

8

## 13.1

## Introduction

9 HUD has worked diligently to ensure its insurance fund remains stable by addressing the  
10 concentration of credit with any single operator. In 2001, HUD issued new processing  
11 procedures for multiple-facility applications. Although each facility is still evaluated  
12 individually, borrowers face increased scrutiny when they seek financing for multiple facilities  
13 ~~within an 18-month time frame.~~

14  
15 HUD ~~will now require~~requires a master lease ~~for when~~ three or more properties and/or \$15  
16 million or more in aggregate loans to projects under the same ownership are submitted to HUD  
17 for FHA mortgage insurance within the same 36-month time period.

18  
19 The HUD master lease structure ties together the operating leases from each healthcare facility  
20 that makes up a portfolio into one master lease. The HUD master lease requires each facility  
21 operator to allow available funds from its project to be used for any other project in the master  
22 lease portfolio that is unable to generate adequate cash flow to make required lease payments to  
23 supplement any liquidity shortfalls. This includes portfolios that may have more than one master  
24 lease due to the use of minority partners or multiple lenders. Master leases are an important tool  
25 used to lessen the financial risk posed by a portfolio and ~~provides~~provide assurance that all  
26 portfolio project resources are available to financially support troubled projects. Master leases,  
27 along with portfolio corporate credit reviews (see Production, Chapter 17) are the primary tools  
28 the Office of Residential Care Facilities (ORCF) uses to identify and mitigate concentration risk  
29 associated with portfolio projects.  
30  
31

## 13.2

## Terms and Concepts

32  
33 **Portfolio:** Two or more borrower entities or two or more operator entities that are under  
34 ~~common ownership and/or~~ common control.

35  
36 **Common Control:** Is exhibited by any individual(s) or entity(ies) that controls the Borrower  
37 and/or operator regardless of the percentage of ownership interest, so long as the individual(s) or  
38 entity(ies) comprise each Borrower and/or operator. Affiliated residential care facilities and/or

39 healthcare operating entities will be grouped into a portfolio if they share common control as  
40 defined here. ~~The type of corporate credit review will depend in part on the size of the combined~~  
41 ~~mortgage amount of the portfolio~~

42  
43 **Single Asset Entity:** For each individual project, the mortgaged property shall be the only asset  
44 of the Borrower and Operator (please see Production, Chapter 2.5.B and 2.5.C for SAE  
45 requirements).

46  
47 **Affiliates/Affiliated:** Any person or business concern that directly or indirectly controls the  
48 policy of a principal or has the power to do so.  
49  
50

## 13.3

## Policies and Guidance

### A. Purpose of Master Lease

51  
52  
53 FHA approves mortgages for individual properties. However, more and more mortgages  
54 approved by FHA have a common or corporate ownership structure, which significantly  
55 increases the concentration risk for FHA should the parent ownership entities encounter  
56 significant financial, market or legal risks. In order to counteract the additional risks, ORCF  
57 has determined that owners of multiple properties must provide additional support in the  
58 form of a master lease.  
59

#### The purpose of utilizing a master lease structure is twofold:

- 60  
61  
62 1. To provide a mechanism for a master tenant to access available profit from any of the  
63 other facilities that are a party to the master lease in order to assist an individual  
64 property that may be experiencing inadequate cash flow to meet its financial  
65 obligations.
- 66  
67 2. ~~The master lease is also a tool to~~To ensure that in the event of a bankruptcy that all  
68 project obligations are utilized to maximize HUD's recovery.

69  
70 A master lease is not a traditional cross collateralization of all project collateral (which would  
71 be an accepted practice for a bank loan, a Commercial Mortgage Backed Securities (CMBS)  
72 or a bond-financed facility). For FHA-insured projects, the master lease is a cross default of  
73 only the individual subtenants. A master lease reduces the risk of “cherry picking” – a  
74 practice in which the subtenants of multiple FHA-insured facilities maintain the lease in  
75 financially successful projects while rejecting the leases of poorly performing projects. A  
76 master lease can prevent “cherry picking” in that the master lease is an indivisible lease  
77 ~~which~~that requires a debtor in bankruptcy to accept all leases or reject all leases included  
78 within a master lease.

