

# DEPARTMENT OF HOUSING AND URBAN DEVELOPMENT

## 24 CFR Part 242

[Docket No. FR-5334-P-01]

RIN 2502-A174

## Federal Housing Administration (FHA): Hospital Mortgage Insurance Program—Refinancing Hospital Loans

**AGENCY:** Office of the Assistant Secretary for Housing—Federal Housing Commissioner, HUD.

**ACTION:** Proposed rule.

**SUMMARY:** This rule proposes to revise the regulations governing FHA's Section 242 Hospital Mortgage Insurance Program (Section 242 program) for the purpose of codifying, in regulation, FHA's implementation of its authority that allows hospitals to refinance existing loans, without requiring such refinancing to take place only in conjunction with the expenditure of funds for construction or renovation, which is the existing program requirement. The current downturn in the economy, which has reduced the availability of private financing, has not only adversely affected the housing industry, but has had a serious impact on hospitals across the Nation. At a time when the demand for health care services is on the rise, the lack of access to capital has made it difficult for hospitals to obtain financing for facility, equipment, and technology needs, as well as to meet obligations on existing debt. By expanding FHA's Hospital Mortgage Insurance Program to allow for refinancing of existing debt without conditioning such refinancing on new construction or renovation, HUD believes it can contribute to alleviating financial stress on hospitals and maintaining the availability of hospitals in many communities. This refinancing authority is specifically for the refinancing of non-FHA-insured loans of hospitals. Hospitals currently insured under FHA's Section 242 program may refinance under the National Housing Act.

In order to allow eligible hospitals seeking to refinance debt the opportunity to immediately apply for a refinanced loan under the Section 242 program, FHA proceeded to implement this authority by notice issued on July 1, 2009, and, as subsequently revised by a January 2010 notice. This proposed rule provides the regulatory format for such implementation and seeks comment on the implementation. Comments received in response to this rule will be taken into consideration in

the development of a final rule that will codify in regulation FHA's refinancing authority for hospitals.

**DATES:** *Comment Due Date:* March 30, 2010.

**ADDRESSES:** Interested persons are invited to submit comments regarding this rule to the Regulations Division, Office of General Counsel, Department of Housing and Urban Development, 451 7th Street, SW., Room 10276, Washington, DC 20410-0500. Communications must refer to the above docket number and title. There are two methods for submitting public comments. All submissions must refer to the above docket number and title.

1. *Submission of Comments by Mail.* Comments may be submitted by mail to the Regulations Division, Office of General Counsel, Department of Housing and Urban Development, 451 7th Street, SW., Room 10276, Washington, DC 20410-0500.

2. *Electronic Submission of Comments.* Interested persons may submit comments electronically through the Federal eRulemaking Portal at <http://www.regulations.gov>. HUD strongly encourages commenters to submit comments electronically. Electronic submission of comments allows the commenter maximum time to prepare and submit a comment, ensures timely receipt by HUD, and enables HUD to make them immediately available to the public. Comments submitted electronically through the <http://www.regulations.gov> Web site can be viewed by other commenters and interested members of the public. Commenters should follow the instructions provided on that Web site to submit comments electronically.

**Note:** To receive consideration as public comments, comments must be submitted through one of the two methods specified above. Again, all submissions must refer to the docket number and title of the rule.

*No Facsimile Comments.* Facsimile (FAX) comments are not acceptable.

*Public Inspection of Public Comments.* All properly submitted comments and communications submitted to HUD will be available for public inspection and copying between 8 a.m. and 5 p.m. weekdays at the above address. Due to security measures at the HUD Headquarters building, an advance appointment to review the public comments must be scheduled by calling the Regulations Division at 202-708-3055 (this is not a toll-free number). Individuals with speech or hearing impairments may access this number through TTY by calling the Federal Information Relay Service at 800-877-8339. Copies of all comments submitted

are available for inspection and downloading at <http://www.regulations.gov>.

### FOR FURTHER INFORMATION CONTACT:

Roger E. Miller, Director, Office of Insured Health Care Facilities, Office of Housing, Department of Housing and Urban Development, 451 7th Street, SW., Washington, DC 20410-8000; telephone number 202-708-0599 (this is not a toll-free number). Hearing- and speech-impaired persons may access this number through TTY by calling the Federal Information Relay Service at 800-877-8339 (this is a toll-free number).

### SUPPLEMENTARY INFORMATION:

#### I. Background—The Section 242 Hospital Mortgage Insurance Program

Section 242 of the National Housing Act (12 U.S.C. 1715z-7) authorizes FHA to insure mortgages to finance the construction or rehabilitation of public or private nonprofit and proprietary hospitals, including for major movable equipment, as well as to refinance existing debt. Section 242 of the National Housing Act (NHA) provides this authority to FHA to: (1) Assist in maintaining the availability of hospitals needed for the care and treatment of persons who are acutely ill or who otherwise require medical care and related services of the kind customarily furnished only (or most effectively) by hospitals (see 12 U.S.C. 1715z-7(a)); and (2) encourage the provision of comprehensive health care, including outpatient and preventive care, as well as hospitalization. In the case of public hospitals, Section 242 of the NHA (Section 242) is designed to encourage programs to provide health care services to all members of a community regardless of ability to pay. (See 12 U.S.C. 1715z-7(f).)

