

# Section III Asset Management

## Chapter 3 General Loan Oversight

### 3.0.0

### Introduction

This chapter addresses details of loan servicing for projects insured under the Section 232 Program covered by this Handbook, and the related necessary actions for the ~~Project~~[project](#) (consisting of the Borrower, Operator, Master Tenant (if applicable) and Management Agent), ~~Mortgagee/Servicee~~[Lender](#) and the Office of Residential Care Facilities' (ORCF) Account Executives (AE). For the purposes of this chapter, the term "~~Mortgagee/Servicee~~[Lender](#)" means the primary servicer responsible for servicing the mortgage loan, whether such party is the originating Lender or third-party servicer for the originating Lender.

ORCF provides asset and risk management of all Section 232 insured projects; however ~~Mortgagee/Servicee~~[Lenders](#) must also provide routine reviews of their portfolio, which includes quarterly and annual reviews of financial performance as discussed in Asset Management, Chapter 4, as well as special reporting to the AE when a project's performance is at risk. ~~This chapter, as discussed in Section I, Chapter 2, Section 2.10. E. and in this Chapter, Section 3.10 below. This chapter also~~ provides guidance regarding performance benchmarks for each project, and also regarding the necessary actions to be taken by the ~~Mortgagee/Servicee~~[Lender](#), AE and project in specific circumstances during the life of the FHA-insured mortgage.

Many tools and resources are posted on the Section 232 Program website, ~~to include~~[including](#) submission checklists, average processing times, and other helpful information that can provide supplemental guidance to this Handbook.

[This chapter concerns general loan oversight. In some instances, Section 232 loans may also be subject to project-based rental assistance contracts or other Use Agreements. ORCF works in coordination with the Office of Multifamily Housing in oversight of these programs.](#)

## Section 3.1

### Servicing and Monitoring of Construction Projects

#### 3.1.1

#### Introduction

This section provides ORCF asset management guidance for Section 232 and 241(a) mortgage loans that include lease-up of units (new construction, substantial rehabilitation and Section 241(a)) (“Construction Projects”).

The risks inherent during the construction and lease-up processes necessitate heightened [Mortgagee/ServicerLender](#) attention during those periods, as well as strong production/asset management coordination within the [Mortgagee/Servicer’sLender’s](#) organization. The risks also necessitate strong [Mortgagee/ServicerLender](#) leadership and coordination with all involved parties.

Within ORCF, and in light of the unique risks inherent during construction and lease-up, a Construction Project will typically (though not invariably) be ~~assigned to an AE on a servicing team focused on servicing such properties (a “lease-up” servicing team). Generally the lease-up AE will then service the property until it reaches sustaining occupancy (see Sec. 3.1.3.A.2.f). Although the AE will be the primary facilitator within ORCF, during the lease-up process the AE will, where appropriate, draw upon the participation of the ORCF Underwriter, Closer, Construction Manager, Appraiser and others within ORCF, as well as the assigned closing attorney from the HUD Office of General Counsel (OGC). initially assigned to an AE on a Risk Mitigation team focused on servicing such properties.~~

In its leadership role, and in close coordination with the lease-up AE, -the [Mortgagee/ServicerLender](#) is expected to assemble--and electronically convene frequently (typically at least monthly)-- a resource team to assist the [Mortgagee/ServicerLender](#) in project monitoring. This “Project Monitoring Team” shall include where appropriate and without limitation the Borrower, Operator, Management Agent and ORCF. Drawing upon the information and expertise thus available, the [Mortgagee/ServicerLender](#) shall monitor the actual lease-up progress compared to the projected (underwritten) progress, and shall assure that its Borrower identifies and carries out steps to remedy unfavorable variations between projected and actual progress.

#### 3.1.2

#### Loan Committee Presentation and Initial Closing

Just as the [Mortgagee/ServicerLender](#) coordinates its own production and asset management functions, so too does ORCF. In that regard, to ensure that the lease-up AE has the opportunity

to fully appreciate the issues, objectives and risks of the construction loan, the lease-up AE's assignment will typically begin with attendance and participation in the project's loan committee presentation. Then, upon issuance of a Firm Commitment, the ORCF Closer staff will facilitate many functions necessary for the Initial Closing, and the AE will work with the Closer and/or the ORCF Construction Manager where needed, leading up to Initial Closing.

### 3.1.3

## Asset Management Functions after Initial Closing

~~The lease~~Lease-up AE's activity after Initial Closing varies according to the type of loan, which determines the asset management lead-time provided by construction.

A. **Projects Having No Operations During Construction.** In the case of a Section 232 construction loan where there are not existing operations that will continue during construction (new construction and some substantial rehabilitation projects), the project's construction phase will typically consume many months, during which time the AE's ~~duties~~Lender's coordination with AE will be minimal. ~~When a project of this type reaches until the point of 70% completion (calculated as a percentage of construction draws), the AE will commence ORCF's pre-operations asset management functions.)~~

1. **Pre-Operations Activities.** When this type of project is scheduled to open within the following quarter, the AELender will begin to work closely with the Mortgagee/Servicee, AE and project participants ~~and ORCF colleagues~~ to help assure a successful transition and business start-up.

a. ORCF Staff Communications. The AE, the Construction Manager and the assigned Closer will communicate after Firm Commitment to ensure that all parties are aware of the project assignment. If project issues arise, the AE will participate as necessary to ensure appropriate resolutions. To keep the AE informed about construction progress, the Construction Manager will send an email notification to the AE when a new construction project reaches 70% completion.

b. Pre-Operations Meeting. When a new project reaches 70% completion, the AE ~~will confer with the Mortgagee/Servicee regarding convening a Project Monitoring Team (referenced above in the Introduction, 3.1.1).~~ The Mortgagee/ServiceeLender, in coordination with the AE, will arrange and facilitate a Pre-Operations Meeting of this Project Monitoring Team. Before doing so, however, the Mortgagee/ServiceeLender will, in coordination with the AE, collect project status information as needed and determine the appropriate participants and agenda.

i. The agenda for this introductory Pre-Operations meeting will generally include, among other topics:

1. Introductions
2. Pre-opening checklist, which the Borrower and Operator can use for guidance during start-up (Please see the Section 232 Program website,)

3. Borrower's summary of the marketing plan and current project status
  4. Status of all state permits, i.e., Operating License, Medicaid/Medicare certifications
  5. Discussion of the Initial Operating Deficit (IOD) tracking worksheet (Please see the Section 232 Program website)
  6. Proper registration in the Business Partner Registration System (BPRS)
  7. Assurance of ~~borrower, operator~~Borrower, Operator and ~~management agent's~~Management Agent's familiarity with the requirements of their respective ~~regulatory agreements~~Regulatory Agreements/certifications and other controlling documents
- ii. A suggested draft Pre-Operations Meeting agenda will be provided on the Section 232 Program website.
- c. Project Monitoring Strategy and Action Plan. The ~~Mortgagee/Servicee~~r ~~should~~Lender needs to ensure that, upon completion of the Pre-Operations Meeting, all participants have a clear understanding of the ~~borrower's/operator's~~Borrower's/Operator's plan/strategy to reach ~~self-sustaining occupancy performance~~, including problems identified, steps to address them, persons responsible, and benchmarks/timelines for follow-up. If ~~necessary~~applicable, the ~~Mortgagee/Servicee~~r ~~may choose to~~Lender shall memorialize in writing any conclusions, agreements, follow-up assignments, information requests, additional meetings ~~schedules~~scheduled, etc.

## 2. Ongoing Asset Management Activities (After Project Opening)

- a. General. The ~~Mortgagee/Servicee~~Lender will monitor the project's performance in accordance with the plan established, and will meet with project participants as scheduled. This includes facilitating the (monthly) Project Monitoring Team meetings, in which the ORCF AE and, where appropriate, other ORCF representatives, will participate, and in which actual progress is compared with projected progress, and any corrective steps are identified, along with persons responsible, target completion dates and benchmarks for progress~~-,~~ as appropriate.
- b. IOD tracking. The ~~AE~~Lender must ~~approve~~have any releases of IOD funds ~~and will seek to ensure that~~approved by the AE. These funds are to be used judiciously by carefully tracking project performance and the availability of remaining funds. Further information regarding IOD funds is provided in the Escrow Accounts section of this chapter.
- c. IOD/Lease-up Tracking Worksheet. A project-specific IOD/Lease-up tracking worksheet, Initial Operating Deficit Escrow Calculation Template (Form HUD-91128-ORCF), will be generated based upon the assumptions regarding the project's lease-up, and is to be completed on a cash basis. The AE will forward the IOD/Lease-up Tracking Worksheet to the ~~Mortgagee/Servicee~~Lender to be forwarded to the Borrower with other materials for the Pre-Operations Meeting. ~~Mortgagee/Servicee~~Lenders must

164 instruct Borrowers to complete and submit the Worksheet on a monthly basis  
165 to the [Mortgagee/Service Lender](#), who will review and promptly make  
166 available to the ORCF AE. The Worksheet will provide the AE with the  
167 project performance documentation and justification necessary for releasing  
168 funds from the IOD escrow account. This worksheet should be addressed  
169 during the Project Monitoring Team meetings. Note that this worksheet is  
170 important in lease-up transactions even when an IOD is not used; the  
171 worksheet serves as an important tool for tracking actual versus projected  
172 performance.

- 173 d. Operating Reports. The [Mortgagee/Service Lender](#) and AE need regular  
174 project performance data to assess the overall health of the project. The IOD  
175 Tracking Sheet will provide them with a trended summary of monthly  
176 occupancy, revenue and expenses. The AE might also require that periodic  
177 financial statements (e.g., Balance Sheet, Statements of Profit/Loss, Cash  
178 Flows, Retained Earnings, Computation of Surplus Cash, AP and AR Aging  
179 Analysis) be submitted depending on how the project is performing. The  
180 HUD Monthly Accounting Reports (MAR) can provide valuable data as well.  
181 e. Performance on surveys, inspections and certifications. Projects must survive  
182 initial regulatory scrutiny. Skilled Nursing Facilities (SNF) in all states  
183 undergo initial CMS compliance surveys in addition to Medicare and  
184 Medicaid certification reviews. Assisted Living Facilities (ALF) and Board &  
185 Care Facilities (B&C) are inspected in accordance with respective state rules.  
186 Issues with surveys and inspections can lead to lost or delayed revenues at a  
187 point where a new project's financial base is fragile. The  
188 [Mortgagee/Service Lender](#) must communicate closely with Borrowers and  
189 Operators to remain abreast of progress on early regulatory reviews and must  
190 keep the AE informed.  
191 ~~f. iREMS updates to the project record. The AE must carefully track and~~  
192 ~~summarize project start up status in iREMS. Monthly entries are~~  
193 ~~appropriate.~~ Achievement of Sustaining Occupancy. For servicing purposes, a  
194 project of this type attains Sustaining Occupancy when all escrows established  
195 at closing (other than long term escrows) are released but then only if the  
196 project also demonstrates, over a six (6) consecutive month period:  
197 ~~f. An average Debt Service Coverage Ratio (from operations) equal to or greater~~  
198 ~~than 1.45 (Achievement of Self-Sustaining Performance. A Section 232 new~~  
199 ~~construction project attains self-sustaining performance when it is a Final~~  
200 ~~Endorsed loan and demonstrates six (6) months of:~~  
201 i. Positive net operating income (NOI) including funding of all  
202 required escrows;  
203 ii. Timely and full mortgage payments ~~on a Finally Endorsed~~  
204 ~~loan,~~ and  
205 iii. No regulatory issues  
206

207 When ~~Sustaining Occupancy~~self-sustaining performance is acknowledged by  
208 the AE, the project, if serviced by a lease-up AE, ~~(see B below)~~, will



generally be transferred to an AE on a regular servicing team for routine monitoring and servicing.

**B. Projects Continuing Existing Operations During Construction.** For Section 232 and 241(a) construction loans where existing operations will continue during construction (including some substantial rehabilitation projects), the AE ~~must begin~~begins asset management duties with respect to the new loan immediately after Initial Closing. Typically, the ORCF servicing (for both the new loan and, if applicable, the existing loan) will be assigned to an AE on the “lease-up” servicing team for these transactions. ~~However, on 241a, with the exception of some 241(a) transactions in which the debt service coverage ratio for both loans exceeds 1.45 based on current revenue, the project will not likely be transferred to a lease-up AE for servicing.~~

1. General. Servicing of these loans generally involves all the elements and challenges of a new construction transaction, *plus* all the requirements related to ongoing servicing of a project currently in operation. Additionally, the element of construction itself can create risk to the project due to resident, visitor and staff safety issues. Furthermore, renovating existing projects often uncovers project issues that were unknown at the time of underwriting, and the scope, duration and cost of construction sometimes changes. Those unexpected changes may raise asset management issues that require the ~~Mortgagee/Servicer's~~Lender's and AE's attention.

2. Timing. Upon Initial Closing of the loan the ~~AE, having participated in Loan Committee and gained information about the transaction, will promptly initiate project~~Lender should expect to commence communications ~~and commence project monitoring and servicing functions related to the new loan, with the AE.~~

3. Initial Meeting. Although not a “Pre-Operations” meeting (as was the case above involving a completely new facility), the ~~AE~~Lender will confer with the ~~Mortgagee/Servicer~~AE regarding first convening an initial meeting (conference call) of the Project Monitoring Team (referenced above in the Introduction, 3.1.1). The ~~Mortgagee/Servicer~~Lender, in coordination with the AE, will arrange and facilitate this initial meeting. Before doing so, however, the ~~Mortgagee/Servicer~~Lender will, in coordination with the AE, collect project status information as needed and determine the appropriate participants and agenda. That initial meeting will typically cover, without limitation:

- a. Review of issues and plans for resolution
- b. Borrower's summary of the plan to continue operations during construction
- c. Review of issues and plans for resolution, if any
- d. Review the status of all permits (e.g., Certificate of Occupancy, operating license, etc.)
- e. Discussion of working capital and IOD/Lease-up tracking, as applicable
- f. Confirmation or discussion to ensure registration in the BPRS

- g. Assurance of ~~borrower, operator~~Borrower, Operator and ~~management agent's~~Management Agent's familiarity with the requirements of their respective ~~regulatory agreements~~Regulatory Agreements/certifications and other controlling documents, such as quarterly financial reporting
- h. Status of progress toward final closing
- i. Scheduling of the subsequent (monthly) meeting of the Project Monitoring Team

3.4. Project Monitoring Strategy and Plan. The ~~Mortgagee/Service~~Lender needs to ensure that, upon completion of the initial meeting, all participants have a clear understanding of the ~~borrower's/operator's~~Borrower's/Operator's plan/strategy to reach ~~self-sustaining~~occupancy performance, including problems identified, steps to address them, persons responsible, and benchmarks/timelines for follow-up. The ~~Mortgagee/Service~~Lender should memorialize in writing promptly after this meeting (and subsequent monthly Project Monitoring Team meetings) any conclusions, agreements, follow-up assignments, information requests, additional meetings scheduled, etc. The ~~Mortgagee/Service~~Lender should ensure that IOD/Lease-up Tracking Worksheet is updated for these meetings, as a tool for comparing actual versus projected progress.

4.5. Achievement of Self-Sustaining Occupancy Performance. See definition in Sec. A.2.f above. ~~When Sustaining Occupancy is reached, If the project, if it had~~ has been ~~with assigned to~~ a lease-up AE, when self-sustaining performance is reached, it will typically be ~~assigned~~reassigned to an AE on a ~~regular~~routine servicing team for ~~routine monitoring and servicing.~~

**C. Projects Having Early Start of Construction.** With projects that are approved for early start of construction, the AE will be alerted to the project by the Underwriter, and the Construction Manager will monitor the construction activities. If a Firm Commitment is issued, the AE will immediately initiate asset management functions. Similar to other construction loans, the AE will work with the ~~Mortgagee/Service~~Lender, who will, drawing on the Project Monitoring Team, make an initial risk assessment, define a monitoring plan, and specify reports requirements.

After Firm Commitment, projects that have been previously approved for early start will thereafter be monitored in accordance with the asset management guidelines above for the specific type of construction loan until the project attains Self-Sustaining Occupancy Performance (as discussed above).

## Section 3.2

### Escrow Accounts

#### 3.2.1

#### Introduction

- A. **Residential Care Facilities:** An FHA-insured project will typically have one or more of the following types of escrow accounts (each one, hereinafter referred to individually, as an “Escrow Account” and collectively, as the “Escrow Accounts”):
1. Reserve for Replacement (Refer to 3.2.2 below)
  2. Residual Receipts (Refer to 3.2.3 below)
  3. Non-Critical Repairs (Refer to 3.2.4 below)
  4. Sinking Fund (Refer to 3.2.5 below)
  5. Mortgage Reserve/Debt Service (Refer to 3.2.6 below)
  6. Initial Operating Deficit (Refer to 3.2.7 below)
  7. [Working Capital Escrow](#) (Refer to [Production, Chapter 2](#))
- B. **Escrow Accounts:** Each Escrow Account has a specific purpose, but all such accounts are intended to protect the interest of the Borrower and FHA mortgage insurance fund. Escrow Accounts are either required by Federal regulations, Regulatory Agreements, contractual agreements established during the underwriting of a project loan or contractual agreements executed subsequent to an initial loan closing. The Escrow Accounts are required to be used for specific purposes as outline in this chapter or in the escrow agreement. The disbursement process requires cooperation between ORCF, the Borrower and the [Mortgagee/Service Lender](#). This chapter sets forth the general requirements for the maintenance of Escrow Accounts and the procedures to request a withdrawal or disbursement from each of the accounts.
- C. **Pending Loan in Review:** If an existing FHA-insured project has a pending application for a 223(a)(7) loan refinance or for any other FHA program, the Borrower must disclose information to the [Mortgagee/Service Lender](#) and AE on a pending loan application of any request for a disbursement from an Escrow Account. Large unanticipated withdrawal requests may affect the financial information required for ORCF to process the pending loan application.
- D. **Specific Escrow Requirements:** ORCF may determine that a requirement that applies to one type of Escrow Account is also applicable to another Escrow Account.



### 3.2.2

## Reserve for Replacement (R4R) Account

#### A. Introduction and Applicability.

The Regulatory Agreement for projects financed with FHA-insured mortgages provides that the Borrower must establish and maintain an account to help defray the costs of replacing a project's capital items (the "Reserve for Replacement Account" or "R4R Account"). The R4R Account is held as a separate account with the [Mortgagee/Service Lender](#) or in a safe and responsible depository designated by the [Mortgagee/Service Lender](#). Initial deposits to the account are to be made in cash at the time of the loan closing, if required. The Borrower is required to begin making monthly deposits into the R4R Account on the date that the Borrower begins making payments to amortize the principal of the FHA-insured mortgage, or on such other date as may be approved by ORCF in writing. The monthly amount to be deposited in the R4R Account is set forth in the Regulatory Agreement which provides that the account is under the control of the [Mortgagee/Service Lender](#).

