



Healthcare Issues in a Retail Lease – Predictable Problems

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Some years ago, I asked a long-standing client why his company was leasing 12,000 square feet of first generation space immediately adjacent to a grocery store to a medical clinic. Clearly, my question was full of sarcasm which my client (a friend) chose to ignore. He explained to me that there were three very good reasons: (i) above pro forma rent; (ii) superior credit; and (iii) an expanded trade area. Chastened, I remembered the answer, and now, with changes in our healthcare laws, this “deliverable” will certainly seek locations more proximate to the consumer. As we have a decreasing opportunity to choose our doctors and move to choices based more on location, healthcare providers (like banks) will attempt to get in the middle of the consumer traffic pattern.

This evolution has begun and healthcare tenants are now beginning to populate traditional retail properties, but retail landlords are often surprised regarding (or perhaps even naïve about) the changes needed to successfully negotiate such leases (or, in some cases, existing documents that restrict such leasing that have not been properly contemplated and addressed). The goal of this article is to neutrally comment upon a number of the predictable issues.

Existing Documents – What do they say? What uses are restricted (i.e. are there restrictions vis-à-vis medical uses)? A lease we recently reviewed noted that the center could not have tenants which were a medical office or medical clinic, but we were negotiating a use which clearly involved a medical “use”. The landlord, clueless about the problem, was equally clueless regarding the solution, suggesting that a waiver from one tenant would be acceptable; insufficient when the lease form used throughout the center clearly prohibited the use.

Co-tenancy – Should a medical user be counted as “leased” for purposes of co-tenancy? More and more tenants are requiring that leases, to be counted, must be “retail” or “restaurant”. This is an issue worth contemplating as errors can be very expensive and landlords need to focus, as with many of these issues, on whether their standard text will work.

Hours of Operation – What hours will the medical office tenant be open? How many days per week will they be open? Is the lease clear that the tenant must close each day (and that overnight stays are not allowable)? Do the leases for the center note that other tenants need not be open unless all tenants are open? Do the rules and regulations properly reflect and serve the medical tenant? Sadly, many landlords have not contemplated these issues.

Use – Some tenants will want to note that their use is “medical office”. This may be fine in some circumstances but a description which might be open to broad interpretation may not be best for the landlord. Again, to what extent may medical “procedures” be undertaken at the office? Can the tenant change its use, by assignment or otherwise? Can the tenant subdivide its space? What is the impact on trash disposal services, as noted below, and heightened privacy of information concerns?

Insurance – Most shopping center leases draft the insurance provision to reflect landlord’s requirements for retail or restaurant tenants. Are the insurance limits required similarly sufficient for medical uses? Will any of Landlord’s insurance cost more due to medical office use? Are

there other forms of insurance which landlord might want to require of the tenant? Normal retail leasing does not require significant interaction with the risk management team; medical office might well require more contact and more team play.

Parking – Many medical office tenants need dedicated parking, reserved or otherwise, and also need curbs/ramps near their spaces. Is this contemplated in the lease? Can landlord modify the parking, handicapped zones and common area access? How do these requirements impact other tenants of the shopping center?

Assignability – In many cases, there is a real hurdle to allowing medical office in the first instance. How likely is it that landlord will want an assignee? Should landlord reserve the clear right in such event to terminate the lease? Should the exercise of an option be allowed only by the initial tenant (or perhaps a directly related entity)?

Lender Approval – At what point, if at all, does the lender need to be involved? Does the lender have the right to approve the lease? Can the lender require changes to the lease? At what point should landlord talk with the lender regarding the use (and the resulting lease)? In fact, should the lender be involved in a philosophical conversation regarding whether medical office is an enhancement?

Hazardous Substances – Does the leasing representative properly contemplate what hazardous substances (including medical wastes) might be utilized? Assuming of course that the tenant will use a first class standard, how is medical waste to be disposed? Who might monitor same for landlord? Who pays for the removal? Can the medical office tenant utilize Common Area trash containers? Can the drains in the premises be utilized for medical waste?

Construction – It is difficult enough to get a cookie store built and what is needed by the medical office tenant is perhaps more complex. Surely more water (sinks and drains) is needed. More HVAC (there really is no store room) may also be required. Perhaps more electrical will be utilized. And what about a generator and, if so, where does it go? Does it remain at the end of the Term? Who supplies utilities to the generator pad? If any construction allowance is to be given by the landlord, how will that be spent by this type of tenant? Will the improvements be at all usable by a future tenant?

These are but a few of the myriad of considerations to be contemplated. Medical office uses are upon us, whether we are prepared or not. Mistakes on these leases can be prevented, but these and other issues should be carefully considered before the deal is reached and the lease is executed.

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