Entities that are insured under FHA's Section 242 program include health-care facilities that range in size from large urban teaching hospitals to small rural hospitals, and critical access hospitals (hospitals with 25 beds or less that have received designation as such by states and the U.S. Department of Health and Human Services). To be eligible for mortgage insurance under the Section 242 program, facilities must be properly licensed, provide primarily acute patient care, and be able to demonstrate the need for the project. Key program criteria include a maximum loan-to-value of 90 percent and a loan term of 25 years.<sup>1</sup>

<sup>1</sup> More information about HUD's Section 242 program can be found at: [http://portal.hud.gov/portal/page?\\_pageid=73,1826910&\\_dad=portal&\\_schema=PORTAL](http://portal.hud.gov/portal/page?_pageid=73,1826910&_dad=portal&_schema=PORTAL).

The regulations for the Section 242 program are codified in 24 CFR part 242. In 2005, HUD initiated rulemaking to update the Section 242 program regulations and to bring them in conformity with current hospital financing practices of that time. Prior to the initiation of the 2005 rulemaking, the regulations were last amended in 1995. (See proposed rule published on January 10, 2005, at 70 FR 17250.) That rulemaking resulted in final regulations being promulgated on November 28, 2007. (See final rule published on November 28, 2007, at 72 FR 67524.) Although HUD has long had the authority, under section 223(f) of the NHA,<sup>2</sup> to provide for refinancing of hospital debt without conditioning such refinancing on new construction or renovation, and HUD has implemented this authority for multifamily rental housing and health care facilities, HUD has not implemented this authority for hospitals. To date, it has been HUD's view that private capital to help hospitals refinance debt was sufficiently available, and that the demand for this type of refinancing was not as great as was the need for financing for new construction, renovation and rehabilitation, and equipment purchases.

Since HUD initiated rulemaking to update its Section 242 program regulations, the availability of credit has rapidly declined. Just as HUD has initiated programs and initiatives to assist troubled homeowners, through this rule, HUD believes it can provide relief to hospitals that are experiencing increased debt-services costs. A report issued by the American Hospital Association on January 6, 2009, describes the financial problems facing hospitals and health care facilities today, and recommends actions that could be undertaken to alleviate the financial stress on hospitals. One of those recommendations is for FHA to implement its authority in section 223(f) of the NHA (Section 223(f)) to refinance existing hospital debt. (See <http://www.aha.org/aha/content/2009/pdf/090106-economic-recovery-mo.pdf>.) HUD has considered this recommendation and has determined that implementing the refinance authority in section 223(f) of the NHA

for hospitals is an action that could and should be taken at this time.

## II. This Proposed Rule

This rule proposes to amend FHA's recently updated Section 242 regulations (which were subject to public comment) to provide for the regulatory codification of FHA's authority to refinance hospital debt under Section 223(f), without conditioning the refinancing on new construction or renovation. The Section 223(f) refinancing authority as a component of the Section 242 program is referred to as the Section 242/223(f) program. This refinancing authority is for hospitals without FHA-insured loans. Hospitals with FHA-insured loans are eligible for refinancing of debt (without conditioning refinancing on new construction or renovation) under section 223(a)(7) of the NHA. Specifically, the amendments proposed by this rule would modify the regulations in 24 CFR part 242, as described in this section of the preamble, to reflect the authority already implemented by notice that allows for refinancing without the necessity for new construction or renovation. As noted earlier in this preamble, FHA proceeded to implement this authority by notice issued on July 1, 2009, and, as subsequently revised by a January 2010 notice, which can be found at <http://www.hud.gov/offices/adm/hudclips/notices/hsg/files/09-05hsgn.doc>. All regulations in 24 CFR part 242 would be applicable to Section 242/223(f) refinancing—those proposed to be modified by this rule and those not modified by this rule.

### Definitions (Section 242.1)

This proposed rule adds a definition of "hard costs" to mean the costs of the construction and equipment, including construction-related fees such as architect and construction manager fees. The rule amends the definition of "substantial rehabilitation" to provide that it includes "cases where the hard costs of construction and equipment are equal to or greater than 20 percent of the mortgage amount."

While Section 242 is principally a construction program, HUD has allowed up to 80 percent of the mortgage amount to be used for refinancing, provided that at least 20 percent is used for construction and/or equipment. In determining how to address the issue of repairs, renovations, and/or equipment in a Section 242/223(f) case, which is directed solely to refinancing debt, HUD decided that, for Section 242/223(f) refinancing, it would allow loan proceeds to be used for repairs,

renovations, and/or equipment, the cost of which is less than 20 percent of the mortgage amount. The statute makes a distinction between "substantial rehabilitation," which cannot be carried out under Section 223(f) authority, and the relatively less substantial work that is allowed under Section 223(f). For this reason, the definition of substantial rehabilitation was revised to make clear the difference between the work performed in a Section 242 project (20 percent or more of the mortgage amount) and the work allowed in connection with a refinance mortgage under Section 223(f) (under 20 percent of the mortgage amount). Since the revision to the definition of "substantial rehabilitation" includes a reference to "hard costs," HUD added this definition for clarity purposes.

### Eligibility for Insurance and Transition Provision (Section 242.4)

This rule expands eligibility for insurance to include "refinancing of the capital debt of an existing hospital pursuant to section 223(f) of the NHA (Section 242/223(f))."

### Limitation on Refinancing of Existing Indebtedness (Section 242.15)

This rule adds a new paragraph (b) to § 242.15 to provide that, in the case of a loan insured under Section 242/223(f), there is no requirement for hard costs. However, if there are hard costs, such costs must total less than 20 percent of the total mortgage amount.

### Applications (Section 242.16)

The rule amends § 242.16(a)(2) to make certain amendments to the regulatory provisions concerning financial eligibility of hospitals seeking refinancing under Section 242/223(f). The proposed rule would establish threshold requirements designed to determine the need of the hospital for refinancing that would not be available through other sources, and to screen out hospitals that would have little or no chance of having a formal application approved, based on their financial performance. HUD specifically seeks comments on these threshold requirements.