Disbursements from the R4R Account, whether for the purpose of effecting replacement of structural elements or mechanical equipment of a project; to cure a mortgage default; or for any other approved purpose, may be made only with the prior written consent of ORCF (or under the provisions whereby HUD allows [Mortgagee/Service Lenders](#) to review R4R releases outlined in this chapter). ~~For HUD-held mortgages, the Secretary will exercise control over the R4R Account pursuant to the authority granted under the National Housing Act.~~ The following are some of the key requirements for a R4R Account:

1. Custodial Escrow Account. The R4R Account must be maintained as a custodial escrow account. The funds in the R4R Account may be combined or commingled with other escrow accounts; however proper disclosures must be made (~~forming the~~ [Master Agreement for Servicer's Escrow Custodial Account, \(Form HUD-11720\)](#) and the requisite systems must be in place to properly account for each type of escrow.
2. Interest Earned on Account. ORCF encourages and in some cases requires that interest earned on the R4R Account remain in the account. Interest may never be disbursed directly to the Borrower of a project or directly to any individuals associated with the Borrower (except for approved releases pursuant to 3.2.2.H of this Chapter). All interest earned must flow through the accounts of the project and must be disclosed on the project's accounting records.
3. [Mortgagee/Service Lender](#) Charges for Handling Investments of the reserve fund. If a [Mortgagee/Service Lender](#) proposes to assess charges for investing the reserve fund, the fees or charges for making or accepting investments must be set forth in an agreement between the [Mortgagee/Service Lender](#) and the Borrower, and may only be collected according to said agreement.
4. Type of Account. Funds may be deposited with the [Mortgagee/Service Lender](#) in the form of cash. If funds in the R4R Account and all Escrow Accounts are invested, such funds must be invested in (a) an interest-bearing account insured or guaranteed

by the Federal Deposit Insurance Corporation, National Credit Union Association, or any United States of America insurance program, or (b) obligations of the Federal Government, including money market or other fund accounts limited to investments in such obligations. All funds, whether in the form of a cash deposit or invested in obligations of, or fully guaranteed as to principal by, the United States of America shall at all times be under the control of the [Mortgagee/Service Lender](#). ORCF is not establishing specific liquidity requirements for the R4R Account. The Borrower, not the [Mortgagee/Service Lender](#), is responsible for deciding the liquidity requirements of funds held in the R4R Account. The Borrower should maintain some portion of its reserves in the form of very liquid assets such as passbook savings accounts. As a guideline only, and depending on the specific project, \$1,000/unit should be enough to meet minimum liquidity requirements for some projects.

**NOTE: ALL MORTGAGORS SHOULD BE CAUTIONED.** If any principal is lost as a result of an early or premature liquidation of an investment that is caused by an owner's requested withdrawal from the R4R Account, the lost principal must be repaid to the R4R Account. This repayment must come from non-project funds and be made by the persons who own the [Borrower](#) entity, by persons with a controlling interest in the project, or by such affiliated/related parties as the project's sponsors. This caution is particularly important for non-profit mortgagors. Accordingly, the terms and durations of investments should be selected prudently and with great care.

5. Regulatory Agreement Not Modified. Nothing contained in this Section 3.2 shall be deemed to modify the terms and conditions of the Regulatory Agreement.

**B. Realty vs. Non-Realty (a.k.a. Major Movable) R4R Funds.**

ORCF no longer recommends that FHA-insured projects maintain two R4R accounts (realty and non-realty). If the project has two R4R Accounts, the [Mortgagee/Service Lender](#), with consent of the Borrower, may combine the two accounts into one account.

**C. Qualified Repair or Replacement Expenses.**

The purpose of the R4R Account is not to provide for a dollar for dollar ability to replace all building structural components and equipment as they wear out, but rather to provide a readily available source of capital to help defray the cost of replacing building structural components and equipment in the latter years of the project. The R4R Account shall not be considered as the primary source of funds for capital project ~~repairs and~~ replacements, but only as a supplemental source of funds to offset the replacement of capitalized assets that are part of the mortgaged security, commonly listed in the PCNA. Borrowers should also maintain a repair, maintenance and/or replacement fund in the annual operating budgets of Section 232 FHA-insured projects. The R4R account is also not for routine maintenance. The following are eligible uses ("Qualified Expenses") for the R4R Account:

1. Capital items including, but not limited to:
  - a. Replacement of windows in the project.

- b. Extensive replacement of kitchen and bathroom sinks and counter tops, bathroom tubs, water closets, and doors (exterior and interior).
- c. ~~Major roof repairs~~Roof replacement/re-roofing, including major replacements of gutters, downspouts, and related eaves or soffits.
- d. ~~Major plumbing~~Plumbing and sanitary system ~~repairs~~replacement, preferably with water-saving features.
- e. Replacement or major overhaul of central air conditioning and heating systems, including cooling towers, water chilling units, furnaces, stokers, boilers, and fuel storage tanks.
- f. ~~Overhaul~~Replacement or major overhaul of elevator systems.
- g. Major repaving/resurfacing/seal coating of sidewalks, parking lots, and driveways of the project.
- h. Repainting of the entire building exterior. Major painting of interior spaces, such as all common areas being repainted at one time, may be considered eligible. (Re-painting of individual rooms is considered routine maintenance, and not eligible.)
- i. Extensive replacement of siding.
- j. Extensive replacement of exterior (lawn) sprinkler systems.
- k. Major carpet replacement (e.g., multiple room replacements or entire common area of a project).

Generally, the following items are Qualified Expenses, provided that they are not a routine maintenance item: office/common area/unit equipment, appliances and furniture, nursing/patient care equipment, food service/laundry/housekeeping equipment and appliances, and maintenance equipment.

2. For certain projects, capital improvements or enhancements to the project may be considered as a Qualified Expense. For example, individual air conditioning units may be added to a project that was not air conditioned when it was built; gutters and downspouts may be added where necessary; or an initial purchase of a computer and some associated software may be purchased/qualified. However, routine repairs, maintenance and service fees, such as internet fees, web hosting, software-hardware maintenance/updates, proprietary software/vendor fees and related expenses are not Qualified Expenses.

Some improvements may be eligible if they can be justified to:

- a. result in enhancing the mortgage security, including making the project energy efficient,
- b. upgrade the project and place the project in a more favorable competitive position in the marketplace, and/or
- c. be necessary to comply with changes in local, state or Federal laws.

Certain capital improvement projects may require the use of a third-party professional, such as a design architect, engineer, etc. The AE may consider approval of such expenses as Qualified Expenses, in the context of an otherwise approvable capital improvement project, not funding through other sources.

3. Projects with a Green Mortgage Insurance Premium (“MIP”) Mortgage Per the Project Capital Needs Assessment (PCNA) and Reserve for Replacement Schedule, all appliances and heating and air conditioning systems must be specified as ENERGY STAR® when replaced. For lighting, electrical, mechanical equipment, and building envelope components with no available ENERGY STAR® label, high-performance and/or sustainable replacements must be used. (See Green MIP Program Guidance for ORCF ML 2022-13).

D. **Non-qualified Expenses:** Items traditionally contemplated as ineligible expenses that may not be paid for with funds from the R4R Account include, but are not limited to the following maintenance items:

1. Repainting of interior areas of projects, including but not limited to, painting of residential units, hallways, community rooms, kitchens, offices, etc. A separate interior painting reserve for this kind of work may be established by mutual agreement and consent of the Borrower, Mortgagee/Service Lender and ORCF.
2. Replacement or repairs of a part or a component of range burners, televisions, computers, routers, bibs, oven elements, controls, refrigerators, valves, wiring, etc.
3. Minor replacements of dwelling unit air conditioning components such as fan motors and window unit compressors.
4. Minor repairs to central air conditioning and heating systems such as valve replacements and the cleaning of boiler interiors.
5. Minor roof repairs, including minor repairs to gutters and downspouts.
6. Minor paving or repairs.
7. Minor caulking and sealing. However, caulking or sealing of the entire project to improve energy efficiency is a Qualified Expense.
8. Window and screen repairs.
9. Purchase of minor equipment, furniture, appliances or fixtures or the purchase of maintenance tools and equipment, such as lawn mowers or snow blowers.
10. Inspection/recharging/replacement of fire extinguishers.
11. Minor carpet or flooring repairs. However, carpet or flooring replacement of multiple areas/units or the entire common area of a project is a Qualified Expense.
12. See 3.2.2.C.3. above regarding eligibility of certain items for Green MIP projects.

515 **E. Adequacy of Reserve for Replacement Account.**

516 The Borrower must analyze the amounts in a project's R4R Account in the light of  
517 anticipated replacement needs (in certain cases ORCF may require that the Borrower perform  
518 an analysis of the account). A Borrower shall rely on its knowledge of the physical condition  
519 of the project, evaluations made by Operators or Management Agents, and physical  
520 inspection reports furnished by the [Mortgagee/Service Lender](#) and by ORCF, including the  
521 PCNA. In general, capitalized replacements anticipated in the Borrower's needs should  
522 mirror that of the last PCNA. If the Borrower's analysis indicates that it is necessary to  
523 increase the rate/amount of deposits into the R4R Account, the Borrower should contact the  
524 [Mortgagee/Service Lender](#) to request authorization to increase the monthly deposit  
525 requirement. The Lender shall notify ORCF promptly upon becoming aware when the R4R  
526 is insufficient to meet capital needs or the minimum threshold.

527  
528 **F. Recommended Minimum Threshold.**

529 Borrowers should ~~submit to~~ maintain a minimum recommended threshold equal to at least  
530 \$1000 per unit in the R4R Account. For example, the minimum R4R Account balance for a  
531 100-unit project is \$100,000. The purpose of the minimum threshold is to ensure that funds  
532 are available for an emergency, such as a major roof failure or a water or sewer main break.  
533 Failure to maintain the minimum threshold could trigger a discussion by the AE with the  
534 [Mortgagee/Service Lender](#), and the Borrower to determine whether an increase in the deposit  
535 amount is appropriate given the reliance on the fund. If the account regularly falls below the  
536 recommended minimum, ORCF may decline to approve a request to withdraw funds from  
537 the R4R Account unless in an emergency situation.

538  
539 **G. Adjustments to Recommended Minimum Threshold.**

540 The Borrower, [Mortgagee/Service Lender](#) or ORCF may increase the recommended  
541 minimum threshold of \$1000 per unit under one or more of the following circumstances:

- 542
- 543 1. Physical Condition. Projects in poor physical condition, as evidenced by a recent  
544 REAC Physical Inspection Score under 60, may require larger balances.
  - 545
  - 546 2. Geographical Location. Exposure to severe or unusual weather conditions, as well as  
547 the widely varying costs of repairs and replacements.
  - 548
  - 549 3. Immediate Replacement Needs. The project is in good physical condition but an  
550 unexpected large capital need arises.
  - 551
  - 552 4. Changes in Replacement Items. If non-traditional items are to become eligible R4R  
553 Account items, the minimum to be held in the account may need to be increased.
  - 554

555 **H. Withdrawals from the Reserve for Replacement Account**

- 556
- 557 1. Borrowers or Operators are to submit Reserve for Replacement (R4R) requests to  
558 ORCF through their [Mortgagee/Service Lender](#) (with the exception of those that can  
559 be directly reviewed and approved by the [Mortgagee/Service Lender](#), as described in



Section 3.2.2.H.5). ~~A checklist of required exhibits to submit for R4R requests will be available on the Section 232 Program website.~~

2. The Mortgage/Service Lender is to receive the R4R requests, review them for completeness, accuracy and eligibility, and then forward them to ORCF with a recommendation for approval (with the exception of those that can be directly reviewed and approved by the Mortgage/Service Lender, as described in Section 3.2.2.H.5).
3. Typically, R4R releases are made for reimbursement on work that is completed. However, advances may be approved in situations where upfront or partial payments to the contractor(s) are required prior to the work being completed. At the Mortgage/Service Lender's discretion, the R4R may be used to allow for multiple draws or a single draw, depending on the scope of work, and the availability of funds in the project operating account, R4R account and other sources (e.g., owner contributions, insurance proceeds). For example, draws may be established at 35 percent, 65 percent and 100 percent completion for more substantive repairs.
4. **Additional Considerations.** The following factors will be considered by ORCF in processing a request to withdraw funds from the R4R Account:
  - a. Whether the expense is a Qualified Expense, as defined in Section 3.2.2.C.
  - b. Adequacy of the funds in the R4R Account.
  - c. If the project has an active or pending refinancing/financing application (i.e., 223(a)(7) or other loan program), the Borrower must disclose this information with the request to withdraw funds from the R4R Account.
  - d. If the submittal proposes remodeling, adding to, subtracting from, reconstructing, or demolishing a portion of the mortgaged project (as discussed further in Section 3.4.4 of this chapter), an environmental review as required by 24 CFR Part 50 will be conducted.
  - e. **Timing.** It is recommended that requests for withdrawals be made not more often than quarterly, or three months from the last approved request, unless an emergency exists. Additionally, requests for withdrawals shall be made no more than one year after the expenditure occurred. The Borrower should presume that a withdrawal request for expenditures beyond 365 days will be denied; only in extraordinary circumstances and for good cause shown will ORCF consider approving such a request.
  - f. **Invoices.** Copies of invoices are not required to be submitted to ORCF if the description of the work done or items replaced is sufficiently detailed to permit an inspection and verification; however, the Borrower must keep copies of the invoices on file for at least three years and have the invoices available for ORCF staff to review.
  - g. **Temporary Removal of Lender Delegated Authority.** In certain circumstances, a temporary hold on approvals of withdrawals from the R4R Account may be indicated, such as repeated requests for ineligible items, or other patterns of financial risk. In such cases, the AE may request additional

information and/or also request a temporary removal of the Lender Delegated Authority, (as discussed below) per Section I, Introduction, Chapter 2, Section 2.12.C.

5. **Optional Mortgagee/ServiceLender Review and Delegated Approval of R4R Requests:**

In an effort to streamline operations, decrease response times, and allow ORCF staff to focus on more complex R4R or escrow review requests, there are certain requests that may be approved by the Mortgagee/ServiceLender, as long as the criteria below are met. Special Requests (see Section 3.2.2.I below) must be submitted to ORCF for processing and approved only by the AE, and are not eligible for Mortgagee/ServiceLender approval.

This Mortgagee/ServiceLender review and delegated approval is not a requirement and is optional for those who agree to administer the review and approvals within the HUD and Section 232 guidelines.

- a. **Delegated Approval Process.** A prerequisite for participation in this process is HUD approval of the Mortgagee/ServiceLender to participate in this delegated review. If a Mortgagee/ServiceLender has been approved by Multifamily Housing in accordance with their process related to delegated review of R4R requests, ORCF shall consider the Mortgagee/ServiceLender approved to perform delegated review of R4R requests for all residential care facility loan types (provided the specifics of the transaction meet the below criteria). If a Mortgagee/ServiceLender wishes to apply for approval solely to administer R4R Requests on Section 232 projects, the request must be submitted to the HUD (see procedures available on the Section 232 website) LeanThinking@hud.gov email. The request must include a revised Quality Control Plan addressing the items in 5.b-f below: Quality Control oversight of the items in this Section and 5.b-f below. The Lender shall have sufficient full-time staff with the requisite experience to approve releases within the required guidelines. ORCF will retain responsibility for review of R4R requests in all cases where there is an identity of interest between the Borrower, the Mortgagee/ServiceLender, or affiliates of either.
- b. **Authority.** Delegated Authority is revoked if the project is serviced by ORCF's Risk Mitigation Branch. ORCF reserves the right to revoke Delegated Authority on individual or a portfolio of related projects, either temporarily or permanently, based on patterns of Owner non-compliance or other financial risk (such as prior to achieving self-sustaining performance). ORCF also reserves the right to either temporarily or permanently revoke the Lender's Delegated Section 232 R4R Approval Authority overall, based on a pattern of non-compliance with Program requirements or failure to comply with the Quality Control Plan.
- c. **Reimbursements and Advances.** Typically, R4R releases are made for reimbursement on work that is completed. However, advances may be approved in situations where upfront or partial payments to the contractor(s)

are required prior to the work being completed. At ~~the~~  
~~Mortgagee/Servicee~~~~r's~~~~Lender's~~ discretion, the R4R may be used to allow for  
multiple draws or a single draw, depending on the scope of work, ~~and the~~  
~~availability of funds in the project operating account, R4R account and other~~  
~~sources (e.g., owner contributions, insurance proceeds).~~ For example, draws  
may be established at 35 percent, 65 percent and 100 percent completion for  
more substantive repairs.

- d. **Minimum Threshold.** The R4R account balance must be at a minimum level  
of \$1,000 per unit after the release.
- e. **Modifying the Project.** If the R4R request is for a situation where there is a  
proposed remodeling, adding to, subtracting from, reconstructing, or  
demolishing of a portion of the mortgaged project (as discussed further in  
Section 3.4.4 of this Handbook), the R4R request is not eligible for this  
optional ~~Mortgagee/Servicee~~~~Lender~~ review. Such proposals must be  
submitted to ORCF for routine processing and approval.
- f. **Qualifying Expenditures.** Only qualifying expenditures, as defined in  
Section 3.2.2.C above, and as eligible and reported on the Funds  
Authorization (Form HUD-9250-ORCF) ~~and Borrower Certification and~~  
~~Request Detail (Form HUD-9250A-ORCF)~~ may be submitted for  
reimbursement.
- g. **Delegated Approval.** ~~Mortgagee/Servicee~~~~Lender~~ will review the request and  
determine eligibility, and may approve qualifying requests (as described  
above) by signing the form, noting their Name (also to include Title and  
Organization), ~~Signature~~, City, State, and Date in the respective fields.
- h. **Notification to ORCF.** Once completed, all Funds Authorizations signed by  
the ~~Mortgagee/Servicee~~~~Lender~~ must then be submitted electronically to ORCF  
for record keeping. This must be received by ORCF, within seven (7)  
business days of ~~Mortgagee/Servicee~~~~Lender~~ approval.
- ~~i. **Surcharges and Penalties.** ORCF will not surcharge or penalize~~  
~~Mortgagee/Serviceers for approved R4R releases, provided the instructions in~~  
~~this handbook, and on designated HUD forms were followed.~~
- i. **Recordkeeping.** Delegated Lenders must keep copies of all Funds  
Authorizations on file for the lifetime of the loan.

## I. Special Requests.

1. Request to suspend or reduce monthly deposits into the R4R Account. ~~Absent~~  
~~compelling operational reasons for suspension, the recommendations made in the~~  
~~PCNA schedule for deposits shall apply for the first five years of the loan.~~ Generally,  
~~after the first five years,~~ a request to suspend or reduce monthly deposits will be  
considered only when the project is in good financial, physical and regulatory  
standing, ~~including consideration of future capital needs identified in the last PCNA.~~  
The R4R Account balance must be equal to at least sixty (60) months of deposits.  
~~Monthly and no single request for suspension of monthly~~ deposits ~~cannot be~~  
~~suspended for more than~~ can exceed 12 months ~~at a time.~~ The ~~following items~~

are completed Funds Authorization is required to be submitted to ORCF in connection with a request to suspend or reduce monthly deposits into the R4R Account.

~~a. Completed Funds Authorization;~~

~~a. Completed Borrower Certification and Request Detail.~~

If the request for suspension or reduction in the monthly R4R deposit is being requested because a project cannot currently fund the deposit, the Mortgage/Service Lender and AE will conduct a meeting to discuss the financial situation, cash flow problems and any other concerns leading to this request from the project.

