

**DEPARTMENT OF HOUSING AND  
URBAN DEVELOPMENT**

**24 CFR Part 242**

[Docket No. FR-5334-F-02]

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.

**ACTION:** Final rule.

**SUMMARY:** This rule revises 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 to refinance existing loans of hospitals without FHA-insured mortgages, without conditioning the exercise of such authority on the expenditure of funds for construction or renovation. Hospitals with FHA's Section 242 mortgage insurance may refinance existing debt under section 223(a)(7) of the National Housing Act, and such refinancing under section 223(a)(7) is not conditioned upon the hospital undertaking new construction or renovation. When credit availability contracted considerably in 2008, FHA, in 2009, commenced the exercise of its authority to refinance the capital debt of hospitals without section 242 mortgage insurance. FHA exercised this authority through notices issued on July 1, 2009, and February 22, 2010. FHA initiated rulemaking to make this refinancing authority a permanent part of the Section 242 regulatory program through a January 29, 2010, proposed rule, which solicited comment on HUD's implementation of this refinancing authority to date.

This final rule provides for codification in regulation of HUD's refinancing of existing debt and acquisitions for non-FHA insured loans of hospitals without conditioning such refinancing and acquisition on new construction or renovation. This rule makes certain changes to the regulations proposed January 2010 in response to public comments submitted on the proposed rule and further consideration of issues by HUD.

**DATES:** *Effective Date:* March 7, 2013.

**FOR FURTHER INFORMATION CONTACT:**

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**SUPPLEMENTARY INFORMATION:**

**I. Executive Summary**

*A. Purpose of the Regulatory Action*

FHA's Section 242 program, by insuring the mortgages of hospitals, serves as credit enhancement, offering borrowers the opportunity to issue bonds up to the equivalent of an "AA" or "AAA" rating, receive lower interest rates, lower monthly debt service costs, and borrow funds for renovations or new construction. This rule amends the Section 242 program regulations to exercise statutory authority to insure refinancing to hospitals that do not have FHA-insured mortgages, and to do so without conditioning such refinancing on new construction or renovation. While HUD has long had the authority to provide such refinancing, HUD had taken the position that, for hospitals without FHA-insured mortgages, private capital for refinancing debt was sufficient, and the demand for refinancing existing debt was not as great as the need for financing new construction, renovation and rehabilitation, and equipment purchases. However, when the credit markets became more restrictive in 2008, hospitals, organizations representing hospitals, and members of Congress appealed to HUD to use its authority to help hospitals without FHA-insured financing to refinance their debt. In 2009, HUD commenced exercising this authority, initially by notice. This rulemaking, which commenced with a January 29, 2010, proposed rule, reflects HUD's commitment to make the refinancing of debt of hospitals without FHA-insured mortgages a permanent part of the Section 242 program. In doing so, HUD will provide, through clear requirements, including eligibility requirements for the refinancing, a needed source of funding for hospitals that will aid in reducing interest rates, eliminating restrictive debt covenants, and stabilizing the hospital's financial situation so that the hospital can continue to provide healthcare to the community it serves.

*B. Summary of the Major Provisions of the Regulatory Action*

Consistent with implementation to date, this rule allows for 100 percent of the mortgage amount to be used for

refinancing, with less than 20 percent eligible to be used for construction and/or equipment. The rule establishes threshold requirements that are designed to determine the need of the hospital for the refinancing that would not be available through other sources, and to eliminate from eligibility hospitals with poor financial performance. The rule requires that applicants for refinancing 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 allows for insurance of advances in cases where there is a need for advances to fund construction activities and the purchase of equipment. The rule revises the existing application process to minimize burden and to also minimize the possibility that meritorious applicants will be eliminated before their application is given full consideration. The rule also adds terminology, based on experience to date, to facilitate understanding how the Section 242 program works.

*C. Costs and Benefits*

This rule will not address all financing needs of hospitals. The program is not designed for the entire industry of 5,000 hospitals. The pool of applicants is limited by eligibility restrictions. The goal of the rule 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.

HUD expects the rule to result in a \$1.26 million transfer per year per healthcare facility. The estimate of healthcare facilities assisted per year under the Section 242 program is 10 facilities, resulting in an aggregate annual impact is \$12.59 million. A multiyear scenario, in which the number of participants increases to 17, yields an aggregate annualized transfer to hospitals of \$17.63 million by the third year of the program. HUD estimates that this program will raise net receipts of the Federal Government by \$79 million (from \$79 million to \$158 million). Costs of the rule include up-front application costs, which may be as high as \$870,000 per applicant but which are likely to be much lower given that non-FHA insured lenders impose transaction costs as well. HUD does not have enough information to quantify or evaluate the opportunity costs or distortionary effects of the program.

The primary benefit of this rule is to keep hospitals with a high degree of

financial strength operating in their communities. Allowing refinancing can reduce the probability of default and the expected social cost of hospital foreclosure. If closure of a hospital were to occur, the negative economic impacts would be drastic. In addition to loss of needed healthcare options, hospitals are among the largest employers in their communities. Therefore the benefits of this rule can be twofold—maintaining needed healthcare services in a community as well as avoiding loss of jobs.

## II. 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 insurance 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 is designed to encourage programs to provide healthcare services to all members of a community regardless of ability to pay. (See 12 U.S.C. 1715z-7(f).)

The regulations for the Section 242 program are codified in 24 CFR part 242. Prior to the refinancing changes proposed to the Section 242 program in 2009, HUD had taken the position that, for hospitals without FHA insured mortgages, private capital for refinancing debt was sufficient, and that the demand for refinancing debt was not as great as the need for financing for new construction, renovation and rehabilitation, and equipment purchases. In fact, HUD has long had the authority, under section 223(f) of the NHA,<sup>1</sup> to provide for refinancing of

hospital debt to hospitals without FHA insured mortgages without conditioning such refinancing on new construction or renovation (See 12 U.S.C. 1715n(f)).

When the credit crisis emerged, both the hospital industry and congressional members, commencing in 2009, urged HUD to use its statutory authority under section 223(f) to provide refinancing to hospitals without FHA insured mortgages. HUD responded to the credit crisis promptly by implementing its authority through notice, Housing Notice H-09-05, issued July 1, 2009, which was amended and superseded by Housing Notice H-10-06, issued February 22, 2010. On January 29, 2010 (at 75 FR 4964), HUD published a proposed rule to commence the process to provide for permanent regulatory codification of its refinancing authority, and to seek public comment on the HUD's implementation of its 223(f) refinancing authority, as set out in the Housing notices.

The January 29, 2010, rule proposed to establish in regulation the criteria and procedures set forth in notice, by which HUD would refinance hospital debt under section 223(f). The preamble to the January 29, 2010, proposed rule sets out in detail the proposed changes to HUD's regulations in 24 CFR part 242 to implement its section 223(f) refinancing authority, referred to in this preamble as Section 242/223(f) refinancing.

## III. Overview of Key Changes Made at Final Rule Stage

HUD is making several changes to the January 29, 2010, proposed rule in response to public comment, HUD's experience in administering its refinancing authority to date, and further consideration of issues by HUD.

### Changes Made in Response to Public Comment

Key changes made to the proposed rule by this final rule in response to public comment include the following. The final rule:

- Adopts certain new definitions that describe the costs that can be insured under the Section 242 program. Adds definitions of "acquisition" and "refinancing" to the definitions of activities eligible for insurance. The proposed rule listed "acquisition" and "refinancing" as eligible categories, but did not include definitions for these terms. Including definitions in the final regulation is intended to facilitate borrower's understanding of the distinctions between the financing categories.

and care home, or any combination thereof)." (12 U.S.C. 1715n(f).)

- Adds a definition of "capital debt" in part in response to comments requesting that HUD provide flexibility to allow certain financing costs approved by HUD to be included as part of a refinancing mortgage. HUD is including a definition of "capital debt" as "the outstanding indebtedness used for the construction, rehabilitation, or acquisition of the physical property and equipment of a hospital, including those financing costs approved by HUD. This gives HUD the flexibility to approve certain financing costs associated with a refinancing as part of the refinancing mortgage. Examples of financing costs are found in the definition of "soft costs", as provided in the discussion below.

