

HEALTHCARE MORTGAGEE ADVISORY COUNCIL

Financing Seniors Housing for America

Lender Narrative Training

Understanding Key Questions and
Helpful Tips

The DeLorean Dashboard



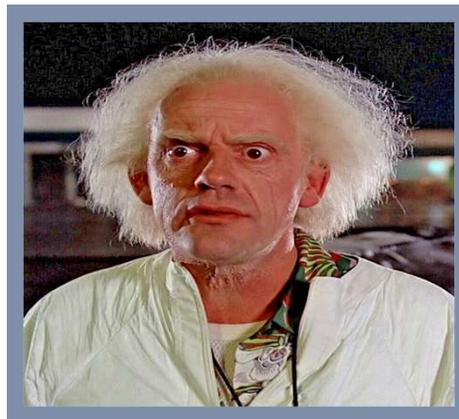
Alison Lemle

VIUM Capital
Senior Managing Director
Chief Underwriter



Marty McFly

Department of Transportation
Hoverboarded to places
unknown



Doc Brown

Department of Energy
Furloughed to the Future



Biff Tannen

Department of Defense
Location Classified

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The Narrative...Marty, We've got to Go Back!

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- Prior to the publication of the first Lean Handbook on May 22, 2014 (and updated effective January 19, 2017), the Section 232 program guidance was based on a combination of Lean Blasts and the MAP Guide (effective August 2011).
 - Because there was no formal Handbook at the inception of the Lean program, the Lender Narrative was specifically created to act as the underwriter’s “guide” when compiling an application.
 - The narrative asks several “Key Questions” that helps to identify areas of underwriting concern, issues with eligibility, and key programmatic requirements that must be followed.
 - The intent of this presentation is to take a deeper dive into the guidance behind the key questions and offer helpful hints to work through challenges that may arise based on responses to these questions.
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Lender Narrative - Executive Summary

Section 38 Signatory – What is it and who should be the signatory?

What is Section 38 of the Regulatory Agreement?

- Published on March 14, 2013, Section 38 of the Healthcare Regulatory Agreement requires that individuals or entities who will be personally liable for certain enumerated matters (bad boy acts) be identified within the document

What events trigger the bad boy carve-outs?

- As stated in HUD-92466-ORCF, the Borrower Regulatory Agreement: *“each said individual or entity shall remain personally liable under this Agreement only with respect to the matter hereinafter stated; namely: (a) for funds or property of the Project coming into its hands which, by provisions of this Agreement, it is not entitled to retain; (b) for authorizing the conveyance, assignment, transfer, pledge, encumbrance, or other disposition of the Mortgage Property or any interest therein in violation of this Agreement without prior written approval of HUD; and (c) for its own acts and deeds, or acts and deeds of others, which it has authorized in violation of the provisions of this Section.”*



Who signs Section 38? This is important to discuss with the client early on.

- **For privately held entities:** Generally, requires two signatures for project sponsors. Most cases, one individual and the project parent/sponsor entity.
- **For publicly traded corporations or REITS, or Non-profit organizations:** The parent/sponsor entity itself. The individual signing on behalf of the entity does not need to sign in an individual capacity.
- **Any corporate entities:** Whoever is authorized to bind the company in connection with the proposed transaction.

It is important to bring up this topic early!

Lender Narrative - Portfolios

“You’re just not thinking fourth-
dimensionally!”



Portfolio Key Questions 3-6 – Do the Principals of the Borrower and/or Operator have prior HUD experience and/or expect to submit additional applications or TPAs?

- Why is this question important?
 - HUD requires a Corporate Credit Review (CCR) for “large borrowers.” If the threshold is met, a CCR must be approved prior to approval of new applications.
- Note! The narrative language is based on the old guidance which required a CCR if submitting +90M in an 18-month window.
- What’s changed?
 - Mortgagee Letter 2024-03 ([2024-03hsgml.pdf](#))
 - Eliminated the 18-month window and created limits where a CCR was required regardless of time.
 - The CCR limit is based on certain % of UPB as of 10/1 (start of the HUD fiscal year). Due to the shutdown, the UPB total for FY2026 has not been provided.

	Classification Criteria ^{1 2}	Corporate Credit Review
Small Portfolios	Up to 1% of UPB for common control Borrower only Up to 0.6% UPB for common control Operator only or Identity-of-Interest Borrower/Operator.	Not Required
Large Portfolios	1%-5% of UPB for common control Borrower only 0.6%-5% of UPB for common control Operator only or Identity-of-Interest Borrower/Operator.	Required



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Financing Seniors Housing for America

Transaction Overview – Key Questions

“Roads? Where we’re going, we don’t need roads.”

