

Complete Healthcare Compliance Manual 2024

Contracts with Referral Sources: Real Estate Compliance

By Goran Musinovic,^[1] J.D., CHC; Michael E. Honeycutt,^[2] CCIM, CRE; and Gregory P. Gheen,^[3] CCIM, CRE

What Is Real Estate Compliance?

Healthcare real estate is unique. The Stark Law,^[4] the Anti-Kickback Statute,^[5] the False Claims Act,^[6] and a myriad of other healthcare statutes and regulations create a complex regulatory environment in which healthcare providers must operate daily. A course of action that may be perfectly acceptable in any other type of real estate transaction could, in the context of healthcare real estate, result in serious regulatory violations and expose healthcare providers to significant liability.

Real estate transactions can be subdivided into two broad, general categories: lease transactions and purchase and sale transactions. Although purchase and sale transactions can and do expose healthcare providers to regulatory liability, lease transactions present greater compliance risk for two reasons. First, healthcare providers enter into far more lease transactions with referral sources than purchase and sale transactions. Second, lease transactions are long-term arrangements and, as a result, require constant monitoring and enforcement of their terms to avoid compliance infractions. Consequently, this article will focus on real estate lease arrangements with referral sources and outline the governing laws, common compliance risks with these arrangements, ways to mitigate compliance risks, and compliance resources for healthcare providers.

Risk Area Governance

To avoid violating the Stark Law, lease arrangements between referring physicians and healthcare providers must comply with the rental of office space exception under the Stark Law (Lease Exception), which consists of the following elements:

1. The lease arrangement must be in writing, signed by all parties, and adequately describe the leased premises;
2. The term of the lease arrangement must be at least one year;
3. The leased premises must not exceed that which is reasonable and necessary for the legitimate business purposes of the lease;
4. Leased space must be used exclusively by the lessee;
5. Rent under the lease arrangement must be set in advance and consistent with fair market value (FMV);
6. The rental charges under the lease arrangement cannot be determined in a manner that considers the volume or value of any referrals or other business generated between the parties, uses a formula based on a percentage of the revenue attributable to the services performed or business generated in the office space or is based on per-unit of service rental charges; and
7. The lease arrangement would be commercially reasonable even if no referrals were made between the

lessee and the lessor.^[7]

One of the key elements of the Lease Exception is the requirement for the lease arrangement to be consistent with FMV, which is defined, in pertinent part, under the Stark Law as follows:

- Fair market value means, “with respect to the rental of office space, the value in an arm’s-length transaction of rental property for general commercial purposes (not taking into account its intended use), without adjustment to reflect the additional value the prospective lessee or lessor would attribute to the proximity or convenience to the lessor where the lessor is a potential source of patient referrals to the lessee, and consistent with the general market value of the subject transaction.”^[8]
- General market value means, “with respect to the rental of equipment or the rental of office space, the price that rental property would bring at the time the parties enter into the rental arrangement as the result of bona fide bargaining between a well-informed lessor and lessee that are not otherwise in a position to generate business for each other.”^[9]

Additionally, under the Lease Exception, the lease arrangement must be commercially reasonable, which has recently been defined under the Stark Law to mean the following:

Commercially reasonable means that the particular arrangement furthers a legitimate business purpose of the parties to the arrangement and is sensible, considering the characteristics of the parties, including their size, type, scope, and specialty. An arrangement may be commercially reasonable even if it does not result in profit for one or more of the parties.^[10]

A lease arrangement between a healthcare provider and a referral source that is not consistent with FMV and/or that is not commercially reasonable can violate the Stark Law, exposing healthcare providers to potential liability to the government.

Regarding lease arrangements, the Anti-Kickback Statute is similar to the Stark Law in that it prohibits space leasing arrangements between healthcare providers and referral sources unless the arrangement meets the space rental safe harbor, which contains similar elements to the Lease Exception.^[11] Therefore, the compliance risks outlined in this article not only expose healthcare providers to potential liability under the Stark Law but to potential liability under the Anti-Kickback Statute.

