



PG Bulletin

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Key Differences Between Health Care Leases and Commercial Leases

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In the practice of medicine there is rarely a “one-size-fits-all” diagnosis, and the same is true for health care facility leases. There are material differences between health care leases and other commercial/retail leases. Well-drafted leases are intended to address all the terms and requirements that are necessary to govern a mutually productive relationship between a landlord and tenant. For health care leases, this requires a working understanding of the health care industry and various regulatory frameworks. This article details several key differences between health care leases and other commercial leases.

1. Increased Potential Liability for Health Care Leases.

Leases with nominal economic terms do not necessarily have nominal risks for health care providers. In a health care context, the liability associated with a lease can be exponentially greater than the dollar value of the rent.

For example, a commercial lease with a month-to-month term (terminable at will by either party) and a nominal rent typically presents limited risk for the parties involved, yet this is not necessarily the case in the health care context. Health care leases (particularly those between parties who refer patients to one another) often implicate a variety of regulatory frameworks such as the Stark Law¹ and Anti-Kickback Statute² (AKS) and their applicable implementing regulations, which create another layer of analysis and materially greater risks if these applicable laws are violated.

The requirements of these health care laws are not always intuitive, and a lease could potentially violate these laws for a variety of reasons, including, without limitation, failure to be in writing or failure of the terms to be consistent with fair market value. Negotiating rental terms that are below fair market value might be desirable in a typical commercial lease, but such terms can be problematic in the health care context. Not only do the economic terms of a health care lease typically have to be within fair market value, but also the parties might need to consider having written documentation that supports this determination of fair market value. If a health care lease violates these applicable laws, the penalties are significant and can include material financial penalties, exclusion from billing under Medicare or Medicaid, and even criminal liability. Even a small or nominal lease—if not documented properly—could expose a health care provider to material risk.

- 2. Landlord Inspection Rights Should Be Limited.** Nearly all commercial leases give landlords broad discretion to enter and inspect the leased premises with minimal notice to tenants. In a health care context, these rights should be limited due to the sensitive nature of certain materials that might be on the premises as well as applicable health care-related privacy laws, such as the Health Insurance Portability and Accountability Act (HIPAA). Health care leases should specifically exclude landlords from accessing

occupied patient examination or treatment areas during patient office hours, and landlords should not be able to access medical records cabinetry, pharmacy cabinets, or drug supply storage areas.

3. **Tenant Improvement Costs Are Often Increased.** Build-out costs are generally much higher in health care leases for a variety of reasons, including the increased amount of plumbing work typically needed in each patient examination room and millwork needed in examination rooms and nursing stations. Imaging, cancer, and surgery centers often increase build-out costs even further due to potential floor reinforcement needed to support heavy equipment; lead walls and other control measures to contain radiation; special infection control protocols; and access requirements for specialty services such as compressed air. These additional build-out costs should be considered early in the transaction so the deal can be structured accordingly.

4. **Relocation Provisions Might Have an Increased Impact.** Commercial leases routinely include the right of a landlord to relocate a tenant to another space in the building. Though standard relocation provisions often include an obligation that the landlord build out the new space to be substantially similar to the existing space and cover other costs in connection with the relocation, the impact of relocating a health care provider might have other, less obvious financial repercussions that are not covered and expose health care providers to material risks. For example, certificates of need, health care licenses, and other regulatory entitlements that allow health care providers to perform certain services and bill at certain rates are often tied to specific locations (even specific suite numbers) and might not always be easily transferable. Any change in the location of a health care facility can potentially have material impacts on the health care licenses or medical billing structure for that particular facility, and these considerations need to be carefully addressed in any health care lease.

5. **The Term Cannot Be Less Than One Year.** Commercial leases typically provide parties the freedom to establish any length of term or amend the financial terms of the lease at any time. Health care leases often have much less flexibility. Though exceptions apply, health care leases

governed by the Stark Law typically must be for a term of at least one year, and the parties are prohibited from entering into financial amendments during that first year. Even after the first year has passed, the financial terms cannot be amended more than once per year.

