AMERICAN HEALTH LAWYERS ASSOCIATION

PRACTICE GROUP email alert

To: Business Law and Governance Practice Group Members

From: Stuart Silverman, Chair
Matthew Aiken, Vice Chair of Educational Programs
Susan Duffy, Vice Chair of Research
Catherine Dunlay, Vice Chair of Membership
William Horton, Vice Chair of Publications
Dale Van Demark, Vice Chair of Strategic Activities

Date: April 2, 2010

Business Law Update

Highlights of FHA-Insured Financing for LTC Facilities--HUD § 232 Loans Become More Popular

Andrea Barach*

In the current market, financing options for long term care providers have been shrinking. Those borrowers who are still able to obtain commercial bank financing have found the terms revised from the merely onerous to the downright unacceptable. These market forces have caused an increased level of interest in financing insured by the Federal Housing Administration (FHA). At the same time, the U.S. Department of Housing and Urban Development (HUD), which administers these finance programs, has completed a system-wide revision to the processing of loans in the long term care program, called "Lean Thinking," which has improved the efficiency and processing of these loans. The result is a dramatic increase in loan volumes and a growing "queue" as applications are in line for processing by HUD underwriters.

The loan programs available for long term care projects are offered under § 232 of the National Housing Act.[1] Under the program, private lenders who are qualified under HUD guidelines will make mortgage loans to *eligible borrowers* secured by first priority mortgages on *eligible projects* , and HUD will issue mortgage insurance to the qualified lender. Depending upon the exact nature of the project (new construction, refinance, for-profit or nonprofit) the loan terms will be nonrecourse thirty-five- or forty-year terms with level amortization at fixed rates of interest. Interest rates are set by the lenders making the loans, but at present they are somewhere between 5.20% and 5.5%. The loan amounts will be the lower of: (1) between 75% and 90% of the appraised value (depending on type of project and borrower); and (2) total *eligible costs*.

Eligible projects under § 232 include skilled nursing homes, intermediate care nursing homes, board and care homes, and assisted living facilities. In general, § 232 eligible projects must be licensed facilities, although there are some special rules for assisted living facilities in states without licensing requirements, and independent living (senior living), unlicensed units are permitted so long as they are less than 25% of the entire project.

Eligible borrowers are single asset, single purpose entities that may be either nonprofit or profit motivated, and may be corporations, limited liability companies, or partnerships. To be an eligible borrower, the principals of the entity must be disclosed and must not have been in bankruptcy for the preceding five years nor may any of them have been a principal in another FHA-insured financing that is now in default.

Eligible costs include the repayment of third-party financing, construction costs, renovation costs, purchase price paid to nonaffiliated sellers, and closing costs. It is important to understand that under no event will a cash out of equity be allowed under these programs, and certain types of payments to affiliates will be scrutinized to ensure that they are not disguised transactions to take cash equity from the transaction.

In recent years, HUD has developed a greater understanding about working capital financing, and recognizes that many long term care owners require some sort of accounts receivable financing in order to cover the gap between the date of service and the date, much later, when the facility is paid for such service. The interaction between the HUD form documents and the needs of accounts receivable lenders can be somewhat trying, and it is very helpful to obtain accounts receivable financing from a lender that has experience in loans to facilities with HUD-insured mortgages.

The loan applications under § 232 will include many of the same types of information as are required under commercial financing, although in some respects there will be a higher level of facility-related information required.[2] Also, the Lean Thinking processing reforms have required many more due diligence items to be submitted with the application, rather than having them submitted after the commitment has been issued during the preparation for closing.[3] This means that the process of application is more difficult, but there are fewer potential pitfalls as the parties proceed to the closing.

Timing has always been an issue with § 232 loans. HUD loans in general have been notoriously slow. However, the Lean Thinking program has been an improvement. Once an application is assigned to an underwriter at HUD, the commitment is issued in approximately seventy days, on average, and from the date of the commitment, the closing will occur on average about sixty days later. These statistics are comparable to private lenders. Unfortunately, because the program has become so popular, there are not enough HUD underwriters to review applications, and thus there is a waiting list, or queue during which a newly filed application awaits assignment. As of early 2010, that queue is on the order of 100 days, however HUD is working diligently to reduce the length of the queue.

An owner of multiple facilities may obtain § 232 financing for a portfolio of facilities. There are guidelines that have been in place for many years[4] that require heightened underwriting for medium-sized portfolios (eleven or more properties and a total of more than $75 million financed) and large-sized portfolios (fifty or more facilities and a total of more than $250 million financed).[5] In general, the loans will be structured as a series of single facility loans, and due to the requirement of a single purpose single asset eligible borrower for each facility, it can be difficult to create a structure that will allow for some level of pooled support, so that the stronger facility can provide economic support for the weaker facility.

Recently, HUD has recognized the advantages of allowing "pools" of facilities to support each other economically, and has begun using a form of master lease structure that allows such a pooling. It is worth recognizing that the migration to a new structure for multiple facility loans represents an entirely new focus by HUD and creates a number of structural difficulties within the statutorily mandated HUD loan structure.

The future for many long term care providers will include a visit to the world of FHA finance, and the increased volume and interest in the program is already generating changes in the program in both procedure and structure. This author suggests that these changes will continue in the future as FHA-insured finance becomes an increasing common form of financing for long term care projects.

**We would like to thank Andrea C. Barach, Esquire (Bradley Arant Boult Cummings LLP, Nashville, TN) for authoring this alert and sharing her expertise with other colleagues.*

[1] 12 U.S.C.1715w (2009); *see also* 24 C.F.R. §232 (2009).

[2] U.S. Dep't Of Hous. And Urban Dev., Guide To Multifamily Accelerated Processing (Map), Ch. 3: Eligible Multifamily Mortgage Insurance Programs § 3.9 (2002).

[3] U.S. Dep't of Hous. and Urban Dev., Office of Housing, *232/223(f) LEAN Processing Training for Lenders* (2008).

[4] U.S. Dep't of Hous. and Urban Dev., Review of Health Care facility Portfolios and Changes to the Section 232 Program Notice H 01-03 (April 10, 2001).

[5] *Id.* Medium-sized portfolios first must obtain a mortgage credit review from HUD Headquarters before any application is submitted, and there will also be site visits. For large-sized portfolios, in addition to each of the requirements for medium portfolios, there must be a rating agency credit analysis in a specified form. *Id.*