



# OFFICE OF HEALTHCARE PROGRAMS



## Office of Hospital Facilities Lender Training

Virtual Training Session  
September 22<sup>nd</sup> and 24th

HOSPITAL

## OHF “Best Practices” for Asset Management

- **Reminder: As the saying goes “When you have seen one Regulatory Agreement, you have seen one Regulatory Agreement” as there have been many changes to the Reg Agreements over the life of the program.**
- **Therefore it is extremely critical to review the Regulatory Agreement for your respective borrower.**

# Best Practices for Asset Management

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- Sometimes issues with the Reg Agreement are reported “after the fact”.
- Examples include, but are not limited to:
  - Distribution of Assets to Affiliate
  - Additional Indebtedness
  - After-acquired property
  - Collateral Release
  - Board Report of Business Plan section
  - Remodeling and renovations to collateral

## ➤ Compliance Monitoring and Reporting:

- Need to understand Borrower's Compliance Monitoring.
- HUD and the Lender should work together to identify:
  - Who in the Borrower's organization monitors regular compliance with the HUD Regulatory Agreement and other legal documents
    - Examples include Compliance officer; CFO; others in the C-suite
  - Frequency of compliance monitoring and reporting by Borrower's Management and the Board
  - Who in the Borrower's organization is responsible for contacting OHF for modifications and renovations to FHA-insured collateral.

## ➤ Regulatory Agreement – Filing of financial statements:

- Per Reg 242.58:
  - Quarterly unaudited financials must be submitted within 40 days following the end of each quarter (or 40 days after month end if requested by HUD)
    - This also applies to fourth quarter unaudited financials.
    - Note that the reg wording does not allow for extensions on interims.
- Board Certified financials within 120 days following the close of the FYE (if the audit has not yet been filed with HUD) and at such times as HUD may designate on a case-by-case basis.
  - “On a case-by-case basis” allows HUD to provide extensions, if appropriate.
  - Requires written request from borrower with reason for 30-day extension and filing date. Must be received in advance of filing deadline.
    - 30 day is maximum extension that can be provided but borrowers can request additional extensions beyond that with good cause.

## ➤ Regulatory Agreement – Filing of financial statements

### ■ Regulatory Agreement:

- ✓ New Regulatory Agreement: Requires Borrower to provide financial information to both HUD and the Lender.
- ✓ Old Regulatory Agreements:
  - Borrower not required to share information with the Lender and HUD cannot forward/share information provided by the Borrower to outside parties, including the Lender.
  - Borrower must provide Lender with annual audited financial statements in accordance with Handbook 4350.4, Chapter 2-10.f.2 (MF Housing: Loan Administration: Responsibilities of Mortgage Servicing) and GNMA requirements where applicable.

## ➤ Regulatory Agreement – Timely filing of financial statements:

- Late filing of financials.
  - Potential red flag for operational or accounting issues.
  - Continual lateness may require action by Enforcement.
- Occasionally HUD will receive a request from a Borrower to provide a letter that there will be no Enforcement actions if financial statements are late.
  - Reminder - OHF cannot write letters dealing with Enforcement issues or actions.



## ➤ **Regulatory Agreement – Collateral Releases:**

### § 242.62 Releases of lien:

- The mortgagor shall not sell, dispose of, transfer, or permit to be encumbered any security property without the prior approval of the lender and Commissioner, subject to thresholds or such other standards as HUD may establish for the approval requirement.
- Where there is a partial release of lien, the lender must make a determination, subject to prior review and approval by HUD, that the remaining or replacement property subject to the first lien provides adequate security for the remaining principal indebtedness.

Note that year end audits may be a source of information with regards to property sales requiring HUD and Lender review “after the fact”.

## ➤ Regulatory Agreement – Collateral Releases (cont)

- If a Borrower is requesting a release of real property that serves as collateral for the HUD-insured loan:
  - Need the Lender's decision prior to HUD's letter being issued.
  - Unless otherwise approved by HUD, sales proceeds are to be placed in an escrow (new HUD escrow form forthcoming).
  - Unless otherwise approved by HUD, escrowed funds may only be used for improvements to collateral.
  - Draws from the escrow to be approved by both HUD and Lender.
  - OAE involvement required when necessary.