2. Borrowing funds to cover mortgage payments or operating deficits. In extreme cases, ORCF may consider a Borrower's request for a short term loan of funds from the R4R Account. The purpose should be related to a condition or circumstance beyond the normal control of the Borrower. A request for a loan from the R4R Account may trigger an enhanced analysis of the project. The following items are required to be submitted to ORCF in connection with a request for a short-term loan of funds from the R4R Account:

~~b.a.~~ Narrative explaining the proposed loan terms, expenses to be paid and the reason for the request (including an explanation of any outstanding -ORCF and state compliance issues);

b. Completed Funds Authorization;

~~c. Completed Funds Authorization;~~

~~d.c.~~ Completed Borrower Certification and Request Detail request detail;

~~e.d.~~ The three (3) most recent monthly financial statements for the project.

All Special Requests are to be submitted via the Mortgage/Service Lender, who must first review them for completeness, accuracy and eligibility, and then forward them to ORCF with a recommendation for approval.

### 3.2.3

### Residual Receipts Account

#### A. Definition.

During the life of an FHA insured mortgage, Residual Receipts are an asset of the Borrower held under the control of ORCF. If a Borrower is required to establish a Residual Receipts Account for a project, the requirement will be set forth in the Regulatory Agreement which will set forth the type of assets that are included in the definition of "Residual Receipts."

#### B. Calculation of Residual Receipts.

The Borrower should use Form HUD-93486 -ORCF Computation of Surplus Cash, Distributions, and Residual Receipts (Form HUD-93486 -ORCF) either semi-annually or annually (depending on the Regulatory Agreement for the project) to calculate allowable

distributions and any amounts that may be due for deposit in the Residual Receipts Account. Instructions for completing the form are shown on the [backend](#) of the form and the calculation for distributions must be included in the audited annual financial statements filed with HUD.

**C. Depositing Residual Receipts.**

Residual Receipts must be deposited in a separate- Residual Receipts Account, except to the extent that the Non-profit Borrower's Regulatory Agreement may provide some limited right to retain Residual Receipts. Funds in the Residual Receipts Account may not be combined or commingled with other escrow accounts, including, but not limited to, the accounts listed in Section 3.2.1 above, without the prior written approval of ORCF. The Regulatory Agreement specifies when Residual Receipts are to be deposited into the Residual Receipts Account. The account must be maintained by the [Mortgagee/ServiceeLender](#).

**D. Holding and Investing Funds.**

Funds in the Residual Receipts Account for all projects with FHA-insured mortgages must be invested in, and all interest earned on the investments must be credited to, a financial vehicle that meets HUD approval. Funds in Residual Receipts Account are to be invested and safeguarded by [Mortgagee/ServiceersLenders](#) and Borrowers in the manner described in Section 3.2.2 of this chapter.

**E. Qualified Uses for the Residual Receipts Account.**

Borrowers may request disbursement of funds from the Residual Receipts Account for the following purposes:

1. To reduce operating deficits when legitimate cash flow deficits exist.
2. To make mortgage payments when a mortgage default has occurred or is imminent.
3. To make repairs or replacements to the project that are not covered by the R4R Account described in Section 3.2.2 above.
4. To provide additional project amenities such as air conditioning, a sprinkler system, fire or smoke detectors, or energy saving devices as well as office equipment such as computers and associated software.
5. For other expenses deemed necessary, and in the best interest of the project as determined by ORCF and the [Mortgagee/ServiceerLender](#). Generally, all expenses [whichthat](#) qualify for reimbursement under the R4R Account may also be reimbursed from funds in the Residual Receipts Account.

**F. Withdrawals from the Residual Receipts Account.**

The [Mortgagee/ServiceerLender](#) must submit the following (provided by the Borrower):



- 787
- 788 1. Required Documents. A checklist of required exhibits to submit to ORCF for
- 789 withdrawals from the Residual Receipts Account will be available on the Section 232
- 790 Program website. Requests are to be submitted via the [Mortgagee/Service Lender](#),
- 791 who must first review them for completeness, accuracy and eligibility, and then
- 792 forward them to ORCF with a recommendation for approval.
- 793
- 794 2. Additional Considerations. The following issues will be considered by ORCF in
- 795 processing a request to withdraw funds from the Residual Receipts Account:
- 796
- 797 a. Whether the expenses are qualified items to be paid from the account.
- 798 b. If the submittal proposes remodeling, adding to, subtracting from,
- 799 reconstructing, or demolishing a portion of the mortgaged project (as
- 800 discussed further in Section 3.4.4 of this chapter), an environmental review as
- 801 required by 24 CFR Part 50 will be conducted.
- 802
- 803

### 3.2.4

### Non-Critical Repair Escrow Account (NCRE)

- 804
- 805 A. **Applicability:** Non-Critical Repair Escrow (“NCRE”) Accounts are established during the
- 806 underwriting of a project and funded at Closing. The funds in the NCRE Account are
- 807 intended to pay for repairs identified in the Escrow Agreement for Non-Critical, [Deferred](#)
- 808 Repairs (the “NCRE Agreement”), (Form HUD-92476-ORCF). Generally, the repairs
- 809 must be completed within 12 months from the date of the NCRE Agreement. The specific
- 810 requirements and conditions for the completion of the repairs are set forth in the NCRE
- 811 Agreement. [For purposes of this Agreement, a Borrower elective repair shall be treated](#)
- 812 [identically to a non-critical repair.](#)
- 813
- 814 B. **Depositing, Holding and Investing:** Funds in the NCRE Account must also be deposited,
- 815 held and invested in accordance with the requirements set forth in Section 3.2.2 of this
- 816 chapter. However, since the funds are intended to be disbursed within a 12-month period,
- 817 they must be deposited in an account that can be withdrawn from or immediately accessed in
- 818 the full amount. Depositing NCRE Account funds in a long-term investment account is not
- 819 recommended.
- 820
- 821 C. **Interim Draws and Closeout of the NCRE Account**
- 822
- 823 1. Interim Draws: At the [Mortgagee/Service Lender’s](#) option, the NCRE Account
- 824 may be established to allow for multiple draws or a single draw, depending on the
- 825 scope of work. For example, draws may be established at 35 percent, 65 percent and
- 826 100 percent completion for more substantive repairs.
- 827
- 828 2. Holdback/Retainage: HUD does not require a holdback/retainage on interim draw
- 829 releases, ~~however.~~ However, the [Mortgagee/Service Lender](#) may require a
- 830 holdback/retainage at their discretion.
- 831

- 832 3. Advances: Typically, draws are approved for reimbursement on work that is  
833 completed. However, advances may be approved in situations where upfront or  
834 partial payments to the contractor(s) are required prior to the work being completed.  
835
- 836 4. Review of Proposed Draws and Closeout: When determining whether to approve a  
837 proposed interim draw or final draw (closeout) of the NCRE, the  
838 Mortgagee/Service Lender shall review the submission from the borrower/Borrower  
839 to determine whether there is adequate documentation to evidence that the  
840 repairs/improvements associated with the requested release were completed (or there  
841 is evidence that an advance is required per Section 3.2.4.C.3. above). With the  
842 exception of NCRE accounts administered by the Mortgagee/Service Lender under  
843 Section 3.2.4.H, the requests are to be submitted via the Mortgagee/Service Lender,  
844 who must first review them for completeness, accuracy and eligibility, and then  
845 forward them to ORCF with a recommendation for approval (submitted  
846 electronically in accordance with the instructions on the Section 232 program  
847 website). A checklist of documents for review will be available on the Section 232  
848 Program website.  
849

850 D. **Latent Defects Deposit.** A Latent Defects Deposit is required when the total cost of the  
851 non-critical repairs is equal to or exceeds \$1,000,000. The Latent Defects Deposit is  
852 calculated at 2.5% of total amount of repairs and is held by the Mortgagee/Service Lender to  
853 be released to the borrower/Borrower upon the later of: (i) 15 months from the completion of  
854 repair work, or (ii) at such time the latent defects have been corrected to the satisfaction of  
855 ORCF. In accordance with the Request for Approval of Advance/Release of Escrow Funds,  
856 Section 232 (Form HUD 92464-ORCF), the location of where excess funds from the Latent  
857 Defects Deposit may be released is determined by whether the funds were from loan  
858 proceeds or provided by the owner. If funds were funded by loan proceeds, then they must  
859 be deposited into the R4R, or as directed by HUD. Please see the Escrow Agreement for  
860 Non-Critical Deferred Repairs (HUD-92476-ORCF).  
861

862 E. **Change of Scope of Repairs.** The Mortgagee/Service Lender must request approval from  
863 ORCF for proposed revisions to the scope of the required repairs/improvements (submitted  
864 electronically by the Mortgagee/Service Lender, in accordance with the instructions on the  
865 Section 232 program website). For such a request, the following must be submitted:  
866

- 867 1. A narrative detailing why a change of scope is requested; or the reason that some or  
868 all of the non-critical (and/or Borrower elective) repairs were not completed, as  
869 applicable.  
870
- 871 2. Copy of the original NCRE Agreement.  
872
- 873 3. Certification from an individual determined to be qualified by the  
874 Mortgagee/Service Lender (e.g., PCNA provider, lender construction analyst,  
875 architect, engineer). The individual providing the certification must have equal or  
876 greater qualifications in training, skills, education or experience (as required in the  
877 PCNA Scope of Work) as the individual who identified the required repair (typically

the PCNA preparer) and similar level of independence. The certification must provide that: failure to complete the non-critical repairs will have no serious negative impact on the condition of the project; and the project, as completed, is in compliance with local building and zoning codes, and/or state regulations. The certification must also explain in detail how the PCNA comments and recommendations with regard to the repair in question were taken into consideration along with the recommendation. Changes to Borrower elective repairs will not require a certification.

4. NCRE cost overruns must be funded by the Borrower, not the R4R Account.

5. Projects with a Green MIP Mortgage. Any changes that will affect the Energy Professional's design will need to be reviewed and approved by both the Energy Professional and HUD. Additionally, the PCNA and Reserve for Replacement Schedule must specify all appliances and heating and air conditioning systems as ENERGY STAR® when replaced, and for lighting, electrical, mechanical equipment, and building envelope components with no available ENERGY STAR® label, the PCNA and Reserve for Replacement Schedule must specify high-performance and/or sustainable replacements

F. **Timing of Completion of Repairs and Extensions** – All repairs must be completed within the 12-month prescribed time period, unless otherwise provided in the NCRE Agreement. The ~~Mortgagee/Service Lender~~ may provide a six-month extension at their discretion without ORCF approval where the ~~borrower~~Borrower demonstrates adequate justification. Notification of the six-month extension must be submitted to ORCF (see procedures available on the Section 232 website). Any extension beyond six months requires ~~Mortgagee/Service Lender~~ review and recommendation to ORCF for approval (submitted electronically by the ~~Mortgagee/Service Lender~~, in accordance with the instructions on the Section 232 program website). Under no circumstances may an extension beyond 12 months be made for repairs necessary to correct accessibility deficiencies. All such repairs must be made within the time periods prescribed in the Accessibility Matrix for Section 232. Failure to complete repairs in the required time-frame is a violation of the Escrow Agreement, as is a failure to request an extension.

G. **Excess Funds at Closeout** - In cases where the actual cost of the repair work is less than estimated, any resulting excess funds in the escrow attributable to the Repair Estimate amount that were funded from loan proceeds may be used for the following purpose(s):

- to pay for additional repairs approved by ~~Mortgagee/Service Lender~~ and ORCF,
- to reduce the outstanding Loan balance; or
- to deposit in the R4R.

Excess funds in the escrow that were not funded from loan proceeds may be used to reduce the outstanding loan balance in the event of default or client request, pending GNMA approval. ORCF may also require that certain repairs be completed when the specified repairs are deemed necessary for the proper operation of the facility, for resident care and/or if the repairs are needed to comply with local and state regulations. Release of excess funds

that were not funded from loan proceeds to the Borrower is governed by the conditions in form HUD-92476-ORCF.

## H. Optional Process for Delegated NCRE Administration to ~~Mortgagees/Service~~Lenders.

### 1. Purpose and Background.

This optional process applies only to residential care facility transactions originated under Sections 223(f) and 223(a)(7). A prerequisite for participation is HUD approval of revisions to the ~~Mortgagee/Service~~Lender's Quality Control Plan incorporating the requirements of this Handbook. The Lender shall have sufficient full-time staff with the requisite experience to approve releases within required guidelines.

### 2. ~~Mortgagee/Service~~Lender Approval Process

If a ~~Mortgagee/Service~~Lender is approved by Multifamily Housing in accordance with Notice H2013-14 for delegated NCRE administration, ORCF shall consider the ~~Mortgagee/Service~~Lender approved to perform delegated NCFE administration for the loan types referenced in the previous paragraph. If a ~~Mortgagee/Service~~Lender wishes to apply for approval solely to administer NCRE's on residential care facilities, the request must be submitted to HUD (see procedures available on the Section 232 program website).

ORCF will retain responsibility for release of non-critical repair escrow funds in all cases where there is an identity of interest between the Borrower, the ~~Mortgagee/Service~~Lender, or affiliates of either.

~~Delegated Authority is revoked if the project is serviced by ORCF's Risk Mitigation Branch.~~

Delegated Authority is revoked if the project is serviced by ORCF's Risk Mitigation Branch. ORCF reserves the right to revoke Delegated Authority on individual or a portfolio of related projects, either temporarily or permanently, based on patterns of Borrower non-compliance or other financial risk (such as prior to achieving self-sustaining performance). ORCF also reserves the right to either temporarily or permanently revoke the Lender's Delegated Section 232 R4R Approval Authority overall, based on a pattern of non-compliance with Program requirements or failure to comply with the Quality Control Plan.

### 3. General Requirements.

Should the ~~Mortgagee/Service~~Lender elect to take responsibility for this task (and receive HUD approval to do so), HUD will not charge an inspection fee on Section 232, pursuant to Section 223(f), transactions. Section 223(a)(7) transactions do not require an inspection fee. ORCF has not established a minimum or maximum repair/improvement amount on which this delegated process may be used.

This delegated authority allows the [Mortgagee/Service Lender](#) to review and approve all interim draw requests and the close-out of the account. Under this delegated authority, the request to close-out the account must include a report from an individual determined to be qualified by the [Mortgagee/Service Lender](#) (e.g., the PCNA provider, lender construction analyst, architect or engineer), indicating they have performed an inspection and all required repairs or improvements have been acceptably completed. No such inspection or report is required for interim draws; however, at the [Mortgagee/Service Lender's](#) discretion, interim inspections may be conducted.

3. Interim Draws and Closeout of the NCRE Account, Latent Defects Deposit, and Change of Scope of Repairs shall be addressed in accordance with the provisions above in Section 3.2.4.C through G of this section.
4. The [Mortgagee/Service Lender](#) is delegated to approve the final close-out of the NCRE. The request to close-out the account shall follow the same procedure as outlined above.
5. If there is a Latent Defects Deposit remaining after the close-out of the account, such Latent Defects Deposit may be reviewed and released by the [Mortgagee/Service Lender](#) after the required seasoning period has passed. No further documentation on this is required to be sent to ORCF.
6. Copies of the final fully executed HUD-92464-ORCF and HUD-92117-ORCF (without attachments) and final inspection report must be submitted electronically to ORCF within seven (7) business days of the [Mortgagee/Service Lender's](#) final approval.

The [Mortgagee/Service Lender](#) must keep electronic or hard copies of the documentation related to any NCRE accounts administered by the [Mortgagee/Service Lender](#) under this delegated process for at least three years.

### 3.2.5 Sinking Fund

- A. **The Sinking Fund Agreement** is the controlling document for the Sinking Fund. The Sinking Fund Account must remain in compliance with the Sinking Fund Agreement. ORCF must be promptly notified by the [Mortgagee/Service Lender](#) in the event of any breach by the Borrower of the Sinking Fund Agreement and the [Mortgagee/Service Lender](#) must further agree to seek specific performance or other injunctive relief for any breach.
- B. **Requests for Withdrawal from the Sinking Fund Account.** Withdrawals from the Sinking Fund Account may only be made for the specific purposes stated in the Sinking Fund Account Agreement. Requests are to be submitted via the [Mortgagee/Service Lender](#), who must first review them for completeness, accuracy and eligibility, and then forward them to



ORCF with a recommendation for approval. A checklist will be available on the Section 232 Program website.

- C. **Requests to close a Sinking Fund Account prior to expiration.** Generally, a request to close the account prior to expiration of the mortgage is submitted when the state Medicaid provider, where the project is located, no longer requires the maintenance of a Sinking Fund Account, and the project is in good physical and financial condition. Since a Sinking Fund Account is beneficial to the interests of the Borrower, [Mortgagee/Service Lender](#) and HUD in the latter years of a mortgage, a state rule eliminating the Sinking Fund Account does not automatically modify or remove this requirement for FHA-insured projects. Requests are to be submitted via the [Mortgagee/Service Lender](#), who must first review them for completeness, accuracy, [advisability](#) and eligibility, and then forward them to ORCF with a recommendation for approval. A checklist will be available on the Section 232 Program website.

### 3.2.6

### **Debt Service Escrow and Long-Term Debt Service Reserve Reserves and Short-Term Debt Service Escrow Accounts**

- A. **Applicability.** In specific instances, ORCF may have a Long-Term Debt Service Reserve account established at closing (See Production, Chapter 2). This account is a mortgageable item and is controlled by the terms of the Borrower Regulatory Agreement. This account is different from a Debt Service Escrow account, which is for a shorter term, is funded by the Borrower, and is governed by a separate escrow agreement. The Long-Term Debt Service Reserve Escrow Account, if required, is established during the underwriting of a project either at initial or final closing. Each of these accounts is intended to provide Borrowers with an extra "cushion" to meet debt service payments on the FHA-insured mortgage and thus, safeguard the project's financial viability- [while maintaining quality of care](#). Funds in these accounts are to be used exclusively for payments of principal and interest on the Mortgage Note, or to meet project escrows such as insurance premiums, real estate taxes or special assessments.
- B. **Holding and Investing Funds.** Generally, the requirements of Debt Service Escrow [AccountAccounts](#) are set forth in the Escrow Agreement, and the requirements of the Long-Term Debt Service Reserve [AccountAccounts](#) are set forth in the Borrower Regulatory Agreement. The funds in these accounts are to be invested and safeguarded by [Mortgagee/Service Lenders](#) and Borrowers in the manner described in Section 3.2.2 of this Handbook. The procedures and sanctions described in Section 3.2.2 also pertain to these accounts.
- C. **Request for Withdrawal:** Requests are to be submitted via the [Mortgagee/Service Lender](#), who must first review them for completeness, accuracy and eligibility, and then forward

them to ORCF with a recommendation for approval. [Requests for withdrawal and close-out of Short Term Debt Service Escrow Accounts are subject to the terms and conditions in the Escrow Agreement, which may set forth a quality-of-care component.](#) A checklist will be available on the Section 232 Program website.

**SPECIAL NOTE:** Any request deviating from the Mortgage Reserve/Debt Service Reserve Agreement, or any amendments and schedules thereto, shall be closely analyzed by ORCF. The approval will be conditioned with a full repayment of the funds to the account within a reasonable time frame.

D. **Additional Considerations.** The following issues will be considered by ORCF in processing Mortgage Reserve/Debt Service Reserve Account.

- Financial and ~~Physical Condition~~[physical condition](#) of the ~~Project~~[project](#).
- Open ORCF and State compliance Issues.
- Other relevant issues, information or documents as determined by ORCF.