To receive consideration for Section 242/223(f) refinancing, the hospital must meet two financial thresholds. First, the hospital must have a 3-year aggregate operating margin of at least 0 percent and a 3-year average debt service coverage ratio of at least 1.4. Also, the proposed rule provides that the hospital must demonstrate that its financial health depends upon refinancing its existing capital debt and that it provides an essential service to

<sup>2</sup> Section 223(f)(1) provides that "Notwithstanding any of the provisions of this Act, the Secretary is authorized, in his discretion, to insure under any section of this title a mortgage executed in connection with the purchase or refinancing of an existing multifamily housing project or the purchase or refinancing of existing debt of an existing hospital (or existing nursing home, existing assisted living facility, existing intermediate care facility, existing board and care home, or any combination thereof)." (12 U.S.C. 1715n(f).)

the community in which it operates. This demonstration is met by providing documentation of the following:

(1) If the hospital were no longer in operation, the community in which it presently operates would suffer from inadequate access to an essential service that the hospital presently provides;

(2) There are few alternative affordable financing vehicles available to the hospital; and

(3) The hospital meets three of the following seven criteria: (i) The proposed refinancing would reduce the hospital's total operating expenses by at least 0.25 percent; (ii) the interest rate of the proposed refinancing would be at least 0.5 percentage points less than the interest rate on the debt to be refinanced; (iii) the interest rate on the debt that the hospital proposes to refinance has increased by at least one percentage point at any time since January 1, 2008, or is very likely to increase by at least one percentage point within one year of the date of application; (iv) the hospital's annual total debt service is in excess of 3.4 percent of total operating revenues, based on its most recent audited financial statement; (v) the hospital has experienced a withdrawal of its credit enhancement facility, or the lender providing its credit enhancement facility has been downgraded, or the hospital can demonstrate that one of the events is imminent; (vi) the hospital is party to overly restrictive or onerous bond covenants; or (vii) there are other circumstances that demonstrate that the hospital's financial health depends upon refinancing its existing capital debt.

The inclusion of these threshold factors to determine hospitals eligible for consideration for Section 242/223(f) refinancing is designed to assure that HUD is assisting those hospitals that merit serious consideration based on their financial strength and on need—theirs and that of the communities in which they serve.

In offering this new insurance product, and as the proposed threshold requirements may reflect, HUD is taking a conservative approach intended to attract those hospital applicants that already meet the minimum operating margin and debt-service coverage ratios required for application approval under the current Section 242 program.

The rule amends § 242.16(b)(5) to provide that the study of market need may not be required, subject to HUD's discretion, for an application for Section 242/223(f) mortgage insurance. In most cases, however, HUD does require this study. Although HUD may determine not to require a study of market need

with respect to a Section 242/223(f) mortgage, HUD will always consider market need in the preliminary threshold requirement phase, as discussed in § 242.16(a)(4).

The importance of market need varies from case to case. For example, an in-depth review of market need might not be necessary for a hospital with historically strong utilization and financial statistics that is seeking a pure refinancing or a refinancing with minor repairs. However, an in-depth review is likely needed in the case of a hospital that is using close to 20 percent of the mortgage proceeds (the maximum allowed under Section 242/223(f)) for construction and equipment in order to expand the services it provides to the public in a competitive market area. Other examples of cases where a study may not be needed are geographically remote critical access hospitals and sole community provider hospitals. These designations by Centers for Medicare and Medicaid Services are strong indicators of market need. HUD will consider the characteristics of each case in determining whether the study must address market need.

In addition to the amendment to § 242.16(b)(5), this rule amends § 242.16(b)(3) to require that, in applications for Section 242/223(f) refinancing, the applicant must provide a description of any repairs, renovations, and/or equipment to be financed with mortgage proceeds, and how those repairs, renovations, and/or equipment will affect the hospital. The rule amends § 242.16(b)(6) to provide that the required architectural plans and specifications are not required of an application for Section 242/223(f) mortgage insurance, except when requested by HUD. This rule also amends § 242.16(d) to provide that an application for Section 242/223(f) mortgage insurance shall be on an approved FHA form, submitted jointly by an approved mortgagee and the prospective mortgagor.

#### *Commitments (Section 242.17)*

This rule amends § 242.17(a) (Issuance of Commitment) to add a new paragraph (a)(2) to provide that in the case of an application for Section 242/223(f) mortgage insurance where advances are not needed for funding any repairs, renovations, or equipment, a commitment for insurance upon completion shall include the mortgage amount, interest rate, mortgage term, date of commencement of amortization,

and other requirements pertaining to the mortgage.<sup>3</sup>

Section 242.17(a) provides for insurance of advances in cases where there is a need for advances to fund construction activities and the purchase of equipment. This is the case in Section 242 projects and Section 242 projects pursuant to Section 241. However, in Section 242 projects pursuant to Section 223(f), the circumstances of each case will determine whether the commitment will be for insurance of advances or insurance upon completion. In a pure refinancing, or a refinancing with minor repairs, renovations, and/or equipment that the hospital can fund from its operations and cash reserves, there is no need for advances and the commitment will be for insurance upon completion. However, if a significant portion of the mortgage proceeds (subject to the 20 percent limitation) is to be used for repairs, renovations, and/or equipment, and the hospital cannot fund these from its own cash, then the commitment may provide for insurance of advances.

#### *Inspection Fee (Section 242.18)*

This rule amends § 242.18 to provide that in the case of mortgages insured under Section 242/223(f), the inspection fee shall be paid at endorsement, as described in the amendments to § 242.39, as discussed below.