- Reorganizes § 242.16 to consolidate certain paragraphs and divide other. Additionally, revises certain threshold factors that make an initial determination of a hospital's eligibility for Section 242/223(f) refinancing, which are designed to enhance screening for applicant eligibility for Section 242/223(f) refinancing and assure that HUD is assisting hospitals that merit serious consideration based on need and financial strength. The revision to the threshold factor includes a supplement to the factor that requires the hospital to have an aggregate operating margin of at least zero percent, and an average debt service coverage ratio of at least 1.40, when calculated from the three most recent annual audited financial statements. The supplementary provision to this factor provides that in performing such calculations, if HUD finds that performance in one of the three years was affected by exceptional, one-time events that substantially altered financial performance, HUD may calculate three-year performance based on the four most recent years with the unusual year omitted.

- Requires, consistent with current practice, that the inspection fee be paid no later than at the time of initial endorsement.

- Provides a sliding scale for inspection fees that is developed based upon the mortgage amount attributable to the newly defined "hard costs."

- Specifies insurance upon completion when advances are not needed for limited rehabilitation.

- Revises requirements for the § 242.16(d) application process to introduce more flexibility for applicants and minimize the possibility that meritorious applicants will be screened out.

<sup>1</sup> Section 223(f)(1) of the National Housing Act 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

### Changes Initiated by HUD Based on Section 242/223(f) Refinancing Experience to Date

In addition to changes that HUD is making at this final rule stage in response to public comments, and which are discussed in detail in Section III of this preamble, HUD is making the following changes at this final rule stage based on HUD's experience to date in implementing the Section 242/223(f) refinancing authority.

To complement a definition of "hard costs" contained in the proposed rule, the final rule adds a new definition of "soft costs" and, to complement the definition of "substantial rehabilitation," adds a definition of "limited rehabilitation" incorporating into the regulation terms that reflect these categories of Section 242/223(f) refinancing.

#### Definitions (Section 242.1)

**Soft Costs.** Based on HUD's experience to date administering its Section 242/223(f) refinancing authority, and in response to questions from refinancing applicants about the scope of "hard costs," HUD determined that it would be helpful to specify those costs that constitute "soft costs." Accordingly, the final rule defines "soft costs" as follows: "Soft costs means reasonable and customary legal, organizational, consulting, and such other costs associated with effecting the proposed project and its financing or refinancing, including, but not limited to, interest capitalized during construction, permanent financing fees, initial service charge, tax, title and recording expenses, special tax assessments, Allowance to Make Project Operational (AMPO),<sup>2</sup> insurance costs during construction, FHA fees and charges including application, commitment and inspection fees; mortgage insurance premium for advances during construction, prepayment penalties associated with retiring the hospital's existing bonds; and termination costs for interest rate protection facilities that are integrated

<sup>2</sup> Allowance to Make Project Operational (AMPO) relates to nonprofit 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 24 CFR 242.43.

into the original financing, as applicable."

**Limited rehabilitation.** HUD is also including a definition of "limited rehabilitation" in this final regulation, which describes categories of construction costs distinguishable from substantial rehabilitation. As noted, in § 242.91(b)(2) of the January 29, 2010, proposed rule, the proceeds of any refinancing can be employed to pay for repairs totaling less than 20 percent of the mortgage amount. The final rule adopts the numeric criteria for repairs that were included in the proposed regulation as the definition of "limited rehabilitation."

#### Funds and Finances; Deposits and Letters of Credit (Section 242.49)

This section establishes the requirements mortgagees must meet for funds deposited to support the project. HUD did not receive public comment on this issue. However, in the course of operating the Section 242 program over the last several years, HUD has found that some mortgagees are not able to hold funds on behalf of the mortgagor. Several state healthcare finance agencies have mentioned this problem to HUD with respect to the Mortgage Reserve Fund defined in codified § 242.1, stating that, under their state laws, state healthcare finance agencies are not authorized to hold such funds. In such cases, the deposits must be with a depository acceptable to the mortgagee and HUD. HUD recognizes the issues involved in the state law requirements, and accordingly is modifying its regulations in § 242.49 to specify that the depository which has the funds, rather than the mortgagee, will be legally responsible in those cases.

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

This section establishes the maximum mortgage amounts and cash equity amounts for mortgages insured under Section 242/223(f). The proposed rule revised the maximum mortgage amount to provide that the amount would not exceed the cost to refinance the existing indebtedness as defined in § 242.23. The final rule retains the proposed rule language but revises this provision to incorporate the terms that are being newly defined in this rule.

#### IV. Discussion of Public Comments and HUD Responses

The public comment period on the proposed rule closed March 30, 2010, and HUD received seven comments. The public commenters included national trade associations involved in healthcare financing, national and state

hospital and healthcare associations, national associations of healthcare financial management professionals, law professors, and attorneys who are active in the field. Although one commenter supported the rule as proposed, the remaining six commenters submitted suggestions for changes to the manner in which HUD implements its Section 242/223(f) refinancing authority. The changes suggested by the commenters included expansion of the program by, among other things, relaxing the threshold financial screening tests to allow more hospitals to meet the eligibility requirements for financing, covering additional costs, and permitting the leasing of hospitals with Section 242 financing to operators.

HUD did not receive comments on the following sections of the proposed rule: §§ 242.4; 242.15; 242.16(b)(3) and (b)(6); 242.16(d); and 24 CFR 242.17(a)(2). While Section 242.15 is not revised in this final rule, the other sections are revised in the final rule to be consistent with HUD changes to definitions or other elements of the final rule.

#### Definitions (Section 242.1)

The proposed rule added the following three definitions to 24 CFR part 242: "hard costs," "Section 242/223(f)," and "substantial rehabilitation." The definition of "Section 242/223(f)" was included as an easy way to refer to HUD's refinancing authority under section 223(f) of the NHA as applied to hospitals financed under section 242 of the NHA. The term "hard costs" was defined to mean the costs of the construction and equipment, including construction-related fees such as architect and construction manager fees. The term "substantial rehabilitation" was defined to address "cases where the hard costs of construction and equipment are equal to or greater than 20 percent of the mortgage amount." HUD did not receive any comments on these terms and the final rule adopts these definitions without change.

Commenters proposed changes to other definitions included in the proposed rule, and suggested that additional terms be defined. HUD has adopted certain of the commenters' recommendations and made some additional changes to other definitions to reflect adoption of the new terms. Accordingly, the final rule includes several new terms beyond those included in the proposed rule: "acquisition," "capital debt," "limited rehabilitation," "refinancing," and "soft costs." In addition, HUD is revising definitions already in the current regulations to respond to the inclusion

of these categories in the terms “construction,” “project,” and “substantial rehabilitation.”

*Comment: Include definitions for “acquisition,” “capital debt,” and “refinancing.”* Commenters recommended adding definitions for the terms “acquisition,” “capital debt” and “refinancing” to ensure clarity with respect to the indebtedness eligible for Section 242/223(f) refinancing.

A commenter suggested adding a definition of acquisition as follows: “Acquisition” means the purchase by an eligible mortgagor of an existing hospital facility and ancillary property associated therewith.”

A commenter was particularly concerned that the term “capital debt” be defined to confirm that termination costs for “interest rate protection facilities”<sup>3</sup> (such as fixed to variable interest rate swaps used as a hedge against rising variable interest rates) constitutes a type of debt eligible for refinancing. The commenter stated that the 2007–2008 collapse of the auction rate and variable rate markets had created significant issues for those hospitals which had used “interest rate protection facilities” to achieve savings, because they were not shown as “debt” on hospital financial statements under Generally Accepted Accounting Principles (GAAP)<sup>4</sup> methodology. The commenter submitted that instead Internal Revenue Service guidance should be used to categorize these transactions. In addition, the commenter further stated that “termination costs” for interest rate protection facilities should be considered the functional equivalent of prepayment premiums due in connection with the early redemption of capital debt. The commenter stated that those prepayment premiums are routinely permitted as eligible program costs by HUD in connection with the refinancing of capital debt in the basic Section 242 construction program.

A commenter suggested including the following definition of “refinancing”: “Refinancing means the discharging of the existing capital debt of a hospital.”