Is the borrower a non-profit entity and is the non-profit mortgage criteria utilized in Underwriting?

- What are the non-profit mortgage criteria?
 - Max LTV for Refinance: 85%
 - Max LTC for Acquisition: 90%
 - Real Estate Tax Abatements
- If the non-profit criteria was utilized in UW, the Operator must also be a non-profit entity.
- Distributions and Residual Receipts: A non-profit Borrower must set up a residual receipts accounts and cannot take distributions if the non-profit criteria were utilized. If non-profit criteria was not utilized, HUD will allow the Borrower to take distribution, following the conditions set forth in the Regulatory Agreement.
 - Residual Receipts balance must be greater than or equal to 6 months of required debt service (including all escrows and MIP).
- Principals: For NFP Corporations, principals include officers of the board of directors and any staff members who are designated by the corporation as corporate officers.

Transaction Overview Key Question - Is there a ground lease?

- What is a ground lease?
 - A ground lease is an agreement in which a tenant is permitted to develop a piece of property during the lease period, after which the land and all improvements are turned over to the property owner.
- Why is this question important?
 - ORCF has very specific requirements for proposed 232 transactions where a ground lease is present:
 - Term: Lease term must be at any stage of a 99-year lease (so long as it is renewable) or have at least 10 years remaining after the maturity date of the proposed mortgage.
 - Ground Lease Payment: Variable ground lease payments are generally not accepted unless they comply with the following methods:
 - A fixed percentage of EGI so long as the percentage remains the same throughout the term of the lease.
 - A fixed percentage of net cashflow so long as the percentage remains the same throughout the term of the lease.
 - A stated dollar amount per year which must remain fixed for at least 10 years more than the term of the mortgage.
 - HUD Lease Addendum (HUD-92070-ORCF): Any transaction involving a ground lease must complete the HUD Lease Addendum. This document should be provided to the deal team as soon as it is determined a ground lease is in place. Attention should be directed to paragraph (b) of this document which reads:
 - *In the event that HUD acquires title to this leasehold estate or otherwise acquires title to the tenant's interest herein, HUD shall have the option to purchase good and marketable fee simple title to the Property and the landlord's interest, if any, in the Improvements, free of all liens and encumbrances except such as may be waived or accepted by HUD. HUD may exercise such option within twelve (12) months after HUD so acquires such leasehold estate or the tenant's interest. The purchase price shall be the sum of _____ Dollars (\$_____)*
 - Mortgage Amount Limitation: HUD regulations state, "In the event the mortgage is secured by a leasehold estate rather than a fee simple estate, the value of the property described in the mortgage shall be the value of the leasehold estate which shall in all cases be less than the value of the property in fee simple (24 CFR 232.903(a))."

Transaction Overview Key Question - Is there a ground lease? (continued)

- How to comply with HUD regulations for leasehold value:
 - The appraiser is asked to develop a Hypothetical Fee Simple Value of Going Concern as if unencumbered by the ground lease. The Lender enters this amount into the MILC Page 1 – Line D.a.
 - Next, the lender will enter the option to purchase price from the Lease Addendum into the “Optional Purchase price from 92070M” (MILC page 1 – Line D.b):

D. Amount Based on Required Loan to Value
a. Value in Fee Simple
b. Optional Purchase Price from 92070M
c. Unpaid Balance of Special Assessment
<u>d. Less: 90% of As-is Value (for 241(a) only)</u>
e. Total line b plus line c (lines b through d for 241(a))
f. Line a minus line e

- The MILC will automatically deduct the option to purchase price from fee simple value before applying the prescribed LTV limitation.
 - **Upfront review and discussion ground leases is critical as it has the potential to kill a transaction or dramatically impact proceeds.**
- Does ORCF allow for a waiver of completing paragraph (b) of the Lease addendum?
 - Only government entities can request waivers to not name a purchase price.

