Section II
Production

Chapter 2
Eligible Section 232 Mortgage Insurance Programs

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2.1 Introduction

This chapter contains the basic program requirements for the Section 232 Residential Healthcare Facilities mortgage insurance programs for which Lenders can submit applications.

2.2 Eligible Projects

A. **Nursing Home:**

1. A public project, proprietary project, or project of a private nonprofit corporation or association, which consists of at least 20 beds and is licensed or regulated by the State (or, if there is no State law providing for such licensing and regulation by the State, by the municipality or other political subdivision in which the project is located).

2. Provides for the accommodation of convalescents or other persons who are not acutely ill and not in need of hospital care but who require skilled nursing care and related medical services, in which such nursing care and medical services are prescribed by, or are performed under the general direction of, persons licensed to provide such care or services in accordance with the laws of the State where the project is located.

B. **Assisted Living Facility:**

1. A proprietary, public or nonprofit project of at least ~~5~~20 beds ~~residential units (not to exceed 4 persons per unit)~~ that is designed for frail elderly. Frail elderly means an elderly person of at least 62 years who is unable to perform at least three activities of daily living. Activities of daily living are activities regularly necessary for personal care including bathing, dressing, eating, getting in or out of beds and chairs, walking, going outdoors, using the toilet, preparing meals, shopping for personal items, obtaining and taking medications, managing money, using the

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telephone or performing light or heavy housework. Residents may make their own arrangements for support services, such as physical therapy, nursing care, podiatry, etc. Residents may employ their own private staff to provide assistance with activities of daily living or other household/personal needs. A resident may have a contract with a home health agency for nursing and personal care services.

2. Must be licensed or regulated by the State, municipality or other political subdivision in which the project is located.

3. Must provide areas for central dining, kitchen (or preparation area where food is supplied from an offsite location), lounges, recreation, and other projects appropriate for the provision of supportive services to the residents of the project. Where food is provided from an offsite location, the preparation area in the project must be of sufficient size to allow for the installation of a full kitchen if it becomes necessary, or additional land must be available to add kitchen space.

4. Must provide continuous protective oversight that at a minimum includes awareness by management and staff of the residents' condition and location as well as the ability to intervene in a crisis on a 24-hour basis.

5. Must offer three meals per day to each resident.
    a. Residents in accommodations without kitchens must take three meals a day provided by the project.
    b. Residents whose accommodations have a kitchen must take at least one meal a day provided by the project.

6. The assisted living project's admission agreement must state that no dwelling unit in the project will be occupied by more than one person without the consent of the other residents of that unit. The resident who signed the admission agreement must consent before another person(s) may occupy the unit.

7. Not less than one (1) full bathroom must be provided for every four (4) residents and bathroom access from any bedroom or sleeping area must not pass through a public corridor or area.

C. **Intermediate Care Facility:**

1. A proprietary residential project or project of a private nonprofit corporation or association which consists of at least 20 beds and is licensed or regulated by the State, the municipality or other political subdivision in which the project is located.

2. Provides for the accommodation of persons who require minimum but continuous care (24-hour staffing/supervision) but are not in need of continuous medical or nursing services.

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3. Corresponds to the Department of Health and Human Services definition of "Intermediate Care Facility" (ICF).

   These types of facilities are under heightened scrutiny for deinstitutionalization under Title II of the Americans with Disabilities Act (ADA) and the United States Supreme Court landmark decision in Olmstead v. L.C., 527 U.S. 581 (1999).

D. **Board and Care Home.** Board and Care facilities considered eligible for Section 232 mortgage insurance must meet the following requirements:

1. A proprietary residential project or a residential project owned by a private nonprofit corporation or association which consists of at least 20 accommodations, bedrooms with a maximum of 4 persons for each accommodation, each with a full bath.

2. Must be regulated by the State in accordance with Section 1616(e) of the Social Security Act (Keys Amendment) and meet the State's eligibility requirements. The State also must have certified to the U.S. Department of Health and Human Services that the State is in compliance with the provisions of 1616(e). Specifically, the State must have the legislative authority and regulatory body that enables it to conduct unscheduled inspections of the project.

3. Provides room, board and continuous protective oversight. At a minimum continuous protective oversight includes awareness by management and staff of the residents' condition and location, as well as the ability to intervene in a crisis on a 24-hour basis.

4. Must be a freestanding structure or an identifiable and separate portion of an assisted living project, intermediate care project or nursing home.

5. Must provide areas for central dining, kitchen (or preparation area where food is supplied from an offsite location), lounges, recreation, and other multipurpose rooms. Where food is provided from an offsite location, the preparation area in the project must be of sufficient size to allow for the installation of a full kitchen if it becomes necessary, or additional land must be available to add kitchen space.

6. Must offer three meals per day to each resident.
   a. Residents in accommodations without kitchens must take the three meals a day provided by the project.
   b. Residents whose accommodations have a kitchen must take at least one meal a day provided by the project.

7. Charges may be assessed for providing other services that are in addition to those services included in the basic residential fee. Such services may include

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housekeeping, laundry, supervision of nutrition or medication and assistance with daily living (bathing, dressing, shopping, and eating).

8. Not less than one (1) full bathroom must be provided for every four (4) residents and bathroom access from any bedroom or sleeping area must not pass through a public corridor or area.

2.3 Ineligible Projects

The following projects are not eligible for FHA mortgage insurance:

A. Projects with "Founder's Fees," "Life Care Fees," or other similar charges associated with "Buy-in" projects.

B. Projects not meeting program intent such as hospitals, clinics, diagnostic and treatment centers, group practice facilities, and halfway houses. (Residential care projects may include clinics, medical offices and similar related services as commercial space).

C. Projects where the ~~Project,~~ Borrower/former owner, Operator or any of their affiliates, renamed or reformulated companies, filed for or emerged from bankruptcy within the last 5 years. A project in bankruptcy that is acquired by a non-identity-of-interest owner in good standing may be eligible for mortgage insurance, subject to HUD review. HUD will review updated financial information (post-bankruptcy) and the new senior management team.

D. Projects where the Project, Borrower, Operator or any of their affiliates, renamed or reformulated companies, are currently in bankruptcy.

E. Projects not providing the continuous protective oversight or minimum assistance required, such as retirement homes, boarding houses or single room occupancy residences that provide only food and shelter.

F. Projects designated by the Centers for Medicare and Medicaid Services (CMS) as Special Focus Facilities or similar future designation.

~~F.~~G. Projects designated as long~~-~~-term acute care facilities.

2.4 Loan Types

A. **Section 232 New Construction**. A project qualifies as new construction when all project and construction elements are installed as part of the construction contract and no work has been done prior to the issuance of the HUD Firm Commitment.

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B. **Section 232 Substantial Rehabilitation**. A project undergoing substantial repairs or improvements.

C. **Section 232 Blended Rate.** A blended rate project allows an existing project to add new beds/units – outside the existing building footprint. This program allows for a loan-to-value that is partially based on 223(f) requirements and partially based on 232 new construction requirements. Production, Chapter 3 describes the calculation of the blended loan-to-value.

Any ~~new~~ construction, outside of the existing building footprint, regardless of whether new units are added, must be treated as a blended rate. Please note that this applies regardless of the percentage increase to the project's value after completion of all additions.

D. **Section 232/223(f) Purchase/Refinance**. Loans for projects that do not meet the requirements for substantial rehabilitation and do not propose construction ~~of new beds/units~~ outside the existing building footprint are eligible for refinance or purchase under this Section. Existing FHA-insured loans may refinance under Section 223(f).

E. **Section 232/223(a)(7) Refinance**. Streamlined refinance of an existing FHA-insured loan.

F. **Section 232/241(a) Supplemental Loans**. Supplemental loans under Section 241(a) are permitted for existing FHA-insured loans to complete an addition, repairs, replacements (including major movables), energy conservation measures and/or improvements. The purpose of these loans is to provide financing to keep the property competitive, extend its economic life, and provide for replacement of obsolescent equipment.

G. **Section 223(d) Operating Loss Loan (OLL)**. The OLL is a supplemental loan program that provides owners of FHA-insured projects a vehicle for recouping their out-of-pocket expenditures to fund unforeseen operating deficits during the early years of the project's operation.

H. **Section 232(i) Fire Safety Equipment Loan Program.** To be eligible, the loan must be for the purpose of financing the purchase and installation of fire safety equipment, primarily fire sprinkler systems. This includes the cost of structural modifications where necessary to install the equipment. The equipment to be installed must be in compliance with or exceed the requirements approved by Centers for Medicare and Medicare Services (CMS). For non-CMS regulated residential healthcare facilities, the Lender must provide documentation sufficient to ORCF that the fire sprinkler system is in compliance with its State's regulatory authorities.

2.5 General Section 232 Requirements

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The following requirements or program features apply to *all* Section 232 mortgage insurance programs:

A. **Regulatory Agreement.** All Borrowers and Operators must execute an ORCF Regulatory Agreement governing the operation of the project in order to comply with Program Obligations, the requirements of the National Housing Act, as amended, and the regulations adopted by HUD. The regulatory agreement will be recorded at Initial Closing and will continue during such period of time as HUD is the owner, holder or insurer of the Note. Borrowers and Operators are responsible for any violations of the Regulatory Agreements and may be subject to adverse actions if violations occur. The Borrower Regulatory Agreement is Form HUD-92466-ORCF and the Operator Regulatory Agreement is Form HUD-92466A-ORCF.

~~A.~~B. **Single Asset Entity Borrower.** Single-asset entities (SAE) may also be referred to as single-purpose entities (SPE). The mortgaged ~~property~~ healthcare facility must be the only asset of the Borrower; however, the Borrower entity is permitted to operate the project. ORCF may approve, in very limited circumstance, a non-single asset government-entity Borrower~~ entity~~, such as a Public Housing Authority.

~~B.~~C. **Single Asset Entity Operator.** Single-asset entities (SAE) may also be referred to as single-purpose entities (SPE); i~~I~~t is HUD's intent that the Operator will generally only own assets related to or necessary for the operation of the healthcare project.~~).~~ ~~As delineated in 24 CFR 232.1003, T~~~~the~~Unless one of the circumstances below applies, the Operator entity ~~shallmust~~ that operates the Section 232 healthcare project shall be a SAE.~~ that operates the Section 232 healthcare project.~~ ~~It is HUD's intent that the Operator will only own assets related to or necessary for the operation of the healthcare project.~~ The Operator entity is not required to be a SAE when any one or more of the following circumstances applies.

~~Circumstances under which exemption from this single asset operator entity requirement may be considered~~ are acceptable to ~~include, without limitation, those in which:~~

1. The entity, although named on the license (in which HUD must obtain a security interest), does not hold or control substantial other project assets.

2. The entity's organizational purpose is limited to operating healthcare facilities, and the entity demonstrates, to HUD's satisfaction, (a) strong overall operational and financial capacity, and (b) that all operator assets of the project are legally protected from expenses or claims arising from the operator's activities outside of the subject Section 232 facility and other facilities covered by the same HUD-approved master lease, or

3. The project is a currently FHA-insured project for which refinance or a Transfer of Physical Assets is being requested and, during the operator's extended tenure at the project, the project's performance has been acceptable to the Lender and HUD.

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Operators who are not SAEs must fully document that one of the above enumerated circumstances applies.

