

How to Take Advantage of HUD's Hospital Mortgage Insurance Program

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ALL TYPES OF HOSPITALS—CAH HOSPITALS, LARGE URBAN TEACHING HOSPITALS, FOR-PROFITS AND NOT-FOR-PROFITS, HOSPITALS IN SYSTEMS, GOVERNMENT-OWNED HOSPITALS—HAVE RECEIVED LOANS THROUGH THE FHA'S SECTION 242 PROGRAM. HERE ARE THE DETAILS ON THIS POPULAR FEDERAL PROGRAM.

St. John's Lutheran Hospital in Libby, Montana, a 25-bed critical access hospital (CAH), needed \$32 million to build a new 79,000-square foot replacement facility. Lacking high credit ratings, it had poor prospects of pinning down affordable financing. But in August of last year, it got the full amount in a Federal Housing Administration (FHA)-insured mortgage loan at 3.58 percent, which will save the hospital an estimated \$21 million in interest costs over the 25-year life of the loan.

St. John's is one of 401 acute care hospitals in the United States that have received loans since 1968 through FHA's Section 242 Hospital Mortgage Insurance Program. Currently, the program has about 85 hospitals in its portfolio with 110 different loans amounting to \$9.2 billion in assets, according to Roger Lukoff, associate deputy assistant secretary of FHA's Office of Healthcare Programs (OHP).

In each case, government backing enhances the creditworthiness of the hospital, resulting in AA to AAA credit ratings, which translate to lower interest rates. And, of course, lower interest rates equal more spending power to address community needs.

Why is the government willing to provide financial help for hospitals that are not among the nation's top performers? There are two primary reasons: to meet demonstrated community need and to reduce healthcare costs to the local community, the states, and the federal government.

What follows is some important information about the 242 program that can help hospitals reach an informed decision about whether to apply.

The Hospital Isn't the Client

As Lukoff explains it, the 242 program looks at hospitals as working partners in ventures meant to benefit both the government and the community organizations—but the hospitals are not the program's clients. The Department of Housing and Urban Development (HUD) doesn't actually lend hospitals money at all; instead, it insures mortgages that hospitals obtain from commercial lenders, which are the program's clients.

And no, HUD doesn't recommend lenders. The agency does, however, post [a list](#) of all lenders that have been approved to submit and process hospital mortgage applications using Multifamily Accelerated Processing (MAP).

Loan Possibilities

Many hospitals use their FHA-insured loans to finance new construction. Loans can also be used for remodeling, expansion, and modernization projects. In 2013, a brand-new program was added that allows hospitals to refinance existing debt, in some cases at under 3 percent.

Hospitals can also use the money for new equipment. However, since most healthcare organizations have been able to take advantage of meaningful use incentives for electronic health records, 242 is currently more focused on making it possible for facilities to purchase clinical equipment, says Lukoff.

Loan Terms and Funding Options

The federal government is not always known for its flexibility or its generosity but, in this case, it exhibits both. Funding options include taxable bonds, tax-exempt bonds, Ginnie Mae securities, and whole loan placements. And the terms are highly attractive:

- No maximum loan amount
- No cash required at closing (with sufficient equity)
- FHA insures up to 90 percent of the loan amount
- Loan term can be up to 25 years
- Fixed annual premium of 0.7 percent of remaining balance for new construction projects
- Low upfront mortgage insurance fees: 0.15 percent application, 0.3 percent commitment, 0.5 percent inspection

Application Criteria

Just because HUD is willing to back mortgages for hospitals that are not top performers does not mean it is willing to back hospitals that are poor performers. In fact, hospitals that do a poor job from either a quality, access, or a financial perspective will not be able to meet 242 criteria. Even for a proposed new hospital, the sponsor must have a strong track record. “We do not embrace the ‘We will build it and they will come’ approach,” says Lukoff.

Minimum eligibility criteria include the following:

- A loan-to-value ratio of no more than 90 percent
- Sufficient days cash on hand to make a cash equity contribution at the closing of a Section 242 loan and to maintain sufficient working capital to operate post-closing
- A net operating margin for three continuous years
- For a new hospital: sufficient start-up capital, evidence that it will meet a market need, and a viable physician recruitment plan
- An aggregate operating margin of 0.00 percent or greater
- An average debt service coverage ratio at or above 1.25
- Substantial compliance with federal and state regulations governing the operation and reimbursement of hospitals
- For refinancing projects: construction costs equaling 20 percent or more of the mortgage amount
- A first lien position on property, plant, equipment, receivables, and revenues
- Limited amount of site preparation prior to submission of application
- For design-build projects: mortgage amounts totaling less than \$60 million
- Satisfaction of state certificate of need requirements

Expert Help

As part of the process, hospitals pay a mortgage insurance premium and work with 242 asset managers who check their progress on a continual basis. The asset managers are not focused on catching hospitals underperforming, although the program has the authority to act in the rare instances where this happens (more often from incompetence rather than fraud). Indeed, once financing is obtained through the program, HUD cannot cancel out on a hospital.

Instead, the asset managers’ goal is to make the project a success by working collaboratively with the hospital over what may be a quarter-century relationship. Many 242 staff are former hospital administrators, says

Lukoff, who is one of them, “and extremely familiar with the pressures faced within the hospital environment.”

On behalf of the hospitals in the HUD portfolio, Lukoff points out, the program can communicate with both financial and regulatory stakeholders to advance the interests of the hospital. “In addition, we have expert resources internally—and can tap national expertise as well—in finance, operations, and physician relations to help the hospital advance its strategic plan,” he says. “For example, we can help a hospital rework its marketing plan to identify and attract additional support from primary care physicians in the community.”

The program also has an office of healthcare architecture and engineering that works with a hospital to review its project plans and specifications, often increasing efficiency and reducing total project costs in the process.

Streamlined Processing

Hospitals interested in obtaining mortgage insurance through the 242 program will be pleased to know that the application process, while exacting, is not endless. The process provides a provisional determination of a candidate’s viability prior to payment of any fees. As a result of this preliminary review, the application process ends happily for a majority of applicants.

“The median processing time was reduced to 63 days in fiscal year 2012—that’s actually less than half of what it was the previous year,” says Lukoff.

The steps to obtaining an FHA-insured mortgage are as follows:

- Self-assessment
- Selection of FHA lender
- Initial contact with HUD
- HUD’s preliminary review
- Pre-application meeting
- Application
- Application review
- HUD decision
- Insurance commitment
- Initial closing
- Construction
- Final closing

Economic Stimulus

The underlying purpose of 242 is to meet community need and cut costs, but these are not the only happy results of the program. There are also jobs generated—both during and after construction—and economic activity spurred, both of which OHP tracks. In 2012, new economic activity following construction equaled more than \$1.3 billion dollars. The typical hospital 242 project is responsible for 150 new jobs.

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A lot more information about HUD's Section 242 program, along with an Applicant's Guide, is available at [on the HUD website](#).