<sup>3</sup> An interest rate swap is a derivative in which one party exchanges a stream of interest payments for another party’s stream of cash flows. Interest rate swaps can be used by hedgers to manage their fixed or floating assets and liabilities. They can also be used by speculators to replicate unfunded bond exposures to profit from changes in interest rates. Interest rate swaps are very popular and highly liquid instruments.

<sup>4</sup> The common set of accounting principles, standards and procedures that companies use to compile their financial statements. GAAP are a combination of authoritative standards (set by policy boards) and simply the commonly accepted ways of recording and reporting accounting information.

*HUD Response:* HUD has added new definitions to clarify the types of costs that would be eligible for Section 242/223(f) refinancing. Rather than adopt other recommendations of the commenters pertaining to new definitions, HUD has developed alternative definitions that define the categories of eligible costs which applicants must identify in their applications. The definitions and HUD responses are outlined as follows:

*Acquisition:* As recommended by a commenter, HUD has defined “acquisition” to mean “the purchase by an eligible mortgagor of an existing hospital facility and ancillary property associated with the facility.” Through this definition, the purchase of the hospital and such items as medical equipment and ambulances will be eligible for financing under HUD’s Section 242 program.

*Capital Debt:* For some time, HUD has recognized the risks inherent in interest rate protection facilities. Consequently, the regulations at § 242.63 that address additional indebtedness and leasing prohibit hospitals with FHA-insured loans from engaging in such transactions without prior HUD approval. Specifically, the regulations provide that “the mortgagor shall not enter into any \* \* \* derivative-type transactions, except in conformance with policies and procedures established by HUD.” Also, HUD will maintain its policy that hospitals with interest rate protection facilities seeking FHA-insured financing must terminate those facilities in order to be eligible for a mortgage insurance commitment.

Therefore, to address the request for a definition of “capital debt” and to provide a definition that also addresses HUD’s policy concerns, the final rule defines “capital debt” as “the outstanding indebtedness used for the construction, rehabilitation, or acquisition of the physical property and equipment of a hospital, including those financing costs approved by HUD.” Examples of financing costs are reasonable and customary legal, organizational, consulting, and such other costs associated with effecting the proposed project and its financing or refinancing, including, but not limited to, interest capitalized during construction; permanent financing fees; initial service charge; tax; title and recording expenses; special tax assessments; AMPO; insurance costs during construction; FHA fees and charges, including application, commitment and inspection fees; mortgage insurance premium for advances during construction; prepayment penalties associated with

retiring the hospital’s existing bonds; and termination costs for interest rate protection facilities that are integrated into the original financing. This gives HUD the flexibility to consider a range of financing costs associated with the refinancing mortgage.

In this regard, HUD also revises the definition of “construction” to mean “the creation of a new or replacement hospital facility, the substantial rehabilitation of an existing facility, or the limited rehabilitation of an existing facility. The cost of acquiring new or replacement equipment may be included in the cost of construction.” HUD adds a definition for “limited rehabilitation,” which is defined as “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 less than 20 percent of the mortgage amount.”

*Refinancing:* In this final rule, HUD is largely adopting the commenter’s definition of “refinancing.” The final rule defines “refinancing” as the discharging of the existing capital debt of a hospital through entering into a new debt.

#### Eligible Hospitals (Section 242.4)

HUD’s codified regulation in § 242.4, entitled “Eligibility for insurance and transition provision,” provides that a hospital to be financed with an FHA insured mortgage shall involve the construction of a new hospital or the substantial rehabilitation (or replacement) of an existing hospital. The proposed rule expanded 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)).”

At this final rule stage, HUD changes the heading of § 242.4 to read simply “Eligible hospitals” and revises the definition of eligible hospitals to accommodate the new definitions of “limited rehabilitation,” “acquisition,” and “refinancing” that are being added by this final rule.

#### Applications (Section 242.16)

HUD’s existing regulation at § 242.16(a)(2)(ii) provides that hospitals with an average debt service coverage ratio of less than 1.25 in the three 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.<sup>5</sup> Section 242.16(a)(2)(ii) further provides that, 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 service 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 service to determine the debt service coverage ratio, hospitals must have an average debt service coverage ratio of 1.40 or greater.

In implementing its Section 242/223(f) refinancing authority, HUD relied on the existing threshold factors in § 242.16(a)(2). HUD stated that to receive consideration for Section 242/223(f) refinancing, a hospital must meet two financial thresholds. First, the hospital must have a 3-year aggregate operating margin of at least zero percent and a 3-year average debt service coverage ratio of at least 1.40. Second, the hospital must demonstrate that its financial performance would be materially improved by refinancing its existing capital debt. The hospital must also demonstrate that it provides an essential healthcare service to the community in which it operates. The inclusion of these threshold factors to determine hospitals eligible for consideration for Section 242/223(f) refinancing was 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 they serve.

In implementing its Section 242/223(f) refinancing authority, HUD took 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. Under the existing Section 242 regulations, HUD also looks at financial feasibility. As implemented for Section 242/223(f) refinancing, HUD established a threshold requirement to determine the hospital's need for refinancing that would not be available through nongovernmental sources. This threshold requirement would also screen out hospitals that would have little or no chance of having a formal

application approved, based on their financial performance.

As noted earlier in this preamble, HUD revised, at this final rule stage, the structure of § 242.16 and in the discussion that follows strives to distinguish the applicable paragraph in the proposed rule and the redesignated paragraph in the final rule.

*Comment: Calculation of operating margin excludes qualified applicants.* A commenter stated that using a 3-year average to calculate the operating margin<sup>6</sup> and debt service coverage ratio has the potential to exclude well-qualified providers. The commenter stated that temporary declines in these ratios might be a direct result of the recent economic downturn and credit market crisis. The commenter suggested that many providers might need to exit a financing arrangement in which the interest rate has already increased substantially due to problems in the credit market, causing a decrease in operating margin and debt service coverage ratio. The commenter suggested that using a 5-year average would provide a more accurate picture of a hospital's performance and financial stability.

Another commenter stated that the recasting of debt service in proposed § 242.16(a)(3)(ii), which involves recalculating the operating margin and debt service coverage with a projected interest rate rather than the historical rate, should be a mandatory rather than an optional requirement to avoid the arbitrary application of this threshold limitation in the cases of otherwise eligible projects that would benefit under the new program.

*HUD Response:* With respect to the suggestion made by the first commenter, HUD recognizes that extending the time period to calculate the operating margin and debt service coverage may moderate fluctuations caused by economic variability and interest rate fluctuations, but HUD finds a 3-year average to present a reasonable and preferred time frame for evaluating potential borrowers.

In response to the second commenter's concern, HUD has revised proposed § 242.16(a)(3)(iii) (now § 242.16(a)(3)(ii) in the final rule) to make the recasting mandatory rather than optional. It is HUD's position that the commenter's concern is addressed by the provision that if the operating margin and debt service coverage thresholds are not met, HUD will recast the operating margin and debt service coverage ratio for prior periods by using

the estimated projected interest rate in lieu of the historical interest rate. HUD agrees that this will provide a uniform standard that will result in an equitable standard evaluation of the financial strength of the hospital.

*Comment: More flexible screening criteria needed.* A commenter suggested that HUD adopt more flexible threshold criteria. Specifically, the commenter stated that the requirement that hospitals meet three of seven benchmarks will prevent FHA from considering some meritorious applications that either narrowly miss some of the benchmarks, or that could establish legitimate financial need but under different criteria. The commenter requested that FHA consider accepting evidence that (1) the hospital provides access to essential health services, (2) the hospital has few alternative vehicles for affordable refinancing, and (3) the financial health of the hospital depends on refinancing.

*HUD Response:* The requirement that a hospital meet only three out of seven benchmarks provides considerable flexibility for a hospital to pass the threshold screening. In particular, potential program applicants should recognize that one of the seven benchmarks provides applicants with an opportunity to supplement their application with unique, specific materials to support their need for refinancing. Specifically, § 242.16(a)(3)(vi)(B)(7) of this final rule (§ 242.16(a)(3)(iv)(B)(7) of the proposed rule) states that "there are other circumstances that demonstrate that the hospital's financial performance would be materially improved by refinancing its existing capital debt."

