



**2007 ADVANCED LENDER TRAINING:  
THE HOSPITAL MORTGAGE INSURANCE APPLICATION PROCESS**

**CASE STUDY  
AND  
EXERCISE  
WORKBOOK**

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**CASE STUDY****Submitted by: Banker Bill at First Choice Lending**

Community Hospital, located in the county seat of Anywhere County, USA, is a 170-licensed bed not-for-profit hospital. The hospital has 120 medical/surgical beds, 10 ICU beds, 20 psych beds, and 20 beds in a rehab unit. It also has a newborn nursery of 10 beds. Community has 35,698 acute care patient days, 9,104 psych & rehab days and 44,802 total patient days.

The current building, which has a net book value of \$10,000,000, will be demolished at the end of the construction and the space will then be used to provide additional parking and possibly a Medical Office Building. Review of audited financial statements show \$25,000,000 in cash and investments and \$30 million in net PP&E. The hospital also has a \$2,000,000 line of credit with First Choice Lending with nothing drawn against it.

Calculated from consolidated financial statements

<b>Year</b>	<b>2004</b>	<b>2005</b>	<b>2006</b>
<b>Operating Income</b>	\$1,692,000	\$1,627,000	\$2,494,000
<b>Operating Margin</b>	0.9%	0.9%	1.2%
<b>DSC</b>	5.6	6.2	7.0

Community is one of two hospitals in Anywhere County and is located in a state that requires a Certificate of Need. Anywhere County has been designated as a Medically Underserved Area and has been designated as a Health Professional Shortage Area (HPSA). The other hospital in the county is 25 miles distance and has been designated as a Critical Access Hospital. Community serves as a referral center for the CAH hospital.

The project is to build a replacement hospital on land that is part of the current site. There will be no change in the licensed beds, although the current hospital has semi-private rooms and all rooms will be private rooms in the new hospital. Community Hospital has been working with ABC Architects on the site design, which entails a 170-bed 4-story building with approximately 400,000 square feet. The hospital plans to hire a general contractor to manage the construction. Site work is scheduled for March 2008 with foundations work starting in June 2008 and substantial completion in March 2010.

<b>Estimated Project Costs</b>	
Construction	\$100,000,000
Architect Fee	\$ 9,000,000
Construction Manager	\$ 200,000
Other	\$ 5,000,000
Contingency (5%)	\$ 5,000,000
<b>Total Construction</b>	<b>\$119,200,000</b>
Equipment	\$ 10,000,000
<b>Total for Improvements &amp; Equip</b>	<b>\$129,200,000</b>
Cap. Interest @ 6% for 24 mo.*	\$ 7,380,000
Taxes	\$ 0
Insurance	\$ 0
HUD MIP (.5% @yr for 2 yrs)	\$ 1,450,000
HUD exam fee (.3%)	\$ 435,000
HUD inspect fee (.5%)	\$ 725,000
Financing Expense (2%)	\$ 2,900,000
Placement Fee (1.5%)	\$ 2,175,000
AMPO (2%)	\$ 2,900,000
Title & Recording	\$ 100,000
<b>Total Financing Expense</b>	<b>\$ 18,065,000</b>
Legal & Org	\$ 200,000
<b>Total Replacement Cost</b>	<b>\$147,465,000</b>
Net PP&E to be transferred	\$ 20,000,000
Capitalized Leases	\$ 0
<b>Total Estimated Replacement Cost of Project</b>	<b>\$167,465,000</b>
Refinancing	\$ 22,000,000
<b>Total Project Cost</b>	<b>\$169,465,000</b>
Proposed Mortgage	\$145,000,000
Cash Equity Contribution	\$ 24,465,000

\*  $6\% \times 2 \text{ yr} \times \$123,000,000 \times 0.5 = 7,380,000$  (hospital will pay interest on the \$22M refinance portion from its earnings during the 24-mo. construction period)

**EXERCISE 1: Perform a Preliminary Review**

HOSPITAL: Community Hospital, Anywhere County, USA

SUBMITTED BY: Banker Bill  
Senior Vice President  
First Choice Lending  
800-555-1200