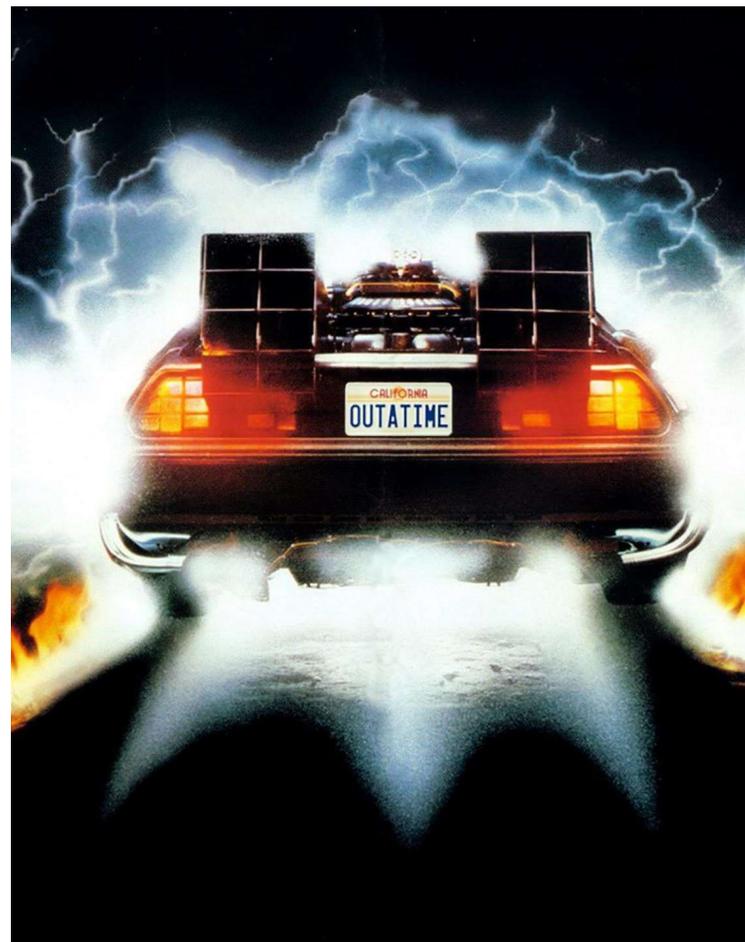
Transaction Overview Key Questions - Does the facility require more than four residents to share a full bathroom and are any residents required to access a qualifying bathroom by moving through a public corridor or area?

- Why is this question important?
 - 24 CFR 232.7 requires that not less than one (1) full bathroom must be provided for every four (4) residents and bathroom access from any bedroom or sleeping area must not pass through a public corridor or area.
 - Applicable to all Assisted Living and Board and Care facilities
 - Does not apply to Skilled Nursing facilities
 - FR 6022-F-02: Updating Section 232 Program Regulations for Memory Care Residents Final Rule published June 26, 2020
 - The Final Rule was game changer for the program and the prior requirement that 24 CFR 232.7 apply to Memory Care.
 - The Final Rule provides an exemption from the current requirements for **only memory care** facilities when the following requirements are met:
 1. Memory care residents must reside in a separate, secured, and locked area of the B&C or Assisted Living facility.
 2. Any bathroom access from a memory care resident's bedroom or sleeping area that passes through a public corridor or area must be in that separate, secured and locked area.
 3. Memory care residents of such areas require full assistance or supervision with bathing
 4. Wards serving memory care residents have no more than two beds per unit and a ½ bathroom in each unit.



Transaction Overview Key Questions - Does the facility require more than four residents to share a full bathroom and are any residents required to access a qualifying bathroom by moving through a public corridor or area? (continued)

- Can compliance with 24 CFR 232.7 be waived?
 - Prior to the June 2020 Final Rule, ORCF allowed for the submission of waivers for Memory Care facilities. These waivers were considered Regulatory and would take several months to process.
 - Since the June 2020 Final Rule, ORCF will no longer accept any waivers. Assisted Living / Board and Care facilities must fully comply with the CFR and Memory Care must fully comply with the Final Rule.
- What are some helpful hints to ensure compliance with this rule?
 - Don't be afraid to ask the Borrower/Operator about bathroom count for any Assisted Living / Memory Care facility worked on.
 - Ask for floorplans to confirm compliance yourself. If after review there is still uncertainty/concerns, speak with the PCNA firm. Ultimately, they will be determining compliance as part of their report, and we want to ensure up-front they agree with our assessment.
 - Pay attention to unit layouts during site visits. Did you see a full bathroom in every room inspected?
 - If you are working on a transaction where the building is older or originally constructed as another use, this could be a warning that the subject has the potential to not comply.
 - It is important to determine conformance with this requirement early in the process. If a facility is severely deficient in full bathrooms, cost or space limitations to get into compliance could kill the transaction.



Transaction Overview Key Questions – Has the property changed ownership in the last two years?

- Why is this important?
 - Applications with a change in ownership within the last two years are considered a “Recent Purchase” and closely reviewed.
- Areas of focus:
 - Performance History: Significant increases in NOI after ownership. Risk of sustainability.
 - Value vs. Purchase Price: Recent performance increases that drive up value and create wide discrepancies between value and purchase price in a short amount of time.
 - IOI Debt: Debt included in the application includes IOI or shareholder notes equating to the sponsor’s equity in the initial purchase.
- How to make your application a success:
 - Focus on sponsor’s experience. It is essential to demonstrate the sponsor’s experience successfully turning around like facilities ([Turnaround Template.xlsx](#)).
 - Ensure NOI for value is supported by performance (understanding the most recent performance might be significantly higher than historical).





