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Operating Loss Loan 223(d) – COVID Firm Commitment Update

The Operating Loss Loan 223(d) – COVID Firm Commitment has been updated ([here](https://www.hud.gov/sites/dfiles/Housing/documents/Firm223d-COVID.docx)) to include language on escrows. Please see the updated Firm Commitment for more details.

***Keywords:*** *COVID, 223(d)*

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Clarifications on Decision Circuit Financial Tables and Net Operating Income

ORCF recognizes that COVID-19 has impacted financial performance of healthcare facilities, and these financials will be included in applications going forward for the next several years.  ORCF is providing the below guidance for lenders when submitting financial tables on applications.

* Historical Financials:
	+ Include actual historical financials including any temporary COVID-19 rate, expense, or census changes.  Describe and analyze impact to the project’s financial history and trends in the Lender Narrative.
	+ Do not include large capital expenditures.
	+ Do not include stimulus funds.
	+ The lender is free to show adjusted financials in the yellow highlighted optional reporting period columns.
* Appraisal Column:
	+ Take directly from the appraisal.
	+ Assumes a typical market owner.
* UW Column:
	+ Assumes actual owner/operator.
	+ Assumes No COVID-19 revenue or non-recurring expenses, but assumes actual taxes, Reserve for Replacement, etc.
	+ Include increases in ongoing expenses that have resulted from COVID-19 (e.g., additional infection control expenses) and are anticipated to continue into the future.
	+ The Lender Underwriting column should be more reflective of historic operations that do not include temporary shifts in revenue and expenses.

***Keywords:*** *Financial Tables, Net Operating Income (NOI)*

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Cashflow Stress Test Instructions Reminder

Lenders are reminded to review and follow the instructions on the Instructions tab of the Cashflow Stress Test when completing the workbook information:

Terms:  Most of the inputs are self-explanatory and should represent the information submitted in the application.

* Forgivable Aid/Relief:  List the remaining balances of any forgivable aid or relief the Operator has received to assist in meeting financial needs during the COVID-19 national emergency.

Analysis:

* Income Categories: The income labels in this section should mirror those identified in the decision circuit and/or lender narrative table.

Actual or Estimated Column Designations:

* If you have Actual Income supported by a financial statement, select Actual and input actual census and income detail.
* COVID Revenue sources should not be included, for example stimulus or business interruption insurance proceeds should not be included.
* Medicaid rate reimbursement increases for COVID should not be included.  Only typical, long-term Medicaid rate increases may be included and considered.
* If you only have Actual Census Data, choose Estimated and input the actual census days.  DO NOT ALTER THE EXPENSE FORMULAS.
* Current Month:  If it is after the 15th of the current month, gather actual to-date monthly census data from the facility and extrapolate the data to estimate the full month census.  DO NOT ALTER EXPENSE FORMULAS.

Appraisal Column:  The income and census data for this column should reflect 1/12th (the average monthly) of the annual income, expenses (including reserves) and census from the appraisal.

Lender (for DSCR) Column:  The income and census data for this column should reflect 1/12th (the average monthly) of the annual income, expenses (including reserves) and census used to determine the Net Operating Income (NOI) used for the Lender's Debt Service Coverage Ratio (DSCR) underwriting.

Expenses:

* Input the monthly operating expenses, including replacement reserves, for the reported period.
* For Actual months, the underwritten amount for replacement reserves should be included.
* For Estimated months, the template will default to the Lender's assumption for DSCR.
* One-time COVID expenses may be removed, but ongoing, recurring expenses must be included.

***Keywords:*** *Cashflow Stress Test*

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Quality of Care/Survey Issues

A successful performance record includes a history of providing quality of care. Lenders are reminded that they must present evidence that owners and operators have the *demonstrated ability* to provide strong quality of care to the facility’s residents. Quality of care is addressed in the Section 232 Handbook, Section II, Production, Chapter 8, Section 8.8 ([here](https://www.hud.gov/sites/documents/42321S2C8HSGH.PDF)), in the underwriting Lender Narratives and in various Email Blasts including our February 26, 2020 ([here](https://www.hud.gov/sites/dfiles/Housing/documents/FebEmailBlast02262020.docx)) and December 18, 2019 ([here](https://www.hud.gov/sites/dfiles/Housing/documents/DecEmailBlast12182019.docx)) Blasts.

