This Practice Note discusses some of the unique issues that arise with a lease for medical use in a retail setting. It examines landlord and tenant considerations for several provisions in a retail lease, including use clauses, landlord services, tenant improvements and assignment and subletting clauses. It provides drafting and negotiating tips for both landlords and tenants.

As a result of the growing demand for medical services and a change in the shopping habits of consumers, shopping center owners have the opportunity to lease vacant space in their centers to non-traditional tenants, including:

- Acute care clinics.
- Satellite hospital facilities.
- Oncology treatment centers.
- Other medical specialty centers.

Shoppers often seek the convenience of combining a quick trip to the doctor with other errands. A visit to a remote health care facility is typically cheaper, requires a shorter waiting time and is more convenient than a visit to a hospital emergency room.

The standard shopping center lease form must be modified to address the unique considerations that arise as a result of medical use in a retail setting. In addition, counsel must analyze existing leases, governmental requirements and restrictions of record to determine the impact of a medical use at a retail center.

This Note examines some of the typical lease provisions that require analysis and modification in a retail lease for a medical use. Although retail leases are governed by state and local laws and customs, this Note addresses both landlord and tenant negotiation and drafting techniques for key provisions found in retail leases nationally. Attorneys specializing in retail leasing with knowledge of local laws and customs can provide insight to the negotiations process, especially regarding due diligence and regulatory issues and the default and remedies provisions (see Practice Note, Retail Leasing: Drafting and Negotiating Key Provisions in a Retail Lease: Box, Retail Leasing: Important Questions to Ask your Local Counsel (http://us.practicallaw.com/4-507-0793#a798028)).

For more guidance on local laws and customs in leasing transactions, see Real Estate Leasing: State Q&A Tool (http://us.practicallaw.com/1-517-4023) and Managing Commercial Real Estate Leases: State Q&A Tool (http://us.practicallaw.com/9-535-6665).

DUE DILIGENCE ISSUES

Before entering into a lease for medical purposes, landlords and tenants must conduct appropriate due diligence to confirm that the proposed use does not violate any governmental or private restrictions encumbering the shopping center. Because medical uses are not typically contemplated when shopping centers are developed, landlords and tenants must be thorough and careful in their review of all potential restrictions.

ZONING AND LAND USE CONSIDERATIONS

Counsel should review municipal codes and ordinances to determine whether the tenant’s proposed use requires a variance or conditional use permit, which may result in additional costs and delays in occupying the premises.

Additionally, private agreements with the applicable municipalities should be reviewed to confirm that the proposed use is permitted. These agreements can include:

- Those concerning tax increment financing (TIF), which is a public financing method used to spur redevelopment, infrastructure and other local improvement projects.
- Planned unit development (PUD) agreements, which relate to the type of building development that may occur in a certain area.

RESTRICTIONS OF RECORD

Shopping center declarations and other reciprocal easement agreements (REAs) must be reviewed to confirm that the proposed use is not prohibited under those agreements.
REAs have historically limited uses in shopping centers to retail sales or "high end retail uses and no other use or purpose." In some REAs, business office uses are permitted, and medical, dental or other related uses may be included in the definition of "business office."

Shopping centers built on brownfield sites or former gas station locations might be encumbered by environmental restrictive covenants, which prohibit use of the property as a hospital or for other medical facilities.

If any REAs or restrictive covenants do not permit the proposed medical-related use, the parties must decide whether they can and want to amend the restriction of record to permit the medical use.

EXISTING LEASES
Anchor and other existing leases at the shopping center may contain limitations on the types of uses that are permitted at the shopping center or in certain defined areas in the shopping center. These restrictions may be found in:

- An exclusive use clause.
- A co-tenancy clause.
- A prohibited use clause.

If, for example, an existing tenant has an exclusive right to provide therapeutic massage at the shopping center, the proposed medical-related use should be appropriately limited to exclude physical therapy so that the exclusive is not violated.

Co-tenancy clauses in existing leases should be reviewed carefully to confirm that the proposed lease does not unintentionally trigger a co-tenancy failure because the proposed use is not considered a typical retail use or one that generates shopping foot traffic.

If the shopping center’s lease form contains clauses providing that the landlord does not permit certain uses, counsel should review these clauses to confirm that the proposed medical use does not violate the prohibited uses.

Unless contained in a recorded memorandum of lease, these types of restrictions are typically not of public record and therefore, there is no way for a tenant to know of them. Accordingly, tenants should include in the lease agreement representations and warranties from the landlord to ensure that the tenant’s proposed use does not conflict with any existing, unrecorded restrictions.