### B. Description of the Master Lease

79  
80 A master lease is a primary lease that controls subsequent leases. The master tenant will  
81 sublease its interest to a subtenant operator. All subtenant operators are subject to the master  
82 lease. A master lease essentially ties together multiple facilities with the same ownership.

83  
84  
85  
86  
87  
88  
89  
90  
91  
92  
93  
94  
95  
96  
97  
98  
99  
100  
101  
102  
103  
104  
105  
106  
107  
108  
109  
110  
111  
112  
113  
114  
115  
116  
117  
118  
119  
120  
121  
122  
123  
124  
125  
126  
127  
128  
129

Under each sublease, the operator will be obligated to pay to the master tenant a minimum of base rent plus reserves and escrows owed by the borrower on the FHA-insured loan. Each operator will sign a Cross-Default Guaranty of Subtenants, pursuant to which each operator guarantees to the master tenant the performance of the obligations of the other subtenants under their collective subleases. If any subtenant defaults on any single sublease, that default would trigger a default on the master lease and all subtenants.

It is not in FHA’s interest for a default to occur for all subtenants, so it has provided a mechanism to provide a reasonable timeframe for the master tenant and the parent operator to correct any deficiencies and/or cure a default to the project as long as there is not a substantial and imminent risk of a revocation or termination of the license or other necessary permits or approvals.

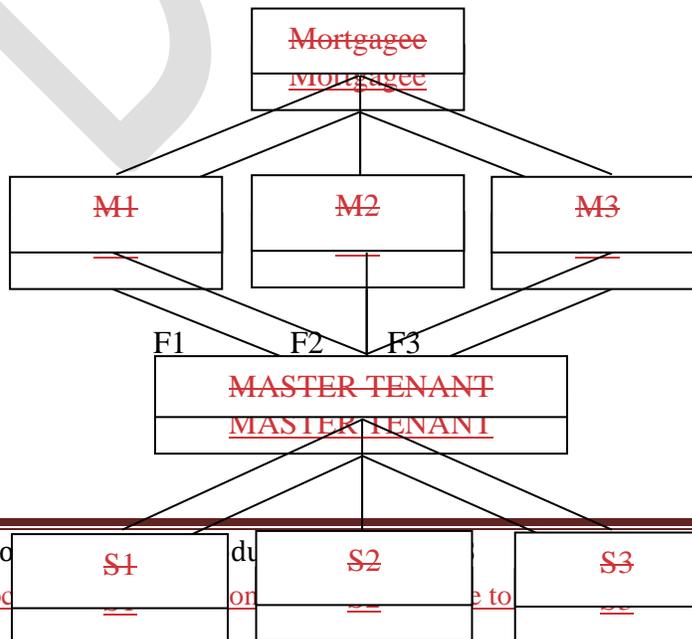
**C. Underwriting of Projects included in a Master Lease**

Each mortgage insurance application must meet FHA’s underwriting standards on its own merit. HUD does not permit a master lease structure to be used to justify the approval of applications for mortgage insurance for fundamentally weak projects, and HUD will not accept the premise that “the strong projects will take care of the weak projects.” As with all FHA projects, each loan will have a separate note for each borrower and each note will be secured by its own security instrument. FHA does not cross collateralize the real estate of projects included in a master lease structure.

**D. Master Lease Structure**

Under the master lease arrangement, the Borrower for each property included in the master lease is collectively known as the landlord. The landlord enters into a master lease with the master tenant. The master tenant will enter into a separate operating sublease with each healthcare project operator entity. Each sublease will be included in the master lease. ~~Each subtenant operator therefore enters into a separate lease agreement with the entity that owns the facility (i.e. the landlord).~~

Master Lease Structural Map



130  
131  
132  
133  
134  
135  
136  
137  
138  
139  
140  
141  
142  
143  
144  
145  
146  
147  
148  
149  
150  
151  
152  
153  
154  
155  
156  
157  
158  
159  
160  
161  
162  
163  
164  
165  
166  
167  
168  
169  
170  
171  
172  
173  
174  
175

The chart above describes the master lease structure. The chart demonstrates that the mortgagee issues a note and provides a mortgage for each individual standalone project (M1, M2 M3). Each individual standalone project is then leased to the master tenant via the master lease. The master tenant ~~leases all of the facilities and then~~ enters into subleases (F1, F2, F3) for each subtenant (S1, S2, S3).

