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Medical Leasing

Elizabeth A. Holden*

Leases for medical space can have far-reaching (and sometimes unintentional) consequences for the future of the practice and the costs of the business. In order to prevent hardship and expense down the line, it is especially important to review the lease to make sure that it reflects the practice's goals, needs, and structure. This article provides a number of provisions that are especially crucial to review and negotiate when leasing medical space, including use restrictions, assignment and subleasing clauses, build-out terms, and legal compliance requirements.

KEY WORDS: Lease; premises; medical; facility; HIPAA.

*Senior Associate, Hodgson Russ LLP; phone: 716-848-1692; fax: 716-819-4727; e-mail: eholden@hodgsonruss.com.

Whether you are a specialty clinic, a hospital adding space, or a sole- or multi-physician practice, there are a number of important considerations for leasing medical property that could have a significant impact on your practice. Your lease will be a multiyear and dollar-heavy investment that can have significant implications for the future of your practice and the costs of your business.

If the landlord is writing the lease, you can be certain that it will be favorable to the landlord and not automatically include provisions that are protective of the practice or even reflective of the business terms that were initially discussed or agreed to in the term sheet. The goal in reviewing and negotiating the lease is to make sure that the document reflects the reality of the situation and addresses the particularities of the medical practice in question in order to prevent significant costs and practice constraints down the line.

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While all of the terms and conditions of the lease should be reviewed to confirm that they are appropriate for the leasing situation at hand, there are a number of specific clauses that must be given additional consideration when the space will be used for medical purposes. Most importantly, it is necessary to make sure that the lease terms reflect the practice goals. Do they adequately describe the intended use of the space, but allow for a change in the practice, its structure, and personnel? Does the length of the lease and any renewal terms align with important milestones for the practice? Does the lease protect the business against competition? Does it comply with healthcare regulations? Most practitioners do not realize that their lease can seriously affect these issues.

MEDICAL PRACTICE AND GOALS

One of the most important questions to ask when reviewing a lease for a medical facility is whether the terms of the lease match the medical practice's structure and goals. There are several lease provisions that play a key role in this consideration. They include provisions regarding the permitted and restricted uses of the leased premises, restrictions on changing the structure of the tenant's business entity, assignment and subleasing rights, and the term of the lease.

Use Clause

Most leases typically include a "use clause" that dictates the activities that are permitted to occur in the leased premises. Commercial leases typically contain fairly general use clauses that require the lease to be used for such things as "office space" or "warehouse and manufacturing space." Medical leases, however, often have some of the most highly negotiated use clauses in the leasing industry. Typically, a medical tenant would desire to have as open-ended use of the premises as possible (e.g., "for any medical practice"), providing that it fits within the practice's licensure status. However, that desire is tempered when dealing with medical campuses and hospitals.

Often landlords find it very lucrative, and medical offices find it practical and attractive to patients, if they have complementary medical service providers within close proximity to one another. Consequently, to make sure that the services that are provided are complementary but not overlapping or competing, medical leases will often very specifically describe both the uses that are permitted and prohibited in the leased premises. For example, the use could be limited to oncologic treatments, or oral surgeries, or pediatrician's offices.

In some instances, it may be difficult or undesirable to entirely prevent specific services from overlapping. For example, if a physical therapy practice reserves the right to provide physical therapy services within its offices at a medical complex, a podiatrist that provides some physical therapy treatments as services associated to his or her practice would technically be in default of a restricted use clause. In order to address the situation, the lease may be drafted to allow a certain amount of rehabilitative services providing they do not exceed a certain amount of practice hours or gross billings.

Conversely, if the practice is restricted to performing within one medical niche at the leased premises, one may want to make sure that no other tenants are permitted to perform that type of medical work at the property or any other properties owned by the landlord. If the practice is concerned that another tenant may offer duplicative services, one may want to approach the landlord to guarantee that it will provide the practice with the exclusive right to provide that service and to promise that it will enforce that restriction among its other tenants. A landlord that may otherwise be reluctant to get into the fray of a tenant dispute should be cooperative and take on the responsibility of policing restrictions among tenants if the aim is to create a cohesive and attractive location for medical offices.

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Use restrictions can also be used by landlords to prohibit activities that they deem undesirable for religious or safety reasons. For example, if the leased property is owned by or affiliated with a religious organization, it may seek to prohibit procedures or activities that it deems objectionable, such as abortions, sterilization, artificial insemination, stem cell research, or the provision of contraceptives. Additionally, if the landlord has concerns about medical waste on the property and its proper disposal, it may try to prohibit certain substances from being used or dispensed.

