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FHA Boost Sought For Hospitals

HUD Aims to Help Health Care Sector

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By Gavin Murphy

LAS VEGAS — The U.S. Department of Housing and Urban Development is making a push to expand its presence in the nation's health care sector by ramping up its long-standing FHA mortgage insurance program for hospitals.

Hospitals are eying the Federal Housing Administration Section 242 mortgage insurance program as a way to get financing for projects that can qualify as they have found themselves cut off from the credit markets due to the collapse of the bond insurance business and other factors.

Speaking Friday at The Bond Buyer's 10th Annual Nonprofit Hospital Finance Conference, Steven W. Hunt, a senior account executive for HUD, said the program aims to support hospital projects by helping to reduce their cost of capital. It focuses on hospital construction but can be used for other purposes. Traditionally aimed at urban hospitals with most participants located in New York, the program is now in 43 states.

Many hospitals and their financiers ignored the program in the past because they perceived HUD's standards as too onerous, according to Alan P. Richman, president and chief executive offier of InnoVative Capital, a mortgage banking and financial advisory firm. And municipal bond deals associated with the program have been few in number and relatively small in size. But given the tightening of lending standards as a result of the financial crisis, HUD's way of doing thing is "now in vogue," Richman said.

Under the program a qualifying hospital can get an FHA-insured mortgage that can be securitized as a Ginnie Mae loan that is guaranteed by the federal government and purchased by an investor. Most current participants in the program are critical-care facilities in urban and rural areas.

Nonprofit hospitals can use the program to structure tax-exempt bond deals that seek to achieve ratings at the double-A level. More lower investment-grade or unrated hospitals that until recently could access the market by using bond insurance or selling debt to a local bank are now looking at the Section 242 program.

Nonprofits can structure a transaction that combines the backing of the FHA-insured mortgage with bank letters of credit and guaranteed investment contracts. The LOCs and GICs are used as reserves to collateralize the expense associated with negative arbitrage that results from paying interest on the bonds as proceeds are gradually drawn down for construction purposes. Despite the interest, few such deals are getting done because of the difficulty of obtaining LOCs and GICs in the current marketplace and other factors.

Richman, however, sees a potential rush by publicly owned hospitals to do deals under the Build America Bond program before it expires at the end of 2010. Such entities can issue BABs while nonprofits can't. And he expects larger municipal hospitals that traditionally have not taken advantage of the Section 242 program to be among the issuers. Such institutions in the past shunned the program because the FHA wanted to be the primary lienholder. But they may find a BAB/Section 242 deal much more compelling.

Selling taxable BABs allows the issuer to use Ginnie Mae securities in the structure, which cannot be done with tax-exempt deals. In such a taxable deal the issuer takes advantage of the 35% federal interest subsidy under the BAB program. Such deals can achieve triple-A ratings.

HUD has been working to expedite the process for approval of projects under Section 242 and has instituted preliminary reviews to give candidates more information on what it will take to quality. But those candidates need to come prepared and have their project planning documentation in order.

"Hospitals need to keep good records," said Robert A. Vento, senior vice president at Quorum Health Resoures, a hospital management company.

The Section 242 process can be “lawyer-intensive” said Patricia Hunt Holmes, a partner at Vinson & Elkins. She has worked as bond and underwriters’ counsel on Section 242 deals. Lawyers need to be familiar with HUD’s process and state law, she said, and disclosure needs to be a focus because some potential investors mistakenly believe that FHA insures the bonds. “The mortgage is insured by FHA,” Holmes said.

HUD is working to get final approval time down to about 6 months but more deal-makers are getting into line to apply and some of them don’t understand that HUD is selective, focusing on a hospital’s revenue and insisting on adequate debt-coverage ratios and other parameters.

In fiscal 2009 HUD did 43 preliminary reviews and 23 candidates didn’t make the cut to apply for the program. Nonetheless HUD’s Hunt expects 2010 to be a record year.

HUD earlier this year instituted a program to help hospitals refinance floating-rate debt that became bank debt after the auction-rate securities market collapsed as the credit crisis unfolded. But according to Richman, those coming to the program for a bailout will be disappointed.

“HUD won’t coopt the program,” he said.
