



U.S. DEPARTMENT OF HOUSING AND URBAN DEVELOPMENT
WASHINGTON, DC 20410-8000

ASSISTANT SECRETARY FOR HOUSING-
FEDERAL HOUSING COMMISSIONER

Date: January 15, 2021

Mortgagee Letter 21-01

To: All FHA Section 232 and Section 242 Approved Mortgagees

Subject: COVID-Related Supplemental Loans Pursuant to Fiscal Year 2021 Consolidated Appropriations Act

Purpose

This Mortgagee Letter (ML) implements temporary statutory authority to insure operating loss loans under Section 223(d) of the National Housing Act to mitigate healthcare facilities' COVID-related temporary revenue reductions.

Effective Date

This Mortgagee Letter is effective immediately upon its issuance. Its effective duration is statutorily constrained. Consistent with Section 542 of the Consolidated Appropriations Act of 2021, this Mortgagee Letter is effective for applications for insurance submitted pursuant to its terms for which firm commitments are issued *no later than* September 30, 2021. In light of this statutory time constraint and to allow time for processing, HUD is hereby imposing an application receipt deadline of Monday, August 30, 2021.

Affected Program

Section 223(d) of the National Housing Act, as applied to underlying loans made pursuant to Section 232 or Section 242 of the National Housing Act.

Public Feedback

HUD welcomes feedback from interested parties for a period of 30 calendar days from the date of issuance. To provide feedback on this policy document, please send comments to HUD's Office of Residential Care Facilities (ORCF) at Leanthinking@hud.gov. HUD will consider the feedback in determining the need for future updates.

Background

On March 13, 2020, President Donald Trump issued a Proclamation on Declaring a National Emergency Concerning the Novel Coronavirus Disease (COVID-19) Outbreak. Hospitals and residential care facilities have been and continue to be significantly impacted by the National Emergency, as have the patients and residents those facilities strive to serve. Many of those healthcare facilities, though viable before the National Emergency, are now experiencing significant financial loss which threatens their continued viability and heightens the risk of an FHA mortgage insurance claim. For certain FHA-insured healthcare facilities, this temporary statutory authority under the Consolidated Appropriations Act of 2021 to insure operating loss loans under these circumstances is a potential tool that may address this COVID-related risk.

Consistent with the temporary statutory authority, this Mortgage Letter sets forth overall requirements for these supplemental loans for hospitals (insured pursuant to Section 242) and residential care facilities (insured pursuant to Section 232). Additionally, residential care facility lender narrative guidance is forthcoming (pending approval). As with other OHP mortgage insurance programs, application and closing checklists as applicable will be available on OHP's website, [here](#).

Overall Requirements and Scope of Section 223(d) Loans Pursuant to Emergency Legislation

The Operating Loss Loan Program has long supplemented underlying FHA-insured mortgage loans in certain very limited circumstances. The longstanding Section 223(d) Operating Loss Loan Program requirements are contained in the statute itself and, in the case of such loans for residential care facilities, are further constrained by handbook provisions and controlling documents. The temporary statutory authority in the FY 21 Consolidated Appropriations Act, however, sets forth an *alternative* set of criteria through which Section 223(d) loans may be determined.

These statutory criteria emphasize the nexus between the National Emergency and a facility's need for additional mortgage funds. Facilities that were (a) not financially sound immediately prior to the Proclamation or (b) are either (i) obtaining sufficient supplemental resources through other means or (ii) not availing themselves of some other available resources are not eligible under this temporary statutory authority.

Additionally, HUD has determined that a facility that was financially sound pre-Proclamation but now has insufficient net operating income to cover debt service will be ineligible unless the applicant demonstrates that, with this supplemental loan and other resources, the facility can regain financial viability within two years of final endorsement. Absent other convincing evidence, HUD would expect that demonstrating the projected financial viability would include demonstrating projected debt service coverage of at least 1.1. If a facility's financial viability will require significant capital improvements, the applicant will need to demonstrate a means of accomplishing those improvements. Funding such capital improvements is beyond the scope of this limited-term program.

