

# HUD – 242 HOSPITAL FINANCING

# Mission

- To support affordable financing of needed hospital projects by reducing the cost of capital
- Supports HUD's community development mission
- Improves access to quality and cost-effective healthcare
- Fills unique role not served by private market

# Current Market Constraints Makes 242 Program Attractive

- Banks tightening lines of credit
- Bond market has become restrictive
- Rating Agencies downgrading issued bonds
- Applications doubled in fourth quarter of 2008

# Other Hospital Challenges

- Rising healthcare costs
- Changing Medicare reimbursement policies
- Increased competition

# Value of FHA Insurance to Hospitals

- Example - \$100 million application under review
- Rated B+ by S&P
- Interest rate on tax-exempt bonds:
  - ... Without insurance about 10%
  - ... With insurance about 6%
- Savings to hospital:
  - \$3 million per year in debt service
  - \$75 million over life of loan

# Why Choose HUD 242

- U.S. government backing enhances hospital's creditworthiness
- Resulting increased credit rating = lower interest rates
- Lower interest rates = more spending power to address community needs



# Hospitals that Choose the 242 Program

- Hospitals in all 50 States and Territories
- Acute Care Hospitals
- Critical Access Hospitals
- Large Urban Teaching Hospitals
- Hospitals in Systems
- For-Profit, Not-for-Profit and Government Owned



# Use of Proceeds

- Remodeling
- Expansion
- Modernization
- Equipment
- Refinancing

# Flexible Funding Options

- Whole Loan Placements
- Taxable Bonds
- Tax-Exempt Bonds
- Ginnie Mae Securities

# Continual Improvement of 242 Program

- Geographic Diversification
- Marketing
- Website
- Council of Experts
- Applicant's Guide
- Design/Build Construction
- Streamlining Application Process

# Adding Talented Staff

- Former Healthcare CEOs and CFOs
- Healthcare System Executives
- CPAs
- Engineers
- Architects

# Attractive Loan Terms

- No maximum loan amount
- Loan-to Value may be up to 90%
- Fixed Rate
- Construction to permanent in one loan
- No cash required at closing with sufficient equity
- Non-recourse
- HUD/FHA insures 99% of the loan

# Other Program 242

## Advantages

- Design-Build for of contracting allowed for projects less than \$30 million
- Enables flexible loan covenants
- One of the best claims track records in HUD/FHA portfolio
- Self-funding not requiring federal appropriations

# Streamlining Application Process

- Reducing requested information
- Improving communication with application checklist
- Condensed and more focused credit committee report
- Fast track review for financially strong hospitals

# Process Steps

1. Self assessment
2. Initial contact with HUD or HHS
3. Preliminary HUD assessment
4. Pre-application meeting
5. Application and feasibility study
6. Application review by HUD/HHS
7. HUD decision
8. Insurance commitment
9. Initial closing
10. Construction
11. Final closing



# Step 1: Self Assessment

- Uses of FHA loan
- Construction financing, modernization, equipment, refinancing, remodeling, expansion
- Coverage, Cost, and Conditions
- FHA insures 99% of the loan amount
- One-time fees total 0.8 percent of the loan amount
- Fixed annual premium is 0.5 percent of the remaining mortgage balance

# Step 1: Self Assessment

- The HUD-insured lender must have a first lien position
- Note: For refinancing, at least 20% of mortgage amount must be used for construction and equipment and no more than half of that can be used for equipment

# Step 1: Self Assessment

- Adjusted patient days at least 50% acute care
- Critical Access Hospitals Are Exempt
- Past 3 years average operating margin  $>0$
- Past 3 years average debt service coverage ratio  $>1.25$
- For hospitals recently designated as Critical Access, calculate financial information as though it had been a CAH for all three years

# Step 2: Initial Contact with HUD

- Describe hospital and project
- Ask questions
- Provide additional information
- Receive Pre-application list

# Step 3: Preliminary Review

- Purpose of the Preliminary Review: Advise applicant of factors that could disqualify an application
- Mortgage banker submits preliminary review materials to HUD
- If favorable: HUD and HHS assign an Account Executive, and pre-application meeting is scheduled

