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Subpart A—General Eligibility Requirements

§ 242.1 Definitions.

As used in this subpart, the following terms shall have the meaning indicated:

Act means the National Housing Act (12 U.S.C. 1701 *et seq.*).

Affiliate means a person or entity which, directly or indirectly, either controls or has the power to control or exert significant influence on the other, or a person and entity both controlled by a third person or entity, which may be a parent entity. Indicia of control include, but are not limited

to: Interlocking management or ownership, identity of interests among family members, shared facilities and equipment, common use of employees, or a business entity organized following the suspension or debarment of a person or entity that has the same or similar management, ownership, or principal employees as the suspended, debarred, ineligible, or voluntarily excluded person or entity or as defined in the Medicare reimbursement regulations.

AMPO (Allowance for Making Project Operational) relates to non-profit projects and means a fund that is primarily for accruals during the course of construction for mortgage insurance premiums (MIPs), taxes, ground rents, property insurance premiums, and assessments, when funds available for these purposes under the Building Loan Agreement have been exhausted; and also for allocation to such accruals after completion of construction, if the income from the hospital at that time is insufficient to meet such accruals. AMPO may also be used for such other purposes as approved by HUD. Any balance remaining unused in the fund at final endorsement will be treated in accordance with § 242.43.

Applicant means a HUD multifamily-approved lender that would be the mortgagee of record.

Chronic convalescent and rest means skilled nursing services, intermediate care services, respite care services, hospice services, and other services of a similar nature.

Construction means the creation of a new or replacement hospital facility, or the substantial rehabilitation of an existing facility. The cost of acquiring new or replacement equipment may be included in the cost of construction.

Days of cash on hand means the number of days of operating cash available to the hospital, calculated pursuant to standards determined by HUD.

Debt service coverage ratio is a measure of a hospital's ability to pay interest and principal with cash generated from current operations. Debt service ratio is calculated as follows: Debt Service Coverage Ratio (total debt service coverage on all long-term capital debt) equals the excess of revenues over expenses (not-for-profit) or net income (for-profit) plus interest expense plus depreciation expense plus amortization expense, all divided by current portion of long-term debt (including capital leases) from the previous year's audited financial statement plus interest expense. The calculation can be expressed as:

$$\frac{(\text{Excess of revenues over expenses OR net income}) + \text{interest expense} + \text{depreciation expense} + \text{amortization expense}}{\text{Current portion of long-term debt [prior year, including capital leases]} + \text{interest expense}}$$

Hospital means a facility that has been proposed for approval or has been approved by HUD under the provisions of this subpart, and:

(1) That provides community services for inpatient medical care of the sick or injured (including obstetrical care);

(2) Where not more than 50 percent of the total patient days during any year are customarily assignable to the categories of chronic convalescent and rest, drug and alcoholic, epileptic, mentally deficient, mental, nervous and mental, and tuberculosis, except that the 50 percent patient day restriction does not apply to Critical Access Hospitals (hospitals designated as such

under the Medicare Rural Hospital Flexibility Program) between January 28, 2008 and July 31, 2011.

(3) That is a facility licensed or regulated by the state (or, if there is no such state law providing for such licensing or regulation by the state, by the municipality or other political subdivision in which the facility is located) and is:

(i) A public facility owned by a state or unit of local government or by an instrumentality thereof, or owned by a public benefit corporation established by a state or unit of local government or by an instrumentality thereof;

(ii) A proprietary facility; or

(iii) A facility of a private nonprofit corporation or association.

Identity of interest means a relationship that must be disclosed and may be prohibited pursuant to the requirements of the Regulatory Agreement. Examples of a prohibited Identity of Interest relationship are, but are not limited to, a financial or family relationship between the mortgagor (which includes but is not limited to an officer, director, or partner of the mortgagor) and general contractor, subcontractor, seller of the land or property, any consultants, or other parties to the transaction.

Mortgage means such classes of first liens as are commonly given to secure advances on, or the unpaid purchase price of, real estate under the laws of the state in which the real estate is located, together with any mortgage note secured thereby. The mortgage may be in the form of one or more trust mortgages or mortgage indentures or deeds of trust securing notes, bonds, or other mortgage notes; and, by the same instrument or by a separate instrument, it may create a security interest in the personalty, including, but not limited to, the equipment, whether or not the equipment is attached to the realty, and in the revenues and receivables of the hospital.

Mortgagee or lender means the applicant for insurance or the original lender under a mortgage.

Mortgagor means the original borrower under a mortgage and its successors and assigns.

Mortgage Reserve Fund means a trust account, or an account held by the mortgagee, for and on behalf of the mortgagor, to which the mortgagor contributes and from which withdrawals must be approved by HUD. The purpose of the fund is to provide HUD a means to assist the hospital to avoid mortgage defaults and to preserve the value of the mortgaged property and the hospital's business.