### 3.2.7

### Initial Operating Deficit (IOD) Escrow

**A. Applicability.** Initial Operating Deficit (IOD) Escrow Accounts are restricted accounts that are primarily designed to allow or assist the project in achieving ~~sustained occupancy self-sustaining performance~~ and adequate revenue. [See Production, Chapter 2 and Appendix 2.1 for additional information.](#)

**A.B. Request for Withdrawal:** Disbursements from the IOD Escrow Account may be authorized monthly, commencing upon the issuance of the Certificate of Occupancy, by ORCF to meet any cash deficit in the operation of a project for the period immediately following substantial completion of construction. Requests are to be submitted via the ~~Mortgagee/Service~~[Lender](#), who must first review them for completeness, accuracy and eligibility, and then forward them to ORCF with a recommendation for approval. [Lenders must use the Initial Operating Deficit Escrow Calculation Template \(Form HUD-91128-ORCF\) for tracking the IOD releases.](#)

**B.C. SPECIAL NOTE:** The IOD Escrow Account is a part of the project's necessary start-up working capital. ORCF does not consider depreciation, officers' salaries, and identity of interest management fees to be reasonable operating expenses; therefore, funds in the IOD Escrow Account may not be used cover those costs.

## Section 3.3

### Prepayment Provisions and Prohibitions

#### 3.3.1

#### Introduction

**Applicability.** The Residential Care Facilities Program permits Lenders to insert prepayment lockouts and penalties into the FHA-insured Note for the benefit of the source of the financing in accordance with the guidelines set out in Production, Chapter 3. Prepayment request review procedures are as follows.

#### 3.3.2

#### Prepayment Procedures

[HUDORCF](#) must receive notification in writing from the [Mortgagee/Service Lender](#), requesting to prepay a loan insured by FHA (or [to](#) voluntarily terminate its mortgage insurance). The [Mortgagee/Service Lender](#) is to receive the requests, review for completeness, accuracy and eligibility, and then forward to ORCF with a recommendation for approval.

The following are the steps for processing a request for prepayment of an FHA-insured mortgage or a voluntary termination of mortgage insurance:

- A. [Mortgagee/Service Lender](#) submits the Insurance Termination Request [for Multifamily Mortgage](#) form (Form HUD-9807-ORCF) (without Block 5 completed) to the [Multifamily Insurance-232 Healthcare Portal, linked on the ORCF website. ORCF will coordinate review and processing of the form with the Multifamily Operations Branch Division](#) in HUD Headquarters. ~~That and HUD Office forwards a copy of the form and supporting documentation to the ORCF, which will verify that there are no prepayment restrictions for the particular project. In most cases, HUD of General Counsel review will not be required, but ORCF will coordinate, as necessary, needed.~~
- B. ~~The If applicable, the~~ following [list of items \(subject to update and available on the HUD website\)](#) must accompany the Insurance Termination Request for [Multifamily Healthcare Mortgage](#) request from the [Mortgagee/Service Lender](#):

- [Form HUD-9807-ORCF \(with blocks 1, 2, 3, 4, 6, 7 & 17 completed\),](#)
- [Copy of Current Finally Endorsed Note,](#)
- [Copy of Allonges and any prior Modifications to Endorsed Note,](#)
- [Supplemental Notes \(if applicable\),](#)

- Recorded copy of Mortgage Instrument (including any prior modifications),
- Mortgage, Prepayment Rider,
- Mortgage Note,
- Deed of Trust,
- Deed of Trust Note,
- Riders,
- Any Allonges or Amendments,
- Regulatory Agreement,
- Trust Indenture (applicable if the Projectproject is bond financed),
- Any secondary financing and status,
- Use restrictions, and
- Any special requests from A/R line status
- Lender Certification that the FHA loan is or is not part of a Master Lease and
- Prepayment Checklist

\*Note- Per Mortgagee/Servicee or Borrower Letter 2018-07 (Revision to Mortgagee Letter 2004-21 dated June 15, 2004-Revised Procedures for the Submission of Form HUD 9807, Insurance Termination Request (OMB Approval November 2502-0416) for Prepayment Approval), projects that are part of a Master Lease require an analysis of impact of the prepayment on the remaining projects in the Master Lease, (e.g, trailing 12-month debt service coverage ratio on the operations of each remaining project). Eligibility to be removed from a Master Lease is dependent upon the Master Lease Analysis, which documents the lease coverage ratio for the projects currently under the Master Lease and provides a proposed lease coverage ratio after the release.

The following documents are only required if the property is part of a Master Lease: Lender Letter of Recommendation, to include:

- List of projects on Master Lease,
- Identify which projects are being removed,
- Identify the section of the Master Lease where the requirements are stated that a project can be released from the group,
- Recommendation,

For projects that are attached to an A/R line and a Master Lease, please see the ORCF Loan Servicing website for additional document requirements.

Review of the prepayment request by HUD cannot begin without the above information, along with the executed Insurance Termination Request for MultifamilyHealthcare Mortgage form- (Form HUD-9807-ORCF). The complete submission of the documents is the responsibility of the Mortgagee/ServiceeLender. Note that time limits may apply.

C. ORCF will ensure the following:

- 1179 1. Determine if prepayment falls within any lockout period;  
1180  
1181 2. Determine status of any secondary financing and review the HUD asset management  
1182 system (iREMS);  
1183  
1184 3. Determine status of any outstanding Departmental Enforcement Center (DEC) or  
1185 Office of Inspector General (OIG) -investigations, ~~based on iREMS;~~ if any exist,  
1186 obtain input from the appropriate Division on prepayment approval.  
1187  
1188 a. Determine the impact of the prepayment on the Master Lease, and  
1189 remaining projects, if applicable. See Section III, Asset Management,  
1190 Chapter 9 for additional information.  
1191  
1192 ~~a.b.~~ Address any special requests the Mortgagee/Service Lender may have  
1193 prior to closing. Termination of the Borrower Regulatory Agreement  
1194 would be deemed a special request, and would need to be prepared by  
1195 HUD's Office of General Counsel.  
1196  
1197 D. The ~~Office of~~ Multifamily Insured Operation Branch Operations Division will perform an  
1198 audit of the loan(s) to calculate the estimation of payoff (based on projected closing date) and  
1199 any refund due to the ~~Project~~ project for overpayment of MIP, if applicable.  
1200  
1201 E. The Mortgagee/Service Lender must ensure the ~~Office of~~ Multifamily Insured Operation  
1202 Branch Operations Division (via ORCF) is notified of the closing date that is scheduled by the  
1203 Project's project's counsel (and bond issuer, if applicable).  
1204  
1205 F. For closing and bond defeasance, the bond issuer defeases the bonds and sends HUD the  
1206 complete Form HUD-9807-ORCF. Prior to closing the Mortgagee/Service Lender must  
1207 coordinate with ORCF and the Multifamily Insured Operation Branch Chief Operations  
1208 Division to ensure timely processing of the Form HUD-9807-ORCF.  
1209  
1210 ~~G. ORCF will reflect the prepayment once the Office of Multifamily Insured Operation Branch~~  
1211 ~~has confirmed that the payoff occurred. The AE must update iREMS to ensure the Project no~~  
1212 ~~longer is required to submit financial statements (if fully terminated from FHA insurance)~~  
1213 ~~and document that the prepayment has occurred. Special care must be taken to ensure the~~  
1214 ~~Project is fully terminated from FHA insurance prior to making updates to iREMS. For~~  
1215 ~~example, a refinance under Section 223(a)(7) involves a payoff of the existing loan, but the~~  
1216 ~~refinanced loan is still required to submit financial statements.~~  
1217  
1218 G. Once the Lender confirms all conditions noted in the prepayment approval have been met,  
1219 and prepayment is accepted, the Lender may then submit Form HUD-9807-ORCF, with all  
1220 blocks completed, along with a copy of the prepayment approval, to  
1221 Revised9807Terminations@hud.gov for review and processing of the termination of  
1222 mortgage insurance. After prepayment, it is critical that the fully completed form gets sent to  
1223 the Multifamily Operations Division or there may be a delay in the loan termination.  
1224



H. ORCF will recognize the prepayment once the Multifamily Operations Division has confirmed that the payoff occurred, for the purposes of updating HUD systems.

I. After termination of mortgage insurance through prepayment in full or mortgage maturity, the Borrower can request a release of Regulatory Agreement. Any requests for release of Regulatory Agreement for a Section 232 project must be sent, one FHA number at a time, to 232RegReleases@hud.gov for processing and/or response. Each request must include the following documentation:

1. A copy of the recorded Regulatory Agreement(s) including any amendment(s) with legible recordation stamp(s), dates and signatures.
2. Written evidence of Termination of Mortgage Insurance by HUD, if available. If submitting a Form HUD-9807-ORCF as evidence, the bottom section titled “For HUD Use Only” of Form HUD-9807-ORCF, must reflect cancellation of the HUD insurance endorsement and be signed by a designated HUD Official. Prepayment approval is not evidence of mortgage insurance termination.
3. The FHA project name and number in the subject line (e.g., XYZ Nursing Home, FHA No. 000-12345). Only one project per email, please.
4. Title report, policy or commitment.
5. Submitter’s contact information to include email address and a mailing address for the hard copy releases to be sent.

Note, releases of Uniform Commercial Code filings for FHA-insured loans must be handled by the Lender.

Requests for satisfaction of HUD-held mortgages/deeds of trust and releases of associated Regulatory Agreements must be sent to the Multifamily Notes Servicing Branch.

### 3.3.3

### Prepayment Lock Outs and Penalties

- A. Language allowing HUD to override the prepayment lockout and/or penalty provisions in the event of a default is included in the Healthcare Facility Note, (Form HUD-94001-ORCF), or Supplemental Healthcare Facility Note (Form HUD-94001A-ORCF), as applicable. The Mortgagee/Service Lender is to receive the request, review for completeness, accuracy and eligibility, and then forward to ORCF with a recommendation for approval.
- B. Where these restrictions exist, and the Mortgagee/Service Lender does not waive its optional prepayment or lockout penalty provisions, HUD may, in rare circumstances, HUD would consider exercising an override of a

Mortgagee/Service's Lender's prepayment lock-out or penalty provision in order to avoid a full claim. Any override to the lockout must receive approval by the Deputy Assistant Secretary for OHP. Generally speaking, these projects will be in, or transferred to, the Risk Mitigation Branch portfolio due to the troubled nature of the project. As part of the any workout necessary to avoid a claim, a background memo is prepared from by the Risk Mitigation AE, explaining the circumstances justifying the request. Consideration must be given to all of the following, in providing such justification:

1. The Borrower has defaulted and HUD has received notice of such default as required by the program regulations.
  2. HUD determines that the project has been experiencing a net income deficiency that was not caused solely by management inadequacy or lack of Borrower interest and that is of such a magnitude that the Borrower is currently unable to make required debt service payments, pay all project operating expenses, and fund all required reserves.
  3. HUD finds there is a reasonable likelihood that the Borrower can arrange to refinance the defaulted loan at a lower interest rate or otherwise reduce the debt service payments through partial prepayment.
  4. HUD determines that refinancing the defaulted loan at a lower rate or partial prepayment is necessary to restore the project to a financially sound condition and to avoid an insurance claim.
- C. ORFCORCF must be satisfied that the Borrower in these circumstances did not intentionally cause a default in order to obviate prepayment penalties or lockout provisions.

DRAFT

## Section 3.4

### Request to Release or Modify Original Loan Collateral

#### 3.4.1

#### Introduction

- A. From time to time the collateral securing a FHA-insured mortgage needs to be modified or released. The Regulatory Agreement provides language requiring prior HUD approval of a revision to the security or collateral, including the following:
1. Reduction, Addition, or Sale of Beds (Please refer to 3.4.2 below)
  2. Easements, Eminent Domain, or Sale of Land or Other Security (Please refer to 3.4.3 below)
  3. Remodeling, Adding to, Subtracting From, Reconstructing, or Demolishing Portions of the Mortgaged Project (Please refer to 3.4.4 below)
- B. A checklist of required exhibits to submit to HUD in each situation will be available on the Section 232 Program website. Lenders must submit requests using the Lender Narrative-Requests to Release or Modify Original Loan Collateral Section 232 (Form HUD-90030-ORCF), as applicable.

#### 3.4.2

#### Reduction, Addition, Change in, or Sale of Beds or Units

- A. **Applicability:** Licensed beds are valuable project assets securing the mortgage. Any time the number of licensed beds in the project are being reduced or increased, the value of the mortgaged project may be affected. Therefore, such changes, including changing beds/units from one license to another, must be reviewed and approved by HUD. In some States, even temporarily removing beds from service, sometimes known as “bed banking,” may result in a change to the license. Therefore, the Lender must ensure that Borrower/Operator actions such as reducing the number of occupied beds/units and/or physically reconfiguring beds/units do not impact the license.
- B. **Additional Considerations:** The following issues will be considered by ORCF in processing a Reduction or Increase of number of change in the licensed beds/units:
1. Financial and Physical Condition of the Project.

2. Open HUD and State ~~Compliance Issues~~ compliance issues.
3. Project's PCNA (~~Physical Condition and~~ Project Capital Needs Assessment). If the PCNA is more than 10 years old, ORCF may require a new PCNA to be performed.
4. ~~The~~ Whether the value of the remaining project after approval will be unaffected and/or if the value will still be sufficient to cover the remaining balance of the mortgage.
5. Other relevant issues, information or documents as determined by ORCF, including, but not limited to an appraisal, market study, and/or broker's opinion of value.
6. ORCF will engage the services of HUD OGC (and as needed, OHP Architecture & Engineering, Environmental, and/or Appraisal teams) to review all legal and technical issues.
7. In processing release of collateral requests in which funds are being received for the sale of beds, ORCF will expect to receive market value for the released collateral and the funds will be directly applied to the mortgage balance. Any deviation from this (including deposits into the R4R Account) must be expressly approved by ORCF.
8. An environmental review as required by 24 CFR Part 50 will be conducted on any proposal for remodeling, adding to, subtracting from, reconstructing or demolishing a portion of the mortgaged project. Environmental Review Requirements are described in further detail in Section II, Production Chapter 7 and on Form HUD-90030-ORCF, including: Phase I, Radon and other Environmental concerns.
9. The project must retain program eligibility.
- C. **Processing Time.** The concurrent reviews by HUD OGC and OHP Architecture & Engineering, Environmental and Appraisal, if required, will affect the length of processing time.
- D. **Other ORCF Requirements.** It should be noted that in all ~~increase or reduction~~ change of licensed bed requests, ORCF may require or request additional relevant documents or information. The ~~Mortgagee/Service~~ Lender is to receive the requests, review for completeness, accuracy and eligibility, and then forward to ORCF with a recommendation for approval.

### 3.4.3

## Easement, Eminent Domain, or Sale of Land or Other Security

- A. **Applicability.** The Regulatory Agreement provides that the Borrower shall not, without the prior written approval of HUD, convey, transfer, or encumber any of the mortgaged project. Generally, there are two types of partial release of security requests. Negotiated release is



when the transaction is voluntarily negotiated between the parties. Involuntary or eminent domain action is when a state, municipality or other public agent exercises its function to use a project asset for public use. In both situations, the project must be compensated for the asset appropriated or affected (Please see Section 232 Program website). The [Mortgagee/Service Lender](#) is to receive the requests, review for completeness, accuracy and eligibility, and then forward to ORCF with a recommendation for approval.

**B. Negotiated or Voluntary Partial Release of Security.** This can include the sale of a portion of project land, part of a building, major assets, etc. Note: Although Easements and Right of Ways are not technically a release of security, the approval requirement in this sub-chapter will be applicable. Normally, ORCF will consider approving such requests when:

1. The quiet enjoyment of the present tenancy will not be negatively affected.
2. The amount of the reimbursement (or sale) is greater than or equal to the ORCF-determined value of the severed portion at the time of severance.
3. The value of the project will be unaffected by the partial release of security or the value will increase as a result of it.
4. The terms of the sale are cash.
5. The security to be released is not in place to mitigate an environmental condition on the site; [and the proposal does not generate any other environmental concerns.](#)
6. [There are no unresolved Title issues, as evidenced by a date-down endorsement.](#)

**C. Additional Considerations.** The following issues will be considered by ORCF in processing a Partial Release of Security request:

1. Financial and [Physical Conditions](#) ~~physical conditions~~ of the ~~Project~~ [project](#).
2. Open HUD and State compliance ~~Issues~~ [issues](#).
3. Project's PCNA (~~Physical Condition and Needs Assessment~~); If [the](#) PCNA is more than 10 years old, ORCF may require a new PCNA to be performed.
4. The value of the remaining project after approval will be unaffected by the partial release of security or the value will still be sufficient to cover the remaining balance of the mortgage.
- 5.—Other relevant issues, information or documents as determined by ORCF.
6. ORCF may also engage the services of the HUD OGC, the OHP Architecture & Engineering, [Environmental](#), and/or Appraisal teams to review all legal and technical issues.

1431  
1432 7. If Ginnie Mae securities are involved, the [Mortgagee/Service Lender](#) must ensure  
1433 compliance with Ginnie Mae.  
1434

1435 8. In processing Partial Release of Security requests in which funds are being received,  
1436 ORCF will expect to receive market value for the released collateral and the funds  
1437 will be directly applied to the mortgage balance. Any deviation from this (including  
1438 deposits into the R4R Account) must be expressly approved by ORCF.  
1439

1440 9. An environmental review as required by 24 CFR Part 50 will be conducted on any  
1441 proposal for remodeling, adding to, subtracting from, reconstructing, or demolishing a  
1442 portion of the mortgaged project. Environmental Review Requirements are described  
1443 in further detail in Section II Production, Chapter 7 and on Form HUD-90030-ORCF,  
1444 including: Phase I, Radon and other Environmental concerns.  
1445

1446 D. **Processing Time.** The concurrent reviews by HUD OGC and OHP Architecture and  
1447 Engineering, [Environmental and Appraisal](#), if required, will affect the length of processing  
1448 time.  
1449

1450 **Involuntary or Eminent Domain Partial Release of Security.** As soon as an involuntary  
1451 partial release is known, the Borrower, Operator, Management Agent and/or

1452 E. ~~**Involuntary or Eminent Domain Partial Release of Security.** As soon as an involuntary~~  
1453 ~~partial release is known, the Borrower, Operator, Management Agent and/or~~  
1454 [Mortgagee/Service Lender](#) shall immediately notify ORCF. A copy of all received notices,  
1455 documents, plans, proposals, or documents related to the proceeding, shall immediately be  
1456 given or forwarded to ORCF. Urgency is required, because when a portion of the mortgaged  
1457 project is taken by a public authority through the use of condemnation proceedings, such  
1458 taking can be without the prior approval of either the [Mortgagee/Service Lender](#) or ORCF.  
1459

1460 If ORCF's field review indicates that the proposed condemnation has the potential to cause  
1461 default of the mortgage or negatively impact on the quiet enjoyment of the intended purpose,  
1462 [as early as possible in the process](#), ORCF field staff must consult with the Director, Asset  
1463 Management and Lender Relations immediately.