As outlined in the underwriting Lender Narratives, when data suggest either recent quality-of-care concerns or a patternof such concerns, the Lender must provide a detailed explanation of the analysis supporting their quality-of-care recommendation. Examples of quality-of-care indicators that ORCF has found concerning include:

1. 1 Star or 2 Star CMS rating for overall or health inspections,
2. “G” or Higher survey tags in the past 2 years,
3. Instances of abuse or neglect in the past 2 years, or
4. Other care related issues.

When an application has presented such concerns, ORCF has looked to the lender’s analysis of how the matters have been well addressed. Such analyses have included (and should at a minimum include) identifying:

1. Specific, remedial steps the operator has taken to improve the overall quality of care, addressing the specific survey tags and quality of care in general.
2. Evidence that these steps have led to improved care and survey results.
3. Explanation for survey and Star ratings issues at other owned or operated facilities, and Star Ratings including detailed information on any Denials of Payment or Civil Money Penalties

Additionally, it has become common practice for lenders to propose a one-time third-party on-site risk assessment when quality-of-care concerns such as those above exist. ORCF has found the practice useful. ORCF encourages Lenders to obtain such an assessment *pre-submission* when quality-of-care concerns exist; such assessment can inform the lender’s analysis and position ORCF to reach a decision more promptly. A one-time risk assessment would be expected to include:

1. Review of both operational and clinical processes
2. Review of the environment for liability risk exposures
3. Identification of operational and clinical opportunities
4. Recommendations for improvement of operational and clinical processes
5. Development of a strategy to implement the recommendations

The recommendations in the one-time risk assessment should be used to strengthen the required risk management program described in the Lender Narrative. Additionally, in summarizing the assessment and its recommendations, the lender should explain which, if any, recommendations have not been followed and why.

Lenders have sometimes addressed quality-of-care concerns not only by establishing how processes have recently improved but also by using a “Quality-of-Care Escrow Agreement” (comprised of non-mortgageable funds). Such an escrow can be a helpful mitigant; it involves the borrower’s own funds and its release is tied in part to sustained favorable quality-of-care indicators.

***Keywords:*** *Quality of Care, Underwriting, Operator and Management Analysis, Lender Narrative*

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Supplemental Income Sources

ORCF has previously communicated use of conservative underwriting and loan sizing with regard to supplemental income sources such as Upper Payment Limit (UPL), Intergovernmental Transfer (IGT), Quality and Accountability Supplemental Payment (QASP), Quality Incentive Payment Program (QIPP), or other similar income sources (See, for example, the Blasts of [February 24, 2021](https://www.hud.gov/sites/dfiles/Housing/documents/FebEmailBlast02242021.docx), [June 24, 2015](https://www.hud.gov/sites/documents/JuneEmailBlast062415.doc) [June 27, 2012](https://www.hud.gov/sites/documents/HUDLeanBlastJun272012.doc)). In the current reimbursement environment, many of these programs appear to be at increased risk of continuing in the long term, and Lenders are reminded that additional underwriting scrutiny is applied as the percentage of NOI derived from supplemental income sources increases, and conservative underwriting represents having little to no inclusion of these revenue streams in value for loan sizing, given the long-term nature of Section 232 insured mortgages.

***Keywords:*** *Underwriting,* *Supplemental Income*

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Borrower/Operator Experience requirements

ORCF has long emphasized the importance of Lenders carefully assessing Borrower and Operator qualifications for participating in the Section 232 Program. This matter is addressed in multiple locations in the Section 232 Handbook (See Section II, Production, Chapter 2, Section 2.5.FF ([here](https://www.hud.gov/sites/documents/42321S2C2HSGH.PDF)) and Chapter 8, Sections 8.1 and 8.4 ([here](https://www.hud.gov/sites/documents/42321S2C8HSGH.PDF)) and is required in the applicable Lender Narrative. An established successful track record of and commitment to ownership and, as applicable, development, marketing, lease-up, and operations of the proposed facility type, continue to be critical for successful participation in the Section 232 program.

