THE NON-PROFIT REAL ESTATE FOUNDATION: SAVE MONEY AND TAKE CONTROL

Unlocking real estate value and protecting one's balance sheet are objectives hospitals and health systems have pursued for decades. The Non-Profit Real Estate Foundation ("NPF") ownership structure is a compelling solution to unlock real estate value, significantly lower occupancy costs, provide many of the benefits of ownership, create alignment with a nonprofit owner and enhance facility flexibility as compared to a traditional sale to a private developer or REIT. Particularly in the wake of the COVID-19 health care crisis and subsequent financial fall-out, non-profit hospitals and health systems everywhere may employ the NPF to re-build liquidity and lower costs.

The NPF ownership structure provides dramatic occupancy cost savings (as compared to for-profit real estate ownership), increased liquidity and cash reserves, lessened balance sheet burden, and provides non-profit mission alignment of real estate ownership.

1. WHAT IS A NON-PROFIT REAL ESTATE FOUNDATION?

Non-profit Real Estate Foundations were generally formed in the late 1980s and early 1990s in reaction to 1986 changes in tax law. Early applications of these ownership structures focused on higher education and select charitable health care organizations. The charitable purpose of the foundation is to establish a below-market cost real estate solution to further the sponsoring non-profit charitable mission. The financial terms offered by a non-profit foundation are more competitive than those offered by REITs or other for-profit investors, largely because the foundation, by virtue of its non-profit status, does not seek to capture any beneficial real estate value. Rather, this value is passed through to the underlying non-profit health care provider.

2. HOW DOES IT WORK?

The foundation serves as the owner of the facility in question and obtains financing based upon the lease terms with the underlying non-profit tenant. Rent structures are based on the foundation's cost of debt and are set at levels substantially below market. Even after including costs of issuance and an annual foundation administrative fee, the result is a rental rate substantially below those offered by for-profit alternatives. The financing mechanisms are 100% transparent to the tenant.

Lease terms in the NPF model range from 10-30 years depending upon the goals and objectives of the underlying non-profit tenant. Shorter-term leases may be structured to receive favorable accounting treatment and will generally lessen balance sheet impact when compared to traditional ownership or private landlord structures. Favorable purchase options may be established, and the foundation's donative intent policy may provide full ownership to the underlying non-profit tenant upon retirement of the foundation's debt. Purchase options may differ in sale-lease-back scenarios as compared to new asset development.

3. SUMMARY BENEFITS OF THE FOUNDATION OWNERSHIP MODEL

If a hospital is considering a facility solution OTHER than direct hospital financing and ownership, the benefits of the foundation model are quite compelling.

a. Lower Rental Cost: Rental rate savings and dollar per square foot rent savings have proven to be substantial.
b. Lower Project Cost: In the case of a new development, lower financing costs accrues to lower overall project cost. A non-profit owner might also be able to secure sales tax exemption on materials purchased.
c. Property Tax Exemption: While this is not a guaranteed outcome, it is a likely outcome in states and markets that support property tax exemption for hospitals and their charitable purposes.
d. Mission and Facility alignment: TThe foundation does not seek upside property value or "profits". Its purpose is to support the mission of the hospital by delivering a favorable real estate structure.
e. Donative Intent: Many foundations employ a donative intent policy that evidences their charitable intentions and provides for all upside value of the facility in question to accrue to the benefit of the tenant. Donative intent policies also provide for conveyance of the facility to the underlying tenant upon retirement of the foundation's debt.
f. Flexible lease terms and flexible purchase options: Lease terms can be structured to meet the underlying tenant's preferred accounting treatment and purchase options are generally more favorable than those offered by for-profit developers or REITs.
g. 100% transparent: All costs and fees are known to the underlying tenant and the tenant will have total transparency into the

foundation's financing of the facility (the terms of which flow through and affect the tenant's lease obligations).

h. Favorable Balance sheet treatment: Hybrid lease models have been shown to lessen balance sheet impact by more than 50% as compared to direct ownership.