- **Regulatory Agreement – “Business Plan” section:**
  - Needs to be reviewed carefully, especially in light of COVID-19 impact and potential accounting restatements.
  - Note that Business Plan sections vary for specific borrowers and this section may not be found in the older Regulatory Agreements.
  - Typical key features:
    - Notes frequency of Board Review of financial statements.
    - Financial triggers that require Board Report to OHF and timelines
    - Describes steps, options and timing available to HUD to require a turnaround plan, etc.
    - Latest version of Reg Agreement (2017) requires that Borrower send information and reports to both HUD and the Lender.

## ➤ “Business Plan” section (continued):

- Report: When certain conditions exist, the Board is to submit a written “Report” to OHF on the steps being taken to improve the Borrower’s operations. Typical conditions include:
  - Operating loss equal to or greater than 1%
  - Net income less than zero
  - MRF not fully funded in accordance with schedule
  - These are typical examples – please review your Borrower’s Regulatory Agreement for the conditions.

## ➤ “Business Plan” section (continued):

### ■ Report

- There is no standard OHF template for the Board “Report”. This is a written Report from the Board which should include the information required by the Regulatory Agreement.
- The deadlines for submission of the Report are outlined in the Regulatory Agreement, typically 30 days after the Board review. If unable to meet the deadline, the Borrower needs to submit a request for an extension for no more than 30 days.

## ➤ “Business Plan” section (continued):

- If the Report deadline is missed or the Report is inadequate, the Regulatory Agreement describes steps, options and timing available to HUD to require a turnaround plan, etc.
- OHF and Lender to work closely together on addressing key issues to monitor the performance issues detailed in the Board’s report.

- **Turnover in Borrower Management or Board Members:**
  - Previous Participation (2530s)
  - If requested, HUD can provide a Regulatory Agreement review with Borrower, Lender and OHF.

## ➤ Mortgage Reserve Fund (MRF) Issues:

- HUD has limited discretion for MRF usage as defined in the MRF Agreements. Acceptable uses may include:
  - To prevent or cure default under the FHA-insured mortgage.
  - To pay for a management consultant to implement a turnaround plan to prevent a default with respect to the FHA-insured mortgage.
  - To apply for any other purposes that HUD may determine reduces its insurance liabilities as insurer of the mortgage.



## ➤ Mortgage Reserve Fund (MRF) Issues:

- Process: All distributions from the MRF are at HUD's discretion with HUD providing written direction to the Borrower and MRF Trustee (and Lender when necessary).
  - In the event of Bankruptcy, default or a claim, reference is made to the MRF Trust Agreement for next steps.
- If Borrower makes a request to use the MRF for debt service or for a consultant to prevent a default:
  - All MRF requests from the Borrower need to include a plan to replenish the MRF to the required minimum balance.
  - Requires a higher level of internal FHA review
- The MRF is not to be confused with an R4R in the 232 program.

## ➤ Other Issues:

- Attorneys for either Borrower or Lender
  - OHF must include an attorney from OGC on a call or in a meeting if there are other attorneys present.
  - If Borrower or Lender schedules a meeting with OHF and includes their attorneys, OGC (HHQ or Field Counsel) must also be included.
  - No exceptions.

## Mortgagee Letter 2016-23

## Mortgagee Letter 2016-23: Lender Responsibilities in Servicing Section 242 Loans

- <https://www.hud.gov/sites/documents/16-23ML.PDF>
- Checklist format of a summary of important servicing responsibilities of Lenders of Record holding Section 242 hospital loans.
- Covers Initial Endorsement, Construction Phase, Final Endorsement, Loan Servicing & Monitoring and Event-Driven Risk Management.

