



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

ASSISTANT SECRETARY FOR HOUSING-
FEDERAL HOUSING COMMISSIONER

Special Attention of:

All HUD Office of Insured Healthcare
Facilities and Office of Multifamily Housing
Staff

Notice: H 10-06

Issued: February 22, 2010

Expires: February 28, 2011

Cross References:

SUBJECT: Hospital Mortgage Insurance: Section 223(f) Refinancing in Conjunction with Section 242 Financing – Amendments to Threshold Criteria

This notice supersedes Notice H-09-05 of the same subject matter issued on July 1, 2009, which advised of FHA's immediate implementation of its authority under section 223(f) of the National Housing Act to provide, in conjunction with financing under Section 242 of the National Housing Act, refinancing of debt for hospitals, without conditioning such refinancing on new construction or renovation as is the current program requirement. This notice amends the July 1, 2009, notice only with respect to the criteria in section 242.16, pertaining to the application process. For purposes of clarity of the significance of the criteria in section 242.16, this notice refers to the criteria as threshold requirements, established to determine a hospital's eligibility for consideration of Section 223(f) refinancing. All other provisions of the July 1, 2009, notice remain unchanged. The change made to the threshold requirements is to reflect that in this provision HUD is focused on determining which hospitals should receive refinancing assistance based in significant part on need—theirs and that of the communities in which they serve. FHA's implementation of its Section 223(f) refinancing authority is directed to hospitals currently without Section 242 insured financing. Hospitals currently insured under FHA's Section 242 program may refinance under section 223(a)(7) of the National Housing Act.

The content of the July 1, 2009, notice is set out in its entirety, as amended, in this notice for the convenience of the reader.

Eligible entities seeking refinancing under Section 223(f) in conjunction with Section 242 financing (Section 242/223(f)) shall follow FHA's regulations in 24 CFR part 242, except as modified in this notice to accommodate requirements applicable to Section 223(f) refinancing. The modifications made to the part 242 regulations in this notice are highlighted in bold.

In addition to issuance of this notice, HUD will be publishing a rule, as committed in the July 1, 2009, notice that proposes to amend the regulations in 24 CFR part 242 to incorporate the provisions applicable to Section 223(f) refinancing as presented in this notice, and therefore make refinancing under Section 223(f) a permanent component of the Section 242 Hospital Mortgage Insurance Program. That rule will provide a 60-day public comment, and FHA encourages review and comment on that rule, which incorporates the provisions in this notice.

Eligible entities seeking financing under Section 242/223(f) may submit an application in accordance with the provisions provided in this notice, or entities may opt to defer submission of an application until the completion of rulemaking and in anticipation of any changes to Section 223(f) refinancing that entities believe are important before seeking Section 223(f) refinancing.

I. Background:

Section 223(f)(1) provides that “Notwithstanding any of the provisions of this Act, the Secretary is authorized, in his discretion, to insure under any section of this title a mortgage executed in connection with the purchase or refinancing of an existing multifamily housing project or the purchase or refinancing of existing debt of an existing hospital (or existing nursing home, existing assisted living facility, existing intermediate care facility, existing board and care home, or any combination thereof).” (12 U.S.C. 1715n(f).) While FHA has implemented this authority for multifamily rental housing and healthcare facilities, to date, FHA has not implemented this authority with respect to hospitals.

Until recently, it has been HUD’s view that private capital to assist hospitals refinance debt was sufficiently available, and the demand for this type of refinancing was not as great as was the need for financing for new construction, renovation and rehabilitation, and equipment purchases. However, the downturn in the economy, which has adversely affected the availability of credit for consumers and homeowners and businesses, is increasingly affecting the financing needs of hospitals and other health care facilities. At a time when the demand for health care services is on the rise, the lack of access to capital has made it difficult for hospitals to obtain financing for facility, equipment, and technology needs, as well as meet obligations on existing debt.

By expanding FHA’s Hospital Mortgage Insurance Program to allow for refinancing of existing debt without conditioning such refinancing on new construction or renovation, FHA believes it contributes to alleviating financial stress on hospitals, and maintaining the availability of hospitals in many communities. The action taken in this notice is consistent with FHA’s statutory purpose under Section 242 of the National Housing Act (NHA) which includes assisting in the availability of needed hospitals for the care and treatment of persons who are acutely ill or who otherwise require medical care and related services of the kind customarily furnished only (or most effectively) by hospitals.