Lender Narrative – Program Eligibility

"Don't worry. As long as you hit that wire with the connecting hook at precisely 88 miles per hour, the instant the lightning strikes the tower... everything will be fine."

Lender Narrative - Program Eligibility

Does the facility charge “founder’s fees,” “life care fees,” or other similar charges associated with “buy-in” facilities?



- Why do these types of fees matter?
 - Buy-in facilities are not eligible for FHA mortgage insurance.
- What are buy-in facilities and the fees associated?
 - Typically, buy-in facilities are CCRCs, which offer full continuum of care to allow an individual to age in place for the remainder of life. The associated fees are structured as a large upfront sum of money – this causes cash flow to be lumpy and difficult to value (per HUD)
 - You will typically notice these fees as a liability on the borrower’s balance sheet.
- **Potential Remediation:** If the buy-in policy is eliminated and the community shifts to a rent basis, HUD can get comfortable if there is an asset (often in the form of an escrow) that can be collateralized against the remaining founder fee liabilities.

If an ALF, are there residents who do not meet the statutory definition of frail elderly?

- What is the statutory definition of frail elderly?
 - 24 CFR 891.205 states, “Frail Elderly is an elderly person (*at least 62 in age*) who is unable to perform at least three activities of daily living.”
- Why is this question important?
 - ORCF takes a literal interpretation of this guidance and requires the following for all Assisted Living transactions:
 - Borrower must certify that all residents are and will be 62+.
 - If there are residents below 62+, ORCF will allow them to remain, but the Borrower must certify going forward they will only accept residents 62+.
 - The borrower may be unwilling to certify to continued age restriction as it is allowed under the license, and it has the potential to impact future operations.



If an ALF, are there residents who do not meet the statutory definition of frail elderly? (continued)

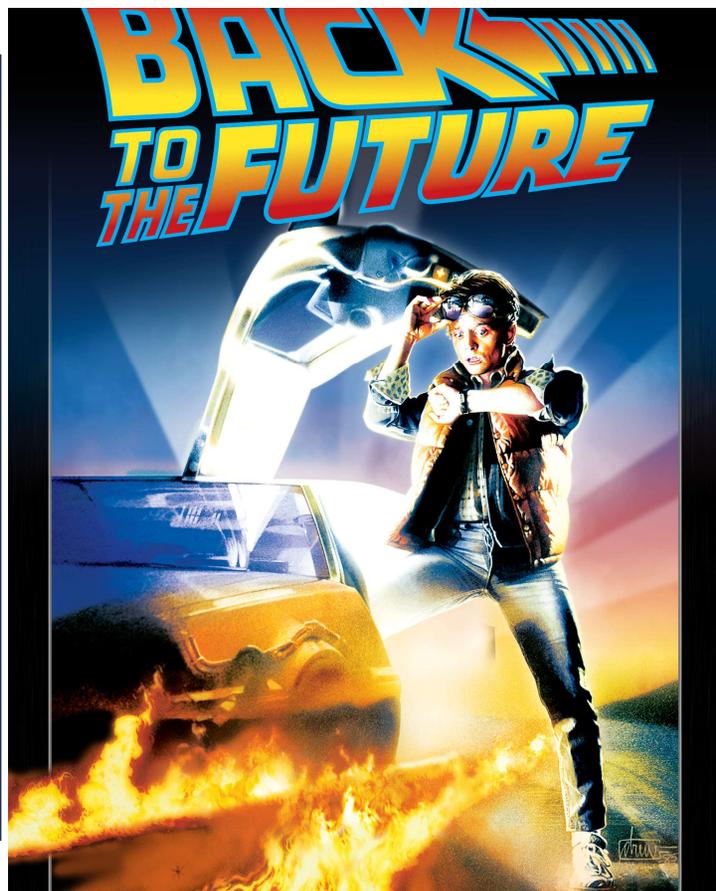
How can this issue be resolved?

- Look to qualify units under the HUD definition of Board & Care (See Handbook Section II, Production, Chapter 2.2 D for definition) as it does not have the 62+ age requirement found in the Assisted Living definition.
- To qualify under Board and Care, the facility must be regulated by the State in accordance with Section 1616 of the Social Security Act (Keys Amendment) and meet the State's eligibility requirements. The state must also have certificated compliance with the Keys Amendment ([ORCF: Keys States | HUD.gov](#)). Specifically, the State must have the legislative authority that enables it to conduct unscheduled inspections of the project.
- Like many of the key questions reviewed, it is critical that we are asking about age of residents early in the process to ensure we are appropriately presenting the transaction in the underwriting narrative.