Use restrictions also have a significant impact on both the tenant's and landlord's ability to market their properties in the future. If, for example, the practice decides to move locations before the end of the current lease term or desires to close the practice, one option to limit the liability on the remaining term of the lease would be to assign or sublet the leased premises to another party. If the use of the leased premises is restricted to a narrow band of medical services, it may be hard to locate a party willing to step into the lease. Conversely, if the landlord agrees to enforce use restrictions on other parts of its property, the landlord will be restricted in the types of tenants to whom it can market its remaining space.

Consequently, use clauses should be reviewed carefully to ensure that they do not pigeonhole the practice into too narrow a band of services. The clause should adequately describe the practice and any ancillary or associated services. If the practice plans to expand its capabilities in the future, the right to add those additional services should be preemptively reserved in the lease. The failure to preserve those rights up front places the practice's ability to grow in the hands of the landlord, which may either be unwilling or unable to accommodate the request in the future.

Business Entity

Special attention should also be paid to the type of business entity that is used to lease the space. Medical providers come in a number of different business structures including solo practitioners, medical groups, laboratories, urgent care centers, in-store clinics (such as pharmacies and eye doctors in box retailers), hospitals, and combinations thereof. The size of the practice and the variability of the practitioners who make up the practice will impact its legal structure. That, in turn, can have significant impact on liability issues and the ownership of the practice and the lease. Whenever possible, it is typically best to use a business entity to act as the tenant on the lease rather than to sign the lease individually in order to limit personal liability for rental obligations. The landlord may still require the principal physicians to personally sign guarantees for the payment of lease rentals and observation of lease obligations; however, limitations on the dollar amount, length, and applicability of the guarantees may be negotiated into the guarantee.

In the case of solo practitioners or small medical offices, one may also want to pay special attention to the consequence of the death or incapacity of a medical practitioner. In that circumstance, the parties will need to consider negotiating a termination right if there is a loss of the main practitioner.

Assignment and Subleasing Rights

The assignment and subleasing rights in the lease should also be reviewed to confirm whether the language restricts the tenant's ability to sell the practice, enter into office- or desk-sharing arrangements, transfer the lease to another party, enter into a joint venture or management agreement,

and/or make changes in the ownership or partnership structure of the practice (including adding and removing partners). Often, the standard office lease places a blanket restriction on these actions, and it will take careful revisions to the lease agreement to remove those restrictions and make appropriate revisions that will address the practice's particular makeup and goals.

For example, if the practice consists of two practitioners that sign the lease individually or as a partnership, they will want to make sure that the addition or subtraction of a partner does not cause a default under the terms of the lease. A departing physician will also want to ensure that his or her liability for lease obligation ends when he or she leaves the practice.

Term Length and Extension Rights

With regard to the term of the lease, it is important to make sure that the length and termination dates for the initial term of the lease and any extension periods align with your plans for the practice. For example, if the practice is well-established, plans to be in the same location for a significant period of time, and does not expect that its size will fluctuate, then it may be advisable to accept a simple five- to 10-year initial lease term with a few options to extend.

Medical offices tend to have more particular space and improvement requirements than standard lease agreements.

Alternatively, if the practice is a fledgling business and desires to start with a shorter term to test the viability of the practice, it may be best to start with a one- to three-year term and then have some standard-length renewal options that are exercisable if the practice performs well. Additionally, if there are concerns about the increasing expense of the medical malpractice insurance in the future, the practice may want to negotiate for lease terms and extension rights based on the renewal schedule of its insurance.

SPACE REQUIREMENTS

Medical offices tend to have more particular space and improvement requirements than standard lease agreements for both aesthetic and practical reasons. Special improvements may be required to ensure the utility of the space, including accessibility for disabled patients, security of patient records, and structural requirements for the installation of medical equipment. For example, floors may need to be reinforced or lowered, or walls may need to be reconfigured to allow for the installation of large, heavy, or potentially hazardous medical machinery (e.g., x-ray machines, MRI machines, CT scanners). Electromagnetic shielding or radiation protection equipment or systems may need to be installed. Ceilings may need to be designed to accommodate sophisticated HVAC and electrical systems. Plumbing may need to be altered for the installation of exam room sinks.

Build-out and improvement provisions should be reviewed to confirm that the initial build-out requirements clearly and correctly describe who is responsible for the construction and cost of altering the space to meet the specific requirements of the particular practice. Licensure or state regulations may also specify requirements for improvements or modifications to the space and should be reviewed before the alterations are made. In addition, if the landlord is providing a construction allowance or loan to the tenant, the terms of the financial arrangements should be clearly stated.

Restoration

The lease should also be reviewed to confirm who is responsible to restore the premises at the end of the lease term. Often, standard office leases will require the tenant to be responsible to remove equipment and any tenant improvements unless the landlord specifically permits them to remain. The standard lease could also require the tenant to restore the premises to its original condition and fix any damage to the property resulting from the removal of the tenant's property. This could have a very significant financial impact at the end of the lease. For example, if the premises required special wall or floor housing for an audiology booth and removing the booth would require the destruction of those walls or necessitate the restoration of flooring, it would be important to know which party is responsible for the cost of such work.