6. **Percentage Rent, Referral Fees, and Compliance with Health Care Laws.** Percentage rent and referral fees are common in a variety of commercial settings, especially in a retail setting. These payment structures, while often found in commercial leases, cannot be used for most health care leases. The Stark Law and AKS are designed to protect patient choice rights and prevent corruption of medical decision-making, so arrangements that encourage, or appear to encourage, rewards or kickbacks for referrals are strictly prohibited and can result in drastic penalties. A health care lease should in no way be tied or connected to the volume or value of referrals between landlord and tenant—or to any referral relationship between landlord and tenant—and there should be a representation to this effect included in the lease.

7. **Limitations on Space-Sharing Arrangements.** Although space-sharing arrangements are common in other industries to promote certain symbiotic relationships, sharing space between health care referral sources is subject to particularly high scrutiny from a regulatory perspective. If a health care tenant would like to consider space-sharing arrangements with other health care providers, not only is it important to consider whether subleasing is permitted under the terms of lease, but relevant Stark Law, AKS, and other regulatory requirements must be considered as well. For example, certain types of equipment are not permitted to be shared under the timeshare exception to the Stark Law, and an accurate description of the exclusive and shared space is essential. A timeshare arrangement governed by the Stark Law must be in writing and signed by the parties, specifying the premises, equipment, personnel, items, supplies, and/or services covered by the arrangement. Additionally, there are additional space-sharing limitations and prohibitions applicable to certain health care industries and services lines, such as the limitations on durable medical equipment suppliers sharing a practice location with any other Medicare supplier or provider.³

8. Additional Utilities and Special Services Requirements.

Health care leases often require more consideration regarding utilities and building services than standard commercial leases. For example, the specialized equipment used in some health care facilities, such as imaging equipment, typically demands a significantly higher electrical capacity than does a standard office or retail space and generates significantly higher electricity usage. Additionally, after-hours access to utilities and building systems is critical for urgent care facilities or sleep centers that have extended operating hours beyond those of typical commercial facilities. Further, depending on the type of health care service provided, the need for compressed air, supplemental HVAC, or backup generators could also arise, and these issues should be addressed directly in a health care lease to ensure these services are available. Just last year, a fertility clinic in Ohio lost power, resulting in a total loss of thousands of frozen eggs and embryos. The damage caused by such power loss was catastrophic for this health care facility. Finally, many commercial waste removal providers will not collect the biohazardous waste generated by many health care providers; therefore, special hazardous waste disposal requirements should be considered. Failure to properly address these considerations in the lease can jeopardize a health care facility's ability to effectively operate its business.

9. Landlord Lien Rights Should Be Limited. Commercial leases routinely provide for a lien on all assets of the tenant within the premises as security in the event the tenant fails to pay amounts due under the lease, and in some states, landlords also may have statutory lien rights on personal property. In health care leases it is important to limit these lien rights or have landlords expressly waive these lien rights. For example, patient medical records should be expressly excluded from any such liens because health care providers have a duty to appropriately safeguard protected health information, keep such information confidential, and make such information available to patients upon request. Additionally, many health care providers often obtain financing on expensive medical equipment—financing that is secured by a lien on the equipment. This financing often prohibits any other party from having a lien on the specialized equipment. These special considerations should be addressed before

granting the landlord a lien on all personal property in a health care facility.

This article sets forth just a few of the unique factors to be considered in health care leases. When negotiating a health care lease, it is important to understand the landscape of the health care industry to avoid unnecessary risks to your organization or client. Therefore, it is often beneficial to consult with real estate professionals specializing in the ever-changing intricacies of health care law and its interplay with commercial leasing.

¹ 42 U.S.C. § 1395nn et seq.

² 42 U.S.C. § 1320a-7b(b).

³ 42 C.F.R. § 424.57(c).

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