NEW TO PRACTICE - PREMISES

Kent LMC

James Gransby – March 2023

Agenda

How GP property is funded

Differences between owned and leased

Q&A

Who am I?

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Topical !

GP DAILY

GPonline - 17th February 2023

Latest news, information and guidance, for life in general practice

GPs put off partnerships as borrowing costs spike, accountants warn

GPs are being put off partnerships by a sharp rise in interest rates on loans to buy into practices, specialist accountants have warned.

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Premises – The basics

- Rent is paid for by the NHS
  - If the premises is leased, it covers that cost
  - If owned by the partners then they receive the rent
- Rates are reimbursed
- Service charges on leased premises are a cost of the surgery (ie cleaning, utilities, repairs, etc)

Premises – The ‘Premises Costs Directions 2013’

- Rent and costs
- Grants
- Owned vs leased

PCD 2013 – Terminology

- Rent reimbursement (leased)
- Cost rent (old method, linked to build cost)
- Notional rent & running costs (where partner owned, review every 3 years)
- Abatement (if rent out rooms or improvement grant)

Leased premises vs owned premises

- One might think that GPs who are nervous of owning their own surgeries would prefer to lease them. Unfortunately they are often nervous of the risks of leasing premises as well!
  - Will rent reimbursement continue?
  - Could there be a gap between rent paid and rent reimbursement?
  - What if the practice fails? How long will I continue to be responsible?
  - What if I resign? Can I be removed from the lease?
  - What if I am the last man standing? (Future centrally underwritten leases?)
- These concerns are understandable, however they are the same issues facing every other independent business. GP Practices do however have a much better chance of their income continuing than other businesses. It is likely to be a long time before there are too many doctors!

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Owner Occupied Properties

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Agenda – Owner Occupied Properties

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Premises funding

Rent reimbursement and improvement grants

Premises funding

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When a surgery is either developed or rented for the first time the District Valuer, on behalf of the ICB, will establish how much of the building is to be used for NHS purposes.

In most instances that is 100% but it may be less if the building is regarded as over sized for the number of patients.

Whatever percentage is approved will then generate a proportional reimbursement of business rates and water rates.

Premises funding

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If the surgery is rented from a third party the District Valuer will assess what they believe the market rent of the building should be and approve the appropriate percentage of that sum.

In most cases that will match the rent being charged by the landlord, but there is the potential for a shortfall.

Technically this is a Rent Reimbursement, not a rent allowance, so the practice should actually pay the rent before the ICB reimburse the appropriate proportion.

In practice some ICBs are prepared to ensure that the agreed “reimbursement” gets to the practice just before they are due to actually pay the rent to assist with cash flow.

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Premises funding

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Where a surgery is owner occupied the practice will either receive funding under the Cost Rent, Cost of Borrowing or Notional Rent schemes.

Cost rent schemes are now rare and generally originated before 2004. Under that scheme the District Valuer would assess what it should cost to build a surgery of the approved size in the location. That did not mean that the surgery had to spend that much actually building the surgery.

If the DV assessed a build cost of £2m the LHA would have effectively paid interest on that sum by way of a Cost Rent payment. The rate they paid depended on the type of loan the practice took to fund the build.

If they took a variable rate loan then they would be paid variable rate cost rent which would be adjusted each quarter in line with the movement in variable interest rates.

Premises funding

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However if the surgery took out a fixed rate loan then they would be paid fixed rate cost rent which would reflect interest rates at the time the loan was taken out.

If therefore the DV agreed a notional build cost of £1m at a time when fixed cost rent rates were 12% the practice would continue to be paid £120,000 per annum until the loan was repaid.

If the practice were very careful with the build cost and managed to only spend £900,000 then they would receive more in Cost Rent than they would pay in interest.

Premises funding “Cost of borrowing”

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The Cost Rent scheme was replaced by a Cost of Borrowing option which is rarely used.

The problem is that the potential build cost is assessed and the practice funded at a rate of 1% over base, and loans at 1% over base have not in practice been seen since 2007!