Requirement that Facility was “Financially Sound Immediately Prior to” the Proclamation

OHP will apply two primary means to confirm that this statutory requirement is satisfied.

The first is debt service coverage. OHP requires applicants to be able to demonstrate a debt service coverage ratio (DSCR) over the twelve months ending February 29, 2020 of at least 1.0.

The second primary means of confirming this statutory requirement is mortgage payment history. Specifically, OHP will require that the project’s mortgage payments have not been delinquent for more than 30 days at any point during the six months prior to the Proclamation.

If either one of these two requirements is not met, OHP would not consider the application unless unique additional circumstances clearly establish that the facility was financially sound immediately prior to the Proclamation. Additionally, even if these two requirements are met, if other evidence nevertheless indicates that the facility was, in fact, not financially sound immediately prior to 3/13/20, the lender will need to adequately address those matters to establish eligibility.

Requirement that the Facility Have “Exhausted All Other Forms of Assistance”

The temporary statutory authority addresses this constraint in two ways. First, it only authorizes mortgage insurance with respect to facilities that have “exhausted all other forms of assistance.” HUD has determined that facilities that are either (i) obtaining sufficient supplemental resources through other means or (ii) not availing themselves of some other available resources do not meet this requirement and, therefore, are not eligible under the temporary statutory authority. Second, the statute requires that when sizing a loan, OHP first take into account “all other realized or reasonably anticipated assistance (including reimbursements, loans, or other payments from other Federal sources).”

The Lender must thoroughly address this requirement with the Borrower. The Borrower will be required to provide a certification (a) confirming that the Borrower has exhausted all other forms of assistance to date, and (b) identifying the forms and amounts of assistance (i) received since March 13, 2020 and/or (ii) reasonably anticipated to be received. If the Borrower and Operator are separate entities with an identity of interest or the Borrower is forgoing Operator receipts, deferring Operator receipts or lending funds to the operator in order to help operationally sustain a COVID-impacted facility, then the Operator must also provide such a certification. Additionally, the Lender Narrative will need to demonstrate that despite exhaustion of all other assistance, the genuine need for the requested supplemental loan remains.

Requirements Regarding Loan Sizing

Loan sizing limitations historically set forth specifically for 223(d) operating loss loans do not apply to loans insured via this temporary statutory authority. Rather, for the loans insured via this authority, sizing constraints will include the constraints specifically set forth in the temporary

statutory authority as well as other requirements appropriate to prudent underwriting as detailed in the Lender Narrative.

Consistent with the temporary statutory authority, the loan size will be limited by the lesser of two independent constraints, those being (a) COVID-related temporary losses or additional expenses and (b) supplemental funds needed to cover one-year debt service requirements, as explained below.

Temporary Losses or Additional Expenses

The new statutory authority specifies that the loan size shall not exceed the “[t]emporary losses or additional expenses incurred or expected to be incurred by the healthcare facility as a result of the impact of the circumstances giving rise to” the President’s March 13, 2020 Proclamation.

In applying this quoted statutory language, OHP will also draw upon the statutory definition of “operating loss” cross-referenced in this new statutory authority itself. Per 223(d) (12 USC 1715n(d)), operating loss “means the amount by which the sum of the taxes, interest on the mortgage debt, mortgage insurance premiums, hazard insurance premiums, and the expense of maintenance and operation of the project covered by the mortgage, exceeds the income of the project.” In this context, HUD understands the broader reference of “temporary losses or additional expenses” to reference the combined effect of incurred or expected temporary reductions in revenue (for example, reductions associated with reduced census) and incurred or expected temporary increases in operating expenses (for example, additional staffing or supplies expense) due to the COVID-19 national emergency. Overall, however, this criterion speaks to an operating loss (as statutorily defined) only to the extent incurred or expected to be incurred as a result of the circumstances giving rise to the Proclamation. The period of this impact analysis would not extend back before 1/1/20 nor beyond 12/31/21.

