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THE COMING COVID-19 CASH BURN: NEW REAL ESTATE STRATEGIES CAN HELP YOU BUILD CASH

The financial ripple effects of the COVID-19 crisis are likely to hit hospitals and health systems soon. As elective procedures are postponed or cancelled, and as COVID-19 costs escalate, many hospitals and health systems will begin burning cash and will find liquidity deteriorating. Declining investment portfolio values only add salt to the wounds. Aside from the obvious operational challenges presented, those subject to days' cash on hand covenants may soon find themselves approaching covenant levels and potentially crashing through them. In the near term, treating patients and slowing the spread of the virus is of course job one for all of us. In the medium and longer term, hospitals and health systems will need to find ways to restore their liquidity and return to more normal operations.

In light of this coming cash burn, many hospitals and health systems have shifted into cash conservation mode. Doing so is a prudent and necessary step. If you have not taken steps to conserve resources, you should do so now.

Moreover, many of our clients have contacted lenders to request increases in their available lines of credit and/or have activated commercial paper programs in order to tap the market if and when necessary. Having these short term liquidity tools at the ready is also a prudent and necessary move.

Unlike cash conservation and short-term borrowing, utilizing one's real estate assets to build cash at a time like this may not be on everyone's radar. Historically, hospitals and health systems have from time to time "monetized" real estate assets by selling non-core assets to third parties and leasing those facilities back. Traditional buyers have been real estate investment trusts ("REITs"), insurance companies and other institutional investors.

More recently, nonprofit real estate foundations have become active in the health care industry and are proving to be a more attractive option. Nonprofit real estate foundations are third-party nonprofit organizations who source low-cost capital to acquire or develop assets used by hospitals and health systems in furtherance of their charitable purposes. The terms offered by these nonprofits are generally better than those offered by REITs or other for-profit investors. Terms include lower rents, favorable purchase options and the possibility of securing or maintaining a property tax exemption.[1] Moreover, hospitals and health systems may find it easier to work with a mission-aligned nonprofit real estate foundation to structure favorable lease terms. As one example, leases may be structured to provide initial periods of $0 rent or several years of "interest-only" rent payments where lease payments are set in relation to the interest payable by the nonprofit landlord.

Beyond real estate currently owned by hospitals or health systems, third-party for-profit owners of leased buildings may themselves be looking for capital. Such for-profit owners of health care real estate may be willing to sell their assets to a nonprofit real estate holding company who could, in turn, restructure the lease with more favorable terms for the hospital or health system tenant.

Yes, $0 rent periods or interest-only lease structures merely "back-load" the true costs of the facility, but in times such as these, building cash and liquidity may outweigh current amortization of facility costs.

PRACTICAL TAKEAWAYS

If your hospital or health system is concerned that it may need additional cash on hand to combat COVID-19 or to survive during this crisis, we suggest the following:

- **Debt Covenants** – Review existing debt covenants within bond or loan documents to ensure that your hospital or health system will be able to comply with the covenants. If you anticipate falling below the required levels, be proactive in reaching out to lenders or bond investors.
- **Credit Lines** – Tap into lines of credit and/or pursue an increase in existing lines of credit.
- **Owned Real Estate** – Take inventory of real estate holdings to determine if it makes sense to pursue a sale-leaseback transaction with a nonprofit real estate foundation for a particular facility in order to unlock cash currently in owned real estate.

- **Leased Real Estate** – For mission-critical facilities that are leased from for-profit owners, consider negotiating with the landlord to purchase the facility and simultaneously entering into a sale-leaseback with a nonprofit real estate foundation in order to lower rental expenses.

If you have any questions or would like additional information about health care real estate matters, please contact:

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[1] The availability of property tax exemptions to nonprofit real estate foundations is dependent on state and local laws and varies by jurisdiction.