On December 2, 2020, the Department of Health & Human Services Office of Inspector General (OIG) published the Revisions to Safe Harbors Under the Anti-Kickback Statute and Civil Monetary Penalty Rules Regarding Beneficiary Inducements final rule, and the Centers for Medicare & Medicaid Services (CMS) issued the Modernizing and Clarifying the Physician Self-Referral Regulations final rule to reduce regulatory barriers to care coordination and accelerate the transformation of the healthcare system into one that pays for value and promotes the delivery of coordinated care.^{[12][13]} The final rules went into effect on January 19, 2021, and brought several important changes and clarifications affecting real estate lease arrangements with referral sources, including, but not limited to, changes to the definition of FMV for leasing arrangements and the creation of the statutory definition of commercial reasonableness as outlined above, changes to the exclusive use requirements under the Lease Exception clarifying that the exclusive use requirement requires only the lessor to be excluded from the space, and the expansion of certain Stark Law exceptions (i.e., the fair market value exception, the certain arrangements with hospitals exception, and the payments by a physician exception) that could apply to space leases in some circumstances.^{[14][15][16][17][18][19]}

Common Compliance Risks

Real estate lease arrangements between referral sources and healthcare providers present numerous compliance risks, any one of which can trigger a violation under the Stark Law or the Anti-Kickback Statute. Compliance risks associated with lease arrangements can be generally classified as “transactional” or “operational.” Transactional compliance risks stem from the lease arrangement itself and the specific structure of the transaction. Operational compliance risks stem from the subsequent administration, or lack thereof, of the terms of the lease arrangement with a referring physician. Both compliance risks are caused by structural deficiencies in healthcare providers’ compliance programs, and both can expose healthcare providers to significant liability.

Transactional Compliance Risks

Healthcare providers face a myriad of transactional compliance risks when they enter into lease arrangements with referral sources. Some, such as the lease being signed by all the parties, are easy to identify. Others, particularly compliance risks associated with FMV and commercial reasonableness requirements, are more subtle and have a greater potential to result in violations. Healthcare providers must be especially cognizant of the compliance risks associated with rent rates, commercial reasonableness analyses, square footage measurements of leased premises, and tenant improvement allowances.

Rent Rates

Healthcare providers are legally obligated to charge or pay rent to referral sources that is consistent with FMV. The failure of healthcare providers to procure FMV support from qualified and independent third-party valuation experts or to procure FMV reports that align with the transactions they are supposed to support are common transactional compliance risks relating to rent rates.

Application of the FMV Report

Even if healthcare providers procure and rely on FMV reports from qualified valuation experts, an FMV report that is inaccurate or, as is more often the case, misapplied to the transaction can leave healthcare providers responsible for Stark Law violations. Consequently, healthcare providers should have internal protocols to ensure that they procure high-quality FMV reports that support their real estate lease transactions and apply those reports accurately to those transactions.

Commercial Reasonableness

In addition to charging rent rates consistent with FMV, lease arrangements with referral sources must be commercially reasonable. Many healthcare providers fail to undertake or document commercial reasonableness analyses of real estate lease arrangements with referral sources. Consequently, if a real estate lease arrangement is challenged on commercial reasonableness grounds, the healthcare providers lack documentary evidence to defend the arrangement. Additionally, many healthcare providers are under the mistaken belief that so long as a transaction is consistent with FMV, it is automatically commercially reasonable. That, however, is not always the case. If a healthcare provider enters into a lease arrangement with a referral source that is consistent with FMV, but for space that the healthcare provider does not need, the arrangement may not be commercially reasonable, which is one of the requirements under the Lease Exception.

Square Footage Measurements

While it is critically important for healthcare providers to charge referral sources rent rates per square foot that are consistent with FMV, it is equally important to ensure that the square footage of the leased premises is accurately measured. Remuneration to referral sources can be accomplished by charging rent rates below FMV or

by not charging the referral source for the entirety of the space the referral source is occupying. For example, if a referral source leases 10,000 square feet from a healthcare provider but only pays for 9,500 square feet because the space was inaccurately measured or inaccurately accounted for in the lease arrangement, the referral source receives remuneration from the healthcare provider by not having to pay for 500 square feet of space that it occupies.