If the tenant is responsible for restoration, it would be best to know that up front so that the tenant can take that potentially costly requirement into consideration and plan accordingly ahead of time. If the tenant is moving on to a different location and expending costs to outfit that location, the last thing the practice may want to do is to spend money restoring the space it is leaving. In addition, if the landlord plans to make significant alterations to the premises to prepare it for a new tenant, it may not be entirely fair to saddle the former tenant with the cost or the obligation to restore parts of the premises that will be subsequently demolished. Therefore, when reviewing the lease, the tenant should aim to limit the restoration obligations and should also confirm that it is permitted to remove any important equipment or improvements.

Utilities

Another key consideration regarding the functionality of the leased premises is the availability of utilities. Most standard leases do not require the landlord to take on responsibility for the delivery or interruption of utilities. Since

landlords have little control over utility concerns such as power outages outside of their responsibility for their private connections to the public lines, landlords generally try to eliminate their liability for interruption in service.

If the practice has special utility requirements, including greater electric or water usage than a standard office, then the tenant will also want to review the availability of utilities at the premises and confirm that they are available in sufficient quantities for the practice. The landlord may want the tenant to set up a separate metering system for the tenant's utility usage. In addition, if the practice cannot tolerate any loss of service because, for example, it must keep medications at a set temperature, air purifiers working for a sterile environment, or power available for surgical operations, the parties may need to consider installing backup generators and decide which party will be responsible for the maintenance of those generators.

Parking

Finally, the availability and accessibility of parking (including handicapped parking) should be considered when negotiating the lease. If there are other tenants located in the same building or location as the leased premises, the tenant may want to require reserved parking spaces for the doctors, staff, and/or patients in order to make sure that the lease adequately addresses the needs of the practice. When making a request for reserved parking spaces, the tenant may want to consider whether it will request that the landlord place signs or other markers on the parking spaces to designate them as reserved and whether the landlord should be responsible for policing the reserved spaces against use by other parties.

LEGAL REQUIREMENTS

Legal regulations of the medical industry also have a significant impact on the terms of medical leases. Laws such as HIPAA, the Stark Law, and the Anti-Kickback Statute should be considered to make sure that in signing the lease, the practice does not inadvertently violate those laws.

HIPAA

Typically, landlords reserve the right to enter the leased premises on reasonable notice for the purpose of making repairs or showing the space to potential tenants or purchasers. In cases of emergency, landlords are typically granted the right to immediately access the space. For general office leases, the landlord's right to access the space may not be a significant concern. However, for medical tenants that are required by HIPAA to be responsible for the privacy of patients' medical records and personal information, access to the space by the landlord or its contractors may threaten the medical practice's compliance with the law.

Various modifications to the landlord's standard practice may need to be made in order to address this situation. For example, the tenant may require that the landlord and its contractors be escorted in the leased premises by one of the tenant's staff, the lease provide a longer notice period than usual for non-emergency visits in order to allow time to remove protected information, or the lease prohibit the landlord from accessing exam rooms while patients are being seen. The tenant may also need to provide the landlord with contact information for someone who can help preserve the confidentiality of the records in an emergency situation.

Finally, the tenant should consider placing a confidentiality clause into the lease that makes the landlord responsible for maintaining the confidentiality of any information the landlord receives. The tenant should aim to read the lease in connection with the practice's security and HIPAA compliance program in order to confirm that the lease does not jeopardize the viability of those protocols.

The Stark Law and the Anti-Kickback Statute

Finally, the ownership structure of the landlord, and its ability to transfer the lease to another entity, should be reviewed in order to confirm that the lease complies with the Stark Law and the Anti-Kickback Statute. If the relationship between the landlord and tenant is such that they may either receive or provide referrals to one another, the lease will need to be reviewed to confirm compliance with federal Medicare Anti-Kickback Statutes. Under federal law, it is a felony to offer, solicit, pay, or receive any compensation if that compensation was intended to influence referrals. The law does contain a "safe harbor" exemption with regard to leasing space and a number of criteria that need to be established in the lease in order for the parties to use that exclusion.

Similarly, the Stark Law regulates referrals between landlords and tenants that are both healthcare providers of a particular list of procedures that are paid in part or wholly by Medicare and Medicaid. As with the Medicare Anti-Kickback Statute, there are a number of requirements that must be documented in the lease between the healthcare providers and followed in order to prevent costly penalties for violating the Stark Law. In addition to federal laws, state law where the leased premises is located must also be reviewed to confirm whether it contains additional restrictions on the practice.

CONCLUSION

The special legal and practical needs of a medical practice require that particular attention be paid to leasing arrangements for medical space. In order to protect the practice from unintentional legal and business hardships, it is important to understand the individual needs of the practice and negotiate the lease to fit those needs.