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 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;

(D) Community-wide use rates (discharges and days/1000);

(E) Statewide use rates (for benchmarking purposes);

(F) Current population and 5-year projection by age cohort;

(G) Staffed versus licensed beds;

(H) Applicant hospital's occupancy rate;

(I) Competitors' occupancy rates;

(J) Outpatient volume;

(K) Availability of emergency services;

(L) Teaching hospital status;

(M) Services offered by hospitals in the service area;

(N) Migration of patients out of the service area;

(O) Planned construction at other facilities in the region;

(P) Historical market share by major service category;

(Q) Disproportionate Share Hospital designation; and

(R) Distance to other hospitals.

(2) *Operating margin and debt service coverage ratio*. (i) Hospitals with an aggregate operating margin of less than 0.00 when calculated from the three most recent annual audited financial statements are not eligible for Section 242 insurance, unless HUD determines, based on the financial data in those statements, that the hospital has achieved a financial turnaround resulting in a positive operating margin in the most recent year, calculated using classifications of items as operating or non-operating in accordance with guidance that shall be provided in written directives by HUD. In any event, HUD shall not issue an insurance commitment for any hospital in a turnaround situation that has not achieved 2 consecutive years of positive operating margin immediately prior to issuance of the commitment.

(ii) Hospitals with an average debt service coverage ratio of less than 1.25 in the 3 most recent audited years are not eligible for Section 242 insurance, unless HUD determines, based on the audited financial data, that the hospital has achieved a financial turnaround resulting in a debt service coverage ratio of at least 1.40 in the most recent year. In cases of refinancing at a lower interest rate, HUD may authorize the use of the projected debt service requirement in lieu of the historical debt in calculating the debt service coverage ratios for each of the prior 3 years. In cases where HUD authorizes the use of the projected debt service requirement in lieu of the historical debt to determine the debt service coverage ratio, hospitals must have an average debt service coverage ratio of 1.40 or greater.

(3) *Financial feasibility*. The approval process entails a determination of the financial feasibility of the proposal, i.e., a determination that it is probable that the proposed mortgagor will be able to meet its debt service requirements during the period projected. It includes analysis of the reimbursement structure of the proposed hospital (including patient/payer mix); actions of competitors; and the probable projected impact on the proposed hospital of general health care system trends, such as the development of alternative health care delivery systems and new reimbursement methods. In addition to historical operating margin, determination of financial feasibility includes, but is not limited to, evaluation of the following factors, which the application must address and which HUD will review:

(i) Current and projected gains from operations and a manageable debt load using reasonable assumptions;

(ii) Current debt service coverage ratio of 1.25 or higher and projected debt service coverage ratio of 1.40 or higher;

(iii) Cushion in the balance sheet sufficient to demonstrate the ability to withstand short periods of net operating losses without jeopardizing financial viability;

(iv) Patient utilization forecasts (including average length of stay, case intensity, discharges, area-wide use rates) that are consistent with the hospital's historical trends, future service mix, market trends, population forecasts, and business climate;

(v) The hospital's demonstrated ability to position itself to compete in its marketplace;

(vi) Organizational affiliations or relationships that help optimize financial, clinical, and operational performance;

(vii) Management's demonstrated ability to operate effectively and efficiently, and to develop effective strategies for addressing problem areas;

(viii) Systems in place to monitor hospital operations, revenues, and costs accurately and in a timely manner;

(ix) A Board that is appropriately constituted and provides effective oversight;

(x) Required licensures and approvals; and

(xi) Favorable ratings from the Joint Commission on Accreditation of Healthcare Organizations or other organizations acceptable to HUD.

(4) *Preliminary Review*. A Preliminary Review is a general overview of the acceptability of a potential mortgagor performed at the request of a hospital, a financial consultant representing a hospital, or a lender, to identify any factors that would likely cause an application to be rejected, should an application be submitted.

(i) The purpose of the preliminary review is for HUD to identify any obvious factors that would cause an application to be rejected, before the potential mortgagor or mortgagee expends resources to prepare one. The hospital, financial consultant, or lender shall submit a preliminary information package to HUD that provides evidence of statutory eligibility, market need, financial strength, and such other documentation as HUD may require. The scope of the preliminary review does not include approval of any specific site in the community.

(ii) If HUD identifies factors that would cause an application to be rejected, HUD shall issue a Preliminary Review Letter notifying the potential applicant that an application for mortgage insurance would probably not be successful and providing the reasons for this decision. Also, no further request from the proposed applicant for a Preliminary Review shall be entertained for a period of one year from the date of HUD's notification. HUD may grant an exception to this one-year limitation if, during the year, there is a major change in the circumstances that caused HUD to determine that the project would be rejected. For example, if the sole reason for HUD's determination was the hospital's failure to meet the historical operating margin test, and a new audited annual financial statement contains results that would cause the hospital to meet the test, then the lender may request a new Preliminary Review within one year of HUD's notification.

