

Refinancing of Section 232 Projects

Legal Opinion: GHM-0087

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Subject: Refinancing of Section 232 Projects

July 13, 1993

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Dear Ms. Hyde:

This responds to your letter to Millicent Potts of my staff, which listed a number of questions regarding the purchase or refinancing of nursing homes and adult congregate living facilities. For your information, the Department has issued Handbook 4600.1 REV-1, "Section 232 Mortgage Insurance for Residential Care Facilities (Nursing Homes, Intermediate Care Facilities, and Board and Care Homes)," which Handbook contains administrative guidance on this subject, particularly as it relates to the Department's implementation of section 223(f) of the National Housing Act for the section 232 mortgage insurance program. A copy of Handbook 4600.1 REV-1 may be obtained through your local HUD Field Office. Our answers to your specific questions are as set forth below.

1. May a nursing home with an existing FHA insured mortgage refinance under 232 (with reference to 223(F) without 15% rehab.?

Yes. If the nursing home is covered by an existing mortgage insured by FHA under section 232 of the National Housing Act ("Act"), it may refinance under section 232, pursuant to section 223(f) of the Act provided, among other things, it does not require substantial rehabilitation. There is no requirement that an existing FHA-insured nursing home undertake "15% rehabilitation" in order to qualify for refinancing under section 232, pursuant to section 223(f) of the Act. In fact, as discussed more fully below, if the cost of rehabilitation to such a nursing home will exceed 15% of the nursing home's value after completion of the rehabilitation, the transaction would not be eligible to refinance under section 232, pursuant to section 223(f) of the Act.

To begin, section 223(f) of the Act authorizes the Department to insure a mortgage executed in connection with the purchase or refinancing of the existing debt of, among other things, an existing nursing home, intermediate care facility, board and care home, or any combination thereof. The Department has implemented this statutory authority as to these types of projects at 24 C.F.R. Part 232, Subpart E. As such regulations make clear, the Department has implemented such statutory

authority only for projects which are currently FHA-insured under the Department's Section 232 Program, i.e., Section 232 Projects. The Department's Section 232 Program provides mortgage insurance for the new construction or substantial rehabilitation of nursing homes, intermediate care facilities, board and care homes, or combinations thereof.

In this regard, 24 C.F.R. Section 232.901 provides that "a mortgage executed in connection with the purchase or refinancing of an existing Project covered by a mortgage insured by the Commissioner may be insured under this subpart [E] pursuant to section 223(f) of the Act." Also, 24 C.F.R. Section 232.902(a) states, in part, that "[e]xisting Projects covered by a mortgage insured under section 232 of the Act ... are eligible for insurance under this subpart [E]..." Finally, in connection with your specific question, we note that as established in 24 C.F.R. Section 232.1(j), the term "Project" as used in these regulations includes a "nursing home" that is approved by the Department under the provisions of 24 C.F.R. Part 232, Subpart A. Along with nursing homes, the term "Project" as used in these regulations also includes other projects eligible for insurance under section 232, i.e., intermediate care facilities, board and care homes or any combination of the foregoing. See 24 C.F.R. 232.1(j).

In addition, there is no requirement that an existing FHA-insured nursing home undertake "15% rehabilitation" in order to qualify for refinancing insurance under section 232, pursuant to section 223(f) of the Act. Further, the need for "substantial rehabilitation" disqualifies a Section 232 Project, such as an existing FHA-insured nursing home, from refinancing under section 232, pursuant to section 223(f) of the Act. As set forth in 24 C.F.R. 232.902(b), "substantial rehabilitation" consists of: "repairs, replacements, improvements and additions: (1) The cost of which exceeds the greater of fifteen percent (15%) of the Project's value after completion of all repairs, replacements, improvements, and additions, or (2) That involve the replacement of more than one major building component. For purposes of this definition, the term major building component includes: (i) Roof structures; (ii) Ceiling, wall, or floor structures; (iii) Foundations; (iv) Plumbing systems; (v) Heating and air conditioning systems; (vi) Electrical systems."

24 C.F.R.  
Sections 232.902(a) and (b).

Accordingly, a proposal to undertake substantial rehabilitation of a Section 232 Project in connection with a refinancing (such as where the cost of rehabilitation will exceed 15% of an existing FHA-insured nursing home's value after completion of such rehabilitation) would render the mortgage ineligible for insurance under section 232, pursuant to section 223(f) of the Act. See 24 C.F.R. Sections 232.902(a) and

(b). See also Handbook 4600.1 REV-1, 2-2(3) and 2-9.