The master lease and the related subleases are subordinate to the FHA-insured mortgage. The master lease should be structured so that additional properties may be added later to the master lease in connection with future FHA-insured loan transactions upon approval by HUD.

Note: ~~Portfolios~~A group of projects financed through a CMBS often have provisions that allow projects to be removed from their master lease into one with an FHA-insured mortgage.

**E. Alternative Forms of Project Structures and Variations in Master Lease Structures**

The basic master lease structure described above may not always be appropriate due to other factors such as follows:

- Multiple Minority Owners
- Multiple Operators
- Multiple Lenders
- Legal Restrictions
- Contractual Restrictions

**1. Multiple Minority Owners**

For projects that have majority common owners but have a limited number of minority owners, the master lease structure will be used but with minor modifications. The master lease project cash flows may be segmented so that minority partners do not need to share their minority profit with other projects where they do not have an ownership interest. However, the majority owners’ profit will be pledged to all projects in the master lease. If there is more than one master lease, the majority owners will pledge their profit to support all master leases.

If the minority ownership interests are different between projects or there is more than one non-related minority partner, the carve-out amounts shall be proportionally determined. The master lease should have a provision that if the minority ownership position is purchased or obtained by the majority owners, the master lease will be changed to reflect that the interests of the majority partners is 100% or whatever the ownership position is determined to be. Any related party to the minority party after the buyout shall be considered the common majority owner.

176 HUD understands that the ownership interests of multiple facilities can vary due to  
177 the inclusion of minority interests in differing ownership entities. ORCF has  
178 structured master lease transactions with unique and atypical circumstances. HUD  
179 has been able to achieve creative solutions in consultation with lenders and OGC to  
180 structure master lease documents that protect HUD’s interest while not interfering in  
181 the legal rights of or fairness to minority ownership interests.

182  
183 **See the Pledge of Cash Flow Model in Appendix 13.1 for a sample diagram.**

184  
185 **2. Multiple Operators**

186 For projects that have multiple third-party operators, such as REITS, a master lease  
187 can be constructed for only those units that are leased to one operator. HUD  
188 recognizes that one operator cannot and should not be liable for the financial  
189 obligations of another unrelated third-party operator. However, the owner is not  
190 excused from its obligation to provide financial support to all troubled projects. If  
191 there is more than one master lease for a common ownership group due to different  
192 operators, the majority ownership group will pledge their profit from all master leases  
193 constructed with different operator entities to support all of the projects that are  
194 subject to each of all master leases. This may be accomplished through a master  
195 landlord.

196  
197 **See the Master Landlord Structure in the Appendix 13.2 for a sample diagram.**

198  
199 **3. Multiple Lenders**

200 If the same borrower uses multiple lenders for its financing, the borrower will be  
201 allowed to enter into a separate master lease ~~with~~for each lender. The duties and  
202 obligations of each lender may conflict if projects within one master lease have  
203 differing requirements or need to utilize funds or obligations under the control of a  
204 different lender. HUD does not support allowing one lender to interfere with another  
205 lender’s master lease ~~terms~~ in a manner that could jeopardize the viability of another  
206 lender’s projects that are performing under a separate master lease for a different lender  
207 that is meeting all of its performance obligations.

208  
209 In such situations, a master lease for each lender with subordinate cross-default  
210 guarantee agreements may be a suitable alternative.

211  
212 **See Multiple Lender Master Lease Alternative diagram in Appendix 13.3.**

213  
214 Also, the master leases ~~from~~for different lenders may contain a provision that a  
215 default under one master lease may constitute a default under all master leases if  
216 HUD, in consultation with all lenders, determines that a cross-default provision  
217 should be ~~exercised~~included.

218  
219 **F. Alternatives to Master Lease. The master lease requirement applies to projects that are**  
220 **utilizing, or will utilize, a lessee-operator “PropCo/OpCo” structure. HUD understands that**  
221 **there may be a limited number of situations where a master lease is not feasible due to**

external factors such as jurisdictions where a master lease would be inconsistent with State law or the projects have no operating lease. In those cases, HUD will impose alternative risk mitigation requirements. HUD looks to an alternative means of mitigating the concentration of risk inherent in the common ownership (e.g., a Limited Guaranty and Security Agreement will generally be required on Principal ownership interests of 25% or greater).