Recently, ORCF has received numerous lender narratives that fail to establish the experience appropriate to the particular transaction. Examples of concerning issues are below. Lenders should consider these issues carefully before submission, as they can impact the acceptability of parties and of the transaction overall.

One such area of concern regarding experience relates to *recent acquisitions*. Given market, regulatory and funding variations, the facility *types* and facility *locations* relied on for experience are key. Thus, substantial experience with the subject facility itself is most directly relevant. Where that experience is limited (as with an acquisition in the past three years), ORCF looks for borrower/operator recent experience operating the same type of facility in the same state or market as the subject application.

Additionally, if the application is underwritten on an improvement in operations as a result of the new Borrower or Operator taking over the property, ORCF considers the evidence presented of operational improvements in borrower/operator’s other similar properties in the same state. The operator must have a proven track record of successfully improving and then maintaining operations. ORCF considers not general assertions but specific evidence of such a track record. For example, ORCF looks for evidence in the Lender Narrative of other similar specifically identified projects, evidence such as operating metrics over the time period (3 or more years) including before, during and after transition to the new operator. Relevant metrics include, without limitation:

1. Revenue
2. Net Operating Income
3. Number of beds, units, or residents
4. Occupancy
5. Star rating (as applicable)

Another area of concern regarding experience relates to construction projects, which present additional risk to the FHA-insurance fund as the project moves through the construction, lease-up and operations stabilization phases. As a result of these riskier project phases, the Lender Narrative should thoroughly address the Borrower’s depth of experience and ability to successfully complete the construction and lease up of the proposed project. For example, discussing how the proposed borrower principals (or in the case of a joint venture, the borrower team) will participate in the project, and providing evidence of having at least three years of experience successfully operating multiple projects of the same care type, in the same market. As a reminder, the experienced participants must have experience marketing, operating, developing, and leasing up the types of beds and units proposed (Please see Handbook 4232.1, Section II, Chapter 2.5.FF). Experience of a Management Agent or Operator is not an acceptable mitigant to offset the Borrower’s lack of experience.

Finally, some lenders have seen their transactions delayed and the participation of a particular party denied based on (i) the party’s track record and (ii) HUD concerns related not only to ability, but to *reliability* of a particular party. A key concern in a participant’s experience track record is evidence of unreliability. In that regard, proposed participants with prior convictions of fraud or other types of activities indicative of reputational risk, particularly related to healthcare facilities, may not be permitted to participate in the Section 232 Program. This is in addition to Previous Participation requirements in Housing Notice 16-15.

***Keywords:*** *Underwriting*

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Recent Purchases and Short-Term Turnaround Projects

With increasing frequency, ORCF is receiving applications for facilities that the borrower acquired recently (within the past three years) either as a distressed asset with poor financial performance, or where the new borrower projects significant increases over the facility’s historic financial performance.

As a reminder, Lenders must review the annual and trailing 12-month financial statements to assess the project’s financial performance, and must base underwritten income and expenses on a consideration of historic and trailing twelve-month performance. Changes in recent performance relative to historic performance must be carefully reviewed to assure conservative underwriting (Please see Handbook 423.21, Section II, Chapter 2.9.N). For example, a project that was recently purchased but has not yet achieved or sustained operations at the underwritten NOI for value loan sizing may not represent conservative underwriting, and a reduced loan sizing may be appropriate to reflect the additional risk of the transaction.

***Keywords:*** *Underwriting,* *Recent Purchase*

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Limited Debt Seasoning Exception Projects

HUD Handbook 4232.1, Section II, Chapter 3.13.D, states that “Consideration for less than two years seasoning requires value supported by a third-party appraisal and 3+ years of stabilized historical cash flow which supports the value.” To clarify, stabilized cash flow refers to projects where there have been no ownership or operator changes and projects where there have been no changes in operational model or bed capacity in the last three years.

