

# Office Space Planning and Design for Medical Practices, Part 4: Development Issues

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**T**he decision to build anew or remodel/add-on to your existing facility has been a tough one. After that decision was reached, the implementation of design and construction presented many difficult hurdles on the road to achieving a functional office space in a cost-effective manner.

*This article will continue to explore just how a practice proceeds with some of the further details of the implementation process.*

**Key words:** Medical practice facilities; building new medical practice facilities; remodeling medical practice facilities; planning medical practice facilities.

**Editor's Note:** In this issue, we present the last of four articles that describe the process of evaluating space needs, planning and construction for medical offices (see Volume 18: Page 244–249; Volume 18: Page 299–303; Volume 19: Page 19–26). While some readers may not currently be contemplating remodeling or new construction for their practices, we believe the points described will be of value for understanding the intricacies of the process. (Parenthetically, they are useful as a background even for home improvements!)

## INTRODUCTION

In the final article of this series, a few concepts that will surround your development need to be discussed. This includes deciding how to finance and construct your project. Reviewing the Flow Chart that has been part of each article, we are now at the end of the decision-making tree (Fig. 1).

## FINANCING

If you are merely remodeling your existing space, chances are that you will go to your local commercial bank and secure a loan to have the work performed. This loan may well be outside the mortgage you already have on the property and will just be an improvement loan. However, if you are doing major renovation and new additions to your building, it may be in your interest to acquire a new mortgage on the entire completed project.

This may also be the opportunity to renegotiate a more favorable rate in the current low-interest rate environment.

If you are building a new building, you will need a mortgage loan on the entire project. There are two types of loans that are typically done when you develop real estate.

### Mortgage Loan

The first loan is the mortgage on your property, sometimes referred to as the take-out loan. This is the loan that you pay off over time (10, 15, or 20 years perhaps) as you occupy and use your building. Your local banker can discuss with you all the various types of mortgage loans that exist, including fixed rate, adjustable rate, and fixed rate with a balloon payment.

### Construction Loan

For many projects, the money from the mortgage loan is not released until the project is actually constructed, has been inspected by the lending authority, and has been determined that the mortgage loan is ready to be closed. Although this is the lending institution's requirement, it does not necessarily meet the cash flow expectations of the contractors, subcontractors, and materials groups who

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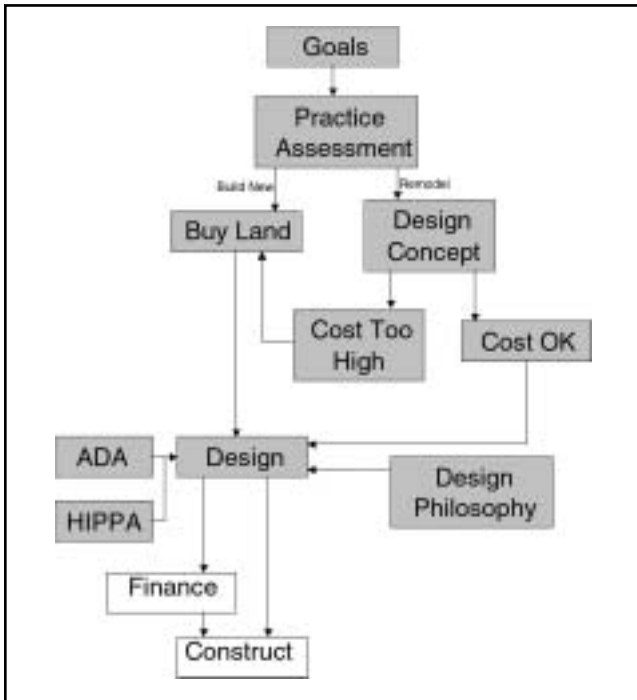


Figure 1. Flow chart of decision-making and design process.

actually build the building. To make funds available to them as they perform the work, you need another loan, a construction loan. This is the money that you use while the building is actually built.