## **Initial Endorsement**

- Each time a commitment is issued, Lender to:
  - Review documents
  - Coordinate with all parties to assist in fulfilling conditions for Initial Endorsement
  - Confirm DACAs are in place
  - Assist Borrower with preparing HUD 92403-OHF, Application for Insurance of Advance of Mortgage Proceeds

<https://www.hud.gov/sites/documents/92403.PDF>

## **Construction Phase - Lender Responsibilities**

- Ongoing
  - Escrows & Deposits
  - Monitor insurance policies and surety bonds
  - Letters of Credit
  - Perform Lender Servicer Tasks as described in OHF Handbook  
[https://www.hud.gov/program\\_offices/administration/hudclips/handbooks/hsg/4615.1](https://www.hud.gov/program_offices/administration/hudclips/handbooks/hsg/4615.1)
- Hospital Requests Advance
  - Review for completeness and submit to HUD for approval
- Approved advance received from HUD
  - Obtain evidence that title is clear; arrange funding
  - Obtain title insurance endorsement increasing coverage to the total of all advances
  - Release approved funds to hospital

## **Construction Phase (cont.)**

- Change Order, Line Item Change or Change of Scope Request
  - Determine if change is acceptable to hospital, architect and HUD
  - Verify source of payment for change and availability of funds for payment
  - Approve/disapprove the change and forward to OAE
- Request for Mortgage Increase
  - Review Request to determine if loan is in balance in accordance with BLA and if provision has been made for payment of any fees required.
  - Contact AE – will need HUD consent
- Monthly Requisition Meeting w/ OAE, Architect and CM
  - Attend, as needed, to review work progress
  - Always attend preconstruction conference and meetings at end of project to discuss close out procedures.

## **Construction Phase (cont.)**

- Loan for new construction or Substantial Rehab
  - Monitor the disbursements of capitalized interest and advise OHF AE if failure to disburse capitalized interest will cause a default in a note payment.
  
- Each Final Endorsement
  - Assist in Cost Certification Process
  - Request Borrower to execute and deliver all required FHA documents and to fund all escrows and deposits required by FHA for final endorsement.
  - Coordinate with OHF to assist Borrower in fulfilling all conditions for final endorsement.



## **Permanent Loan Servicing – Administrative Functions**

- Ongoing
  - Insurance
  - Escrow Analysis at least annually
  - Maintain current and complete mortgage loan files
  
- Monthly/Annually
  - Collect monthly mortgage payments
  - Prepare and distribute monthly mortgage loan statement and annual statement of account
  - Remit MIP payments

## **Permanent Loan Servicing – Periodic Monitoring**

- Ongoing
  - Monitor Letters of Credit if any
  - Verify that the project has required Fidelity Bond Coverage.
    - ✓ Reference 242 Handbook 4615.1 REV-1 Appendix 7 for insurance requirements.
- Annually
  - Deposit Account Control Agreements (DACAs).
  - Confirm all UCC filings are continued every 5 years and all personalty for the HUD-insured loan is securitized for the life of mortgage.

## **Permanent Loan Servicing – Periodic Monitoring (cont)**

- Quarterly/Annually (Monthly for Credit Watch/Priority Watch accounts)
  - Review annual audited financials, interim statements and actual-to-budget variance reports.
  - Identify signs/trends of financial weakening.
    - ✓ Discuss with OHF Account Executive.
    - ✓ Identify items for follow up in quarterly meetings with hospital CFO.
- Regulatory Agreement:
  - ✓ New Regulatory Agreement: Requires Borrower to provide financial information to both HUD and Lender.
  - ✓ Old Regulatory Agreements:
    - Borrower not required in all cases to share information with the Lender and HUD cannot forward/share information provided by the Borrower to outside parties, including the Lender.
    - Borrower must provide Lender with annual audited financial statements in accordance with Handbook 4350.4, Chapter 2-10.f.2 (MF Housing: Loan Administration: Responsibilities of Mortgage Servicing) and GNMA requirements where applicable.

## **Permanent Loan Servicing – Periodic Monitoring (cont)**

- Quarterly (Monthly for Credit Watch/Priority Watch accounts and other identified accounts)
  - Set up periodic discussions with Borrower CFO to review financial performance.
  - Discussion should include the assigned OHF AE.
  - Identify and discuss changes in the Borrower's business plans and operations.
  - During pandemic, recommended reaching out to borrowers to review operations, cash flow and ability to service debt. If a borrower is facing challenges, reach out to the OHF AE.
- Persistent decline in financial performance
  - Discussions with OHF to consider whether the services of a turnaround consultant should be employed.