### 3.4.4

## Remodeling, Adding to, Subtracting from, Reconstructing, or Demolishing Portions of the Mortgaged Project

- A. **Applicability.** The various forms of Borrower and/or Operator Regulatory Agreements existing on residential care facility projects require written approval from HUD prior to remodeling, adding to, subtracting from, reconstructing, or demolishing a portion of the mortgaged project. The [Mortgagee/Service Lender](#) is to receive the requests, review for completeness, accuracy and eligibility, and then forward to ORCF with a recommendation for approval. “Remodeling” for purposes of this Section is defined as repairs/improvements that constitute “Substantial Rehabilitation” – as defined in the Production, Chapter 2.6.B. This chapter provides instructions on submitting a request for partial release of security from the insured mortgage. (See Section 3.4.3 of this chapter - Easement, Eminent Domain, or Sale of Land or Other Security).
- B. **Prior Approval.** It is important that no major capital additions or reductions are performed without prior ORCF consent. However, in some instances when the additions or reductions were already completed without prior ORCF approval, a retroactive approval may be available. The same documents required in this section must be submitted. It should be noted although a retroactive approval is being processed, ORCF reserves the right to enforce its regulatory authority.
- C. **Additional Considerations.** The following issues will be considered by ORCF in processing a request for Major Capital Additions or Reductions of the mortgage security:
1. Financial and [Physical Condition](#) ~~physical condition~~ of the [Project](#) ~~project~~.
  2. Open ORCF and State [Compliance Issues](#) ~~compliance issues~~.
  3. Project’s PCNA ~~(Physical Condition and Needs Assessment)~~. If [the](#) PCNA is more than 10 years old, ORCF may require a new PCNA to be performed.
  4. The value of the remaining project after approval will be unaffected by the Major Capital Addition or Reduction, or the value will still be sufficient to cover the remaining balance of the insured mortgage.
  5. Other relevant issues, information or documents as determined by ORCF.
  6. ORCF may also engage the services of the HUD OGC and OHP Architecture and Engineering, [Environmental](#), and/or Appraisal teams to review all legal and technical issues.
  - ~~7. An environmental review as required by 24 CFR Part 50 will be conducted on any proposal for remodeling, adding to, subtracting from, reconstructing, or demolishing a portion of the mortgaged project.~~

1506 7. An environmental review as required by 24 CFR Part 50 will be conducted on any  
1507 proposal for remodeling, adding to, subtracting from, reconstructing, or demolishing a  
1508 portion of the mortgaged project. Environmental Review Requirements are described  
1509 in further detail in Section II Production, Chapter 7, on Form HUD-90030-ORCF,  
1510 including: Phase I, Radon and other Environmental concerns.

1511  
1512 D. **Processing Time.** The concurrent reviews by HUD OGC and OHP Architecture and  
1513 Engineering if required, will affect the length of processing time.  
1514  
1515

### 3.4.5

## **Surplus Cash Note or Secondary Financing Request**

1516 Borrowers and Operators may not use project funds for non-project related expenses, including  
1517 borrowing against the project. However, once Surplus Cash is distributed per the project  
1518 Regulatory Agreement, it is no longer considered part of the project. HUD understands that  
1519 Owners may want to borrow against this projected income stream, or parts thereof.  
1520 Nevertheless, HUD retains an interest in the financing of Borrower ownership interests and in  
1521 secured or unsecured private secondary financing. Per the Regulatory Agreement, Borrowers  
1522 may not enter into any contract, agreement or arrangement to borrow funds or finance any  
1523 purchase or incur any liability, direct or contingent, other than in accordance with the Loan  
1524 Documents and Program Obligations. Therefore, the Borrower shall seek prior HUD approval of  
1525 such arrangement, in accordance with the restrictions noted below. Similarly, when there is a  
1526 Borrower expectation of repayment of funds advanced to the project, repayment may also only  
1527 take place from Surplus Cash, although prior HUD approval to advance funds is not required,  
1528 subject to the limitations noted below.

1529  
1530  
1531 As Lenders become aware of new non-FHA secondary financing, they shall review the financing  
1532 in accordance with the Loan Documents and the Program Obligations. Upon receipt of a request  
1533 for a Surplus Cash Note or non-FHA secondary financing request from the Borrower, the  
1534 Mortgagee/Service Lender will review the request for completeness, accuracy and eligibility,  
1535 determine cause for the Note, and provide any necessary supporting information to the AE, along  
1536 with a recommendation for approval, modification or rejection. A checklistChecklists will be  
1537 made available on the Section 232 Program website.

1538  
1539 A. Requests for approval of a Surplus Cash Note must be made using the Surplus Cash Note  
1540 Section 232 (Form HUD-92223-ORCF).

1541  
1542 B. Payments on any Surplus Cash Note or any other non-FHA secondary financing are limited  
1543 to 75% of available Surplus Cash. The Borrower shall not take distributions prior to making  
1544 the Surplus Cash calculation and prior to making any payment thus due on the note. At the  
1545 time of such distribution is made, the Borrower shall apply the required percentage of said  
1546 distribution to reduce the balance owed on the note.

1547  
1548 C. Surplus cash notes or any other secondary financing, including mezzanine financing shall not  
1549 jeopardize the project or result in unauthorized changes of participant.

1550  
1551 D. The Lender must disclose if the Surplus Cash/Residual Receipts Note is being created with  
1552 the intent of refinancing both the Surplus Cash/Residual Receipt Note and the FHA-insured  
1553 loan into a new 223(f).

1554  
1555 E. Secondary financing, such as mezzanine financing proposed after Final Endorsement, shall  
1556 follow the same underwriting criteria as outlined in Production, Chapter 3.

- 1557  
1558 1. Mezzanine Financing is provided by a private lending source and is usually  
1559 secured by a pledge of partnership interests rather than by a secondary lien on the  
1560 real estate. If a Borrower (or Controlling Participant of a Borrower) seeks post-  
1561 closing mezzanine debt for any reason, the existence and terms of all mezzanine  
1562 debt must be fully disclosed to and approved by HUD prior to its entering into an  
1563 applicable mezzanine debt agreement. As mezzanine debt of the property is  
1564 considered private secondary financing, repayment of this debt can only be made  
1565 from surplus cash. If acquisition of said debt is contemplated, it must be shown  
1566 that the projected surplus cash may be reasonably expected to pay the interest due  
1567 on the mezzanine loan. The mezzanine loan interest rate typically will be higher  
1568 than the rate of the first mortgage, but must be reasonable, consistent with market  
1569 rates for mezzanine debt, and must not be so high a rate that it jeopardizes the  
1570 ownership stability of the property or that the interest due cannot reasonably  
1571 expected to be repaid from 75% of surplus cash. Interest due or accruing on the  
1572 mezzanine loan must be approved as reasonable by ORCF.  
1573 2. Any transfer of an ownership interest in the Borrower entity or in its principals to  
1574 the mezzanine Lender in the event of nonpayment or a default on the mezzanine  
1575 debt must have prior written approval by ORCF through the Change of  
1576 Participants (CHOP) process, or it will be invalid. The mezzanine Lender can  
1577 exercise no enforcement remedies against the real estate or against the Borrower  
1578 entity during the term of the mezzanine loan. Repayment of mezzanine financing,  
1579 including interest, must be soft and be made solely from 75 percent of the  
1580 available surplus cash or residual receipts. The Borrower's principals may elect  
1581 to make additional payments from non-project funds; however, these payments  
1582 must not be pledged or scheduled for repayment.  
1583  
1584



## Section 3.5

### Nursing Home Surveys and Licensure

#### 3.5.1

#### Introduction

The ORCF insures mortgages for skilled nursing facilities. This type of project is licensed, highly regulated, and routinely monitored by the State in which the project is located. Maintaining ongoing compliance with the State is critical in ensuring the quality of care provided to the residents and the success of the project over the life of the mortgage.

ORCF does not intend to intervene between the State and another Federal agency. However, ORCF ~~monitors~~ does monitor the FHA-insured portfolio and ~~when it is clear that the project is not able to~~ expects Borrowers and/or Operators to come into compliance, the project will be turned over to the Risk Mitigation Branch provide notification and plans for correction of special servicing and work-out efforts circumstances related to nursing surveys and licensure, as detailed in Section 3.10 of this Chapter. Since the license is collateral for the FHA-insured mortgage, it is critical that the license remains intact and the residents of FHA-insured projects receive safe, sanitary, and decent housing.

This chapter will provide an overview of the inspection process and other tools the Center for Medicare and Medicaid Services (CMS) uses to rate and rank projects in order to help consumers, their families, and caregivers compare nursing homes in a specific area.

#### 3.5.2

#### State Licensing and Surveys Overview

CMS contracts with each State to provide nursing home surveys that ensure that minimum Medicare and Medicaid quality and performance standards are being met. CMS, a part of the Federal government, certifies projects to receive payments from Medicare and Medicaid. Once certified the project is then a nursing home provider for Medicare and Medicaid services. Each State government oversees the licensure process for each project with that State. There are over 150 regulatory standards that nursing homes must meet at all times in order to ensure quality and performance standards. Meeting these minimum standards allows a project to receive Medicare and Medicaid payments and remain licensed with each State. If the regulatory standards are not being met, as shown through the survey process, then CMS can impose penalties, remedies or sanctions and possibly revoke all Medicare & Medicaid funding.

### 3.5.3

## State Inspection Process

Nursing Home State Surveys and Health Inspection are two terms that describes the nursing home State Inspection process and the terms are often used conterminously, in conjunction and/or separately from each other (e.g., State Survey, Health Inspection Survey, State Health Inspection, State Inspection, etc.). States contract with CMS to monitor nursing homes that provide care to individuals that receive Medicare and Medicaid. Health Inspections of nursing homes are conducted routinely, about every 9-15 months, by the State survey team. The State will perform more frequent survey inspections if there are complaints or the project is poorly performing. During the nursing home inspection process the State reviews many aspects of quality and performance standards. The survey is comprised of an inspection team that is normally made up of trained inspectors which include but are not limited to a registered nurse, a licensed or certified social worker and a certified life safety code inspector. Surveys are performed unannounced to the project and can be performed ~~24 hours a day and can fall at any time~~ on any ~~of the 365 calendar days~~ day. A survey generally lasts 3-5 days which can include non-business hours and/or weekends. The survey team routinely ensures residents are safe and free from immediate jeopardy. If severe deficiencies are found which has risen to the level of harm or immediate jeopardy then the survey may be extended. The survey team follows the survey process and evaluates whether the project is meeting individual resident needs and providing quality of care as defined by CMS. The survey covers various aspects of a resident's stay within a nursing home such as resident life, quality of care, safe and sanitary food preparation processes, staff/resident interactions, environment, policy and procedures and, among numerous others, abuse and neglect.

When an inspection team finds that a project does not meet a regulatory standard they issue a deficiency/citation. The State routinely allows 45 days from the date of the survey to correct deficiencies. The State also requires the project to provide a statement of correction to prevent the deficiency from occurring in the future. The State may follow up at the project by conducting another unannounced visit to the project or completing a desk review. If the deficiency is not corrected then the State recommends appropriate enforcement actions to the State Medicaid agency for Medicaid and to the regional office for Medicare. The CMS regional office determines a project's eligibility to participate in the Medicare program based on the State's survey results and the project's compliance. If the regulatory standards are ~~still~~ not being ~~corrected~~ met, then CMS can, depending on the severity of the violation, take action against the nursing home including imposing various remedies and possibly revoking all Medicare and Medicaid funding.

Nursing home surveys are posted on the Medicare.gov website.

### 3.5.4

## State Inspection Process (Life Safety)

To be eligible to be a Medicare & Medicaid Nursing Home Provider the project must be in compliance with the ~~2000~~2012 edition of Life Safety Code (LSC). Projects that have waivers of

the health occupancy provisions of the LSC or an acceptable Plan of Correction (POC) are also considered in compliance. The LSC is a set of fire protection requirements that provides a reasonable degree of safety from fire.

The LSC ~~uses~~ only qualified fire safety inspectors to perform the Life Safety Survey. The nursing home must also meet the minimum Life Safety Code at all times and will receive deficiencies for non-compliance of the Life Safety Code. The LSC inspectors will make reports and recommendations to the State agency. The State routinely allows time to correct a deficiency. If the regulatory ~~standards~~ standard deficiencies are not being corrected, then CMS can, depending on the severity of the violation, take action against the nursing home including imposing various remedies and possibly ~~revoke~~ revoking all Medicare & Medicaid funding.

The Life Safety Surveys are located on the [Medicare.gov](https://www.medicare.gov) website.

### 3.5.5

### Quality of Care Provided to the Residents

The survey process each project undergoes is an effort of CMS to oversee that quality of care is being given to each resident. CMS has established Quality Measures that are used during the survey. These Quality Measures are measurable, valid, reliable and are submitted to CMS on a routine basis. The nursing home quality measures come from actual residents ~~that~~ who stay within each project. This data is routinely collected and measures the resident's physical and clinical conditions and abilities, as well as preference and life care wishes. This data is further converted to allow consumers ~~to~~ another source of information that shows how well nursing homes are caring for their ~~resident's~~ residents' physical and clinical needs. This data can be viewed on the [Medicare.gov](https://www.medicare.gov) website.

CMS may also establish certain quality performance measures, as detailed on the Medicare.gov website, for the distribution of annual incentive payments.

### 3.5.6

### Star Rating

CMS created a Five-Star Quality Rating System. This system is intended to assist family members, consumers and care givers to compare nursing homes more easily and help identify questions that they may wish to ask. The Five-Star Quality Rating System is located on the [Medicare.gov](https://www.medicare.gov) website. The website has a quality rating system that gives each of the 4 categories between 1 and 5 stars. Nursing homes with 5 stars are considered to have "much above average" quality and a nursing home with a 1 star rating is considered to have quality "much below average". Though the categories and ~~descriptions~~ descriptions are subject to change, and the Medicare website is the most current and accurate location to read about details, at the time of publication, the four categories of the Star Rating are Overall, Health Inspections, Staffing, and Quality Measures. The actual star rating is based on technical guidelines to establish each star rating.

**Overall Star Rating:** Takes into account the other categories (e.g., Health Inspections, Staffing and Quality Measures) and then gives an Overall Star Rating for the project.

**Health Inspection:** The health inspection rating contains information from previous years of onsite inspections, including both standard surveys and any complaint surveys. The most recent survey findings are weighted more than the prior years, based on the technical guidelines.

**Staffing:** The staffing rating has information about the number of hours of care on average provided to each resident each day by nursing staff. This rating considers differences in the level of ~~need-of~~ care ~~of~~needed by residents in different nursing homes. The staffing rating can have a proportionally greater impact on the overall Star Rating than the other factors.

**Quality Measures:** The quality measure rating has information on different physical and clinical measures for nursing home residents. This information is collected by the nursing home for all residents. The Quality Measures offers information about how well nursing homes are caring for their residents' physical and clinical needs.

The Star Rating can be viewed on the [Medicare.gov](https://www.medicare.gov) website.

### 3.5.7

### Special Focus Designation

CMS has a Special Focus Facility ([SFF](#)) Initiative that places a nursing home, with a history of serious quality issues, into a special program that is meant to stimulate the project to improve their quality of care to residents (see also, Section 3.10.4). CMS may also publish an SFF Candidates List. Most of the projects placed on the Special Focus Facility Initiative Program have previously shown the following within the past three-year survey history:

- A. Surveys have twice the amount of deficiencies as other nursing homes.
- B. More serious survey deficiencies than most other nursing homes. These deficiencies would include Harm and Injury experienced by the residents.
- C. A pattern of problems that persisted over the past 3 years of surveys.

These projects are visited twice as often as regular projects (twice per year). Enforcement action becomes more stringent as more problems continue. There are three options after the project has been in the program and within the more than 18-24 month timeframemonths:

1. **Improvement and Graduation:** The project advances to an Improved Status and eventually Graduates from the program. This project would resume annual surveys and continue being a Medicare and Medicaid Provider.

- 1753 2. **Termination:** This project has not met the criteria to graduate from the Special  
1754 Facility Program, is not making progress and is terminated from providing services to  
1755 Medicare and Medicaid recipients.  
1756
- 1757 3. **Extension of Time:** An extension of time can be given to a project that is showing  
1758 improved progress but not enough progress to advance to Improving/Graduated  
1759 status. An extension of time could also be granted if there is a sale of the project.  
1760

1761 Special Focus Designation can be found on the [www.CMS.gov](http://www.CMS.gov) and  
1762 <http://www.medicare.gov/> website.  
1763

1764 ~~All Special Focus Facilities will be serviced by the Risk Mitigation Branch.~~  
1765



## Section 3.6

### Approval to Participate in HUD Programs - APPS and BPRS

#### 3.6.1

#### Overview

- A. The Office of Healthcare Programs' Section 232 Program requires participants in a proposed transaction to submit certain types of forms containing information. This information is requested in order to demonstrate to HUD their experience and that of the team of people who are planning to own, operate or manage a project with a Section 232 FHA-insured mortgage. Application submission requirements are contained in the application exhibits for new endorsement in accordance with the appropriate Section of the Act, including but not limited to, resumes, credit reports, and project licenses. In addition to proposed applications for a FHA-insured mortgage, a proposed change of Borrower (Transfer of Physical Assets), Change of Participant (CHOP) requires approval by ORCF including changes in the Borrower, Operator, or Change of Management Agent require approval by ORCF. These requirements can be found in Asset Management, Chapter 7 and Chapter 8.
- B. Regardless of the proposed transaction or event that triggers participant approval (i.e., newly proposed FHA mortgage insurance requests or change of entity), approval as a Section 232 Program participant by ORCF is a HUD requirement. ORCF uses Active Partners Performance System (APPS) and the Business Partner Registration System (BPRS) to ensure proper clearance and up-to-date information on participants doing business with HUD. Additional information regarding participation and compliance requirements may be found in Housing Notice H 2016-15 (or successors thereto).
- C. The purpose of the Previous Participation certification review is to assure that Controlling Participants in ORCF projects are responsible parties with regard to their participation in other governmental housing transactions. Controlling Participants in a proposed transaction must submit information regarding previous participation in governmental housing transactions either via the electronic Active Partners Performance System (APPS) or on the Consolidated Certification. APPS submissions and Previous Participation Certification submissions must be approved prior to issuance of a Firm Commitment. Should participants change, revised submissions must be completed and approved prior to closing. Additional information on the previous participation certification requirements can be found in Housing Notice H 2016-15 (or successors thereto).
1. **Controlling Participants.** Controlling Participants are those entities serving in the specified capacity of Borrower, Management Agent, Operator, General Contractor, or Master Tenant. Controlling Participants are individuals and entities determined by HUD to exercise financial or operational control over the project. Housing Notice H 2016-15

(or successors thereto) provides additional detail on who HUD considers to be a Controlling Participant for Previous Participation Review purposes.

- 2. Organization Charts.** Organization charts are a visual representation of the ownership structure of an organization. The organization chart must be clear enough so that a person unfamiliar with the project and the entities involved can understand the ownership and control structure. Housing Notice H0 2016-15 (or successors thereto) details the organization chart submission requirements.

DRAFT

## Section 3.7

### Physical Condition

#### 3.7.1

#### Introduction

The physical condition of every ORCF Section 232 FHA-insured facility is a critical factor in managing the overall risk to the FHA mortgage insurance fund ~~to ensure~~and in ensuring that the residents are residing in decent, safe and sanitary housing. ORCF strives to provide and promote the effective use of timely and reliable information to monitor and assess the condition of the ORCF Section 232 portfolio. Such assessment tools also provide valuable information to help ensure safe, decent and affordable housing is maintained throughout the ORCF Section 232 portfolio.

