



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

ASSISTANT SECRETARY FOR HOUSING-  
FEDERAL HOUSING COMMISSIONER

**December 1, 2016**

**Mortgagee Letter 2016-23**

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**To** **All Lenders of Record for Section 242 Hospital Loans**

**Subject** **Lender Responsibilities in Servicing Section 242 Loans**

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**Purpose** Provide, in a checklist format, a summary of important servicing responsibilities of Lenders of Record holding Section 242 hospital loans.

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**Affected Policy** This Mortgagee Letter supersedes Mortgagee Letter 2015-19.

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**Effective Date** The guidance in this Mortgagee Letter is effective immediately.

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**Foreword** The servicing of Section 242 loans is performed either by the Lender of Record (“Lender”) or by another HUD-approved lender acting as Agent for the Lender. In either case, interactions with the borrower put the Lender in a position to monitor the borrower’s financial well-being and to share critical information and concerns with HUD.

The following HUD handbooks have provided requirements for the servicing of multifamily and healthcare mortgage loans:

4350.1 REV-1 Multifamily Asset Management and Project Servicing

4350.4 Insured Multifamily Mortgagee Servicing and Field Office Handbook

Because these handbooks are focused primarily on Multifamily projects, they do not address many issues of importance to the hospital program, and many of the issues they do address are irrelevant to the servicing of hospital loans. Currently the handbooks are being updated by the Office of Multifamily Programs, after which they will no longer apply to the healthcare facility programs.

Meanwhile, the Office of Healthcare Programs recently completed a thorough “document reform” initiative, resulting in the updating, deletion, and addition of many program documents, the results of which have been

approved by the Office of Management and Budget (OMB). Many of the documents establish servicing requirements. Additional requirements are found in the Section 242 regulations and Handbook 4615.1 REV-1.

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**Information  
Collection**

The information collection requirements contained in this document have been approved by OMB under the Paperwork Reduction Act of 1995 (44 U.S.C. 3501-3520) and assigned OMB control numbers 2502-0602 and 2502-0041. 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.

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**Servicing  
Responsibilities**

The matrix starting on Page 3 describes servicing responsibilities.

**Abbreviations**

AE	HUD Account Executive
AR	Accounts Receivable
CM	Construction Manager
CON	State-issued Certificate of Need
DACA	Deposit Account Control Agreement
GNMA	Government National Mortgage Association
MIP	Mortgage Insurance Premium
MDDR	Multifamily Delinquency and Default Reporting
MRF	Mortgage Reserve Fund
OAE	HUD Office of Architecture and Engineering
OGC	Office of General Counsel
TEFRA	Tax Equity and Fiscal Responsibility Act of 1982
UCC	Uniform Commercial Code
UPB	Unpaid Principal Balance

Event or Frequency	Lender's Responsibility
<b>Initial Endorsement</b>	
Each time a commitment is issued	Review documents prepared by the hospital, HUD, and lender's counsel and provide comments to them as appropriate.
	Coordinate with all parties to assist in fulfilling all conditions precedent to Initial Endorsement and to set a date for closing.
	Confirm that Deposit Account Control agreements (DACA)s are in place at closing for all depository accounts on the list provided by the borrower.
	Assist the borrower in preparing the form 92403, Application for Advance of Mortgage Proceeds, for HUD's approval of the initial disbursement of loan proceeds.
<b>Construction Phase</b>	
Ongoing	Maintain escrows and deposits where required pursuant to the FHA commitment (except reserve funds held in escrow accounts).
	Monitor all insurance policies and surety bonds issued or received in connection with project and secure timely renewals in accordance with FHA requirements.
	Determine need for extensions, renewals, or releases of letters of credit held by Lender pursuant to the FHA commitment.
	Perform lender/servicer tasks described in "11-STEP DRAW PROCEDURE" as applicable (Ref. Handbook 4615.1 REV-1 CHG-1, Appendix 8, Part I, Section 15).
Hospital requests advance	Review for completeness and correctness and submit to HUD for approval.

Event or Frequency	Lender's Responsibility
Approved advance received from HUD	Obtain evidence that title is clear; arrange funding.
	Obtain title insurance endorsement increasing coverage to the total of all advances.
	Release approved funds to hospital.
Change Order, Line Item Change, or Change of Scope request	Determine change is acceptable to hospital, architect, and HUD.
	Verify source of payment for change and availability of adequate funds for payment.
	Approve/disapprove the change and forward to OAE.
Request for mortgage increase	Review request to determine if the loan is in balance in accordance with the Building Loan Agreement <sup>1</sup> and if provision has been made for payment of any fees required. Forward request to AE.
Monthly requisition meeting w/OAE, architect, and CM	Attend, as needed, to review work progress. Always attend preconstruction conference and meetings at end of project to discuss close out procedures. (Note: does not include responsibility for verifying percent of completion or accuracy of charges on CM requisition.)
Loan for new construction or substantial rehabilitation	Monitor the disbursements of capitalized interest and advise AE if failure to disburse capitalized interest will cause a default in a note payment.
Each final endorsement	Assist in cost certification process.
	Request borrower to execute and deliver all required FHA documents and to fund all escrows and deposits required by FHA for final endorsement.
	Coordinate with AE to assist borrower in fulfilling all conditions for final endorsement, establishing a date for final endorsement, and causing final endorsement to occur.