### 1. Legal Restrictions

HUD understands that there may be a limited number of situations where a master lease is not feasible due to external factors such as jurisdictions where a master lease would be inconsistent with State law ~~or would be subject to onerous asset transfer taxes.~~ In those cases, HUD will impose alternative risk mitigation requirements.

If there are legal restrictions or other legal provisions that effectively negate the advantages of the master lease structure, the lender and HUD must seek comparable ~~remedies that offer the utmost protection to~~ HUD's ~~interest by ensuring that provisions are~~ interests. Provisions may be adopted in the form of guarantees that provide a means by which profit from projects performing successfully ~~to~~ will be utilized to support projects that are unable to meet their financial obligations. ~~If comparable protections are not available, HUD reserves the option not to approve the portfolio.~~ HUD may compensate for the loss of protection normally achieved by master leases by requiring, without limitation, cross guarantees, corporate guarantees, increased debt service reserves, more stringent underwriting criteria for debt service coverage and loan to value, and/or restrictions on surplus cash distributions. If none of these comparable protections are available, HUD reserves the option not to approve the portfolio.

~~In the event that the lender has additional issues or restrictions that interfere with executing a standard master lease, the lender should contact the Director of ORCF to work with the lender and OGC to try to structure reasonable modifications that will permit HUD's objectives to be met while accommodating any unique needs of the portfolio.~~

### 2. Contractual Restrictions

In the event that existing contractual arrangements, such as credit facilities, do not permit a traditional master lease structure, a HUD-acceptable alternative will be required. HUD may consider alternative structures that will provide equivalent protection. If HUD determines that the proposed alternative mechanism is satisfactory, then HUD may accept the projects for mortgage insurance.

In the event that the lender has additional issues or restrictions that interfere with executing a standard master lease, the lender should contact the Director of ORCF to work with the lender and OGC to try to structure reasonable modifications that will permit HUD's objectives to be met while accommodating any unique needs of the portfolio.

~~F. Alternatives to Master Lease. The master lease requirement applies to projects that are utilizing, or will utilize, a lessee operator "PropCo/OpCo" structure. For organizational structures with no operating lease, however, HUD looks to an alternative means of mitigating~~

268 ~~the concentration of risk inherent in the common ownership (e.g., a Limited Guaranty and~~  
269 ~~Security Agreement).~~

## 270 13.4

## 271 Master Lease Criteria

272 The master lease procedures that are applicable to for-profit and non-profit owners and operators  
273 of residential care facilities are stated below.

274 ~~A. A master lease will be required where there is:~~

275 ~~A. The types of transactions that could trigger the requirement for a master lease (“applicable~~  
276 ~~transactions”) include:~~

- 277 1. An application for mortgage insurance for purchase or refinance of an existing facility  
278 pursuant to Section 223(f);
- 279 2. An application for mortgage insurance involving new construction or substantial  
280 rehabilitation pursuant to Section 232 NC/SR;
- 281 3. An application for mortgage insurance for refinance of an existing FHA-insured  
282 facility currently in a master lease pursuant to Section 223(a)(7);
- 283 4. ~~A transfer~~Change of physical assets (TPA);~~Participants (CHOP) of the facility owner;~~  
284 or
- 285 5. ~~A change in control~~CHOP of ~~the~~ facility operator. This will generally be a change in  
286 the lessee of a facility, a change in the operating license holder, or a change in the  
287 operating entity that provides patient care to residents (a management agent in some  
288 circumstances).

289 B. A new master lease and/or ~~an addendum~~ a joinder to an existing master lease will ~~also~~ be  
290 required when:

- 291 1. ~~A~~An applicable transaction includes three or more properties and/or \$15 million or  
292 more in aggregate mortgage amount (meeting either threshold is sufficient);
  - 293 a. The borrowers will either be under same ownership or a majority ownership  
294 individual or group will control the properties; and/or
  - 295 b. The operators of each property will be ~~a lessee~~lessees with the same ownership;  
296 and
- 297 2. The applications for mortgage insurance are submitted within any rolling 36-month  
298 timeframe that begins when the first application is assigned to an ORCF underwriter.  
299 The submission of an application creates an open window for a master lease.  
300 Subsequent application received within 18 months from the last project~~The window~~  
301 remains open for 36 months following the start of processing of the most recent  
302 application. Thus, for multiple submissions, the cumulative open window may be  
303 longer than 36 months from the first application to the last. This 36-month timeframe  
304 may be expanded, or a master lease alternative required, at the discretion of ORCF  
305 where necessary, to accomplish the intent of a master lease and to fully evaluate the  
306 risk to the General Insurance Fund.