DATE: April 1, 2007

**What is the nature and amount of the project?**

**Are statutory eligibility criteria met including 50% patient days calculation?**

**Are minimum financial criteria met?**

**Is at least 20% of the mortgage amount for a construction or modernization project?**

**Is physician ownership present?**

**Hospital Type:**

**Does local government ownership pose first lien problems?**

**Is hospital willing and able to grant a first lien on hospital property, plant, equipment, and receivables?**

**Is it a Critical Access Hospital? (different process)**

**Has construction begun already or is it about to?**

**Is this a design-build project?**

**Is the hospital in a CON state (if yes, have required CON's been issued)?**

**Does the hospital have a mortgage lender?**

**How knowledgeable is the lender about 242?**

**Is applicant prepared to bring sufficient cash to the table for equity and working capital?**

**Is there a current or planned receivables financing program?**

**Is it a Sole Community Provider or Regional Referral Hospital?**

**Need Evaluation**

**Conclusion**

**EXERCISE 1: Perform a Preliminary Review****ANSWER KEY**

HOSPITAL: Community Hospital, Anywhere County, USA

SUBMITTED BY: Banker Bill  
Senior Vice President  
First Choice Lending  
800-555-1200

DATE: April 1, 2007

**What is the nature and amount of the project?**

*Replacement hospital. The new hospital will be a 170-bed 4-story building with approximately 400,000 sq feet. Demo site work is scheduled for March 2008 with foundations work starting in June 2008 and substantial completion in March 2012.*

<i>Total Construction</i>	<i>\$119,200,000</i>
<i>Equipment</i>	<i>\$ 10,000,000</i>
<i>Total Financing Expense</i>	<i>\$ 18,065,000</i>
<i>Legal &amp; Org</i>	<i>\$ 200,000</i>
<b><i>Estimated Replacement Cost</i></b>	<b><i>\$147,465,000</i></b>
<i>Plus Refinancing</i>	<i>\$ 22,000,000</i>
<b><i>Total Project Cost</i></b>	<b><i>\$169,465,000</i></b>
<i>Less Cash Equity</i>	<i>(\$24,465,000)</i>
<b><i>Proposed Insured Mortgage</i></b>	<b><i>\$145,000,000</i></b>

**Are statutory eligibility criteria met including 50% patient days calculation?**

*Yes. % of days for Acute Care Services = Acute Care Patient Days / Total Patient Days (35,698/44,802 = 0.79). Approximately 80% of patient days are for acute care services*

**90% loan to value calculation:**

<i>Value of Property Plant &amp; Equipment</i>	<i>\$20,000,000</i>
<i>Less Capital Leases</i>	<i>(0)</i>
<i>PLUS: Improvements to be undertaken</i>	<i>\$147,465,000</i>
<i>Net Value</i>	<i>\$167,465,000</i>
	<i>X 90%</i>
<b><i>Maximum Insurable Mortgage</i></b>	<b><i>\$150,718,500</i></b>

*The proposed mortgage is \$145,000,000 and is under the limit.*

**Are minimum financial criteria met?**

*Yes. Community Hospital's financial statements for the past 3 years show an average operating margin  $\geq 0.00$  and an average DSC  $\geq 1.25$ .*

*Average operating margin for last 3 years  $\geq 0.00$*

<i>Year</i>	<i>2004</i>	<i>2005</i>	<i>2006</i>	<i>Average</i>
<i>Operating Income</i>	<i>\$1,692,000</i>	<i>\$1,627,000</i>	<i>\$2,494,000</i>	<i>\$1,937,667</i>
<i>Operating Margin</i>	<i>0.9%</i>	<i>0.9%</i>	<i>1.2%</i>	<i>1.0%</i>

*Average DSC for last 3 years  $\geq 1.25$*

<i>Year</i>	<i>2004</i>	<i>2005</i>	<i>2006</i>	<i>Average</i>
<i>DSC</i>	<i>5.6</i>	<i>6.2</i>	<i>7.0</i>	<i>6.3</i>