LOAN DOCUMENTS
Landlords must carefully review the loan documents encumbering the shopping center to confirm that use of portions of the shopping center for purposes that are traditionally non-retail does not:

- Violate the terms of the loan documents.
- Require the lender’s prior approval.

Shopping center owners negotiating acquisition financing or refinancing should anticipate wanting to lease space to non-retail tenants and try to achieve flexibility in any use restrictions in their loan documents.

REGULATORY AND LICENSING CONCERNS
Federal, state and local legislation and regulations must be considered in drafting any lease for a medical use. Delays may be encountered in obtaining requisite approvals, and the lease and build-out schedule should be appropriately structured to account for the approval process. Certain medical uses require prior approvals from governmental licensing agencies, such as a:

- Certificate of need.
- Pharmacy license.

In some cases, public comment and public hearings may be required before applicable governmental approvals are issued.

The lease should expressly require the tenant to comply with all health-related federal and state laws, including:

- The Health Insurance Portability and Accountability Act of 1996 (HIPAA).
- The Ethics in Patient Referrals Act (Stark Law) (see 42 U.S. Code § 1395nn).
- The federal Anti-Kickback Statute (see 42 U.S. Code § 1320a–7b).
- Any applicable state anti-kickback laws.

Certain typical retail concepts, such as the payment of percentage rent, may be prohibited under health-related laws.

Many states have enacted, or are considering enacting, legislation pertaining to retail health clinics, including what services can be provided in a retail health clinic.

USE CONSIDERATIONS
Like other retail tenants, medical tenants want flexibility regarding their permitted use and defining what:

- Services can be delivered.
- Procedures can be performed in the premises.

Conversely, landlords want to limit the tenant’s use of the premises by retaining some control rights over what uses are permitted.

PERMITTED USE
The tenant prefers a broadly defined permitted use provision, such as "medical or medically-related uses." This definition enables the tenant’s business to change as best practices for patient care and technological advances in medicine evolve.

However, such a broad permitted use provision can be a challenge for landlords who must ensure that exclusive use clauses in favor of other tenants are not violated (see Existing Leases). Future leasing of the shopping center may also be adversely affected by a broadly defined permitted use clause.

For an example of a typical permitted use clause in a lease for medical use, see Standard Clause, Permitted Use Clause (Medical Lease in Shopping Center (http://us.practicallaw.com/4-582-0426)).

PROHIBITED USES
The landlord should consider what restrictions should be imposed on the medical tenant’s proposed use. The lease generally should prohibit noxious uses. However, specific prohibitions should also be addressed, such as:

- Animal testing.
- Overnight in-patient stays.
Above-standard services to the premises may also be required by the tenant, such as:
- Particular janitorial services.
- Disposal of hazardous substances, medical waste and biological waste.
- Excess electrical capacity.
- Chilled water availability.
- Excessive utility consumption.

The landlord can limit its involvement in these increased services and costs by requiring the installation of separate utility meters and billing the medical tenant separately for some of these services instead of adding them to the CAM charges for the entire shopping center. The landlord may also want to require the medical tenant to contract directly with service providers, such as a security guard to patrol the shopping center after normal retail hours.

UNINTERRUPTED UTILITY SERVICE REQUIREMENT

The medical tenant’s demand for uninterrupted services may be more acute than that of the typical retail tenant. For example, the impact of a power failure on a fertility clinic or a pathology laboratory would be much more serious than the impact on a high-end retail clothier. A dedicated generator or uninterruptible power supply (UPS) system may be required to ensure continuous utility services to the medical tenant and to minimize risk to both the landlord and the tenant in a utility failure.

ENVIRONMENTAL LIABILITY CONCERNS

The landlord must understand what hazardous materials are used in the tenant’s operations. All hazardous materials, medical waste and biological waste should be used, stored, managed and disposed of properly and in accordance with all applicable laws. This includes:
- Nuclear waste.
- Hazardous chemical substances.
- Volatile gasses.
- Controlled substances.
- Infectious, toxic and radioactive materials.

The landlord should have the right to inspect the premises and to engage an environmental specialist to confirm compliance with all applicable environmental laws. The landlord may want to require the medical tenant to have an inspection of the premises completed by an environmental specialist on surrender of the premises to confirm the absence of hazardous materials, medical waste and biological waste.

