



OFFICE OF HEALTHCARE PROGRAMS



Office of Hospital Facilities Lender Training

HUD Headquarters
Brooke-Mondale Auditorium

July 16, 2019

- Welcome to 2019 OHF Lender Training
- Opening remarks by:

Roger Lukoff

Deputy Assistant Secretary for the Office of Healthcare Programs

Geoffrey Papsco

Director, Office of Hospital Facilities

The background of the slide is a collage of four images showing different hospital buildings. The top-left image shows a modern building with a curved, metallic roof structure. The top-right image shows a multi-story building with a mix of brick and wood paneling. The bottom-left image shows a building with large windows and the word 'HOSPITAL' in large, blue, 3D letters. The bottom-right image shows another multi-story building with a brick and wood facade.

Overview of the 242 Portfolio

Mr. Geoffrey Papsco
Director
Office of Hospital Facilities



OFFICE OF HEALTHCARE PROGRAMS



- **Office of Healthcare Programs (OHP) consists of:**
 - Office of Hospital Facilities
 - Office of Residential Care Facilities
 - Office of Architecture and Engineering (support office)
- **OHP's mortgage insurance programs enable affordable financing of healthcare facilities:**
 - Section 242 Mortgage Insurance for Hospitals
 - Section 232 Mortgage Insurance for Nursing Homes, Assisted Living Facilities, Board & Care Homes



Buffalo grazing outside Rio Grande Hospital
Del Norte, CO

History of FHA's Office of Healthcare Programs

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Hollywood Presbyterian
Medical Center
Los Angeles, CA

- Section 242 of the National Housing Act was enacted by Congress in 1968:
 - To support capital financing for urgently-needed hospitals and encourage lending for needed hospital projects.
- Section 232 of the National Housing Act was established by Congress in 1959:
 - To support the critical care needs of a vulnerable aging population in residential care facilities across the country.

Role of FHA in Helping Private Lenders Serve the Healthcare Market

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- FHA facilitates the construction and refinancing of healthcare facilities through private lenders
- Without FHA mortgage insurance, lenders would not lend to most of the facilities that have FHA loans, or would only do so at prohibitively high interest rates
- Without FHA, results would be:
 - Fewer facilities built, modernized, or refinanced, limiting access to hospital care
 - Higher operating costs for facilities that chose high rates



Office of Healthcare Programs: What We Do

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- Enable the affordable financing of needed healthcare facilities
- Strengthen communities - healthcare facilities are economic engines
 - Nationwide, hospitals employ approx. **7.0 million people** and generate a total revenue of over **one trillion U.S. dollars.**

*Statistics based on data as of 11/8/18, <https://www.statista.com/topics/1074/hospitals/>



OFFICE OF HEALTHCARE PROGRAMS



Office of Hospital Facilities Highly Specialized Staff

- **An office of 27 professionals with expertise in and a single focus on the financing and operations of hospital facilities**

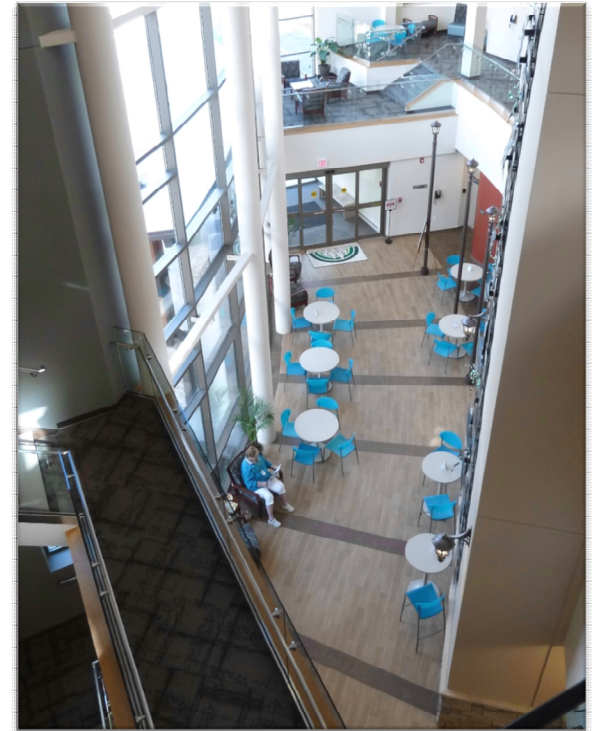


University of New Mexico Hospital
Albuquerque, NM

Qualifications of OHF Program Staff

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- Former Health Care Executives
- Former Business (Lending, Finance, etc.) Executives
- Professional Society Fellows
- Former State Finance Authority Executives
- Majority of Staff Possess Graduate Degrees, including:
 - PhDs, Juris Doctors, MBAs, MHAs
- Certified Public Accountants
- Registered/Licensed Nurses



Interior of Coquille Valley Hospital
Coquille, OR

➤ Comprised of two divisions:

- Underwriting Division
 - Functions include all underwriting activities involved in the review and processing of Section 242 mortgage insurance applications, client assistance, and staff training.
- Asset Management Division
 - Functions include portfolio management, client assistance, default prevention, and risk management.