D. **Leased Projects.** Section 232 Borrowers are permitted to lease projects to qualified Operators. See Production, Chapter 8 for details on the requirements for leased projects.

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E. **Special Use Facilities.** Special use facilities are facilities that serve a niche market (e.g. psychiatric facilities; facilities for the developmentally disabled; drug, alcohol, or eating disorder recovery facilities; hospice facilities). ORCF has continued to experience extremely high claim rates of such facilities. ~~Lenders interested in submitting an application for a Special Use Project must contact ORCF in advance to discuss the project, its eligibility or non-eligibility, and its feasibility~~. If the Section 232 Lender decides to submit an application for a Special Use Facility, ORCF would anticipate a very conservatively underwritten application which would address, without exclusion, the following (as appropriate):

1. The uncertain future viability of the project in the context of state initiatives to re-balance Medicaid funding toward home and community-based services (HCBS),
2. The impact on the subject facility of the Centers for Medicare and Medicaid's Final Rule on home and community-based settings,
3. The potential risk to the project in the context of continuing efforts to enforce the 1999 Olmstead decision, which requires states to eliminate unnecessary segregation of persons with disabilities and to ensure that persons with disabilities receive services in the most integrated setting appropriate to their needs, and

~~1.~~4. The obsolescence risk of a high acuity facility, and the facility's capacity to continue servicing the debt in the event that market/provider payment changes dictate that alternative/modified uses of the facility be pursued.

~~E.~~F. **Independent Living Units:**

1. ORCF will allow up to 25% of the units or beds in a Section 232 project to be for Independent Living residents. Residents in Independent Living Units do not need to meet ORCF's definition of frail elderly. The project must offer services to all residents in the project comparable to those found in a skilled nursing project, assisted living project, board and care project or intermediate care project. Independent Living Units do not need to be licensed—they may be licensed or un-licensed. The units must be of a complimentary design and use to the rest of the project.

2. Lenders proposing a project containing a percentage of Independent Living Units exceeding 25% may wish to insure the project under two loans. ORCF has insured loans on projects where a portion of the project was insured under Section 232 and another portion was insured under Section 221(d)(4) or Section 231. Lenders wishing to pursue such a project must contact ORCF and ORCF will need to coordinate with Multifamily

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staff in the processing of the project – the Section 232 loan would be processed by ORCF and the Section 221(d)(4) or Section 231 loan would be processed by the Office of Multifamily Housing.

~~F.~~G. **Assessment Fees.** Assessment fees are paid upon entry to the project for purposes of covering the cost of assessing a new resident's need for services. Assessment fees that are in line with the prevailing market conditions are permitted.

~~G.~~H. **Scattered Site.** Projects not located on the same contiguous site are eligible for mortgage insurance under Section 232 under certain conditions. HUD generally requires that the two sites are under the same license, but may consider projects involving two different types of facilities, such as a Skilled Nursing Facilities (SNF) and an Assisted Living Facility (ALF), that cannot be under the same license. Additionally, HUD would look for evidence submitted by the Lender that demonstrates the parcels physically comprise a readily marketable real estate entity (e.g., the same immediate neighborhood) and that they are within an area limited enough to allow convenient and efficient management.

~~H.~~I. **Project Design.** Project design must cater to the specialized needs of the residents and be consistent with the market and industry best practices and accessibility requirements.

~~I.~~J. **Commercial Space.** Varies by program.

~~J.~~K. **Non-Resident Adult Day Care.** An eligible Healthcare project may provide nonresidential (outpatient) care for elderly individuals and others (e.g., persons with physical or mental disabilities) who require care during the day. A project that contains *only* a day care component is *not* eligible under Section 232. Non-resident adult day care space may not exceed 20% of the gross floor area of the project and nonresident day care income may not exceed 20% of gross income. The Lender must provide a Certificate of Need or operating license, if applicable, and must demonstrate that the day care space will be self-supporting.

~~K.~~L. **Real Estate requirements.** The mortgage must be on real estate held:

1. In fee simple;

2. Under a ground lease for not less than 99 years which is renewable; or

3. Under a ground lease approved by ORCF with a minimum term of 10 years beyond the loan maturity date.

~~L.~~M. **Environmental Review.** ORCF must comply with various environmental laws and regulations. ORCF imposes submission requirements on Lenders to assist in this review. These requirements are detailed in Production, Chapter 7, Environmental Review.

~~M.~~N. **Lender Site Visit.** The site inspection is an integral part of the overall underwriting process, and it is most appropriate that the Lender's underwriter for that transaction

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perform that site inspection. In rare circumstances this may be infeasible, in which case either the underwriter trainee assigned to that particular project or another Lean-approved underwriter in that firm may conduct the inspection. If the Lender has an employee who is a licensed appraiser (not a third-party contractor), ORCF will consider approving that individual to do a site inspection on a transaction-by-transaction basis. Requests for such approvals must be submitted to Lean Thinking.

~~N.~~O. **Prior Defaults/Claims.** ORCF does not prohibit applications for mortgage insurance for formerly HUD-held loans. However, ORCF is not obligated to accept any application with a Borrower/principal who has not proven to be a good business partner or for a property which has proven to be unsuccessful in the past. In such cases, the Lender should accept such applications only after they have considered and documented the economic, physical, operational or management factors that led to the specific changes that have occurred which would justify an application for new mortgage insurance.

~~O.~~P. **Non-recourse.** The ORCF Healthcare Project Note (Form HUD-94001-ORCF) contains a non-recourse provision. The non-recourse nature of the loan is not absolute, and can be overridden based on intentional bad acts as described in Section 8 of the Healthcare Project Note, Section 38 of the Healthcare Regulatory Agreement—Borrower, and Section 6 of the Healthcare Security Instrument, Form HUD-94000-ORCF. See Production, Chapter 6.1 E.3 for guidance on identifying those individuals or entities who will be personally liable for certain enumerated matters identified in the Regulatory Agreement.

~~P.~~Q. **Liens/Secondary Financing.** Section 232 of The National Housing Act requires mortgages insured under Section 232(either directly or pursuant to 223(f) or 223(a)(7) to be first liens. Mortgages insured under Section 241, 223(d), or 232i may be subordinate to other loans Secondary liens are permitted , in accordance with requirements for secondary financing described in Production, Chapter 3.

~~Q.~~R. **Loan Term.** Varies by program. See individual program sections below for more information.

~~R.~~S. **Amortization plan.** All FHA-insured loans must fully amortize through a level annuity monthly payment plan (LAMP), which requires equal monthly payments of principal and interest. LAMP variations are permissible for transactions involving bond financing and/or tax abatement.

~~S.~~T. **Interest Rate.** The interest rate on an FHA-insured loan is negotiated between the Borrower and Lender and must be fixed for the term of the loan. If the interest rate is locked at a higher rate than is represented in the Firm Commitment, ORCF may reevaluate the terms of the Firm Commitment.

~~T.~~U. **Prepayment Restrictions.** ORCF permits prepayment restrictions in connection with the financing in compliance with 24 CFR 200.87.

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~~U.~~V. **Underwriting Existing ORCF insured projects.** When underwriting projects that are currently FHA-insured, the Lender must do the following:

1. Disclose in the application that the project is FHA-insured and provide the existing project number.

2. Review the latest Real Estate Assessment Center (REAC) physical inspection report, if applicable, to assure that the Property Capital Needs Assessment or 3rd Party Architecture and Cost Report addresses the deficiencies if the score was below 60 or had any Health and Safety deductions.

3. Review the current interest rate. If the loan will increase the interest rate, identify reasons why the increased interest rate is an acceptable risk to ORCF.

4. Review the current monthly Principal, Interest and Mortgage Insurance Premium (MIP) payment. If the monthly payment will increase, identify reasons why the increased payment is an acceptable risk to ORCF.

5. Prepayment approval must be obtained from ORCF via the Insurance Termination Request for Multifamily Mortgage.

6. Disclose whether any principals that participate in the project have changed and comply with Previous Participation requirements.

W. **HUD Fees:**
~~V.~~

1. **HUD Application Fee.** An application for Firm Commitment must be accompanied by an application commitment fee equal to $3 per $1,000 (30 basis points) of the requested loan amount with the exception of 232 (i) Fire Safety Equipment Loan Program. That fee is listed in Section 2.12 of this Chapter.

2. **HUD Inspection Fee:** Varies by program. See individual program sections below for more information.

X. **HUD Mortgage Insurance Premium (MIP):** The mortgage insurance premiums are based on a percentage of the loan amount and may vary, depending on the insurance program. The initial premium is payable in advance at Initial Endorsement (for Insurance of Advances transactions) and at Initial/Final Endorsement (for Insurance Upon Completion transactions). Current fees are published in the Federal Register. ORCF does not regulate the amount or timing of mortgage insurance premium collection by Lenders from Borrowers. Lenders may have their own policies as they deem appropriate, although regardless of such policies the lender remains responsible for remitting the MIP to HUD under the mortgage insurance contract.

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~~W.~~Y. **Lender Fees and Charges.** Varies by program. See Production, Chapter 3 for limits to lender fees and charges.

~~X.~~Z. **Non-profit Developer and Housing Consultant Fees.** Non-profit Developer and Housing Consultant Fees are not permitted as mortgageable expenses on Section 232 projects.

~~Y.~~AA. **Reserve for Replacement.** Varies by program. Initial deposits to the account are to be made in cash at the time of the loan closing. See individual program sections below for more information.

~~Z.~~BB. **Cost Certification.** Cost Certification requirements can be found in Production, Chapter 11. Cost Certifications are not required on Section 232/223(a)(7) (except those 232/223(a)(7) projects with repairs without a PCNA provided in the Firm Application) or Section 232/223(d) projects. Projects with housing tax credits may be exempt from cost certification requirements (See Production, Chapter 12).

~~AA.~~CC. **Insurance Requirements.** ORCF requires several types of insurance for Section 232 projects such as Professional Liability Insurance, Fidelity Bond Insurance, Property Insurance and Hazard Insurance. These insurance requirements are detailed in Production, Chapter 14.

~~BB.~~DD. **Licensing.** Licenses are pledged as security for the loan, and any modifications (additions, deletions or major improvements) in the bed authority must be approved by ORCF. Any change in bed capacity without ORCF approval is a violation of the Regulatory Agreement. The Firm Application must include a copy of any current project licenses related to the project as well as an explanation in the Lender Narrative of the number of beds and units licensed vs. underwritten. For beds requiring licensing, the number of licensed beds must be greater than or equal to the number of underwritten beds.

~~CC.~~EE. **State Approvals.** The following approvals are required:

1. Certificate of Need. If applicable in the State where the project is located, Skilled nursing care and intermediate care beds require a certificate of need (CON) from the state agency with jurisdiction.