Lender Narrative Program Eligibility - Is the project designated by the Centers for Medicare and Medicaid Services (CMS) as a Special Focus Facility or similar future designation?

- What is the Special Focus Facility (SFF) List?
 - A list of nursing homes, created by CMS, that have historically cycled in and out of compliance which haven't addressed underlying systemic problems that give rise to repeated issues or deficiencies.
- The SFF Candidate List is updated monthly.
- If a facility is designated as an SFF or SFF Candidate, it is precluded from HUD mortgage eligibility.



SFF Designation – CMS outlines four categories in their monthly release:

Current SFF Facilities: SNFs currently in the SFF program. Results of the most recent inspection noted as “met” or “not met.” SFF facilities must meet graduation criteria on two consecutive surveys to be eligible for graduation.

Facilities that have Graduated from SFF: SNFs with sustained improvement for about 12-months.

No Longer in Medicare and Medicaid: SNFs that were terminated by CMS from participation in Medicaid/Medicare within the last 12 months.

SFF Candidate List: SNFs that qualify to be selected as an SFF. Varies by state with minimum of 5 and maximum of 30.

Program Eligibility – Is there a Floodway Onsite?

Why is this question important?

- 24 CFR 55.12 states “mortgage insurance shall not be approved for a property located in (a) a Floodway, (b) a coastal high hazard area, or (c) a FEMA identified Special Flood Hazard Area (SFHA) in which the community has been suspended from or does not participate in the National Flood Insurance Program.

Is a property with an onsite floodway always excluded from mortgage insurance?

- Exceptions: 24 CFR 55.12 lists exceptions to this rule that will allow for an application with a floodway onsite to be processed:
 1. All construction (including existing improvements) or landscaping activities (except for minor grubbing, cleaning of debris, pruning, sodding, etc.) must not occupy or modify the relevant **floodplain**. Due to the constraint that activities must “not occupy or modify” the floodplain, the 100-year and 500-year floodplains cannot be utilized in the development or support of any project activity , except as open passive green space.
 2. Appropriate provision is made for site drainage; and
 3. In accordance with 24 CFR 55.12(c)(7)(iii), a protective covenant must be placed on the property’s continued use to preserve the floodplain.

Have Things Changed? Well, yes and no.

- Federal Flood Risk Management Standard (FFRMS) – The update to CFR Part 55 has increased the flexibility when a floodway is onsite, and improvements are in the floodplain. However, there is still additional risk with this scenario, and it is highly recommended that Lean Thinking be consulted to ensure a path forward.

Helpful hints when dealing with floodways:

- Check the FEMA Flood Map and Preliminary Map searches at the very beginning of each transaction to ensure this matter is identified immediately.
- Sometimes it is difficult to confirm from FEMA that the floodway is onsite. As such, we need to be reviewing the survey to confirm the exact location of any floodways or floodplains.
- If project’s do not meet the exception noted above or there is concern about acceptance despite FFRMS guidance, the owner can look to carve-off the portion of the site containing the floodway. This can sometimes be a challenging process, so it is critical that it is started immediately.

Program Eligibility – 3-Year Rule and Substantial Rehabilitation

- **3-Year Rule:** the project must meet one of the following criteria or it is precluded from immediate 232/223(f) mortgage eligibility:
 - The entire facility was constructed more than 3 years ago and has not undergone any substantial rehabilitation in the last 3 years.
 - An addition to the facility was constructed less than 3 years ago. However, the addition was not larger than the project in size (gross floor area) and number of beds.
- **Substantial Rehabilitation:** To be eligible under a 232/223(f) refinance, the following must be met:
 - The estimated cost of the proposed repairs cannot exceed 25% of the project's value after completion.
 - *Note: costs associated with an addition to the building are not included in the 25% calculation.*
 - Mortgagee Letter 2025-20 ([ML 2025-20](#)) made changes to the substantial rehabilitation definition from that reflected in the narrative.
 - Percentage increase from 15% to 25%
 - Elimination of replacement of two or more major systems as a criteria
- Like so many items in the narrative, asking questions on this topic early is so important as seasoning comes into play and it could impact your deal.





Lender Narrative – Risk Factors

“Hey, Doc, we better back up. We don't have enough road to get up to 88.”

Risk Factors - Is this a “special use facility” that serves a “niche” type of market (i.e., psychiatric facilities; drug, alcohol, or eating disorder recovery facilities; hospice facilities; or short-term rehabilitation facilities)?

Why is this question important?

