

**L-4 OFFICE SPACE AND EQUIPMENT LEASES WITH
PHYSICIANS AND OTHER POTENTIAL REFERRAL SOURCES**

FREQUENTLY ASKED QUESTIONS:

January 10, 2005, March 1, 2007, November 1, 2008, September 19, 2013

Updated: February 1, 2017

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I. GENERAL LEASE TERMS

1. **Question:** Can a tenant move into the premises prior to the execution of the lease agreement?

Answer: No. The landlord shall not permit the tenant to occupy the premises, including moving any office furniture and/or supplies into the premises, prior to the execution of the lease agreement and receipt of the security deposit, if required by the lease. Further, the tenant shall not be given a key to the premises prior to the execution of the lease and payment of the security deposit.

2. **Question:** Is a Tenet entity required to utilize measurements of the amount of square footage in a suite that have been obtained from an independent third party that uses BOMA (Building Owners and Managers Association) standards (2010) when leasing space to/from a referral source?

Answer: Unless otherwise approved by the Tenet Real Estate Department, the Tenet entity is required to use a measurement from an independent third party that uses BOMA standards (2010) in measuring space. Measurements must be made through vendors approved by the Tenet Real Estate Department. In the event that the Tenet entity seeks to rely on a standard other than BOMA, the Tenet Real Estate Department shall approve the proposed measurement.

3. **Question:** How often should a Tenet entity obtain an updated independent measurement?

Answer: Unless otherwise approved by Operations Counsel, the Tenet entity should obtain an updated independent measurement only when there are changes to the footprint of the premises. For these purposes, a change in the footprint of the space does not refer to changes in the layout within the four walls of the space, but rather work that changes one or more of the demising walls, *i.e.*, one of the walls bordering the space of other tenants or common area, such as the addition of more space from an adjoining suite or common area or a reduction in the size of the space by partitioning off a portion of the space to reduce the size of the premises. As soon as possible after completion of the anticipated changes in the space, the Tenet entity should proceed with obtaining updated measurements through the vendor who previously measured the space or other vendor approved by the Tenet Real Estate Department.

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4. **Question:** What is the difference between a gross lease and a triple net lease?

Answer: These two basic types of leases are different based on how the tenant pays rent and operating expenses to the landlord. A gross lease is a lease in which the base rent amount includes operating expenses. In other words, the flat rent paid by the tenant covers all expenses which are normally associated with ownership, *e.g.*, common area maintenance, utilities, property insurance and taxes.

A triple net lease is a lease in which the tenant pays base rent to the landlord and *separately* pays the landlord a proportionate share of operating expenses, including common area maintenance, utilities, property taxes and insurance.

In addition to gross leases and triple net leases, there are modified gross leases. Under a modified gross lease, the tenant pays base rent to the landlord and pays a portion of the operating expenses, such as utilities, and the landlord pays the remaining operating expenses.

5. **Question:** Does the rental rate stated in the fair market value survey prepared by our outside appraisers reflect a gross lease or triple net lease?

Answer: Each FMV Survey determines fair market value rent based on either a gross basis, a modified gross basis or a triple net basis. Every person involved in the leasing and approval is responsible to confirm that lease rate is consistent with the fair market value range in the FMV Survey and is based on the same type of lease the parties are executing. It should be noted the lease posted on eTenet is a gross lease which is the recommended form of lease arrangements for Tenet entities. If the FMV Survey reflects rent on a basis other than on a gross lease basis, then the template lease agreement needs to be modified to reflect the rent set forth in the FMV Survey. This is important to make certain the rent charged is consistent with fair market value.

6. **Question:** What is the difference between rentable square feet and usable square feet?

Answer: Rentable square feet and usable square feet have to do with the measurement of space in the building for purposes of determining the amount of square footage to calculate the base rent. The Building Owners and Managers Association (BOMA) defines rentable and useable square feet as follows:

-**Rentable** area means the tenant's pro rata portion of the entire building.

-**Useable** area means the tenant's actual occupiable area of a floor or an office.