2. If no authorized State agency exists, or if it is not empowered to execute a CON, the State may conduct or commission an independent study of market need and feasibility acceptable to ORCF that:
   a. meets the standards of the American Institute of Certified Public Accountants, as certified by the State and/or preparer of the market study,

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b. assesses market need on a market wide basis, including excess beds and typical market wide operating occupancy rates of existing projects,
c. discusses the impact of the proposed project on other healthcare projects and services in the area,
d. provides demographic projections (size, density, distribution and vital statistics on household income) for the proposed project and market area,
e. discusses available alternative healthcare delivery systems (geriatric day care, board and care, etc.),
f. describes the reimbursement structure or payment sources of the proposed project and that of the competing projects in the area, including percentage of self-pay clients and daily cost to the client; percentage of Medicaid/Medicare clients and reimbursement rate; percentage of other clients (managed care, etc.).
g. estimates market absorption period of beds in the proposed project by month including discussion of market supply, market reaction to unit type (private, semiprivate, 3-bed, etc.) and resident turnover.

3. If the State is not authorized to conduct, commission or certify the study as to form and substance, the Lender must provide financial and market information acceptable to ORCF.

4. The proposed Borrower may reimburse the State for the cost of the independent market and feasibility study.

5. Substantial Rehabilitation. If the authorized State agency requires a new CON, a new certification on Form Certificate of Need, (CON), for Health Project and Assurance of Enforcement (Form 92576A-ORCF) must be submitted. If the authorized State agency does not require a new CON, the Lender must provide a statement from the State agency that a new CON is not required and a copy of the original CON, if available. If a copy of the original CON is not available, please explain. If there is no authorized State agency and the rehabilitation involves new beds, the alternative market study described above must be submitted.

6. Acquisition or Refinancing. If the authorized State agency requires a new CON, a new certification on Form 92576A-ORCF must be submitted. If the authorized State agency does not require a new CON, a statement from the State agency and the original CON must be submitted, if available. If a copy of the original CON is not available, please explain. .

7. Bed authority modifications. Any proposed modifications (additions, deletions or major improvements) in the bed authority for any Section 232 project must receive prior approval from ORCF in order to protect ORCF's security interest. The Lender is expected to provide certification that the security for the loan after the release still exceeds the unpaid principal balance.

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8. If the State requires a CON for assisted living or board and care facilities, the Lender must submit a copy to ORCF.

~~DD.~~FF. **Experience of the Development Team.** Only Borrowers, Operators and Management Agents whose principals have at least three years of experience successfully operating multiple projects with the types of beds proposed will generally qualify for ORCF mortgage insurance. Those participants with experience successfully operating only one project must have a longer operating history than three years. Experience in a market near the proposed market is more highly valued than experience in a different region of the country. The experience must include marketing, operating, and where applicable, developing and leasing up the types of beds proposed. Experience of the Management Agent or Operator is generally not an acceptable mitigant to offset the Borrower's lack of experience. The evidence provided to document this experience must include a complete list of the names of each project, types of care provided, locations, unit and bed count, and dates. If a firm application proposes to add units to the market, the evidence must also include key operating metrics from initial lease-up to stabilization, including fill pace, occupancy, and Net Operating Income. If the firm application cites the experience of the principals of the Operator or Management Agent, the evidence must also include the specific responsibilities for those entities at each project. ORCF must ensure that participants have the requisite business and healthcare expertise to operate the project successfully and understand the health-related and hospitality-oriented needs of the proposed clientele.

~~EE.~~GG. **Previous Participation Certification.** The purpose of the Previous Participation Certification process is to assure that participants in ORCF projects are responsible parties with regard to their participation in other governmental housing transactions. Participants in the proposed transaction must submit information regarding previous participation in governmental housing transactions either via the electronic Active Partner Participation System (APPS) or on the Previous Participation Certification for approval for participation in any HUD program of mortgage insurance. All entities and principals that submit a Previous Participation Certification must also register in the Business Partner Registration System (BPRS) prior to submitting their Previous Participation Certification. APPS submissions and Previous Participation Certification submissions must be approved prior to issuance of a Firm Commitment. Should participants change, revised submissions must be completed and approved prior to closing. Note that, though the guidance presented here regarding Previous Participation Certification is current at the time of publication, the applicable requirements are subject to amendment from time to time via Rule, Notice or other means, in which case the more current publications will control over what is set forth herein.

1. The following entities and their principals must file either an electronic APPS submission or a paper Previous Participation Certification:
    a. Borrower
    b. Management Agent
    c. Operator

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d. Master Tenant
e. General Contractor

Note: Previous Participation Certifications are not required for Project Administrators.

2. Principals are defined as follows for APPS and Previous Participation Certification purposes:
   a. Limited Liability Companies (LLCs)
      i. All Managing Members regardless of their ownership percentage
      ii. All Members with 25% or more ownership in the LLC
   b. Limited Partnerships (LPs)
      i. All General Partners regardless of their ownership percentage
      ii. Limited Partners with 25% or more ownership. EXCEPT: Limited Liability Corporate Investors (LLCIs) may file a LLCI certification instead of the Previous Participation Certification.
   c. Corporations
      i. All Corporate Officers (President, Vice-President, Secretary, Treasurer, etc. This includes non-profit officers of the board of directors and staff members who are considered corporate officers)
      ii. All voting members of the board of directors (this includes all non-profit board members)
      iii. ~~For publicly traded companies, a~~All stockholders that own 10% or more of the company's stock

3. **Organization Charts.** Organization charts are a visual representation of the ownership structure of an organization. An organization chart must be submitted for each entity that submits an APPS or Previous Participation Certification submission. The organization chart must include the following:
   a. Clearly show all tiers of the ownership structure.
   b. Shows all participants, not just those who the Lender considers to be principals.
   c. Shows percentages of ownership and role in the entity (e.g. Limited Partner, General Partner, Managing Member, etc.).
   d. Includes a natural person/people, and not just entities.
   e. Each entity must be shown on a separate organization chart (e.g. Borrower, Operator, Management Agent, Master Tenant, etc.).

4. For both APPS and paper Previous Participation Certification submissions, APPS will check the following data sources for derogatory information on the entities being reviewed:
   a. Government-wide Suspensions and Debarments that APPS downloads from the GSA Excluded Parties List System (EPLS).
   b. Participant Flags that HUD staff entered into APPS.

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c. PPRS/F19 Participant Flags that HUD staff originally entered into that system and which have been converted into APPS.
d. Previous participation that the industry entered into APPS (with REAC and non-REAC physical inspection ratings).
e. REAC Physical Inspections.
f. Participant marks that HQ entered into APPS.
g. Certifications that the industry entered into APPS.

5. If the participant is found to have derogatory information in the APPS system, the ORCF underwriter may request an explanation from the Lender.

~~FF.~~HH. **Risk Management Program.** Operators must implement and maintain a risk management program which incorporates a real-time incident reporting and tracking system that informs Operator's senior management of all incidents with the potential to expose the Operator to liability for personal injury or other damages. Each incident must be reviewed by the Operator's appropriately-trained professional staff, and such staff must follow-up on incidents as necessary. The risk management program must include appropriate training for Operator's staff.

The risk management program, which must be reviewed and approved by ORCF prior to closing, is expected to be maintained for the life of the loan. If at some time in the future the Operator requests to make any changes to the original risk management program that was approved by ORCF prior to closing, Asset Management would review and consider the request on a case-by-case basis.

1. **Internal.** Operator has the capacity to administer risk management that includes developing and documenting a risk management plan, incorporating a comprehensive software-based risk management program and have designated staff positions to implement the risk management program**.** In this approach, a highly experienced long-term care risk manager develops the company's risk management program, tracks incidents, analyzes incident trends, trains/re-trains front line staff as needed, works with the professional liability insurance carrier, etc. This could be implemented across multiple projects. This would be acceptable if the Operator has the capacity and track record as demonstrated through appropriate quality of care indicators.

2. **External.** Operator contracts with an experienced third party provider of electronic risk management. This would be required if the Operator does not have the capacity to develop and implement an internal program or if the quality of care indicators are below an acceptable level. This level of risk management provides the highest degree of confidence, accuracy and follow-through on reducing incidents and claims.

The statement of work must include, at a minimum, the following:
a. Access and use of an electronic incident tracking and reporting system

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b. Project incident reporting and tracking with the third party provider's data processing/risk management center
c. Clinical specialists to review all incidents and trends and train staff accordingly
d. Assist the project in developing, implementing and maintaining appropriate risk prevention initiatives

~~GG.~~II. **Deposit Account Control Agreement (DACA-Non-Governmental Receivables).** ORCF requires the Borrower, Operator and/or Master Tenant to execute one or more deposit account control agreements or similar agreements in a form approved by the FHA Lender and ORCF. In this agreement(s), the Borrower, Operator and/or Master Tenant acknowledge the FHA Lender as a secured party and grants to the FHA Lender control (as defined in Section 9-104 of the UCC) of one or more deposit accounts of the Project and all cash, moneys and other property on deposit.

~~HH.~~JJ. **Deposit Account Instructions and Service Agreement (DAISA-Governmental Receivables).** ORCF requires the Borrower, Operator and/or Master Tenant to execute one or more DAISAs or similar agreements in a form approved by the FHA-insured Lender and ORCF on all projects with Governmental Receivables including accounts receivable from Medicaid, Medicare, or any other federal/state/local governmental entity that reimburses a health care project for patient services**.** This agreement outlines the instructions to the depository bank regarding its receipt of funds from governmental reimbursements and generally requires a daily sweep of such funds into an account subject to a deposit account control agreement.

~~II.~~KK. **Accounts Receivable Financing and Deposit Account Control Agreements.** For projects involving Accounts Receivable ("AR") financing, the AR Lender will also be a party to the deposit account control agreements. In some instances, the AR Lender will also be the depository bank under the deposit control account agreements. The deposit account control agreements must address the priorities between the AR Lender and the FHA Lender in the deposit account. Generally, the AR Lender will have a first lien on the AR and the FHA Lender will have a second lien on the AR. The FHA insured Lender must have a secured interest in the AR and the FHA Lender must be able to capture the funds in the event that HUD takes possession of the Project.

~~JJ.~~LL. **Sinking Fund.** The purpose of a Sinking Fund Account is to capture excess project capital in the earlier years of a FHA insured mortgage and to set aside funds in a separate account to make principal payments in the later years of the mortgage in the event that project revenues are not sufficient to make the principal payments. The amount to be set aside is provided in the amortization schedule for the FHA mortgage. ORCF requires the establishment of a Sinking Fund Account for nursing homes in States that:

1. Include a capital component (depreciation and interest) that is greater than an insignificant amount in their Medicaid reimbursement to nursing homes, and

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2. Use a pass-through method of paying the provider for the depreciation (straight line depreciation) on assets.

The sinking fund is "funds held by Lender on behalf of the Borrower," is held under the contract of mortgage insurance "for and on behalf of the Borrower," and as such, is unrelated to the bond transaction.

1. The Borrower must:
    a. Agree to all requirements and conditions of ORCF.
    b. Authorize through a power of attorney the appointment of the Lender as payee of third-party reimbursement checks (project funds) in the event of a default.
    c. Sign a sinking fund agreement with the Lender in addition to a regulatory agreement with HUD.
    d. In the event of default under the terms of the mortgage, pursuant to which the loan has been accelerated, the Secretary may apply or authorize the application of the balance in such fund to the amount due on the mortgage debt.
    e. In the event of any conflict or inconsistency between this agreement and the FHA mortgage insurance documents, rules or regulations, the FHA mortgage insurance documents, rules and regulations shall control and prevail.