**Is at least 20% of the mortgage amount for a construction or modernization project?**

*Yes*

**Is physician ownership present?**

*No*

**Hospital Type;**

*Not-For-Profit*

**Does local government ownership pose first lien problems?**

*No*

**Is hospital willing and able to grant a first lien on hospital property, plant, equipment, and receivables?**

*Yes*

**Is it a Critical Access Hospital? (different process)**

*No*

**Has construction begun already or is it about to?**

*No, but the plan is to begin in March 2008.*

**Is this a design-build project?**

*No*

**Is the hospital in a CON state (if yes, have required CON's been issued)?**

*Yes. CoN will be applied for in the near future.*

**Does the hospital have a mortgage lender?**

*Yes, First Choice Lending.*

**How knowledgeable is the lender about 242?**

*In this case study we will assume the lender has prior experience.*

**Is applicant prepared to bring sufficient cash to the table for equity and working capital?**

*The hospital has \$25 million in investments and cash.*

**Is there a current or planned receivables financing program?**

*The hospital has a \$2 million line of credit, with nothing drawn against it, to provide liquid capital if needed. Because HUD requires the first lien on all personalty, the line of credit will need to be closed out prior to closing, but may be re-established subject to the additional indebtedness clause.*

**Is it a Sole Community Provider or Regional Referral Hospital?**

*No. To be a Sole Community Provider, a hospital must be the only provider within a 35-mile radius, but in the case of Community Hospital, there is a Critical Access Hospital 25 miles away. Furthermore, for a hospital to receive Medicare designation as a Regional Referral Hospital, one requirement is a minimum of 275 beds. Community Hospital has 170 beds.*

**Need Evaluation**

*Key factors demonstrating need is that Community Hospital is the primary hospital serving the community and serves as a referral center for the nearby Critical Access Hospital. It is also located in a MUA and HPSA. HUD will also use the HUD Need Tool to assess need.*

**Conclusion**

*It appears that this hospital is a candidate for the program*

## CASE STUDY: ALTERNATE SCENARIOS

### SCENARIO A: No Cash Requirement (rehab/expansion)

Example is the same as the main case study, except the hospital project is a rehabilitation project with \$100 million in net PP&E to transfer over into the new project.

#### RESULTING IMPACTS:

##### Revised amount of project:

<i>Total Construction</i>	<i>\$119,200,000</i>
<i>Equipment</i>	<i>\$ 10,000,000</i>
<i>Total Financing Expense</i>	<i>\$ 21,702,566</i>
<i>Legal &amp; Org</i>	<i>\$ 200,000</i>
<b><i>Estimated Replacement Cost</i></b>	<b><i>\$151,102,566</i></b>
<i>Plus Refinancing</i>	<i>\$ 22,000,000</i>
<b><i>Total Project Cost</i></b>	<b><i>\$173,102,566</i></b>
<i>Less Cash Equity</i>	<i>(\$566)</i>
<b><i>Proposed Insured Mortgage</i></b>	<b><i>\$173,102,000</i></b>

##### 90% loan to value calculation:

<i>Value of Property Plant &amp; Equipment</i>	<i>\$100,000,000</i>
<i>Less Capital Leases</i>	<i>(0)</i>
<i>PLUS: Improvements to be undertaken</i>	<i>\$151,102,566</i>
<i>Net Value</i>	<i>\$251,102,566</i>
	<i>X 90%</i>
<b><i>Maximum Insurable Mortgage</i></b>	<b><i>\$225,992,309</i></b>

*The proposed mortgage of \$173,102,000 is well under the maximum insurable mortgage limit with virtually no cash down payment required.*

### SCENARIO B: Insufficient Cash & Equity

Example is same as the main case study, except the balance sheet reflects only \$2 million in cash and investments.