4. PROPERTY APPLICATIONS OF THE NPF

Any facility which is used in furtherance of the underlying non-profit hospital or health system's charitable purpose qualifies. Here are some examples:

a. A comprehensive outpatient care facility (on or off-campus) in which the hospital might lease a significant portion.
b. A hospital or joint-venture operated specialty care facility such as a skilled nursing facility, or an in-patient rehab hospital
c. An administrative building
d. A central supply facility
e. A grant-funded research-based facility
f. An on-campus parking garage
g. A comprehensive oncological care facility
h. The hospital's central power plant
i. Etc.

Any of these can be existing facilities or build-to-suit new developments. Generally speaking, the foundation model is best applied in projects and facilities that have a longer-term occupancy horizon. In ANY real estate situation whereby a hospital might be considering a longer lease term with a for-profit owner, the foundation model is likely to be financially more competitive.

5. PROJECT EXAMPLES

a. An on-campus 156,000 square foot administrative building in a dynamic market in the Southwest had been leased by a health system for 10 years. The lease renewal was pending for a new 10-year lease, rates had escalated substantially, and the hospital was searching for alternative, lower-cost options. In conjunction with the health system, a foundation stepped in and purchased the building, including the ground which was transferred to the hospital at closing (and ground-leased back to the foundation). The foundation and hospital entered into a new 10-year lease agreement with annual rent savings of nearly $10 per square foot, resulting in $17 million in rental savings over the initial 10-year term as compared to the prior rent structure. A property.

tax exemption application will save an additional $1.3 million annually. The property will revert to hospital ownership upon the repayment of the foundation debt.

b. A prominent regional hospital in the Southeast desired a new comprehensive outpatient care center (79,000 square feet) and entertained proposals from for-profit developers. The hospital wanted to self-develop the project, yet wanted to protect its liquidity and debt capacity. A foundation was selected to own and finance the project, which achieved an annual rental savings of approximately $300,000 when compared to for-profit proposals. The facility achieved an additional annual property tax savings of $150,000 via an available property tax exemption. Moreover, the foundation, as a non-profit, was able to finance the project through a local governmental issuer thereby obtaining a sales tax exemption on materials. The rent schedule was structured "flat" at the request of the Tenant = no escalators.

c. A large Northwest regional health care provider had developed four micro-hospital facilities (2 complete, 1 under construction and 1 to be built) and was seeking to redeploy this capital expense elsewhere in the system. After issuing an RFP to several for-profit national owners of health care real estate, a non-profit foundation was chosen to structure a four-building sale-leaseback. The foundation structured a 20-year self-amortizing lease which achieved the lowest rent as compared to the for-profit options, AND the foundation will secure $800,000 annual property tax exemption.

6. WHAT ARE MY NEXT STEPS TO EXPLORE A FOUNDATION STRUCTURE?

The next steps are quite simple: If you desire to explore the benefits and financial creativity offered by a foundation model, contact Hall Render Advisory Services and let's discuss the applications and solutions. Working in conjunction with the Hall Render law firm, Hall Render Advisory Services can help you consider the best and most appropriate structure for any transaction.

Hall Render Advisory Services provides non-legal advice to hospitals and health systems in all manner of real estate matters. We offer objective, transparent and ethical guidance without conflict of interest or ownership.

Our team of seasoned health care thought leaders brings a client-side perspective, an average of more than 20 years of experience each and innovative solutions to help solve our clients' challenges. As an affiliate of Hall, Render, Killian, Heath & Lyman, P.C., Hall Render Advisory Services may draw on the talent and resources of a diverse attorney population—all of whom are focused exclusively on health care.

For more information about the content detailed above or any questions related to this matter, please contact:

- John Marshall at (317) 670-8527 or jmarshall@HallRenderAS.com;
- Andrew Dick at (317) 977-1491 or adick@HallRender.com.

Hall Render Advisory Services ("Advisory Services") is a wholly-owned consulting subsidiary of Hall, Render, Killian, Heath & Lyman, P.C. Advisory Services acts as a real estate advisory to clients in various real estate transactions. Advisory Services does not provide legal services, nor is a registered broker-dealer or a registered municipal advisor. Advisory Services does not provide municipal advisory services to entities or obligated persons under Section 15B of the Securities Exchange Act of 1934. HRAS does not provide advice or recommendations concerning swaps or other derivatives or other municipal financial products or concerning the structure, timing or terms of the issuance of municipal securities.