Tenant Improvement Allowances

Providers should carefully consider the amount of tenant improvement allowances granted to referral source tenants. Failing to account for tenant improvement allowances in FMV reports can result in incorrect FMV rent range determinations. Additionally, overly generous and unnecessary allowances for tenant improvements to referral sources can also lead to transactions not being commercially reasonable (e.g., typically, it would not be commercially reasonable to provide a \$100,000 tenant improvement allowance for a lease arrangement that generates \$125,000 in total rent revenue). Finally, a healthcare provider's use of internal benchmarks and caps for tenant improvement allowances can create additional compliance risks, especially if those benchmarks are exceeded or if tenant improvement allowances are given for leased spaces that are already in turnkey condition, as this could be perceived as remuneration for inducing or rewarding patient referrals.

Off-Lease Benefits

Healthcare providers should also be aware of providing benefits to referral sources at no cost that are not referenced in a lease arrangement and not accounted for in the rent rate. Examples of off-lease benefits include free hazardous/medical waste removal services, free parking, free meals, free telephone, free cable and internet, and free transportation services. Any benefit that a healthcare provider grants at no cost to the referral source could be interpreted as remuneration to the referral source to induce or reward patient referrals, subjecting the healthcare provider to significant penalties.

Operational Compliance Risks

Structuring lease arrangements properly and in compliance with the Stark Law is only half the battle. The proper administration of the lease arrangements is just as important. A lease arrangement structured in perfect compliance with healthcare regulations can still expose healthcare providers to compliance violations if the arrangement is not properly administered. Common operational compliance risks involve rent collection, operating expense reconciliations, off-lease benefits, space creep, and timeshare arrangements in general.

Rent Collection

To avoid liability under the applicable healthcare regulations, healthcare providers must collect all rent due under their lease arrangements with referring physicians. Despite this requirement, many healthcare providers regularly fail to do so. This failure can manifest in many different forms.

Tenant physicians may fail to pay rent for their spaces for various reasons, yet healthcare providers inadvertently allow them to continue occupying their spaces for extended periods. When this happens, many healthcare providers fail to send notice of default letters and seek available remedies under the law. If and when the delinquent tenants finally decide to pay their outstanding rent, healthcare providers often fail to impose and collect late fees or interest charges on the delinquent amounts despite lease arrangements requiring them to do so. These failures can happen because of administrative oversights or healthcare providers' reluctance to engage in actions that could upset the physicians or result in the healthcare providers garnering a negative reputation with physicians.

Similar issues arise with rent escalators and holdover premiums. Most lease arrangements contain annual lease escalators through which a tenant's base rent increases by a certain percentage (typically between 2% and 4%) each year throughout the term of the lease. However, healthcare providers do not always apply these rent escalations, resulting in tenant physicians paying less in total rent during the term of the lease than required under the lease. Many lease arrangements also require physicians who go into holdover to pay a higher rent, typically set as a percentage of the base rent rate for the year immediately preceding the holdover period (typically between 125% and 200%), during the holdover period. Just like with late fees and rent escalators, these holdover premiums are often not imposed and collected. As a result, physicians pay less rent than required under the lease arrangement.

Tenant Improvement Allowances

Typically, tenant improvement allowances are capped by the landlord, and most lease arrangements require tenants to pay for costs of improvements in excess of the tenant improvement allowance as additional rent. Problems arise when healthcare providers fail to charge these tenant improvement allowance overages as additional rent, resulting in healthcare providers not collecting the full amounts due under the lease arrangements.

Operating Expenses

Healthcare providers face additional compliance risks when they enter into triple net leases and modified gross leases. These types of leases require tenants to pay for a specified share of the enumerated operating expenses based on the amount of space they occupy in the building. Many healthcare providers fail to reconcile operating expenses, resulting in referring physicians not paying the operating expenses for which they are responsible.