2. May a nursing home with a high rate non-FHA insured mortgage refinance without the 15% rehab.?

It depends. To begin, by a "non-FHA insured mortgage," we presume you mean a mortgage that is not FHA-insured. Two provisions of the Act, namely, section 223(a)(7) and section 223(f), expressly provide for the refinancing of mortgages of, among other things, section 232 eligible projects, including nursing homes. In addition, section 232's insurance program for the substantial rehabilitation of such projects also provides a means to refinance an existing mortgage on a nursing home. Each of these three provisions is explored below with respect to your specific question. As you will see, however, only one scenario offers the possibility that a non-FHA insured nursing home could effect an insured refinancing without "15% rehabilitation."

First, a nursing home with a non-insured "high rate mortgage" may not refinance under section 232, pursuant to section 223(a)(7) of the Act. The express language of section 223(a)(7) limits itself in application to the refinancing of "an existing mortgage insured under this Act." (Emphasis added.) The Department's implementing regulation for section 223(a)(7) as it applies to Section 232 Projects, including nursing homes, is 24 C.F.R. 232.42. In accordance with the statute, 24 C.F.R. 232.42 clearly states that only a mortgage given to refinance an existing FHA-insured mortgage is eligible for insurance under section 232, pursuant to section 223(a)(7) of the Act.

Therefore, a non-insured nursing home is not eligible to refinance under section 232, pursuant to section 223(a)(7) of the Act. It follows then that the issue of "15% rehabilitation" raised in your question is not relevant.

Second, a nursing home with a non-insured "high rate mortgage" may not refinance under section 232, pursuant to section 223(f) of the Act. As indicated in our response to question 1, only an existing FHA-insured Section 232 Project, such as a nursing home, may refinance under section 232, pursuant to section 223(f) of the Act. While the section 223(f) statute is broad enough to permit HUD to insure refinanced mortgages under section 232 where the original mortgage is not FHA-insured, HUD by regulation in 24 C.F.R. Part 232, Subpart E, has not implemented such authority under section 232. Again, because a non-insured nursing home is ineligible to refinance under section 232, pursuant to section 223(f) of the Act, the issue of "15% rehabilitation" is not relevant.

Finally, section 232's insurance program for the substantial rehabilitation of, among other things, nursing homes, also provides a means to refinance an existing mortgage on a nursing home. Section 232 of the Act is not a refinancing provision. Nevertheless, as implemented by the Department at 24 C.F.R. Part 232, an eligible project under section 232 (such as a nursing home) that seeks to be insured by undergoing substantial rehabilitation, can refinance its existing mortgage in accordance with 24 C.F.R. Sections 232.32(b) and 232.90(b).

There is no requirement that a nursing home be currently insured by the Department in order to be eligible for mortgage

insurance as a substantial rehabilitation case under section 232 of the Act. However, as stated, there is a requirement that the project undergo substantial rehabilitation. For insurance under section 232 of the Act "substantial rehabilitation" exists when: "[t]he hard cost of repairs, replacements, and improvements ... and additions exceeds 15% of the property's value after completion of all repairs, replacements and improvements, or [t]wo or more major building components are replaced ... [that is] ... (1) roof structures; (2) ceiling, wall or floor structures; (3) foundations; (4) plumbing systems; (5) heating and air conditioning systems; and (6) electrical systems. See paragraph 2-2(2)(a) of Handbook 4600.1 REV-1. Your question seems to be seeking a mechanism that would allow an insured refinancing of a nursing home (that has a mortgage that is not FHA-insured) without significant, i.e., "15%," rehabilitation. Therefore, under the facts set forth in your question, the need for substantial rehabilitation would appear to be an impediment to the nursing home's utilizing the section 232 insurance program in order to refinance its existing mortgage.

Nevertheless, we must apprise you of one caveat to this last conclusion. As noted in footnote 5 of this response, the test for substantial rehabilitation consists of two parts, the "15% rehabilitation test" and the "two or more major building components" test. Therefore, a non-insured nursing home that replaces two or more major building components could qualify as a section 232 substantial rehabilitation case, and thereby refinance its mortgage. This mechanism would be available even if the proposal did not contemplate "15% rehabilitation," i.e., rehabilitation that exceeds 15% of the project's value after completion of the rehabilitation.