Most recent audited financial statement means the audited financial statement required under the regulatory agreement for the prior fiscal year.

Net income means the net income of a for-profit entity, or, in the case of a nonprofit entity, the excess of revenues less expenses.

Non-operating revenues and expenses are those revenues and expenses not directly related to patient care, hospital-related patient services, or the sale of hospital-related goods. Examples of items classified as non-operating are state and federal income tax, general contributions, gains and losses from investments, unrestricted income from endowment funds, and income from related entities.

Classification of items as operating or non-operating shall follow written guidance by HUD.

Operating margin is operating income divided by operating revenue, where:

(1) *Operating revenue* is the revenue from the core patient care operations of the hospital. It includes revenues from the provision of such items as patient care (including, but not limited to, hospital-based nursing home and physicians' clinics); transfers from temporarily restricted accounts that are used for current operating expenses; and patient-related activities such as the operation of the cafeteria, parking facilities, television services to patients, sale of medical scrap or waste, etc. (Additional sources of revenue, which are classified as non-operating, are excluded from this measure, provided, however, at HUD's discretion, that revenue that has historically been received reliably and is expected to continue to be received may be considered operating revenue for underwriting purposes); and

(2) *Operating income* is operating revenue minus operating expenses, where operating expenses are the expenses incurred in providing patient care, including such items as salaries, supplies, and the cost of capital.

Parent means an organization or entity that controls or has a controlling interest in another organization or entity.

Personalty means all furniture, furnishings, equipment, machinery, building materials, appliances, goods, supplies, tools, books, records (whether in written or electronic form), computer equipment (hardware and software) and other tangible or electronically stored personal property (other than fixtures) that are owned or leased by the borrower or the lessee now or in the future in connection with the ownership,

management, or operation of the land or the improvements or are located on the land or in the improvements, and any operating agreements relating to the land or the improvements, and any surveys, plans, specifications, and contracts for architectural, engineering, and construction services relating to the land or the improvements, chooses in action and all other intangible property and rights relating to the operation of, or used in connection with, the land or the improvements, including all governmental permits relating to any activities on the land. Personalty also includes all tangible and intangible personal property used for health care (such as major movable equipment and systems), accounts, licenses, bed authorities, certificates of need required to operate the hospital and to receive benefits and reimbursements under provider agreements with Medicaid, Medicare, state and local programs, payments from health care insurers and any other assistance providers (“Receivables”); all permits, instruments, rents, lease and contract rights, and equipment leases relating to the use, operation, maintenance, repair, and improvement of the hospital. Generally, intangibles shall also include all cash and cash escrow funds, such as but not limited to: Depreciation reserve fund or mortgage reserve fund accounts, bank accounts, residual receipt accounts, all contributions, donations, gifts, bequests, and endowment funds by donors, and all other revenues and accounts receivable from whatever source paid or payable. All personalty shall be securitized with appropriate UCC filings and any excluded personalty shall be indicated in the Regulatory Agreement.

Preapplication meeting means a meeting among HUD, a potential mortgagee (applicant), and a potential mortgagor for mortgage insurance where there has been a positive Preliminary Review of the proposed project. The preapplication meeting is an opportunity for the potential mortgagee and mortgagor to summarize the proposed project, for HUD to summarize the application process, and for issues that could affect the eligibility or underwriting of the proposed loan to be identified and discussed.

Preliminary Review Letter means a letter from HUD to a potential applicant communicating the result of the Preliminary Review. The letter may state that an application for mortgage insurance would probably not be successful and provide the reasons for this determination, or state that no factors that would cause an application to be rejected have been identified, and therefore there appears to be no bar to the applicant proceeding to a preapplication meeting.

Project means the construction (which may include replacement of an existing hospital facility) or substantial rehabilitation of an eligible hospital, including equipment, which has been proposed for approval or has been approved by HUD under the provisions of this subpart, including the financing and refinancing, if any, plus all related activities involved in completing the improvements to the property. However, in particular closing documents, “project” may be used to mean the mortgagor entity, the operation of the mortgagor, the facility, or all of the mortgaged property, depending on the context in which it is used.

Regulatory Agreement means the agreement under which all mortgagors shall be regulated by HUD, as long as HUD is the insurer or holder of the mortgage, in a published format determined by HUD, and such additional covenants and restrictions as may be determined necessary by HUD on a case-by-case basis.

Secretary means the Secretary of Housing and Urban Development or his or her authorized representatives.

Security instrument means a mortgage, deed of trust, and any other security for the indebtedness, and shall be deemed to be the mortgage as defined by the National Housing Act, as amended, implementing regulations, and HUD directives.

Service area means that geographical area, identified by zip codes, from which a substantial majority of a hospital’s patients derive.