312 2.3. Also, when subsequent application(s) are received with the same ownership and  
313 operating structure as an existing FHA-insured portfolio with a master lease in place,  
314 that property must be added to the existing master lease. In cases where there are  
315 different minority owners, different operators or different lenders, refer to the  
316 guidance in Section 13.3.E. above - Alternative Forms of Project Structures and  
317 Variations in Master Lease Structures; ~~and,~~

318 ~~3. The applications for mortgage insurance are submitted within any rolling 18-month~~  
319 ~~timeframe that begins when the first application is assigned to an ORCF underwriter.~~  
320 ~~The submission of an application creates an open window for a master lease. The~~  
321 ~~window remains open for 18 months following the start of processing of the most~~  
322 ~~recent application. Thus for multiple submissions, the cumulative open window may~~  
323 ~~be longer than 18 months from the first application to the last.~~

324  
325 ~~This 18-month timeframe may be expanded, at the discretion of ORCF where~~  
326 ~~necessary, to accomplish the intent of a master lease and to fully evaluate the risk to~~  
327 ~~the General Insurance Fund.~~

328  
329 The master lease must be in place at closing for all projects that meet ~~any of~~ the above criteria.  
330 The master lease is required regardless of whether the borrower and operator are ~~either~~ identity-  
331 of-interest ~~or independent or third party~~ entities.

332  
333 The master lease requirement applies to newly insured facilities, CHOPs and TPAs. ~~existing~~  
334 ~~insured facilities currently in a master lease. If existing insured facilities meet the above criteria~~  
335 ~~but are not currently in a master lease, HUD will not reach back and require that existing FHA-~~  
336 ~~insured those facilities be placed in a new master lease except when they are within a portfolio of~~  
337 ~~properties submitted for financing or refinancing within the open window, or if unless credit~~  
338 considerations on a new transaction would otherwise warrant a master lease requirement being  
339 imposed as a risk mitigant.

340  
341 The master lease shall only include facilities with mortgages insured by FHA under the Section  
342 232 program. Projects with affiliated ownership that are not insured under Section 232 shall not  
343 be included in a HUD master lease.

## 344 345 346 **13.5**

## **Term of Master Lease and Subleases**

347  
348 The master lease is meant to mitigate the concentration of risk for the term of the mortgages to  
349 which the master lease applies. Accordingly, it is expected that the master lease shall run at least  
350 as long as the mortgage having the longest remaining term.

351  
352 HUD recognizes that in some situations such an initial term may not be feasible, such as where,  
353 for example, the operator entities and ownership entities are unrelated parties, or where state law  
354 would prohibit or impose substantial negative financial consequences on such a long-term lease.  
355

356 In such situations, the lender must provide the basis for that determination and propose an  
357 alternative ~~term~~term that addresses HUD's long-term intent. Any proposed alternative structure  
358 shall, at a minimum, specify that:

- 359
- 360
- 361 1. Unless HUD approves otherwise, the subleases shall each be, and remain,  
362 coterminous with one another, and
- 363 2. Each borrower's Regulatory Agreement will include an addendum to be approved by  
364 HUD requiring that in the event the master lease will terminate prior to the maturity  
365 date of the FHA-insured mortgage, the borrower shall enter into a new master lease  
366 with another party acceptable to HUD covering all subject properties prior to the  
367 expiration of the existing master lease.
- 368

369 ~~The master lease shall only include facilities insured by FHA under the Section 232 program.~~  
370 ~~Projects with affiliated ownership that are not insured under Section 232 shall not be included in~~  
371 ~~a HUD master lease.~~

## 372 13.6

## 373 Master Lease Review

374 HUD has developed a series of approved legal documents that are required to be utilized for  
375 master lease transactions.