3. May an ACLF with an existing FHA insured mortgage refinance under 232 or 207 without the 15% rehab. requirement?

To begin, we note that your question states that the adult congregate living facility, or ACLF, has an existing FHA-insured mortgage. We do not opine as to State law. However, a review of Florida's Adult Congregate Living Facilities Act, FLA. STAT. ANN. Section 400.401 et seq. (West 1986 and Supp. 1992), suggests that

the ACLF would most likely be insurable under section 232 of the Act. Florida's Adult Congregate Living Facilities Act defines ACLFs as follows: "any building ... residence, private home, boarding home, home for the aged, or other place, whether operated for profit or not, which undertakes through its ownership or management to provide, for a period exceeding 24 hours, housing, food service, and one or more personal services for four or more adults, not related to the owner or administrator by blood or marriage, who require such services; or to provide extended congregate care, limited nursing services, or limited mental health services, when specifically licensed to do so pursuant to [State law.] A facility offering personal services, extended congregate care, limited nursing services, or limited mental health services for fewer than four adults is within the meaning of this definition if it formally or informally advertises to or solicits the public for residents or referrals and holds itself out to the public to be an establishment which regularly provides such services." FLA. STAT. ANN. 400.402(2) (West Supp. 1992).

Accordingly, we assume that the ACLF has an existing

mortgage insured under section 232 of the Act.

As previously discussed, two provisions of the Act expressly authorize the Department to insure a mortgage executed in connection with a refinancing of a Section 232 Project, namely, section 223(a)(7) and section 223(f). In addition, the Department's Section 232 Program for insurance in connection with the substantial rehabilitation of eligible section 232 projects also provides a mechanism to refinance an existing insured mortgage on such projects. Each of these three provisions is explored below with regard to your specific question.

First, an ACLF with an existing mortgage insured under section 232 of the Act, is eligible to refinance under section 232, pursuant to section 223(a)(7) of the Act. There is no requirement that rehabilitation exceed 15% of the project's value after completion of the rehabilitation in order for the project to qualify for such an insured refinancing. The analysis is as follows.

As described in response to question 2, section 223(a)(7) states, in part, that the Department "is authorized ... to insure ... any mortgage ... given to refinance an existing mortgage insured under this Act." The Department's implementing regulation for section 223(a)(7), as it applies to Section 232 Projects, is 24 C.F.R. Section 232.42. As set forth in this regulation, a project with an existing mortgage insured under section 232 of the Act may refinance under section 232, pursuant to section 223(a)(7), if it meets the requirements of 24 C.F.R. Section 207.32(a) through (c), 24 C.F.R. 207.32(a) through (c) basically set forth limitations as to principal amount, debt service rate and mortgage term. Also, we note that 24 C.F.R. 232.42 provides that the existing insured mortgage need not cover

five or more rental units as is required in 24 C.F.R. 207.32. as well as the requirements of 24 C.F.R. Part 232, Subpart A.

There is no "15% rehabilitation" requirement connected with a refinancing under section 232, pursuant to section 223(a)(7). In fact, paragraph 1-6 of Handbook 4260.1, "Miscellaneous Type Home Mortgage Insurance Section 223(a), (e), and (d)," states that "[s]ection 223(a)(7) is a refinancing provision," and is "not to be construed as a rehabilitation provision." Paragraph 1-6 goes on to imply that a proposal constitutes rehabilitation, rather than refinancing, if the project is to be upgraded in connection with the refinancing, and "the cost of the upgrading will amount to one-fifth or more of the total mortgage amount ..." In such an instance, according to Handbook 4260.1, the transaction is "likely to be accepted directly under another Departmental program as a rehabilitation case." Of course, a section 223(a)(7) refinancing can include repairs and capital improvements. See 24 C.F.R. 207.32(a)(2). However, one factor does limit the amount of rehabilitation that may be undertaken in connection with a refinancing under section 232, pursuant to section 223(a)(7). This factor is the original principal amount of the mortgage. In all cases the principal amount of a new mortgage in such a refinancing cannot exceed the original principal amount of the existing insured mortgage. 24 C.F.R. 207.32(a).

Second, an ACLF with an existing mortgage insured under section 232 of the Act may refinance under section 232, pursuant to section 223(f) of the Act, provided, among other things, it does not require substantial rehabilitation. If the rehabilitation exceeds 15% of the project's value after completion of the rehabilitation, the work to be done constitutes substantial rehabilitation, and the project cannot qualify under section 232, pursuant to section 223(f) for refinancing insurance. The analysis with respect to this scenario is identical to that laid out in response to question 1.

Third, as described in our response to question 2, section 232's insurance program for the substantial rehabilitation of eligible Section 232 Projects also provides a means to refinance such projects. See 24 C.F.R. Sections 232.32(b) and 232.90(b). The project may (but need not) be currently insured by the Department in order to qualify as an section 232 substantial rehabilitation case. However, as we concluded in response to question 2, the requirement that the project undergo substantial rehabilitation would appear to be an impediment to your use of this provision. This is because your question seems to be seeking a mechanism that would allow the ACLF qualify for an insured refinancing without significant, i.e., "15%" rehabilitation. Of course, as discussed in response to question 2, the test for substantial rehabilitation has two parts.