Follow this process:

1. First, you get a mortgage loan commitment from an institution.
2. With this commitment in hand, you can then go to your bank and arrange construction financing. Because the bank knows that you have a mortgage loan ultimately behind your project, they know that the construction loan that they are giving you will be of short duration.
3. When the building is completed, you close the construction loan and activate the mortgage loan.

Some institutions will allow you to arrange a mortgage loan and then allow you to use those monies to build the building. This cuts out the need for a construction loan and can save you some financing dollars as you construct a building. This needs to be discussed with your local institution.

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There are several sources for long-term loans or mortgage loans. On smaller projects, the most common financing source is a local bank. It is very common for an owner to meet with several local banks to receive quotes for

providing the long-term mortgage. One of the assets that the practice has that can influence its leverage with the local banks is its own practice account. Often, doctors willing to move their practice account to the bank that gives them their mortgage loan will help “sweeten the deal” for the local bank to be more aggressive in its terms.

Another source of mortgage money is from institutions. Typically, these are insurance companies that have allocated a certain part of their investment portfolio to financing medical office buildings. It is not unusual for such an insurance company to define the particular characteristics of the types of loans that they wish to place. This could be financing buildings between a quarter of a million and three-quarters of a million dollars, or only over five million dollars or some other financial limit. They may also be looking for particular types of groups, such as multi-specialty or single-specialty groups. Typically, these loans are arranged through a mortgage broker.

There are also several governmental programs that may assist with financing. Typically, the money actually flows from a local bank, but the government program can result in preferential rates. The most common program consists of loans backed by the Small Business Administration. Discuss with your local mortgage broker or your local banker what types of governmental programs are available in your area.

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Another type of financing is a bond. Typically these are used on multi-million dollar projects. The bonds have to be underwritten and sold for you to develop your mortgage financing. The initial underwriting of the bonds can be an expensive process, so it is important to get appropriate legal and accounting advice.

## CONSTRUCTION

The entire reality of your project can be summed up in a relationship between three variables: quality, quantity, and cost. This is illustrated in Figure 2. As the owner, you and your team of professionals can control two of these elements; the third will float in the marketplace. For instance, if you must have 5,000 square feet (quantity) and you want a particular quality of space, then the contractor (the marketplace) will tell you what the cost will be. On the other hand, if you have a budget of \$500,000 and you have a particular quality expectation, the marketplace will determine whether you get 5,000 square foot of space or 8,000 square foot of space.

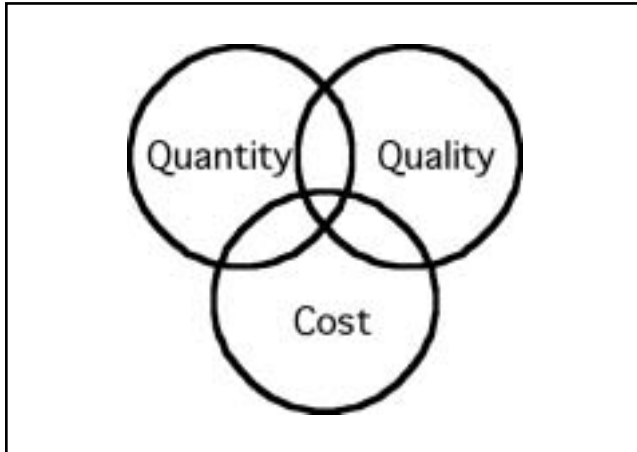


Figure 2.

Given this set of relationships, it is important to understand who on the development team influences which variable.

### Quantity

Typically, the owner controls the quantity of space that is needed. He or she may decide that three more exam rooms and ten more chairs in the waiting room are needed. This establishes the quantity of space that is being built.

### Quality

Often, the architect determines the quality of the space. This is not just in its appearance, but also in the sophistication of the infrastructure behind the appearance. For instance, the architect will determine which walls get soundproofed and whether the sheetrock on the wall is  $\frac{1}{2}$ " or  $\frac{3}{4}$ " thick.