2. The sinking fund agreement must provide that withdrawals be made in accordance with an amortization schedule prepared by the Lender and only with the counter-signature of the Lender. The use of these funds for any other purpose is prohibited, without the express written permission of ORCF.

~~KK.~~MM. **Initial Operating Deficit (IOD).** An IOD analysis is required on all applications where new units are being added to the subject or when the occupancy performance assumptions used in the underwriting are not presently being achieved by the subject. This analysis must be on the Initial Operating Deficit Escrow Calculation Template (Form HUD-91128-ORCF). Instructions for completing the Initial Operating Deficit Escrow Calculation Template can be found in Appendix 2.1. An escrow will be required when any period of deficit operations is identified. The escrow will provide funding for operating expenses and debt service when net income is inadequate during the initial lease-up and stabilization period. The escrow is not mortgageable, and must be funded either through cash or through one or more unconditional, irrevocable letter(s) of credit issued to the Lender by a banking institution.

Disbursements from the escrow may be authorized monthly with written approval from the Lender's Servicer and ORCF to meet any Cash Deficit in the operation of the Project. The term Cash Deficit means the shortfall between Income and Reasonable Operating Expenses. The IOD may also be used to cover Debt Service Payments and Reserve for Replacement Deposits. Expenses not accounted for in the IOD calculation must not be considered reasonable operating expenses. Unused portions will be returned to the Borrower ~~at the later of~~ twelve months after final closing ~~or~~ and when the project has

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demonstrated to ORCF's satisfaction that the Project has achieved a debt service coverage ratio (including the Mortgage Insurance Premium) of at least 1.45 for each month of three consecutive months. ORCF will look to the servicing Lender to certify that this requirement has been met, based on financial statements provided to the Lender by the Borrower.

~~LL.~~NN. **Short-Term Debt Service Reserve Escrow (DSR).** A DSR may be required on applications where units are being added to a market, or in 223(f) applications where projects have not demonstrated the underwritten NOI for an appropriate period of time. The DSR will be between six and twelve months of principal, interest and MIP payments, or longer as needed to mitigate risk. The escrow will provide funding for debt service payments in the event that income is not available during the initial lease up and stabilization period and the IOD is depleted. The escrow is not mortgageable, and must be funded either through cash or one or more unconditional, irrevocable letter(s) of credit issued to the Lender by a banking institution.

Disbursements from the escrow may be authorized monthly with written approval from the Lender's Servicer and ORCF to make debt service payments after the start of amortization. Unused portions will be returned to the Borrower after the project has maintained an average of the underwritten debt service coverage for a twelve month period after final closing. ORCF will look to the servicing Lender to certify that this requirement has been met, based on financial statements provided to the Lender by the Borrower.

~~MM.~~OO. **Assurance of Funds to Meet IOD and DSR.** The Borrower may fund the IOD and DSR the following ways. Excess loan proceeds may not be used to fund these escrows.

1. **Cash.** Escrow Agreement for Operating Deficits (Form HUD-92476B-ORCF) must be used when assurance is funded via cash.

2. **One or more unconditional irrevocable letter(s) of credit**. Letters of Credit must be issued to the Lender by a banking institution. HUD assumes no responsibility for reviewing the letter(s) of credit for sufficiency or enforceability.

~~NN.~~PP. **Long-Term Debt Service Reserve Account.** If ORCF determines the loan presents an atypical long-term risk, ORCF may require that the Borrower establish, at final closing and maintain throughout the term of the loan, a long-term debt service reserve account. This account is an eligible mortgageable expense and is to remain for the life of the loan. The amount required to be initially placed in the long-term debt service reserve account and the minimum long-term balance to be maintained in that account will be determined during underwriting and separately identified in the Firm Commitment. Funds may be released from the account in extreme situations with ORCF approval. In the event that ORCF approves a release, the account must be refunded, and Borrower may take no distributions until the account is fully refunded.

~~OO.~~QQ. **Fair Housing and Equal Opportunity.** Borrowers and all contractors and

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subcontractors must comply with HUD Fair Housing and Equal Opportunity requirements, including selection of occupants, employment, physical and programmatic accessibility See (42 U.S.C. 3601, et seq.), (24 CFR Part 100 and subsequent Sections), and "Affirmative Fair Housing Marketing" (24 CFR Part 200.600 and Handbook 8025.1 Revision 2).

~~PP.~~RR. **Affirmative Fair Housing Marketing Plan.** Varies by program. See individual program sections below for more information.

~~QQ.~~SS. **Accessibility.** ORCF requires that projects be in compliance with various accessibility requirements. See the Section 232 Program website for specific requirements.

~~RR.~~TT. **Federal Labor Standards.** Varies by program. See individual program sections below for more information.

UU. **Military Impacted Areas.** ORCF generally does not provide mortgage insurance in military impacted areas unless ORCF determines that demand from nonmilitary households is sufficient to sustain occupancy in both the insured projects and the market as a whole.

2.6 Section 232 New Construction & Substantial Rehabilitation

A. **New Construction.** A project qualifies as new construction when all project and construction elements are installed as part of the construction contract and no work has been done prior to the issuance of the HUD Firm Commitment.

B. **Substantial Rehabilitation.** A project qualifies as a substantial rehabilitation project when:

1. The hard costs of repairs, replacements, and improvements (not including major movable equipment) exceeds 15% of the project's value after completion of all repairs, replacements, and improvements. Additions (new construction outside the existing building footprint) that are adding units are processed as Blended Rate. Additions (new construction outside the existing building footprint) that do not include new units are permitted in substantial rehabilitation projects, but the costs of the addition are not included in the eligibility test; OR

2. Two or more major building components are being substantially replaced. The component must be significant to the building and its use, normally expected to last the useful life of the structure, and not minor or cosmetic. Substantially replaced means that at least 50% of the component must be replaced. Examples of major building components are: roof structures, wall or floor structures, foundations, plumbing, central heating and air conditioning systems, and electrical systems. An example related to a roof replacement is as follows: major building

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components: roof sheathing, rafters, framing members; minor building components: shingles or built-up roofing.

C. **Insurance of Advances vs. Insurance Upon Completion.** ORCF can insure loans to cover both the construction and permanent loan (Insurance of Advances) or just the permanent loan (Insurance upon Completion). See Production, Chapter 18 for specific instructions for Insurance Upon Completion projects.

D. **Loan Term.** The maximum loan term is 40 years or 3/4 of the remaining economic life of the property, whichever is less. The minimum loan term may not be less than 10 years.

E. **Commercial Space:** Commercial space is limited to a maximum of 10% of the gross floor area of the project and 15% of the gross project income. Commercial space that is intended to exclusively serve the residents of the project is not counted toward the space and income limitations. The Lender must use a minimum vacancy of 20% when underwriting commercial space income. The Borrower must submit copies of the commercial leases to ORCF for approval. ORCF may require additional documentation prior to approving commercial space.

F. **Cost Certification.** The Borrower is required to submit a cost certification prepared by an independent public accountant upon completion of construction or substantial rehabilitation. The general contractor is required to submit a cost certification where a cost plus form of construction contract is used. Subcontractors with an identity of interest with the Borrower or general contractor are also required to cost certify. The loan amount that is finally endorsed for insurance by ORCF after completion of construction may be affected by the ORCF cost certification review. (See Production, Chapter 11 for complete details.)

G. **Federal Labor Standards.** The general contractor and all subcontractors are required to comply with federal wage and reporting requirements, including the payment of Davis Bacon prevailing wages and the submission of weekly certified payroll reports. Prevailing wage schedules are issued by the Department of Labor, and are available on their website. There are two different types of wage rates that could apply to Section 232 projects, Residential and Commercial, based on definitions established by the Department of Labor. The Lender must review which wage decision applies to the project in the Lender narrative, but ultimately the wage decision is determined by HUD's Office of Labor Standards and Enforcement~~Relations~~.

H. **Assurance of Completion.** The Borrower shall provide for assurance of completion of the project in forms approved by ORCF.

1. For non-elevator or three story or less elevator buildings where the cost of construction or rehabilitation is more than $500,000 the assurance must be in the form of corporate surety bonds for payment and performance, each in the amount of 100% of ORCF's estimate of construction or rehabilitation cost. As an option, ORCF would accept a completion assurance agreement secured by a cash deposit or Letter of

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Credit in the amount of 15% of the ORCF estimate of construction or rehabilitation cost.

2. For elevator buildings of 4 stories or more, the assurance must be in the form of corporate surety bonds for payment and performance, each in the amount of 100% of ORCF's estimate of construction or rehabilitation cost. As an option, ORCF would accept a completion assurance agreement secured by a cash deposit or Letter of Credit in the amount of 25% of ORCF's estimate of construction or rehabilitation cost. The Lender may provide more stringent requirements.

I. **Inspection Fee.** The HUD inspection fee is $5 per thousand of loan amount for new construction (0.0050 x the loan amount), and $5 per thousand of improvement costs for substantial rehabilitation (0.0050 x Total Structures on the Form HUD 92264a-ORCF, Maximum Insurable Loan Calculation).

J. **Mortgage Insurance Premium (MIP).** As stated in Section 2.5 above, the current MIP rates are published in the Federal Register. For construction projects, the following apply:

1. The Lender must provide a check for one year of MIP at initial closing.

2. For underwriting and cost certification purposes, the MIP must be calculated on a per diem basis.

3. Lenders may request release of funds from the working capital account to make the year 2 payment if the project has not yet reached final closing. This request must be made in writing to the ORCF Closing Coordinator.

K. **Working Capital Escrow:** The working capital escrow requirement for new construction Insured Advances transactions is 4% of the loan amount, half of which will be a construction contingency for cost overruns and approved change orders. A separate section to the working capital escrow will govern the 2% construction contingency. The construction contingency portion of the escrow will be refunded to the developer at final closing if not used. Change orders funded from the contingency portion of the working capital escrow will not be considered as the basis for a request for an increased loan amount. These funds are not mortgageable and the unused portion will be returned to the Borrower if not needed. The working capital portion of the escrow will be released upon the Lender's request ~~at the later of~~ 12 months after final closing ~~or~~ and when the project has demonstrated to ORCF's satisfaction that the project has achieved ~~6 months of~~ break-even occupancy for each month of six consecutive months. Break-even occupancy is defined as 1.0 debt service coverage, based on all sources of project income including ancillary income, for each of six consecutive months. New Construction projects that apply for insurance upon completion (without insured construction advances) and Substantial Rehabilitation projects must meet the working capital requirements for projects with insurance of advances except for the extra 2% construction contingency section of the working capital requirement.

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The Working Capital Escrow is designed to cover accruals of taxes, insurance, and interest in the case of construction delay, construction contingencies for cost overruns and change orders, and other miscellaneous expenses which are not included in the loan and is required for new construction and substantial rehabilitation proposals. A working capital escrow is required for both for-profit and non-profit projects.

L. **Major Movables.** Reasonable costs of Furniture, Fixture and Equipment (FF&E) may be included in the mortgageable project costs.

M. **Minor Movable Equipment and Supplies.** Costs for expendable nonrealty items such as china, flatware, utensils and instruments, linens, etc. may not be included in the general construction contract nor in major movable equipment. A minor movables equipment escrow account must be established at initial closing. The Lender must complete an analysis of the needed minor movable equipment and provide ORCF with a cost estimate for the minor movable equipment escrow.