Baton Rouge General Hospital
Baton Rouge, LA

Hospitals that Use FHA

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➤ **FHA serves all types of hospitals nationwide**



Matagorda Regional Medical Center
Bay City, TX

- Acute care hospitals
- Rural and Critical Access Hospitals (CAHs)
- Large urban teaching hospitals
- University hospitals
- Not-for-profit, for-profit, and government-owned hospitals

➤ **Enables urgently-needed hospitals underserved by the private capital market to obtain access to capital.**

Attractive Program Features

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New York-Presbyterian
New York, NY

- No maximum loan amount
- Loan-to-value up to 90%
- No cash down if property value is at least 10%
- Loan term up to 25 years
- Fixed annual premiums
- Section 241 supplemental loans
- 223(a)7 and 223(f) refinancing options for hospitals

Current 242 Portfolio

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- 65 hospitals presently in the insured 242 portfolio, totaling 91 active loans*
- \$6.13 billion in unpaid principal balances (UPB) in the current 242 portfolio*
- Facilities located in 29 states and Puerto Rico*



Kirby Medical Center
Monticello, IL

*Statistics based on data as of 7/9/19



Office of Architecture and Engineering Overview

Ms. Robin Senator, R.A.
Director, Office of Architecture and Engineering

Ms. Buthaina Haddadin-Gorham, R.A.
Senior Architect

Mr. Kevin Conway, R.A. LEED AP
Architect

What is OAE's Role

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- Responsible for architectural-engineering technical oversight for FHA-242/241 design and construction projects and FHA 242/223f or 223A refinancing projects.
- OAE works with the assigned OHF Account Executive throughout the hospital's FHA application process from Pre-Application through the Final Endorsement.
- OAE functions as project managers typically prioritizing collateral risk during the construction period for taxpayer FHA commitment.
- OAE works with the HUD Asset Management team.

- Staff are located across U.S. in New York City, Fort Worth TX, Santa Ana CA, and Portland OR.
- Professional staff include Registered Architects, Professional Engineers, environmental specialists, seismic specialists, and LEED accredited staff typically with decades of experience in managing large healthcare projects.
- Coverage for all U.S. States and Territories available through OAE in conjunction with additional OHF field offices.

Application Phase

- Review application completeness with regard to construction, environmental, and construction budget documentation.
- Participates in Initial Site Visit with OHP/OHF Customer Service Team (CST).
 - Performs a walk through the mortgage collateral properties
 - Complete the environmental review and clearance.

OAE Role for FHA Mortgage Insurance:

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- Meet with hospital and their design/construction team to review:
 - Form HUD-92013-OHF, Lines C1-C9
 - Acceptable types of construction contracts
 - Construction Contract requirements: Prevailing Wages, retainage, bonding, and collateral damages
 - Required documents for Mortgage Advance applications
 - Special requirements for construction project locality, i.e. seismic
 - Discuss construction Early Start construction start options
- Prepares a report for the Account Executive related to the design, construction budget, and physical condition of the mortgage collateral

OAE Role for FHA Mortgage Insurance:

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- Make Recommendation to OHF to Proceed to Commitment based on:
 - Completed Construction Documents.
 - Fully executed construction contract.
 - Environmental Review and clearance prepared by OAE.
 - Approved HUD-92013-OHF.



Pre-Application Phase:

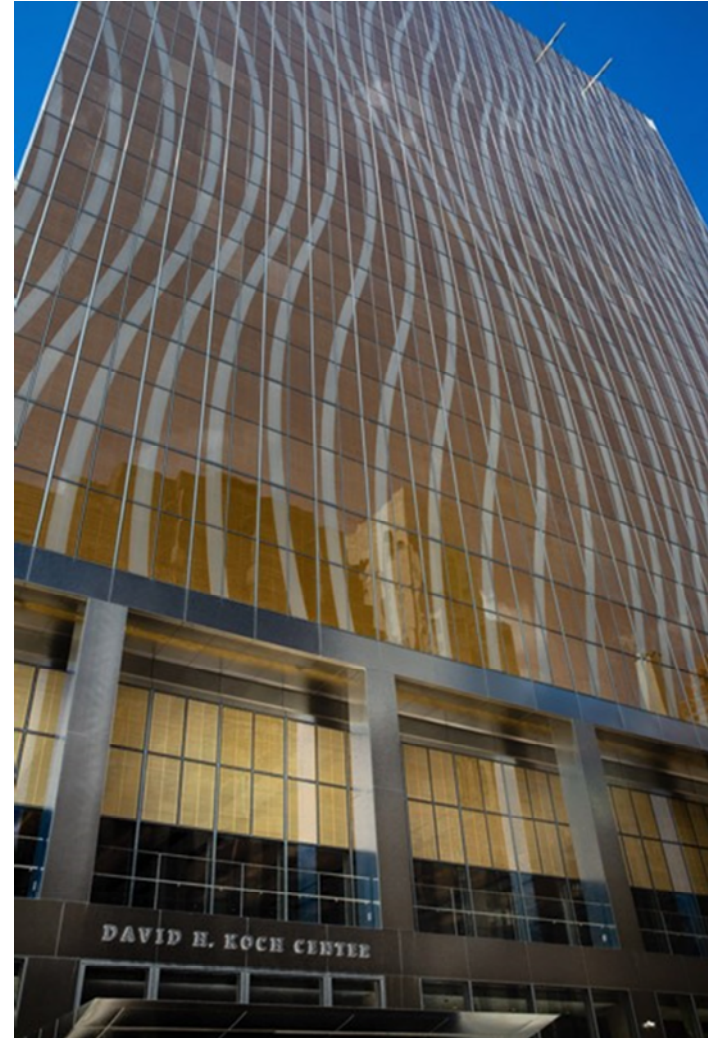
- Attend Pre-Application meetings for an overview of the construction scope.
- Provide guidance on acceptable types of construction contracts, regulations, and overview of required documentation.
- Available to meet separately with hospital's design/construction team