Through the proposed rule that HUD is publishing for the purpose of codifying, in regulation, FHA’s implementation of its Section 223(f) refinancing authority as presented in this notice, HUD seeks public comment on how implementation of its Section 223(f) authority has been structured. Comments received in response to the proposed rule will be taken into consideration in the development of a final rule. That final rule will codify in regulation FHA’s refinancing authority for hospitals. That rule when published and effective, will supersede this notice and will govern applications for Section 242/223(f) refinancing.

II. Section 223(f) Refinancing in Conjunction with Section 242 Financing

HUD’s regulations in 24 CFR part 242 were updated and streamlined in rulemaking

initiated in 2005 and completed in 2007, and which regulations were the subject of public comment, and changes were made to HUD's proposed amendments to part 242 in response to public comment.

Entities seeking and obtaining Section 223(f) refinancing in conjunction with Section 242 financing must follow the regulations in 24 CFR part 242. All requirements in FHA's regulations in 24 CFR part 242 apply, except as modified in this notice. Again, language in **bold** indicates new language added to existing regulatory sections to address Section 223(f) refinancing. Entirely new sections are identified:

1. Definitions (Section 242.1) [New Definition of "Hard Costs" and Revised Definition of "Substantial Rehabilitation"]

Hard costs means the costs of construction and equipment including construction-related fees such as architect and construction manager fees.

Substantial rehabilitation means additions, expansion, remodeling, renovation, modernization, repair, and alteration of existing buildings, including acquisition of new or replacement equipment, **in cases where the hard costs of construction and equipment are equal to or greater than 20 percent of the mortgage amount.**

2. Eligibility of Insurance and Transition Provisions (Section 242.4) [Language Added to Accommodate Section 223(f) Refinancing in Section 242.4(a)]

(a) The hospital to be financed with a mortgage insured under this part shall involve the construction of a new hospital, the substantial rehabilitation (or replacement) of an existing hospital, **or the refinancing of the capital debt of an existing hospital pursuant to Section 242/223(f).**

3. Limitation on refinancing of existing indebtedness (Section 242.15) [Language Added to Accommodate Limitation on Section 223(f) Refinancing]

(a) Some existing capital debt may be refinanced with the proceeds of a section 242 insured loan; however, the hard costs of construction and equipment must represent at least 20 percent of the total mortgage amount.

(b) **In the case of a loan insured under Section 242/223(f), there is no requirement for hard costs. However, if there are hard costs, such costs must total less than 20 percent of the total mortgage amount.**

4. Applications (Section 242.16) [Language Added to § 242.16 to Accommodate Application for Section 223(f) Refinancing and Ensure Financial Eligibility, which, as provided in this notice, does not amend paragraph (a)(2), but adds a new paragraph (3), and redesignates existing paragraphs (3) through (5) as paragraphs (4) through (6).]

(a) Application process. * * *

(2) Operating margin and debt service coverage ratio. ***

(3) Threshold requirements – refinancing candidates. For an application to be

considered for refinancing pursuant to Section 223(f), a hospital must meet the following requirements in lieu of those described in paragraph (a) (2) of this section.

(i) The hospital must have an aggregate operating margin of at least 0 percent when calculated from the three most recent annual audited financial statements.

(ii) The hospital must have an average debt service coverage ratio of at least 1.4 when calculated from the three most recent annual audited financial statements.

(iii) HUD may, at its discretion, recast the operating margin and debt service coverage ratio for prior periods by using its estimate of the projected interest rate in lieu of the historical interest rate(s).

(iv) The hospital must demonstrate that its financial health depends upon refinancing its existing capital debt and that it provides an essential service to the community in which it operates. This demonstration is met by providing documentation of the following:

(A) If the hospital were no longer in operation, the community in which it presently operates would suffer from inadequate access to an essential service that the hospital presently provides;

(B) There are few alternative affordable financing vehicles available to the hospital; and

(C) The hospital meets three of the following seven criteria:

(1) The proposed refinancing would reduce the hospital's total operating expenses by at least 0.25 percent;

(2) The interest rate of the proposed refinancing would be at least 0.5 percentage points less than the interest rate on the debt to be refinanced;

(3) The interest rate on the debt that the hospital proposes to refinance has increased by at least one percentage point at any time since January 1, 2008, or is very likely to increase by at least one percentage point within one year of the date of application;

(4) The hospital's annual debt service is in excess of 3.4 percent of total operating revenues, based on its most recent audited financial statement;

(5) The hospital has experienced a withdrawal or expiration of its credit enhancement facility, or the lender providing its credit enhancement facility has been downgraded, or the hospital can demonstrate that one of these events is imminent;

(6) The hospital is party to overly restrictive or onerous bond covenants;

(7) There are other circumstances that demonstrate that the hospital's financial health depends upon refinancing its existing capital debt.