However, to improve flexibility and to reduce the possibility that meritorious hospitals will be screened out, HUD has made the following changes:

Section 242.16(a)(3)(iv) in the proposed rule stated that "The hospital must demonstrate that its financial health depends upon refinancing its existing capital debt \* \* \*" This requirement could be read to mean that the hospital must be in desperate financial trouble to qualify, which was not HUD's intent. Therefore, the wording of § 242.16(a)(3)(iv) in this final rule has been changed to: "The hospital must document that \* \* \* its financial performance would be materially improved by refinancing its existing capital debt." Where the same language appears in § 242.16(a)(3)(vi)(B)(7) of this final rule, the same change is made.

Section 242.16(a)(3)(iv)(B) in the proposed rule would have required the hospital to demonstrate that "there are few alternative affordable financing

<sup>5</sup> Debt Service Coverage Ratio (DSC). The debt service coverage ratio measures a hospital's ability to pay interest and principal with cash generated from current operations. A high coverage ratio indicates that an institution is in a good financial position to meet its long-term obligations (including its FHA-insured loan) and service its debt. Higher values are preferable.

<sup>6</sup> Operating margin is the ratio of operating income divided by operating expense.

vehicles available to the hospital.” HUD has retained this provision, with minor edits, and the provision is now found in § 242.16(a)(3)(vi)(A) of this final rule.

Section 242.16(a)(3)(iv)(B)(6) in the proposed rule would have required that “The hospital is party to overly restrictive or onerous bond covenants.” Because “overly restrictive or onerous” is not defined and could be interpreted as referring to only the very worst covenants (from a hospital’s point of view), this wording has been replaced by the following: “The hospital is party to bond covenants that are substantially more restrictive than the Section 242 mortgage covenants,” and this provision is now in § 242.16(a)(3)(vi)(B)(6) in this final rule.

These changes will provide more flexibility to hospitals in meeting the threshold requirements while still indicating that the hospitals have a strong business need to refinance.

*Comment: Expand the definition of service beyond health service.* A commenter submitted that § 242.16(a)(3)(iv) of the proposed rule would have required HUD to determine that the hospital provide “an essential service” to a hospital’s community. The commenter stated that an overly narrow interpretation of the undefined term “service” to apply only to medical considerations may inadvertently limit sponsor eligibility. The commenter stated that hospitals provide other significant community benefit services, such as employment, neighborhood stability, community health initiatives, and civic educational programs. Another commenter stated that hospitals in urban areas that serve discrete and insular communities, such as HIV or mental health patients, meet a special need. The commenter stated that closure of hospitals that treat these illnesses would create hardship for those sectors of the communities.

*HUD Response:* If a hospital ceases to operate and its community suffers no inadequacies in essential medical services as a result, there is good reason to believe that there was no market need for the hospital in the first instance. HUD has statutory authority to assist in the provision of urgently 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. (See 12 U.S.C. 1715z–7(a).) Consistent with this authority, it is HUD’s position that while hospitals provide other community benefits, the medical services provided by hospitals must be the focus in considering the need for a facility. Accordingly, in the

proposed rule, HUD offered language in § 242.16(a)(3)(iv) consistent with the language in currently codified regulations in § 242.16(a)(1), *Market Need*, which emphasizes the healthcare services provided by the hospital. However, to eliminate any possible ambiguity, the final rule revises § 242.16(a)(3)(iv) to include the word “healthcare” before “service” and, therefore, confirm that the test of “essential service” applies to healthcare services.

*Comment: Applicants should meet several of the threshold screening elements.* A commenter suggested that a typographical correction is needed to insert an “and” after proposed § 242.16(a)(3)(iv)(B) and before § 242.16(a)(3)(iv)(C).

*HUD Response:* HUD agrees with the commenter and adopted the recommendation. However, in the final rule, the “and” is now found after 242.16(a)(3)(vi)(A) and before § 242.16(a)(3)(vi)(B). Inserting the word “and” clarifies that a hospital demonstrating that its financial health depends upon refinancing would have to document all elements of the threshold test rather than individual discrete elements. Specifically, the hospital would have to document that (1) the community would suffer from inadequate access to an essential service that the hospital provides, (2) there are few alternative financing vehicles, and (3) three of the additional seven criteria are met. Review of all of these elements will assure that there will be strong justifications for the refinancing.

*Comment: Expand the covenant test to include the hospital system.* A commenter stated that the concept of “overly restrictive or onerous” covenants in proposed § 242.16(a)(3)(iv)(C)(6) is appropriate in determining the need for refinancing, and suggested clarifications to cover situations in which a hospital is subject to such covenants as a member of a system and not independently.

*HUD Response:* Because “overly restrictive or onerous” is not defined and could be interpreted as referring to only the very worst covenants (from a hospital’s point of view), this wording has been replaced by the following: “The hospital is party to bond covenants that are substantially more restrictive than the Section 242 mortgage covenants,” and this provision is now in § 242.16(a)(3)(vi)(B)(6) in this final rule.

*Comment: Provide a separate threshold test for acquisitions.* One commenter stated that the threshold requirements in proposed § 242.16(a)(3) provide guidance for determining the

need for a “refinancing.” The commenter stated that its application to “acquisitions” requires clarification.

*HUD Response:* The same requirements that apply to the basic Section 242 program apply to acquisitions. Therefore, changes have been made in this final rule to clarify that the basic Section 242 program requirements apply to acquisitions. These clarifying amendments are made in the following sections: §§ 242.1, 242.4, 242.17, and 242.23 to reflect appropriate differences.

*Comment: Market Need study requirements should be revised.* Section 242.16(b)(5) of the proposed rule provided 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. However, HUD anticipated that, in most cases, this study would be required. In addition, although HUD may determine not to require a study of market need with respect to a Section 242/223(f) refinance transaction, HUD will always consider market need in the preliminary threshold requirement phase, as discussed in § 242.16(b)(5). In the proposed rule, HUD emphasized that market need varies from case to case.

A commenter stated that needy hospitals would be screened out because of the strong emphasis the threshold requirements put on the financial strength of a hospital. The commenter contended that the language demonstrates that the program is not focused on helping the most struggling hospitals, even though they are the hospitals most likely serving the neediest populations. The commenter suggested that the market need study should include a more detailed look at discrete, vulnerable populations.

*HUD Response:* HUD declines to adopt the commenter’s recommendation. Section 242 is a mortgage insurance program, not a grant program. As an insurance program, there is a need to weigh the public benefit provided by a hospital facility against the risk that the hospital may not be able to meet its mortgage debt service obligations. While the program emphasizes market need, the program also emphasizes—and must—emphasize financial strength of the hospital.

*Comment: Need analysis should address refinancing and hard costs.* The proposed rule at § 242.16(b)(5) provides that a study of market need may be required in the case of a Section 242/223(f) refinancing. A commenter expressed recognition that a market need analysis for new construction projects is required, but submitted that a sponsor’s compliance with the

threshold requirements under § 242.16(a)(3) should be sufficient to establish the need for the refinancing portion of the project. The commenter recommended that HUD bifurcate its need analysis into two parts. The first inquiry would be the need for the refinancing portion, and the second would be the need for the "hard costs" portion of the project, if any. The commenter stated that, if the threshold requirements of § 242.16(a)(3) are satisfied, the hospital should be deemed to have satisfied the need requirement as to the refinancing portion of the proposed project.

*HUD Response:* The assessment of market need should be consistent in the Section 242 program and not vary according to the amount of refinancing versus hard costs proposed for insured financing.

Section 242.16(d) was revised in this final rule to specify 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. HUD has determined, at this point, that specifying this requirement is not necessary, and that the current regulatory requirements are sufficient. The proposed revision eliminates the name of the HUD office that takes these applications in order to eliminate the need for future regulatory changes if the name of the office is revised.

#### Commitments (Section 242.17)

Section 242.17(a) (Issuance of Commitment) of the proposed rule included a new paragraph (a)(2) that provided, in the case of an application for Section 242/223(f) refinancing and where advances are not needed for funding any limited rehabilitation of the hospital, 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>7</sup> The final rule retains new paragraph (a)(2) with a modification to accommodate inclusion of limited rehabilitation.

