Medical Office Leasing Issues and Current Trends

Presentation of the Real Estate Affinity Group of the Hospitals and Health Systems Practice Group

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What Makes Medical Office Leasing Unique?

Regulatory Issues – historically have a hospital leasing to a physician
Stark Law

- Prohibits a health service provider (e.g., hospital, imaging center, cancer center) from submitting claims to Medicare/Medicaid for services rendered to a patient referred by a physician who has a financial relationship with the service provider (unless financial relationship falls within an exemption).

- Public policy rationale?
  - To discourage patient referrals for financial compensation – we want doctors making decisions based on sound professional judgment, not money

- Impact on lease transactions?
  - When a physician leases office space from a hospital, or vice versa, the lease arrangement is considered a financial arrangement triggering Stark
Stark Law (continued)

Stark Lease Exception

Lease **MUST** meet all of the following requirements:

- In writing, signed by all parties, adequately describing premises leased
- Term – not less than **one year**
- Leased premises – commercially reasonable and necessary for the legitimate business purpose
- Leased space used exclusively by tenant (allocations of common areas OK if payments for CAM are proportionate to space leased)
Rent – set in advance and consistent with *fair market value*:

- Rent charged is not based on volume or value of patient referrals, or other business generated between the parties

- FMV defined in Stark Law:

  - *Value derived in arm’s-length transaction, consistent with general market value – bona fide bargaining between well-informed, and financially unrelated, parties.*
Anti-Kickback Statute

Prohibits payment or receipt (or offer, solicitation) of any remuneration, directly or indirectly, either:

► To induce, or in exchange for, a referral of a person for services; or

► To induce, or in exchange for, the purchase of an item or service for which reimbursement is sought (in whole or in part) under a federal healthcare program (e.g., Medicare, Medicaid)
Anti-Kickback Statute (continued)

Lease transactions between service provider and referral source are subject to scrutiny unless they can sail into the leasing “safe harbor”

There are six requirements….
Anti-Kickback Statute (continued)

Six requirements for lease “safe harbor”:

1. In writing, signed by all parties
2. Lease covers all premises occupied or used, and adequately describes premises
3. If time-share, lease must specify in detail the schedule of occupancy, length of occupancy periods, and rent for each
4. Term – not less than 1 year
5. Rent is set in advance, is consistent with fair market value (arms-length deal) and not determined in a manner that takes into account value or volume of referrals (or other business generated between parties to the lease), and
6. Premises does not exceed amount of space necessary to accomplish the commercially reasonable business purpose of rental
Penalties

► Stark Law

- Civil Penalties only, but can include loss of eligibility in Medicare/Medicaid programs!

► Anti-Kickback Statute

- Civil penalties, including fines ($25,000 per infraction), loss of eligibility
- Criminal (i.e., prison)
Hospital Leasing Challenges

► Expired Leases
► Failure to enforce Operating Expenses pass-throughs
► Failure to implement annual rent increases required by lease terms
► Providing tenant services not discussed in the lease (i.e., red bag service)
► Space occupied different from space described in Lease
► Unsigned leases
► Confirming FMV
Tenancy/Use Restrictions

- Typically created by Ground Lease or Declaration from Hospital

- Who can waive this exclusive use?

- May have tenant exclusive from prior lease – make sure this exclusive use is documented in your lease form or leasing materials

- Is Hospital/Ground Lessor approval required for all tenants? Are there any conditions placed on this approval?

- Is Hospital/Ground Lessor approval required for subtenants/asignees?

- Should Landlord grant tenant an exclusive use provision for the building? (possible Stark issue)
Tenancy/Use Restrictions

► Specific Procedures prohibited
  • Surgery, physical therapy, birthing center

► Particular equipment prohibited
  • CAT scan, imaging equipment, ultrasound

► Religious Requirements
  • Abortion, end of life care

► Impact of medical technology
  • “Hospital” services now being done off-site at a surgery center or in a doctor’s office

► New procedures and equipment being developed

► Hospital may reserve right to add procedures
Sample Clause

The Premises shall continuously and at all times during the Term be used and occupied by Tenant only as medical offices for licensed physicians ("Physicians") to engage in the private practice of medicine and other related activities incidental thereto, and for no other purpose; provided that the provision or operation of any “Restricted Service” shall not be permitted in the Premises. As used herein, a “Restricted Service” shall mean and include the following: any form of testing for diagnostic or therapeutic purposes, provision or operation of a laboratory (including, without limitation, a pathology laboratory or a clinical laboratory), any form of diagnostic imaging services (which include, without limitation, the following testing facilities: fluoroscopy, x-ray, plane film radiography, computerized tomography (CT) ultrasound, mammography and breast diagnostics, nuclear medicine testing and magnetic resonance imaging), radiation therapy and outpatient or inpatient surgery, provided however, Restricted Services provided to patients of Physicians occupying the Premises shall not be prohibited if (a) such patients were not referred to such Physicians solely for the purpose of obtaining such Restricted Services; and (b) such services are ancillary and incidental to and a necessary part of the examination or diagnosis rendered to Tenant’s patients (i.e., no provision of services to third parties), and neither constitute Tenant’s primary medical practice or specialty, or constitute the predominant services rendered by Tenant to Tenant’s patients.
Tenant Structure

► Who is your tenant?

• Hospital owned practice

• Large physician group operating as LLC or Corporation

• Solo practioner/small practice

► What issues are presented by particular types of tenants?
Construction-Related Issues

► Build-out is expensive

► May require reinforced flooring/thicker walls for medical office equipment

► Tenant may require a license or regulatory approval to operate at the premises which will delay construction and lease commencement

► Special utility requirements – water for dialysis patients, heavy electrical use for medical equipment

► Provide for storage/disposal of medical waste and drugs
Specific Lease Clauses Frequently Negotiated in a Medical Office Lease

1. Assignment and Subletting
   - What happens when the practice group is purchased by another group?
   - Will doctors be coming and going from the tenant entity?
   - Is a particular doctor the primary credit?
   - Office sharing - what constitutes a sublease or an assignment?
2. **Death and Disability Clause**
   - Will tenant be allowed to terminate the lease on the event of the death or disability of a particular doctor?
   - Allocation of risk

3. **Lease Guaranty**
   - Will the doctor(s) guaranty the lease?
   - Will the doctor(s) guaranty the entire lease or just portion of lease?
     - Initial three years of a ten year lease
     - Tenant improvement costs
     - “Liquidated damages” guaranty a certain amount of lease costs
Current Trends

► Healthcare Reform

  • Greater regulatory enforcement
  
  • More people with health insurance = More demand for medical office space

► Physicians “off-campus” or in retail setting/medical technology

► “Monetization” of Hospital Assets
Current Trends (continued)

► Acquisitions by Healthcare REITs
  • Ventas buying NHI
  • Healthcare REIT buying Genesis Healthcare
► Hospitals losing non-profit status/space tenants seeking property tax exemptions
► Sale of non-profit hospitals
► Hospital Employed Physicians