Premises funding “Notional Rent”

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The scheme currently used by most owner occupiers is the Notional Rent scheme.

In many ways this works in the same way as the Market Rent Reimbursement in that the District Valuer will assess what the market rent of the building should be and approve the appropriate percentage of that sum based on agreed NHS usage.

The practice then has that guaranteed income available to them to support the cost of building the surgery. Typically covering the interest on the bank loan plus ideally part of the capital repayment.

Conceptually a GP could put their own money into the development and receive the notional rent as recompense but that rarely happens.

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Premises funding “Notional Rent”

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Both Rent Reimbursement and Notional Rent are reassessed every three years. For high quality modern surgeries those rental values are likely to increase, or at worst remain flat.

For older converted premises which are questionable when it comes to considering fitness for purposes that is less certain.

Since surveyors will typically use an investment return calculation as the basis of establishing a valuation any increase or decrease in notional rent will have a corresponding impact on the value of the surgery.

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LTV and loan structures

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GPs generally aspire to premises ownership being self funding, ideally both in terms of covering the loan interest and the bank loan repayment.

They will generally be looking for 100% LTV plus covering the arrangement fees in the loan.

Many will be looking for fixed rates, some keen to look at 25 years fixed rates, ideally with an option to break at certain points without redemption penalties.

Those looking for variable rates will be looking for rates linked to base rate.

LTV and loan structures

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GPs are not normally keen on short term (i.e. five year) loans even if they are amortised over a longer period, perhaps up to 25 years.

If they are offered 5 year rates because they are cheaper than longer term rates they will not be keen to pay another full arrangement fee at the end of five years.

Individual or practice loans?

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Historically many practices have required each GP to take out their own loan to fund their share of the equity.

The benefit of that is that they are not responsible for others loans and can be confident that once they have repaid their loan the bank have no further potential claim on them.

The downside is that the repayment terms will reflect their own individual circumstances so the term available to someone borrowing at age 50 may result in significant monthly repayments.

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Individual or practice loans?

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From the practice perspective the issue with individual loans is that saying to a prospective partner “we would like to offer you a partnership, and by the way you will need to borrow £300,000 for your share of the surgery” is not regarded as enticing.

Many practices have moved to a situation of fully financing the cost of the surgery via a practice loan. That way they can say to a prospective partner “we would like to offer you a partnership. All the partners own the surgery but there is a practice loan in place to fund it.” – rather less of a disincentive!

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Practice loans

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When GPs are considering a practice loan to cover the value of the surgery one of their key objectives is to minimise the monthly capital and interest payments.

They may therefore want a proportion on an interest only basis (maybe 50%) with the remainder on a repayment basis amortising over as long a period as possible, maybe 25 years.

Agenda – Owner Occupied Properties

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Premises funding

Rent reimbursement and improvement grants

PCD 2013 – Improvement grants

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- New build
- Extension
- Improvement

PCD 2013 – Improvement grants

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✔
Extension
Enlarging rooms
Disabled access
Car parking
Fabric (double glazing, CCTV)
Telephone systems
Specialist floor coverings
Installing a water meter

PCD 2013 – Improvement grants

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✔	✖
Extension	Cost of land
Enlarging rooms	Furniture, furnishings
Disabled access	Restoring structural damage
Car parking	Ancillary residential accom.
Fabric (double glazing, CCTV)	Separate building extension
Telephone systems	Solar power, air con, windows
Specialist floor coverings	Wear and tear
Installing a water meter	P&L items getting a tax ded'n