## **Event-Driven Risk Management**

- Requests from Borrower: Lender is to review and submit recommendation to OHF AE for the following requests:
  - Modify the note and mortgage
  - Transfer of physical assets (TPA)
  - Partial release of liens
  - Permit secondary financing
- Lender requests a loan mod; refi under 223(a)(7) or 223(f); or supplemental loan under 241
  - Contact OHF AE and the 242 Underwriting Director to start HUD review process.
  - Provide an updated title policy to HUD as needed.

## **Event-Driven Risk Management (cont)**

Lender Becomes Aware of:

- Delinquent mortgage payments
  - Notify OHF AE. Report through MDDR system as required.
    - Note – be sure to send a copy of the MDDR filing directly to the AE
  - Work with borrower and management to determine cause of delinquency.
  - Request a report from management describing how delinquency will be resolved.
  - Monitor mortgage payments and keep AE informed of status of loan and circumstances causing delinquency.
- Missed lease payment (for Borrowers with lease arrangements)
  - Notify AE and work with AE, borrower and operator to find out reason for missed payment
  - Request plan from management to avoid missed payments in the future

## **Event Driven Risk Management (cont)**

Lender Becomes Aware of (cont):

- Vacating or condemnation of project
  - Notify HUD AE
  
- Notification of termination of any insurance
  - Work with AE and request management to provide an explanation of the termination and actions being taken to ensure that necessary is in place.
  - Reference to Handbook 4615.1 Rev-1 Appendix 7 for insurance requirements
  
- Default on an Accounts Receivable (AR) Loan
  - Work with AE, discuss with borrower why default occurred and request plan from borrower to deal with this event and prevent future defaults

## **Event-Driven Risk Management (cont)**

Lender Becomes Aware of:

- Unauthorized Distribution
  - Request a plan from management to deal with event and to strengthen controls
  
- Borrower wants to add or amend an AR line of Credit
  - Borrower to send request to both Lender and OHF
  - Lender to review and render decision prior to OHF's decision.
  - HUD-92322-OHF- Intercreditor Agreement (ICA) for 242 program <https://www.hud.gov/sites/documents/92322-OHF.PDF>



## **Event Driven Risk Management (cont)**

- Borrower stops making mortgage payments
  - Work closely with assigned OHF AE and HUD Turnaround Team
  - Request an action plan from the Borrower to return loan back to Performing status
  - Track progress of Action Plan
  - Report through MDDR system as required.
    - Note – be sure to send a copy of the MDDR filing directly to the AE.
- Lender Elects to Assign Mortgage to HUD
  - Continue to bill for and accept payments until mortgage is assigned in Secretary's name
  - Reference to Section 207.258 on the steps required of the Lender/Servicer for assignments.

## **Event Driven Risk Management (cont)**

Lender Becomes Aware of (cont):

- Borrower files for Bankruptcy
  - File appropriate documents to assure that Lender's interest as first lienholder is protected and the security preserved.
  - Obtain an order recognizing Lender's entitlement to the revenues and restricting use of the revenues in accordance with the rules governing cash collateral.
  - Remind Borrower that project assets may not be used to pay attorney fees for legal services in connection with the bankruptcy without HUD approval.
  - Provide HUD with copies of any notice of default; noncompliance from regulatory authorities regarding the hospital's license, CON, or provider agreements.

## **Event Driven Risk Management (cont)**

When Lender Becomes Aware of any of the Event- Driven risks:

- ✓ Notify the OHF Account Executive immediately.
- ✓ If not available, contact the OHF Director of Asset Management or Director of the HUD Turnaround Team.
- ✓ Communication is Critical!

# Mortgagee Letter 2016-23

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If you have any questions or concerns regarding this Mortgagee Letter, please contact Kathryn Killeen at 202-402-3119 (kathryn.e.killeen@hud.gov).

Persons with hearing or speech impairments may access this number via TDD/TTY by calling 1-800-877-8339.



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