SPECIAL RESTRICTIONS OR REQUIREMENTS

Some medical tenants insist on an exclusive use clause in their lease, prohibiting, for example, a competing acute care facility or dental practice. Others may insist that the landlord agree not to enter into future leases for “unhealthy” uses, such as sales of tobacco or alcohol.

Counsel should ensure this type of prohibition is carefully drafted. For example, even if the landlord agrees not to enter into a future lease for a liquor store, the landlord does not want to be precluded from leasing to a restaurant or a tavern that primarily serves food in addition to alcohol. Landlords must consider the impact of any restrictions on future leasing activities, including the landlord’s ability to grant or deny a change in use to an existing tenant.
**DESIGN AND TENANT IMPROVEMENT CONSIDERATIONS**

Medical tenants usually have unique design and tenant improvement requirements compared to typical retail tenants. These tenant improvements tend to be extensive and expensive. Substantial tenant improvement allowances are frequently granted by landlords to attract medical tenants to a shopping center.

**FACILITY CONSIDERATIONS FOR TENANT**

A lease with a medical tenant may require the landlord to make certain modifications in the operation of the common areas. For example:

- Additional curb cuts may be appropriate to enable the tenant’s patients to more easily access the premises.
- Access to service areas and loading docks may be required for ambulances, taxicabs and patient vehicles.
- If possible, a separate drive aisle may need to be added for patient drop-off and pick-up.

Proximity and availability of parking in relation to the premises is important because:

- Patients (particularly those with ambulatory limitations) need easy access to the premises.
- Healthcare professionals may be unwilling to park in employee parking areas or off-site during holiday shopping periods, as is frequently required in a typical retail lease.

**WORKLETTER CONSIDERATIONS**

The build-out of a medical tenant’s space can have some unique challenges. In addition to typical building permit requirements, a medical tenant may also be required to obtain additional regulatory approvals, such as a certificate of need or a pharmacy license (see Regulatory and Licensing Concerns). This can significantly impact the build-out time period and both the tenant and the landlord should pay careful attention to the definitions in the lease of the:

- Delivery date for the premises.
- Build-out period.
- Rent commencement date.
- Any required completion dates.
- The date the tenant must open for business.

Furthermore, the medical tenant may insist that the lease be contingent on its ability to obtain these additional regulatory approvals. This can tie up the premises for a lease that may not ultimately be viable.

A medical tenant is likely to require a substantial tenant improvement allowance. This is because a medical tenant’s improvements are typically extensive, specialized and costly. For example, plumbing in every exam room and above-standard electrical capacity can be very costly. As a result, leases to a medical user are frequently longer in duration than the typical retail lease.

**GENERAL DESIGN UPGRADES**

Because the medical tenant’s use is usually different from other uses that are currently at the shopping center, the medical tenant’s design requirements are likely to be specific and require several upgrades to the premises.

The types of equipment the medical tenant may use in its operations mean it may require:

- Excess electrical capacity and HVAC system capabilities (see Above-standard Services).
- Reinforced floors and walls to ensure appropriate load bearing, insulation and filtering capabilities.
- Additional life safety systems, such as a fire suppression system.
- Additional plumbing requirements.

Additional design considerations may also be required to eliminate noise, odors and vibration coming from adjacent premises. Similarly, demising partitions between tenant spaces should be designed to prevent noise and odors from the medical tenant’s premises from entering adjacent retail spaces. The premises should also be designed to eliminate any interference with other tenants’ telecommunications equipment caused by the medical tenant’s use of x-ray and other electric, electronic or electromagnetic equipment.

**ASSIGNMENT AND SUBLETTING ISSUES**

The assignment and subletting provisions in a typical retail lease merit careful analysis to ensure that the landlord’s interests in having a high quality and creditworthy tenant are balanced with the tenant’s need for flexibility as the medical profession and medical services industry continue to evolve.

For a discussion of a landlord’s and tenant’s considerations regarding assignment and subleasing generally in a retail leasing context, see Practice Note, Retail Leasing: Drafting and Negotiating Key Provisions in a Retail Lease: Assignment and Subleasing Rights (http://us.practicallaw.com/4-507-0793#a93061).

**STANDARD FOR LANDLORD’S APPROVAL OF AN ASSIGNMENT OR SUBLETTING**

Because of the medical tenant’s substantial investment in the premises, the tenant usually insists that the landlord not unreasonably withhold, condition or delay its consent to a proposed assignment or subletting of the premises. In addition to the typical conditions that a landlord requires must be satisfied when determining whether to grant consent, in a medical lease, the landlord should be able to consider the following about potential assignees or subtenants:

- Their reputations.
- Any unethical business practices.
- Any prior criminal conduct.
- Any contemplated change in use.