Therefore, if the insured ACLF plans to replace two or more major building components, it could qualify as a section 232 substantial rehabilitation case even if such rehabilitation did not exceed 15% of the project's value after completion of said rehabilitation.

Finally, we note that your incoming question mentions refinancing under section 207 of the Act. Section 207 authorizes the Department to insure mortgages in connection with the new construction or substantial rehabilitation of multifamily rental apartment projects. The Department's implementing regulations for this statutory authority appear at 24 C.F.R. Part 207. A multifamily rental apartment project that is insured under section 207 as a substantial rehabilitation case may refinance its outstanding indebtedness in accordance with 24 C.F.R. 207.4(d)(2) and 207.29(b). In addition, under section 207, pursuant to section 223(f) of the Act, the Department is authorized to insure a refinancing of a multifamily rental apartment project. The Department's implementing regulation for this statutory authority is 24 C.F.R. 207.32a. This regulation does not require that a multifamily rental apartment project be currently insured by the Department in order to be eligible for an insured refinancing under section 207, pursuant to section 223(f) of the Act. See also footnote 11 for a discussion of elderly rental projects. However, as an ACLF does not appear to be a multifamily rental apartment project, it does not seem eligible to utilize either of these provisions. Based upon the nature of your letter, as well as upon our review of the relevant Florida statute, we have assumed in each of our responses to your questions regarding ACLFs, that an ACLF is a project that is insurable under section 232 of the Act. However, we do note that an ACLF may qualify for

mortgage insurance as an elderly rental housing project. The Department does insure mortgages in connection with the new construction and substantial rehabilitation of elderly rental apartment projects under sections 221 and 231 of the Act. These programs are carried out under 24 C.F.R. Part 221 and 24 C.F.R. Part 231, respectively. We further point out that such elderly rental projects may be eligible for refinancing insurance under section 207, pursuant to section 223(f). See 24 C.F.R. 207.32a(g)(2). However, as set forth in such regulation, the Department has (by implementation) limited this refinancing insurance for elderly rental projects to only those projects with FHA-insured mortgages or HUD-held loans.

4. May an ACLF without an existing FHA insured mortgage refinance under 232 or 207?

It depends. To begin, we again assume in our answer that (although uninsured) the ACLF is a type of project that could be insured under section 232 of the Act, i.e., a nursing home, intermediate care facility, board and care home or combination thereof. As discussed in our previous responses, sections 223(a)(7) and 223(f) of the Act provide insurance for the

refinancing of mortgages of Section 232 Projects. However, section 223(a)(7) is limited by its express statutory language to projects with an existing FHA-insured mortgage. Similarly, section 223(f) is limited by the terms of the Department's implementation thereof as to Section 232 Projects, to the refinancing of existing FHA-insured mortgages. Therefore, an uninsured ACLF may not refinance and qualify for an insured mortgage under section 232, pursuant to sections 223(a)(7) or 223(f), respectively.

However, as also discussed in our previous responses, section 232's insurance program for the substantial rehabilitation of eligible section 232 projects provides a mechanism to refinance such projects in accordance with 24 C.F.R. Sections 232.32(b) and 232.90(b). There is no requirement that a project be currently insured by the Department in order to qualify as an section 232 substantial rehabilitation case. However, as stated, the project must undergo substantial rehabilitation (as described in paragraph 2-2(2)(a) of Handbook 4600.1 REV-1) in order to utilize this program. This definition is set forth in footnote 5 of this response.

Therefore, if an uninsured ACLF requires substantial rehabilitation it may be able to refinance its outstanding indebtedness under section 232 as a substantial rehabilitation case.

Finally, we again note that your incoming question mentions section 207 of the Act. However, as discussed in our response to question 3, section 207 relates to multifamily rental apartment projects. Therefore it does not appear relevant to the type of facility, i.e., an ACLF, referred to in your incoming question. See footnote 11 for a brief discussion of elderly rental projects.

5. What type of projects does 223 F apply to?

Section 223(f) of the Act, by express statutory language,

authorizes the Department to insure mortgages that are "executed in connection with the purchase or refinancing of an existing multifamily housing project or the refinancing of existing debt of an existing hospital (or existing nursing home, existing intermediate care facility, existing board and care home, or any combination thereof)."

As discussed above, the Department has implemented this statutory authority for the Section 232 Program (i.e., for existing nursing homes, intermediate care facilities, board and care homes, and combinations thereof) at 24 C.F.R. Part 232, Subpart E. As also discussed above, the Department has limited

its implementation of this authority to FHA-insured Section 232 Projects. See 24 C.F.R. Sections 232.901 and 232.902. See also Handbook 4600.1 REV-1, 2-2(3) and 2-9.