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7. **Question:** How does the Tenet entity determine whether the measurement of the premises is stated on a usable or rentable basis?

Answer: The determination of whether the square footage is expressed on a usable or rentable basis is generally driven by the markets where the Tenet entity is located. The third party measuring the space needs to identify in writing whether the measurement is on a usable or rentable basis. It is important that the FMV Study also reflect whether the fair market value range is stated on a usable or rentable square foot basis; the same standard must be used for both the space measurement and the fair market value range.

8. **Question:** Can an office space lease agreement require a physician tenant to obtain and maintain medical staff privileges?

Answer: Because the public frequently assumes that tenants in a medical office building adjacent to the hospital are affiliated with the hospital, it is reasonable for the hospital to take steps to assure that these tenants meet its standards for professional ethics and competence. Therefore, at the option of the Tenet entity, an office lease agreement may require that physician tenants obtain and maintain medical staff membership at the Tenet entity. Note that the lease may not require a particular category of medical staff membership (i.e., active staff membership), particular clinical privileges or any minimum level of activity with a Tenet entity.

II. TENANT IMPROVEMENTS/RENT ABATEMENTS

9. **Question:** What constitutes a tenant improvement?

Answer: Tenant Improvements (“TIs”) are improvements made to the leased premises on behalf of the tenant. TIs may be build out of shell space, remodeling or cosmetic refurbishments of existing space. TIs for existing built out space may include but are not limited to repainting, recarpeting, moving walls, reconfiguring plumbing, electrical or phone systems. TIs are distinguished from expenses incurred by the landlord to make the premises leaseable (e.g., ADA compliance expenses).

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10. **Question:** When may a Tenet entity provide a tenant improvement allowance and how much is an appropriate allowance?

Answer: Tenant improvements may be provided if they are commercially reasonable in the marketplace and reflected in the approved FMV Study. To determine whether a tenant improvement allowance is appropriate, the Tenet entity should consult the FMV Survey. The FMV Survey should set forth a range for the tenant improvements and will generally be based on market conditions and whether the space is first, second or third generation space. First generation space is shell space (*e.g.*, never built out), second generation space is space for a new tenant in space previously built out, and third generation space is renewal space, or space re-leased to the original tenant.

11. **Question:** Is a tenant improvement allowance based on rentable or usable square feet?

Answer: Tenant improvement allowances are based on usable square feet.

12. **Question:** If the actual cost of the tenant improvements exceeds the tenant improvement allowance, can the Tenet entity pay the excess amount or is the tenant required to pay the excess amount?

Answer: The tenant is required to pay the excess costs when the actual tenant improvement costs exceed the tenant improvement allowance. However, the excess costs may be paid by the Tenet entity and charged to the tenant as additional rent provided a fair market value annual interest rate is factored into the additional rent calculation and the repayment period is no longer than the lease term. The interest rate used shall be the Prime Rate plus 2%, as set forth in the Money Section of the Wall Street Journal. In addition, if the tenant terminates the lease prior to the end of the lease term, the tenant is required to repay to the landlord the unamortized tenant improvement balance.

13. **Question:** Can the Landlord's Tenant Improvement Allowance be greater than the range set forth in the market rental survey?

Answer: Generally no. However, there may be instances where construction is needed to bring the leased premises up to code, a safety issue exists, or demolition is required as a result of a change in use of the premises (*e.g.*, lead lined walls in space used for radiology must be demolished before the space can be used as physician offices). Please contact your Operations Counsel in these and similar circumstances before negotiating an improvement allowance with the tenant.

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14. **Question:** Following the completion of tenant improvements involving a build out, should the space be re-measured after the finish-out is complete based on BOMA standards to determine whether the rent should be adjusted based on the constructed square footage (instead of retaining the rent amount based on the planned square footage)?

Answer: Maybe. Space should be re-measured if one or more of the demising walls, i.e. the walls separating the space from that of another tenant or walls separating the space from a hallway, corridor or other common area are altered. For example, if two or more suites are combined, or if a suite is reduced in size by walling off part of the space, then re-measurement is appropriate. Re-measurement is not necessary if one or more of the interior walls, i.e. walls dividing space within the leased premises, have been changed. Please note that unless approved by Operations Counsel, space may be reduced in size only by construction of partitions and not by locking doors or other temporary expedients.