376

377 ~~The legal documents are as follows~~include the following and are available on the Section 232  
378 Program website:

- 379
- 380
- 381 1. Cross-Default Guaranty of Subtenants,
- 382 2. Guide for Opinion of Master Tenant's Counsel,
- 383 3. Healthcare Regulatory Agreement - Master Tenant,
- 384 4. Master Lease SNDA,
- 385 5. Master Lease Addendum,
- 386 6. Master Lease Estoppel Agreement, ~~and~~
- 387 7. Master Tenant Security Agreement, ~~;~~
- 388 8. Master Tenant Assignment of Leases and Rents,
- 389 9. Limited Guaranty and Security Agreement (if applicable), and
- 390 10. Subordinate Cross Default Guaranty (if applicable).
- 391

392 Also required, Uniform Commercial Code financing statement and fixture filing for applicable  
393 state.

394

395 HUD requires a ~~Master Lease Review Package~~master lease review that must include the items  
396 listed above, ~~as well as the items listed on the applicable checklist.~~ For ~~midsize and~~ large  
397 portfolios, the master lease documents must be in final form prior to any applications being  
398 submitted to the queue. To that end, ~~both OGC and~~ORCF will review the information to  
399 ~~insure~~ensure that it meets HUD's requirements prior to the application being submitted to the

400 queue.

401

402 For small portfolios, ~~prior to the ORCF Loan Committee and the issuance of a Firm Commitment,~~  
403 ~~both~~ the OGC closing attorney and ORCF underwriter will review the ~~information~~ master lease  
404 documents with the other draft closing documents to ensure that ~~it meets~~ they meet HUD's  
405 requirements.

406

407 Notwithstanding the above, the lender and the borrower are responsible for ensuring that all HUD  
408 requirements are met. Please label and ~~tab~~ arrange all ~~hardcopy~~ materials following ~~this~~  
409 ~~outline~~ ORCF guidance, and submit these documents to ORCF. **HUD's review of documents can**  
410 **be expedited by indicating if the HUD master lease form documents are being used without**  
411 **any requested revisions.**

412

413

414 A. Lender shall provide a narrative ~~which~~ that describes, in general, the following:

415

- 416 1. The terms and conditions of the master lease;
- 417 2. Any waiver or other requests for modifications to the master lease regime that deviate  
418 from the standard requirements specified in the HUD forms, policies or practices for  
419 master leases;
- 420 3. Any proposed payments (fees, income, etc.) to or from the master tenant;
- 421 4. The lease agreements between borrower and the master tenant, and the lease  
422 agreements between the master tenant and the subtenants;
- 423 5. The collection and flow of funds from the subtenants to the master tenant and from  
424 the master tenant to the borrower. Include the involvement of funds flow with the  
425 ARA/R lender if an ARA/R lender is providing ARA/R loans to the project; and
- 426 6. A diagram or other visual depiction of the flow of funds from each Operator to the  
427 master tenant to the Borrower. Specify the depositories for each individual project  
428 funds, as well as for the master tenant as applicable. Refer to Chapter 16 for  
429 DACA/DAISA guidance.

430

431 B. Lender shall provide a spreadsheet with the following:

432

- 433 1. The names of the facilities to be included under the master lease;
- 434 2. The proposed mortgage amount for each facility;
- 435 3. The ~~recommended~~ appraised value of each facility;
- 436 4. The proposed debt service coverage ratio for each facility including the mortgage  
437 insurance payment;
- 438 5. The number of beds at each facility;
- 439 6. The CMS Star Rating at each facility, if applicable;
- 440 7. The current balance of each facility's replacement reserve account; and
- 441 8. Any other reserve funds that will be available to the owner/operator to fund project  
442 costs.

443

444 C. Description of the Legal Structure: A narrative shall be provided describing the legal  
445 structure of the borrower or master landlord entity, the master tenant, and the operating

446 entity/subtenant. The legal structure description must disclose all tiers of ownership. If the  
447 Borrower or Operator has multiple tiers of ownership, the narrative shall include a diagram  
448 or chart identifying all parties and their relationship to one another and any conflicts of  
449 interest between the parties.

450  
451 D. ORCF Review: ORCF, ~~in cooperation with OGC~~, will review the following items to ensure  
452 agreement with the contents of the lender's application:

- 453 1. Master Lease and Subleases;
  - 454 2. Base rent amount;
  - 455 3. Escrow amounts (for example, taxes, MIP, property insurance, etc.);
  - 456 4. Term of the master lease;
  - 457 5. HUD--mandated immediate and/or critical repairs;
  - 458 6. HUD--required replacement reserves; and
  - 459 7. Any other required reserves.
- 460