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COLORADO REAL ESTATE JOURNAL

THE COMMUNICATION CHANNEL OF THE COMMERCIAL REAL ESTATE COMMUNITY

MAY 19, 2010 – JUNE 1, 2010

Medical office leases: Strike balance, satisfy needs of all

Tenants of medical office spaces have unique needs that require flexibility in their leases beyond the standard office tenant. Often these tenants are professional practices composed of individual physicians or one or more medical groups. These practices operate in highly regulated and competitive environments, which necessitates lease arrangements that can accommodate changes in the tenant's structure and business during the term of the lease. Four significant matters that should be considered when negotiating a medical office lease are as follows: assignment and subletting rights; permitted uses; premises reduction and lease termination; and termination or replacement of personal guaranties

■ **Assignment and subletting rights.** Standard office leases typically have onerous restrictions on a tenant's right to assign its lease, sublet all or a portion of its leased premises, or engage in a transaction that causes a change in control of the tenant entity without the landlord's prior consent. These restrictions are intended to protect landlords from losing control over who is actually in its space and obligated to comply with the terms of the lease. However, the process of obtaining the landlord's consent may introduce uncertainty and potential delay into a health care tenant's business transaction. For example, this typical lease provision would require obtaining the landlord's approval in order for the tenant



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to expand its services by bringing in a new specialty group, sell its practice, merge with another medical group, add or change practitioners within the group, or sublet space to or office share with other medical professionals. Even a lease that provides that the landlord shall not unreasonably withhold, condition or delay its consent to an assignment or sublease likely will require the tenant to provide its landlord with financial information about new physicians or medical groups and other pertinent information. Depending on the specific tenant involved, health care tenants should consider negotiating the right to engage in certain types of transactions without the landlord's approval. The landlord may be comfortable making these concessions with certain limitations, such as subletting or office sharing of less than a certain percentage of the leased premises.

■ **Permitted uses.** Commercial leases generally restrict tenants' rights to conduct only certain types of operations within the leased premises. These use restrictions can be particularly narrow if the landlord desires to maintain a broad tenant mix within the building or complex, has grant-

ed exclusive-use rights to other tenants, or is subject to restrictions imposed by a hospital for medical office buildings that are located on or in the vicinity of a hospital campus. However, in order to provide for flexibility in the future for changes to its practice, a medical office tenant may want to negotiate a right to use the leased premises for different types of practices, clinics, and medical equipment, or for any legally permitted use related to the provision of health care or medical services. Tenants who understand the genesis of the landlord's proposed use restrictions will be armed with information crucial to negotiating the broadest feasible permitted use provisions in their leases.

■ **Premises reduction and lease termination.** In certain circumstances, such as the death, incapacity, or departure of a critical (or solo) physician in a practice, the loss of a hospital affiliation or staff privileges, or a change in the regulatory framework that materially affects the tenant's practice, a tenant may need a lease provision that allows it to reduce the size of its leased premises by giving back a portion of its space to the landlord or even to terminate the lease. These rights will not be included in any standard landlord lease form and will need to be specifically negotiated by the tenant. While it is unlikely that a landlord will agree to permit these changes without any penalty or termination fee, the tenant may be able to negotiate the method for calculating this

payment, such as a flat fee plus unamortized tenant improvement costs and broker fees, and other parameters within which the landlord would agree to grant these rights to the tenant.

■ **Termination or replacement of personal guaranties.** Some landlords require personal guaranties of the tenant's obligations under the lease by the principals of the tenant entity. It is likely that the landlord's form of guaranty will provide that each guarantor agrees to guaranty all the tenant's obligations under the lease, without regard to the percentage ownership interest of the guarantors in the tenant or any right to terminate the guaranty or provide a substitute guarantor if the guarantor leaves the practice or otherwise is no longer affiliated with the tenant. Carefully crafted partnership agreements or assignment and subletting provisions could be negated by guaranties that do not contemplate these issues. As an alternative method of security for the landlord, tenants should consider offering a bigger security deposit in place of personal guaranties. Although that option would require a greater up-front financial commitment by the tenant, it would eliminate any issues with guaranties later on.

If landlords and tenants focus on these issues when they are negotiating their medical office leases, they may find that they can strike an appropriate balance in their leases and still satisfy their respective needs.▲