N. **Reserve for Replacement.** Ongoing deposits to the reserve for replacement are required for all projects. The formula for calculating the annual Reserve for Replacement deposit is 0.0060 x Structures plus 0.10 x Major Movable Equipment as noted on the Maximum Insurable Loan Calculation, Replacement Cost Tab. For New Construction projects, there is no initial deposit to the reserve for replacement. For substantial rehabilitation projects, the Lender must assess whether an initial deposit to the reserve for replacement is necessary.

O. **Builder and Sponsor's Profit and Risk Allowance (BSPRA).** HUD's Section 221(d)(4) Multifamily Housing Mortgage Insurance program allows for the use of BSPRA. The calculation of BSPRA is not applicable for Section 232 projects.

P. **Deferred Builder's Profit.** Borrower and General Contractor may wish to defer payment of part or all of the Builder's Profit until final closing. This is allowable, but must be disclosed in the Construction Contract and on Contractor's and/or Mortgagor's Cost Breakdown (Form HUD-2328).

Q. **Affirmative Fair Housing Marketing Plan.** The Affirmative Fair Housing Marketing Requirements (24 CFR 200.600, Subpart M) apply to all insured new construction and substantial rehabilitation projects. Each applicant must submit an Affirmative Fair Housing Marketing Plan (Form HUD-935.2A). The plan must describe an affirmative program to attract tenants regardless of race, color, religion, sex, marital status, actual or perceived sexual orientation, gender identity, disability, familial status or national origin to the housing for initial rental. The affirmative advertising program must use majority and minority media and must identify those groups within the eligible population that are considered least likely to apply for the housing without special outreach. The plan must also include information on the applicant's nondiscriminatory hiring policy, its training program on nondiscrimination for its rental staff, and the display of the Department's Equal Housing Opportunity logo type and slogan. HUD must review and approve the Plan.

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R. **Pre-Opening Management Fees**. Pre-Opening Management Fees include preparing, updating and reviewing lease-up and operational budgets; budgeting, coordinating, and planning for appropriate furniture, fixtures, and equipment; coordination and selection of appropriate business systems (e.g., emergency call, phone and computer systems); occupancy development; licensing submissions and plans; staff hiring and training; and, development of operations and systems manuals for major functions (administration, nursing, marketing, dietary, etc.). ORCF will allow reasonable pre-opening management fees to be included as a mortgageable item in the event that there is not an identity of interest between the Borrower and entity that will be providing the pre-opening management services. The Lender must review the prior experience of the service provider to ensure they have sufficient experience and must submit a line item budget detailing how the funds will be used.

S. **Marketing.** An allowance for marketing expenses may be included as a mortgageable item. The Lender must review the marketing plan and budget to assure that the marketing expenses are reasonable, and that sufficient funds will be available to market the project.

2.7 Section 232 Blended Rate

A Section 232 Blended Rate loan is for a project that combines ~~new~~ construction ~~of units/beds~~ with the purchase or refinancing of existing units/beds that do not require substantial rehabilitation – in one loan. These requirements blend together Section 232 New Construction and Section 232/223(f) underwriting requirements. If repairs on the existing units/beds meet ORCF's definition of substantial rehabilitation, the project must use the Section 232 Substantial Rehabilitation program. Blended rate projects are generally underwritten and reviewed in the same manner as are the Section 232 Substantial Rehabilitation projects as clarified below:

A. **Inspection Fee.** Same as for Substantial Rehabilitation.

B. **Mortgage Insurance Premium (MIP).** The MIP rate is the same as for Section 232 Substantial Rehabilitation projects unless otherwise noted in the Federal Register.

C. **Loan-to-Value.** The Lender may use a blended loan-to-value that takes into account the number of new (using Section 232 substantial rehabilitation loan-to-value) and existing (using Section 232/223(f) Loan-to-Value) beds. See Production, Chapter 3 for more information on calculating the loan-to-value limit.

D. **Loan Term**. The maximum term of the loan will not exceed 75% of the remaining economic life of the existing health care project or 35 years, whichever is less. A lower term may be appropriate to mitigate loan risk, but may not be less than 10 years.

E. **Reserve for Replacement.** A 15-Year Replacement Reserve analysis with recommendations for Initial and Annual Reserve Deposits must be submitted by the Lender

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in the loan application package. The Lender is required to obtain a PCNA to re-analyze the capital needs in Year 10. The Reserve for Replacement schedule must include the following:

1. Combined analysis of both capital items and major movable equipment;

2. Recommendation of an Initial Deposit;

3. Recommendation of Annual Reserve Deposits :
    a. Must reflect level annual deposits in years 1 through 15, and
    b. Must have a minimum balance of $1,000 per unit in years 1 through 15.

F. **Affirmative Fair Housing Marketing Plan Requirements (AFHMP).** ~~An AFHMP is required for projects that are adding units/beds. Projects not adding units/beds are not required to complete an AFHMP. See Section 2.6 Q for more information on completing the AFHMP~~An AFHMP is required for new projects and an updated AFHMP is required when there is an increase or reduction in the number of beds or units, or when there is some other form of physical conversion, such as the conversion of beds to more conventional dwelling units or vice-versa. Such physical changes have implications for possible changes in marketing strategy. When any AFHMP is prepared, it must ~~should~~ include a marketing strategy designed to reach the population in the market area that is least likely to apply for or occupy the particular project. Form HUD-935.2A (the AFHMP) provides instructions for determining marketing targets and completing the form.

An existing AFHMP must be reviewed at least every five years and when there are significant demographic changes in the marketing area - to determine whether an update is needed. Also, an existing AFHMP must be reviewed to see if an update is needed when other significant events occur or changes in occupancy policies are proposed - for example, a proposed change in the targeted mix of elderly residents and non-elderly disabled residents. Other examples of circumstances when an AFHMP should be reviewed for a needed update include if the project is having difficulty maintaining occupancy, if there is a change in the designation of the marketing area or expanded marketing area, and if the composition of current occupancy or the waiting list do not sufficiently match the diversity of the current or proposed marketing area. The project owner or management must maintain records of the result of the review and, whether an updated form must be submitted to HUD for approval or not, the records must show that a review was conducted, the results of the review, and whether/how the AFHMP was updated or why an update was not needed.

~~F.~~G. Federal labor standards that apply to Section 232 new construction and substantial rehabilitation projects also apply to Blended Rate projects.

2.8 Section 232/241(a) Supplemental Loans

A Section 232/241(a) Supplemental Loan may be used to (1) finance improvements or additions to an existing HUD insured Section 232 project (including the addition of new beds/units); (2) provide financing for furniture and major movable equipment to be used in the operation of the project, and/or (3) finance energy conservation improvements. This financing is a supplement to the existing insured loan(s) and is available without refinancing the existing loan(s). The purpose of the supplemental loan is not to provide luxury items, nor is it to provide extensive hospital type equipment in a residential healthcare project. The purpose is to provide projects with a means to keep the project competitive, extend its economic life, and provide for financing replacement of obsolescent equipment.

Borrowers proposing to include a land purchase with a Section 241(a) Supplemental Loan may be able to do so as long as the addition or improvements are funded with the proceeds of the supplemental loan, and the construction is commenced within a reasonable time from closing; however the 241(a) supplemental loan on an existing 232 project may not exceed the maximum mortgage amount prescribed under Section 232 of the National Housing Act.

The supplemental loan does not alter the usual requirements outlined in the original Regulatory Agreement. Section 232/241(a) projects are generally underwritten and reviewed in the same manner as are the Section 232 Substantial Rehabilitation projects as clarified below:

A. Insurance of Advances. Insurance of advances will be available only for supplemental loans of $100,000 or more.

B. Inspection Fee. Same as for Substantial Rehabilitation.

C. Working Capital. No working capital deposit is required.

D. Labor Relations. ~~Supplemental loans under Section 241 of the Act are subject to the provisions of Section 212 that are applicable to the section or title pursuant to which the mortgage covering the project is insured or pursuant to which the original mortgage covering the project was insured.~~ When a supplemental loan is provided under Section 241(a) of the Act, it is subject to Davis-Bacon prevailing wage requirements only if (1) the current mortgage on the project is insured under a program that was subject to Davis-Bacon in accordance with Sec. 212 of the National Housing Act, or (2) the current mortgage is a HUD-held mortgage that was originally insured under a program that was subject to Davis-Bacon in accordance with Sec. 212. Davis-Bacon wage rates would-not apply to a Sec. 241(a) supplemental loan on a project where the current insured mortgage is not subject to Davis-Bacon and/or an earlier FHA-insured mortgage that was subject to Davis-Bacon has been paid off prior to application for the Sec. 241(a) loan. For example, if the project's original loan was a Section 232 New Construction loan (that has not yet matured or been pre-paid), the Section 241 loan would be subject to Davis-Bacon. If the project's original loan was a 232/223(f) loan, then the Section 241 loan would not be subject to Davis-Bacon.

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E. Loan Term. The loan term is limited to the lesser of: ~~the term of the existing insured mortgage, but may not be less than 10 years.~~

1. the term of the existing insured mortgage;
2. 75% of the remaining economic life; or
3. 40 years.

The loan term may not be less than 10 years.

F. Commercial Space. Commercial space is limited to a maximum of 10% of the gross floor area of the project and 15% of the gross project income. Commercial space that is intended to exclusively serve the residents of the project is not counted toward the space and income limitations. The Lender must use a minimum vacancy of 20% when underwriting commercial space income. The Borrowers must submit copies of the commercial leases to ORCF for approval. ORCF may require additional documentation prior to approving commercial space.

~~E.~~ **Reserve for Replacement.**
~~F.~~

G. The Lender must complete an analysis of the existing replacement reserve account to determine whether additional deposits to the account will be required as a result of the supplemental loan. A full 15-year analysis, similar to that completed as part of a Property Capital Needs Assessment (PCNA), may not be required if the status of the reserve for replacement account can be determined in consultation with the ORCF Account Executive. Annual Reserve deposits must be level (the same amount each year) in years 1-15, and must provide for a minimum of at least $1,000 per unit each year.

H. Affirmative Fair Housing Marketing Plan Requirements (AFHMP). ~~An AFHMP is required for projects that are adding units/beds. Projects not adding units/beds are not required to complete an AFHMP. See Section 2.6 Q for more information on completing the AFHMP.~~ An AFHMP is required for new projects and an updated AFHMP is required when there is an increase or reduction in the number of beds or units, or when there is some other form of physical conversion, such as the conversion of beds to more conventional dwelling units or vice-versa. Such physical changes have implications for possible changes in marketing strategy. When any AFHMP is prepared, it must~~should~~ include a marketing strategy designed to reach the population in the market area that is least likely to apply for or occupy the particular project. Form HUD-935.2A (the AFHMP) provides instructions for determining marketing targets and completing the form.

An existing AFHMP must be reviewed at least every five years and when there are significant demographic changes in the marketing area - to determine whether an update is needed. Also, an existing AFHMP must be reviewed to see if an update is needed when other significant events occur or changes in occupancy policies are proposed - for example, a proposed change in the targeted mix of elderly residents and non-elderly disabled

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residents. Other examples of circumstances when an AFHMP should be reviewed for a needed update include if the project is having difficulty maintaining occupancy, if there is a change in the designation of the marketing area or expanded marketing area, and if the composition of current occupancy or the waiting list do not sufficiently match the diversity of the current or proposed marketing area. The project owner or management must maintain records of the result of the review and, whether an updated form must be submitted to HUD for approval or not, the records must show that a review was conducted, the results of the review, and whether/how the AFHMP was updated or why an update was not needed.