(iii) If HUD does not identify any factors that would cause an application to be rejected, HUD shall issue a Preliminary Review Letter advising the potential applicant that there appears to be no bar to the applicant's proceeding to the next step in the application process, provided that if a complete application is not received by HUD within one year following the date of HUD's letter, another Preliminary Review may be required, at HUD's discretion, before the application process may proceed.

(iv) The Commissioner's determination in the preliminary review phase that no factors have been identified that would cause an application to be rejected shall in no way be construed as an indication that a subsequent application will be approved.

(5) *Preapplication meeting*. The next step in the application process is the preapplication meeting. At HUD's discretion, this meeting may be held at HUD Headquarters in Washington, DC, or at another site agreeable to HUD and the potential applicant. The preapplication meeting is an opportunity for the potential 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 project to be identified and discussed to the extent possible. Following the meeting, HUD may:

(i) Advise the potential applicant that there appears to be no bar to submitting an application for mortgage insurance; or

(ii) Identify issues that must be resolved before a full application should be submitted for processing.

(b) *Application contents*. The application for mortgage insurance shall include exhibits that follow such guidance as to content and format that HUD shall provide from time to time. The application shall include:

(1) A description of the proposed sources and uses of funds;

(2) A description of the mortgagor entity, its ownership structure, and its directors and managers;

(3) A description of the project, the business plan of the hospital, and how the project will further that plan;

(4) Historical audited financial statements and interim year-to-date financial results (for existing hospitals);

(5) A study of market need and financial feasibility, addressing the factors listed in paragraphs (a)(1)(ii), (a)(2), and (a)(3) of this section, with assumptions and financial forecast clearly presented, and prepared by a certified accounting firm acceptable to HUD;

(6) Architectural plans and specifications in sufficient detail to enable a reasonable estimate of cost;

(7) 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;

(8) If the state has an official procedure for determining need for hospitals, evidence that such procedure has been followed and that need has been established under that procedure;

(9) A Phase I environmental report; and

(10) Such other exhibits as HUD shall require based upon the facts pertaining to the particular case.

(c) *Fee*. An application fee of $1.50 per thousand dollars of the amount of the loan to be insured shall be paid to HUD at the time the application is submitted to HUD for approval.

(d) *Filing of application*. An application for insurance of a mortgage on a project shall be submitted on an approved FHA form by an approved mortgagee and by the sponsors of such project to the FHA Office of Insured Health Care Facilities.

(e) *Complete application*. Only technically complete applications will be processed. Partial applications cannot be processed. Upon determination that an application is complete, HUD shall issue a Completeness Letter to the applicant stating that the application is complete.

(f) *Application review*. Upon receipt of a complete application, HUD shall evaluate the application to determine if eligibility, market need, financial feasibility, and compliance with applicable regulations (including but not limited to federal environmental regulations, wage rate regulations, and health care regulations) have been demonstrated, and to evaluate any other factors, including but not limited to risk to the Insurance Fund, that should be considered in determining if the application for mortgage insurance should be approved. As a part of this review, HUD may solicit the advice of private consultants and expert staff in the Department of Health and Human Services and other federal agencies. Based on review of the complete application, HUD may request additional information from the applicant. The timeliness of the applicant's submission of the additional information may affect the approval or disapproval of the application. The Commissioner's decision shall be communicated in the form of a Commitment Letter or a Rejection Letter. HUD will not issue a Commitment Letter until HUD completes the environmental review under 24 CFR 242.79.

§ 242.17 Commitments.

(a) *Issuance of commitment*. Upon approval of an application for insurance, a commitment shall be issued by HUD setting forth the terms and conditions under which an insurance endorsement shall be issued for the hospital. The commitment shall include the following:

(1) A commitment for insurance of advances reflecting the mortgage amount, interest rate, mortgage term, date of commencement of amortization, and other requirements pertaining to the mortgage and construction project;

(2) HUD's computation of the replacement cost and maximum insurable mortgage amount;

(3) Financial requirements for closing;

(4) Approval covenants, including any special conditions that must be satisfied prior to initial endorsement;

(5) Mortgage Reserve Fund Agreement.

(b) *Type of commitment*. The commitment will provide for the insurance of advances of mortgage funds during construction.

(c) *Term of commitment*. (1) The initial commitment shall be issued for a period of 90 days.