#### RESULTING IMPACTS:

*With only \$2,000,000 in cash and investments, it appears unlikely that the hospital will be able to come up with the \$24,465,000 cash required for the proposed loan.*

**SCENARIO C: Turnaround situation, negative operating margin**

Example is same as the main case study, except that the hospital has the following financial ratios:

Year	2002	2003	2004
<b>Operating Income</b>	-\$1,692,000	-\$100	\$500,000
<b>Operating Margin</b>	-0.9%	-0.0%	0.5%

**RESULTING IMPACTS:**

Year	2002	2003	2004	Average
<i>Operating Income</i>	<i>-\$1,692,000</i>	<i>-\$100</i>	<i>\$500,000</i>	<i>-\$397,367</i>
<i>Operating Margin</i>	<i>-0.9%</i>	<i>-0.0%</i>	<i>0.5%</i>	<i>-0.13%</i>

*Average operating margin for the last 3 years is less than 0.00 and does not meet HUD threshold. HUD would recommend that the hospital wait before applying to allow time for turnaround financial indicators to improve and demonstrate stability.*

**SCENARIO D: Appraisal**

Example is the same as Scenario A, except that the net PP&E is \$30 million and has an appreciated replacement cost value of \$50 million.

**RESULTING IMPACTS:****90% loan to value calculation:**

	<b><i>Without Appraisal</i></b>	<b><i>With Appraisal</i></b>
<i>Value of Property Plant &amp; Equipment</i>	\$30,000,000	\$50,000,000
<i>Less Capital Leases</i>	(0)	(0)
<i>PLUS: Improvements to be undertaken</i>	\$151,102,566	\$151,102,566
<i>Net Value</i>	\$181,102,566	\$201,102,566
	X 90%	X 90%
<b><i>Maximum Insurable Mortgage</i></b>	<b><i>\$162,992,309</i></b>	<b><i>\$180,992,309</i></b>

*The proposed mortgage of \$173,102,000 is acceptable if the \$50,000,000 value is substantiated by a limited appraisal. Go over appraisal policies in the pre-application meeting including that the firm must be a certified general appraiser with experience in hospitals and hired by the Mortgagee.*







**EXERCISE 3: Operating Margin Calculation**

Given the following line items from Your Local Hospital's financial statement, calculate the Operating Margin:

Net patient revenue	\$ 100,000,000
Other operating revenue	\$ 10,000,000
Contributions	\$ 1,000,000
Rental income from MOB not part of the project	\$ 500,000
Investment income	\$ 500,000
General operating expense	\$ 52,000,000
Salaries & wages	\$ 52,000,000
Interest expense	\$ 1,000,000
Depreciation	\$ 5,000,000
Expenses related to MOB	\$ 495,000
Non-operating revenue & expenses.	\$ 100,000

**EXERCISE 3: Operating Margin Calculation****ANSWER KEY**

Given the following line items from Your Local Hospital's financial statement, calculate the Operating Margin:

Net patient revenue	\$ 100,000,000
Other operating revenue	\$ 10,000,000
Contributions	\$ 1,000,000
Rental income from MOB not part of the project	\$ 500,000
Investment income	\$ 500,000
General operating expense	\$ 52,000,000
Salaries & wages	\$ 52,000,000
Interest expense	\$ 1,000,000
Depreciation	\$ 5,000,000
Expenses related to MOB	\$ 495,000
Non-operating revenue & expenses.	\$ 100,000

**ANSWER**

<i>Net patient Revenue</i>	<i>\$ 100,000,000</i>
<i>Other operating revenue</i>	<i><u>\$ 10,000,000</u></i>
<i>Total Revenue from Operations</i>	<i>\$110,000,000</i>
<i>General operating expense</i>	<i>\$ 52,000,000</i>
<i>Salaries &amp; wages</i>	<i>\$ 52,000,000</i>
<i>Interest expense</i>	<i>\$ 1,000,000</i>
<i>Depreciation</i>	<i><u>\$ 5,000,000</u></i>
<i>Total Expenses from Operations</i>	<i>\$110,000,000</i>
<i>Income from Operations</i>	<i>\$ 0</i>
<i>Contributions</i>	<i>\$ 1,000,000</i>
<i>Rental income from MOB not part of the project</i>	<i>\$ 500,000</i>
<i>Investment income</i>	<i>\$ 500,000</i>
<i>Non-operating revenue &amp; expenses.</i>	<i>\$ 100,000</i>
<i>Expenses related to MOB.</i>	<i><u>(\$ 495,000)</u></i>
<i>Non-operating income</i>	<i>\$ 1,605,000</i>
<i>Net Income</i>	<i>\$ 1,605,000</i>