In the traditional Section 242 program, the inspection fee is generally 50 basis points on all loans. This fee covers such activities as review of architectural plans and specifications, and periodic inspection as the construction gets under way. For applicants seeking refinancing only, an inspection fee that would involve generally no more than a site visit by HUD architects and engineers will not exceed 10 basis points on the loan.

#### *Maximum Mortgage Amounts and Cash Equity Requirements (Section 242.23)*

One of the more significant amendments made to the regulations in 24 CFR part 242 is made to § 242.23, to establish the maximum mortgage amounts and cash equity amounts for mortgages insured under Section 242/223(f).

The rule adds a new paragraph (b) to § 242.23 to provide that, in addition to meeting the requirements of § 242.7 (which addresses maximum mortgage

<sup>3</sup> Note that since there is an existing paragraph (a)(2) in § 242.17, the existing paragraph ((a)(2)) and the paragraphs that follow will be redesignated accordingly). This rule amends § 242.17(b) (Type of Commitment) to provide that in the case of a commitment for Section 242/223(f) insured refinancing, at HUD's discretion the commitment may provide for insurance upon completion.

amounts applicable to all mortgages insured under the Section 242 program)<sup>4</sup>, if the existing hospital debt is to be refinanced by the insured mortgage (*i.e.*, without a change in ownership or with the hospital sold to a purchaser who has an identity of interest, as defined by the FHA Commissioner, with the seller), the maximum mortgage amount must not exceed the cost to refinance the existing indebtedness.

The rule provides that the existing indebtedness will consist of the following items, the eligibility and amounts of which must be determined by the FHA Commissioner: (1) The amount required to pay off the existing indebtedness; (2) reasonable and customary legal, organization, title, and recording expenses, including mortgagee fees under § 242.22; (3) the estimated costs, if any, of repairs, renovation, and/or equipment totaling less than 20 percent of the mortgage amount; and (4) architect's and engineer's fees, municipal inspection fees, and any other required professional or inspection fees.

The rule also provides in the new paragraph (b) added to § 242.23, that, in addition to meeting the requirements of § 242.7, if mortgage proceeds are to be used for an acquisition, the maximum mortgage amount must not exceed the cost to acquire the hospital, which will consist of the following items, the eligibility and amounts of which must be determined by the FHA Commissioner: (1) The actual purchase price of the land and improvements or HUD's estimate (prior to repairs, renovation, and/or equipment replacement) of the fair market value of such land and improvements, whichever is the lesser; (2) reasonable and customary legal, organization, title, and recording expenses, including mortgagee fees under § 242.22; (3) the estimated costs, if any, of repairs, renovation, and/or equipment totaling less than 20 percent of the mortgage amount; and (4) architect's and engineer's fees, municipal inspection fees, and any other required professional or inspection fees.

Because § 242.23 already has a paragraph (b), the existing paragraph (b) and the paragraphs that follow will be redesignated accordingly.

<sup>4</sup> Section 242.7 (24 CFR 242.7) provides: "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."

#### *Insurance Endorsement (Section 242.39)*

This rule amends § 242.39 to divide this section into two main parts. The existing section is designated as paragraph (a) and entitled "New Construction/Substantial Rehabilitation." New paragraph (b), entitled "Section 242/223(f) Refinancing," provides that in cases that do not involve advances of mortgage proceeds, endorsement shall occur after all relevant terms and conditions have been satisfied, including, if applicable, completion of any repairs, renovations, and/or equipment, or upon assurance acceptable to the FHA Commissioner that all required repairs will be completed by a date certain following endorsement. New paragraph (b) provides that in cases where advances of mortgage proceeds are used to fund repairs, renovation, and/or equipment, endorsement shall occur as described in § 242.39(a) immediately above for new construction/substantial rehabilitation.

#### *Labor Standards (Section 242.55)*

This rule amends § 242.55(c) to reflect that the labor standards referenced in that regulatory section are applicable to a refinancing loan under section 223(f) of the NHA.

#### *Eligibility of Refinancing Transactions (Section 242.91)*

This rule amends § 242.91 to consolidate the existing section into a new paragraph (a), and to add a new paragraph (b) that provides that a mortgage given to refinance the debt of an existing hospital under Section 242 of the NHA may be insured pursuant to Section 223(f) of the NHA. The new paragraph (b) also provides that a mortgage may be executed in connection with the purchase or refinancing of an existing hospital without substantial rehabilitation. In addition, the new paragraph (b) provides that the FHA Commissioner shall prescribe such terms and conditions as the Commissioner deems necessary to assure that: (1) The refinancing is employed to lower the monthly debt-service costs (taking into account any fees or charges connected with such refinancing) of such existing hospital; (2) the proceeds of any refinancing will be employed only to: retire (a) the existing indebtedness; (b) pay for repairs, renovation, and/or equipment totaling less than 20 percent of the mortgage amount; and (c) pay the necessary cost of refinancing on such existing hospital; (3) such existing hospital is economically viable; and (4) the applicable requirements of Section

242 for certificates, studies, and statements have been met.

### **III. Corresponding Implementation Notice**

As noted earlier in this preamble, in an effort to immediately address the lack of adequate private financing available to hospitals, HUD issued a notice on July 1, 2009, as recently amended in January 2010, which can be found at <http://www.hud.gov/hudclips/>, that implemented FHA's longstanding refinance authority under section 223(f) of the NHA to hospitals. The issue of the availability of hospitals and other health care facilities in communities is one of the important health care issues to be addressed. With an aging population, and health care demands on the rise, hospitals need access to capital to expand and improve facilities, technology, and equipment. Without access to capital, hospitals and facilities will close or needed improvements in facility, technology, and equipment will not be addressed.