(2) The term of a commitment may be extended in such manner as HUD may prescribe, provided, however, that the combined term of the original commitment and any extensions do not exceed 180 days.

(d) *Commitment fee*. A commitment fee that, when added to the application fee, will aggregate $3 per thousand dollars of the amount of the loan set forth in the commitment, shall be paid within 30 days of the date of issuance of the commitment. If such fee is not paid within this 30-day period, the commitment shall automatically terminate.

§ 242.18 Inspection fee.

The commitment may provide for the payment of an inspection fee in an amount not to exceed $5 per thousand dollars of the commitment. The inspection fee shall be paid at the time of initial endorsement.

§ 242.19 Fees on increases.

(a) *Increase in commitment prior to endorsement*. An application, filed prior to initial endorsement, for an increase in the amount of an outstanding commitment, shall be accompanied by an additional application fee of $1.50 per thousand dollars computed on the amount of the increase requested. Any increase in the amount of a commitment shall be subject to the payment of an additional commitment fee which, when added to the additional application fee, will aggregate $3 per thousand dollars of the amount of the increase. The additional commitment fee shall be paid within 30 days after the date of the amended commitment. If the additional commitment fee is not paid within 30 days, the commitment novation providing for the increased amount will automatically terminate and the previous commitment will be reinstated. If an inspection fee was required in the original commitment, an additional inspection fee shall be paid in an amount not to exceed $5 per thousand dollars of the amount of increase in commitment. The additional inspection fee shall be paid at the time of initial endorsement.

(b) *Increase in mortgage between initial and final endorsement*. Upon an application, filed between initial and final endorsement, for an increase in the amount of the mortgage, either by amendment, consolidation agreement, or by substitution of a new mortgage, an additional application fee of $1.50 per thousand dollars computed on the amount of the increase requested shall accompany the application. The approval of any increase in the amount of the mortgage shall be subject to the payment of an additional commitment fee which, when added to the additional application fee, will aggregate $3 per thousand dollars of the amount of the increase granted. If an inspection fee was required in the original commitment, an additional inspection fee shall be paid in an amount not to exceed $5 per thousand dollars of the amount of the increase granted. The additional commitment and inspection fees shall be paid within 30 days after the date that the increase is granted.

§ 242.20 Reopening of expired commitments.

An expired commitment may be reopened if a request for reopening is received by HUD no later than 90 days after the date of expiration of the commitment. The reopening request shall be accompanied by a fee of 50 cents per thousand dollars of the amount of the expired commitment. A commitment that has expired because of failure to pay the commitment fee may be reopened only upon payment of the commitment fee and the reopening fee. If the reopening request is not received by HUD within the required 90-day period, a new application accompanied by an application fee must be submitted. If a commitment for an increased amount has expired because of failure to pay an additional commitment fee based on the amount of the increase, the reopening fee shall be computed on the basis of the amount of the commitment increase rather than on the amount of the original commitment.

§ 242.21 Refund of fees.

Commitment, inspection, and reopening fees (but not application fees) may be refunded, in whole or in part, if HUD determines that the construction or financing of the project has been prevented because of condemnation proceedings or other legal action taken by a government body or public agency, or in such other instances as HUD may determine as being beyond the control of the applicant and resulting from no fault of the applicant. A transfer fee may be refunded only in such instances as HUD may determine. However, the portion of the inspection fee paid in connection with early commencement of work is not refundable.

§ 242.22 Maximum fees and charges by mortgagee.

The mortgagee may collect from the mortgagor the amount of the fees provided for in this subpart. The mortgagee may also collect from the mortgagor an initial service charge not to exceed 2 percent of the original principal amount of the mortgage to reimburse the mortgagee for the cost of closing the transaction. A permanent financing fee not to exceed 3.5 percent may be collected from the mortgagor; however, the combined initial service charge and permanent financing fee may not exceed 5.5 percent in bond transactions and 3.5 percent in all other transactions. Any additional charges or fees collected from the mortgagor shall be subject to prior approval of HUD and shall be clearly disclosed in the Mortgagee's Certificate.

§ 242.23 Maximum mortgage amounts and cash equity requirements.

(a) *Adjusted mortgage amount-rehabilitation projects.* A mortgage financing the substantial rehabilitation of an existing hospital shall be subject to the following limitations, in addition to those set forth in § 242.7:

(1) *Property held unencumbered.* If the mortgagor is the fee simple owner of the property and the property is not encumbered by an outstanding indebtedness, the mortgage shall not exceed 100 percent of HUD's estimate of the cost of the proposed substantial rehabilitation.

