CHAPTER 1. GENERAL FEATURES OF THE HOSPITAL INSURANCE PROGRAM

1-1. INTRODUCTION. There are serious demands for increasing utilization of modern health facilities today. Many existing hospitals are in need of extensive expansion and modernization. Although much nonprofit hospital construction has been made possible with direct Federal assistance under the Hill-Burton Act, and many nonprofit groups have been able to assist hospitals through fund raising drives and similar efforts, these sources have been inadequate to fund all the nonprofit facilities needed. One source that had not been utilized to its full potential for both nonprofit or proprietary facilities, until enactment of the insured mortgage program for hospitals, was long-term financing at reasonable terms.

a. This program provides mortgage insurance for loans to qualified applicants to build new facilities or modernize existing ones, and can also be used in nonprofit proposals to supplement Hill-Burton grants or HEW guaranteed loans for the same purpose.

b. Inquires concerning HUD mortgage insurance for hospitals may be made to the Director of the HUD Office; the regional office of the Department of Health, Education and Welfare, or the State Hill-Burton Agency, in the area where the proposed project is to be located (see list of HEW regional and State Agency offices in Appendices 5 and 6. Advice on professional and technical matters relating to hospital plans and proposals may be obtained by writing or visiting the HEW Regional Office.

1-2. PROGRAM AUTHORIZATION. The Housing and Urban Development Act of 1968 added a new Section 242 to Title II of the National Housing Act, which authorizes the Secretary of HUD to insure mortgage loans financing the construction or rehabilitation of, and the purchase of major movable equipment for, nonprofit hospital facilities. The Housing and Urban Development Act of 1970 amended Section 242 to allow proprietary facilities. The Secretary has delegated to the Assistant Secretary for Housing Production and Mortgage Credit-Federal Housing Commissioner (HPMC-HUD-FHA) the authority to administer the program. By formal agreement between the Secretaries of HUD and HEW, the responsibility for making a determination as to the feasibility of a proposal, as well as inspections during the construction of a facility, has been delegated to HEW, which is acting as an agent of HUD.

1-3. ELIGIBLE HOSPITALS.

a. Type of hospital. Under this program hospital refers to a facility:

(1) Which provides community service for inpatient medical care of the sick or injured;

(2) Which has not more than 50 per centum of the total patient days during any year assignable to the categories of chronic convalescent and rest, drug and alcoholic, epileptic, mentally deficient, mental, nervous and mental, and tuberculosis, and;

(3) Which is a proprietary facility, or facility of a private nonprofit corporation or association, licensed or regulated by the State (or if there is no State law providing for such licensing or regulation by the State, by the municipality or other political subdivision in which the facility is located).

b. Certificate of Need. The law does not permit the Assistant Secretary-FHA Commissioner to insure a mortgage under this program unless he has received from the State agency (Appendix 6) designated in accordance with Section 604(a)(1) of the Public Health Act for the State in which the hospital is to be located a Certificate of Need, FHA Form 2576 (Hospital) (Appendix 2).

c. Group practice. The law provides that encouragement shall be given to group practice sponsors seeking mortgage insurance for hospitals as defined in a. above.

1-4. ELIGIBLE MORTGAGORS AND SPONSORS. The mortgagor (borrower) is the organization or entity that owns the property which is the Security for the mortgage insured by HUD. The sponsor is the organization or entity that initiates and promotes the development of the facility. The sponsor, if it meets the nonprofit requirements, may qualify as the mortgagor, or it may set up a separate entity for the purpose of qualifying as a mortgagor.

a. Types of mortgagors. Two types of mortgagors may qualify for a HUD insured mortgage under the program.

(1) A proprietary (profit-motivated) mortgagor may be a corporation, partnership, trust, individual, or any other qualified legal entity. It is expected that such hospital will have a board of directors or trustees to include community and consumer participation.

(2) A nonprofit mortgagor must be a nonprofit corporation or association. The law specifically requires that no part of the net earnings of the mortgagor shall inure to the benefit of any private shareholder or individual. The sponsor, if different from the mortgagor, must also be a bona fide nonprofit entity which meets the same test.

b. Continuity of Mortgagor. The mortgagor must show that it has the continuity of organization needed for this long term mortgage program. For new organizations, or those whose continuity is necessarily dependent upon an individual or individuals, broad community participation will be required. A proposal in which the mortgagor is controlled in any manner by the professionals practicing in the hospital will not be eligible.