Including or excluding certain property expenses in or from operating expenses can also raise compliance concerns. For example, healthcare providers may fail to include estimated insurance premiums in operating expenses when they are self-insured, meaning the tenant physicians will not have to pay for their share of insurance on the property. Another potential issue arises when healthcare providers make repairs inside a physician's leased premises despite the tenant being obligated under the lease to pay for the costs of such repairs. If the healthcare provider inadvertently includes the costs of those repairs in the total operating expenses for the property that are then shared by all the tenants in the building, that certain tenant will not be paying for all expenses according to the terms of the lease arrangement.

Space Creep

Space creep is an issue that arises when healthcare providers allow or fail to recognize that physicians are using or have moved into vacant spaces adjacent to the space covered under their lease arrangement without executing a lease amendment or paying additional rent. Often, space creep involves a physician using storage or administrative spaces. These additional spaces are not covered by the physician's existing lease arrangement with the healthcare provider. As a result, the physician ends up occupying space without a written lease in place, which violates the applicable healthcare regulations. The physician receives remuneration from the healthcare provider by not paying for the additional space.

The best way to prevent space creep is for healthcare providers to conduct regular walkthroughs of their real estate portfolio to ensure that physicians do not occupy more space than provided for under their leases. Additionally, a physician should never be allowed to use any space in a building, regardless of how small or immaterial it may be, without first executing an amendment to their existing lease agreement (or a new lease agreement for such space) that incorporates the additional space into the lease and defines the additional rent

the physician must pay.

Lease Expirations

Many healthcare providers fail to track lease expiration dates, and, as a result, referral source tenants may occupy spaces without active lease arrangements in place. This presents several issues. First, even if the lease rates were consistent with FMV and supported by a defensible FMV report when the lease was first entered into, once the lease expires, the rates charged under the expired lease may no longer be consistent with FMV. Second, the healthcare provider may fail to continue collecting rent from tenants occupying the space after lease expiration. Because expired leases are difficult to monitor and may not be reflected on the lists reviewed by healthcare providers' compliance and audit departments, healthcare providers inadvertently allow tenants to occupy spaces for years without a lease in place and without paying rent. Third, where lease arrangements expire through the fault of the healthcare providers or their third-party lease administrators, healthcare providers may be reluctant to impose holdover premiums on the tenants whose leases have expired even though the terms of the lease require them to do so.

Poorly designed leasing policies and procedures are often the root cause when a healthcare provider allows a lease arrangement to expire. Bottlenecks in the leasing process prolong lease renewal discussions and negotiations and can result in the expiration of the lease arrangement before renewal is executed. Additionally, many healthcare providers fail to implement centralized tracking systems that monitor the material terms of leases, such as lease expiration dates, rent escalation dates, payment history, etc., and thus fail to realize that a lease arrangement has expired or is about to expire. Finally, many healthcare providers fail to conduct regular walk-throughs of their real estate portfolios to ensure that the occupied spaces are covered by active lease arrangements and used in the manner prescribed in such lease arrangements.

Timeshare Lease Arrangements

Timeshare lease arrangements, where a physician leases a defined space part-time (e.g., two days a week from 8:00 a.m. to 12:00 p.m.), present significant compliance risks for healthcare providers. Tracking the time spent by a physician in the space covered under a timeshare lease arrangement presents administrative challenges that could result in operational compliance issues. A physician may, for example, advertently or inadvertently use the space for more time than allotted under the timeshare lease arrangement. In such an instance, the healthcare provider could be seen as providing remuneration to the physician through reduced rent.

Space creep issues can be especially prevalent in timeshare lease arrangements. Because physicians do not occupy the spaces full-time, they will often bring patient records and other supplies and materials and ask to store them in closets or spaces not covered by and paid for under their timeshare lease arrangements. Once again, the healthcare providers could be seen as providing remuneration to the physician in the form of free rent on the additional storage space. Similarly, the spaces leased by physicians under timeshare lease arrangements typically include several exam rooms inside a larger suite. The physician should only use the exam rooms covered by the lease arrangement. However, there are situations when the physician uses additional exam rooms inside the suite that are not covered by and paid for under the timeshare lease arrangements.

This document is only available to subscribers. Please log in or purchase access.

[Purchase Login](#)