### Cost

Typically, the contractor and his or her subcontractors and material groups will define the cost of the project based on the owner's quantity and the architect's quality.

With an understanding of these variables and issues, let us look at the different delivery processes that are used to develop medical office space.

## CONSTRUCTION OPTION 1: DESIGN-BID-BUILD

This is the most common way that projects are delivered in the United States. Based on the owner's requirements, the architect designs the space. When the construction documents are completed, a price is secured from a contractor (either through bidding or negotiation). Then the project is built. The diagram shown in Figure 3 illustrates the implications of this project delivery method with the quality, quantity, and cost issues raised above.

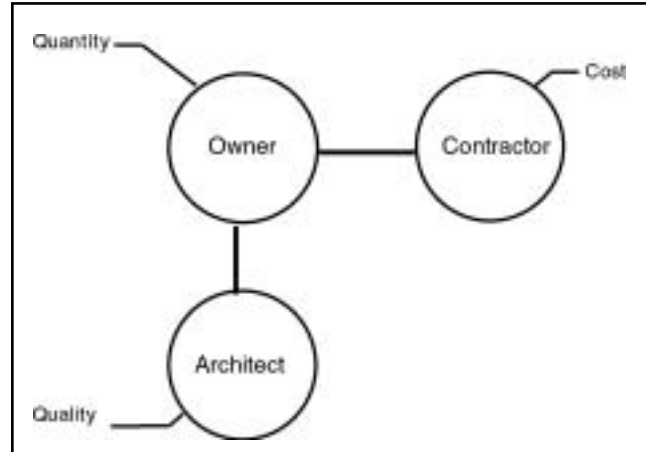


Figure 3.

The advantages of this approach are that you as the owner get actually what you want and there are checks and balances in the system to make sure you are getting what your paying for. For instance, the construction documents that the architect develops for you (under the owner-architect contract) are the primary documents that form the backbone of the owner-contractor relationship. The contractor builds the work described by the architect's documents, and the architect reviews the contractor's work for conformity with those documents. This is all tied together with the price the contractor has agreed to as part of the scope.

The disadvantage to this approach is that the owner does not find out the market value of his or her project until the architect has completed approximately 75–80% of his or her work. This means that those architectural fees are at risk should the project be abandoned for any reason, including the price coming in beyond what the owner can tolerate.

In this process, it is very common for the architect and the contractor to sit down together to define ways to save time and money on the project after the initial price is received from the contractor. This is done whether the project came in on budget or not.

There are two different ways that the project cost is generally developed: through competitive bidding and through negotiation.

### Competitive Bidding

In this scenario, multiple general contractors competitively bid on the project design documents. On public projects, this is often an open bidding in which any licensed contractor who wishes to submit a price is allowed to do so. On private projects, it most commonly is a pre-qualified bidding in which you select three or more contractors, any one of which you would be happy to have build a building. Each of those contractors is requested to provide a competitive bid. In a private bidding, if your

documents properly describe it, you are allowed to accept whatever bidder you wish, regardless of the submitted price. Typically, in public bidding, you are required to take the lowest bid submitted.

The advantage of competitive bidding is multifaceted. If there are several “equal” contractors in your town, by allowing them all to bid, you do not alienate any particular one by keeping them from the process. Typically, in competitive bidding, you get the lowest price for the work described in the documents. It is important if you go through a competitive bidding process that you have a high-quality, comprehensive set of bidding documents. The objective is to describe the project in as much detail as possible to decrease the opportunities for the contractors to request changes later for elements that are not adequately described.

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The disadvantage of competitive bidding is that you get a price from a contractor for a scope. Because the contractor had to put that price together in a competitive atmosphere, he or she may feel entitled to additional compensation for any change that you request. Again, the more complete your bidding and construction documents are, the less opportunity the contractor has to do this.