- Special use facilities are statutorily and programmatically eligible facilities where a facility meets and is licensed/regulated pursuant to the requirements in HUD Handbook 4232.1, Rev. 1, Section II, Production, Chapter 2.2, but also serves a niche market. As such, these transactions are viewed as higher risk and may require additional mitigation such as lower LTV, shorter term, debt service escrows, etc.
- Examples of Types of Special Use Populations are:
 - Behavioral Health
 - Mentally Ill
 - Bariatric Residents
 - Residents aged 21-65 requiring specialized treatment of serious mental illness (excluding dementia and intellectual/developmental disabilities)
- The lender should contact LeanThinking@hud.gov with a summary of the project in advance of application submission to confirm the proposed application meets program requirements.
- When working on a project like this, sponsor experience is SO important!



Risk Factors - Is this a “special use facility” that serves a “niche” type of market (i.e., psychiatric facilities; drug, alcohol, or eating disorder recovery facilities; hospice facilities; or short-term rehabilitation facilities)? (continued)

Below is the information the Lender should discuss in the LeanThinking Request:

1. Name and Address of Project
2. How long have they owned/operated the project
3. Proposed LTV and Loan Term (estimated)
4. Star Ratings/Survey History (discuss G+ tags, particularly any related to the special use population)
5. Type of License(s)
6. Resident Population (discuss diagnoses of residents, services offered, etc.) For behavioral, distinguish between primary and secondary MI treatment needs and % of residents under age 65).



7. Reimbursement/Payors (including rate adjustments and source limitations tied to the special use)
8. State Risk issues related to the special use (e.g., Olmstead, HCBS, State Regulatory changes)
9. Reliance on care provider partners/sub-contracts
10. Experience of Participants in serving this population
11. Characteristics of the building for primary diagnosed MI population. (Locked wards or wings? MI housed separately from other population?)
12. Functional Obsolescence of Building (ward beds, aged physical plant, is the building marketable as market rate, etc.)

Risk Factors - Is this a “special use facility” that serves a “niche” type of market (i.e., psychiatric facilities; drug, alcohol, or eating disorder recovery facilities; hospice facilities; or short-term rehabilitation facilities)? (continued)

Characteristics of Successful Applications

Type	Loan Term	Experience	Maximum LTV	Recent Purchase, Quick Turnaround	Limited Debt Seasoning Exception
Assisted Living/Board and Care Medicaid Waiver with an Enhanced Services Contract	20 years or less	5+ years of relevant experience with this type of facility	60% LTV	No	No
SNF with regular license, but has MI/DD as a primary or secondary diagnosis (20% or more of the facility's revenue)	35 years or less	5+ years of relevant experience with this type of facility	80% LTV	No	No
SNF with regular license, but has MI/DD as a primary or secondary diagnosis (one wing/nominal part of the facility-Less than 20% of revenue)	35 years or less	5+ years of relevant experience with this type of facility	80% LTV	Yes	Yes
Drug and/or Alcohol Rehabilitation Facilities or Transitional Housing	Not Eligible	Not Eligible	Not Eligible	Not Eligible	Not Eligible

Risk Factors Key Questions 5-7: Populations with Mental Illness (MI), Developmental Disabilities (DD), Individuals with Intellectual Disabilities (IID), Olmstead Plans/Settlements, Medicaid Waiver with MI/DD populations, and Home and Community Based Settings requirements (HCBS)

- Why are these Questions/Topics Important:
 - ORCF is very focused on these types of populations and risks associated with Olmstead Plans and final Home and Community-Based Services Rule as they have the potential to significantly impact long term operations of certain types of facilities.
- What is Olmstead / Home and Community Based Settings Regulation?
 - Olmstead v. L.C. (US Supreme Court 1999): The US Supreme court ruled that unjustified institutionalization of individuals with disabilities by a public entity is a form of discrimination under the Americans with Disabilities Act of 1990. As a result, states are generally required to provide community-based care to such individuals.
 - The ruling encouraged state Medicaid programs to rebalance delivery of long-term care services and supports from institutional care to home and community-based.
 - The final Home and Community Based Services (HCBS) regulations set forth new requirements for several Medicaid authorities under which states may provide home and community based long term services and supports.
- When is this important?
 - If you are working on a transaction with the following characteristics, it is important that the risks noted above are considered / addressed:
 - Non-SNFs with high Medicaid census. [Updated State Risk Summary Grid \(hud.gov\)](#)
 - Combined SNF/ALFs that rely on Medicaid for non-SNF residents
 - Projects with a current or historical concentration of MI/DD residents or Projects with ICF beds
 - Be sure to check Statewide Transition Plans to confirm Final Approval and Heightened Scrutiny ([Statewide Transition Plans | Medicaid](#)).



Lender Narrative – Environmental Questions

"Since when can weathermen predict the weather, let alone the future?"

Environmental Questions – Will there be an increase in units or beds?

Why do I care about this question when I'm thinking about environmental matters?