2.9 Section 232/223(f) Refinance

The major requirements for Section 232/223(f) Projects for acquisition or refinancing are as follows:

A. **Property eligibility.** The project must have been completed or substantially rehabilitated for at least three years prior to the date of the Firm Commitment application. Projects with additions completed less than ~~3~~three years previous are eligible as long as the addition was not larger than the original project in size and number of beds.

1. Any property acquired before the date of the mortgage insurance application will be treated as a refinance transaction. Any property acquired after the date of the mortgage insurance application will be treated as a purchase.

2. In a purchase transaction, any identity of interest, however slight, between seller and purchaser requires the application to be processed as a refinance. An owner Operator that continues to operate the project after the sale constitutes an identity of interest.

B. **Ineligible projects.** Projects requiring a level of repairs that constitutes substantial rehabilitation, as defined in this chapter, and projects that propose construction ~~of new beds/units~~ outside the existing building footprint are not eligible for mortgage insurance under this section.

C. **Insurance upon completion.** ORCF will only insure the permanent loan under this program if all critical repairs are completed before ORCF closing of the loan.

D. **No Equity Take-Out.** Borrowers and Operators may not receive any cash proceeds from the refinance of the loan under Section 232/223(f). The sole purpose for the program is for owners to refinance at lower interest rates, reduce debt service requirements, and make needed repairs. Special circumstances may exist when dealing with REITs, see Production, Chapter 3 discussion of existing indebtedness.

E. **Loan Term.** The maximum loan term is 35 years or 75% of the remaining economic life

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of the property, whichever is less. (See 24 CFR 200.82) A lower term may be appropriate to mitigate loan risk, but may not be less than 10 years.

F. **Commercial Space:** Commercial space is limited to a maximum of 20% of the gross floor area of the project and 20% of the gross project income. Commercial space that is intended to exclusively serve the residents of the project is not counted toward the space and income limitations. The Lender must use a minimum vacancy of 20% when underwriting commercial space income. The Borrowers must submit copies of the commercial leases to ORCF for approval. ORCF may require additional documentation prior to approving commercial space.

G. **Inspection Fee:**

1. If the total cost of the critical, non-critical and Borrower-proposed repairs is equal to or less than $3,000 per underwritten bed, the HUD Inspection Fee is $30 per underwritten bed. This includes projects where there are no repairs.

2. If the total cost of the critical, non-critical and Borrower-proposed repairs is greater than $3,000 per underwritten bed, the HUD Inspection Fee is 1% of the total cost of the critical, non-critical and Borrower-proposed repairs.

3. Note that if the Lender elects and is approved to follow the optional process for delegated non-critical repair escrow administration described below in Section 2.9 K 3, ~~HUD will not charge an inspection fee~~ upon request, ORCF will refund the HUD inspection fee paid at closing. Such refund will flow to the borrower. As the HUD Inspection fee will be refunded after closing, it shall not be listed as a HUD eligible cost on the Maximum Insurable Loan Calculation (Form HUD-92264a-ORCF).

H. **Lender Fees & Charges.** The maximum financing fee the Lender may charge is 3.5% of the loan amount. Higher fees up to 5.5% are permissible in bond transactions. (See Production, Chapter 3)

I. **Federal Labor Standards.** To be eligible under this section, the level of required repairs cannot meet the standard for substantial rehabilitation. Therefore, the prevailing wage requirements (Davis-Bacon) of the Department of Labor do not apply to this program.

J. **Affirmative Fair Housing Marketing Plan Requirements.** Mortgage insurance under Section 223(f) of the National Housing Act, while covered by the nondiscrimination provisions of the Fair Housing Act and Executive Order 11063, is exempt from the submission of a written plan. However, a Section 223(f) applicant is required to conceive, implement and maintain records for its affirmative marketing efforts.

K. **Repairs.** If the Lender is proposing that repairs be financed as part of the loan, the Lender must submit a list of the proposed repairs and their associated costs. The Lender must

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include all repairs identified in the PCNA, or an explanation as to why any repairs have not been included.

1. Critical repairs must be performed prior to closing of the loan.

2. Non-critical repairs, including Borrower-Elective Repairs, approved by ORCF may be completed after closing when a financial escrow equal to 120% of the non-critical repair costs is established at closing. Completion of repairs is expected to be performed within 12 months of closing.

3. Optional Process for Delegated Non-Critical Repair Escrow (NCRE) Administration to FHA Lenders/Servicers. See Asset Management, Chapter 3.2.4.G for additional details.
    a. The Lender's Firm Commitment application (in the Lender Narrative) must specify that the Lender will assume noncritical repair escrow administration on that particular transaction.
    b. The fee(s) to pay for the inspection(s) discussed in Asset Management, Chapter 3.2.4.G.3, may be treated as a HUD eligible cost, and must be listed on the Maximum Insurable Loan Calculation (Form HUD-92264a-ORCF) on the Sources and Uses tab in the "Other (Describe)" category under "HUD Eligible Costs."
    c. The Firm Commitment will include a Special Condition acknowledging that the Lender has been approved to administer the NCRE and addressing the refund of the HUD Inspection Fee.

~~3. ORCF will delegate the non-critical repair escrow administration to Lenders and servicers who voluntarily agree to administer the escrow process within the program guidelines. Delegation of this task will eliminate the need for ORCF approval of each disbursement release and is intended to expedite the non-critical repair escrow release while maintaining management controls necessary to ensure the repairs are completed in accordance with program requirements. As part of the NCRE Administration, the PCNA provider should complete a close-out inspection/report following completion of the repairs/improvements. The cost of this inspection/report is a HUD eligible cost, and should be listed on the Maximum Insurable Loan Calculation (Form HUD-92264a-ORCF) on the Sources and Uses tab in the "Other (Describe)" category under "HUD Eligible Costs." Should the Lender choose to follow this process, the Firm Commitment will include a Special Condition acknowledging that the Lender has been approved to administer the NCRE. Additional guidance can be found in Asset Management, Chapter 3.2.4.~~

4. See Production, Chapter 10.16 – Completion of Repairs Pursuant to Section 223(f) and 223(a)7, for details.

L. **Reserve for Replacement.** A 15-Year Replacement Reserve analysis with

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recommendations for Initial and Annual Reserve Deposits must be submitted by the Lender in the loan application package. See Production, Chapter 4.5 – Section 232/223(f), for details. The Lender is required to obtain a new PCNA to re-analyze the capital needs in Year 10. The Reserve for Replacement schedule must be based on the PCNA and must include the following:

1. Combined analysis of both capital items and major movable equipment;

2. Recommendation of an Initial Deposit;

3. Recommendation of Annual Reserve Deposits:
    a. must reflect level annual deposits in years 1 through 15, and
    b. must have a minimum balance of $1,000 per unit in years 1 through 15.

M. **Properties with Fair Housing Act Accessibility violations.** Any property available for first occupancy after March 13, 1991, that does not comply with ~~has violations of~~the Fair Housing Act accessibility design and construction standards must, as a condition of mortgage insurance, be modified or~~/~~ retrofitted to comply with Fair Housing Act accessibility design standards. The modifications/retrofits may be completed after closing with appropriate financial escrows at closing, with~~and the~~all work items ~~must be~~ performed within 12 months in accordance with ORCF instructions and critical items completed immediately. The applicability of various accessibility guidelines and laws, and the permissible time for making such repairs ~~when related repairs must/can be completed,~~ is described in the Handicapped Accessibility Matrix for Section 232 available on the Section 232 Program website Direct link: http://portal.hud.gov/hudportal/documents/huddoc?id=AccessMatrixSec232.docx. Where a state or local law has higher accessibility requirements, the property must be modified or retrofitted to comply with those standards. In addition, refer also to the Uniform Federal Accessibility Standard and for any place of public accommodation at the property (e.g. leasing office, commercial space), refer to Title III of the Americans with Disabilities Act.

N. **Review of the Project's Financial Performance.** The Lender 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. The Lender must use the project-specific expense for underwritten reserve for replacement, taxes and management fee.

2.10 Section 232/223(a)(7) Refinance

The Section 232/223(a)(7) refinance program is an expedited program that requires fewer exhibits

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than other ORCF programs. The major requirements for Section 232/223(a)(7) Projects refinancing of existing FHA-insured projects are as follows:

A. **Property Eligibility**. Section 232/223(a)(7) loans apply to the refinancing of loans insured under Section 232 and Section 232/223(f)/223(a)(7) loans apply to refinancing of loans originally insured under Section 232 pursuant to Section 223(f), Loans originally insured under Section 241(a) or Section 223(d)(3) can be refinanced under Section223(a)(7)) as 241(a)/223(a)(7) and 223(d)/223(a)(7) loans, respectively.

Multiple FHA-insured loans on the same property may be refinanced under one Section 232/223(a)(7) loan as long as it meets the Maximum Insurable Loan Calculation requirements.

Coinsured, risk-share loans and HUD-held loans are not eligible to refinance under Section 232/223(a)(7).

B. **Loan Term and Extensions:**

1. In general, the term of the new refinanced loan will not exceed the remaining term of the existing loan. In the event that two loans with different terms are being refinanced under one Section 232/223(a)(7) loan, the maturity date of the primary loan determines the term of the new loan. The minimum loan term may not be less than 10 years.

2. However, ORCF may approve a term extension if ORCF determines that the longer term will inure to the benefit of the FHA Fund.

3. Extension Rules:
   a. The extended loan term cannot be greater than the remaining term of the existing loan plus 12 years.
   b. The extended loan term cannot be greater than the statutory loan term of the original ORCF loan program. The loan term of a second or greater 223(a)(7) refinance is not impacted by the term of an earlier 223(a)(7) refinance. It is only limited by the statutory loan term of the original ORCF loan program. For example:
      i. The 223(a)(7) refinance of a 232 new construction loan cannot have a loan term greater than 40 years.
      ii. In the case of a second 223(a)(7) refinance of an earlier 223(a)(7) refinance with a 33 year term, which itself refinanced a 232 new construction loan, the second 223(a)(7) loan cannot have a loan term greater than 40 years.
   c. The extended loan term cannot be greater than the term of the original ORCF loan at the time it was first insured by HUD. For example, if a 223(f) loan originally receives a loan term of 25 years at the time it first

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receives ORCF insurance, the 223(a)(7) refinance of that loan cannot have a loan term greater than 25 years.

4. The following criteria will be considered as part of the underwriting risk analysis for a proposed extension of loan term:
   a. An increase in annual deposits to the reserve for replacement account.
   b. An additional deposit to the reserve for replacement account funded either through owner contribution or loan proceeds.
   c. The resulting debt service coverage ratio both with and without a term extension.
   d. Remaining economic life of the project.
   e. The physical condition of the property based on a Property Capital Needs Assessment (PCNA) as well as the latest Real Estate Assessment Center (REAC) inspection report.
   f. Strong occupancy trends
   g. A significant owner equity contribution
   h. A high Medicare Star Rating (if applicable)
   i. Demonstrated strong operator performance.
   j. Other considerations as deemed appropriate by ORCF

C. **Application Fee.** An application for Firm Commitment must be accompanied by an application commitment fee equal to $3 per $1,000 (0.3%) of the requested loan amount. After closing of the loan, the Lender may request half of the application fee to be refunded. Due to this refund, the application fee listed on the Maximum Insurable Loan Calculation, including the Sources & Uses, must show the application fee as .15% of the loan amount, rather than the full 0.3%.