1-5. HUD SUPERVISION. The operation of the project will be supervised by HUD through a regulatory agreement. A complete annual financial statement will be required to be submitted to HEW at the end of each fiscal year. Mortgagors owning other health facilities in addition to the hospital, with a central purchasing system, may prorate expenses for materials, supplies, salaries, etc. Although no specific form of accounts is required, it is suggested that the Chart of Accounts for Hospitals, which is published by the American Hospital Association, be used as a guide.

a. The mortgagor will be required to operate the project as a hospital as long as the property continues to be subject to a HUD insured mortgage. The mortgage shall not be prepaid in full prior to its maturity except under such terms and conditions as may be approved by HUD. In granting approval for such prepayment, HUD may require assurances from the mortgagor of continued operation of the project as a hospital for a specified period of time.

b. The regulatory agreement with the mortgagor (FHA Form 2466 or 2466GP) requires that neither the use of the property nor the services of the professional or other personnel shall be denied to anyone on the basis of race, color, creed or national origin. The mortgagor will be required to comply with local laws and ordinances prohibiting discrimination.

c. Operating fund. The mortgagor must be financially able to meet the expenses of the project for such period as HEW estimates is necessary to establish a self sustaining operation. HEW may require the establishment of an operating fund to meet an anticipated operating deficit. The need for, and size of the fund will be determined by HEW based on the specific proposal being considered. HEW will indicate to HUD the amount of the operating fund (if any) under the remarks section of the HEW Final Approval Letter.

d. Leasing of a hospital in its entirety is not contemplated under this program. Any proposal in which leasing of the entire facility is a factor will be handled on a case-by-case basis. Any leasing or contractual arrangements must be stated in detail and approved prior to filing application for mortgage insurance. Leasing of a nonprofit facility to a proprietary entity will not be considered.

1-6. MORTGAGE FINANCING. The sponsor is responsible for locating a source for the required mortgage funds (both for construction financing and permanent investment). It is important that tentative arrangements for financing be made during the early development of the proposal in order to avoid the unnecessary expenditure of time, effort and money in the event mortgage funds are not available. It is suggested that, immediately upon a decision being made to use this program, the sponsor communicate with the HUD office for a list of approved mortgagees (lenders).

a. Although HUD may not recommend a specific source of mortgage funds, its local field offices may assist sponsors to the extent of providing lists of HUD-FHA approved mortgagees (lenders) in the area who make loans of the type and amount desired. In the nation there are approximately 25,000 financial institutions, including branch offices, approved by HUD-FHA for the insurance of loans under its various programs. These approved lenders include national banks, state banks, mortgage companies, insurance companies, savings and loan associations, and savings banks.

b. FNMA participation. Permanent loans under this program are eligible for purchase by the Federal National Mortgage Association under its regular secondary market operations for multifamily housing mortgages. Upon execution of a commitment for advances by HUD, FNMA will consider participating up to 95% in construction advances as they are insured by HUD.

FNMA will also enter into a preliminary commitment of funds contract upon issuance of a feasibility letter from HUD. Therefore, upon being advised by the HEW regional office of its approval of the sponsor's initial application to HEW, and after receipt of the initial FHA application, Form 2013-HOSP, with fee, (plus for proprietary facilities Previous Participation Certificate, FHA Form 2530) the HUD office will issue a feasibility letter to the sponsor, using the following format:

"We have been advised by the HEW regional office in (city and state) of its approval of your initial application for an insured mortgage under Section 242 of the National Housing Act. We have also received a formal application, FHA Form No. 2013-HOSP from (mortgagee) in the amount of $ __________________________ with the required fee.

By agreement between HEW and HUD, the responsibility for the processing of Section 242 applications has been delegated to HEW. Based on such approval, this proposal is considered feasible subject to HEW's review and approval of the revised HEW application."

c. The sponsor will be dealing directly with the State Hill-Burton agency as well as the HEW regional office during the processing of a proposal. However, the formal application for a HUD-FHA firm commitment must be submitted to the HUD office through the HUD-FHA approved lender who has agreed to make the loan.

1-7. MORTGAGE TERMS. The maximum mortgage amount is governed by a dollar limitation of $50,000,000, and a loan limitation of 90% of the estimated replacement cost of the property, including major movable equipment, covered by the mortgage.

(1-7) a. Special limitations, in addition to those prescribed in the previous paragraph, are imposed when the project involves "rehabilitation," as defined in b. below. The character of the limitations depends upon whether the property is already owned by the sponsor or mortgagor or is to be purchased or otherwise acquired. (See 3-3.c.)

b. Rehabilitation involves alteration, repair, modernization, or addition to an existing hospital (or to an existing structure by an established hospital) including appropriate alteration and landscaping of the grounds. Rehabilitation may also include the installation of technical or professional equipment to be used in the hospital. However, the cost of rehabilitating the existing building and grounds (together with the cost of purchasing and installing technical equipment) must represent at least 20% of the total mortgage amount, with at least one half of such 20% applied to the rehabilitation of the buildings and grounds. No more than one half of such 20% may be applied to equipment for an existing building.

c. Joint Hill-Burton, HUD insured, and HEW guaranteed financing is eligible for nonprofit mortgagors under this program under the following conditions:

(1) If a Hill-Burton grant and a HUD insured loan are involved, the total of the grant and loan cannot exceed the total cost of the project and the required major non-realty (movable) equipment includable under the mortgage and grant.