- If you must answer yes, the questions below need answered:
 - Are there any current Aboveground Storage Tanks (ASTs) on or directly visible from the site?
 - Will any Aboveground Storage Tanks be added?
 - Was an Acceptable Separation Distance (ASD) calculation or mitigation plan submitted for all current or proposed ASTs? (Note that a tank safety letter IS NOT sufficient for projects that are increasing in units or beds. Refer to Handbook chapter 7.5.F.)
 - Was a HUD compliant noise analysis provided?
- HUD also calls this “increasing residential density”



Storage Tank Implications: The tank must meet HUD-compliance, as if the facility were being built ground-up.

- Most ASTs will not meet the ASD calculation
- If the tank is less than 100 gallons and contains liquid fuel (diesel), we do not need mitigation (liquid fuel = flame risk)
- If the tank holds pressurized gas (propane), we need mitigation (pressurized fuel = blast risk)
- Mitigation Examples:
 - Diesel over 100 gallons: HUD-compliant containment vessel to hold 102% of tank volume
 - Propane Tank: move tank (expensive) or bury tank

Environmental Questions – Will there be any site work, construction, ground disturbance or digging?

- Why is this question important?
 - Any time there is work proposed or required that constitutes “ground disturbance” it will trigger additional consultations that if not proactively managed have the potential to cause processing delays.
 - Tribal (THPO) Consultation: ORCF must complete the Tribal Notification process for activities that may require Tribal consultation, including ground disturbance (digging), installation of an underground tank, installation of utility line, construction, etc.
 - Lender must contact LeanThinking@hud.gov ***in advance of application submission*** to allow for ORCF to initiate agency to agency contact. Included in this request are the following items:
 - Project Description: Type of project, purpose of project, proposed activities/site work, current condition of the site (what is on the site now)
 - Maps: Location map, aerial view, site layout map, and topographical map
 - State Historic Preservation (SHPO) Consultation: SHPO consultation is required for transactions proposing construction or rehabilitation, ground disturbance, repairs exceeding “routine maintenance” or that have the “potential to cause effect” to historical places.
 - Once SHPO / THPO have been consulted, the office has 30-days from receipt of sufficient information to reply to requests for consultation.

Avoid Delays: ORCF reviews the SHPO correspondence and if in their review they determine SHPO did not have a clear description of the scope of work, ORCF could require a resubmission to SHPO which could cause delay or reset the 30-day response clock.



Environmental – Does the Project involve repairs in excess of routine maintenance (as defined in Notice CPD-16-02)?

- What is Notice CPD-16-02?
 - Published in February 2016, the notice provides guidance for categorizing an activity as maintenance for compliance with HUD Environmental Regulations, 24 CFR Parts 50 and 58. ([16-02cpdn.pdf](#)).
- What is HUD’s definition of Routine Maintenance?
 - Per Section III of the CPD-16-02 notice, “in general, maintenance activities slow or halt deterioration of a building and do not materially add to its value or adapt it to a new use.”
 - General examples of maintenance activities for environmental review purposes include:
 - Cleaning activities
 - Protective or preventative measures to keep a building, its systems, and its grounds in working order
 - Replacement of appliances that are not permanently affixed to the building
 - Periodic replacement of a limited number of component parts of a building feature or system that are subject to wear and tear
 - Replacement of damaged or malfunctioning component part of a building feature or system.



Environmental – Does the Project involve repairs in excess of routine maintenance (as defined in Notice CPD-16-02)? (continued)

Why is this question important?

Routine Maintenance and 232/223(f)s:

- Any repairs classified as outside of routine maintenance automatically trigger SHPO consultation.
 - It is very important to review the CPD-16-02 noticed in conjunction with the identified repairs to ensure there are none that have the potential to fall into maintenance activities. If unsure, discuss repairs with the Phase I team. Ensure everyone agrees (and will defend) that repairs represent routine maintenance.

Routine Maintenance and Timing of Completion of Critical/Non-Critical Repairs:

- HUD environmental policy requires that there be a limitation of certain activities or actions by any direct or indirect parties of the transaction, from the time of application submission until HUD has completed the environmental review process. Specifically, no actions concerning the proposal shall be taken which (1) have an adverse environmental impact (2) limit the choice of reasonable alternatives or (3) prejudice the ultimate decision on the proposal.
- Based on above, it is critical to review repairs and ensure we are comfortable they are maintenance activities. If HUD deems otherwise and repairs were worked on prior to approval of the environmental review, there could be repercussions/delays from HUD.





HEALTHCARE MORTGAGEE ADVISORY COUNCIL

Financing Seniors Housing for America

Operator – Key Questions

“Don’t worry, I’m sure it’s just a glitch.”