While HUD recognizes that all financing needs of the hospitals and health-care facilities will not be addressed by extending to hospitals, through the Section 242 program, the refinancing authority of Section 223(f) of the NHA, HUD believes that through the action taken initially in the implementing notice of July 1, 2009, as amended in January 2010, and by following through with this rulemaking, it may be able to contribute to alleviating the financial stress faced by many hospitals today. Additionally, the action taken is consistent with HUD's statutory purpose under Section 242, which includes assisting in the availability of needed hospitals for the care and treatment of persons who are acutely ill or who otherwise require medical care and related services of the kind customarily furnished only (or most effectively) by hospitals.

HUD determined that with minimal amendments to its regulations in 24 CFR part 242 (recently the subject of public comment and revised, in part, in response to such comment), HUD could commence receiving applications for Section 242/223(f) mortgage insurance, and that is what the July 1, 2009, implementing notice allowed.

Although HUD determined to proceed to implement, through notice, the Section 223(f) refinancing authority for hospitals, HUD recognizes the value and importance of public input in determining final policy and developing final application and review procedures. It has always been HUD's strategy to supplement its implementing notice with a proposed rule that would solicit

public comment and commence the process of development of a final regulatory structure that will govern the Section 242/223(f) refinancing authority. Before HUD issued its companion proposed rule to the July 1, 2009, notice, HUD received informal feedback from hospitals and hospital representative organizations that the threshold requirements presented a "refinancing only" bar that is too high. In response to such feedback, HUD has amended the threshold requirements, which, again, were designed to determine refinancing need, but not serve as a substitute for the insurance eligibility requirements of the Section 242 program. Those requirements and standards remain in place. This proposed rule, therefore, not only solicits comment specifically on the threshold requirements presented in the companion notice and proposed to be codified by this rule, but on all other aspects of the changes made to the Section 242 regulations to codify the implementation of FHA's Section 223(f) refinancing authority for hospitals with non-FHA-insured loans. The final rule, when issued and in effect, will apply to applications submitted for Section 242/223(f) refinancing authority following the effective date of the rule.

#### IV. Findings and Certifications

##### *Regulatory Planning and Review*

The Office of Management and Budget (OMB) reviewed this rule under Executive Order 12866, Regulatory Planning and Review. OMB determined that this rule is a "significant regulatory action," as defined in section 3(f) of the order (although not an economically significant regulatory action under the order). The docket file is available for public inspection in the Regulations Division, Office of General Counsel, Department of Housing and Urban Development, 451 7th Street, SW., Room 10276, Washington, DC 20410-0500. Due to security measures at the HUD Headquarters building, please schedule an appointment to review the docket file by calling the Regulations Division at 202-402-3055 (this is not a toll-free number). Individuals with speech or hearing impairments may access this number via TTY by calling the Federal Information Relay Service at 800-877-8339.

This Section 242/223(f) program is specifically for the refinancing of non-FHA loans. In offering this new insurance product, and as the proposed threshold requirements reflect, HUD is taking a conservative approach intended to attract hospital applicants that already meet the minimum operating

margin and debt-service coverage ratios required for application approval under the current Section 242 program. The rule is not structured to address all financing needs. The goal in implementing HUD's Section 223(f) refinancing authority for hospitals is to assist those hospitals saddled with unexpectedly high interest rates, and where refinancing is urgently needed for the hospital to continue to remain open and adequately serve its surrounding community. The primary beneficiaries of this rule are the hospitals that receive an FHA-insured loan to refinance debt, and, through such loan insurance, are able to reduce their capital costs by refinancing into a lower interest rate loan through the proposed program. The economic effect constitutes a transfer from the public to hospitals that would not otherwise have been able to refinance out of their current high-cost loans.

HUD estimates that the average decrease in the annual interest cost resulting from an eligible hospital's refinancing its current loan with an FHA loan is 2 percentage points. After the cost of the insurance premium is deducted, the net benefit is 1.5 percentage points. The average loan size from FHA's construction loan portfolio is \$60 million, which is used as an estimate of the size of the principal of loans to be refinanced. Assuming the hospital's current interest rate is 7.75 percent, and it is refinanced down to 5.75 percent (effectively 6.25 percent when the insurance premium is factored in), the annual savings to the hospital would be \$688,740.

The program has not been designed for the entire industry of 5,000 hospitals. As noted earlier, the pool of applicants is limited by the proposed threshold restrictions. Industry experts have estimated that there would be a lead time of approximately 3 months while hospitals and lenders organized their efforts and began to prepare applications. After that (starting, in all likelihood, early in calendar year 2010), they estimated that FHA would receive from 35 to 50 applications during the first year of the program. Assuming that the maximum of 50 applications are received in the first year, that they arrive steadily during the year (4.17 applications per month), and that the average time to process them to commitment is 60 days, 10 months' worth of applications received (approximately 41) could receive insurance commitments in 2010. The economic impact would amount to approximately \$28.2 million annually.

In addition to commenting on the rule, HUD welcomes comment on its

assessment of costs and benefits, as set out in this section of the preamble, and on the number of applications HUD expects to receive upon implementation of the Section 223(f) refinancing authority, as further revised by the January 2010 notice.

##### *Information Collection Requirements*

The information collection requirements contained in this rule were reviewed by OMB under the Paperwork Reduction Act of 1995 (44 U.S.C. 3501-3520) and assigned OMB Control Number 2502-0518. An agency may not conduct or sponsor, and a person is not required to respond to, a collection of information, unless the collection displays a valid control number.