(2) If an HEW guaranteed loan is involved, it may be used in conjunction with a HUD insured loan. The total HUD-FHA insured mortgage and the HEW guaranteed loan cannot exceed 90% of the estimated replacement cost of the property including major movable equipment.

d. The maximum mortgage term is 25 years from the date of beginning of amortization. Payments will be on the level annuity monthly plan. Approved terms for monthly payments, including curtail rates for reducing the principal amount of the mortgage, will be prescribed by HUD.

(1-7) e. The mortgage may bear interest at a rate not in excess of the maximum rate prescribed by FHA regulations.

f. Mortgage insurance premium. The mortgagor's monthly mortgage payments include an amount equal to one-twelfth of the annual mortgage insurance premium which the mortgagee is required to pay HUD-FHA. (Note: During the construction period, on projects involving insurance of advances, the annual premium is approximately one percent of the average outstanding principal obligation of the mortgage).

g. In addition to making monthly payments covering the principal, interest and mortgage insurance premium due under the mortgage, the mortgagor will be required to include in the monthly payment an amount sufficient to provide for the payment of taxes (if any), property insurance and any special assessments and ground rents. Proprietary facilities in addition will be required to make deposits to a replacement reserve fund for the replacement of equipment

h. The HUD insured mortgage must be the first mortgage on the hospital to be constructed or rehabilitated. Generally, this will be the only mortgage on the property.

(1) In certain instances, secondary financing is allowable for nonprofit facilities as follows:

(a) If an HEW guaranteed loan is involved;

(b) If second mortgage money is supplied at a lesser rate than the HUD-FHA insured mortgage, for example, by a State or municipal body.

(2) In either instance, HEW must give its prior approval to the second mortgage, after making a determination that income will be available to meet required payments on both the first and second mortgages. The mortgagee must also give its approval to the second mortgage, as required by the mortgage document. The HUD mortgage must include a mutual default provision requiring that a default on the second mortgage constitutes a default on the first mortgage.

i. Initial processing of an application will proceed only when accompanied by evidence of site acquisition in the form of fee simple title, an option to purchase, contract of sale, a 99-year renewable lease, or a lease which has at least 50 years to run from the date of the insured mortgage. The lease must include the provisions of FHA Form No. 2070, Lease Addendum.

1-8. FINANCING CHARGES. The mortgagee is permitted to obtain reimbursement from the mortgagor for the application, commitment and inspection fees paid to HUD-FHA. In addition, it may collect from the mortgagor an initial service charge not to exceed two percent of the principal amount of the mortgage, as reimbursement for the cost of closing the loan transaction. This initial service charge is included in computing the total estimated replacement cost. Also included in computing total estimated replacement cost is the one and one half percent FNMA commitment and purchase and marketing fee. If the permanent lender is other than FNMA, the one and one half percent is permissible. Financing charges approved by HUD as reasonable, over and above the two percent service charge and one and one half FNMA fee, may be collected from the mortgagor and either turned over to the permanent lender or retained by the construction lander, but may not be included in computing estimated replacement cost.

1-9. PHYSICAL GUIDELINES. The guidelines published by HEW in Public Health Service Publication No. 930-A-7, General Standards of Construction and Equipment for Hospital and Medical Facilities, and in Public Health Service Publication No. 930-D-4, Hospital and Nursing Home Equipment Planning Guide, will be used in this program.

1-10. EVALUATION AND PROCESSING OF PROPOSALS. The sponsor will be dealing exclusively with the HEW regional office during the feasibility processing of a proposal. Therefore, the initial contact should be with the HEW regional office. If the initial contact is made with the HUD office, the sponsor will be furnished with a copy of this handbook and referred to the HEW regional office. Because of the divided responsibilities in this program, a liaison man will be designated by both the HUD and HEW regional offices to coordinate proposals in process, initial and final closings, etc.

On proprietary facilities the sponsors initial contact should be with the HUD Field office as the Previous Participation procedure, FHA Form 2530 is required. Proprietary sponsors prior to filing the HEW application will submit a completed FHA Form 2530 to the local HUD office with a covering letter stating that the proposal is a proprietary hospital. Upon clearance of the sponsors the HUD office will notify the sponsor that he may file the initial application with the HEW Regional Office.