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 type of insurance is provided for section 242 projects and

<sup>7</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, the commitment will provide for insurance upon completion.

section 242 projects insured pursuant to section 241 of the NHA. Section 241 insures mortgage loans to finance repairs, additions, and improvements to multifamily rental housing and healthcare facilities with FHA-insured first mortgages or HUD-held mortgages. However, in section 242 projects insured 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 acquisition, or a refinancing with minor limited rehabilitation that can be funded from 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 limited rehabilitation, and the hospital cannot fund these from its own cash, then the commitment may provide for insurance of advances.

*Comment: Require insurance upon completion when advances are not needed for construction.* A commenter submitted that the proposed language in § 242.17(b) appeared somewhat inconsistent with the language of § 242.17(a)(2), which states: "In the case of an application for Section 242/223(f) insurance where advances are not needed for funding any limited rehabilitation, a commitment for insurance upon completion will be issued." The commenter states that there is no provision for HUD discretion in § 242.17(a)(2), but there is allowance for HUD discretion in proposed in § 242.17(b), which provided HUD discretion for issuing the commitment. The commenter suggested that language of § 242.17(b) be revised to eliminate HUD discretion in those instances where insured advances are not needed for funding limited rehabilitation approved by HUD.

*HUD Response:* HUD agrees with the commenter and has added language to § 242.17(b) to clarify that HUD shall issue the commitment.

*Comment: Make insurance upon completion available for acquisitions.* A commenter suggested that HUD clarify in § 242.17(b) that the option of insurance upon completion should be made available for acquisition as well as refinancing transactions. The commenter suggested that an advantage of insurance upon completion is that it could potentially enable a determination to be made in advance of loan closing that the FHA-insured loan will qualify for Real Estate Mortgage Investment Conduit (REMIC) securitization and the lower interest

rates that REMIC status provides. The commenter suggested that this potential advantage should be made available for acquisition as well as refinancing transactions.

*HUD Response:* As a result of the commenter's suggestion, HUD has reexamined its proposed rule language. HUD agrees that the option of insurance upon completion should, consistent with HUD's statutory authority, be expanded beyond refinancing transactions to acquisition transactions.<sup>8</sup> Accordingly, HUD has revised the commitment language in § 242.17 to cover acquisitions. A corresponding change is also made in paragraph (b) of § 242.39 (Insurance Endorsement). HUD is refraining from commenting on the impact of these changes for REMIC eligibility of the insured loans as interpretation of the tax code does not fall within HUD's statutory authority.

#### Inspection Fee (Section 242.18)

The proposed rule included an amendment to § 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 provided in § 242.39, which is 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 during construction. 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.

*Comment: Pay the inspection fee no later than the time of initial endorsement.* A commenter suggested that the inspection fee be paid no later than the time of initial endorsement because many projects involve precommitment or early start of construction work.

*HUD Response:* HUD agrees with this recommendation. The language change is consistent with FHA's current procedures. FHA currently charges an inspection fee if precommitment or early start work is undertaken prior to initial endorsement.

*Comment: Modify the inspection fee to account for hard costs.* A commenter

<sup>8</sup> Section 223(f)(1) of the National Housing Act 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 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)).

stated that the proposed language in § 242.18 limits the inspection fee amount only in connection with projects which have no applicable hard costs. The commenter suggested that this would mean that the full 50 basis point inspection fee would otherwise apply, even if the hard costs were minimal; e.g., 1 percent of the commitment amount. The commenter suggested that an additional inspection fee, if any, should be based on the amount of actual hard costs exclusive of equipment, calculated at five dollars per thousand dollars of the hard costs.

*HUD Response:* HUD agrees that the inspection fee should better reflect the portion of the mortgage amount that will be used for hard costs. In the basic Section 242 program, in which hard costs must amount to 20 percent or more of the mortgage amount, the maximum inspection fee of 50 basis points is routinely charged. For a pure refinancing with zero hard costs, the proposed rule set a maximum inspection fee at 10 basis points (reflecting that even with no hard costs, the facility must be inspected to assess its condition). HUD has determined that where hard costs are between zero and 20 percent, an inspection fee that is between 10 and 50 basis points would be reasonable, and accordingly is including a schedule in the final rule. However, HUD does not agree to exclude the cost of equipment from “hard costs.” Equipment is included in “hard costs” for the basic Section 242 program and equipment should also be included for refinancing. Major medical equipment has implications for facility design, and can complicate review of plans and construction. Accordingly, HUD has revised the inspection fees to correlate with hard costs.

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

One of the key changes proposed to the regulations in 24 CFR part 242 is the change proposed to § 242.23, which establishes the maximum mortgage amounts and cash equity amounts for mortgages insured under Section 242/223(f). The proposed rule revised the maximum mortgage amount to provide that the amount would not exceed the cost to refinance the existing indebtedness as defined in § 242.23. The final rule adopts this language but revises this formula to coordinate those provisions with the new definitions.

*Comment: Modify the financing terms to coordinate with the new definitions.* Section 242.23(a) and new paragraphs (b) and (c) identified the amounts that would be included in the Section 242/223(f) loan. A commenter stated that

further clarification was needed to coordinate those provisions with the definitions that commenters proposed be included in the final rule. (Please see earlier discussion under “Definitions” of Section IV of the preamble, in which commenters recommended that the final rule define additional terms such as “acquisition,” “capital debt,” and “refinancing.”)

*HUD Response:* HUD agrees with the commenter’s general concerns, and has revised applicable definitions to specify potential costs in § 242.23(a), which establishes the adjusted mortgage amount for rehabilitation projects, and § 242.23 (b), which establishes the adjusted mortgage amount for refinancing and acquisitions.

This final rule revises paragraph (a) of § 242.23 to reflect the definition of the new term “capital debt” and revises new paragraph (b) of § 242.23, which was included in the proposed rule to reflect new terminology defined in this rule. In this final version, language has been added to paragraph (b), which uses new definitions for “soft costs” and replaces “indebtedness” with “capital debt” in the list of items that will provide the total mortgage amount in a rehabilitation project with an existing mortgage. Paragraph (b) is further revised in the final rule to cover acquisitions, and address the categories of hard and soft costs.

#### Mortgage Lien Certifications (Section 242.35)

This section requires the mortgagor to notify HUD in writing of unpaid liens prior to initial or final endorsement of the mortgage note. Although the proposed rule did not contain a revision to this section, the final rule modifies the mortgagor’s responsibilities to include notification of liens in connection with limited rehabilitation, which term is defined by this final rule.

#### Insurance Endorsement (Section 242.39)

The final rule amends § 242.39 to divide this regulatory section into two main parts. The existing section is designated as paragraph (a) and entitled “New Construction/Substantial Rehabilitation.” A new paragraph (b), entitled “Section 242/223(f) Refinancing/Acquisition,” is proposed to be added to address the Section 242/223(f) process. The Section 242/223(f) process, as presented in the proposed rule, provided 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 limited rehabilitation, or upon assurance

acceptable to the FHA that all required limited rehabilitation will be completed by a date certain following endorsement. Proposed new paragraph (b) provided that, in cases where advances of mortgage proceeds are used for limited rehabilitation, endorsement shall occur as described in § 242.39(a) (Insurance Endorsement) for the initial endorsement for new construction/substantial rehabilitation.

The final rule adopts these provisions, with modifications to include the new categories of definitions and to address the commenter’s concerns about insurance upon completion described in the following section.

*Comment: Make the option of insurance upon completion available for acquisition.* As noted previously under the comments to § 242.17(b), a commenter suggested that the final rule clarify that the option of insurance upon completion of any rehabilitation should be made available for acquisition as well as refinancing transactions. The commenter stated that an advantage of insurance upon completion is that it could potentially enable a determination to be made, in advance of loan closing, that the FHA-insured loan will qualify for REMIC securitization and the lower interest rates that REMIC provides. The commenter stated that this potential advantage should be made available for acquisition as well as refinancing transactions.

*HUD Response:* HUD agrees that there is no reason to limit the option of insurance upon completion to refinancing transactions. Therefore, in this final rule, HUD has revised this regulatory section, as was § 242.17, to include acquisitions. These changes do not address the commenter’s statements regarding REMIC eligibility as interpretation of the tax code is not within HUD’s statutory authority.

