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The Use of Fair Market Value Assessments for Health Care Leasing Arrangements

Written by: **Donald Russell, JD, MBA**
Shareholder, Hall Render Killian Heath & Lyman

Under both the Stark Law and the Anti-Kickback Statute, space lease arrangements between referring physicians and hospitals are coming under growing scrutiny as the government's concentration on eliminating Medicare and Medicaid fraud and overpayments increases. Safe harbors and exceptions with respect to lease arrangements exist under both statutes with one of the requirements being that the rental charges under a lease must be consistent with fair market value. The definitions of fair market value under the statutes may be paraphrased as: the value in arm's length transactions, consistent with general market value, for general commercial purposes and not adjusted to reflect the additional value the prospective lessee or lessor would attribute to the proximity or convenience to sources of referrals. In addition, lease arrangements must be commercially reasonable – a separate but equally important requirement under both statutes.

In an effort to insulate themselves from future liability, hospitals and physicians are looking more and more to assessments or appraisals conducted by independent, third party appraising professionals. When is this reliance justified, and are there rules or guidelines that will make the appraisal more likely to be accepted if ultimately reviewed in the course of a later investigation?

There is no statutory or regulatory requirement that a formal appraisal or assessment made by an appraiser or other real estate professional be used. A party is not prevented from utilizing its own internal information and analysis. But, as the commentary to the statutes makes clear, the lack of independence in any such internally generated opinion will affect the evidentiary weight afforded, with the clear implication that such internal opinions will be viewed with increased skepticism.

Best practices would dictate that an independent appraisal or opinion be used to substantiate the fair market value of the rental being charged. Here is a list of some of the items that should be relayed to the broker or appraiser providing the opinion or appraisal which will enhance the efficacy of the opinion or appraisal in the event of later scrutiny:

- Make sure that the health law definition of fair market value is delivered to and used by the opinion giver or appraiser. Use of standard real estate appraisal definitions of fair market value will likely adversely affect the weight given the appraisal should reliance later be required.

- Greater weight should be given to comparable medical office properties versus general office properties. Importantly, adjustments should be made to equalize rents for properties used as comparables having different locations, amenities and rent structures.
- A rental payment cannot be adjusted to reflect the additional value the prospective lessor or lessee would attribute to the proximity or convenience to a potential source of referrals. Appraisers may tell you that proximity to a referral source affects the rental value of a property to certain types of potential tenants, but the appraisal may not take it into account.
- The appraisal should also opine on the commercial reasonableness of the transaction in question, as this analysis is required under the statutes. An arrangement will be deemed to be commercially reasonable in the absence of referrals if the arrangement would make commercial sense if entered into by a reasonable entity of similar type and size and a reasonable physician (or family member or group practice). It is not safe to assume that a rental rate that meets the fair market value in the community will be commercially reasonable. The rate must also be sufficient to generate a return such that a building owner/lessor, acting in a commercially reasonable manner, would be willing to risk its capital on the investment.
- If an appraiser is used, the appraisal should be rendered in accordance with Uniform Standards of Professional Appraisal Practice. Again, the use of standards will help to strengthen the appraisal (and therefore the position of the parties to the lease) in any subsequent investigation.
- The appraisal must be based on reasonable assumptions. Management cannot blindly rely on the results of an opinion or appraisal. Due consideration must be given to the presumptions and methodologies utilized.

The fair market value and commercial reasonableness opinion or appraisal is not a panacea, and the transaction must be compliant with all other aspects of Stark and Anti-Kickback laws and regulations. Nevertheless, a proper opinion or appraisal is an important building block for establishing the needed safe harbor or exception.