***Keywords:*** *Underwriting,* *Debt Seasoning*

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Guidance for Lenders Reporting Quarterly Operator Financials in the 232 Healthcare Portal In Special Situations

Certain triggering events impact how quarterly Operator financials should be reported by the Lender:

* **New Loans:** Beginning with the first complete quarter AFTER Final Endorsement, the Operator Regulatory Agreement, Paragraph 20 (c), requires Operator to submit financial reports on a quarterly and year-to-date basis.
* **Refinances:** Beginning with the first complete quarter AFTER Final Endorsement of the new FHA loan, the Operator Regulatory Agreement, Paragraph 20 (c), requires Operator to submit financial reports on a quarterly and year-to-date basis. Due to the inability of the Portal to accept partial quarterly financial submissions, the last required quarter of financials for the old loan number is the previous full calendar year quarter. See the table below to visualize quarterly Operator submissions required for a refinance based on a Q3 Final Endorsement, both for the prior FHA loan and the new one.

**Quarterly Operator Submission Required for Refinance?**

|  |  |  |  |
| --- | --- | --- | --- |
| Q1 | Q2 | Q3: Final Endorsement | Q4 |
| Yes - Previous Loan | Yes - Previous Loan | No Submission | Yes – 1st Submission for New Loan |

* **Change of Participants (CHOP**): For changes in either the Borrower or Operator, there generally should be no gap in reporting quarterly Operator submissions. In the case of a change of Operator, the Lender will need to combine financials of the old Operator and the new Operator for the quarter during which the change takes effect. If a Change of Operator closed on 12/1/2020, the Q4 2020 Operator financial submissions should consist of the old Operator’s financials for 10/1/2020 through 11/30/2020 and the new Operator’s financials for the period 12/1/2020 through 12/31/2020.
	+ One notable exception to this procedure is the instance where a change of Operator results in a change in the Fiscal Year End Date (FYE) of the Operator. Lenders should communicate these changes to the assigned Account Executive.

As outlined in the Lender Risk Surveillance Dashboard (RSD) Q&As from November 2020, the Lender RSD will not report a T12 DSCR until 4 consecutive quarters of Operator financials are available in the Portal. When there are anticipated periods of time where the Portal cannot accommodate consistent, accurate Operator financial reporting, it will be incumbent upon the Lender to communicate with their Account Executive and keep them apprised of any potential concerns with an Operator’s financial performance.

***Keywords:*** *232 Healthcare Portal, Operator Financial Portal, Operator Financial Reports, Operator Financial Statements, Asset Management*

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State Regulatory Changes

As an increasing number of states have enacted, or are considering enactment of, legislative changes to residential care facility licensing (e.g., Minnesota) and/or strengthening staffing or other facility requirements (e.g., New York), Lenders are advised to ensure that projects remain licensed or certified as necessary under HUD requirements.

As a reminder, the Borrower Regulatory Agreement, Form HUD 92466-ORCF, requires that the “Borrower shall at all times cause Operator, or any lessee or management agent, as applicable, to maintain in full force and effect, all appropriate certificates of need, bed authority, provider agreements, licenses, permits and approvals reasonably necessary to operate the Healthcare Facility or to fund the operation of the Project for the Approved Use (collectively, the “Permits and Approvals”).” The Operator Regulatory Agreement, Form HUD-92466A-ORCF, states that the “Operator shall not alter or terminate, or suffer or permit the alteration, relinquishment or termination of any of the Permits and Approvals that are issued or held in the name of Operator without the prior written consent of HUD.”

If a Mortgagee/Servicer determines that a project is, or will be, unable to maintain license approval in accordance with any State requirements, they are obligated to inform the ORCF Account Executive with the Servicer’s Notification to HUD of Risks to Healthcare Project and Action Plan for Remedy, Form HUD-93334-ORCF ([here](https://www.hud.gov/federal_housing_administration/healthcare_facilities/residential_care/final_232_documents)).