##### *Environmental Impact*

A Finding of No Significant Impact (FONSI) with respect to the environment has been made in accordance with HUD regulations at 24 CFR part 50, which implement section 102(2)(C) of the National Environmental Policy Act of 1969 (42 U.S.C. 4332(2)(C)). The FONSI is available for public inspection between the hours of 8 a.m. and 5 p.m. weekdays in the Regulations Division, Office of General Counsel, Department of Housing and Urban Development, 451 7th Street, SW., Room 10276, Washington, DC 20410-0500. Due to security measures at the HUD Headquarters building, please schedule an appointment to review the FONSI by calling the Regulations Division at 202-708-3055 (this is not a toll-free number). Individuals with speech or hearing impairments may access this number via TTY by calling the Federal Information Relay Service at 800-877-8339.

##### *Unfunded Mandates Reform Act*

The Unfunded Mandates Reform Act of 1995 (2 U.S.C. 1531-1538) (UMRA) establishes requirements for federal agencies to assess the effects of their regulatory actions on state, local, and tribal governments and on the private sector. This rule does not impose a federal mandate on any state, local, or tribal government, or on the private sector, within the meaning of UMRA.

##### *Regulatory Flexibility Act*

The Regulatory Flexibility Act (5 U.S.C. 601 *et seq.*) generally requires an agency to conduct a regulatory flexibility analysis of any rule subject to notice and comment rulemaking requirements, unless the agency certifies that the rule will not have a significant economic impact on a substantial

number of small entities. The amendments proposed by this rule will expand the availability of financing for hospitals and health care facilities, both large and small, under FHA's Section 242 program, based on regulations that were recently the subject of notice and comment. HUD defines a small hospital entity similar to the definition used by the Health Care Financing Administration of the U.S. Department of Health and Human Services: as a hospital of 50 or fewer beds. As noted earlier in this preamble, hospitals, large or small, currently receiving Section 242-insured financing, large or small, are eligible for refinancing under section 223(a)(7) of the NHA. Currently, 21 (approximately 25 percent) of the hospitals with Section 242-insured financing have 50 or fewer beds. HUD has approached development of its eligibility for section 223(f) refinancing to take into consideration criteria that all hospitals, large or small, can meet. The basis for FHA's implementation of its refinancing authority, as has been discussed in this preamble, is to assist hospitals that provide valuable services needed by the communities in which they are located, and for which other refinancing sources are not available. HUD believes that the criteria presented in this rule strikes the appropriate balance.

Accordingly, it is HUD's view that this rule will not have a significant economic impact on a substantial number of small entities, and an initial regulatory flexibility analysis is not required. However, as provided in HUD's analysis under Executive Order 12866 (Regulatory Planning and Review), the impact of this rule on the economy is not anticipated to be significant. This impact encompasses large and small hospital entities, and the impact on small entities does not rise to a level of a significant economic impact on a substantial number of small entities; in this case, small hospitals.

Notwithstanding HUD's determination that this rule does not have a significant economic impact on a substantial number of small entities, HUD specifically invites comments from all entities, including small entities, regarding less burdensome alternatives to this rule that would meet HUD's objectives as described in this preamble.

#### *Executive Order 13132, Federalism*

Executive Order 13132 (entitled "Federalism") prohibits an agency from publishing any rule that has federalism implications if the rule either imposes substantial direct compliance costs on state and local governments and is not required by statute, or the rule preempts

state law, unless the agency meets the consultation and funding requirements of section 6 of the Executive Order. This rule does not have federalism implications and does not impose substantial direct compliance costs on state and local governments nor preempt state law within the meaning of the Executive Order.

#### **List of Subjects in 24 CFR Part 242**

Hospitals, Mortgage insurance, Reporting and recordkeeping requirements.

Accordingly, for the reasons described in the preamble, HUD proposes to amend 24 CFR part 242 to read as follows:

#### **PART 242—MORTGAGE INSURANCE FOR HOSPITALS**

1. The authority citation for 24 CFR part 242 is revised to read as follows:

**Authority:** 12 U.S.C. 1709, 1710, 1715b, 1715n(f), and 1715u; 42 U.S.C. 3535(d).

2. In § 242.1, definitions for "hard costs" and "Section 242/223(f)" are added, and the definition of "substantial rehabilitation" is revised to read as follows:

##### **§ 242.1 Definitions.**

\* \* \* \* \*

*Hard costs* means the costs of the construction and equipment, including construction-related fees such as architect and construction manager fees.

\* \* \* \* \*

*Section 242/223(f)* refers to a loan insured under Section 242 of the Act pursuant to Section 223(f) of the Act.

\* \* \* \* \*

*Substantial rehabilitation* means additions, expansion, remodeling, renovation, modernization, repair, and alteration of existing buildings, including acquisition of new or replacement equipment, in cases where the hard costs of construction and equipment are equal to or greater than 20 percent of the mortgage amount.

\* \* \* \* \*

3. In § 242.4, the section heading and paragraph (a) are revised to read as follows:

##### **§ 242.4 Eligible hospitals.**

(a) The hospital to be financed with a mortgage insured under this part shall involve the construction of a new hospital, the substantial rehabilitation (or replacement) of an existing hospital, or the refinancing of the capital debt of an existing hospital pursuant to Section 242/223(f), or the acquisition of an existing hospital pursuant to Section 242/223(f).

\* \* \* \* \*

4. In § 242.15, the existing text of this section is redesignated as paragraph (a), and a new paragraph (b) is added to read as follows:

##### **§ 242.15 Limitation on refinancing existing indebtedness.**

\* \* \* \* \*

(b) In the case of a loan insured under Section 242/223(f), there is no requirement for hard costs. However, if there are hard costs, such costs must total less than 20 percent of the total mortgage amount.

