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Lease Creep, Ground Leases: Real Estate Stark Risks May Be Overlooked

By Nina Youngstrom

When hospitals lease space to physicians, they may give them tenant improvement allowances, a dollar amount per square foot to customize and enhance the office space. But tenant improvement allowances are a little dicey under the Stark Law. Whether they're commercially reasonable is open to question in some cases because the tenant improvement allowance could swallow up most of the landlord's rent revenue if the space is small and the lease is short, although the loss in revenue may be acceptable because upgrading the space will make it more marketable to the subsequent tenant. This is a calculation hospitals have to make when deciding whether to provide tenant improvement allowances to tenants who are referring physicians and, if so, how much, while keeping their eye on the fraud and abuse laws.

"It's one way remuneration can happen," says attorney Goran Musinovic, vice president of Realty Trust Group in Knoxville, Tennessee.

That's an example of the messy business at the intersection of real estate and the Stark Law. Although hospitals tend to worry how their compensation relationships with referring physicians may run afoul of Stark, they are just as vulnerable because of their leases, Musinovic says. The details, such as lease creep, could be their undoing, or it may be in the bigger arrangements, like ground leases. Hospitals may wind up in a bind because their expertise and their departments are siloed, Musinovic says. Hospital executives who oversee physician arrangements may not be well versed in real estate, and the people managing real estate may not be that aware of the Stark nuances, he says. That's a problem, especially because leases are often implicated in Stark-based False Claims Act settlements ("In \$4M FCA Case, Hospital Disclosed, But Whistleblower Was First," RMC 26, no. 33; "Mich. Hospital Settles FCA Case for \$84.5M Over Physician Payments," RMC 27, no. 29).

"You have transactional and operational pitfalls," Musinovic says. Transactional pitfalls are associated with the way the transaction (e.g., the lease) has been structured and whether it meets exceptions under the Stark Law, including the rental of office space, time-share arrangements or indirect compensation arrangements, which require, in part, the leases to be commercially reasonable and consistent with fair market value (FMV). Operational pitfalls emerge when hospitals execute leases. "If you fail to execute an arrangement in accordance with its terms, you can be committing violations," Musinovic says.

There are three types of leases, says attorney Bob Wade, with Barnes & Thornburg in South Bend, Indiana. They are:

- **Gross rent:** All expenses, including utilities, taxes and maintenance, are included in the rent.
 - **Triple net rent:** Rent per square foot is lower than tenants pay with gross rent, but they pay for common area maintenance in addition to rent.
 - **Modified triple net:** The most common version is a certain amount charged per square foot with increases from the baseline for common area maintenance.
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