#### 3.7.2

#### Physical Condition Monitoring Tools

##### A. Real Estate Assessment Center (REAC) Physical Inspections.

1. **General Background.** ~~On September 1, 1998 (63 FR 35650), HUD published a final rule that~~regulations at 24 CFR Part 5, Subpart G established uniform physical condition stands for housing insured- and or assisted under certain HUD programs. These standards are intended to ensure that this housing is decent, safe, sanitary and in good repair. The September 1, 1998 final rule~~regulations~~ also established uniform physical inspection procedures by which HUD determines compliance with the physical condition standards. In certain cases, additional physical inspection regulations may apply (e.g., Section 232 projects with project-based rental assistance contracts). References to these requirements and other updates to HUD's physical inspection standards can be found on the REAC website (see Appendix 3.1).
2. **REAC and ORCF Section 232 Projects.** HUD's Real Estate Assessment Center (REAC) is charged with responsibility for assessing and scoring the condition of certain projects in which HUD has an interest, including FHA-insured projects under the Section 232 Program, in accordance with the physical conditions standards and procedures of 24 CFR part 5 subpart G.
  - a. **ORCF 232 Projects.** ORCF will continue to use the Real Estate Assessment Center (REAC) to schedule and physically inspect all projects in the ORCF Section 232 portfolio unless stated otherwise below.
  - b. **Skilled Nursing Facilities.** ~~This provision (24 CFR 200.855) Part 5, Subpart G is now applicable and it limits the inspections on skilled nursing facilities. It provides in part that REAC will no longer routinely perform~~HUD may exempt such facilities from routine physical inspections ~~on skilled nursing~~

1857 ~~facilities~~ (though HUD can direct on a case-by-case basis that one be  
1858 conducted if HUD determines that inspection of a particular facility is needed  
1859 to assure protection of residents or adequate preservation of the project). In  
1860 applying this provision, HUD has halted the inspections on projects  
1861 categorized in HUD's database as SNFs-Skilled Nursing Facilities (SNFs).  
1862 This can include skilled nursing facilities that do have some non-skilled  
1863 nursing units, but are predominantly providing skilled nursing care.  
1864 c. **Other Non-SNF Exceptions.** The provision also gives HUD the authority to  
1865 determine that other (non-SNF) 232 projects in a particular jurisdiction do not  
1866 need REAC inspections if HUD finds that a particular jurisdiction provides  
1867 reliable and adequate inspections with readily available results. Action, if  
1868 any, with respect to that authority will be announced at a later date.  
1869

- 1870 3. **Administration of REAC Inspections.** REAC inspects only a random sampling of  
1871 the project to determine if the project is properly maintained. REAC conducts  
1872 physical inspections through the use of contracted inspectors trained by REAC. The  
1873 inspectors schedule on-site inspections with project Borrower's representatives. For  
1874 assistance, questions, clarification, guidance and/or questions, on procedures  
1875 pertaining to REAC physical inspections, - including scoring procedures and  
1876 procedures and timelines to appeal an inspection report, refer to REAC's website  
1877 (see Appendix 3.2)- (see Appendix 3.1).  
1878
- 1879 4. **Exigent Health and Safety Items.** At the conclusion of a REAC Inspection, the  
1880 inspector provides the Borrower, or designated contact, a list of all Exigent Health  
1881 and Safety (EH&S) items. Once an inspection is conducted, the Borrower is  
1882 responsible for mitigating all identified EH&S items within 72 hours, as verified by  
1883 submission of the completed and signed certification Certification of Exigent Health  
1884 and Safety (EH&S) (Form HUD-93332-ORCF) to the assigned Account Executive  
1885 (AE-).  
1886
- 1887 5. **Issuance of REAC Inspection Report.** REAC is responsible for verifying  
1888 inspection data provided from the contracted inspector based on the on-site  
1889 inspection. REAC scores and issues the formal REAC inspection report to the  
1890 Borrower's contact, as verified at the on-site inspection.  
1891
- 1892 6. **ORCF Actions and Referrals to the DEC in Response to REAC Inspection**  
1893 **Report.** If the REAC inspection report score falls under 60 (on a scale of a possible  
1894 100 points) is a failing score as defined by REAC on two consecutive inspections, the  
1895 AE will refer a Borrower to the Departmental Enforcement Center (DEC) for further  
1896 review and possible enforcement action. Before referring to the Enforcement  
1897 Center DEC, the AE will review both inspections and discuss the results with the  
1898 Mortgagee/Service Lender to determine if the project make-up design and permitted  
1899 use is causing improper scoring (locked doors or windows, or other characteristics  
1900 unique to certain healthcare projects). ORCF will also flag the Borrower in APPS.  
1901 See Housing Notice H 2016-15 (or successors thereto), for additional information on

APPS flags. All REAC Inspections receiving a score of 30 and below are automatically referred to the DEC for resolution enforcement action.

- a. **DEC Actions.** The DEC may arrange a conference call to discuss the inspection results with the Borrower and Operator and issue a Notice of Violation (NOV) demanding correction. Requirements of a Borrower and Operator that are included in the NOV include the following:

- i. Conduct and submit a 100% survey identifying the physical deficiencies in the project;
- ii. Correct the physical deficiencies at the project including but not limited to those deficiencies identified in the REAC Inspection; and

~~iii. Execute and provide a certification of corrections. Refer to: <http://portal.hud.gov/hudportal/documents/huddoc?id=10-04hsgnatt1.pdf>~~

iii. Execute and provide a Certification Physical Condition in Compliance (Form HUD-93333-ORCF).

The DEC may take additional enforcement action and seek any and all available remedies, in consultation with ORCF, including ~~to~~, but not limited to, acceleration of the outstanding principal indebtedness, foreclosure, or any other appropriate remedies.

- b. **Follow-up and Monitoring.** In addition to mitigating EH&S items as described in A.4 of this chapter, Borrowers are responsible for correcting all deficiencies noted on physical inspection reports.

Borrowers are required to ensure a complete (100%) inspection of the project is performed. This follow-up inspection shall include the site, all building exteriors, all building systems, all common areas, and all units. For clarification purposes: all areas within a building that are not residential units are considered common areas for inspection purposes. All deficiencies identified on a REAC Report must be corrected. To verify compliance, the Borrower and Operator, where applicable, must complete and sign the certification and provide it to their Mortgagee/Service Lender and assigned AE.

Mortgagee/Service Lenders play a critical role in ensuring the Borrower ~~has~~ and Operator have met their obligation to correct deficiencies and are encouraged to monitor progress and performance. Since the REAC Inspection is just a sample of the physical condition of the project, the 100% inspection of the project is important.

Mortgagee/Service Lenders should encourage the Borrower and Operator to, at a minimum, perform the following on an ongoing basis:

- i. Review of Exigent, Health, and Safety (EH&S) problems identified in the REAC physical inspection. These items should



1947 be considered a priority and should assure that all EH&S  
1948 deficiencies have been and remain corrected.

- 1949 ii. Review of units and common areas to verify that significant  
1950 REAC physical inspection report deficiencies (other than  
1951 EH&S) such as falling retaining walls, broken sidewalks,  
1952 exterior painting, etc. have been corrected.

1953 ~~A Mortgage/Service~~A Lender or HUD may decide to perform a site  
1954 review of a project, to ensure deficiencies are addressed, should there  
1955 be issues of concern with regard to the physical condition of the  
1956 project. Additional Lender notification requirements for physical  
1957 inspections are discussed in Section 3.10.11 of this chapter.  
1958

1959  
1960 Borrowers will be notified as subsequent REAC Inspections are  
1961 scheduled by inspectors.

1962  
1963 Any questions on REAC may be directed to the REAC Technical  
1964 Assistance Center (TAC) at 1-888245-4860 or email at: REAC  
1965 TAC@hud.gov  
1966

- 1967 B. **State Surveys.** As discussed in Section 3.5, part of the State inspection process includes a  
1968 Life Safety Inspection. As this inspection focuses on the compliance with fire protection  
1969 requirements, it may reflect concerns with the physical condition of the project as it impacts  
1970 the residents. ORCF regularly reviews the Life Safety Inspection as well as the entire State  
1971 Survey and Medicare Star Ratings, to determine if there may be issues pertaining to the  
1972 physical condition of the project. For more information on Life Safety, State Surveys and  
1973 Medicare Star Ratings, refer to Section 3.5 and 3.10.5.  
1974  
1975

### 3.7.3

## Resources for Addressing Physical Repairs and Improvements

- 1976  
1977 A. **Reserve for Replacement.** As discussed in Section 3.2.2 of this chapter, a Reserve for  
1978 Replacement (R4R) escrow exists for all FHA-insured and HUD-held mortgages, in  
1979 accordance with the Regulatory Agreement. The R4R is established to help defray costs of  
1980 replacing a project capital items. The R4R is a possible source of funding considered to help  
1981 meet costs to maintain the physical condition of the project, in addition to the operating  
1982 budget. A Borrower should work with their Mortgage/ServiceLender and AE to seek  
1983 approval of withdrawals from the R4R to address capital improvements and repairs. For  
1984 more information on R4R, refer to Section 3.2.2 of this Chapter.  
1985  
1986 B. **Other Resources.** As Borrowers are responsible for maintaining the project's physical  
1987 condition, the Borrower may propose other resources of funding to be utilized to address  
1988 needed physical repairs or proposed for capital improvements. Examples such as Borrower  
1989 provided funding (not project funds); surplus cash notes, residual receipts are all potential  
1990 sources to address physical repair needs. Compliance with regulatory and Section 232

Program requirements must also be ensured. [Other resources may be required for elective improvements. For additional information, see Sections 3.2.3 and 3.2.4 of this Chapter.](#)

C. **Insurance Proceeds.** [Lenders must work with Borrowers and Operators to ensure that insurance proceeds for project casualty losses are applied to the project in accordance with the provisions in 3.7.4.C. below. The Lender shall provide notification and documentation to the AE about damages and ensure that project accounts and escrows are reimbursed, to avoid duplication of payments.](#)

### 3.7.4

## Physical Condition and Regulatory Compliance

Borrowers and ~~operators~~[Operators](#) execute Regulatory Agreements under ORCF's Section 232 Programs. ~~Part of the regulatory~~[Physical condition standards and](#) requirements described in the Regulatory Agreement ~~is to keep~~[mandate](#) the project ~~be maintained~~ in decent, safe and sanitary condition and in good repair. During any period in which HUD insures the Loan or holds a security interest on the ~~Mortgaged Project, it is a Regulatory Violation for an mortgaged project,~~ Borrower ~~or and~~ Operator ~~are prohibited~~, without ~~Mortgagee/Service's~~[Lender's](#) and HUD's express written consent, to proceed to impact the physical condition of the project in any of the following ways:

- A. Make physical change, or permits changes to, the ~~Mortgaged Project~~[mortgaged project](#), whether negligently or intentionally, in a manner that reduces its value;
- B. Fail to maintain the ~~Mortgaged Project~~[mortgaged project](#) in decent, safe, and sanitary condition and in good repair; or
- C. Materially fail to comply with covenants in the Note, the Borrower's Security Instrument, the Regulatory Agreement, or any of the Mortgage Insurance Documents respecting physical care, maintenance, construction, abandonment, demolition, or insurance against casualty of the ~~Mortgaged Project~~[mortgaged project](#).

### 3.7.5

## Project Capital Needs Assessment

The intent of the Project Capital Needs Assessment (PCNA) is to ensure the long term viability of the project and ensure the proper deposit to the [Reserve for Replacement \(R4R\)](#) account. When required by the project's Regulatory Agreement, the existing PCNA must be updated every ten years. Updates to the PCNA must follow the Statement of Work ~~as set forth in~~[Production, Chapter 4 available on the Section 232 Program website](#), for a Limited Scope PCNA. Updated PCNAs ~~must be submitted to the Project's AE every ten years, as or Limited Scope PCNAs may also be~~ required ~~(unless required prior to that date due to other circumstances),~~[such as a changes of ownership or changes of collateral when information about the adequacy of the R4R is insufficient or unavailable. Unless otherwise specified in the Regulatory Agreement, the anniversary date of the PCNA will be the later of the Final Endorsement Date or the date of](#)

2033 [the last PCNA completed for the property.](#) The cost of each such PCNA may be requested for  
2034 reimbursement from the R4R account. [Items identified as critical repairs require immediate](#)  
2035 [attention. Items identified as non-critical repairs must be completed within twelve months unless](#)  
2036 [a different completion schedule is approved in writing in advance by HUD.](#)  
2037

DRAFT

## Section 3.8

### Telecommunications Towers

#### 3.8.1

#### Introduction

This section provides guidance for Borrowers regarding the procedures for requesting permission from ORCF to lease an area of the FHA-insured project for communication towers and/or other telecommunications equipment. A checklist of required exhibits to submit to HUD when requesting approval for communication towers and/or other telecommunications equipment will be available on the Section 232 Program website.

#### 3.8.2

#### General

ORCF supports Borrowers of FHA-insured projects leasing space for communication towers to telecommunication providers for the purpose of increasing revenue for the project. Pursuant to the Regulatory Agreement, the Borrower must submit the required documents prior to execution of the lease, as HUD approval is required for these types of commercial leases. The [Mortgagee/Service Lender](#) is to receive the request and documentation, review for completeness, accuracy and eligibility, and then forward to ORCF with a recommendation for approval. A review of the documents will focus on issues regarding any effect on the project's income and expenses, the Regulatory Agreement and Security Instrument. HUD closing attorneys and HUD engineering staff may review the required documents and provisions prior to the AE making a final determination.

#### 3.8.3

#### Requirements

- A. **Contracts:** In the proposals for telecommunication contracts, the providers typically intend installing all necessary equipment on the project site at no cost to the project, and in return, the project receives lease payments. ORCF is supportive of these arrangements, provided that they bring a higher level of service to our communities in a more competitive atmosphere, increase project revenues, and enhance project marketability, and further provided that any associated physical, business, and legal risk involved with installation and maintenance of such towers is appropriately mitigated. [Physical risks such as the stress on the roof structure and the connections to the roof structure will require a professional engineering \(PE\) certification \(i.e., a signed and stamped report from a professional engineer engaged by any of the parties\).](#) Additionally, a HUD environmental review may be required before HUD approves a contract or lease for telecommunications towers.

2076 B. **Engineered fall distance.** All structures shall be located outside the engineered fall distance  
2077 of any support structure for high voltage transmission lines, radio antennae, satellite towers,  
2078 cellular towers, etc., as discussed in Production, Chapter 7.5.K.2. HUD expects that any fall  
2079 distance calculations will be prepared and certified by a professionally registered engineer.  
2080

2081 C. **Lease:** The following points are to be taken into consideration:  
2082

- 2083 1. The lease may not be modified, extended or terminated without the prior written  
2084 consent of the Mortgagee/Service Lender.  
2085
- 2086 2. The lease may not be modified or extended without the prior written consent of HUD.  
2087
- 2088 3. The lease must be assignable by the Lessor to the Mortgagee/Service Lender and/or  
2089 HUD (i.e., upon foreclosure or deed-in-lieu of foreclosure).  
2090
- 2091 4. The lease is subordinate to the HUD-held or FHA-insured Mortgage (Security  
2092 Instrument).  
2093
- 2094 5. The lease will not be automatically terminated by foreclosure or any other transfer of  
2095 the mortgaged project; and, that in the case of foreclosure or deed-in-lieu of  
2096 foreclosure, the Mortgagee/Service Lender and/or HUD shall have the right to accept  
2097 or terminate the lease.  
2098
- 2099 6. The lease must contain a clause that states that the Lessee shall, upon receipt of notice  
2100 of default under the Mortgage (Security Instrument), pay all rents payable under the  
2101 lease to the Mortgagee/Service Lender and/or HUD.  
2102
- 2103 7. The lease must contain the following information:  
2104 a. a comprehensive list of the equipment to be installed, including a list of any  
2105 proposed improvements to the FHA-insured project;  
2106 b. Lessee is responsible for the maintenance of the equipment;  
2107 c. maintenance schedule;  
2108 d. access information; and  
2109 e. where the equipment is located (i.e., roof) along with a drawing of the  
2110 location.  
2111
- 2112 8. The lease shall contain a provision which conditions approval of the lease on the  
2113 Lessee obtaining all variances, permits, license or approvals required by applicable  
2114 law.  
2115
- 2116 9. The lease must contain a certification from the Lessee that it has performed its own  
2117 investigation of the project and has determined its suitability for use.  
2118
- 2119 10. The lease may contain a provision granting the Borrower, its successors and assigns  
2120 the right to relocate any equipment, wiring or cabling.  
2121



- 2122 11. The lease must contain a provision permitting the Borrower, its successors and  
2123 assigns the right to terminate the lease should, 1) Lessee default in payments owed  
2124 under the lease, 2) Lessee's authorized use of the premises materially interfere with  
2125 Borrower's use and operation of the project and building, or, 3) it be determined that  
2126 the Lessee's equipment constitutes a danger to the health and safety of the project's  
2127 residents or poses a danger to the structural integrity of the building.  
2128
- 2129 12. The lease must contain a provision mandating that hazardous waste materials will not  
2130 be stored, used, generated, etc., on or in the ~~FHA-insured~~ project at any time.  
2131
- 2132 13. Anti-Deficiency Provision: in no event shall HUD be subject to an indemnification  
2133 provision in the lease, whether in the present or future (if it becomes Lessor to the  
2134 lease).

## Section 3.9

---

### Commercial Space

---

#### 3.9.1

#### Introduction

##### A. General Guidance

This section provides guidance pertaining to ORCF's requirements related to additions or alterations to commercial space on projects currently insured under any of the programs covered by this Handbook.

##### B. Categorization of Space.

Commercial space in a Healthcare Facility can be categorized as a space within the project that has been altered or converted for use other than residential purposes from which income is derived or anticipated. In accordance with **24 CFR 200.73**, a project may include such commercial and community facilities as the Commissioner deems acceptable. Commercial space differs from community space or community facilities. The term "community facilities" refers to project amenities, such as a pool, resident parking/parking garage, business center or fitness center that are predominantly used by residential tenants, with or without charging additional fees. Community facilities generally do not produce regular income and any intermittent revenue is to be included as ancillary income.

#### 3.9.2

#### Types of Commercial Space for Assisted Living, Intermediate Care, and Skilled Nursing Facilities

**Commercial Space vs. Community Space.** Generally speaking, due to the special nature of these types of projects, commercial space is to be limited to commercial activities that benefit the type of residents that live in the project. Unless the project has been constructed as a mixed use building, the project shall include commercial activities that are consistent with the type of project and type of residents served. Common Commercial Space areas in ALF, Intermediate Care Facilities (ICF), SNF and Board and Care Facilities include, but are not limited to: hair salons, convenience stores, specialized medical care provider spaces, ice cream parlors, coffee shops, gift shops and non-resident parking. These are deemed "commercial" instead of community spaces if they are income producing on a consistent basis and gain their revenue from residents and customers on a "pay for service" basis separate from the monthly bed charge. Residential parking, if a fee is charged to residents, is still considered community space and is recorded as ancillary income, not commercial income for the purpose of the calculations and limitations below.

