Federal Mortgage Insurance for Acute Care Hospitals

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Program purpose Since Congress passed the Housing and Urban Development Act of 1968, hospitals have accessed the capital markets at lower interest rates through Federal Housing Administration -insured mortgage loans. Since its inception, the FHA has insured hospital designation gives hospitals other advantages in their Medicare reimbursements including using financials that are based on cost-based payments. Essentially, to optimize the financial picture of the hospital in question, HUD permits mortgage bankers to recast critical access hospitals financials for the three-year period prior to their conversion to critical access hospital designation.

Getting started The HUD 242 program administrator has established a target of 120 days for final approval by the Commissioner once an "uncomplicated" application is tendered. Potential applicants must first submit an application to HUD for a preliminary assessment of eligibility. After determining preliminary eligibility, HUD will require that the applicant produce substantial information and documentation related to the hospital and the proposed project. Applicants must provide a significant amount of information, including, but not limited to, audited financial results, management letters with responses and operating statistics for the past three years, various financial ratios, a summary and documentation of malpractice and other insurance, a description of the ownership and management structure, corporate resolutions relating to the project, a current report from the Joint Commission on the Accreditation of Healthcare Organizations, a comprehensive report on the community the hospital serves, contracts with medical and financial consultants, and various disclosures related to the construction project itself.

Limits on expenditures Although there is no minimum or maximum loan limitation for mortgage insurance, the total loan-to-value ratio may not exceed 90 percent of the estimated replacement cost of the property. The maximum loan term may not exceed 25 years and shall be self-amortizing. FHA will insure 99 percent of the borrowers' debt. The balance is typically secured with line of credit or other insurance. Funds from FHA-insured loans may be used for construction financing, refinancing if coupled with a construction project, modernization, remodeling, expansion and moveable equipment. If mortgage proceeds are used for refinancing, a minimum of 20 percent of the proceeds must be used for facility renovation, rehabilitation or the purchase of new equipment but no more than half of the 20 percent may be used for equipment upgrades. Projects that have already commenced in the construction phase are not eligible expenditures. Funds may not be used for acquisitions. Since the lender of the FHA-insured loan must have a first mortgage on all assets of the hospital, existing debt, including that which would otherwise have superior priority on the property, may be refinanced with up to 80 percent of the proceeds.

Terms and conditions of the agreement The agreement between the mortgagor and HUD delineates numerous conditions and requirements with which the mortgagor must comply. Most terms are found within the Regulatory Agreement, Certain Covenants for HUD Section 242 Mortgage Insurance documents, the Assurances for Construction Programs and the Mortgage Reserve Fund Agreement. Some of the most significant covenants are:

- *Mortgage Reserve Fund*--The mortgagor must deposit cash in the Mortgage Reserve Fund, which serves as a reserve for defaulted mortgage payments. Over the course of the mortgage, the balance must reach a cash value of 24 months of debt service within ten years.

- *Requirement for Secretary's Written Approval for Certain Actions*--Prior approval from the HUD Secretary is required for the mortgagor to, among others, pay any compensation to directors, officers or stockholders; or to dispose of or otherwise encumber any personal or real property subject to the mortgage.

- *Control of Project Management*--The HUD Secretary will have significant control over the management of the project in that the Secretary shall ultimately approve hiring and dismissal of the project manager. Further, all contracts related to the project shall provide that the Secretary may terminate the contract with 30 days notice for cause or without.

Cost and benefits FHA charges a one-time fee equal to 0.8 percent of the total loan amount at inception to cover application, administration and inspection fees. A mortgage insurance premium of 0.5 percent of the outstanding principal balance is charged on an annual basis thereafter. Further, the mortgagor must make monthly payments into the Mortgage Reserve Fund which will build to a balance of one year debt service in five years and two years debt service in ten years. Another factor to consider, which may increase the cost of construction, is that laborers or mechanics working on construction funded by the FHA-insured mortgage must, by law, be paid "the wages prevailing in the locality in which the work was performed." Further, overtime pay, defined as any hours worked over 40 in a week or eight within the same day, must be paid when appropriate at a rate equal to at least one-and-one-half times the basic rate of pay. Interested parties may submit an initial application which must include