OAE Role for FHA Mortgage Insurance:

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- OAE makes Recommendation to OHF that Project Proceed to Initial Endorsement:
 - Current certified or draft metes and bounds survey of all properties included in the mortgage.
 - Evidence of Zoning Compliance.
 - Building Permit(s).
 - Engineer's Sub-surface Report.
 - Assurance of Utility Services.



Site Preparation Work

- Site Preparation Work may include: Asbestos abatement and demolition of an existing structure.
- Lender submits a request to OAE after the Hospital is invited to submit an application. A complete request includes:
 - Construction contract for the scope
 - Performance and Payment Bonds.
 - Construction documents for the scope
 - Environmental Phase I
 - A copy of the approved 2530s
- OAE will then issue a letter allowing work to proceed.

Pre-Commitment Work

- Work may include: Ordering long lead items such as steel, excavation, foundations, etc.
- Must be complete before the Initial Endorsement.
- The Lender may submit a complete request package after an application is submitted but before commitment is received.
- Required documents are the same for Site Preparation Work.
- Signed Representations and Warranties are required.
- OHP DAS approval is required.

Early Commencement of Work (Early Start)

- Construction work starts after Commitment but before Initial Endorsement.
- Often due to weather conditions
- Work such as foundation and steel fabrication need to start early.
- Lender submits form HUD-92415-OHF Request for Permission to Commence Construction Prior to Initial Endorsement for Mortgage Insurance.

Pre-Construction Phase

- After Commitment and before Initial Endorsement:
 - Perform site visit for Pre-Commitment work
 - Approve Early Commencement Work
 - Review Initial Advance to be paid at Initial Endorsement
 - Review final certified site surveys.
 - Recommend proceeding to Initial Endorsement
 - Conducts pre-construction conference

Construction Phase:

- Conduct site visits to review construction progress
- Prepare construction progress report.
- Review and Approve monthly Application for Insurance of Advance of Mortgage Proceeds
- Review and approve Construction change orders
- Review Line Item Budget Transfer requests and make recommendation to OHF.

Construction Closeout Phase:

- Conduct final site visit and prepare report.
- Review and approve of retainage reduction.
- Recommend proceeding to Final Endorsement.
- Required Closeout documents:
 - Review Certificate of Actual Cost.
 - Final Certificate of Occupancy.
 - Unconditional Lien Waivers.
 - As Built ALTA Site Survey.

Case Study: Kaleida Health Children's Hospital

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Case Study: Kaleida Health Children's Hospital

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- Kaleida Health is a long-term client of FHA 242 program.
- Largest healthcare organization in western New York.
- Multiple 242, 241 FHA loans financing successful construction projects over the past 20+ years.



Case Study: Kaleida Health Children's Hospital

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- John R. Oishei Children's Hospital was the third major project for Kaleida Health in Buffalo, New York.
- \$270MM construction cost, 410,000 SF; in construction between 2014-2017.



Case Study: Kaleida Health Children's Hospital

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- Environmental review began one year early; project environmentally approved in 1 month.
- OAE worked with client to early approve construction management contracts, construction document compliance with FGI guidelines, NFPA 101, and ADAG.
- OAE worked with client to expedite CON, building permits, and secure bonding.
- OAE worked with client to value engineer project to firm up a GMP within budget.

Case Study: Kaleida Health Children's Hospital

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- OAE worked with client and OHF Account Executive to approve Pre-Commitment work.
- OAE worked with client and OHF Account Executive to approve Early Start work.
- OAE works in tandem with OHF Account Exec to ensure timely Initial Endorsement to keep construction AND loan timeline.
- Significant New York State grants incorporated into timeline as equity contributions, 92013 adjusted.

Case Study: Kaleida Health Children's Hospital

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➤ And then it began to snow!!!



Case Study: Kaleida Health Children's Hospital

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- Lots of it... a blizzard. The City of Buffalo was declared an emergency zone!!