### 3.9.3

## Space and Income Limitations

This section provides guidance pertaining to when a Borrower wishes to change the intended use of part of a project to commercial space.

**A. Commercial Space and Income Limit Computations.** Commercial Space and Income is limited to 20 percent of the total gross floor area of the propertyproject and 20 percent of the Effective Gross Income of the project. Commercial Space that is intended to exclusively serve the residents of the project is not counted toward the 20 percent limit.

**B. Non-Compliance and Retroactive Approval.** There may be instances in which residential space is converted to commercial use without the knowledge of HUD. ORCF shall inform the project Borrower, in writing, that such action is in violation of the Regulatory Agreement and that failure to correct this violation may result in HUD exercising its rights under the Regulatory Agreement, including denial of future participation in HUD programs. ORCF may approve the conversion retroactively, in its determination, provided all requirements are met.

### C. Parking.

1. Parking income attributable to residential tenants is considered to be ancillary income and is not included in the limits contained in Section A, above. Commercial parking spaces reserved for use by motorists who are not project residents or are not parking to use the on-site commercial tenant'stenants' facilities, and the related non-tenant parking income, must be included in the Commercial Space and Income limitations. The income and space attributable to parking spaces reserved for non-residential or non-commercial tenants must be included in the limitations, based on applying the percentage of the total spaces that are reserved for non-tenant use. For existing projects that are to be acquired, refinanced or will undergo substantial rehabilitation, that provide parking for a monthly fee, the Mortgagee/ServiceeLender must identify the percentage of monthly parkers who are non-tenants so as to include these in the commercial income limitations, above. The maximum occupancy factor to be applied to the parking income attributable to parkers who are not associated with either the project's residential or commercial tenants shall be the lower of:
  - a. The amount indicated by the market and by the historic performance of the subject, or
  - b. 50 percent.
2. If the Borrower operates a parking facility that provides parking for residential or commercial tenants of the project, the Mortgagee/ServiceeLender must determine parking income based on an analysis of the past 3 years of operation and the trailing 12-month period prior to application.
3. If the parking facility is operated by a third-party, the Mortgagee/ServiceeLender may use the amount of income collected under the contract if it is a fixed monthly

payment. Parking contracts that specify a percentage rent in addition to or in place of a fixed rent are not permitted without HUD approval.

### 3.9.4

## Submission Requirements and HUD Review

- A. Submission Requirements. Please see the list of exhibits provided on the checklist posted on the Section 232 Program website. The Mortgagee/Service Lender is to receive any requests for additions or alterations to commercial space, review them for completeness, accuracy and eligibility, and then forward them to ORCF with a recommendation for approval.
- B. **Additional Considerations.** The following issues will be considered by ORCF in processing Commercial Leased Lease Applications:
1. Current Financial financial and Physical Condition physical condition of the Project project.
  2. ~~2.~~ Open Federal, State, and local compliance Issues issues.
  3. An environmental review as required by 24 CFR Part 50 will be conducted on any proposal for remodeling, adding to, subtracting from, reconstructing, or demolishing a portion of the mortgaged project. Environmental Review Requirements are described in further detail in Section II Production, Chapter 7 and on Form HUD-90030-ORCF, including: Phase I, Radon and other Environmental concerns.
- C. **Decision on Request for Approval.** ORCF will notify the Mortgagee/Service Lender, in writing.

## Section 3.10

### Special Circumstances Requiring the Notification of the Mortgagee/Service Lender and/or AE

#### 3.10.1

#### Introduction

Borrowers and Operators must notify the Lender and/or the HUD Account Executive of various risk indicators within the required timeframes, as laid out in 24 C.F.R. 232.1015 the HUD Regulatory Agreements, the Lender's Certificate (HUD-92434-ORCF)/Request for Endorsement (HUD-92455-ORCF), other Program Obligations and in this chapter. Some risk indicators will require the Lender to notify HUD directly as well. Certain risk indicators and conditions of non-compliance, including ones identified by HUD, may trigger the need for further information, such as action plans, which are intended to ensure all parties are aware of the risks and the specific actions being taken to address them.

Action Plans: When an action plan is needed, except as noted otherwise in the subsections below, ORCF requires Lenders to upload the action plan into the Portal within 30 calendar days. HUD may accelerate the deadline as necessary. ORCF expects Lenders will obtain from the Borrower and/or Operator, as appropriate, action plans for improving verified deficiencies, within 30 days. In addition to items noted further in this chapter for specific circumstances. All action plans must contain the information request on the Action Plan Template form, available on the 232 Program website, and any other information as requested by the Account Executive. Lenders can find a sample template for guidance on the 232 Program Loan Servicing website.

Throughout this portion of this chapter there are indicators that require a Borrower and/or Operator either to notify the Mortgagee/Service Lender and the AE concurrently, or to notify only the Mortgagee/Service Lender (who would in turn elevate the matter to the AE as appropriate) -of a Project's project's risk, of an action plan or of progress on previously reported situations. ~~ORCF has created a sample format that Mortgagee/Serviceers may use in reporting this information; There are also circumstances where the sample may be found on Lender is required to notify the Section 232 Program website.~~ AE of its own volition.

The Operator's Notification to HUD of Threats to Permits and Approvals Section 232 (Form HUD-93335-ORCF) and Servicer's Notification to HUD of Risks to Healthcare Project (Form HUD-93334-ORCF) are to be used in reporting this information, as applicable.  
When a qualifying risk is present, Borrowers/Operators notify the Lender and HUD through the proper channel, and the Lender will upload it into the Portal within the required timeframes.  
Electronic submission requirements and additional tools are available on the Section 232 Program website.



Notification types are as follows:

1. [Failure to Make Lease Payment](#) (Refer to 3.10.2)
2. [Default of Master Lease](#) (Refer to 3.10.3)
3. [Special Focus Facility](#) (Refer to 3.10.4)
4. [State Inspections](#) (Refer to 3.10.5)
5. [Legal Judgments](#) (Refer to 3.10.6)
6. [Professional Liability Insurance](#) (Refer to 3.10.7)
7. [Fidelity Bond Coverage](#) (Refer to 3.10.8)
8. [Notification of Termination of Insurance](#) (Refer to 3.10.9)
9. [Threat to Abandon Project](#) (Refer to 3.10.10)
10. [REAC Inspections](#) (Refer to 3.10.11)
11. [Accounts Receivable Loans](#) (Refer to 3.10.12)
12. [Bankruptcy](#) (Refer to 3.10.13)
13. [Delinquent Mortgage Payments](#) (Refer to 3.10.14)
14. [Unauthorized Distributions](#) (Refer to 3.10.15)
15. [Failure to File Financial Statements](#) (Refer to 3.10.16)
16. [Financial Risks Metrics of Operator](#) (Refer to 3.10.17)
17. [Lender Assignment of the Note](#) (Refer to 3.10.18)
18. [Other Circumstances](#) (Refer to 3.10.19)

### 3.10.2

### Failure to Make Lease Payment

- A. The [Mortgagee/Service Borrower](#) and ~~AE~~/or [Operator](#) must ~~be immediately notified~~ [by notify the Borrower Lender and HUD within two \(2\) business days](#) of a failure to make a Lease payment.
- B. The ~~Mortgagee/Service~~ and ~~AE will work with~~ Borrower and Operator [must submit an action plan to understand the Lender that identifies](#) the financial or business circumstances that have resulted in the non-payment, and ~~try to facilitate an action plan that will remedy remedies for~~ the non-payment status.
- C. The ~~Mortgagee/Service~~[Lender](#) will continue to monitor the situation, to ensure timely payments continue in the future.
- D. Borrowers and Operators are strongly encouraged to work together with the [Mortgagee/Service Lender](#) to facilitate remedies to any problems with the Lease payments because the [Mortgagee/Service Lender](#) can be of assistance in such scenarios. If the [Mortgagee/Service Lender](#) knows of the payment status early enough, they may be able to work with the [Project project](#) to create an action plan and remedies with the parties before any non-payment penalties are incurred.
- E. In the event of a non-payment related to a Borrower/Operator dispute or other non-financial reason, the [Mortgagee/Service Lender](#) must contact the AE to discuss the severity of the situation ~~and whether it should be transferred to the Risk Mitigation Branch.~~

### 3.10.3

### Default of Master Lease

- A. Notification of Default of a master lease must be provided from Borrower to Mortgagee/Service Lender and HUD within two (2) business days following the Borrower's receipt of the notification.
- B. Once notified, Mortgagee/Service Lender will evaluate other projects within the master lease, to determine cash flows and the ability to cover the failing project(s). The Mortgagee/Service Lender using the Debt Service Coverage Ratio for each project, as well as the overall portfolio. The Lender will collaborate with HUD.
- C. The Borrower and/or Operator must submit an action plan to the Lender that identifies the financial or business circumstances that have resulted in the default and will remedy the situation.
- ~~C.D.~~ Default on a master lease will impact the Project, legal documents, and potentially a default on the mortgage. The project may also need to and/or portfolio could be serviced by the Risk Mitigation Branch.
- Additional details regarding master leases may be found in Production, Chapter 13- and Asset Management, Chapter 9.

### 3.10.4

### Special Focus Facility

CMS has a Special Focus Facility Initiative that places a nursing home, with a history of serious quality issues, into a special program that is meant to stimulate the project to improve their quality of care to residents (see also, Section 3.5.7).

- A. ~~Notifications to HUD and the Mortgagee/Service Lender~~ The Borrower and/or Operator are required to ~~be submitted~~ submit notifications to HUD and the Lender within two (2) business days after the date of receipt of notice of a Special Focus Facility ~~Focus~~ (SFF) designation or candidate status from a state or federal regulatory agency, ~~unless a longer time period is approved by HUD.~~

Failure by the Project to notify HUD and the Mortgagee/Service Lender of a SFF designation or candidate status will be deemed a violation of federal regulation 24 CFR 232.1015 and may lead to the involvement of the HUD Departmental Enforcement Center (DEC).

The Special Focus Facility list may be found at the following web address:

<http://www.cms.gov/Medicare/Provider-Enrollment-and-Certification/CertificationandCompliance/downloads/sfflist.pdf>

- B. ~~The Mortgage/Servicer and AE will work with the~~ The Operator (and, as applicable, the Borrower and Management Agent) will work with the Lender to establish an action plan for being removed from the SFF list.

~~B. The AE will reassign the project to the Risk Mitigation Branch for ongoing servicing.~~

~~Each Project and situation is unique; some may show improvement and move off the SFF list faster than others. The Mortgage/Servicer and AE (Risk Mitigation Branch member) will work with the Project to establish an action plan.~~

### 3.10.5

### State Inspections Notification

- A. **Reporting Requirements.** Keeping the ~~Mortgage/Servicer~~Lender and ORCF informed of problematic surveys and of any actions that could threaten the licensure or provider payments for a project is crucial, since such matters can threaten the viability of operations that are needed to meet operating expenses and make mortgage payments.

1. Except as limited in 3.10.5.A.2, HUD requires , per 24 C.F.R 232.1015 and the HUD Regulatory Agreements, reporting when the Operator and/or Borrower receives a notice, report, survey or other correspondence (regardless of form) from any governmental entity that includes any statement, finding or assertion that:
  - a. Operator (or any principal, officer, director or employee of Operator), any Management Agent, the Projectproject, or any portion of the Projectproject is or may be in violation of or default under any of the Permits and Approvals or any governmental requirements applicable to the operation of the Projectproject within 90 days and/or any denial of payment, or
  - b. Any of the Permits and Approvals are to be terminated, limited in any way, or not renewed; or
  - c. Any civil money penalty ~~(other than a de minimis amount)~~ is being imposed with respect that impacts the project's ability to the Projectmake debt service and/or operate the project, or
  - d. Operator (or any principal, officer, director or employee of Operator), any Management Agent, the Projectproject, or any portion of the Projectproject is subject to any governmental investigation or inquiry involving fraud.
2. Reporting is only ~~The Borrower and/or Operator may be~~ required to submit an action plan with relation to Licensed Nursing Facility surveys (including Standard, Complaint, Fire/Life Safety and Infection Control surveys) when a survey has any findings higher than a "G" level or any repetitive "G" level or higher findings from prior surveys (pursuant to CMS State Operations Manual, Chapter 7, as may hereafter be edited or updated, or any successor guidance). "Repetitive" is defined as

“unresolved from the two most recent consecutive surveys or a repeat violation having the same citation number”. HUD may also require an action plan from the Lender on additional conditions, including placement of an Abuse Icon or receipt of a 1 Star rating (for either Overall, Health, or Staffing).

3. **Reporting Logistics.** Unless otherwise requested by HUD or the Mortgagee/ServiceLender:

- a. The *initial* communication from the Operator and/or Borrower pursuant to this Section shall be a notice by email to the Mortgagee/ServiceLender (not to HUD) describing the conduct cited, the scope and duration of remedy(ies) imposed, and the timelines for corrective actions (not the survey or other extensive communication itself). Such email shall be sent within two (2) business days of receipt of the notice, report, survey, or other correspondence from the governmental entity), using the Operator’s and Borrower’s Notification of Threats to Permits and Approvals-Section 232. HUD may also require an action plan from the Lender on additional conditions, including the placement of an Abuse Icon or receipt of an Overall 1 Star rating or a 1 Star rating for Health Inspections, Staffing or Quality Measures).
- b. The *next* communication from the Operator and/or Borrower shall be email notification to the Mortgagee/ServiceLender that the issue(s) have been addressed to the satisfaction of the issuing regulatory agency.
- c. The Mortgagee/ServiceBorrower and/or Operator shall notify the AE immediatelyLender and HUD within two business days when a matter listed in Section 3.10.5.A.1 is reported by the Operator that is not expected to be readily resolved or poses an immediate threat to licensure or funding. If necessary, the Mortgagee/ServiceLender should work proactively with the operatorBorrower and/or Operator to ensure the issue(s) are addressed to the satisfaction of the issuing regulatory agency. The Mortgagee/Service may use an optional reporting form made available by ORCF for reporting these or other matters of concern regarding the financial or operational performance.
- d. The Borrower and/or Operator may be required to submit an action plan to the Lender to mitigate risks.

B. The receipt by HUD and/or Mortgagee/ServiceLender of notices, reports, surveys, correspondence and other information shall not in any way impose any obligation or liability on HUD, Mortgagee/ServiceLender or their respective agents, representatives or designees to third parties to take (or refrain from taking) any action, and HUD, Mortgagee/ServiceLender and their respective agents, representatives and designees shall have no liability to third parties for any failure to act thereon or as a result thereof.

C. Failure to notify the AEHUD and the Mortgagee/ServiceLender of such inspection reports, Plans of Correction, approval reports or other qualifying communications, will be a violation of federal regulation 24 CFR 232.1015, as well as the operator regulatory agreementBorrower Regulatory Agreement and/or Operator Regulatory Agreement, and may lead to the involvement of the HUD Departmental Enforcement Center (DEC).

### 3.10.6

## Legal Judgments

The Borrower and the Operator must each notify their [Mortgagee/Service Lender](#) within two (2) business days of receiving a legal judgment, penalty or fine against the [Projectproject](#), in excess of \$50,000 if it impacts the project's ability to make the mortgage payment/cashflow.

The ability to cover a judgment/penalty/fine will vary based on the size of the project, the available cash, etc. The [Mortgagee/Service Lender](#) will work with the [Projectproject](#) to discuss reasons for the judgment and impacts on the financial status of the [Projectproject](#), notifying the [AEHUD](#) of outcomes. The Operator must provide the [Mortgagee/Service Lender](#) with an action plan (seeking the [Mortgagee/Service Lender's](#) guidance, as necessary and appropriate), and must work with [Mortgagee/Service Lender](#) to analyze the impact of the judgment, providing information to the AE of the status, until financial stability is regained.

~~A. Depending on the financial position of the Project and its ability to absorb the imposed judgment, it may require a change to "Potentially Troubled" status in the HUD system, by the AE.~~

### 3.10.7

## Professional Liability Insurance

On an annual basis, the [Mortgagee/Service Lender](#) must verify that each [Projectproject](#) has the required Professional Liability Insurance (PLI) coverage, as approved during the [Project'sproject's](#) underwriting. This review must include a current copy of the insurance ACORD, PLI policy, certificate or memorandum of insurance or other evidence of the required insurance coverage, as well as review of the updated loss history, consistent with the underwriting review standards (Section II, Production, Appendix 14.1.VII.D )

1. If coverage is less than required, then the [Mortgagee/Service Lender](#) must work directly with the [Projectproject](#) to resolve the coverage deficiency.
2. If the coverage deficiency is not readily resolved, then the [Mortgagee/Service Lender](#) must notify ~~the AEHUD~~ and work with the Borrower and/or Operator to either submit the insurance or submit an Action Plan outlining resolution and timeframe. The Lender must monitor the [Projectproject](#) until the coverage is adequately provided.
3. ~~–~~If the review of loss history indicates a negative trend in claims, the [Mortgagee/Service Lender](#) must evaluate the situation, discuss with the Operator any financial or operational changes that may be warranted, and discern the [Project'sproject's](#) financial ability to absorb any ramifications imposed by the claim(s). If appropriate, the Operator must establish an action plan. The [Mortgagee/Service Lender](#) will involve ~~the AEHUD~~ as they deem appropriate.



### 3.10.8

### Fidelity Bond Coverage

On an annual basis, the Mortgagee/Service Lender must verify that each Project has the required Fidelity Bond/Employee Dishonesty coverage, as approved during the Project's underwriting.

- A. If coverage amount is less than required (at least two months annualized potential effective gross income receipts, as required at the time of HUD Project approval), then the Mortgagee/Service Lender must work directly with the Project to resolve the coverage deficiency.
- B. If the coverage deficiency is not readily resolved, then the Mortgagee/Service Lender must notify HUD and work with the Borrower and/or Operator to submit an Action Plan outlining resolution and timeframe.
- C. The Mortgagee/Service Lender must monitor the Project until the coverage is adequately provided.

### 3.10.9

### Notification of Termination of Insurance

- A. A project cannot be uninsured in the Section 232 Program. The Project must notify their Mortgagee/Service Lender and AE within two (2) business days of its receiving notification of any termination of insurance.
- ~~B.~~ The Operator must provide the Mortgagee/Service Lender with an action plan (seeking the Mortgagee/Service Lender's guidance, as necessary and appropriate), and must work with Mortgagee/Service Lender to resolve the circumstances surrounding the notification, providing information to the AE HUD of the status, until resolution is reached.
- ~~C.B.~~ Termination of In the absence of a long-term resolution, as part of the action plan, the Lender must keep adequate property insurance or the formal notification of a potential termination of in force. Please see Production, Chapter 14.1 for additional information regarding Lender responsibilities in the event that property insurance will immediately warrant a change to "Troubled" status in the HUD system until the issue is resolved. not kept in force.

Failure to notify the AE and the Mortgagee/Service of such notifications will be a violation of federal regulation 24 CFR 232.1015, and may lead to the involvement of the HUD Departmental Enforcement Center (DEC).