#### Early Commencement of Work (Section 242.45)

*Comment: Remove the 2-year aging requirement.* A commenter submitted that in § 242.45 (Early Commencement of Work), the requirement that existing capital debt be at least 2 years old is a serious threshold impediment to many hospitals that need, and would otherwise be eligible for, Section 242/223(f) refinancing. The commenter suggested language that, if added to § 242.45(b), would allow hospitals with construction less than 2 years old to apply for mortgage insurance on the same basis as hospitals whose structures are more than 2 years old.

The commenter stated that they had no disagreement with the basic purpose of § 242.45(b), which was initially

implemented by HUD in connection with its sections 221(d)(4)/223(f) and 232/223(f) multifamily and skilled nursing programs. The commenter stated that it understood that HUD's rationale was to preclude projects that were intentionally constructed with conventional short-term bank financing in order to avoid prevailing wage, inspections, and other federal construction requirements from using a section 223(f) loan as a source of refunding the sponsor's conventional financing with long-term FHA fixed rate debt.

The commenter suggested that hospitals that had and have no intention of avoiding HUD construction requirements should not be restricted. The commenter stated that any conclusion to the contrary would directly conflict with the proposed rule's public purpose to "contribute to alleviating financial stress on hospitals and maintaining the availability of hospitals in many communities." The commenter submitted that conditioning eligibility on the 2-year rule developed for an entirely different fact pattern would contravene this intention.

The commenter stated that the FHA Commissioner has waived a similar requirement in the multifamily housing program to address the lack of refinancing alternatives in the current marketplace.<sup>9</sup> The commenter suggested extending a similar policy to hospitals where a hospital can demonstrate that there was no attempt to circumvent federal requirements.

*HUD Response:* HUD declines to adopt the commenter's recommendation. The change would encourage developers to build facilities with conventional short-term bank financing in order to avoid prevailing wage, inspections, and other federal construction requirements, then attempt to refinance their short-term debt with long-term FHA-insured financing. The commenter suggests that only applicants who had no intention of avoiding the federal requirements would be allowed. HUD should not be put in the difficult, if not impossible, position of judging intent. It is HUD's position that if a hospital can demonstrate that it has no access to capital—so that the hospital may refinance to lower its debt-service burden and secure permanent long term financing—other than an FHA insured loan, the hospital may request a waiver of § 242.45(b) in connection with its request for a preliminary review.

Addressing these situations with waivers allows HUD to assess the unique circumstances presented by a hospital and make a determination whether granting of a waiver would be appropriate.

#### Labor Standards (Section 242.55)

*Comment: Remove the Davis-Bacon requirements for refinancing.* The January 29, 2010, rule proposed an amendment to § 242.55(c) to reflect that the labor standards referenced in that regulatory section, Davis-Bacon requirements, were applicable to a refinancing loan under section 223(f) of the NHA. The commenter proposed that financing be provided if the mortgagor provides a certification or other evidence that construction was undertaken in good faith without intent to avoid any requirement of section 242.

*HUD Response:* HUD determined that Davis-Bacon requirements were presently inapplicable to limited rehabilitation in connection with refinancing and, accordingly, is removing this language in the final rule.

#### Leasing of Hospital (Section 242.72)

*Comment: Establish an Operating Lease Ownership structure to meet REMIC requirements.* A commenter stated that in cases where insurance of advances is needed for a project (whether in the basic Section 242 new construction/substantial rehabilitation program or with respect to Section 242/223(f) refinancing or acquisition) the existing regulations prevent HUD from implementing a solution that would permit the insured loans to become REMIC eligible.

The commenter stated that the so-called "80 percent test" of the Internal Revenue Service provides that, as of loan origination, the value of real property securing the FHA-insured loan must be at least equal to 80 percent of the loan amount. The commenter stated that the problem is that, with insurance of advances, there is a time lag between the date of initial endorsement and the date upon which the certification of costs of improvements funded with loan advances becomes incontestable (final endorsement), during which time the value of the underlying real property can change. The commenter stated that since one cannot be assured as of the initial endorsement date whether the loan will be in compliance at the later final endorsement date, the REMIC sponsor will not provide a pricing commitment to the FHA lender reflective of REMIC eligibility and the lender in turn cannot pass on the benefit of REMIC pricing to the hospital borrower.

The commenter suggested an "alternative test" for REMIC securitization which would provide that an obligation "is principally secured by an interest in real property if substantially all of the proceeds of the obligation were used to acquire or to improve or protect an interest in real property that, at the origination date, is the only security for the obligation\* \* \*

The commenter suggested that FHA-insured loans could qualify under the alternative test if § 242.72 would permit a hospital to separate ownership of real property from non-real property (i.e., equipment). The commenter stated that this would involve an operating lease ownership structure where substantially all of the section 242 or section 242/223(f) loan proceeds would be used for financing real estate owned by the mortgagor and for improvements made to real estate. The commenter stated that the operator, not the mortgagor, would own the hospital equipment used in operating the hospital. The commenter stated that no non-real estate assets would be pledged as security for the loan, nor would any loan proceeds be used to pay for non-real estate costs.

*HUD Response:* HUD declined to adopt the commenter's recommendations. Limiting security to real estate assets would expose FHA to unacceptable risk of loss in the event of an insurance claim. Accordingly, there is no change § 242.72 as currently codified in the CFR.

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

The proposed rule amended § 242.91 to consolidate existing § 242.91 into a new paragraph (a) and to add a new paragraph (b) to provide that a mortgage given to refinance the debt of an existing hospital under section 242 of the NHA could be insured pursuant to section 223(f) of the NHA. The proposed new paragraph (b) also provided that a mortgage could be executed in connection with the purchase or refinancing of an existing hospital without substantial rehabilitation. In addition, new paragraph (b) provided that the FHA Commissioner should prescribe such terms and conditions as the Commissioner deemed 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 would be employed only to: (a) Retire the existing indebtedness; (b) pay for limited rehabilitation totaling less than 20 percent of the mortgage amount; and

<sup>9</sup> Copies of these documents and other HUD notices are available on HUD's Web page [http://portal.hud.gov/hudportal/HUD?src=/program\\_offices/administration/hudclips/notices/hsg](http://portal.hud.gov/hudportal/HUD?src=/program_offices/administration/hudclips/notices/hsg).

(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.

In response to comments submitted on this regulatory section, HUD made several revisions at the final rule stage, as described in this discussion of § 242.91.

*Comment: Revise the calculation of debt service costs.* One commenter suggested three additions to provide details on the calculation of the monthly debt service cost savings required by § 242.91(b)(1). First, the commenter suggested that HUD exclude the monthly debt service on the new 242/223(f) insured loan attributable to any new hard costs included in the insured loan. Second, the commenter suggested that HUD consider additional factors that will predictably increase monthly debt service on the loan to be refinanced above the monthly payment in effect at the time of the commitment, such as default interest rates upon the expiration of any credit enhancement facility. Third, the commenter suggested that, if the existing capital debt to be refinanced consists of more than one loan, the determination of debt service cost savings take into account the weighted average of the monthly debt service payments of the loans to be refinanced.

*HUD Response:* HUD notes that the commenter's second point is addressed elsewhere in the regulations. HUD declines to adopt the commenter's other suggestions. Namely, § 242.16(a)(3) already provides that refinancing candidates demonstrate that the interest rate is very likely to increase by one percentage point within one year of the date of application. Although they do not appear unreasonable, HUD has determined that the issues concerning exclusion of the monthly debt service on the new 242/223(f) insured loan attributable to hard costs and issues related to refinancing multiple loans should be addressed in subsequent guidance. Accordingly, this section has only been revised from the proposed regulation to reflect the newly adopted definitions of capital debt and limited rehabilitation.

## V. Applicability of Revised Part 242 Regulations

This 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.

## VI. Findings and Certifications

### *Regulatory Review—Executive Orders 12866 and 13563*

Under Executive Order 12866 (Regulatory Planning and Review), a determination must be made whether a regulatory action is significant and therefore, subject to review by the Office of Management and Budget (OMB) in accordance with the requirements of the order. Executive Order 13563 (Improving Regulations and Regulatory Review) directs executive agencies to analyze regulations that are “outmoded, ineffective, insufficient, or excessively burdensome, and to modify, streamline, expand, or repeal them in accordance with what has been learned.” Executive Order 13563 also directs that, where relevant, feasible, and consistent with regulatory objectives, and to the extent permitted by law, agencies are to identify and consider regulatory approaches that reduce burdens and maintain flexibility and freedom of choice for the public.