## Negotiation

The other approach aside from competitive bidding is negotiation. In this particular situation, you select the general contractor with whom you wish to work. You identify this early (if you are doing this, it is advantageous to have them involved with the architect early on in the project). You request that the general contractor administer your project in your interest. You are assured of the quality and reputation that that contractor brings to the project. At the same time, you can request that that contractor receive competitive bids from his subcontractors and materials groups to help control cost and keep them down as much as possible.

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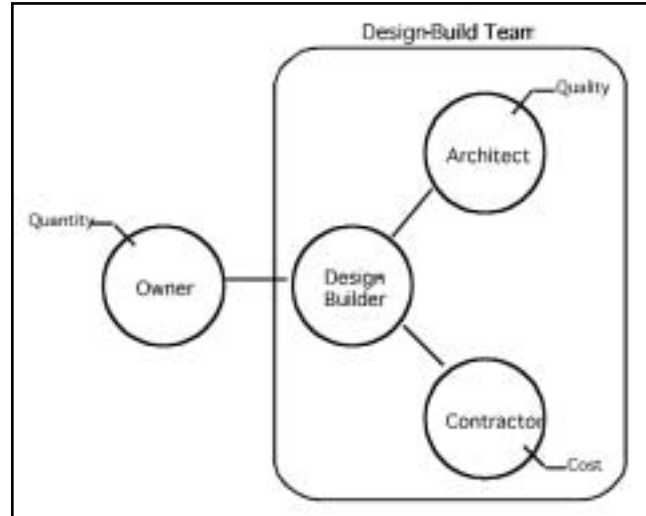


Figure 4.

higher quality of product. The process can be smoother with less acrimony.

The disadvantage of negotiating is that the cost tends to run a little bit higher than it would for a competitively bid job, and you do not get a true reading in the marketplace of the value of your project.

Regardless, either approach can get you a fine result at an appropriate price. The direction you choose is typically a function of the quality of contractors in your locality and your comfort level of one delivery approach versus another.

## CONSTRUCTION OPTION 2: DESIGN-BUILD

In this situation, you as the owner have an agreement with a single company who promises to design and build your project. The architect and the contractor both work for the design-builder (Fig. 4).

With this form of project delivery the owner still makes the decisions on quantity. The architect still makes the quality decisions, and the contractor makes the cost decisions. In this case, however, both the architect and contractor work for the design-builder.

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The advantage of the design-build approach is that it gives the owner one point of contact to the development team: the design-builder. Any disagreements between the architect and the contractor do not come through to the owner but are resolved at the design-builder level. Another advantage of this approach is that frequently the

design-builder will give the owner a guaranteed price early in the project.

The disadvantage of the design-build approach is that the early guaranteed price is often based on preliminary design documents; the relationship between scope and cost is ill defined. The owner accountability on the design-builder is not as comprehensive as it is in the design-bid-build process in which a complete set of contract documents has been prepared.

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Another disadvantage of design-build is that there is no true marketplace test for the value of the project. The design-builder has promised to deliver the building at a certain price. However, the design-builder's team develops the quality and cost of the project is independent of the owner or the owner's team. The savings that accrue to the design-builder do not necessarily flow through to the owner.

## **CONCLUSION**

With this series of articles you have now learned:

- How to assess your needs.
- How to assess your productivity potential.

- How to size the implications of your needs.
- How to determine whether to remodel and expand or build new.
- The design process for your project.
- Financing options for your project.
- Construction delivery methods.

Taking these issues in sequence, answering each question before proceeding to the next will allow you a smooth development process with the least amount of redundancy and the least risk of pursuing a project that will not come to fruition. Ultimately you may spend a year or two going through all these steps.

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However, when properly done, you will be able to enjoy the results of this endeavor for many years. In response to a comment that "it costs just as much to build a bad facility as it does to build a good one," a practice manager responded "Oh no! It is much more expensive to build a bad office." Of course, she was referring to the operational realities of a bad office compared to that of a good one. Economics aside, there is also an issue of quality of practice life. In the final analysis, you will spend many hours in your office. It should be an enjoyable place to work, not only for you but also for your staff. ■