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Case study

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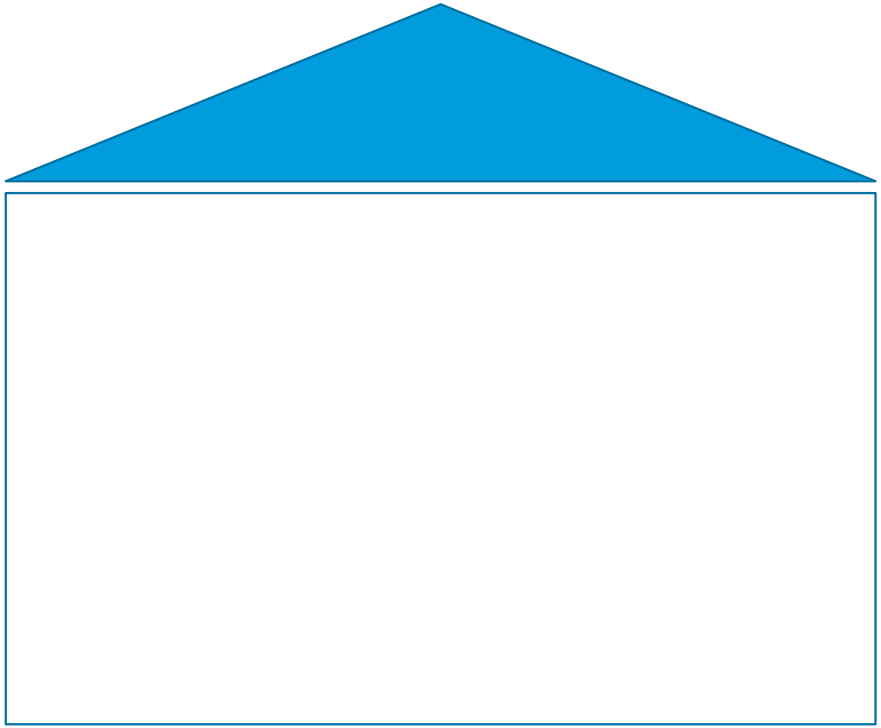

Case study

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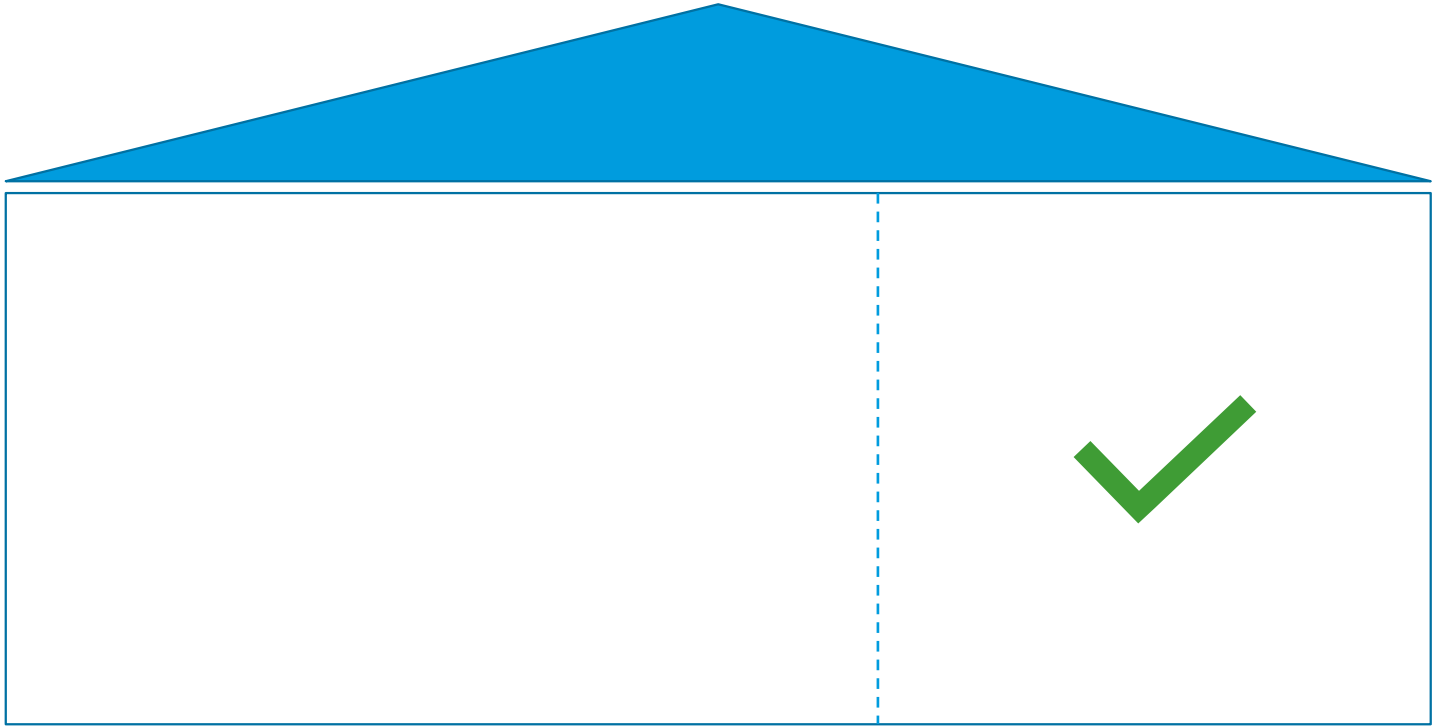