<sup>1</sup> “The Loan is in balance only when the undistributed proceeds of the Loan (after provision for reserves, fees, expenses and other deposits required by the Lender or HUD) equal or exceed the amount necessary (based on HUD’s estimate of the cost of construction) to pay for all work completed and all materials delivered, for which payment has not been made, and the cost of completing construction of the Project in accordance with the Drawings and Specifications.”

Event or Frequency	Lender's Responsibility
<b>Permanent Loan Servicing – Administrative Functions</b>	
Ongoing	Monitor hazard and all other insurance to ensure compliance with the requirements set forth in the Mortgage and the Regulatory Agreement.
	Conduct escrow analysis at least annually, maintain escrows and pay taxes, insurance, etc. on or before due date.
	Maintain current and complete mortgage loan files.
Monthly	Collect monthly mortgage payments.
Monthly/Annually	Prepare and distribute monthly mortgage loan statement and annual statement of account.
Annually	Remit MIP payments
<b>Permanent Loan Servicing – Periodic Monitoring</b>	
Ongoing	Monitor Letters of Credit if any.
Annually	Confirm that Deposit Account Control agreements (DACA)s are in place for all depository accounts that receive or hold the borrower's operating revenues and do not contain government receivables, and confirm that deposit accounts into which government receivables are deposited have an agreement that requires the funds in said deposit accounts to be swept into a deposit account covered by a DACA. If not, inform hospital management and AE that DACAs or changes to sweep arrangements are needed. HUD will provide confirmation of any deposit accounts that are not required as security for the 242 loan.

Event or Frequency	Lender's Responsibility
Annually	Confirm that UCC filings are continued every 5 years and that all personalty for the HUD-insured loan is securitized for the life of the mortgage.
Ongoing	Verify that the project has required Fidelity Bond Coverage. If coverage is inadequate, encourage management to resolve deficiency. If not resolved, notify AE. Ref. 242 Handbook 4615.1 REV-1 Appendix 7 on insurance requirements.
Quarterly (monthly for Credit Watch List/Priority Watch List hospitals) <sup>2</sup>	<p>Review annual audited financials, interim reports, and comparison of actual performance to budget. Identify signs of financial improvement, such as:</p> <ul style="list-style-type: none"> <li>• Improving operating margin</li> <li>• Improving balance sheet</li> </ul> <p>Identify possible signs of financial weakening or increased risk, such as:</p> <ul style="list-style-type: none"> <li>• Deteriorating operating margin or balance sheet</li> <li>• Declining patient utilization</li> <li>• New lines of credit or letters of credit <ul style="list-style-type: none"> <li>○ Notify AE if this requires subordination of HUD collateral.</li> </ul> </li> <li>• Draws on lines or letters of credit</li> <li>• Loans or advances to/from affiliates <ul style="list-style-type: none"> <li>○ Notify AE</li> </ul> </li> <li>• Sale of assets</li> </ul> <p>Discuss with AE. Identify items for follow-up in quarterly meeting with hospital's Chief Financial Officer.</p>
<p><u>Note:</u> HUD expects the Lender to be aware of whether and why the hospital's financial position is trending up or down, and to recognize when it needs to make the hospital aware of its concern about negative trends. By expressing this concern, Lenders have been able to bring about positive changes that have helped troubled hospitals avoid mortgage defaults.</p>	

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<sup>2</sup> Owners are required to submit annual audited financial statements to the Lender. See Handbook 4350.4, Chapter 2-10, and Hospital Regulatory Agreement – Borrower, HUD-92466-OHF. Quarterly financial and utilization data will be submitted to the Lender by owners that are required by the Lender, HUD, or GNMA to do so, or that voluntarily submit the data.

