes

Liquidity - the impact on selling the property or shares in the property
A property company with a lease that services its debt can provide more options if you need to sell e.g. better liquidity

Which scenario “goes round all day long”?

Case Study Scenarios	Low rent 65% LVR ($000)	100% debt ($000)	High rent 65% LVR ($000)
Total Project Cost	$3,391	$3,436	$3,017
Valuation Upon Completion	$3,291 (8.5% CR)	$3,567 (9.0% CR)	$3,776 (8.5% CR)
Development Profit	**-(100)**	**+130 (4%)**	**+760 (25%)**
Equity	**$1,252 (35% value)**	**$0**	**$562 (35% value)**
Lease Income (750 sqm)	$280	$321	$321
Debt servicing	$150	$464	$172
Net cashflow	**$91**	**-($167)**	**$104**
5 year cashflow	$398	-($807)	$456
5 year gain on revaluation / sale	$171	$424	$1,071
Total return	**$569**	**-($382)**	**$1,527**
5 year Return on Investment	17%	-(11%)	51%
Annual Return on Investment	**3%**	**-(2%)**	**10%**

Resources

- MOH: IFHC feasibility funding – Up to $30k
- MOH: feasibility funding for GP “amalgamation” – up to $20k
- MoH Implementation Support Groups (ISG)
  - Tuia Synergia
  - Midland Tripartite
  - Sapere
  - Cranleigh Health
- DHB
- PHO
- Regional Networks
- GPSI and NSI
- Primary and secondary colleagues
- Your project team
- Anybody who has done this before
- The Consultants - Architects, Health Planners, Project Managers, QS, Bank
- Everybody who works in your facility – the frame and lenses are different