(2) *Property subject to existing mortgage.* If the mortgagor owns the property subject to an outstanding indebtedness, which is to be refinanced with part of the insured mortgage, the mortgage shall not exceed the total of the following:

(i) The Commissioner's estimate of the cost of substantial rehabilitation, plus

(ii) Such portion of the outstanding indebtedness as does not exceed 90 percent of HUD's estimate of the fair market value of such land and improvements prior to substantial rehabilitation.

(3) *Property to be acquired.* If the property is to be acquired by the mortgagor and the purchase price is to be financed with a part of the insured mortgage, the mortgage shall not exceed 90 percent of the total of the following:

(i) The Commissioner's estimate of the cost of substantial rehabilitation, plus

(ii) The actual purchase price of the land and improvements or HUD's estimate (prior to substantial rehabilitation) of the fair market value of such land and improvements, whichever is the lesser.

(b) *Reduced mortgage amount—leaseholds.* In the event the mortgage is secured by a leasehold estate rather than a fee simple estate, the value or replacement cost of the property described in the mortgage shall be the value or replacement cost of the leasehold estate (as determined by HUD), which shall in all cases be less than the value or replacement cost of the property in fee simple.

(c) *Cash equity.* Depending on the financial circumstances of each hospital facility, HUD shall have the discretion to evaluate, on a case-by-case basis, the amount of equity that a mortgagor must supply in addition to the value of plant, property, and equipment and other values recognized as loan security in the commitment process. Exercise of this discretion shall never cause a loan to exceed 90 percent of estimated replacement cost, although it may cause it to be less than 90 percent. The equity contribution may not be made from borrowed funds. A private nonprofit or public mortgagor, but not

a proprietary mortgagor, at the mortgagee's option and subject to 24 CFR 242.49, may provide any such required equity in the form of a letter of credit.

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

§ 242.24 Initial operating costs.

In the case of a new hospital or a hospital expansion, HUD shall establish, on a case-by-case basis, the amount of initial operating capital, if any, that must be deposited in cash or a letter of credit (or combination) to be available to the new hospital upon commencement of operations. Generally, the initial operating capital other than AMPO shall not be borrowed funds unless HUD determines that there are offsetting financial strengths to compensate for the risk associated with borrowing.

Subpart C—Mortgage Requirements

§ 242.25 Mortgage form and disbursement of mortgage proceeds.

(a) *Mortgage form.* The mortgage shall be:

(1) Executed on a form approved by HUD for use in the jurisdiction in which the property covered by the mortgage is situated; the form shall not be changed without the prior written approval of HUD.

(2) Executed by an eligible mortgagor.

(b) *Disbursement of mortgage proceeds.* The mortgagee shall be obligated, as a part of the mortgage transaction, to disburse the principal amount of the mortgage to (or for the account of) the mortgagor or to his or her creditors for his or her account and with his or her consent.

§ 242.26 Agreed interest rate.

(a) The mortgage shall bear interest at the rate or rates agreed upon by the mortgagee and the mortgagor.

(b) The amount of any increase approved by HUD in the mortgage amount between initial and final endorsement in excess of the amount that HUD had committed to insure at initial endorsement shall bear interest at the rate agreed upon by the mortgagee and the mortgagor.

§ 242.27 Maturity.

The mortgage shall have a maturity not to exceed 25 years from the date amortization begins.

§ 242.28 Allowable costs for consultants.

Consulting fees for work essential to the development of the project may be included in the insured mortgage. Allowable consulting fees include those for analysis of market demand, expected revenues, and costs; site analysis; architectural and engineering design; and such other fees as HUD may determine to be essential to project development. Fees for work performed more than 2 years prior to application are not allowable. Fees for work performed by any party with an identity of interest with the proposed mortgagor or mortgagee are not allowable.

§ 242.29 Payment requirements.

The mortgage shall provide for payments on the first day of each month in accordance with an amortization plan agreed upon by the mortgagor, the mortgagee, and HUD.

§ 242.30 Application of payments.

All payments to be made by the mortgagor to the mortgagee shall be added together and the aggregate amount thereof shall be paid by the mortgagor each month in a single payment. The mortgagee shall apply each payment received to the following items in the following order:

(a) Premium charges under the contract of mortgage insurance;

(b) Ground rents, taxes, special assessments, and fire and other hazard insurance premiums;

(c) Interest on the mortgage; and

(d) Amortization of the principal of the mortgage.

§ 242.31 Accumulation of accruals.

(a) The mortgage shall provide for payments by the mortgagor to the mortgagee on each interest payment date of an amount sufficient to accumulate, in the hands of the mortgagee one payment period prior to its due date, the next annual MIP payable by