Case Study: Kaleida Health Children's Hospital

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- OAE worked with client's CM to ensure credit was given to hospital for excavating equipment commandeered by the State of New York during blizzard of 2014! Timeline adjusted, then mitigated.
- OAE worked with client to "RE-VALUE ENGINEER" project since GMP came in underbudget and significant cost adds were desired by hospital but within loan parameters. AE documents revised, costs added, construction resumes on timeline.

Case Study: Kaleida Health Children's Hospital

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- OAE works with client to add HELIPORT atop hospital as last minute change.
- OAE approves additional ½ of 2 floors entirely redesigned during construction.
- OAE processes 131 change orders timely, GMP holds.
- CCIP insurance change orders tracked separately at client's request to allow a cost effective line item transfer later in the project.

Case Study: Kaleida Health Children's Hospital

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- Several dozen “donor adds” accommodated into project budget but off of GMP and loan funds (nice problem to have!), timeline holds.
- OAE approves all advances digitally and almost paperlessly.
- Advances paid within 30 day window of submission by construction manager.
- New York State grant targets met during construction and loan implementation period.

Case Study: Kaleida Health Children's Hospital

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- OAE functions entirely digitally, almost paperless, all functions “LEANed” out.
- OAE / OHF excelled at “AGILE” project management to best position the project for timely and cost effective construction completion.
- OAE receives commendations on speed of processing construction advances / requests for information.
- We are your partners in this endeavor.

Case Study: Kaleida Health Children's Hospital

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- Ultimately project opened slightly early and slightly under budget.



Case Study: Kaleida Health Children's Hospital

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- HUD Regulatory Agreement requires review of additional construction and renovation projects on mortgage collateral properties.
- The is to maintain the capital value of hospital collateral over the life of the loan.
- OAE review and approval is required for *any capital improvement project that*:
 - *Requires securing a construction permit*
 - *Modifies NFPA 101 Life Safety Code Features*
 - *Modifies ADA accessibility requirements (ADAAG)*

- *Classes of work on existing structures as described by the International Building Code Level 2 Alterations and Level 3 Alterations.*
 - *Any changes or repairs that may affect the characteristics of a Historic District*
 - *All new structures on the mortgage collateral funded by the hospital*
-
- Hospitals to report Capital Projects to Lenders, OHF, and OAE.
 - HUD 4128 Environmental Review is required.

HUD Environmental Review Requirements

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- HUD guidance for all HUD reviewers is that only maintenance does not require an Environmental Review. What is maintenance?
 - Activities that slow or halt deterioration of a building and do not materially add to its value or adapt it to new uses.
 - Maintenance of a building feature or system that requires periodic replacement of individual component parts that are subject to normal wear and tear.
 - The type of the activity, not its budget category, determines whether it qualifies as maintenance for environmental review purposes.

HUD Environmental Review Requirements

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- All non-maintenance work requires an Environmental Review (Form 4128 review in HEROS). The Environmental Review scope depends on the scope of the rehabilitation, renovation, or repair activities:
 - Deferred maintenance that has resulted in a need for extensive repairs and rehabilitation does not qualify as maintenance.
 - If maintenance is included with an extensive remodeling or renovation of a building that amounts to rehabilitation, the entire job is considered rehabilitation.
 - Depending on the extent of damage, activities performed after a disaster event are typically not maintenance.

HUD Environmental Review Requirements

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- Non-maintenance activities may nullify a previous HUD Environmental Review due to:
 - Historic preservations issues, i.e., change the appearance of the building or excavation that may affect archeological resources.
 - Landscaping, new construction or renovations encroaching on newly identified floodplains and wetlands.



Underwriting Overview – Program Eligibility Requirements and the Underwriting Process

Ms. Shelley McCracken-Rania, CPA, MBA
Senior Financial Analyst
Office of Hospital Facilities

Underwriting Division Outline

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- Hospital Mortgage Insurance Programs
- Statutory/Regulatory eligibility requirements
- Pre-Application and Application Processes



Hospital Mortgage Insurance Programs

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➤ Insurance Types Available:

- §242: For hospitals not currently in the FHA portfolio seeking financing for new construction projects or substantial rehabilitation (may include mortgage proceeds for existing debt refinance – up to 80% of the loan amount).
- §223(f): For hospitals either not currently in the FHA portfolio seeking to refinance existing capital debt (may include mortgage proceeds for capital improvements – up to 20% of the loan amount) or for hospitals already in the FHA portfolio.
- §241: For hospitals already in the FHA portfolio seeking financing for new construction projects, substantial rehabilitation, or additions.
- §223(a)(7): For hospitals already in the FHA portfolio seeking to refinance existing FHA loans.
- Interest Rate Reduction: For hospitals already in the FHA portfolio seeking interest rate reductions on existing FHA loans, without increasing UPB or the term of the existing loan.