With respect to Executive Order 12866, this rule was determined to be a “significant regulatory action” as defined in section 3(f) of the Executive Order (although not an economically significant regulatory action, as provided under section 3(f)(1) of the Executive Order). The final rule will not have costs, benefits, or transfers greater than \$100 million.

As discussed in this preamble, this rule revises the regulations governing FHA's Section 242 Hospital Mortgage Insurance Program for the purpose of codifying, in regulation, FHA's implementation of its authority that allows hospitals to refinance existing loans and provide for acquisitions, without requiring such actions only in conjunction with the expenditure of funds for construction or renovation. The section 223(f) is not designed for the entire industry of 5,000 hospitals. The pool of applicants is limited by eligibility restrictions. At the time the proposed rule was published on January 29, 2010 (75 FR 4964), industry experts estimated that FHA would receive from 25 to 40 applications during the first year that Section 242/223(f) refinancing was offered. In fact, FHA received only 15 preliminary stage applications, and most of those were eliminated based on a failure of the hospital to meet the threshold requirements in Section 242. FHA issued only one insurance commitment for Section 242/223(f) refinancing in the amount of \$29 million.

For this final rule, HUD expects the rule to result in a \$1.26 million transfer per year, per hospital, and if refinancing

is provided to over 10 hospitals, the aggregate annual impact is \$12.59 million. A multiyear scenario, in which the number of participants increases to 17, yields an aggregate annualized transfer to hospitals of \$17.63 million by the third year of the program. HUD estimates that this program will raise net receipts of the Federal Government by \$79 million (from \$79 million to \$158 million). Costs of the rule include up-front application costs, which may be as high as \$870,000 per applicant but which are likely to be much lower given that non-FHA insured lenders impose transaction costs as well. HUD does not have enough information to quantify or evaluate the opportunity costs or distortionary effects of the program.

With respect to Executive Order 13563, HUD is offering needed refinancing authority to hospitals without FHA-insured loans. By offering this product to such hospitals, the hospitals are able to reduce their capital costs by refinancing into a lower interest rate loan through the proposed program. The opportunity to refinance to lower interest rates can also make the difference of whether a hospital can continue operating in the community it serves. The opportunity for an FHA-insured loan to refinance existing debt can reduce a hospital's probability for default and possible foreclosure and thereby also reduce the social welfare loss, in healthcare services and in jobs that result from foreclosure.

The complete regulatory impact analysis (also referred to as a cost-benefit analysis) is published at [www.regulations.gov](http://www.regulations.gov) along with this final rule, under docket number FR-5334-F-02.

The docket file is available for public inspection at [www.regulations.gov](http://www.regulations.gov) under docket number FR-5334-F-02.

### *Paperwork Reduction Act*

The information collection requirements contained in this final rule have been submitted for review and approval by OMB under the Paperwork Reduction Act of 1995 (PRA) (44 U.S.C. 3501 *et seq.*). The information collection requirements for the Hospital Mortgage Insurance (Section 242) program are assigned OMB control number 2502-2602. The information collection requirements in this final rule do not introduce new information collection requirements but make modifications to existing requirements to reflect the inclusion of regulatory text to provide refinancing for hospitals without existing FHA-insured mortgages. The sections in this rule that contain the current information collection requirements and the estimated adjusted

time to fulfill each requirement that is affected by this rule are set forth in the following table. The following table includes only the revisions to burden hours affected by the codification of the changes to HUD's regulations included in this rule to implement Section 223(f) refinancing and acquisition for hospitals.

Recently, HUD conducted a review of the paperwork burden associated with the hospital mortgage insurance program. As a result of that review, there were changes to the number of respondents, frequency of response, burden hours per response, and hourly cost per response for many data collection items affecting various aspects of the program. HUD believes that the changes lead to a much more

realistic estimate of burden hours. A modified supporting statement incorporating the results of HUD's review shows, for the same assumed annual volume of 15 Section 242 applications, 74,825 annual burden hours for an annual cost of \$7,471,875. This modified estimate of burden hours and cost became the new baseline against which program changes, or changes in program volume, were assessed.

This final rule contains provisions that increase the number of applications for Section 242 refinancing. HUD expects initially to insure five Section 242/223(f) loans per year, increasing application volume from 15 to 20, and is changing some forms and procedures. When the modified estimates of burden

hours and cost are applied to the additional volume, the results are 98,819 burden hours for an annual cost of \$9,882,200. These are the numbers that appear in the modified Supporting Statement OMB Number 2502-0602 that HUD has submitted for OMB approval. These information collection documents can be found at <http://www.reginfo.gov/public/do/PRAMain>.

The difference between the 15 applications and the 20 applications is an additional 23,994 burden hours and \$2,410,325 in cost. This is the PRA impact of introducing Section 223(f) refinancing and acquisition loans as part of the Section 242 hospital mortgage insurance program and processing five additional Section 242/223(f) applications per year.

CFR Section (related forms referenced)	Respondent universe (mortgages)	Total annual responses*	Average time per response** (hours)	Total annual burden hours**
<b>Subpart B—Application Procedures and Commitments</b>				
242.16. Applications—Prepare full application for hospital mortgage insurance. (HUD-92013-HOSP) .....	20	20	4,664	93,280
242.17. Commitments—Review HUD insurance commitment. Negotiate desired changes with HUD, and accept commitment. (HUD-92453, HUD-92432, HUD-92580) .....	20	40	18	720
<b>Subpart C—Mortgage Requirements</b>				
242.35. Mortgage lien certifications. Paragraph (d) requires the mortgagor to notify HUD in writing of all unpaid obligations in connection with the mortgage transaction, among other things. (Information is provided to HUD in a letter, not a form) .....	20	40	1	40
<b>Subpart D—Endorsement for Insurance</b>				
242.39 Request final endorsement (HUD-92023) .....	20	20	1.5	30

\* The total annual response assumes 15 Section 242 loans (including Section 241 supplemental loans and Section 223(a)(7) refinancing loans) and 5 Section 223(f) refinancing or acquisition loans.

\*\*The average response times for the sections of the rule are based on a review of recent program applications. The resulting increases in total annual burden hours reflect the adjusted average response time and the increase in the loan volume of five additional loans due to 223(f).

All estimates include the time for reviewing instructions, searching existing data sources, gathering or maintaining the needed data, and reviewing the information.

The docket file is available for public inspection. For information or a copy of the submission to OMB, contact Colette Pollard at 202-708-0306 (this is not a toll free number) or via email at [Colette.Pollard@hud.gov](mailto:Colette.Pollard@hud.gov).

In accordance with the Paperwork Reduction Act, 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 currently valid OMB control number.

*Environmental Impact*

A Finding of No Significant Impact (FONSI) with respect to the

environment was made at the proposed rule stage 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 remains applicable to this final rule and is available for public inspection at [www.regulations.gov](http://www.regulations.gov) under docket number FR-5334-F-02.

*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 would 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. At the proposed rule stage, HUD certified that this rule, if issued in final, would not have a significant economic impact on a substantial number of small entities, within the meaning of the Regulatory Flexibility Act (See 75 FR 4969). HUD continues to stand by its findings on this issue.

This final rule will expand the availability of financing for hospitals and healthcare facilities, both large and small, by FHA's offer of Section 242/

223(f) refinancing. HUD defines a small hospital entity similar to the definition used by the Centers for Medicare and Medicaid Services, 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, are eligible for Section 242/223(f) refinancing. 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. It is HUD's position that the criteria presented in this rule strikes the appropriate balance.

*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 amends 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 "acquisition," "capital debt," "hard costs," "limited rehabilitation," "refinancing," "Section 242/223(f), and "soft costs," are added in alphabetical order, and the definitions of "construction," "project," and "substantial rehabilitation" are revised to read as follows:

**§ 242.1 Definitions.**

\* \* \* \* \*

*Acquisition* means the purchase by an eligible mortgagor of an existing hospital facility and ancillary property associated therewith.