**LANDLORD’S RIGHTS UPON CHANGE OF CONTROL**

If the medical tenant consists of a small group of practitioners, the landlord and the tenant should consider the effect of change of control language in the assignment provision, including whether the admission of a new practitioner to the practice or the departure of an existing practitioner should trigger a change of control. If the parties agree that neither scenario should be deemed an assignment, the landlord should still consider whether it wants to require notice of either event.

The parties should also consider whether they want a key person provision included in the lease. For example, the landlord or the tenant may want
the right to terminate the lease in the event of the death, disability or retirement of a certain individual who is instrumental to the practice.

**USE OF PREMISES BY OTHERS**

Typical restrictions on the use of the premises by others may not be workable in the context of a medical lease. A medical tenant often wants the right to allow third parties to use portions of the premises, such as:

- Affiliated practice groups.
- Medical vendors.
- Medical suppliers.
- A blood bank.
- A diagnostic laboratory.
- Unrelated healthcare professionals, under a time-sharing arrangement.

Even if these arrangements are acceptable to the landlord, certain restrictions may be appropriate. For example, the landlord must ensure that the tenant is not engaging in space sharing as a means of avoiding a prohibited assignment of the lease or subletting of the premises. The landlord should require notice of any space sharing arrangements, even if a formal sublease is not executed.

Further, the landlord may want to limit the amount of space other users may occupy or the amount of time other users are entitled to use the premises. In any event, the landlord should insist that all users be licensed, active and in good standing with the applicable licensing authorities.

For an example of a time-sharing clause included in the assignment and subletting provision of a medical lease, see *Standard Clause, Time-sharing Clause (Medical Lease in Shopping Center)* (http://us.practicallaw.com/7-582-0665).

**LANDLORD’S APPROVAL RIGHTS IN A SALE OF TENANT’S BUSINESS**

Medical tenants, like other retail tenants, typically request that the assignment of the lease in connection with the sale of the tenant’s business be considered a permitted transfer under the lease. However, in a medical lease, this automatic right without additional restrictions may not be appropriate.

The landlord should be entitled to impose additional conditions on the assignment of the lease in connection with the sale of the business, including:

- Reasonably acceptable business reputation, experience and character of the purchaser.
- No change in the use of the facility.
- The purchaser must be properly licensed, active and in good standing.
- The purchaser must be sufficiently capitalized.

While the landlord cannot prevent a physician from retiring or selling the practice to a third party, the landlord should be entitled to:

- Review the transaction.
- Require additional security in the form of a cash security deposit, a letter of credit or personal guaranty.
- Recapture the space if the landlord cannot get comfortable with the proposed purchaser.

**OTHER STANDARD LEASE PROVISIONS TO CAREFULLY CONSIDER**

In negotiating a lease with or on behalf of a medical tenant at a retail shopping center, several additional issues to consider include:

- The landlord’s access to the premises (see Access).
- The landlord’s right to relocate the tenant (see *Landlord’s Right to Relocate the Premises*).
- Events of default under the lease (see *Events of Default*).
- Landlord remedies (see *Landlord Remedies*).
- Additional security deposit requirements (see *Additional Security Deposit Requirements*).
- Landlord defaults (see *Landlord Default and Tenant Self-help*).
- Insurance requirements (see *Insurance*).
- Surrender obligations (see *Surrender*).

**ACCESS**

The parties must carefully weigh the landlord’s right to access the premises against the tenant’s privacy obligations to its clients or customers based on the medical use of the premises. In determining when the landlord should be able to access the premises, the parties should consider:

- The period of notice required by the tenant to adequately protect its clients’ or patients’ privacy rights.
- A prohibition against the landlord accessing certain areas of the premises due to privacy and other regulatory concerns.
- Requiring that the landlord be accompanied at all times by a tenant representative.

**LANDLORD’S RIGHT TO RELOCATE THE PREMISES**

While landlords are reluctant to forfeit the typical right to relocate a tenant to new premises, this right may not be practical or appropriate for the landlord of a medical tenant because:

- The premises contain specialty equipment that cannot be moved.
- The build-out cost to relocate a medical tenant may be prohibitive (see *Design and Tenant Improvement Considerations*).
- If uninterrupted utility service is required by the tenant, relocation requires creation of redundant power supplies during the relocation.
- Medical equipment in the premises may be leased and may not be movable without the lessor’s consent.