### 3.10.10

### Threat to Abandon Project

- A. The Borrower must notify their [Mortgagee/Service Lender](#) within two (2) business days of ~~any threat~~the decision to close or abandon the ~~Project~~project, when initiated by the Borrower or Operator, but no later than 60 days before the facility will actually be closed. This is separate from an inspection/ survey decertification.
- B. The [Mortgagee/Service Lender](#) must investigate the threat to abandon the project, and attempt to mediate a resolution. The [Mortgagee/Service Lender](#) must escalate the threat to ~~the AE~~HUD if it becomes more imminent and/or cannot be resolved quickly without HUD involvement.
- C. The Operator must provide the Lender with an action plan (seeking the Lender's guidance, as necessary and appropriate), and must work with the Lender to resolve the circumstances surrounding the threat to abandon, providing information to HUD of the status, until resolution is reached and/or a workout plan is accepted.

### 3.10.11

### REAC Inspections

- A. The Borrower must notify their [Mortgagee/Service Lender](#) within two (2) business days of receiving a [REAC Physical Inspection](#) score of 30 or below or a second [REAC inspection](#)Physical Inspection score below 60.
1. A score of 30 and below creates an automatic [REAC Physical Inspection](#) referral to the DEC and must be addressed immediately.
  2. A second consecutive score of below 60 will warrant a referral to the DEC and must be addressed immediately.
  3. The [Mortgagee/Service Lender](#) must assist the [Project](#)project in determining if an appeal of the inspection score is appropriate, and provide assistance in preparing the appeal to REAC.  
  
Appeals to REAC have extremely time-sensitive deadlines which must be met. Please reference the Physical Condition portion of this chapter for more details on the [REAC Physical Inspections](#) appeals process.
  4. The [Mortgagee/Service Lender](#) must review the inspection report to ensure repetitive findings are being addressed and physical plant items are taken care of immediately.

### 3.10.12

## Accounts Receivable Loans

As further defined in the Production, Chapter 15 and Asset Management, Chapter 10:

- A. When a [Projectproject](#) proposes to add or amend an Accounts Receivable ([ARA/R](#)) loan, it must be reviewed with the same scrutiny that such a loan would be reviewed during the initial underwriting process. The [Projectproject](#) must submit the required documentation to the [Mortgagee/ServiceeLender](#), who will review the information for completeness, accuracy and eligibility, and then forward the submission to ORCF with a recommendation for approval.

A change in the [ARA/R](#) loan status initiated due to extenuating circumstances that have adversely impacted the [Projectproject](#) (rather than straightforward changes in business) should be evaluated by the [Mortgagee/ServiceeLender](#) and brought to AE's attention for particular scrutiny. [The FHA Lender should bring to the AE's attention if the A/R loan costs have substantially increased, if there are other non-performing properties on the A/R Line or Credit or if there are other new risks to HUD.](#) If the [ARA/R](#) loan change is a [straightforwardminor](#) change in the loan, there would be less of a concern than the need for a new loan due to a change in provider payments or other financial burdens.

- B. [The project must notify the Lender and HUD by written notice by electronic mail within 24 hours of an "Availability Reduction" that results in Availability being reduced by greater than twenty percent \(20%\) of the Maximum Commitment Amount. The Lender must notify HUD using HUD-93334-ORCF Servicer's Notification to HUD of Risks to Healthcare Project and Action Plan for Remedy - Section 232.](#)

- ~~B.C.~~ [The project](#) must notify their [Mortgagee/ServiceeLender](#) within two (2) business days of any notification of default on its [AccountAccounts](#) Receivable ([ARA/R](#)) loan.

1. Default on an [ARA/R](#) loan may be an indicator of potential default on the mortgage. Therefore, once notified, the [Mortgagee/ServiceeLender](#) must evaluate why the [ARA/R](#) Loan has defaulted, reviewing cash flows and the ability to cover the failing loan, and work with the [Projectproject](#) to create an action plan for moving the loan out of a default status.
2. The [Mortgagee/ServiceeLender](#) must collaborate with AE (and Risk Mitigation Branch, if assigned) as necessary until the remedies are put in place and the action plan has been fully implemented. The [Mortgagee/ServiceeLender](#) must also monitor the [Projectproject](#) closely to ensure financial and operational viability are restored.

### 3.10.13

## Unauthorized Distributions Bankruptcy

~~A. The Borrower must notify their Mortgagee/Servicer within two (2) business days of receiving a Notification of Unauthorized Distribution by the HUD Financial Assessment Subsystem (FASS).~~

~~1. The notification also includes a designated cure period which must be adhered to.~~

~~2. This notification is sent automatically to the email the Project registered in the system when an unauthorized distribution has been determined by FASS, as well as to the AE. The AE must also immediately notify the Mortgagee/Servicer of the violation.~~

~~3.1. The Borrower and, where applicable, the Operator, must provide the Mortgagee/Servicer with an action plan (seeking the Mortgagee/Servicer's guidance, as necessary and appropriate), and must work with Mortgagee/Servicer to ensure the cure period will be met to resolve the violation, and to further review the circumstances leading to the violation. The unauthorized distribution may be a sign of financial distress that needs to be closely monitored, and an action plan may need to be put in place to do so.~~

~~4. The Mortgagee/Servicer must notify the AE if there are extenuating circumstances that are preventing the immediate submission of the action plan, and provide the AE with the action plan expeditiously, and assure that the funds are repaid within the cure period.~~

~~B. There are times when REAC/FASS findings trigger contact from the DEC directly to the Project. Although the AE is also copied on such the notification, and must notify the Mortgagee/Servicer, the Borrower is responsible for notifying the Mortgagee/Servicer within two (2) business days of receipt of a REAC/FASS notification from the DEC.~~

~~The Mortgagee/Servicer will then work with the Project to cure the violation or devise an action plan to cure the finding(s), including the AE as appropriate, and communicating with the DEC during the process.~~

### 3.10.14

## Bankruptcy

A. The Borrower and Operator must notify their Mortgagee/Servicer~~Lender~~ within two (2) business days of any bankruptcy petition related to any of the Project~~project~~ participants who may file for bankruptcy (i.e., Borrower, Operator, or Management Agent).

B. ~~The Mortgagee/Servicer must review the bankruptcy status and circumstances, and~~ within~~Within~~ two (2) business days of being notified by the Project~~Borrower/Operator of the~~ bankruptcy filing, the Lender must provide the AE with the specifies of those ~~circumstances~~relevant information related to the bankruptcy, including, but not limited to: bankruptcy type, contact information of the participants and their respective legal counsels, the reason for petition, and whether the petition is voluntary or involuntary.

- 2670
- 2671 1. A copy of the bankruptcy notice along with all other relevant filing documents and
- 2672 court orders must also be provided to ~~the AE~~HUD at this time.
- 2673
- 2674 ~~2. Generally speaking, a bankruptcy status will warrant transfer to the Risk Mitigation~~
- 2675 ~~Branch portfolio due to the troubled nature of the project..~~
- 2676
- 2677 ~~2. The Project~~ The Lender shall document the Action Plan for Remedy using the
- 2678 Servicer's Notification to HUD of Risks to Healthcare Project and Action Plan for
- 2679 Remedy form, in coordination with the Borrower.
- 2680
- 2681 C. The project Participant must notify ~~their Mortgagee/Servicer~~the Lender of any imminent
- 2682 bankruptcy proceedings of which it is aware. The ~~Mortgagee/Servicer~~Lender must notify the
- 2683 AE of the imminent bankruptcy proceedings within two (2) business days of obtaining such
- 2684 knowledge.
- 2685
- 2686 1. ~~Until an FHA insurance claim is filed, HUD expects the Mortgagee/Servicer to~~The
- 2687 Lender must fully participate in the bankruptcy proceedings; ~~until it no longer has a~~
- 2688 lien or security interest in the collateral. Unless, and until, HUD intervenes in the
- 2689 proceedings, the ~~Mortgagee/Servicer~~Lender is expected to ~~guard~~ensure that HUD's
- 2690 interests are protected and keep HUD fully informed as to the case's progress and
- 2691 major developments, as outlined in item C.3 below.
- 2692
- 2693 ~~2. The AE will assign the Project~~project to the Risk Mitigation Branch, if ~~warranted.~~
- 2694
- 2695 ~~2. The Mortgagee/Servicer should be reviewing the~~the Borrower, Operator or
- 2696 Management Agent files bankruptcy. If the Borrower or Operator notifies HUD of
- 2697 the intent to file bankruptcy, the HUD AE will consult with the Risk Mitigation
- 2698 Branch.
- 2699
- 2700 3. The Lender must monitor the bankruptcy proceedings to ensure:
- 2701
- 2702 a. The nursing home license, certificate of need, and provider agreements remain
- 2703 with the project;
- 2704 b. Rights to the ~~operator's account receivables~~ (~~"AR"~~Operator's Accounts
- 2705 Receivable ("A/R")) remain with the ~~Project~~project or are paid towards
- 2706 ~~ARA/R~~ financing if approved by HUD for the ~~Project's~~project's benefit;
- 2707 c. Lease payments are ~~be~~ sufficient to cover debt and ~~R4R~~requirements
- 2708 requirements;
- 2709 d. ~~Compliance~~There is continued compliance with all ~~covenant remains~~
- 2710 intactcovenants;
- 2711 e. ~~Mortgage and security instruments~~Security Agreements and Security
- 2712 Instruments remain enforceable in accordance with their terms;
- 2713 f. All Regulatory Agreements pertaining to the ~~Project~~project remain in effect
- 2714 and the parties to these agreements are complying with the requirements
- 2715 contained therein; and



g. ~~All actions required of the Mortgagee/Servicer under Mortgage Letter 91-17.~~

g. The Borrower, Operator or Management Agent does not use project assets to pay attorney fees for legal service in connection with any aspect of the bankruptcy action without HUD approval.

D. The Lender must take necessary actions to protect its interest and to preserve the collateral, including filing the appropriate documents and petitioning the Court to acknowledge all Regulatory Agreements pertaining to the project. (Note that project rents are part of the loan security and are denoted as cash collateral under the Bankruptcy Code. Therefore, the Lender shall petition the bankruptcy court for an Order recognizing its entitlement to the rents under the assignment of rents clause and restricting use of the rents in accordance with the rules governing cash collateral.)

~~D.E.~~ Particularly for Projects/projects under a master lease, it ~~will~~is not be-unusual for a Project/project to be ~~involved~~named in the bankruptcy proceedings without there being a monetary default; ~~however it is still necessary for the Mortgagee/Servicer.~~ In such cases, the Lender is required to work closely with the representatives for the troubled Project/project, and other projects within the master lease, to ensure that the bankruptcy has as minimal ~~ana~~ negative impact as possible on ~~the other projects, its~~ project(s), and to avoid further financial disruption in the ~~other remaining~~ projects in the master lease.

~~E.F.~~ The Mortgagee/Servicer/Lender must provide routine bankruptcy status updates to the assigned AE and/or their designee. The Mortgagee/Servicer/Lender may also be responsible for working with the Risk Mitigation Branch, OGC, DEC and/or a Department of Justice (DOJ) legal team.

G. If there is a change in Operator, the Lender and Borrower are responsible for following HUD procedures for CHOPS.

### 3.10.1514

## Delinquent Mortgage Payments

- A. Delinquent mortgage payments are not only a violation of legal obligations by the Borrower, but are also a sign of financial distress for a Project/project and are to be closely monitored by the Mortgagee/Servicer/Lender. The Borrower is required to notify the Mortgagee/Servicer/Lender if the mortgage payment is delinquent as of the 16<sup>th</sup> of the month.
- B. The Multifamily Delinquency and Default Reporting (MDDR) System will notify the AE of a delinquency after the 16<sup>th</sup> of the month. The AE will reach out to the Mortgagee/Servicer/Lender for a status of the delinquency and expectations of when the payment will be made.
- C. Upon notification of a delinquency, the Mortgagee/Servicer/Lender must work with the Borrower (and Operator, if applicable) to ascertain the financial, operational and/or other

circumstances leading to the non-payment, including, but not limited to evaluating the ability of the Borrower to pay the mortgage, any anticipation of payments to be made, the financial strength of the Borrower (and Operator), recent state survey results, extenuating circumstances and other concerns potentially leading to the delinquency.

- D. The Borrower (and Operator, if applicable) must provide the Mortgagee/Service Lender with an action plan (seeking the Mortgagee/Service Lender's guidance, as necessary and appropriate) if it is not immediately resolved or if the entity(ies) have been delinquent three or more times in the last 12 months. The Mortgagee/Service Lender must then notify the AE of the situation, and provide the AE with an action plan to remedy the delinquency.
- E. The Mortgagee/Service Lender and AEHUD may also, at this time, request and review financial reports from the Project to determine an supplement the action plan.
- F. Once notified of the delinquency, if no action from the Borrower or Mortgagee/Service Lender has taken place by the end of the month, the AE will work directly with the Mortgagee/Service Lender and Borrower to escalate the action plan.
- G. The Mortgagee/Service Lender will monitor any mortgage payment that is over 30 days delinquent until it is paid.
- H. Once a non-payment has aged between 45 to 60 days, and no evidence of payment is anticipated, the Mortgagee/Service Lender must again notify the AEHUD and provide additional information regarding cash flow problems or other circumstances within the Project that have led to the delinquency.

At this stage, the project will be evaluated to determine if a transfer to the Risk Mitigation Branch is warranted and/or to escalate the HUD involvement with the Borrower (and Operator) in an effort to avoid default of the loan. The Project The project will also be monitored until the financial status and mortgage payments return to a stable level.

### 3.10.15

### Unauthorized Distributions

- A. The Borrower must notify their Lender within two (2) business days of receiving a Notification of Unauthorized Distribution by the HUD Financial Assessment Subsystem (FASS).
1. The notification also includes a designated cure period which must be adhered to.
  2. This notification is sent automatically to the email the project registered in the system when an unauthorized distribution has been determined by FASS, as well as to the AE.
  3. The Borrower and, where applicable, the Operator, must provide the Lender with an action plan (seeking the Lender's guidance, as necessary and appropriate), and must

work with Lender to ensure the cure period will be met to resolve the violation, and to further review the circumstances leading to the violation. The unauthorized distribution may be a sign of financial distress that needs to be closely monitored, and an action plan may need to be put in place to do so.

I. ~~For systemic late fees and delinquencies, but not beyond 30 days, the Mortgagee/Servicee may use discretion in involving the AE, but must notify HUD if this occurs more than 6 out of 12 months. These systemic delinquencies may not necessarily warrant transition to the Risk Mitigation Branch nor indicate a "Troubled" project, but further evaluation will be required.~~

4. The Lender must notify the AE if there are extenuating circumstances that are preventing the immediate submission of the action plan, and provide the AE with the action plan expeditiously, and assure that the funds are repaid within the cure period.

B. There are times when REAC/FASS findings trigger contact from the DEC directly to the project. The Borrower is responsible for notifying the Lender within two (2) business days of receipt of a REAC/FASS notification from the DEC.

The Lender will then work with the project to cure the violation or devise an action plan to cure the finding(s), including the AE as appropriate, and communicating with the DEC during the process.

### **3.10.16**

### **Failure to File Financial Statements**

A. The Borrower must notify their Lender within two (2) business days of receiving a Notification of Failure to File Financial Statements by the HUD Financial Assessment Subsystem (FASS).

1. This notification is sent automatically to the email the project registered in the system when an unauthorized distribution has been determined by FASS, as well as to HUD.

2. If there are extenuating circumstances preventing the immediate submission, the Lender will then work with the project to cure the violation or devise an action plan to cure the finding(s), including the AE and the DEC, as appropriate, during the process.

3. Additional information about FASS due dates is located in Asset Management, Chapter 4.

B. Operators are required to submit, on a quarterly and year-to-date basis (or more frequently if specified by HUD), financial statements no later than sixty (60) days after the period covered by the reports, except for reports relating to the final quarter of each year, which shall be submitted no later than ninety (90) days after end of the fiscal year.

1. Operator financial statement data is submitted to ORCF by the Lender using the Healthcare Portal.

- 2850 2. The Lender must advise the AE of extenuating circumstances that are preventing  
2851 submission.
- 2852 3. The Lender will then work with the project to cure the violation or devise an  
2853 action plan to cure the finding(s), including the AE and the DEC, as appropriate,  
2854 during the process.
- 2855 4. Operator financial statement data submitted later than required subjects the  
2856 Borrower and Operator to DEC referral and APPS flags.  
2857

### **3.10.17**

## **Financial Risk Metrics of Operator**

2858

2859 A. Key indicators of the Operator financial statements will be used to monitor performance and  
2860 to measure against future routine reviews. Key indicators include (but are not limited to) the  
2861 following:

- 2862
- 2863 1. Debt service coverage ratio (DSCR) under 1.00 for the Trailing 12 month (T12). If a  
2864 T12 is not available due to missing financials or recent refinances, then the fiscal year  
2865 to date DSCR will be used.
- 2866 2. Excessive aged accounts receivable and/or aged accounts payable.
- 2867 3. Receipt of notification of a payment reduction and/or delay from the State (i.e.,  
2868 Medicaid, Medicare, etc.).
- 2869 4. Request for a reduction or suspension of the R4R deposits due to inability to fund.  
2870  
2871  
2872

### **3.10.18**

## **Lender Assignment of the Note**

2873

2874 Elections by the Lender to assign the note must comply with 24 CFR Section 207.258 and do not  
2875 impact the Lender's responsibilities for entry in the MDDR system or the assignment/claim  
2876 requirements in 24 CFR Sections 207 and 232.

2877

2878 Per the CFR, Lender must request a 90-day extension (in 30 day increments) of the deadline for  
2879 filing the notice of an election to assign, and during this period must assist the Borrower and  
2880 HUD in curing the default and averting an insurance claim. Lender must provide updates at least  
2881 monthly. Lenders should direct all communications concerning these matters to ORCF's Risk  
2882 Mitigation Branch.  
2883  
2884

### **3.10.19**

## **Other Circumstances**

2885

2886 The Operator and/or Borrower must notify the Lender of any circumstance not addressed above  
2887 that would place the financial viability of the project at substantial and imminent risk. The  
2888 Lender must notify HUD about any circumstances that have negatively impacted the project.  
2889 Examples include property damage from natural disasters, failure to meet Home and Community  
2890 Based Settings Rule requirements and project quarantines.

DRAFT

## Section 3.11

### Changes in Flood Insurance

#### 3.11

#### Change in Flood Insurance

- A. Life-of-loan monitoring for a change in floodplain status is required for every Section 232 mortgage. Because floodplain conditions may change over time, the status of a zone may change. As a result, unless HUD already requires flood insurance for improvements outside the Special Flood Hazard Area for the life of the mortgage, the Lender must obtain from its flood zone determination firm "life-of loan" monitoring and coverage. Life-of-loan monitoring coverage means that the monitoring company will notify the Lender if and when flood insurance is required regardless of whether it was initially required at the time of loan inception. The Lender must ensure that the monitoring company agrees to continue monitoring for all of the covered Properties in the event the Lender sells or otherwise transfers its servicing rights to another Mortgage Loan servicer.
- B. The Lender must ensure that flood insurance is promptly obtained if any property improvements are determined to lie within a re-mapped Special Flood Hazard Area (SFHA), at any time during the course of the loan. Flood insurance must comply with the requirements in Production, Chapter 14.
- C. The Lender must promptly notify HUD of any change in Flood Hazard Insurance requirements as a result of the life-of-loan monitoring and provide evidence that flood hazard insurance has been obtained, if required as a result of a re-mapping change, in accordance with requirements for flood hazard insurance as stated in Production, Chapter 14.