(C) There are few alternative affordable financing vehicles available to the hospital.

* * *

(6) Preapplication meeting. The next step in the application process is the preapplication meeting (**this step is optional, at HUD's discretion in Section 242/223(f) cases**). At HUD's discretion, this meeting may be held at HUD Headquarters in Washington, DC, or at another site agreeable to HUD and the potential applicant. The preapplication meeting is an opportunity for the

potential mortgagor to summarize the proposed project, for HUD to summarize the application process, and for issues that could affect the eligibility or underwriting of the project to be identified and discussed to the extent possible. Following the meeting, HUD may:

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(b) Application contents. * * *

(3) A description of the project, the business plan of the hospital, and how the project will further that plan, **or, for applications pursuant to Section 223(f), a description of any repairs, renovations, and/or equipment to be financed with mortgage proceeds and how those repairs, renovations, and/or equipment will affect the hospital ;**

(4) Historical audited financial statements and interim year-to-date financial results (for existing hospitals);

(5) A study of market need and financial feasibility, addressing the factors listed in paragraphs (a)(1)(ii), (a)(2) and (a)(3) of this section, with assumptions and financial forecast clearly presented, and prepared by a certified accounting firm acceptable to HUD, **except that in the case of an application for Section 242/223(f) mortgage insurance, at HUD's discretion the study may not be required to address market need and at HUD's discretion there may be no requirement for involvement of a certified accounting firm;**

(6) Architectural plans and specifications in sufficient detail to enable a reasonable estimate of cost (**not applicable to a Section 242/223(f) application except when architectural plans and specifications are requested by HUD**);

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(d) Filing of application. An application for insurance of a mortgage on a project shall be submitted on an approved FHA form by an approved mortgagee and by the sponsors of such project to the FHA Office of Insured Health Care Facilities. **An application for insurance of a mortgage pursuant to Section 223(f) shall be submitted on an approved FHA form by an approved mortgagee and by the proposed mortgagor.**

5. Commitments (Section 242.17) [New Provision Added to § 242.17(a) and Language Added to § 242.17(b) a Accommodate Section 223(f) Refinancing]

(a) Issuance of commitment. * * *

(2) In the case of an application for Section 242/223(f) insurance where advances are not needed for funding any repairs, renovations, or equipment, a commitment for insurance upon completion reflecting the mortgage amount, interest rate, mortgage term, date of commencement of amortization, and other requirements pertaining to the mortgage that will be issued.

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(b) Type of commitment. The commitment will provide for the insurance of advances of mortgage funds during construction. **In the case of a commitment for Section 242/223(f) insured refinancing, at HUD's discretion the commitment may provide for insurance upon completion.**

6. Inspection Fee (Section 242.18) [Language Added to § 242.18 to Address Payment of Fee for Section 223(f) Refinancing]

The commitment may provide for the payment of an inspection fee in an amount not to

exceed \$5 per thousand dollars of the commitment. The inspection fee shall be paid at the time of initial endorsement. **In the case of mortgages insured under Section 223(f), the inspection fee shall be paid at endorsement, as described in section 242.39 of this subpart. For applicants seeking refinancing only, an inspection fee which would involve a site visit by HUD architects and/or engineers, or their review of a site visit report prepared by the architects and/or engineers of the applicant hospital, will not exceed 10 basis points on the loan.**

7. Maximum Mortgage Amounts and Cash Equity Requirements (Section 242.23) [New Provision Added to § 242.23 to Provide Additional Limits for Section 223(f) Refinancing]

Section 242/223(f) refinancing – additional limit. (1) In addition to meeting the requirements of § 242.7, if the existing hospital debt is to be refinanced by the insured mortgage (i.e., without a change in ownership or with the hospital sold to a purchaser who has an identity of interest as defined by the Commissioner with the seller), the maximum mortgage amount must not exceed the cost to refinance the existing indebtedness, which will consist of the following items, the eligibility and amounts of which must be determined by the Commissioner:

- (i) The amount required to pay off the existing indebtedness;
- (ii) Reasonable and customary legal, organization, title, and recording expenses, including mortgage fees under § 242.22;
- (iii) The estimated costs, if any, of repairs, renovation, and/or equipment totaling less than 20 percent of the mortgage amount;
- (iv) Architect's and engineer's fees, municipal inspection fees, and any other required professional or inspection fees.