Case study

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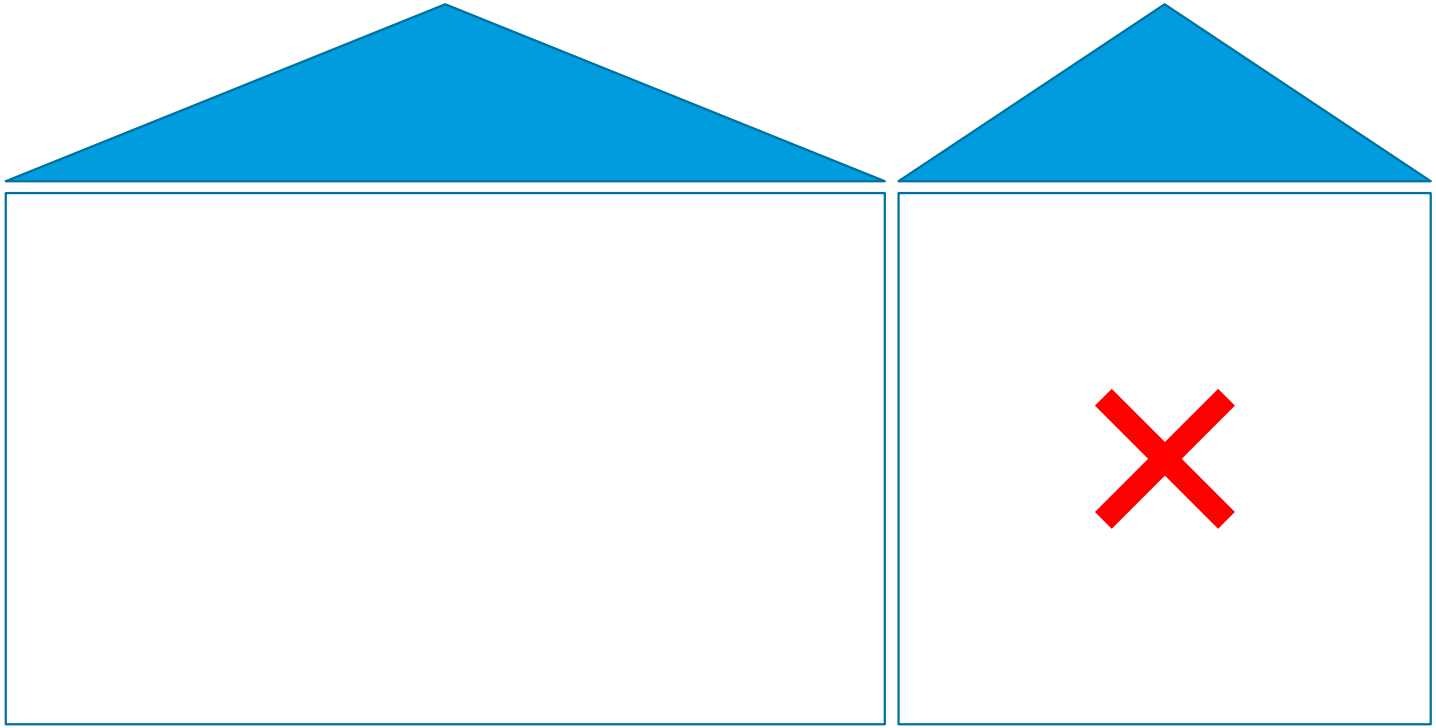