**EVENTS OF DEFAULT**

The landlord should consider adding some additional events of default to the lease because of the medical use of the premises, such as:

- The loss, suspension or surrender of required licenses. The landlord should require the tenant to show at the landlord’s request and at least annually that each physician and medical professional working at the premises:
  - has a current valid medical license; and
  - is in good standing with the applicable licensing authorities.
- Conviction of medical malpractice or fraud.
- Occurrence of criminal conduct.
- Conduct of unethical business practices.
Failure to comply with laws pertaining to the handling of medical waste and biological waste.

Failure to maintain professional liability insurance.

**LANDLORD REMEDIES**

Some of the typical remedies available to a landlord following an unsecured tenant default may be unenforceable in a lease to a medical tenant, such as the landlord's ability to:

- Place a lien on the personal property and equipment located in the premises, since the personal property and equipment is frequently leased or financed.
- Seize, store or destroy the property located in the premises, such as patients' medical records.
- Perform self-help in the premises, such as curing a tenant's failure to make repairs to the premises.

In connection with any medical equipment used by the tenant that may be leased or financed through an equipment lease, the landlord may need to subordinate or waive any statutory or common law lien rights granted to the landlord. The landlord may need to execute and deliver a landlord waiver and consent agreement with the lender or equipment lessor. For an example of a landlord lien waiver, see Standard Document, Landlord Lien Waiver and Collateral Access Agreement (http://us.practicallaw.com/0-519-3201).

Privacy protocols and considerations associated with patients' medical records may prevent the landlord from seizing and destroying the tenant's property and from performing self-help in the premises.

**ADDITIONAL SECURITY DEPOSIT REQUIREMENTS**

The landlord may require a substantial security deposit, in the form of cash or a letter of credit, from a medical tenant. This is appropriate for several reasons:

- Extensive and expensive tenant build-out requirements (see Design and Tenant Improvement Considerations).
- Potential liability to the landlord due to the medical tenant's use of hazardous materials, medical waste and biological waste (see Environmental Liability Concerns).
- Substantial removal and restoration requirements at the end of the lease term (see Surrender).
- Significant wear and tear of the premises as a result of the medical tenant's use.
- Concerns about an individual practitioner's ability to meet its payment and performance obligations under the lease.

**LANDLORD DEFAULT AND TENANT SELF-HELP**

Due to the specialized use of the premises, there may be circumstances when the tenant should be entitled to self-help rights. For example, if the landlord fails to adequately maintain a generator or the HVAC equipment, the tenant should be able to perform self-help and remedy the failure. The lease should:

- Provide adequate and appropriate notice and cure periods before the tenant can exercise these self-help rights.
- Differentiate between emergency situations and routine repair and maintenance.

**INSURANCE**

Both the landlord and the tenant should have the insurance provisions of the lease reviewed by an insurance or risk consultant to ensure that the provisions provide adequate protection and appropriately cover risks associated with the medical use of the premises.

Additional tenant insurance requirements may include an affirmative obligation for the tenant to maintain:

- Key person insurance.
- Medical professional liability insurance.
- Property insurance covering the full replacement value of the medical equipment.

**SURRENDER**

The surrender requirements in the lease should be carefully reviewed to ensure that both the landlord and the tenant agree regarding the tenant's obligations, if any, to restore the premises at the expiration or earlier termination of the lease term.

Additional tenant surrender obligations may include:

- Removal and proper disposal of all hazardous materials, medical waste and biological waste.
- Removal of reinforced walls and flooring needed to support and filter the tenant's specialty equipment.
- Removal of special life safety systems (such as a dry fire suppression system).
- Removal of additional cabling and conduits that may have been constructed to support the medical tenant's excess utility requirements.

If the tenant has leased or financed any of the equipment in the premises, the tenant should ensure the timely removal of that equipment at the end of the lease term to avoid an inadvertent holdover in the premises and the potential liability for holdover rent and consequential damages.

The landlord also may want to require the medical tenant to have an inspection of the premises completed by an environmental specialist on surrender of the premises to confirm the absence of hazardous materials, medical waste and biological waste.

For an example of a surrender provision, see Standard Clause, Surrender Clause (Medical Lease in Shopping Center) (http://us.practicallaw.com/6-582-1566).

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