(2) In addition to meeting the requirements of § 242.7, if mortgage proceeds are to be used for an acquisition, the maximum mortgage amount must not exceed the cost to acquire the hospital, which will consist of the following items, the eligibility and amounts of which must be determined by the Commissioner:

- (i) The actual purchase price of the land and improvements or HUD's estimate (prior to repairs, renovation, and/or equipment replacement) of the fair market value of such land and improvements, whichever is the lesser;
- (ii) Reasonable and customary legal, organization, title, and recording expenses, including mortgage fees under § 242.22;
- (iii) The estimated costs, if any, of repairs, renovation, and/or equipment totaling less than 20 percent of the mortgage amount;
- (iv) Architect's and engineer's fees, municipal inspection fees, and any other required professional or inspection fees.

8. Insurance Endorsement (Section 242.39) [New Paragraph (b) Added to § 242.39 to Accommodate Section 223(f) Refinancing]

Section 242/223(f) refinancing. (1) In cases that do not involve advances of mortgage proceeds, endorsement shall occur after all relevant terms and conditions have been satisfied, including, if applicable, completion of any repairs, renovations, and/or equipment, or upon assurance acceptable to the Commissioner that all required repairs will be completed by a date certain following endorsement.

- (2) In cases where advances of mortgage proceeds are used to fund repairs, renovation,

and/or equipment, endorsement shall occur as described in paragraph (a) of this section immediately above for new construction/substantial rehabilitation.

9. Labor Standards (Section 242.55) [New Language Added to § 242.55(c) Address Section 223(f) Refinancing]

(c) Each laborer or mechanic employed on any facility covered by a mortgage insured under this part (except under 24 CFR 242.91(a), but including a supplemental loan under section 241 of the National Housing Act or a refinancing loan under section 223(f) of the National Housing Act made in connection with a loan insured under this part) shall receive compensation at a rate not less than one and one-half times the basic rate of pay for all hours worked in any workweek in excess of eight hours in any workday or 40 hours in the workweek.

11. Environmental Quality Determinations and Standards. [Section 242.79] [New Language Added to Address Environmental Requirements for Section 242/223(f) Projects]

The requirements set forth in 24 CFR part 50, “Protection and Enhancement of Environmental Quality,” 24 CFR part 51, “Environmental Criteria and Standards,” and 24 CFR part 55, “Floodplain Management,” governing environmental review responsibilities (as applicable) and any additional environmental standards, reviews, or determinations required by HUD apply to this program. **While 24 CFR part 50 applies to Section 242/223(f) projects, those projects are categorically excluded from review under National Environmental Policy Act (NEPA), pursuant to 24 CFR 50.20(a)(5), because of their lack of potential for significant environmental impact, but will be reviewed by HUD under other applicable environmental laws and authorities. Additionally, the requirement under § 242.16(f) to perform an environmental review under 24 CFR part 50 prior to issuance of a commitment letter also applies to Section 242.223(f) projects without rehabilitation.**

12. Eligibility of Refinancing Transactions (Section 242.91) [New Provision Added to § 242.91 to Address Section 223(f) Refinancing]

(b) A mortgage given to refinance the debt of an existing hospital under Section 242 of the National Housing Act may be insured under this subpart pursuant to Section 223(f) of the National Housing Act. The mortgage may be executed in connection with the purchase or refinancing of an existing hospital without substantial rehabilitation. A mortgage insured pursuant to this subpart shall meet all other requirements of this part. The Commissioner shall prescribe such terms and conditions as the Commissioner deems necessary to assure that:

- (1) the refinancing is employed to lower the monthly debt service costs (taking into account any fees or charges connected with such refinancing) of such existing hospital;
- (2) the proceeds of any refinancing will be employed only to retire the existing indebtedness; pay for repairs, renovation, and/or equipment totaling less than 20 percent of the mortgage amount; and pay the necessary cost of refinancing on such existing hospital;
- (3) such existing hospital is economically viable; and
- (4) the applicable requirements for certificates, studies, and statements of Section 242 have been met.

III. Contact Information

If you have any questions concerning this notice, please contact the Office of Insured Health Care Facilities at 202-708-0599.

Sincerely,

David H. Stevens
Assistant Secretary for Housing -
Federal Housing Commissioner