D. **Inspection Fee.** There is no inspection fee.

E. **Cost Certification.** There is no cost certification.

F. **Prepayment Approval.** Prepayment approval must be obtained from ORCF via the Insurance Termination Request for Multifamily Mortgage (Form HUD-9807).

G. **Federal Labor Standards.** Not applicable.

H. **Affirmative Fair Housing Marketing Plan (AFHMP) Requirements.** No new AFHMP is required as part of the 223(a)(7) application.

I. **Previous Participation Certification.** Existing principals that have previously submitted a Previous Participation Certification (Form HUD-2530) or an APPS submission for the subject project are not required to re-submit as part of the Section 223(a)(7) refinance. If new principals are proposed, or current principals have not yet been approved by ORCF, these principals must submit either a Previous Participation Certification form or an APPS submission and register in HUD's Business Partners Registration System. See Section 2.5

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J. **Physical Assessment of the Property.** The application is to include either a Project Capital Needs Assessment (PCNA) or a narrative description of the Lender's site visit.

1. **PCNA.** A PCNA is required as part of the 232/223(a)(7) if any of the following apply:
   a. A PCNA has not been completed for the project in the last ten years,
   b. A term extension is requested,
   c. If the project is not fully sprinklered (Skilled Nursing Facilities only). HUD will use the CMS database which lists projects that are fully sprinklered. The CMS database can be found here: http://www.medicare.gov/Download/DownloadDB.asp

   If a PCNA is required, the application must also include a Reserve for Replacement schedule that is based on the PCNA and includes the following:

   a. Combined analysis of both capital items and major movable equipment
   b. Rollover of the existing Reserve for Replacement Account
   c. Recommendation of any additional Initial Deposit
   d. Recommendation of Annual Reserve Deposits
      i. must reflect level annual deposits in years 1 through 15, and
      ii. must have a minimum balance of $1,000 per unit in years 1 through 15.

   The Lender is required to obtain a new PCNA to re-analyze the capital needs in Year 10. See the PCNA Statement of Work on the Section 232 Program website. Direct link: http://portal.hud.gov/hudportal/documents/huddoc?id=PCNA_SOW_223a7.docx. In addition, refer also to the Uniform Federal Accessibility Standard and for any place of public accommodation at the property (e.g. leasing office, commercial space), refer to Title III of the Americans with Disabilities Act"

2. **Lender Site Visit.** If a PCNA is not submitted, the Lender must conduct a site visit of the project. The site inspection is an integral part of the overall underwriting process, and it is most appropriate that the Lender's underwriter for that transaction perform that site inspection. In rare circumstances this may be infeasible, in which case either the underwriter trainee assigned to that particular project, or another Lean-approved underwriter in that firm, may conduct the inspection. If the Lender has an employee who is a licensed appraiser (not a third-party contractor), ORCF will consider approving that individual to do a site inspection on a transaction-by-transaction basis. Requests for such approvals must be submitted to Lean Thinking.

   The Lender must provide the following information regarding the site visit:

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a. Date of the site visit;

b. Name of the Lender representative who visited the project and eligibility to conduct the inspection per the requirements above;

c. Describe the property's general condition, curb appeal and marketability;

d. Confirm that deficiencies from the latest Real Estate Assessment Center (REAC) inspection have been addressed. It is recommended that the Lender representative use the latest REAC report to ensure that all deficiencies have been corrected;

e. Name(s) of the individual(s) with whom the Lender representative met with on site (e.g., project administrator, etc.); and

f. Photographs (optional).

K. **Environmental Review:**

1. **Flood Hazards.** The Lender must consult the most recent Federal Emergency Management Agency (FEMA) Flood Map to determine if the property is located in a 100-year or 500-year floodplain.~~ If the property is located in a floodplain, t~~ The Lender must submit a completed Standard Flood Hazard Determination Form (FEMA Form 086-0-32) and ORCF will review the project to ensure compliance with federal law. Depending on the type and location of any floodplain on the property, the Borrower may be required to obtain and maintain flood insurance for the duration of the mortgage (please see Production, Chapter 14, Section 7.H for further information). Additional special conditions related to flood hazards may be added to the Firm Commitment.

2. Refinances of FHA-insured projects under Section 232/223(a)(7) require an environmental review similar to Section 232/223(f) projects under the following circumstances:

   a. The project has completed a building addition without an environmental review~~having obtained HUD's approval~~;

   b. The project will acquire or has acquired land that was not insured under the original mortgage loan and the project has yet to receive HUD's approval of the additional land; or

   c. The project will involve changes, improvements or repairs that do not qualify as routine maintenance.

3. When an environmental review is required per Section 2.10 K 2:

   a. The Lender must supply a Phase I Environmental Site Assessment~~ on the additional land~~;

   b. ~~The Lender must initiate consultation with the State Historic Preservation Officer~~To assist HUD in making its historic preservation determination, the Borrower or Lender may submit a letter to the appropriate State Historic Preservation Officer (SHPO). Doing so may greatly expediate the Section 106 consultation process. See Production, Chapter 7.5.D.4.;

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c. The Lender must provide the information discussed at Sections 7.5, 7.6 and 7.7 of Production, Chapter 7 to assist HUD in preparation of an Environmental Assessment; and may provide a draft Environmental Assessment and Compliance Findings for the Related Laws (Form HUD-4128) and HEROS-Form HUD 4128 as available.
d. HUD will complete the Environmental Assessment and Compliance Findings for the Related Laws (Form HUD-4128) and HEROS-Form HUD 4128 as available.

L. **Repairs.** If the Lender is proposing that repairs be financed as part of the loan, the Lender must submit a list of the proposed repairs and their associated costs. If a PCNA was completed, the Lender must include all repairs identified in the PCNA, or an explanation as to why any repairs have not been included.

1. Critical repairs must be performed prior to closing of the loan.

2. Non-critical repairs, including Borrower-Elective Repairs, approved by ORCF may be completed after closing when a financial escrow equal to 110% of the non-critical repair costs is established at closing. Completion of repairs is expected to be performed within 12 months of closing.

3. Repairs Paid for with Reserve for Replacement Funds. If any repairs proposed under the Section 232/223(a)(7) will be paid for with funds from the project's current reserve for replacement account, the cost of those repairs cannot be included as a mortgageable item. If any of the repairs are non-critical or Borrower-Elective Repairs, the reserve for replacement funds must be deposited into the non-critical repair escrow at closing and will be subject to the 10% owner contribution.

4. <u>Optional Process for Delegated Non-Critical Repair Escrow Administration to FHA Lenders/Servicers.</u> See Section 2.9 K 3 for details.

5. See Production, Chapter 10.16 – Completion of Repairs Pursuant to Section 223(f) and 223(a)7, for details.

M. **Payback Period.** The payback period for transaction costs in a Section 232/223(a)(7) refinance must be 10 years or less. To determine the payback period, divide the costs of the transaction that are outlined in the Maximum Insurable Loan Calculation (Form HUD-92264a-ORCF) by the annual debt service savings including MIP. Exclude from the calculation: Reserve for Replacement Deposit, Required Repairs, Final Month's Interest, and Initial MIP. Any prepayment penalty must be included as a transaction cost in the payback period calculation, but only the portion not covered by an interest rate premium.

N. **REAC Inspection Review.** The Lender must review the latest REAC inspection report. If the latest inspection resulted in a score below 60, the Lender must submit documentation evidencing that all deficiencies cited in the latest inspection report have been addressed.

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The documentation may take the form of photographs and invoices.

O. **Review of Life Safety, Compliant, and State Annual Surveys.** ORCF staff will review findings from the most recent Life Safety, Compliant, and State Annual Surveys to determine if outstanding findings have been addressed.

P. **Review of the Project's Financial Performance.** The Lender must review the trailing 12 month financial statements to assess the project's financial performance, and must base underwritten income and expenses on the recent trailing 12 month performance. The Lender must use the project specific expense for underwritten reserve for replacement, taxes and management fee.

Q. **No Equity Take-Out.** Borrowers and Operators may not receive any cash proceeds from the refinance of the loan under Section 232/223(a)(7). The sole purpose for the program is for owners to refinance existing FHA-insured debt at lower interest rates, reduce debt service requirements and make needed repairs. In no event may the Borrower "cash out" the Reserve for Replacement or Residual Receipts account. The existing reserves and residual receipts are to be rolled over to the newly refinanced loan.

R. **Use of Operating Funds for Refinance Costs.** All expenses associated with a Section 223(a)(7) refinance (e.g. transaction costs) must be borne by the Borrower (i.e. principals thereof) and must not come from the project operating account. The use of project operating funds for the Section 223(a)(7) transaction is strictly prohibited and will result in a Borrower violation of the Regulatory Agreement, an Audited Financial Statement finding of non-compliance and possible referral to the Departmental Enforcement Center.

2.11 Section 232/223(d) Operating Loss Loan

Section 223(d) Operating Loss Loans (OLL) provide Borrowers of FHA-insured loans a vehicle for recouping their out-of-pocket expenditures to fund unforeseen operating deficits on projects during the early years of the project's operation. HUD's authority to approve a Section 223(d) Operating Loss Loan is set forth in Section 223(d) of the NHA, which was later amended by Section 427 of the Housing and Community Development Act of 1987. Section 223(d) authorizes two types of OLL, both of which are available to FHA-insured Section 232 new construction and substantial rehabilitation health care projects managed by ORCF. Section 223(f) projects ~~are ineligible~~ may also be eligible for the OLL, if all requirements are met.

The OLL is an indication of HUD's awareness that a project may struggle in the early years of operations due to cash flow demands and unforeseen expenses; and that HUD is concerned about these debt service problems and net operating losses. To preserve projects and to encourage Borrowers to provide working capital to fund early financial shortfalls and avert mortgage defaults, the OLL permits Borrowers to recover their unplanned contributed equity more quickly

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than surplus cash notes and surplus cash distributions would otherwise allow. Thus, the OLL may serve as a valuable incentive for encouraging Borrowers to remain financially committed to their projects.

The OLL proposal must demonstrate that the project is financially viable (i.e., that it has sufficient net operating income to meet the increased debt service obligations that come with the OLL). The OLL covers losses that occurred during a 24-month period. This is called the "Loss Period."

A. **Types of OLLs:**

1. Section 232/223(d)(2): Loss period is the 24-months immediately following the cost cut-off date. The application must be submitted to ORCF within 3 years following the end of the loss period.

2. Section 232/223(d)(3): Loss period is any 24 month period within the first ten years following the cost cut-off date. The application must be submitted to ORCF within ten years following the end of the loss period.

There may be two OLLs (one under Section 223(d)(2) and one under Section 223(d)(3)) for any individual project but no more than one per subsection, and loss periods may not overlap.