Case study

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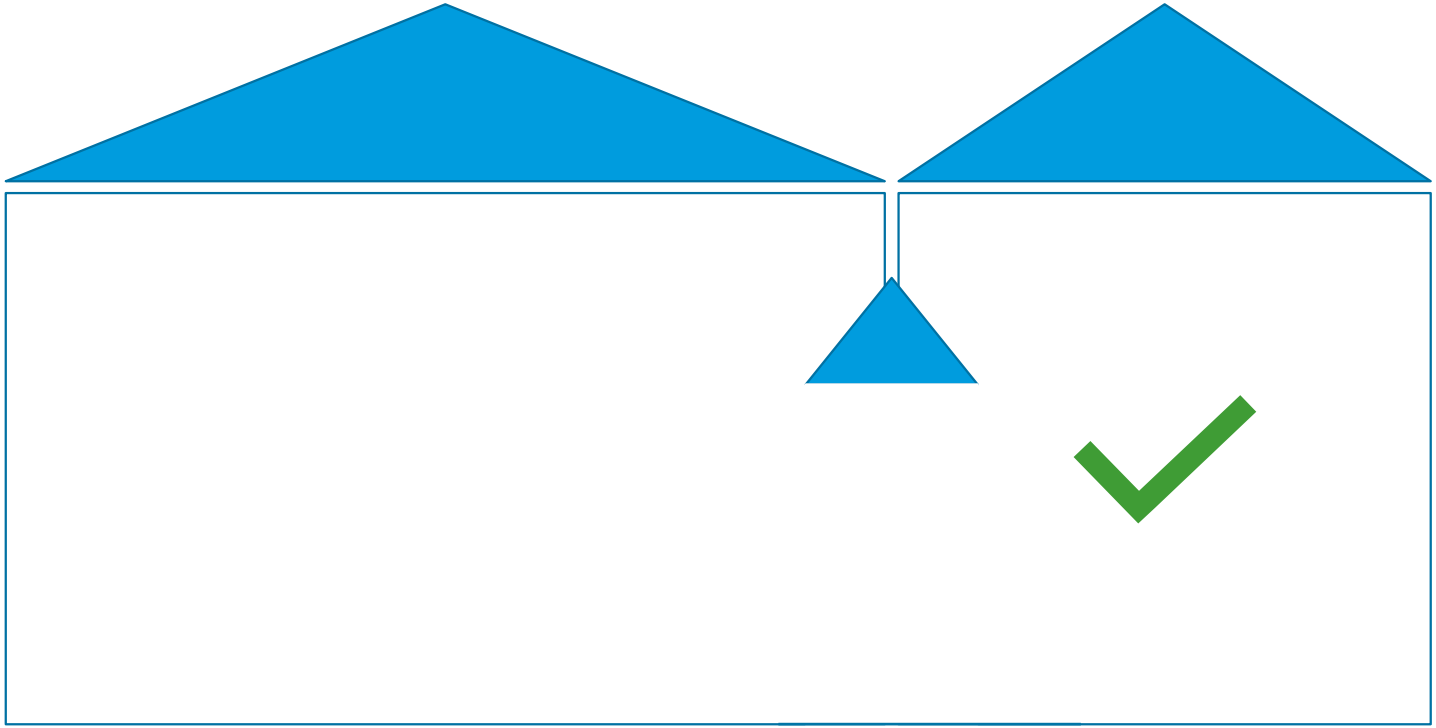

