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Practice Intelligence: The Independent Physician's Alternative to Selling Their Health Care Practice

Practice Intelligence: Business Solutions for Health Care Professionals

The Independent Physician's Alternative to Selling Their Health Care Practice

There is a growing trend of independent physicians selling their practices to health care institutions, such as hospital systems, after which the physicians become employees of the institution. Although a purchase is the norm, there is an alternative method to link a physicians' practice with a hospital system without an outright purchase. This alternative is called "lease to perm" in the staffing industry, but the same concept can be applied via the non-permanent affiliation of the physicians' practice and a health care system.

The transaction can be structured as a lease of tangible property such as real estate, computers, medical equipment, etc., with a concurrent Professional Services Agreement ("PSA") to manage the operation and financial relationship between the practice and the hospital.

The key to establishing a transaction which will pass regulatory guidelines is to ensure the components of a "lease to perm" transaction are measured at fair market value. Health care is a highly regulated industry, adhering to a law referred to as "Stark," which is a three-part law. The aspects of "Stark" as it relates to the sale of physicians' practices, as well as "lease to perm" transactions, are guided by the central theme that the sale price or lease cost must be calculated at fair market value. Fair market value in this context is defined as 'the price, expressed in terms of cash equivalents, at which property would change hands between a hypothetical and willing and able buyer and a willing and able seller, acting at arms-length in an open and unrestricted market, when neither is under compulsion to buy or sell and both having reasonable knowledge of relevant facts'.

When a health care practice is sold, to comply with "Stark," the buyer and seller must be able to demonstrate the purchase price is in a range consistent with fair market value. In a "lease to perm" transaction, essentially, the same is true, except the various major components of the transaction must each pass the fair market value test. While "lease to perm" is more rigorous, for a seller who prefers either a break in period or a non-permanent affiliation, this tradeoff may be well worth while. Essentially, here are the components of a "lease to perm" transaction:

Establishing Real Estate and Personal Property Lease Values
Real estate and personal property such as equipment are identified, and their fair market values are determined. The resulting lease price between the parties must be in the range determined to be fair market value. This is accomplished by obtaining a fair market value assessment of the real estate lease(s), and subsequently setting the rental to the hospital system at or near that value assessment. For equipment, the fair market value should be determined via equipment appraisals for the more significant equipment, and for less significant or older equipment, alternative procedures to appraisals (which are less costly) can be used. The value of the equipment is then used to extrapolate the fair market value for the lease terms. The lease cost of comparable equipment can also be used, if available.

Determining Physician's Rate of Compensation
Physician compensation, i.e., the compensation paid to the physicians by the hospital system, is set forth in the "PSA". Medical billing is denominated by the use of "working relative value units" ("wRVU"). All medical procedures performed by physicians have a specific number of wRVU's assigned to them. Typically the physicians' practice will be compensated by the hospital system, based on the number of its annually billed and collected wRVU's. The compensated rate per wRVU must be in a range which is consistent with fair market value. To determine this, business valuation analysts utilize published database information to determine fair market values of physician compensation, including the compensated amount per wRVU. Databases commonly used to obtain this information are the American Medical Group Association, the Medical Group Management Association, and Sullivan Cotter and Associates, Inc. The data provided by these sources enable the business valuation analyst to review various metrics such as specialty, years of practice, physician age, and region.

Assessing Overhead Costs
In a "lease to perm" arrangement, the practice overhead costs will typically be reimbursed to the practice by the hospital. In order to accomplish this, the individual major components of overhead must be assessed to determine they are in the range of fair market value, after which a system of reimbursement can be established and set forth in the "PSA."

Most of the health care practices I have valued are purchased outright rather than using the "lease to perm" method described in this article. I believe this to be the case because either the buyer, a hospital system, prefers this option or because there is a lack of knowledge of options on the part of the seller, the independent physician.

An independent health care practice must be of a size sufficient to warrant these additional valuation procedures. If it is, and the physician/owners are ready to affiliate with a hospital system, but not ready for an outright sale, “lease to perm” is a viable alternative.