

ON-CAMPUS MEDICAL OFFICE GROUND LEASES

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Addenda:

Addendum 1 - Form of Professional Office Building Ground Lease

Addendum 2 - Form of Medical Office Lease

I. INTRODUCTION

The ground lease is a traditional real estate investment device long used in many different types of transactions. It can be of particular utility in the development of medical office buildings and other professional facilities on or near hospital campuses, as it enables both the owning hospital and developer to attain the levels of control and economic performance that they wish to achieve, which can otherwise be difficult to contractually delineate.

Attached as Addendum 1 is a form of ground lease for development of a professional building on a hospital campus which will serve as an outline, to some extent, for this paper. Attached as Addendum 2 is a form of medical office for leasing space in a completed building.

II. WHAT DISTINGUISHES MEDICAL OFFICE BUILDING DEVELOPMENT IN GENERAL

A. Hospital Motivations

(1) The primary motivation for a hospital to develop a medical office building may not necessarily be to make a traditional real estate profit. Rather, the hospital wishes to have doctors with high levels of hospital admissions in close proximity to their campus so as to make it convenient for the doctors and their patients to utilize the hospital's facilities. Thus, to some extent, profitability in the sense that a regular developer looks at a project may be of secondary importance. However, as discussed below, there are certain limits on what a hospital may do with respect to doctors and the admissions of patients, and, accordingly facilitating the development of a high quality office building close to the hospital has significant value.

(2) Because of the underlying goal of the hospital, it is essential that it participate to some extent in the leasing of the space in the buildings on its campus. A ground lease offers an excellent way to accomplish this.

(3) On an economic basis, there is, of course, an advantage to the hospital in not tying up its critical capital for non-core functions such as real estate development or ownership. By engaging a third party developer to own and develop office buildings and other facilities the hospital frees up its capital for medical facilities and equipment.

B. Developer Motivations

The developer is motivated by the typical developer goals – developing a quality product, leasing it and making a profit. To some extent, the developer will have to deal with a greater level of third-party control than it is used to in more typical commercial developments in exchange for having the opportunity to develop at a truly unique location. The hospital may also want the developer to offer limited partnership or limited liability company interests in the development entity to doctors that lease space in the target building. This offers both an opportunity to raise equity and the potential for structural complications to the developer.

III. LEGAL LIMITATIONS – STARK AND ANTI-KICKBACK LAWS

A. Stark Law (42 U.S.C. § 1395nn)

A detailed examination of the Stark Law and the Federal Anti-kickback statutes (discussed below) is far beyond the scope of this paper. However, a general, but simplified statement of the Stark Law is to the effect that a physician may not make a referral of a designated health service to an entity in which the physician holds a financial relationship unless an exception applies. In a situation where a developer wholly owns the medical office building, it does not appear as though the Stark Law would be applicable. But if, as is frequently the case, physicians are limited partners or members in the entity developing the building, then the potential for Stark violations may exist. Because the Stark Law is a strict liability statute, hospitals and developers want to be careful to be sure no such issues are raised in the development and leasing of a medical office building utilizing a ground lease of land on a hospital campus.

(1) Safe Harbor for Rental Office Lease under Stark (42 C.F.R. § 411.347(a))

- (a) The agreement is set out in writing.
- (b) The agreement is signed by the parties.
- (c) The agreement specifies the premises covered by the lease.
- (d) The space rented does not exceed that which is reasonable and necessary for the legitimate business purposes of the lease.
- (e) The space is used exclusively by the lessee (except for common area maintenance).
- (f) The term of the lease agreement is for at least one year.
- (g) The rental charge to be paid over the term of the agreement is set in advance.
- (h) The rental charge is consistent with fair market value.
- (i) The rental charge is not determined in a manner that takes into account the volume or values or referrals or other businesses generated between the parties.
- (j) The agreement would be commercially reasonable even if there were no referrals between lessee and lessor.

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