Event or Frequency	Lender's Responsibility
<p>Quarterly (Monthly for Credit Watch List/Priority Watch List hospitals)</p>	<p>Meet with the hospital's Chief Financial Officer quarterly, either in person or telephonically, to review financial performance during the year and the quarter. For Credit Watch List/Priority Watch List hospitals, discuss results monthly.</p> <p>Identify and discuss changes in the hospital's business plans and operations, including but not limited to:</p> <ul style="list-style-type: none"> <li>• Changes in senior management or Board <ul style="list-style-type: none"> <li>o Remind hospital that Previous Participation Certification (HUD-2530) must be filed</li> </ul> </li> <li>• Expansion or reduction in services</li> <li>• Plans to enter into affiliations with other providers <ul style="list-style-type: none"> <li>o Notify AE – HUD consent may be required</li> </ul> </li> <li>• Changes in capital budget</li> <li>• Certificates of need applied for</li> <li>• Requests for, or receipt of, major grants or contributions</li> <li>• Concerns or questions resulting from review of financial statements</li> </ul> <p><b>NOTE:</b> This meeting and discussion will be of greatest value if the AE participates along with the Lender.</p>
<p>There is a persistent decline in financial performance which is not turned around by the efforts of the hospital's Board, management, and consultants.</p>	<p>The Lender should consider whether the services of a turnaround consultant should be employed to assist the hospital, and if so, recommend actions to be taken by HUD and the Hospital, in collaboration with the Lender, to provide such assistance.</p>

Event or Frequency	Lender's Responsibility
<b>Event-Driven Risk Management</b>	
Request from Borrower	Consider request from borrower to: <ul style="list-style-type: none"> <li>• Modify the note and mortgage</li> <li>• Approve transfers of physical assets</li> <li>• Approve partial releases of lien</li> <li>• Permit secondary financing</li> </ul> Independently review and submit to AE with recommendation.
Lender requests a loan modification, a refinancing under 223(a)(7) or 223(f), or a supplemental loan under Section 241, or any other time that HUD believes it necessary to ensure that the loan remains in a first lien position	Contact AE to start HUD review process. Provide an updated title policy to HUD as needed.
<b>Lender Becomes Aware of:</b> <ul style="list-style-type: none"> <li>• Missed lease payment from hospital's operator/lessor (for those hospitals for which leasing of the entire facility has been approved)</li> </ul>	Notify AE and work with AE, borrower, and operator to find out why the payment was not made on time and to request from management its plan to avoid missed payments in the future.
<ul style="list-style-type: none"> <li>• Notification of termination of any insurance</li> </ul>	Together with AE, request management to provide an explanation of the termination and actions being taken to ensure that necessary insurance is in place.  (See Handbook 4615.1 REV-1 Appendix 7 for insurance requirements.)
<ul style="list-style-type: none"> <li>• Default on AR loan</li> </ul>	Together with AE, discuss with borrower why default occurred and request a plan from borrower to deal with this event and prevent future defaults.
<ul style="list-style-type: none"> <li>• Unauthorized distribution</li> </ul>	Request a plan from management to deal with this event and to strengthen controls. Notify AE.



Event or Frequency	Lender's Responsibility
Borrower wants to add or amend an accounts receivable line of credit.	Review and approve/disapprove loan documents and Intercreditor agreement and, if approved, submit to AE along with borrower's request.
Delinquent mortgage payment	Report through MDDR System as required and notify AE.
	Work with borrower and management to determine cause of delinquency.
	Request a report from management describing how delinquency will be resolved and how future delinquencies will be avoided. Provide report to AE.
	Monitor mortgage payments and keep AE informed of status of loan and circumstances causing delinquency.
Vacating or condemnation of project.	Notify AE
Borrower stops making mortgage payments.	Participate in meetings with the AE that discuss: <ul style="list-style-type: none"> <li>• Designation of an asset manager to work with AE and the HUD Turnaround Team.</li> <li>• Requesting an action plan from the borrower for returning the loan to performing status.</li> <li>• Tracking progress of the action plan.</li> <li>• Whether any assets might be liquidated to avoid a claim.</li> </ul>
Lender elects to assign mortgage to HUD.	Continue to bill for and accept all payments until mortgage is assigned in the Secretary's name.

Event or Frequency	Lender's Responsibility
Borrower, operator, or management agent files for bankruptcy.	<p>File appropriate documents to assure that Lender's interest as first lienholder is protected and the security is preserved.</p> <p>Obtain an order recognizing Lender's entitlement to the revenues and restricting use of the revenues in accordance with rules governing cash collateral.</p> <p>Remind Borrower that project assets may not be used to pay attorney fees for legal service in connection with the bankruptcy without HUD approval.</p> <p>Provide AE with copies of any notice of default or non-compliance from any regulatory or licensing authority regarding the hospital's license, CON, or provider agreements.</p>

**Questions**

If you have any questions or concerns regarding this Mortgagee Letter, please contact Kathryn Killeen at 202-402-3119 ([kathryn.e.killeen@hud.gov](mailto:kathryn.e.killeen@hud.gov)). Persons with hearing or speech impairments may access this number via TDD/TTY by calling 1-800-877-8339.

**Signature**

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