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Contracts Without Complications



# The Top 5 Regulatory Issues Affecting Hospital Leasing Arrangements

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Over the past decade, hospitals have become increasingly regulated. In response, most hospitals have elected to implement corporate compliance programs. While these programs serve an important purpose, most fail to specifically address an area that is highly regulated – the leasing of hospital real estate. Managing hospital leasing arrangements can be extremely tedious work and often requires the assistance of legal counsel and sophisticated property management personnel in order to avoid financial and legal pitfalls. A hospital is well advised to work with its legal counsel to supplement its corporate compliance program with a policy or program for the management of its lease agreements. At a minimum, that policy or program should be built around the following regulatory regimes:

- 1. Fraud and Abuse Laws** – A sizeable amount of the federal government’s budget is devoted to federal health care programs. With the implementation of the Affordable Care Act, the federal government has dedicated additional resources to prosecuting health care fraud. The primary tools used to prosecute fraud are the Stark Law and the Anti-Kickback Statute. A leasing arrangement between a hospital and a group of physicians that refer to the hospital, for example, will be subject to both the Stark Law and the Anti-Kickback Statute. Both require that the leasing arrangement satisfy very specific requirements or the parties will be deemed to have violated the laws. If the leasing arrangement is deemed to have violated the laws, the hospital and the physician practice group could face significant civil and criminal penalties.
- 2. Non-Profit Status** – Non-profit hospitals that are exempt from income taxes are subject to additional regulatory requirements. In particular, leasing arrangements with for-profit landlords or tenants should be at arm’s length, and the rental amount should be fair market. Federal regulators want to prevent the hospital from using its charitable assets (i.e., space or proceeds) to benefit for-profit enterprises. These concepts are often referred to as private benefit or private inurement, depending on the circumstances. If a hospital is deemed to have violated these concepts, it could lose its income tax exemption.
- 3. Reimbursement Rates** – Most hospitals provide physician services outside of the hospital itself. If the physical space satisfies certain regulatory requirements, then the hospital may be entitled to additional reimbursement for treating Medicare and Medicaid patients. This is often referred to as “provider-based billing,” and the space is often referred to as “provider-based space.” Hospitals often run into regulatory issues when they elect to lease all or a portion of their provider-based clinics to third party tenants (e.g., independent physician practice groups).

Provider-based space must be separate and distinct from space occupied by any other tenant. For example, signage must clearly identify the provider-based space, and the two tenants should have separate entrances in some cases. A hospital could lose its ability to seek additional reimbursement for treating Medicare and Medicaid patients if the space fails to comply with provider-based requirements.

**4. Property Tax Exemptions** – Hospital-based property tax exemptions have come under scrutiny over the past few years. In many cases, hospitals are granted property tax exemptions based on the understanding that the hospital will provide charitable health care services within the space. When a hospital elects to lease all or a portion of its space to a non-exempt user (e.g., a for-profit hospice provider), it could place its property tax exemption for the entire facility in jeopardy. Before a hospital enters into a lease for space that is exempt, it should understand the impact of the leasing arrangement on the property tax exemption.

**5. Bond-Financed Space** – Hospital space is often financed through the issuance of tax-exempt bonds. Unlike conventional financing that is used to finance commercial facilities, bond-financed space is subject to a number of use restrictions. The restrictions are mandated by the federal government because the hospital and the purchaser of the bonds both receive tax benefits from the financing arrangement. One such restriction prohibits the facility from being used for any private business use. For example, a hospital is prohibited from leasing bond-financed space to a non-exempt user. If the hospital were to violate the restriction, the tax benefits received under the financing arrangement could be revoked.