# Step 3: Preliminary Review

1. Last three years audited financial statements
2. Need Tool - Applicant Data Request Form
3. Draft HUD Form 92013
4. Preliminary Review Template

# Patient Day Test

- Section 242 Statutory requirement: 50% acute care patient day rule
- Non-acute patient days include skilled nursing, rehabilitation, psychiatric, and other services
- HUD allows adjustment of patient days based on revenues
- Critical Access Hospitals are exempt from the patient day rule

# Loan-to-Value

- LTV calculation =  
Total Mortgage Amount  
Divided by  
Total Estimated Replacement Cost + Net PPE
- Maximum LTV = 90 percent



# Project Description

- Basic information on the hospital (location, number of beds, etc)
- Information on the project (replacement, expansion, renovation, refinancing)
- The need for the project

# Ownership Structure

- Types of ownership
  - Non-profit, privately-owned
  - Government-owned
  - Investor-owned hospitals
    - Stark and Anti-kickback

# Financial Screens

- Average operating margin for last 3 yrs > 0
- Operating Margin =  
    Operating Income from Last Full FY  
    + Operating Income from Two Full FYs Ago  
    + Operating Income from Three Full FYs Ago  
    Divided by
  - Total Operating Revenues from Last Full FY
  - + Total Operating Revenues from Two Full FYs Ago
  - + Total Operating Revenues from Three Full FYs Ago
- HUD removes non-operating revenues from the calculation

# Financial Screens

- Average DSC for last 3 years > 1.25
- Debt Service Coverage Ratio (DSC) =  
    Net Income + Depreciation Expense + Interest Expense  
    Divided by  
    Current Portion of Long-Term Debt (Prior Year) + Interest Expense
- For hospitals recently designated as Critical Access, calculate ratios as though they have been a CAH for all three years

# Other Program Requirements

- Hospital must agree to contribute to a Mortgage Reserve Fund
- All projects in a CON state must have the appropriate CON approval

# Other Program Requirements

- Borrower must have sufficient equity and working capital on hand to be considered for 242 mortgage insurance
- HUD cannot insure a mortgage for a project in progress

# Applicant Data Request (Need Tool)

- The Purpose of the Need Tool
- Project Description
- Service Area Definition
- Quantify Number of Beds-- Current and Proposed
- Identify Competitor Hospitals
- Outpatient/Emergency Services
- Hospital Classification
- Teaching Hospital Status

# Next Steps

- Length of Preliminary Review Process
- HUD informs mortgage bankers of decision
- If favorable: HUD and HHS assign an Account Executive, and pre-application meeting is scheduled



# Fast--Track Review for Financially Strong Hospitals

- Hospital must meet financial ratios when debt is superimposed on historical financials
- Determined in Preliminary review based on historical data submitted by lender and hospital
- HUD analyzes all Preliminary information before deciding on fast track
- If approved for fast track processing:
  - Application may be prepared faster
  - Underwriting review may be faster

# Step 4: Pre-Application Meeting

- Participants:
  - Mortgage Banker
  - Hospital executives, attorney, architect, others
  - HUD/HHS underwriting team
  - HUD's Office of General Counsel
  - HHS' Division of Engineering Services

# Step 4: Pre-Application Meeting

- Purpose:
  - Introductions
  - Hospital team presents project
  - Discuss issues identified during preliminary review process
  - Legal and engineering discussions
  - HUD explains the application process

# Step 5: Application Development and Feasibility Study

- Consultant prepares study of market need and feasibility
- Hospital project team prepares application and Account Executive answers questions
- Hospital sends application including study to HUD/HHS

# Step 5: Application Development and Feasibility Study

- Application Submission
- Items to be sent to the HUD Regional Office
  - Submit a copy of the HUD - 92013
  - Application and inspection fees,
  - Phase I Environmental, and
  - Previous Participation Certificate and HUD Form 2530 (submit electronically)