➤ Statute – Section 242 of the National Housing Act

- 12 U.S.C. 1715z–7
 - https://www.hud.gov/sites/documents/SEC242_STATUTE.PDF
- Regulation - Hospital Mortgage Insurance Program - 24 CFR Part 242
 - <https://www.ecfr.gov/cgi-bin/retrieveECFR?gp=1&SID=0d6edd1462c5c07502e67d556895bc0e&ty=HTML&h=L&mc=true&n=pt24.2.242&r=PART>
- Handbook - 4615.1
 - https://www.hud.gov/program_offices/administration/hudclips/handbooks/hsgh/4615.1

➤ **Loan-to-Value Requirement**

- Maximum LTV for Section 242, 241, 223(f) programs = 90%
- Based on net book value of property, plant, and equipment
- Appraisals may be used to meet the LTV requirement

➤ **First Lien**

- The FHA-insured lender must have a first lien position on real estate
- FHA requires that the Lender also have a first lien on revenues, accounts receivable, etc.

➤ Market Need

- Per language in the Statute: “The purpose of this section is to assist the provision of urgently needed hospitals...”
- OHF performs a market need review, based on data provided by the hospital and other in-house sources

➤ Patient Day Requirement

- Acute care patient days must be greater than 50% of total patient days
- Non-acute patient days include skilled nursing, rehabilitation, psychiatric, and other services

- **§242.16 - Historical Operating Margin Requirement**
 - The 3-year aggregate Operating Margin must exceed 0%.
- **§242.16 - Historical Debt Service Coverage Ratio Requirement**
 - The 3-year average Debt Service Coverage Ratio must exceed 1.25x (1.4x for Section 223f).
- **§242.72 - Owner/Operator**
 - The Owner must also be the facility operator

➤ **§242.8, §242.64, Collateral Requirements**

- All critical pieces of the property and operations must be captured as collateral

➤ **§242.4 - Capital Purchases**

- Mortgage Proceeds must be used for capital purchases, or to refinance loans originally used to purchase capital

➤ **§242.11 - Compliance with State and Federal Regulations**

- If under investigation, it must be disclosed to HUD and evaluated

➤ §242.14 – Mortgage reserve fund (MRF)

- An MRF must be funded after loan closing (223f) or construction completion (242, 241)
 - Standard Requirements:
 - At 5 years, the Borrower must have deposited 12 months of debt service
 - At 10 years, must have deposited 24 months of debt service
- One-Year MRF Program (stay tuned!):

➤ **Application (One-Time) Fees**

- Application fee (0.15% of the mortgage amount)
- Commitment fee (0.15% of the mortgage amount)
- Inspection fee (ranges from 0.1% to 0.5% of the mortgage amount, depending on the Section of the Act)

➤ **Ongoing (Annual) Fees - MIP**

- Ranges from 55 bps (223a7) to 70 bps (242), with first-year exceptions

➤ Pre-Application

- Pre-Screening Tool
- Preliminary Review
- Pre-Application Meeting

➤ Application Process

➤ Pre-Screening Tool

- https://portal.hud.gov/hudportal/HUD?src=/federal_housing_administration/healthcare_facilities/section_242/Prescreening242

➤ What is the purpose of the Preliminary Review

- Evaluate hospitals against minimum eligibility requirements

➤ How does it benefit Lenders and HUD?

- There are no fees associated with the Prelim process
- Identify Statutory/Regulatory/Credit barriers
- Identify areas of focus for the Pre-Application Meeting and application underwriting

➤ Preliminary Review Submission Contents

- Preliminary Review Template
- Audited financial statements
- Utilization statistics
- Project description
- Organizational chart/collateral discussion

➤ OHF Review

- Review of eligibility
- Credit review

➤ Credit/Programmatic Review

- Financial Statement review
- Market Review
- Regulatory/Policy Review
- Other Unique Issues

➤ Process – Underwriter review, followed by brief committee review

➤ Goal: Provide feedback to lender in 2 weeks

- **What is the purpose of the Pre-Application Meeting**
 - Discuss issues identified during the Preliminary Review
 - Overview of the Hospital and its project
- **Following the meeting, OHF staff meets and determines next steps**

➤ **Application Requirements/Development**

- Volume 1
 - Application form (sources and uses)
 - Information on the Board Members, Executives
 - Other requirements
- Volume 2
 - Financial Statements and budget
 - Forecast (if applicable)
 - Other Requirements
- Volume 3
 - Architectural and Engineering documents

➤ Steps in the Application Process

1. Application Receipt and Completeness Review
2. Underwriting Questions
3. OHF Site Visit
4. Previous Participation (2530) review
5. Architectural/Engineering/Environmental Review
6. Credit Report development
7. Credit Committee Review
8. Approvals (if applicable) - ORM, FHA Commissioner

➤ Preliminary Review

- 10 business days for Sections 242, 241, 223(f)

➤ Application Completeness Review

- 10 business days for Sections 242, 241, 223(f)

➤ Application Review

- 120 business days for Section 242 and 241
- 90 business days for Section 223(f)
- 30 days for Section 223(a)(7)



Underwriting Transaction Metrics

Mr. Paul Giaudrone
Director of Underwriting
Office of Hospital Facilities

➤ Volume Trends

- 1 commitment issued in FY18
- 2 commitments issued so far in FY19.