State includes the several states, Puerto Rico, the District of Columbia, Guam, the Trust Territory of the Pacific Islands, American Samoa, and the United States Virgin Islands.

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Substantial rehabilitation means additions, expansion, remodeling, renovation, modernization, repair, and alteration of existing buildings, including acquisition of new or replacement equipment.

Surplus Cash means any cash remaining after all of the following conditions have been met:

(1) Final endorsement of the HUD-insured note has occurred;

(2) Mortgage payments for the preceding 12 months have been made when due, including any grace period;

(3) The Debt Service Coverage Ratio is greater than or equal to 1.50 in the most recent audited financial statements and as of the date of distribution;

(4) Days in Accounts Receivable are less than or equal to 80 in the most recent audited financial statements and as of the date of distribution;

(5) The average payment period is less than or equal to 80 in the most recent audited financial statements and as of the date of distribution;

(6) The Mortgage Reserve Fund (MRF) is fully funded as of the date of the distribution in conformity with the MRF schedule;

(7) All income, property, and statutory employer payroll taxes and employee payroll withholding contributions (including penalties and interest, if applicable) have been deposited as of the date of the distribution, as required;

(8) The Current Ratio is greater than or equal to 1.50 in the most recent audited financial statements and immediately after the distribution;

(9) Days of cash on hand are greater than or equal to 21 days in the most recent audited financial statements and immediately after the distribution;

(10) The distribution may not be more than 50 percent of Net Income as reflected in the most recent audited financial statements, unless the Mortgagor has an equity financing ratio equal to or greater than 20 percent in the most recent audited financial statements and immediately after the distribution; and

(11) The Equity less any assets excluded from the mortgaged property is greater than 0.00 in the most recent audited financial statements and immediately

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diately after the distribution is made. As used in this definition:

“Most recent audited financial statements” refers to the audited financial statement required under section 242.58 for the prior fiscal year;

“Net Income” means Net Income for for-profit entities; Excess of Revenues over Expenses for not-for-profit entities; and Excess of Revenues over Expenses before Capital Grants, Contributions, and Additions to Permanent Endowment for governmental entities; and

“Equity financing ratio” means (Equity less any assets excluded from the mortgaged property)/(total assets less any assets excluded from the mortgaged property). Equity is defined as Equity for a for-profit entity, Total Net Assets for not-for-profit entities, and Total Net Assets for governmental entities.

[72 FR 67546, Nov. 28, 2007, as amended at 73 FR 35922, June 25, 2008]

§ 242.2 Program financial self-sufficiency.

The Commissioner shall administer the Section 242 program in such a way as to encourage financial self-sufficiency and actuarial soundness; i.e., to avoid mortgage defaults and claims for insurance benefits in order to protect the mortgage insurance fund.

§ 242.3 Encouragement of certain programs.

The activities and functions provided for in this part shall be carried out so as to encourage provision of comprehensive health care, including outpatient and preventive care as well as hospitalization, to a defined population, and in the case of public and certain not-for-profit hospitals, to encourage programs that are undertaken to provide essential health care services to all residents of a community regardless of ability to pay.

§ 242.4 Eligibility for insurance and transition provision.

(a) The hospital to be financed with a mortgage insured under this part shall involve the construction of a new hospital or the substantial rehabilitation (or replacement) of an existing hospital.

(b) This part applies only to applications for FHA mortgage insurance submitted after a pre-application meeting (as defined in § 242.1) with HUD that occurred on and after January 28, 2008. HUD's regulations and practices prior to January 28, 2008 apply to applications for FHA mortgage insurance submitted after a pre-application meeting that occurred before January 28, 2008.

§ 242.5 Eligible mortgagees/lenders.

The lender requirements set forth in 24 CFR part 202 regarding approval, recertification, withdrawal of approval, approval for servicing, report requirements, and conditions for supervised mortgagees, nonsupervised mortgagees, investing mortgagees, and governmental and similar institutions, apply to these programs.

§ 242.6 Property requirements.

The mortgage, to be eligible for insurance, shall be on property located in a state, as defined in § 242.1. The mortgage shall cover real estate in which the mortgagor has one of the following interests:

- (a) A fee simple title;
- (b) A lease for not less than 99 years that is renewable; or
- (c) A lease having a term of not less than 50 years to run from the date the mortgage is executed.

§ 242.7 Maximum mortgage amounts.

The mortgage shall involve a principal obligation not in excess of 90 percent of HUD's estimate of the replacement cost of the hospital, including the equipment to be used in its operation when the proposed improvements are completed and the equipment is installed.

§ 242.8 Standards for licensure and methods of operation.

The Secretary shall require satisfactory evidence that the hospital will be located in a state or political subdivision of a state with reasonable minimum standards of licensure and methods of operation for hospitals, and satisfactory assurance that such standards will be applied and enforced with respect to the hospital.