Potential changes to the NHS Premises Directions

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Amended abatement/use periods have been proposed as:

Current abatement / use period

(up to 66% funded)

Up to £100k: 5 years

£100k - £250k: 10 years

Over £250k: 15 years

New abatement / use period

(up to 100% funded)

Up to £120k: 6 years

£120k - £300k: 9 years

£300k - £550k: 12 years

£550k - £1m: 15 years

Over £1m: 18 years

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Leased properties

Agenda – Leased Properties

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Dilapidations vs repairs reserves

Service charges

Sub-letting and rent abatement

Dilapidations vs repairs reserves

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- What are they?
- What is the difference between them?
- Do we need one?

Dilapidations

dilapidation

Pronunciation /dɪlapɪˈdeɪʃ(ə)n/

1.1 (**dilapidations**) Repairs required during or at the end of a tenancy or lease.

Dilapidations

Dilapidations reserve

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- Partners put money aside each year to build up a sum of money over the period of the lease to meet the dilapidations cost when the lease ends
- Best estimate of final amount payable
- Tax relief allowed on build up if contractual (constructive obligation)
- Charged to each partner in proportion to profit %

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Dilapidations reserve – why vs why not

Why?

- To ensure no-one gets to leave the partnership without paying their fair share
- To ensure future incoming partners don't get landed with the bill

Why Not?

- If dilapidations aren't likely to be paid, ie
  - Not part of the lease terms
  - If property will be converted to residential property

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Repairs reserve

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- Build up a warchest of money ready for when repairs might be needed in future (even for new premises)
- Covered in partnership agreement
- Useful if partners are retiring and before new partners join (avoids the awkward conversation and conflicting viewpoints)

Repairs reserve

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- Discretionary amount
- Can be used towards the cost of repairs when incurred
- No tax relief until the money actually spent
- Depleted Partner Current and Capital accounts
- Not necessary if cyclical repairs undertaken anyway

Should we have one?

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- Case by case basis
- My preference is for a dilaps reserve plus cyclical repairs undertaken rather than a repairs reserve

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Dilapidations vs repairs reserves

Service charges

Sub-letting and rent abatement

Service charges

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service charge

[service charge]

NOUN

service charge *(noun)* · ***service charges*** *(plural noun)*

1. an extra charge made for serving customers in a restaurant.
2. a charge made for maintenance on a property which has been leased.

Service charges

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Big problem for those leasing an NHS Property Services (PropCo) building

Who are NHSPS?

- Established December 2011, began activity April 2013
- 2,900 properties (18% of NHS buildings)
- 7,000 tenants (over half are Trusts and GP practices)

- Roles
  - Manage estate as landlord
  - Strategic assets management
  - Facilities management

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Service charges

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How many of attendees today are in an NHSPS building?

Where does that leave us?

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Service charges in dispute

(mainly just NHSPS are main protagonists)

- Similar to dilapidations reserve:
  - Establish the amount
  - Hold back from partners based on costs accrued to date
  - Ensure held back on retirement / death
  - Avoids someone picking up the bill later
  - If charges are written off then retired partners get refunds of creditors held?

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Dilapidations vs repairs reserves

Service charges

Sub-letting and rent abatement

Renting spare space to third parties

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- Ensure permitted in the lease
- Rent received can lead to abatement (previously 10% rule)
- Charging a ‘Service fee’ leads to VAT issues, rent doesn’t
- Best of both worlds?

Summary – leased premises

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- Consider a dilapidations and / or repairs reserve
- Rent spare space correctly
- Leases are important to get right – take advice
- Use specialists who understand the NHS

Session summary

- Buildings will be owned or leased
- Either way, NHS pay the rent (at a level agreed by District Valuer)
- NHS also pay rates, but not service charges
- Check for dilapidations or repairs reserve in accounts

Thank You

Any Further Questions?

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