

3 Things RE Attys Need To Know About Acute Care Facilities

By **Andrew McIntyre**

Law360, New York (October 21, 2014, 6:43 PM ET) -- An uptick in development and leasing of post-acute health care facilities across the nation means real estate lawyers who work on such deals must get up to speed on regulatory and licensing matters that don't typically accompany their traditional commercial real estate transactions.

Such facilities, which offer continued treatment and therapy to patients after they've been treated for acute injuries or illnesses in hospitals, are becoming more popular as hospitals and medical care providers seek to operate most efficiently and profitably under the Affordable Care Act and as real estate investment trusts show more and more interest in the asset class.

Because the ACA penalizes hospitals for readmitting patients, care providers are increasingly looking to post-acute care facilities to avoid readmitting patients. That, combined with a flurry of buying among REITs, is driving increased activity in the space, lawyers say.

Here, Law360 looks at three aspects of post acute care facility transactions real estate lawyers need to keep in mind as they help their clients navigate such deals.

Stay on Top of License Issues

Whether buying, selling, developing or leasing a post-acute care facility, the parties in such deals face a flurry of licensing requirements, given the nature of the real estate assets.

Although some of the licensing work is handled by non-real estate lawyers, real estate attorneys must be up to speed on the various licensing issues because those matters are intertwined with the real estate portion of such deals, according to Adam R. Salis of Manatt Phelps & Phillips LLP.

"As a real property lawyer, you really have to be cognizant of the interplay of the various disciplines and make sure your real property documents reflect the risks," said Salis, who is currently working on deals in California and Texas. "Traditional real estate lawyers need to retool a little bit."

Central to the question of risk is licensing. Such facilities have to gain state licensing approval before they can open, and that variable needs to be addressed in real estate documents in such a way as to limit liability, should the licensing approval not come through.

"Any time you're dealing with a health care facility — new construction or acquisition — there are

numerous industry-specific issues that drive the deal," Bobby Guy, a health care mergers and acquisitions lawyer at Frost Brown Todd LLC, said. "Those issues range from state licensing provider agreements and especially certificate of need laws. On top of that, you still have all of the normal real estate issues."

Such certificates of need, ostensibly vehicles that ensure there's a need for a facility in a specific geographical area, complicate the process from a real estate lawyer's point of view.

That certificate, Salis said, needs to be accounted for in the lease.

And some transactions also require approval from the attorney general. In California, for example, when nonprofits are involved, such deals typically require attorney consent, which also needs to be a part of leases, Salis said.

"When drafting a lease, you need a contingency in there. 'If we don't get the certificate of need, we need to get out,'" Salis said. "If you don't get that AG consent, you're dead in the water."

Owner-Operator Structure Creates Complications

While not an entirely new concept, the model of one company owning a facility and another operating it deviates from the historical model of a single entity owning and operating a health care facility.

While the owner-operator model adds little complication to a commercial real estate deal, when health care is involved, such model creates various issues, many of which real estate lawyers need to be aware of, attorneys say.

"It gets more complex when you are looking at the bridge between having an owner and an operator," Guy said. "If you're buying or building a facility, you have to think about both the real estate ownership side and then the operation side. On top of that, if they're split, you may now be dealing with owner issues on one side and the operator on the other side."

Adding to the owner-operator complications is the increased interest REITs have shown in health care facilities, banking on such assets as solid long-term investments.

"Real estate investment trusts, especially in the health care industry, are ravenous," Eric Altman of Sheppard Mullin Richter & Hampton LLP said. "It's become the darling of that industry to add a large portfolio of acute care ... facilities."

For example, Medical Properties Trust Inc. **said Monday it was paying €705 million** (\$897 million) to buy and lease back 40 real estate assets from German post-acute care provider Median Kliniken Group, part of a deal in which the REIT and Waterland Private Equity will acquire Median.

On top of the question of owners and operators is the issue of investors in such properties. There are state and federal laws governing the financial relationship between investors and recipients of capital, laws that are particularly apposite when physicians are investors in such projects, according to Karl A. Thallner of Reed Smith LLP.

"These laws may prohibit physician investment in the facility, and require careful planning when another type of referral source is an investor," Thallner wrote in an email. "It would be necessary to substantiate

that a referral source's ownership in a facility is proportionate to the fair market value of its investment."

As to the legal work for real estate lawyers, the more parties involved in the ownership and operation of the facility, the more complex the provider agreements, licensing agreements and management agreements become, lawyers say.

"If you're doing one that has split ownership and operation, you have to be thinking much like a bank if you're owning the real estate and leasing it to an operator," Guy said. "If the operator, for example, becomes insolvent, you have huge issues about how to keep the facility open. The owner of the facility doesn't have the license and provider agreements to operate it."

Versatility Key in Health Care Development

Much of the real estate positioning of health care providers is based on the Affordable Care Act, with companies seeking to maximize the amount of federal government support they can receive. Lawyers say the mood has been one of wait and see, although they say we are now starting to see how the ACA is playing out, which makes it difficult for development of medical properties because they can take years to build.

In an effort to try to remain as relevant as possible, many new developments now are emphasizing versatility, lawyers say.

"They also are looking to maximize flexibility. They're spending a lot more time in the design phase with architects," Altman said. "You need to have a flexible floor plan, in case the health care system takes another zig or zag."

As health care companies continue to study the ways in which the ACA may affect federal reimbursement, rehabilitation continues to be a popular area for growth, lawyers say.

"I'm seeing a lot of interest in rehab," James F. Owens of Paul Hastings LLP said. "There's been such a need to get patients out of the hospital. ... There's just been more of a demand because of the way care is delivered."

But while real estate investment trusts and other investors remain hungry for such properties, just how exactly to design those properties remains somewhat of a guessing game for developers, lawyers say.

"The challenge is to design something that will take a year or two to be built," Altman said.

--Editing by Chris Yates.