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Ten Considerations for Financing Medical Office Buildings

An Intersection of Real Estate and Healthcare
By: Timothy Davis, William Johnston and Michael Mentzel
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The financing of medical office buildings (MOBs) is on the upswing. These transactions present many complex and interrelated issues for lenders and borrowers alike when structuring their deals. While certainly not an exhaustive list, below are ten threshold issues for consideration from a legal and business perspective when evaluating the financing of MOBs:

1. Is the building or complex that is being financed "on campus" or "off campus" as it relates to the hospital? If the building or complex is on campus, how interrelated or interdependent are the MOBs to the hospital from a real estate perspective? On campus MOBs and the hospital can be "intertwined" from an operational perspective, adding a layer of complexity to the lender's collateral. Is there, for example, a shared parking arrangement or other unique real estate features, such as connector hallways or sky bridges?
2. Is the MOB owned in fee simple or pursuant to a long term ground lease? Many MOBs are held under ground lease arrangements. A ground lease structure always adds a layer of complexity to any financing and MOBs situated on ground leases are no exception. Is the fee interest held by the hospital or an affiliated entity? An unaffiliated third party? Is there other financing encumbering the fee interest?
3. How will the MOB be owned? Will the MOB be owned directly by the hospital system, a newly formed single purpose entity, or in some other manner, such as an existing joint venture? This structuring issue will be of paramount interest to any third party lender and each lender will have its own requirements and/or preferences with respect to how the collateral will be owned.
4. Who (beyond the borrower) will provide credit support to the financing in the form of recourse carve out guarantees, environmental indemnification, or otherwise? Will the guarantor be the hospital system or some other related "deep pocket" with acceptable liquidity and net worth? Is the hospital system permitted (either contractually or under law) to guaranty the obligations of the owner of the MOBs?
5. What types of consents will the borrower need to obtain in order to enter into the financing? This list could include the hospital system board, a governmental agency, or some other third party stakeholder. Much of this will depend on what type of hospital is involved. Will the hospital be university affiliated, religiously affiliated, or otherwise?
6. Who are the tenants? Are they "hospital-controlled" or otherwise "affiliated" with the hospital? The mix of tenants will vary from MOB to MOB. How many tenants have "exclusives" and what "types" of exclusive are they? What happens under the leases if the hospital undergoes a merger? A bankruptcy?
7. What is the long term viability of the hospital or health system associated with the MOB? How would the closure of the hospital or conversion to another use such as an out-patient or skilled nursing facility affect the desirability and the ultimate financial viability of the MOB?
8. Considerable attention must also be paid to the application and effect of the regulatory scheme that impacts medical professionals and medical organizations today, such as various federal and state fraud and abuse laws, including the Federal Anti-Kickback Statute, the Stark Law, and the False Claims Act.
9. How is the MOB (and indeed the entire hospital system) "managed"? There will likely be a "property level" management agreement common to traditional real estate financings, but there also may be a "manager" of the hospital system that oversees the hospital

system's broader operations and assets. How does this system-wide agreement affect the proposed financing?

10. The exercise of rights and remedies by a lender in a default and/or foreclosure scenario will in all likelihood be more complex and involved than a "traditional" real estate financing in light of many of the issues noted above. Thinking ahead about the exercise of rights and remedies under the loan documents and applicable law is particularly important when MOBs are the primary collateral for the loan.

With increased market interest in the financing of MOBs, lenders and borrowers are working through many unique and nuanced issues as their deals are structured and due diligence is conducted. We hope this list of issues to consider is helpful when analyzing potential financings of MOBs in today's market.

If you have questions or would like additional information, please contact Tim Davis (davist@whiteandwilliams.com; 215.864.6829), Will Johnston (johnstonw@whiteandwilliams.com; 215.864.6341) or Mike Mentzel (mentzelm@whiteandwilliams.com; 215.864.7156).