PART FOUR IN A SERIES

Financial feasibility for dental buildings

Under or over capitalising can make or break you

By Genna Levitch, BDS

The big question is what is your project going to cost and what can your practice afford to support?

In the last issue, we discussed the process known as the Architectural Feasibility Study. We looked at how council regulations affect the possible size and shape of the building and how to establish the regulation 'envelope' in which the building can evolve.

Having established that the land is in a suitable location, is large enough to take a dental building and its parking requirements, what can you afford to pay? For the land, the building, the internal fit-out and related equipment?

Let's break the project down to its component parts to simplify the process. To begin with, put the dental fit-out and equipment to one side, put on a developers hat and ask yourself: " What could I afford to spend if I was building commercial premises to rent to any professional?"

When a developer is building commercial premises, he includes in his budget the land purchase, the building 'shell' plus air-conditioning, ceiling, lighting, minimum toilets, landscaping, parking and common areas. It is up to the tenant to fit-out the tenancy to suit the business's needs.

The answer to this budgetary question is your critical starting point. If you bought the land, constructed a building then rented it out so that it paid for its mortgage and made a modest profit, you would be safe. If, touch wood, something happened to you, the project would be self-supporting. Your estate would have a cash flow positive asset. On retirement, you would hope to have this debt free so it would be your superannuation.

Table 1. Sale value on a 260sqm NLA based on percentage return

% Return	$225/sqm	$250/sqm	$275/sqm	$300/sqm
PA	$58,500	$65,000	$71,500	$78,000
Cap. Return	**Value**	**Based on**	**PA/%**	
5%	$1,170,000	$1,300,000	$1,430,000	$1,560,000
6%	$975,000	$1,083,333	$1,191,667	$1,300,000
7%	$835,714	$928,571	$1,021,429	$1,114,285
8%	$731,250	$812,500	$893,750	$975,000
9%	$650,000	$722,222	$794,444	$866,666

The key then is to know what rental you would achieve. We spend a lot of time talking to commercial real estate agents all around Australia. In our experience, in country and suburban regions, new, purpose-built, well-located commercial premises can vary between $150/sqm/yr to $350+/sqm/yr. As an example, let us assume a mid-point of $225/sqm/yr. If you were building a 6-surgery practice, you would need a building with around 260sqm of Net Lettable Area (NLA). As a developer, your rental return on 260sqm at $225/sqm/yr would be $58,500pa.

The sale value of a new commercial property is directly related to its rental return. Table 1 shows how an investor calculates the value of a property.

You can see straight away how the rental return can effect the project. Not doing your homework here can be fatal. If you assume that you could get $350/sqm/yr and your property will be valued on a 5% investment return, you would give yourself a budget of $1,560,000. If, on completion the best rental you could achieve was $225/sm/yr and investors thought it was too risky unless they had a 9% return, it is worth only $650,000 and you have lost $910,000. Ouch!

In the next article in the next issue, we will look at how to take this approach further and allocate the various components of your budget.

About the author

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