➤ Closing Documents

➤ Handbook

➤ Mortgagee Letters

➤ Policy - Multi-Hospital Systems

- Patient Day Rule – applied to each hospital in the system
- LTV – Based on the entire entity

➤ Other Policy

- Audited Financial Statements
- MRF requirements for loans with terms shorter than 25 years
- Pre-funding MRF with mortgage proceeds

Hospital Program Production (FY14 – FY19 YTD)

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- **24 successful applications**
- **\$1.85 Billion**
 - 11 Section 241 loans totaling \$888M
 - 5 Section 223(a)(7) loans (including 1 portfolio hospital 223(f) loan) totaling \$420M
 - 8 Section 223(f) loans totaling \$540M

Median Processing Times (FY14 - F19 YTD)

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- **Preliminary Reviews** – 22 days (ranged from 8 to 85 days).
- **Prelim Review Letter to Pre-App Meeting** – 56 days (ranged from 13 days to 116 days).
- **Pre-App Meeting to Complete Application** – 143 days (ranged from 32 to 307 days).
- **Application Complete to Commitment** – 82 days (ranged from 21 to 188 days).

OHF Commitment Metrics

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Medians for FY 2014 to 2019 (YTD) Commitments

	223(f)	223(a)(7)	241
Number of Commitments	8	5	11
Total Revenue	\$165,606,000	\$96,799,597	\$436,421,000
Mortgage Amount	\$38,883,450	\$50,976,000	\$51,124,000
Operating Margin	0.4%	1.1%	2.8%
Total Margin	0.7%	1.3%	3.9%
Debt Service Coverage	1.6	1.9	2.8
Days Cash on Hand	112.3	92.9	53.6
LTD to Capitalization	44.8%	62.7%	56.0%
Loan to Value	71.5%	78.0%	75.0%
Mortgage Amount/Revenue	0.39	0.85	0.18



OFFICE OF HEALTHCARE PROGRAMS



Mortgage Amount to Total Revenues

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- A ratio considered during the Preliminary Review phase
- A complement to the loan-to-value calculation
 - Hospitals often valued by the revenues generated
- Underwriting considerations –
 - The higher the ratio, the more difficult it is to support the mortgage
- Helpful when sizing loans

Pro Forma Analyses

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- Pro Forma “Baseline” analysis
- Performed informally at the preliminary review stage
- Analysis performed on operating margin, debt service coverage ratio, as well as leverage ratios
- May generate discussion for the pre-application meeting

Metrics Analysis – Takeaway Points

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- OHF looks for a combination of strengths in broad metric areas (liquidity, leverage, profitability).
- High Risk – very low or negative net assets, very low days cash on hand (<10 days), Mortgage/Revenue ratio > 1.0, going concern opinion
- Disclaimer – all projects are different, and evaluated on their individual merits



Key Asset Management Issues & Best Practices

Ms. Joan Schmiedicke
Mr. Gary Broadwater
Mr. Geoffrey Papsco
Ms. Robin Senator
Ms. Kelly Gil

Committee on Healthcare Finance (COHF) Letter and HUD Response

➤ **Committee on Healthcare Finance (COHF) letter to HUD dated July 18, 2018 regarding:**

1. Post Closing Work on Mortgaged Property.
2. Section 242 Insurance Requirements in the HUD Section 242 Handbook, Appendix 7 as it relates to insurance deductibles and financing of insurance premiums.

➤ Post-Closing Work on Mortgaged Properties:

- COHF requested that the Office of Architecture and Engineering (OAE) provide guidance regarding those capital projects that HUD wants approval pursuant to the Regulatory Agreement and the Security Instrument, and
- HUD limit its approval requirement to post closing capital projects that change the use of the space from hospital use to non-hospital use, that change the footprint or the building, or are considered “substantial rehabilitation:”.

➤ HUD Response on Post-Closing Work on Mortgaged Properties:

- Currently, OAE's interpretation of the intent of the Regulatory Agreement language is:
 - Any capital improvement or maintenance project that requires securing a construction permit, modifies and NFPA 101 Life Safety Code Features, or modifies any ADA Accessibility Guidelines (ADAAG) amenities requires the consent and approval by HUD via document review by OAE.
 - The main function of this requirement is to maintain the capital value of hospital collateral over the life of the loan for FHA, the insurer of the loan, and the FHA insured lender. Building improvements typically add to the value of the collateral, decrease loan to value ratios, and benefits all parties.

➤ HUD Response on Post-Closing Work on Mortgaged Properties (cont):

- However, if a hospital undertakes a project without regulatory approval from the local authority having jurisdiction via a construction permit, the chances of violating a building, fire, environmental and accessibility requirements increases and collateral value decreases. This clarification language seeks to support collateral value and mitigate any code violations while providing a quick and simple test to determine when to submit construction documentation.
- Typically, construction work requiring OAE review are those described as “Classes of Work On Existing Structures” as described by the International Building Code Level 2 Alterations and Level 3 Alterations.
- Nonetheless, if construction impacts fire safety, ADAAG accessibility, or exterior cosmetic changes (if in a historic district) a repair or Level 1 alteration should be submitted to OAE for review.
- Conversely, a “paint and re-carpet / re-tile” construction should not be submitted for review.