B. **General Requirements.** To be eligible for an operating loss loan, the following conditions apply:

1. The existing project loan must be insured by the Secretary under Section 232 of the National Housing Act.

2. An allowable loss has been experienced. The loss loan must not exceed the amount of the operating loss and, for loans insured under 223(d)(3), may not exceed 80% of the unreimbursed cash contribution..

3. The operating loss must have occurred during a specific period of time outlined below.

4. The Borrower entity must have owned the project during the loss period.

5. All funds in the Initial Operating Deficit, if applicable, have been disbursed.

6. All cost certification requirements have been satisfied.

7. The Borrower, Operator, and Management Agent, as applicable, meet ORCF standards for project management.

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8. The Lender on the first mortgage must consent in writing to the OLL.

~~8.~~9. The original mortgage and the operating loss loan must be cross-defaulted.

C. **Definition of an Operating Loss.** An Operating Loss is the difference between project income and project operating expenses. The following operating expenses may be included: taxes, interest on the mortgage debt, mortgage insurance premiums, hazard insurance premiums, maintenance, salaries, supplies, and other expense for project operation. The following payments and charges may not be included: loan principal payments, depreciation, payments to the reserve for replacement account, payments to a sinking fund, lender fees, charges incurred in connection with the application for the Operating Loss Loan (OLL), projected anticipated losses, expenses that were funded or should have been funded from the working capital deposit (e.g., tax and insurance escrows), construction cost overruns, Officers' salaries, and bad debt or write-offs as a result of an identity of interest tenant.

D. **Determination of the Operating Loss Period.** The loss period (or 10-year period, under 223(d)(3))begins the day after the cost certification cut-off date. (The National Housing Act refers to the date of completion, as determined by the Secretary. Since costs as of the cut-off date are considered in the original loan computation, the date of completion referenced in the law has been interpreted to mean the completion of development. Therefore, the cut-off date, not the final completion date is used in determining the loss period.) The maximum loss period is two years. Applications within the two-year period may be made, if necessary, to prevent foreclosure or assignment. Losses claimed during the loss period must be evidenced by audited financial statements.

E. **Loan Term.** The loan term may not exceed the unexpired term of the original loan.

F. **Preliminary Discussions for Operating Loss Loan.** At the request of the Borrower, or the Lender, ORCF representatives will meet with the Borrower and/or Lender to conduct informal, preliminary discussions. These preliminary discussions will define the objectives that might be addressed by the OLL, and will seek to ensure that the Borrower is acquainted with ORCF guidelines relative to OLL's. In certain instances where market conditions have changed or not borne out the original underwritten project forecasts; or in instances were a project has failed to perform as originally underwritten, ORCF may require an independent appraisal, market study or operational assessment, in addition to the firm application exhibits. This preliminary communication must include a discussion of whether an appraisal, market study or other third-party assessment report will be required.

G. **Sustaining Occupancy.** Implicit with the concept of an OLL, is that this special supplemental loan is intended for those projects that survived early financial struggles and finally attained a sustaining occupancy. The OLL proposal must demonstrate that the project is financially viable and stabilized, i.e., that it is currently solvent (revenues exceed expenses and current assets exceed current liabilities) and that it has sufficient net operating income to meet the increased debt service obligations that come with the OLL.

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H. **Projects not at Sustaining Occupancy.** In certain instances, an OLL may be proposed as an essential element of a work-out strategy designed to avert an ORCF claim. In those infrequent instances, an OLL may be approved based on *projected* sustaining occupancy. However, only actual losses may be funded, and there must be evidence that sustaining occupancy will be reached within a reasonable period of time.

With regard only to these OLL loans proposed to avert ORCF claims, the proceeds of the loan may be required to cure financial deficits. If the loan proceeds are needed to cover mortgage loan deficit situations, all or part of the loan proceeds must be held in escrow by the Lender until the project has reached sustaining occupancy. The funds escrowed for these purposes may be released only with prior approval from ORCF. The requirements for the escrow will be defined as a Special Condition in the Firm Commitment.

The method of disbursement from the operating loss loan escrow is as follows. The Borrower must submit to ORCF:

1. Monthly income and expense statements signed by a Principal of the Borrower entity and approved by the Lender. The owner's monthly statements must contain the following acknowledgement:

   WARNING: 18 USC 1001 provides, among other things, that whoever knowingly and willingly makes or uses a document of writing containing any false, fictitious, or fraudulent statement or entry, in any manner within the jurisdiction of any department or agency of the United States, shall be fined or imprisoned for not more than five years, or both.

2. Quarterly and year-to-date financial statements submitted by the licensed operator and covering the project operations, including:
   a. Profit and Loss Statement
   b. Balance Sheet
   c. Accounts Payable Aging
   d. Accounts Receivable Aging
   e. Census
   f. Cash Flow Statement

3. The statements must be submitted within 30 days of the end of each quarter. The statements may, at the Operator's option, be Operator-certified rather than audited provided, however, that if ORCF determines that a particular Operator's certified statements are inadequate, unreliable, or not presented in a manner that is as consistent as feasible with Generally Accepted Accounting Principles, then ORCF may, on a case-by-case basis, require more detailed and/or audited financial statements from the Operator. This requirement will continue until all losses have been substantiated as actual losses by an audited statement. This must be a condition of the Commitment. If the Borrower has not submitted the quarterly statement by the due date, ORCF will withhold approval of the disbursement until the statements are

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submitted. ORCF will review the certified annual statement against the uncertified statements submitted by the Borrower and make necessary adjustments in future disbursements.

4. Operating loss loan funds must be held in escrow and can only be used to offset current losses until it is evident the project is on sound footing. Once the project reaches sustaining occupancy, any balance remaining in the escrow must be held until sustaining occupancy is maintained for a one-year period.

I. **Federal Labor Standards.** Not applicable.

J. **Reserve for Replacement.** The project is subject to an existing loan, so it will continue to retain the existing reserve for replacement requirements. No reserve for replacement analysis will be completed as part of the Operating Loss Loan.

K. **Cost Certification.** Not applicable.

L. **Inspection Fee.** This program does not require an inspection fee.

M. **Affirmative Fair Housing Marketing Plan (AFHMP) Requirements.** No new AFHMP is required as part of the OLL application.

2.12 Section 232(i) Fire Safety Equipment Loan Program

A section 232 (i) loan is used to purchase and install fire safety equipment, primarily fire sprinkler systems. The costs may also include structural modifications where necessary to install the equipment. The equipment to be installed must be in compliance with or exceed the requirements approved by CMS. For non-CMS regulated residential healthcare facilities, the Lender must provide documentation sufficient to ORCF that the fire safety equipment is in compliance with its State's regulatory authorities. Where a state or local law has higher accessibility requirements, the property must be modified or retrofitted to comply with those standards.

The major requirements for Section 232(i) Projects are as follows:

A. **Insurance upon completion.** ORCF will only insure the permanent loan under this program.

B. **Mortgage Insurance Premium.** The ORCF loan insurance premium is 1% of the loan balance per annum unless changed by Notice in the Federal Register.

C. **Loan Term:**

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1. Maximum Term of Loan in the amount of $100,000 or greater.
    a. Co-terminus with the maturity of the existing ORCF loan (if applicable),
    b. 15 years or
    c. 100% of the remaining economic life of the property (if applicable), whichever is less.

2. Maximum Term of Loan in the amount less than $100,000
    a. Co-terminus with the maturity of the existing ORCF loan (if applicable),
    b. 10 years or
    c. 75% of the remaining economic life of the property (if applicable), whichever is less.

D. **Fees.** The HUD application fee is $4 per $1,000 of the fire safety loan amount. The HUD inspection fee is $5 per thousand of loan amount.

E. **Assurance of Completion.** The commitment under this program is for insurance upon completion, therefore, an assurance of completion is not required.

F. **Loan Security.** In proposals where the property is already encumbered by a first mortgage or deed of trust, ORCF will accept a mortgage or deed of trust that is subordinate to the first lien.

G. **Federal Labor Standards.** Davis-Bacon requirements do not apply to fire safety equipment installation..

H. **Affirmative Fair Housing Marketing Plan Requirements.** Mortgage Insurance under Section 232(i) of the National Housing Act, while covered by the nondiscrimination provisions of the Fair Housing Act and Executive Order 11063, is exempt from the submission of a written plan. However, a Section 232(i) applicant is required to conceive, implement, and maintain records for its affirmative marketing efforts.

I. **Property Capital Needs Assessment (PCNA).** For non-FHA insured projects, the application must include a PCNA. The Lender must also include an analysis of the reserve for replacement account that is consistent with the PCNA. See the PCNA Statement of Work on the Section 232 Program website.

J. **Reserve for Replacement.** The property must have a reserve for replacement account for the project or establish a replacement reserve account prior to closing. For non-FHA insured projects, the PCNA must be used to complete an analysis of the reserve for replacement account. Additional deposits to the account will be required as a result of the fire safety loan. The Lender must also determine the appropriate annual reserve for replacement deposit for the project.

K. **Repairs:**

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1. Critical repairs must be performed prior to closing of the loan.

2. Non-critical repairs, including Borrower proposed repairs approved by ORCF, may be completed after closing when a financial escrow equal to 120% of the non-critical repair costs is established at closing. Completion of repairs is expected to be performed within 12 months of closing. Any repair unrelated to fire safety equipment installation cannot be funded by loan proceeds.

L. **Cost Certification.** A cost certification must be completed by the Borrower on the Borrower's Certificate of Actual Costs (Form HUD-ORCF-2205A) and must be approved by ORCF prior to closing. The Borrower must furnish a certification of all costs including cost charged by the contractor for the improvements and also must certify that no rebate, kickback, refund, etc. has been or will be received.

M. **Properties with Fair Housing Act violations.** Any property available for first occupancy after March 13, 1991, that has violations of Fair Housing Act accessibility design standards is to be in compliance prior to closing of the fire safety equipment loan. Occupancy improvements cannot be funded out of the fire safety loan proceeds. Where a state or local law has higher accessibility requirements, the property must be modified or retrofitted to comply with those standards.

N. **Prior Defaults/Claims.** ORCF does not prohibit applications for mortgage insurance for formerly HUD-held loans, but only does business with Borrowers that have good track records. ORCF may accept such applications where the Lender has considered and documented the economic, physical, operational, or management factors that led to the specific changes that have occurred which would justify an application for new mortgage insurance.

O. **Previous Participation Certification.** Principals that have a previously approved Previous Participation Certification or an APPS submission for the subject project are not required to re-submit as part of the Section 232(i) application. If new principals are proposed, or current principals have not yet been approved by ORCF, these principals must submit either a Previous Participation Certification or an APPS submission. See Section 2.5 BB for more information.

P. **Environmental Review.** For non-FHA insured projects, the Lender must supply a Phase 1 Environmental Site Assessment and meet all other environmental requirements identified in Production, Chapter 7.

Q. **Review of Life Safety, Compliant, and State Annual Surveys.** The Lender will review findings from the most recent Life Safety, Compliant, and State Annual Surveys to determine if outstanding findings have been addressed.

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R. **Review of the Project's Financial Performance.** The Lender must review the annual financial statements to assess the project's financial performance, and must base underwritten income and expenses on the recent trailing 12 month performance. The Lender must use the project specific expense for underwritten reserve for replacement, taxes and management fee.

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