The Department has implemented section 223(f)'s statutory authority for the section 207 program (i.e., for multifamily rental apartment projects) at 24 C.F.R. Section 207.32a. The Department's implementation of section 223(f) for multifamily rental apartment projects is not limited to FHA-insured multifamily rental apartment projects. See 24 C.F.R. Section 207.32a. However, as discussed in footnote 11, the Department has (by implementation) limited refinancing insurance for elderly rental projects, under section 207, pursuant to section 223(f), to only those projects with FHA-insured mortgages or HUD-held loans. See 24 C.F.R. Section 207.32a(g)(2).

Finally, the Department has not promulgated regulations to implement its statutory authority to insure a mortgage executed in connection with the refinancing of the existing debt of an existing hospital.

6. What type of projects does 237 A apply to?

To begin, there does not exist a section "237 A" of the Act. Therefore, we presume that you are referring to section 237(a) of the Act. The Department's Section 237 Program is used to aid in the financing of single-family homes by low or moderate income families that are unable to meet the credit requirements for mortgages insured under other programs of the Department. See 24 C.F.R. Part 237. Section 237(a) of the Act is not relevant to the area you appear to be concerned with, namely, the refinancing or purchase of nursing homes, intermediate care facilities, board and care homes, or combinations thereof.

7. In the event of a sale or acquisition of a facility, may a nursing home or an ACLF or a combination thereof obtain FHA mortgage insurance without the 15% rehab. requirement?

Possibly. First, if the nursing home, the ACLF, or some combination thereof, is currently insured under section 232 of the Act and does not require substantial rehabilitation, it is eligible to be purchased under section 232, pursuant to section 223(f) of the Act. There is no requirement that the project undertake "15% rehabilitation" in order to qualify for

such a transaction. Second, section 232's insurance program for the substantial rehabilitation of such projects also provides a means to refinance an existing mortgage on a nursing home in connection with a purchase. As discussed below, as to this program only one scenario offers the possibility for such a project to effect an insured purchase without "15% rehabilitation."

To begin, as in our preceding responses, we assume that the nursing home, ACLF, or combination thereof, is a project eligible for insurance under section 232 of the Act. As described in detail in our response to question 1, section 223(f) of the Act authorizes the Department to insure a mortgage executed in connection with the purchase or refinancing of the existing debt of, among other things, an existing nursing home, board and care home, or any combination thereof. The implementing regulations for this authority (for both purchases and refinancings) appear at 24 C.F.R. Part 232, Subpart E.

Because purchase and refinancing transactions under section 232, pursuant to section 223(f) of the Act are governed by the same regulations, the analysis as to eligibility for an insured purchase transaction is identical to that set out in response to question 1 for an insured refinancing transaction. Therefore, in accordance with 24 C.F.R. Part 232, Subpart E, a project must be currently insured under section 232, and must not require substantial rehabilitation, in order to be eligible for purchase under section 232, pursuant to section 223(f) of the Act. See 24 C.F.R. Sections 232.901 and 232.902. See also Handbook 4600.1 REV-1, 2-2(3). There is no requirement that the project undertake "15% rehabilitation" in order to be purchased under section 232, pursuant to section 223(f) of the Act.

In addition, the Section 232 Program for the substantial rehabilitation of, among other things, nursing homes, board and care homes, and combinations thereof, may be utilized in connection with a sale or purchase of any such project. 24 C.F.R. Sections 232.32(b) and 232.90(b). The project need not have an FHA-insured mortgage to qualify as a section 232 substantial rehabilitation case. Nevertheless, as described in response to question 2, there is a requirement that the project undergo substantial rehabilitation in order to qualify for insurance under the Section 232 Program.

As discussed earlier, the requirement that the project undergo substantial rehabilitation appears to be an obstacle to the transaction you contemplate, since you do not seem to want significant, i.e., "15% rehabilitation." However, as discussed in question 2, the requirement for substantial rehabilitation can be met in two ways, i.e., by satisfying the "15% rehabilitation test" or the "two or more major building components test." Therefore, if the transaction contemplates the replacement of two or more major building components it could conceivably qualify under section 232 as a substantial rehabilitation case even if the rehabilitation will not exceed 15% of the project's value after completion of the rehabilitation. See Handbook 4600.1

REV-1, paragraph 2-2(2)(a).

Please contact Frances A. MacFarlane, of my staff, at (202) 708-4107 with any questions you may have on this matter.

Very sincerely yours,

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