➤ OHF Handbook, Appendix 7 – Insurance requirements

- Appendix 7 of the Section 242 Handbook was updated May 2013 with two major changes to insurance deductibles and financing of insurance premiums.
- Insurance Deductibles: The COHF noted that the updated insurance requirements outlined in HUD's Section 242 Handbook, Appendix 7 adopted many of the insurance requirements HUD used for the Section 232 Program
 - Same deductibles for all FHA-insured 242 borrowers, no matter size.
 - Created disruptions for hospitals who now are elevated to equal status and requirements thus they may be required to purchase levels of coverage they may not need.

- **OHF Response and Recommendation dated May 6, 2019 on Insurance Deductibles:**
 - OHF to review Handbook waivers submitted by Lenders regarding insurance deductibles for a Borrower.
 - To be considered for a HUD handbook waiver, the Lender's request should:
 - Indicate that the insurance is of a type and amount customary in the hospital industry as supported by:
 - An independent consultant report and
 - Approved by the Lender.

➤ OHF Handbook, Appendix 7 – Insurance requirements:

- Additionally, the COHF letter indicated an additional burden for hospitals being prohibited from financing insurance premiums.
- HUD lenders escrow for property insurance payments, so this issue applies only to the other required insurances, e.g., professional liability, general commercial.
- One noted difference is that the Section 232 Handbook provides that "premiums" for General Liability and Professional Liability policies may be paid through an alternative payment plan (e.g., monthly or quarterly) approved in writing by the Lender and the insuring entity. This is not the case for the 242 program.

➤ OHF Response and Recommendations on Financing Premiums:

- OHF to review Handbook waivers submitted by Lenders regarding Financing Premiums for alternative payment plans for General Liability and Professional Liability for a Borrower.
- To be considered for the Handbook waiver, the alternative payment plan must be approved in writing by the Lender and insuring entity.
- However, the Borrower shall not finance premiums for renewals of any policy covering the physical damage to collateral of the loan.

➤ Other Insurance reminders

- HUD must be listed as additional insured on all Accords, aside from Professional Liability.
 - HUD cannot be listed as Loss Payee
- Lender must ensure the project has the HUD required insurance coverage.

OHF Best Practices for Asset Management

➤ **Regulatory Agreement:** Sometimes issues with the Reg Agreement are reported “after the fact” or discovered by auditors (“findings”). Examples include, but are not limited to:

- Distribution of Assets to Affiliate
- Additional Indebtedness
- After-acquired property
- Timely filing of financial statements
- Collateral Release
- Board Report of Business Plan section
- Remodeling and renovations to collateral

- **Regulatory Agreement issues reported “after the fact” or discovered by auditors (“findings”):**
 - 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 OAE 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 extension and filing date. Must be received in advance of filing deadline.

➤ 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.

➤ Regulatory Agreement – Collateral Releases (cont)

- If the hospital is asking for a release of real property that serves as collateral for the HUD-insured loan:
 - Need the Lender's consent.
 - 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 as specific requirements vary by Reg Agreement.
 - Not found in the older Reg 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.
 - Since 2017, Reg Agreement requires that Borrower send information and reports to both HUD and the Lender.

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

➤ Mortgage Reserve Fund (MRF) Issues:

- HUD receives many requests from borrowers to use the MRF.
 - Reference should be made to the MRF agreement for acceptable uses which must be approved by HUD.
- Process: MRF requests must be in writing from the borrower to HUD.
 - All MRF relief requests from the borrower need to include a plan to repay the MRF up to the required minimum balance.
- 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: 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.



New Pilot Programs

Mr. Paul Giaudrone
Mr. Jim Pugh



OFFICE OF HEALTHCARE PROGRAMS



➤ **FHA Email Blast dated May 15th on two program enhancements:**

1. 1-Year Reduced Mortgage Reserve Fund (MRF) Program
2. Green Lane / Abbreviated Underwriting Process

**Office of Hospital Facilities:
One-Year Mortgage Reserve Fund (MRF)
Program**

➤ § 242.14 Mortgage Reserve Fund:

- As a condition of issuing a commitment, HUD shall require establishment of a Mortgage Reserve Fund (MRF).
- The mortgagor shall be required to make contributions to the MRF such that, with fund earnings, the MRF will build to one year of debt service at 5 years following commencement of amortization, increasing thereafter to 2 years of debt service on and after 10 years following commencement of amortization according to a schedule established by HUD, **unless** HUD determines that a different schedule of contributions is appropriate based on the mortgagor's risk profile, reimbursement structure, or other characteristics.

➤ § 242.14 Mortgage Reserve Fund (continued):

- In particular, hospitals that receive cost-based reimbursement may be required to have MRFs that build to more than 2 years of debt service.
- Expenditures from the fund are made at HUD's sole discretion or in accordance with the mortgagor's MRF Schedule.
- Upon termination of insurance, the balance of the MRF shall be returned to the mortgagor, provided that all obligations to HUD have been met.