5. In § 242.16:

a. Paragraphs (a)(3) through (a)(5) are redesignated paragraphs (a)(4) through (a)(6), respectively;

b. New paragraph (a)(3) is added;

c. Newly redesignated paragraph (a)(6) introductory text is revised; and

d. Paragraphs (b)(3), (5), and (6) and paragraph (d) are revised to read as follows:

##### **§ 242.16 Applications.**

(a) \* \* \*

(3) *Threshold requirements—refinancing candidates.* For an application to be considered for refinancing pursuant to Section 223(f), a hospital must meet the following requirements in lieu of those described in paragraph (a)(2) of this section:

(i) The hospitals must have an aggregate operating margin of at least 0 percent, when calculated from the three most recent annual audited financial statements.

(ii) The hospitals must have an average debt service coverage ratio of at least 1.4 when calculated from the three most recent annual audited financial statements.

(iii) HUD may, at its discretion, recast the operating margin and debt service coverage ratio for prior periods by using its estimate of the projected interest rate in lieu of the historical interest rate(s).

(iv) The hospital must demonstrate that its financial health depends upon refinancing its existing capital debt and that it provides an essential service to the community in which it operates. This demonstration is met by providing documentation of the following:

(A) If the hospital were no longer in operation, the community in which it presently operates would suffer from inadequate access to an essential service that the hospital presently provides;

(B) There are few alternative affordable refinancing vehicles available to the hospital.

(C) The hospital meets three of the following seven criteria:

(1) The proposed refinancing would reduce the hospital's total operating expenses by at least 0.25 percent;

(2) The interest rate of the proposed refinancing would be at least 0.5 percentage points less than the interest rate on the debt to be refinanced;

(3) The interest rate on the debt that the hospital proposes to refinance has increased by at least one percentage point at any time since January 1, 2008, or is very likely to increase by at least one percentage within one year of the date of application;

(4) The hospital's annual total debt service is in excess of 3.4 percent of total operating revenues, based on its most recent audited financial statement;

(5) The hospital has experienced a withdrawal or expiration of its credit enhancement facility, or the lender providing its credit enhancement facility has been downgraded, or the hospital can demonstrate that one of these events is imminent;

(6) The hospital is party to overly restrictive or onerous bond covenants; and

(7) There are other circumstances that demonstrate that the hospital's financial health depends upon refinancing its existing capital debt.

\* \* \* \* \*

(6) *Preapplication meeting.* The next step in the application process is the preapplication meeting (this step is optional, at HUD's discretion, in Section 242/223(f) cases). 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:

(b) \* \* \*

(3) A description of the project, the business plan of the hospital, and how the project will further that plan, or, for applications pursuant to Section 223(f), a description of any repairs, renovations, and/or equipment to be financed with mortgage proceeds and how those repairs, renovations, and/or equipment will affect the hospital;

\* \* \* \* \*

(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, except that in the case of an application for Section 242/223(f)

mortgage insurance, at HUD's discretion, the study may not be required to address market need and, at HUD's discretion, there may be no requirement for involvement of a certified accounting firm;

(6) Architectural plans and specifications in sufficient detail to enable a reasonable estimate of cost (not applicable to a Section 242/223(f) application, except when architectural plans and specifications are requested by HUD);

\* \* \* \* \*

(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. An application for insurance of a mortgage pursuant to Section 223(f) shall be submitted on an approved FHA form by an approved mortgagee and by the proposed mortgagor.

\* \* \* \* \*

6. In § 242.17, paragraphs (a)(2) through (5) are redesignated as paragraphs (a)(3) through (6), a new paragraph (a)(2) is added, and paragraph (b) is revised to read as follows:

#### § 242.17 Commitments.

(a) \* \* \*

(2) In the case of an application for Section 242/223(f) insurance where advances are not needed for funding any repairs, renovations, or equipment, a commitment for insurance upon completion, reflecting the mortgage amount, interest rate, mortgage term, date of commencement of amortization, and other requirements pertaining to the mortgage that will be issued.

\* \* \* \* \*

(b) *Type of commitment.* The commitment will provide for the insurance of advances of mortgage funds during construction. In the case of a commitment for Section 242/223(f)-insured refinancing, at HUD's discretion the commitment may provide for insurance upon completion.

\* \* \* \* \*

7. Section 242.18 is revised to read as follows:

#### § 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. In the case of mortgages insured pursuant to section 223(f), the inspection fee shall be paid at endorsement, as described in § 242.39

of this subpart. For applicants seeking refinancing only, an inspection fee that would involve a site visit by HUD architects and/or engineers, or their review of a site visit report prepared by the architects and/or engineers of the applicant hospital, will not exceed 10 basis points on the loan.

8. In § 242.23, paragraphs (b) and (c) are redesignated as paragraphs (c) and (d), respectively, and a new paragraph (b) is added to read as follows:

#### § 242.23 Maximum mortgage amounts and cash equity requirements.

\* \* \* \* \*

(b) *Section 242/223(f) refinancing—additional limit.* (1) In addition to meeting the requirements of § 242.7, if the existing hospital debt is to be refinanced by the insured mortgage (i.e., without a change in ownership or with the hospital sold to a purchaser who has an identity of interest, as defined by the FHA Commissioner, with the seller), the maximum mortgage amount must not exceed the cost to refinance the existing indebtedness, which will consist of the following items, the eligibility and amounts of which must be determined by the FHA Commissioner:

(i) The amount required to pay off the existing indebtedness;

(ii) Reasonable and customary legal, organization, title, and recording expenses, including mortgagee fees under § 242.22;

(iii) The estimated costs, if any, of repairs, renovation, and/or equipment totaling less than 20 percent of the mortgage amount;

(iv) Architect's and engineer's fees, municipal inspection fees, and any other required professional or inspection fees.