# Step 6: Application Review

- Completeness review
- Underwriting review (different for CAH) by Account Executive and team (financial, engineering, legal, environmental)
- HUD feasibility consultant performs independent review
- Application fee: 80 basis points
  - 15 with application
  - 15 at loan commitment
  - 50 at initial closing

# Step 7: Decision

- Joint HUD/HHS team presents to Program Management Group (underwriting/credit committee)
- PMG recommendations sent to the Director of the Office of Insured Health Care Facilities
- FHA Commissioner makes final decision

# Step 8: Insurance Commitment

- FHA Commissioner instructs the OIHCF Director to issue commitment
- Conditioned on hospital agreeing to covenants
- Commitment allows financing to be finalized



# Step 9: Initial Closing

- Held at local HUD Field Office
- Proceeds of FHA-insured loan may now be used

# Step 10: Construction

- HHS Office of Engineering Services monitors construction
- Advances made as project proceeds

# Step 11: Final Closing

- After construction completed and costs certified
- Final mortgage amount

# Hospital Case Studies

# Hospital Reposition

## Challenge

- A client constructed a new Hospital through a \$26M Bond and wanted to reposition their old hospital (1950 construction), located 5 miles away, into an income producing asset. Under the bond documents they were not allowed to sponsor or guarantee the new loan.

## Assignment

- (i) identify the highest and best use for the property, (ii) develop an optimal funding solution, and (iii) facilitate the financing.

## Solution

- Worked with a market specialist and appraiser and concluded the best use would be to rehab the facility into an assisted living and memory impaired facility. We then funded a \$9M HUD commitment which credit enhanced a new tax exempt bond offering. The combined financing reduced the interest rate by 1% and the loan was fixed for 40 years. In addition, the hospital did not have to sponsor the loan.

# Hospital Refinance

## Challenge

A client received a notice from their bond lender that their interest rate was increasing due to a technical loan default in the loan documents. The increased rate impacted their cash flow and plans to expand the facility.

## Assignment

(i) complete due diligence, (ii) evaluate the capital needs and equipment budget, (iii) review the bond documents, and (iii) develop an optimal funding solution.

## Solution

Processed and funded a HUD loan that paid off the bond issue and provided the client funds to purchase equipment and complete capital improvements to the facility. Under our program, the loan term increased to 25 years and the interest rate was reduced from 8% to 6%. The facility is now financially positioned to meet the changing market demands.

# Rehab Hospital Refinance

## Assignment

A client had permanent financing through a REIT and was paying over 10%. Area banks declined to refinance the property because they would not factor in the business value of the operation.

## Solution

Processed and funded a HUD loan that: (i) paid off the loan and lowered the interest rate below 6%,(ii) extended the loan term from 20-35 years and (iii) funded \$5,000,000 in capital improvements to enhance the facility The facility is now financially positioned to meet the changing market demands.

# Other HUD Programs

In addition to the 242 program, we offer HUD financing for other senior housing facilities under the 232 loan programs. These programs offer the owners/operators of a hospital an opportunity to acquire or refinance other senior housing facilities at very attractive terms.



# Healthcare Programs

- New Construction
- Substantial Rehabs
- Acquisitions
- Refinances

# Types of Properties

- Skilled Nursing
- Assisted Living
- Independent Care
- Res Care

# New Construction

- L to V: - 90% -for Profit – 95% Non-Profit (75% for assisted living)
- DCR: - 1.18 for Profit – 1.11 Non-Profit
- Term: - 40 Years
- Rate - Fixed Rate (during construction period)
- Non-Recourse from Day 1
- Construction to Permanent Loan
- Interest Carry is built in Loan
- Recognize entitled value of land
- Soft costs are MORTGAGABLE

# Loan Features - Acquisition

- 85% Loan to Value
- Allow 7.5% seller financing
- Up to 35 years
- Non-Recourse
- Assumable
- Can finance unseasoned properties
- Can blanket properties
- Low Fixed Rates - today 6%

Main Spring Real Estate Services LLC  
509 S. Chickasaw Trail #246, Orlando, FL 32825  
Ph:866-777-8145  
[www.MainSpringRealEstate.com](http://www.MainSpringRealEstate.com)