➤ Who is Eligible:

- Proposal is for financially strong existing and new borrowers in the 242 program.
- Borrowers that qualify for this program will be required to:
 1. Have one year of debt service in the MRF after the start of debt amortization
 2. Initially qualify based on certain financial performance and utilization metrics.
 3. Maintain and report certain financial performance and utilization metrics on a monthly basis.

➤ Rationale:

- Incentives stronger financial performance by borrowers.
- Allow borrowers the opportunity to deploy capital in a less restricted manner than required by existing MRF Agreements.

➤ Next Steps:

- OHF is working with OGC and other HUD offices on a Mortgagee Letter or Housing Notice to provide details on this effort.
 - Initial Qualification Requirements
 - Application Process
 - Ongoing Participation Requirements and Reporting
 - Termination/Loss of Participation
- At this time, there is no timeline for issuance of the proposed guidance.

Proposed Qualification Requirements

➤ Proposed Initial Qualification Requirements:

- All of the following proposed qualifications must be met to participate:
 - One year of debt service must be in the existing MRF for all loans that are final endorsed;
 - All Statutory Tax and PILOT payments are current;
 - All Mortgage Payments, Mortgage Insurance Premiums and Insurance escrows are current;
 - The borrower is not currently on the OHF Watch List;
 - The Borrower certifies that it is not currently the subject of a Federal, State, or Local governmental inquiry or investigation;
 - Financial performance metrics as outlined in the HUD notification;
 - Any other factor that HUD may consider at its sole discretion.

Proposed Application Process

- **Once One Year MRF program is finalized at HUD:**
 - To participate, a Borrower must submit a written request to HUD to include initial Qualification requirements, including detailed calculations when applicable.

**Office of Hospital Facilities:
Abbreviated Underwriting Process (Green Lane)**

"Green Lane" – Abbreviated Underwriting Process

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"Green Lane" –
Abbreviated
UW Process



Program Overview

- **Green Lane:** Upon issuance of a planned Mortgagee Letter (currently under development), OHF will implement a new underwriting process for needed, financially strong hospitals that may not have access to attractive non-FHA capital options
- Eligible participants can expect simpler application requirements and expedited processing times
- OHF estimates that this could cut traditional processing times in half.

➤ Program Benefits (How do the standard and Green Lane processes differ?)

- The Green Lane process allows the borrower and lender to proceed directly to application submission following a successful Preliminary Review
- Eliminates the requirement that the application include a feasibility study (no CPA-prepared nor self-prepared study is necessary)
- Allows the underwriting process to start prior to receipt of a full application. Upon receipt of key information from the lender and borrower, HUD may schedule a site visit and begin the underwriting review.

- **Program Benefits (What steps in the standard process are preserved in the Green Lane?)**
- HUD will still require a Preliminary Review process to determine if the project is eligible for the Green Lane.
 - With the exception of the feasibility study, the application requirements are the same
 - A site visit will still occur.
 - OAE's requirements (A/E and environmental) must be met.
 - The approval process will still involve development of a Credit Report and presentation to the Credit Committee.
 - Office of Risk Management and FHA Commissioner approval may still apply.

➤ Who is Eligible:

- Proposal is for financially-strong borrowers seeking Section 223(f) transactions that do not include substantial rehabilitation

➤ Rationale:

- Encourages financially-strong borrowers to consider using the Hospital Mortgage Insurance Program
- Potentially strengthens and grows the HUD Hospital portfolio

➤ Next Steps:

- OHF is working with OGC and other HUD offices on a Mortgagee Letter or Housing Notice to provide details on this effort.
 - Eligibility Requirements
 - Application Process

➤ Summary of Proposed Process

- HUD receives a standard Preliminary Review package (in accordance with existing Handbook requirements).
- HUD reviews the package against established criteria and determines whether the proposal is eligible. The goal for a decision is 20 business days.
- If HUD decides that a proposal is not eligible for the Green Lane, and a pre-application meeting is scheduled, the request for Green Lane processing may be reconsidered following the meeting.

➤ Summary of Proposed Process (continued)

- If invited to apply via the Green Lane, HUD will provide a list of documentation requirements within the invite Letter.
- When the documents are submitted, the Account Executive will begin underwriting and the AE and Lender may schedule and complete a site visit.
- If credit issues arise during the process that could challenge the timing of application processing, these issues are discussed with the Credit Committee early in the process.
- Upon completion of the site visit and Credit Report, the project is presented to Credit Committee and ORM (if applicable).

➤ Summary of Proposed Process (continued)

- OHF briefs ORM during the underwriting process, so that ORM concurrence may be obtained shortly after the Credit Committee vote.
- Following a successful Credit Committee meeting, OHF communicates the result to the Lender and directs the Lender to submit any outstanding application materials prior to Commitment issuance.
- Upon completion of OAE’s work, and upon receipt of missing Volume 1, 2 of 3 application materials, FHA Commissioner approval is sought (if applicable).
- Commitment is issued

Thank you for attending the Office of Hospital
Facilities 2019 lender training!