\* \* \* \* \*

*Capital debt* means the outstanding indebtedness used for the construction, rehabilitation, or acquisition of the physical property and equipment of a hospital, including those financing costs approved by HUD.

\* \* \* \* \*

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

\* \* \* \* \*

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

\* \* \* \* \*

*Limited 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 less than 20 percent of the mortgage amount.

\* \* \* \* \*

*Project* means the construction (which may include replacement of an existing hospital facility), or the substantial or limited 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 the term "project" is used.

\* \* \* \* \*

*Refinancing* means the discharging of the existing capital debt of a hospital through entering into new debt.

\* \* \* \* \*

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

\* \* \* \* \*

*Soft costs* means reasonable and customary legal, organizational, consulting, and such other costs associated with effecting the proposed

project and its financing or refinancing, including, but not limited to, interest capitalized during construction; permanent financing fees; initial service charge; tax; title and recording expenses; special tax assessments; AMPO; insurance costs during construction; FHA fees and charges, including application, commitment, and inspection fees; mortgage insurance premium for advances during construction; prepayment penalties associated with retiring the hospital's existing bonds; and termination costs for interest rate protection facilities that are integrated into the original financing, as applicable.

*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, the limited rehabilitation of an existing hospital, the acquisition of an existing hospital, or the refinancing of the capital debt of an existing hospital pursuant to Section 223(a)(7) or Section 223(f).

\* \* \* \* \*

■ 4. Section 242.15 revised to read as follows:

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

(a) 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.

(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. Amend § 242.16 as follows:

■ a. Revise paragraph (a)(2)(ii), redesignate paragraphs (a)(3) through (a)(5) as (a)(4) through (a)(6), and add new paragraph (a)(3).

■ b. Revise redesignated paragraph (a)(6) introductory text.

■ c. Revise paragraphs (b) (3), (5), and (6) and paragraph (d) to read as follows:

§ 242.16 Applications.

- (a) \* \* \*
(2) \* \* \*

(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 1.4 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 service 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 service to determine the debt service coverage ratio, hospitals must have an average debt service coverage ratio of 1.4 or greater.

(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 hospital must have an aggregate operating margin and average debt service coverage ratio as follows:

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

(B) The hospital must have an average debt service coverage ratio of at least 1.4 when calculated from the three most recent annual audited financial statements; or

(ii) If the requirements of paragraphs (a)(3)(i)(A) and/or (B) of this section are not satisfied, HUD will recast the operating margin and debt service coverage ratio for prior periods by applying its estimate of the projected interest rate at the time the mortgage is expected to close in lieu of the historical interest rate(s).

(iii) In performing the calculations called for in paragraphs (a)(3)(i)(A) and (B) of this section, if HUD finds that performance in one of the three years was affected by exceptional, one-time events that substantially altered financial performance, HUD may calculate the three-year performance based on the four most recent years with the unusual year omitted.

(iv) The hospital must document that it provides an essential healthcare

service to the community in which it operates and that its financial performance would be materially improved by refinancing its existing capital debt.

(v) The hospital may show that it provides an essential healthcare service to the community in which it operates by submitting an analysis quantifying how the community in which it presently operates would suffer from inadequate access to an essential healthcare service that the hospital presently provides if the hospital were no longer in operation.

(vi) The hospital may show that its financial performance would be materially improved by providing documentation of the following:

(A) There are limited comparable affordable refinancing vehicles available to the hospital; and,

(B) 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 bond covenants that are substantially more restrictive than the Section 242 mortgage covenants; and

(7) There are other circumstances that demonstrate that the hospital's financial performance would be materially improved by 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 and refinancing, if any; 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 limited rehabilitation to be financed with mortgage proceeds and how that limited rehabilitation will affect the hospital;

\* \* \* \* \*

(5) A study of market need and financial feasibility, addressing the factors listed in paragraphs (a)(1)(ii) and (a)(2), or (a)(3) of this section, (whichever applies), with assumptions and financial forecast clearly presented.

The study should be prepared by a certified public accounting firm acceptable to HUD. In the case of an application for Section 242/223(f) mortgage insurance, the study may not be required to address market need and there may be no requirement for involvement of a certified public 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 FHA.

\* \* \* \* \*

■ 6. In § 242.17, paragraphs (a)(2), (a)(3), (a)(4), and (a)(5) are redesignated as paragraphs (a)(3), (a)(4), (a)(5), and (a)(6) respectively, 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 limited rehabilitation: 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 and to any limited rehabilitation;

\* \* \* \* \*

(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 or acquisition financing of an existing hospital, the commitment shall provide for insurance upon completion unless insured

advances are needed for funding any limited rehabilitation approved by HUD, in which case the commitment shall provide for insurance of advances.

\* \* \* \* \*

■ 7. Section 242.18 is revised to read as follows:

**§ 242.18 Inspection fee.**

(a) 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 no later than the time of initial endorsement.

(b) In the case of mortgages where the applicant is seeking only refinancing or acquisition, the inspection fee will not exceed 10 basis points on the loan. For applicants seeking a loan for refinancing or acquisition that also involves limited rehabilitation, the commitment shall provide for an inspection fee according to the following schedule:

Hard cost % of mortgage amount	Inspection fee limit (basis points)
Less than 5% .....	10
5% or greater but less than 10% .....	20
10% or greater but less than 15% .....	30
15% or greater but less than 20% .....	40
20% or greater .....	50

■ 8. In § 242.23, paragraph (a)(2)(ii) is revised, paragraphs (b) and (c) are redesignated as (c) and (d) respectively, and new paragraph (b) is added to read as follows:

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

(a) \* \* \*

(2) \* \* \*

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

\* \* \* \* \*

(b) *Section 242/223(f) refinancing and acquisition—additional limits.* (1) In addition to meeting the requirements of § 242.7, if the hospital's existing capital 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 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 Commissioner:

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

(ii) The estimated hard costs, if any, totaling less than 20 percent of the mortgage amount; and

(iii) Soft costs that would normally be allowable in a Section 242 insured loan.

(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 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 plus the replacement cost of improvements, whichever is the lesser;

(ii) The estimated hard costs, if any, totaling less than 20 percent of the mortgage amount; and

(iii) Soft costs that would normally be allowable in a Section 242 insured loan.

\* \* \* \* \*

■ 9. In § 242.35, paragraph (d) is revised to read as follows:

**§ 242.35 Mortgage lien certifications.**

\* \* \* \* \*

(d) The mortgagor has notified HUD in writing of all unpaid obligations in connection with the mortgage transaction, the purchase of the mortgaged property, the construction, limited rehabilitation, or substantial rehabilitation of the project, or the purchase of the equipment financed with mortgage proceeds.

■ 10. Section 242.39 is 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 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.

(b) *Section 242/223(f) refinancing/acquisition.* (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 limited rehabilitation, or upon assurance acceptable to the Commissioner that all limited rehabilitation will be completed by a date certain following endorsement.

(2) In cases where advances of mortgage proceeds are used to fund limited rehabilitation, endorsement shall occur as described in paragraph (a) of this section immediately above, for new construction/substantial rehabilitation.

(c) *Contract rights and obligations.* The 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.

■ 11. In § 242.49, paragraph (a) is revised to read as follows:

**§ 242.49 Funds and finances: deposits and letters of credit.**

(a) *Deposits.* Where HUD requires the mortgagor to make a deposit of cash or securities, such deposit shall be with

the mortgagee or a depository acceptable to the mortgagee and HUD. Any such deposit shall be held in a separate account for and on behalf of the mortgagor, and shall be the responsibility of that mortgagee or depository.

\* \* \* \* \*

■ 12. 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), but including a supplemental loan under section 241 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.

\* \* \* \* \*

■ 13. Section 242.91 is revised to read as follows:

**§ 242.91 Eligibility of refinancing transactions.**

(a) *Refinancing an FHA-insured mortgage.* 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) *Refinancing capital debt not insured by FHA.* A mortgage given to

refinance the capital debt of an existing hospital that is not insured under section 241 or section 242 of the Act may be insured under this subpart pursuant to Section 223(f) of the National Housing 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 capital debt; pay for limited rehabilitation 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: January 29, 2013.

**Carol J. Galante,**

*Assistant Secretary for Housing—Federal Housing Commissioner.*

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