§ 242.9 Physician ownership.

Ownership of an interest in the mortgagor by physicians or other professionals practicing in the hospital is permitted within limits determined by HUD to avoid insurance risks that may be associated with such ownership. The Commissioner shall determine if the proposed mortgagor will be at low risk for violation of regulations of the U.S. Department of Health and Human Services, other federal regulations, and state regulations governing kickbacks, self-referrals, and other issues that could increase the risk of eventual default. The Commissioner's determination shall be based on an unqualified legal opinion as to compliance with applicable federal law, among other considerations.

§ 242.10 Eligible mortgagors.

The mortgagor shall be a public mortgagor (i.e., an owner of a public facility), a private nonprofit corporation or association, or a profit-motivated mortgagor meeting the definition of "hospital" in § 242.1. The mortgagor shall be approved by HUD and, except in those cases where the hospital is leased as permitted in § 242.72, shall possess the powers necessary and incidental to operating a hospital. Eligible proprietary or profit-motivated mortgagors may include for-profit corporations, limited partnerships, and limited liability corporations and companies, but may not include natural persons, joint ventures, and general partnerships. Any proposed mortgagor must demonstrate that it has a continuity of organization commensurate with the term of the mortgage loan being insured. For new organizations, or those whose continuity is necessarily dependent upon an individual or individuals, broad community participation is required.

[72 FR 67546, Nov. 28, 2007, as amended at 73 FR 35922, June 25, 2008]

§ 242.11 Regulatory compliance required.

An application for insurance of a mortgage under this part shall be considered only in connection with a hospital that is in substantial compliance with regulations of the Department of

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Health and Human Services and the regulations of the applicable state governing the operation and reimbursement of hospitals. A hospital that is under investigation by any state or federal agency for statutory or regulatory violations is not eligible so long as the investigation is unresolved, unless HUD determines that the investigation is minor in nature; that is, the investigation is unlikely to result in substantial liabilities or to otherwise substantially harm the creditworthiness of the hospital.

§ 242.13 Parents and affiliates.

As a condition of issuing a commitment, HUD may require corporate parents, affiliates, or principals of the proposed mortgagor to provide assurances, guarantees, or collateral to protect HUD's interests. The Commissioner may also require financial and operational information on the parent, other businesses owned by the parent, or affiliates of the proposed mortgagor and may also require a parent or affiliate to be regulated by HUD as to certain actions that could impact on the insurance of a mortgage loan for the benefit of the hospital.

§ 242.14 Mortgage reserve fund.

As a condition of issuing a commitment, HUD shall require establishment of a Mortgage Reserve Fund (MRF). The mortgagor shall be required to make contributions to the MRF such that, with fund earnings, the MRF will build to one year of debt service at 5 years following commencement of amortization, increasing thereafter to 2 years of debt service on and after 10 years following commencement of amortization according to a schedule established by HUD, unless HUD determines that a different schedule of contributions is appropriate based on the mortgagor's risk profile, reimbursement structure, or other characteristics. In particular, hospitals that receive cost-based reimbursement may be required to have MRFs that build to more than 2 years of debt service. Expenditures from the fund are made at HUD's sole discretion or in accordance with the mortgagor's MRF Schedule. Upon termination of insurance, the balance of the MRF shall be returned

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to the mortgagor, provided that all obligations to HUD have been met.

§ 242.15 Limitation on refinancing existing indebtedness.

Some existing capital debt may be refinanced with the proceeds of a section 242 insured loan; however, the hard costs of construction and equipment must represent at least 20 percent of the total mortgage amount.

Subpart B—Application Procedures and Commitments

§ 242.16 Applications.

(a) *Application process*—(1) *Market need*. The approval process entails a determination of the market need of the proposal and stresses, on a market-wide basis, the impact of the proposed facility on, and its relationship to, other health care facilities and services (particularly other hospitals with mortgages insured under this part and hospitals that have a disproportionate share of Medicaid and uninsured patients or provide a substantial amount of charity care); the number and percentage of any excess beds; and demographic projections. Generally, Section 242 insurance may support start-up hospitals or major expansions of existing hospitals only if existing hospital capacity or services are clearly not adequate to meet the needs of the population in the service area.

(i) If the state has an official procedure for determining need for hospitals, HUD shall require that such procedure be followed before the application for insurance is submitted, and that the application document that need has also been established under that procedure.

(ii) The following factors are relevant in evaluating market need for the project and should be addressed, as applicable, in the study of market need and feasibility submitted with the application. Because each hospital presents a unique situation, there is no formula or cutoff level that applies to all applications:

- (A) Service area definition;
- (B) Existing or proposed hospital;
- (C) Designation as sole community provider, Critical Access Hospital, or rural referral center;