(2) In addition to meeting the requirements of § 242.7, if mortgage proceeds are to be used for an acquisition, the maximum mortgage amount must not exceed the cost to acquire the hospital, which will consist of the following items, the eligibility and amounts of which must be determined by the FHA Commissioner:

(i) The actual purchase price of the land and improvements or HUD's estimate (prior to repairs, renovation, and/or equipment replacement) of the fair market value of such land and improvements, whichever is less;

(ii) Reasonable and customary legal, organization, title, and recording expenses, including mortgagee fees under § 242.22;

(iii) The estimated costs, if any, of repairs, renovation, and/or equipment totaling less than 20 percent of the mortgage amount;



(iv) Architect's and engineer's fees, municipal inspection fees, and any other required professional or inspection fees.

\* \* \* \*

9. In § 242.39, the introductory text is removed and paragraphs (a) and (b) are revised to read as follows:

**§ 242.39 Insurance endorsement.**

(a) *New construction/substantial rehabilitation.* Initial endorsement of the mortgage note shall occur before any mortgage proceeds are insured, and the time of final endorsement shall be as set forth in paragraph (a)(2) of this section.

(1) *Initial endorsement.* The FHA Commissioner shall indicate the insurance of the mortgage by endorsing the original mortgage note and identifying the section of the Act and the regulations under which the mortgage is insured and the date of insurance.

(2) *Final endorsement.* When all advances of mortgage proceeds have been made and all the terms and conditions of the commitment have been met to HUD's satisfaction, HUD shall indicate on the original mortgage note the total of all advances approved for insurance and again endorse such instrument.

(3) *Contract rights and obligations.* The FHA Commissioner and the mortgagee or lender shall be bound from the date of initial endorsement by the provisions of the Contract of Mortgage Insurance stated in subpart B of part 207, which is hereby incorporated by reference into this part.

(b) *Section 242/223(f) refinancing.* (1) In cases that do not involve advances of mortgage proceeds, endorsement shall occur after all relevant terms and conditions have been satisfied, including, if applicable, completion of any repairs, renovations, and/or equipment, or upon assurance acceptable to the FHA Commissioner that all required repairs will be completed by a date certain following endorsement.

(2) In cases where advances of mortgage proceeds are used to fund repairs, renovation, and/or equipment, endorsement shall occur as described in

paragraph (a) of this section immediately above, for new construction/substantial rehabilitation.

\* \* \* \*

10. In § 242.55, paragraph (c) is revised to read as follows:

**§ 242.55 Labor standards.**

\* \* \* \*

(c) Each laborer or mechanic employed on any facility covered by a mortgage insured under this part (except under 24 CFR 242.91(a), but including a supplemental loan under section 241 of the Act or a refinancing loan under section 223(f) of the Act made in connection with a loan insured under this part) shall receive compensation at a rate not less than one and one-half times the basic rate of pay for all hours worked in any workweek in excess of 8 hours in any workday or 40 hours in the workweek.

\* \* \* \*

11. Section 242.91 is revised to read as follows:

**§ 242.91 Eligibility of refinancing transactions.**

(a) A mortgage given to refinance an existing insured mortgage under Section 241 or Section 242 of the Act covering a hospital may be insured under this subpart pursuant to Section 223(a)(7) of the Act. Insurance of the new, refinancing mortgage shall be subject to the following limitations:

(1) *Principal amount.* The principal amount of the refinancing mortgage shall not exceed the lesser of:

(i) The original principal amount of the existing insured mortgage; or

(ii) The unpaid principal amount of the existing insured mortgage, to which may be added loan closing charges associated with the refinancing mortgage, and costs, as determined by HUD, of improvements, upgrading, or additions required to be made to the property.

(2) *Debt service rate.* The monthly debt service payment for the refinancing mortgage may not exceed the debt service payment charged for the existing mortgage.

(3) *Mortgage term.* The term of the new mortgage shall not exceed the

unexpired term of the existing mortgage, except that the new mortgage may have a term of not more than 12 years in excess of the unexpired term of the existing mortgage in any case in which HUD determines that the insurance of the mortgage for an additional term will inure to the benefit of the FHA Insurance Fund, taking into consideration the outstanding insurance liability under the existing insured mortgage, and the remaining economic life of the property.

(4) *Minimum loan amount.* The mortgagee may not require a minimum principal amount to be outstanding on the loan secured by the existing mortgage.

(b) A mortgage given to refinance the debt of an existing hospital under Section 242 of the Act may be insured under this subpart pursuant to Section 223(f) of the Act. The mortgage may be executed in connection with the purchase or refinancing of an existing hospital without substantial rehabilitation. A mortgage insured pursuant to this subpart shall meet all other requirements of this part. The FHA Commissioner shall prescribe such terms and conditions as the FHA Commissioner deems necessary to assure that:

(1) The refinancing is employed to lower the monthly debt service costs (taking into account any fees or charges connected with such refinancing) of such existing hospital;

(2) The proceeds of any refinancing will be employed only to retire the existing indebtedness; pay for repairs, renovation, and/or equipment totaling less than 20 percent of the mortgage amount; and pay the necessary cost of refinancing on such existing hospital;

(3) Such existing hospital is economically viable; and

(4) The applicable requirements of Section 242 for certificates, studies, and statements have been met.

Dated: December 19, 2009.

**David H. Stevens,**

*Assistant Secretary for Housing—Federal Housing Commissioner.*

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