Operator Key Questions

Does the operator contract out nursing services other than temporary staffing through an agency and/or contracting for ancillary services (e.g., therapies, pharmaceuticals)?



- Why is this important?
 - Special attention needs paid to this topic moving forward in the underwriting process.
 - Trends indicate a staffing shortage and higher agency usage – a portion of this may be related to the pandemic, but HUD especially is pushing back on assumptions that agency usage returns to zero, or pre-pandemic levels in the near-term.
 - This affects appraisal and pro forma conclusions, as well as quality of care.
- Having an effective game plan to combat heavy agency usage will be important when telling the story to HUD.

Operator Key Questions - Does the Operator currently own/operate an assets other than the property or participate in any other business?

- Why is this important?
 - Unlike the HUD Mortgagor that is required to be a Single Purpose Entity, ORCF allows for the Operator to be a non-SPE entity if at least one of the three circumstances applies:
 1. The entity, although named on the license (in which HUD must obtain a security interest), does not hold or control substantial other project assets.
 2. The entity's organizational purpose is limited to operating healthcare facilities, and the entity demonstrates, to HUD's satisfaction (a) strong overall operational and financial capacity and (b) that all operator assets of the project are legally protected from expenses or claims arising from the operator's activities outside of the Section 232 facility and other facilities covered by the same HUD-approved master lease, or
 3. The project is a currently FHA-insured project for which refinance or Transfer of Physical Assets is being requested, and during the operator's extended tenure at the project, the project's performance has been acceptable to HUD.
 - There can be many implications around the need to create a new Operating entity that have the potential to greatly delay or even stall a transaction all together. As such, it is important that a non-SPE operator is identified early in the process to ensure it can meet one or more of the circumstances above.





Do the Aging of Accounts Receivable schedules show any material accounts receivables (amounts in excess of 2% of gross income) over 120 days?

What are follow-up questions for the client if they have large A/R balances?

- What are the A/R balances related to?
- Why are there large outstanding A/R balances?
- Do they expect to collect on any of the A/R balances? What amount do they plan to write off and during what timeframe?
- How do they plan to change/improve their collection practices?

- Guidance from HUD: Projects with material accounts receivables over 120 days that do not intend to have Accounts Receivable Financing should address the project State's recent trends in length of time until reimbursement is made. The Lender should address these projects' ability to handle delayed payments, e.g. access to sources of liquidity in an amount comparable to material accounts receivable over 120 days.
 - Note: While this question targets individual accounts, it is important to look at overall A/R and its relation to EGI.
- Why is this question important?
 - Can indicate a systemic collection practice issue
 - Can impact underwriting – may have to underwrite to higher bad debt



HEALTHCARE MORTGAGEE ADVISORY COUNCIL

Financing Seniors Housing for America

Surviving Debt

“I promise you this is it!”

Surviving Debt - List and discuss all existing long-term debt that will survive closing and any Secondary Sources

- Why is this important?
 - If it is anticipated that there will be other debt that will survive the HUD closing or secondary sources to fund equity requirements, it must be in the form of a Surplus Cash Note (HUD-922223-ORCF).
- When secondary financing is from a private source:
 - Section 232 NC or Sub Rehab: Secondary financing from a private source is not permitted.
 - Section 232/223(f): Secondary financing is permitted to cover a portion of the equity requirement for a 232/223(f), but the aggregate amount of the FHA-insured loan and the private second loan cannot exceed 92.5% FMV.
- Under HUD-922223-ORCF, repayment of the obligation must be made solely from 75% of available surplus cash or residual receipts. The Borrower's principals may elect to make additional payments from non-project funds, however these payments must not be pledged or scheduled for repayment.
- If you are working on a transaction where there will be debt surviving closing or a secondary source coming in as debt, it is important to discuss early and provide the HUD form of Surplus Cash Note to the proposed/existing Lender. The HUD form of Surplus Cash note is very restrictive and this could become problematic if not discussed up front.
 - Section 12 of the Surplus Cash Note: "Maker has no claim, and will not later assert any claim for payment due under this Surplus Cash Note against the Mortgaged Property, any mortgage proceeds, any reserve or deposit held by the Lender or another entity required by HUD in connection with the mortgage transaction documented by the Borrower's Security Instrument and the Borrower's Regulatory Agreement."

- TAKEAWAYS:

- No one expects you to be an expert right away!
- If you answer a question in the narrative differently than you have on past applications, ask yourself “why is this important?”
- When looking at a new deal, remember there is a lot to consider besides financial performance.
- There are no dumb questions. It’s always better to ask early than face an issue at submission. Sometimes it’s the little things that can turn into big things if not uncovered early.

QUESTIONS?

