**HUD’s Lean 232 Program**

**Office of Residential Care Facilities (ORCF)**

**Update as of September 12, 2019**

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**Patient Driven Payment Model (PDPM)**

The Section 223(f) Lender Narrative ([here](https://www.hud.gov/sites/dfiles/Housing/documents/9002N_orcf.docx)) requires that lenders carefully identify and analyze risk factors and explain how they are mitigated. A change effective October 1, 2019 to the payment model used by the Centers for Medicare and Medicaid Services (CMS) presents a significant risk in some skilled nursing facilities. Accordingly, consistent with the Lender Narrative requirements, ORCF expects that the Mortgagee’s Lender Narrative submission will show cognizance of this risk where it exists, speak to the magnitude of the risk in the specific transaction, and identify sufficient and appropriate mitigants.

Specifically, in July 2018, CMS finalized the Patient Driven Payment Model (PDPM) that will become effective on October 1, 2019. PDPM is the new case-mix classification system for classifying skilled nursing facility patients in a Medicare Part A covered stay into payment groups under the SNF Prospective Payment System. The new reimbursement model will replace the current case-mix classification system, the Resource Utilization Group, Version IV (RUG-IV).

We understand that many providers are already preparing for the upcoming transition to PDPM. ORCF is analyzing the impact of PDPM on its portfolio as skilled nursing facilities account for approximately 75% of the insured portfolio of residential care facilities. Recognizing that the new reimbursement model may result in a negative financial impact on skilled nursing facilities, we want to ensure that the risks are adequately mitigated by the owners/operators of FHA insured facilities. Therefore, we would expect that lenders include a thorough discussion in the lender narrative of the impact of PDPM on the financial condition and operations of the skilled nursing facilities coming in for FHA financing. We also would anticipate that the Lender Narratives will include a detailed discussion of the plan that the operator has in place to mitigate any potential negative results from the new reimbursement model. These discussions should be facility- or operator-specific and reflect the lender’s own risk analysis, rather than being simply a recitation of or a commentary on the CMS-publicized projections. On projects that have already been submitted, the contract/ORCF underwriter will reach out to lenders to address this issue as necessary.

The introduction of the PDPM is also highly relevant to operators and loan servicers, given its potential impact on net operating income. Owners and operators should anticipate that the lenders, or ORCF directly, may inquire of them regarding any effect the shift to the PDPM is having or is expected to have on their revenue stream, and how they are planning to address the matter. Moreover, even without receiving such a specific inquiry, Owners/operators may wish to proactively contact their lender regarding the PDPM’s impact. ORCF would recommend doing so.

***Keywords:*** *Patient Driven Payment Model (PDPM), Lender Narrative*

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**Appraisal Reviews**

ORCF has received several inquiries about the status of the appraisal review queue. The backlog in the queue peaked in April but has since been reduced significantly. There are a few things lenders can do to help the appraisal reviews move along quickly, including the following:

1) As mentioned in the Email Blast dated 2/28/19 ([here](https://www.hud.gov/sites/dfiles/Housing/documents/FebEmailBlast022818.docx)), please clearly address which line items (by name) in the historical income and expense statements have been eliminated from the historic Net Operating Income (e.g. depreciation, facility rent, large capital expenditures). This will make the reconciliation portion of the appraisal review go quicker.

2) Be cautious about moving individual line item expenses into the management fee category. The concern is that we don’t want legitimate expenses to be erased when we normalize the management fee to a market rate. Not only does there need to be a clear explanation of why the expenses are best categorized as management fees, but the expense comparables must also support the conclusions. The sales comparables used to establish a capitalization rate need to get the same treatment as the subject when it comes to management fee conclusions.

3) The ORCF review appraiser will be reconciling the historical periods contained in the appraisal. The most recent income and expense statement supplied with the application is often out of sync with the one available at the time of the appraisal. It will save time if the lender includes not just the updated financial reports but the version that the appraisal used. Another option is to have the appraisers include the financials they used as an exhibit within the addenda of the appraisal.

4) Many lenders are saving processing time by filling out the Decision Circuit for the review appraiser. In order to keep things standardized, ORCF will be entering the four historical periods contained in the appraisal in the main section (shaded blue) of the “Hist Exp” tab. Updated financials will be entered in the “Optional Reporting Periods” columns (shaded yellow). It will save time if the lenders follow the same format.

