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Structured Real Estate Financing Alternatives: What to Know

Many hospitals and health systems seeking to access funds for capital needs are facing several challenges. Although financial performance began to stabilize in 2024, resources remain tight at many organizations, with only approximately one-third of hospitals and health systems showing a positive change in margin from 2019. At the same time, limited capital investment in 2021 and 2022 has created a backlog of capital needs, with average-age-of-plant medians creeping upwards. Further, despite the Federal Reserve’s movement to begin reducing the federal funds rate in 2024, long term tax-exempt bond rates have remained elevated compared to recent history.

These factors are driving interest in non-traditional financing structures—often involving real estate—which include:

- [Energy-as-a-Service \(EaaS\) transactions](#), which provide alternative financing and risk-transfer opportunities for hospital energy usage
- [Real estate monetization opportunities](#), which enable health systems to raise unrestricted liquidity in properties and improve their liquidity metrics
- Structured real estate financing alternatives—often in the form of what are known as synthetic leases—which may provide favorable rate and balance sheet impacts

We have seen active marketing efforts for synthetic lease transactions in recent months, which can extend beyond the CFO’s office to members of the board of directors



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or individuals within the health system’s real estate and facilities office. While there are many use cases for synthetic leases—including real estate development, acquisitions, or capital-raising efforts around existing assets—there are also several considerations that must be carefully thought through to ensure that a synthetic lease is a desired financing alternative.

Among the advantages promoted for synthetic lease transactions is that they are easy to execute, “off balance sheet”, and may not affect debt capacity under the organization’s Master Trust Indenture (MTI). However, these transactions are in fact fairly complex, involving, for example, a total return swap structure, and although they may be “off the balance sheet” for accounting purposes, they will not be off the radar for the rating agencies.

Key Components of a Synthetic Lease

- The leasing company acquires the property and executes a lease with a not-for-profit health system.
- The lease is pledged to a municipal issuer that issues tax-exempt bonds backed by the lease payments (tax-exempt eligible property is required).
- The bonds are purchased by the capital provider.
- The lessee health system pays rent to the leasing company, which is based on the debt service of the bonds.
- A total return swap is executed to achieve a floating rate cost of funds.
- The lessee health system guarantees a residual value for the property at the end of the lease.
- At the end of the lease, the lessee can purchase the property, negotiate a renewal of the synthetic lease, vacate the lease and pay off the residual value, or arrange a sale of the asset for the benefit of the leasing company and its lenders.

Benefits and considerations for synthetic lease transactions

A fair assessment of synthetic lease transactions as a financing alternative requires an understanding of their primary benefits and considerations. Benefits of synthetic leases include:

- They often are facilitated using a “single source” capital solution for ease of execution.
- Compared with other financing alternatives, they may offer a quicker speed to completion.
- Compared with outright asset ownership secured by a loan, synthetic leases may offer a favorable balance sheet treatment under ASC 842.
- Lessees nonetheless benefit from an “ownership-like” structure, maintaining the rewards of real estate ownership.
- Synthetic leases are not debt directly backed by the MTI.
- Tax-exempt financing treatment provides for lower transaction costs.
- A private placement structure does not require offering documents, ratings, or investor marketing.

Notwithstanding these benefits, there are several considerations that may make synthetic leases a less attractive alternative. These include:

- Cost of capital: there may be lower cost alternatives available to the health system.
- The structure of synthetic leases is somewhat complex and likely requires auditor input.
- Synthetic leases are a relatively new solution in the healthcare space and may carry a higher degree of execution risk.

While there are many use cases for synthetic leases there are also several considerations that must be carefully thought through.

- While lessees maintain the rewards of real estate ownership, they also maintain the risks.
- Lessees may maintain “end of term” risks (e.g., interest rate, future credit/covenant requirements, market liquidity) associated with the maturity of the underlying financing.
- Limited synthetic lease capital providers lessen competition in the marketplace.
- The structure requires a separate swap/derivative between the lessee and capital provider and includes related ISDA swap documentation and credit terms.

Additional considerations

A synthetic lease transaction may require the execution of two separate but interrelated transactions: a real estate transaction or development and the synthetic lease financing. A multi-disciplinary approach that combines real estate and financing expertise to evaluate all aspects of a proposed transaction will help ensure that a synthetic lease is the most appropriate financing option for the organization and that all aspects of the transaction, if pursued, provide the most benefit to the organization.

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