15. **Question:** When is rent abatement (*e.g.*, free rent) appropriate?

Answer: Rent abatements are appropriate if they are commercially reasonable in the marketplace and reflected in the approved Annual FMV Study or the Ad Hoc FMV Survey report. If rent abatements are offered, the free rent should be spread over the term of the lease instead of front loaded at the beginning of the lease term. For example, if the lease is a 3 year term and the FMV Survey indicates it's appropriate to offer one month's free rent for each year of the lease, then free rent may be offered in months 1, 13 and 25. The annual net effective rent after taking into account the rent abatement must remain within the annual fair market value range set forth in the FMV Study.

III. TIME-SHARE LEASES

16. **Question:** Under a time-share lease, can the Tenet entity lease certain employees, e.g., staff, RNs or LPNs so long as the costs are included in the timeshare FMV rate?

Answer: Generally, yes. The Tenet entity can lease certain employees so long as the costs (including salary and benefits) are included in the time-share rate. However, many states impose statutory and regulatory requirements upon individuals who lease employees. For example, some states require the leasing physician to be held jointly and severally liable for unpaid unemployment contributions due by the Tenet entity. In addition, some states impose certain requirements on the physicians related to securing workers' compensation insurance. Please contact your Operations Counsel for guidance in this area.

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17. **Question:** What expenses should be included to calculate the rent charged to a physician or other potential referral source to lease space or equipment on a time-share basis?

Answer: To calculate the rent charged to a physician or other potential referral source for lease of space or equipment on a time-share basis, the Tenet entity needs to factor in all expenses associated with the space. For example, if the Tenet entity provides personnel, equipment or supplies, then these costs need to be factored into the rental calculation. Also, expenses for telephone usage, medical supplies, computer and printer usage, fax machine, copier, furniture, office equipment and any other items or services provided should also be factored into the rental rate.

18. **Question:** For time-share leases, is there a standard time share rent calculation methodology or format?

Answer: Generally, the time share rent calculation is calculated on a per slot basis. The Tenet entity should total the annual costs for the use of the space, including personnel, equipment and any other costs, divided by fifty-two weeks to determine the weekly cost for the use of the space. The weekly cost should be divided by the number of slots available for that space to determine the per slot rent amount, which should be annualized to determinate the monthly rent for the slots. For example:

$$\text{Annual Cost} \div (52 \text{ weeks/year})(\# \text{ of slots per week}) = \text{Per Slot Rent}$$

$$\text{Per Slot Rent} * [52 \text{ (weeks/year)}] \div 12 = \text{Monthly Per Slot Rent} * \text{Number of Slots Rented}$$

IV. EQUIPMENT LEASES

19. **Question:** How do you determine a fair market value rental rate, whether the equipment is leased on a full-time basis or on a per use or per click basis?

Answer: Fair market value for equipment means the value of the equipment when obtained or leased from a manufacturer or professional distributor, but shall not be adjusted to reflect the additional value one party (either the prospective lessee or lessor) would attribute to the equipment as a result of its proximity or convenience to sources of referrals or business otherwise generated for which payment may be made in whole or in part under Medicare, Medicaid or other federal health care programs. Thus, when leasing equipment to or from a physician or other potential referral source, the Tenet entity should obtain a written quote from a manufacturer, distributor or other non-referral source third party vendor of similar equipment on what it would charge for similar equipment on the same terms. If these vendors are not available, then the Tenet entity should obtain at least three quotes from other vendors and document their file as to the efforts undertaken to demonstrate fair market value. Lease rates cannot be based on

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formulas taking into account the revenue earned, billed collected or otherwise attributable to the use of the leased items. Timeshare leases for equipment are permitted if reasonable under all of the circumstances. Existing leases should be examined and revised if necessary prior to that time. The Tenet entity should also contact their Operations Counsel for guidance in this area.