***Keywords:*** Appraisals, Expense, Historic NOI, Management Fee, Reconciliation, Income & Expense Statements

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**Reminder on Valuation, State Risk, Rebalancing**

As a reminder, Handbook 4232.1, Section II, Chapter 5.3.R.4 ([here](https://www.hud.gov/sites/documents/42321S2C5HSGH.PDF)) states:

*In projecting all sources of income for the subject property, consideration should be given to foreseeable changes in competitive market conditions that will affect current occupancy, payer mix, and rate levels. Examples include changes in: the condition of state finances, state laws offering alternative forms of housing types, reimbursement structures, and competitors in the marketplace.*

As highlighted in the 6/28/17 Email Blast, Rebalancing Efforts are noted as an underwriting risk. It is noted that the Money Follows the Person (MFP) Rebalancing Demonstration Grant continues to be funded and make an impact on SNF occupancy (see results of the study funded by HHS ([here](https://clpc.ucsf.edu/sites/clpc.ucsf.edu/files/MFP%20webinar%20slides%207-25-19.pdf))).  Items on the State Risk Summary Grids provided in our 6/28/2017 and 2/29/2016 Email Blasts are not meant to limit the extent of the Lender’s inquiry.  As a demonstration program, MFP has spawned a number of innovative State Rebalancing programs, including restructuring of capitation rates (see the Medicaid and CHIP Payment and Access Commission (MACPAC) report on Olmstead ([here](https://www.macpac.gov/publication/twenty-years-later-implications-of-olmstead-v-l-c-on-medicaids-role-in-providing-long-term-services-and-supports/))).

In particular, the State of Connecticut has made detailed data publicly available on its website ([here](https://portal.ct.gov/dss/Health-And-Home-Care/Medicaid-Long-Term-Care-Demand-Projections/Medicaid-Long-Term-Care-Demand-Projections)) regarding the projected impact of its ongoing Rebalancing efforts.  This data includes a breakout by Labor Market Area, of the projected 6,000 bed decrease in SNF demand in the State by 2040.  The State initially published demand data in 2012 and subsequently closed a number of low-performing facilities.  On 9/3/2019, the State also published site- level analyses on the same website, of the impact of legislation ([here](https://www.cga.ct.gov/asp/cgabillstatus/cgabillstatus.asp?selBillType=Bill&which_year=2019&bill_num=7164))–(Substitute bill 7164 January Session 2019), an excerpt of which is as follows:

*For the fiscal  year ending June 30, 2020, no facility shall receive a rate that is more than two percent lower than the rate in effect on June 30, 2019,* ***unless the facility has an occupancy level of less than seventy percent, as  reported in the 2018 cost report, or an overall rating on Medicare's Nursing Home Compare Internet web site of one star on June 1, 2019.*** *Emphasis added*

As ORCF expects Lenders to address State budget and regulatory constraints as appropriate, applications for facilities located in Connecticut need to make particular note of the State’s continued efforts to focus on low-performing facilities (both low Star ratings and low occupancy).

***Keywords:*** *Valuation, State Risk*

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**Document Links Included In This Blast**

1. [Section 223(f) Lender Narrative](https://www.hud.gov/sites/dfiles/Housing/documents/9002N_orcf.docx)
2. [Impact of the Money Follows the Person Program Study funded by HHS](https://clpc.ucsf.edu/sites/clpc.ucsf.edu/files/MFP%20webinar%20slides%207-25-19.pdf)
3. [Medicaid and CHIP Payment and Access Commission (MACPAC) Report](https://www.macpac.gov/publication/twenty-years-later-implications-of-olmstead-v-l-c-on-medicaids-role-in-providing-long-term-services-and-supports/)
4. [Connecticut Medicaid Long-Term Care Demand Data](https://portal.ct.gov/dss/Health-And-Home-Care/Medicaid-Long-Term-Care-Demand-Projections/Medicaid-Long-Term-Care-Demand-Projections)
5. [Connecticut Substitute Bill 7164 January Session 2019](https://www.cga.ct.gov/asp/cgabillstatus/cgabillstatus.asp?selBillType=Bill&which_year=2019&bill_num=7164)

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Past Lean 232 Updates are [available online](http://portal.hud.gov/hudportal/HUD?src=/federal_housing_administration/healthcare_facilities/residential_care/mail_blast_index).

Have questions about the Lean 232 Program? Please contact [LeanThinking@hud.gov](mailto:LeanThinking@hud.gov).

For more information on the Lean 232 Program, check out: <http://www.hud.gov/healthcare>.

Have your loan servicing colleagues joined our email list? The Email Blasts contain information relevant to them as well. You might suggest they [Join here](http://portal.hud.gov/hudportal/HUD?src=/subscribe/signup&listname=Lean%20232%20Updates&list=LEAN-232-UPDATES-L).

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