***Keywords:*** *State Risk, Quality of Care, Asset Management*

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ORCF-HMAC Asset Management Webinar Recordings Now Available

ORCF’s *Virtual Servicing & Asset Management Dialogue & Training Sessions* which were sponsored by the Healthcare Mortgagee Advisory Council (HMAC) in April and May were recorded and are now available. ORCF provided a general update on Asset Management and more focused sessions on risk monitoring and regulatory obligations that we hope you found useful.  ORCF truly appreciated the opportunity to discuss the Risk Surveillance Dashboard process and looks forward to continuing the dialogue with industry stakeholders going forward.  If you were unable to join the webinars or if you would like to view them again, recordings of the full sessions are available on the Section 232 Program Training Presentations website ([here](https://www.hud.gov/federal_housing_administration/healthcare_facilities/residential_care/presentations)). The sessions available are:

Session 1:  *General HUD ORCF Update with Question and Answers*

Session 2:  *Asset Management Lender’s Only Dialogue with ORCF HUD Staff*

Session 3:  *Regulatory Obligations & Risk Monitoring Wrap Up*

In addition, all Q&As resulting from the trainings can be found here ([here](https://mgmt.hud.gov/sites/dfiles/Housing/documents/HMAC_QA_06-21.pdf)).

***Keywords:*** *Asset Management, Webinar*

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FROM THE CLOSING CORNER

Please Use ORCF Posted Documents to Complete Closing and Cost Certification Packages

Please use the most current ORCF Closing Documents to complete your closing and cost certification packages which includes ORCF Closing, Construction and Cost Certification documents. All ORCF Closing Documents are available on the Section 232 website ([here](https://www.hud.gov/federal_housing_administration/healthcare_facilities/residential_care)). You can find Documents by Loan Type ([here](https://www.hud.gov/federal_housing_administration/healthcare_facilities/residential_care/underwriting)) or all Revised Section 232 Healthcare Documents ([here](https://www.hud.gov/federal_housing_administration/healthcare_facilities/residential_care/final_232_documents)). Any updates to ORCF documents will be posted on this website.

***Please use posted documents to complete your closing and cost certification packages***

If you have questions, please contact the assigned ORCF Closing Coordinator.

***Keywords:****Closing Documents*

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| Past Lean 232 Updates are [available online](https://lnks.gd/l/eyJhbGciOiJIUzI1NiJ9.eyJidWxsZXRpbl9saW5rX2lkIjoxMDEsInVyaSI6ImJwMjpjbGljayIsImJ1bGxldGluX2lkIjoiMjAyMTAxMDQuMzI3OTIyMzEiLCJ1cmwiOiJodHRwczovL3d3dy5odWQuZ292L2ZlZGVyYWxfaG91c2luZ19hZG1pbmlzdHJhdGlvbi9oZWFsdGhjYXJlX2ZhY2lsaXRpZXMvcmVzaWRlbnRpYWxfY2FyZS9tYWlsX2JsYXN0X2luZGV4P3V0bV9tZWRpdW09ZW1haWwmdXRtX3NvdXJjZT1nb3ZkZWxpdmVyeSJ9.wD_kyOelsVj0O18oGZ6vB1qZQYtIH2lojk5kd633DYc/s/1356292409/br/92636915983-l).Have questions about the Lean 232 Program? Please contact LeanThinking@hud.gov.For more information on the Lean 232 Program, check out: [http://www.hud.gov/healthcare](https://lnks.gd/l/eyJhbGciOiJIUzI1NiJ9.eyJidWxsZXRpbl9saW5rX2lkIjoxMDIsInVyaSI6ImJwMjpjbGljayIsImJ1bGxldGluX2lkIjoiMjAyMTAxMDQuMzI3OTIyMzEiLCJ1cmwiOiJodHRwOi8vd3d3Lmh1ZC5nb3YvaGVhbHRoY2FyZT91dG1fbWVkaXVtPWVtYWlsJnV0bV9zb3VyY2U9Z292ZGVsaXZlcnkifQ.1u0SLtDtXsU62834yVCK0A042fLMrX4ZfmVsijRPzQI/s/1356292409/br/92636915983-l). Stay Connected with the Office of Housing and the Federal Housing Administration: |
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