Many residential care facilities operate via a lessor-lessee model, by which the facility Operator is often the lessee of the Borrower entity. In underwriting these transactions, OHP will follow its established approach of considering the overall operation. However, the Lender, Borrower and Operator should note the restrictions that will be in place regarding “Use of Loan Proceeds,” below.

One Year of Debt Service

Loans insured under this temporary statutory authority must also be limited to an amount “expected to be needed” to cover the sum of:

- a) one year of principal, interest and mortgage insurance premiums for the underlying FHA-insured loan(s) and this supplemental loan combined,
- b) one year of monthly deposits to reserve accounts as required by HUD,
- c) one year of property taxes and insurance for the healthcare facility, and
- d) transaction costs.

HUD recognizes that the statutory language “expected to be needed” contained in this statutory cap is critical to loan sizing. This statutory cap is not determined simply by calculating the amount

expected to be *incurred* for these four listed items but rather by discerning the incremental amount that, in light of other resources, is nevertheless *expected to be needed* to cover such items.

Loan Sizing Limitations Based on Need to Avert Risk to FHA

The overall import of this statutory authority is that it is a *temporary* measure to avert risk to the FHA related to the National Emergency. Thus, the legislation emphasizes the Borrower's exhaustion of all other available funds and also limits the loan size both by COVID-related financial impacts and, separately, by the amount *expected* to be needed to cover transaction costs and debt service.

Accordingly, if a facility sustained a measurable COVID-related financial impact but nevertheless has maintained, and is projected to maintain, ample debt service coverage, then this is not eligible for insurance under this authority. Likewise, if a facility has declined to an extent that, even with this supplemental assistance, it will remain at substantial risk of a mortgage default, then this temporary statutory authority is not appropriate for that facility. A current, COVID-related heightened risk of default must be evident on a property that was financially sound prior to the Proclamation, that has exhausted all other forms of assistance, and that with this supplemental loan and other realized or reasonably anticipated assistance, is likely to avoid mortgage default.

Use of the Loan Proceeds

Just as this temporary statutory authority limits loan sizing based on the facility having "exhausted all other forms of assistance," so too will HUD, in administering the proceeds, require (via a restricted escrow account) that other available funds will be used first. Moreover, the priority use for such funds will be making mortgage payments where net operating income is temporarily insufficient. In the event that the Borrower-Operator relationship is that of lessor-lessee and the Borrower's mortgage delinquency is due to the Operator's lease delinquency, HUD will require repayment to the escrow of those funds when the Borrower eventually recoups the Operator's delinquent lease payments.

If the facility's revenue is so low as to be insufficient even to meet operating expenses, HUD will evaluate the overall risk to the FHA insurance fund before approving the advance of escrowed loan proceeds for operating expenses. Moreover, the existence of a lessor-lessee relationship between Borrower and Operator will be relevant. Since the Borrower entity is the entity for which the loan proceeds are intended, it is the Borrower entity's obligations to which the released escrow funds must be put. This is true regardless of any identity-of-interest between the Borrower and lessee Operator and is a matter that HUD would expect to be addressed contractually between the Borrower and Operator.

Loan Term

The term of this supplemental loan shall not extend the remaining term of the original outstanding FHA-insured first mortgage

Paperwork Reduction Act

[Need to modify for dealing with this emergency legislation.] The information collection requirements contained in this document have been approved by the Office of Management and Budget (OMB) under the Paperwork Reduction Act of 1995 (44 U.S.C. 3501-3520) and assigned OMB Control Number 2502-0605. In accordance with the Paperwork Reduction Act, HUD may not conduct or sponsor, and a person is not required to respond to, a collection of information unless the collection displays a currently valid OMB Control Number.

Questions

Any questions regarding this Mortgagee Letter may be directed to the Office of Residential Care Facilities by email at LeanThinking@hud.gov. For additional information on the Section 232 Program addressed in this Mortgagee Letter, please visit: https://www.hud.gov/federal_housing_administration/healthcare_facilities/residential_care.

Signature

for
Dana T. Wade
Assistant Secretary for Housing –
Federal Housing Commissioner