

HUD/FHA Section 242 Mortgage Insurance - Critical Access Hospitals

Eligible Projects:	Hospital construction projects, including ancillary facilities, such as garages and medical office buildings.
Use of Loan Proceeds:	FHA Section 242 Mortgage Insurance credit enhances low-interest loans to new or existing hospitals for major capital projects, including: construction, expansion, rehabilitation, remodeling, and equipment. Debt refinancing may comprise up to 80% of the insured loan.
Program Description:	Since its inception in 1968, the FHA Section 242 Program has insured over 351 mortgage loans totaling in excess of \$12.8 billion in 41 states. The portfolio is diversified among all hospital types, from critical access hospitals to major tertiary care facilities; with an overweighting in non-rated credits.
Borrowers:	Nonprofit or proprietary hospitals and all hospital related facilities where more than 50% of revenues and adjusted patient days are attributable to acute care services (provision is waived for critical access hospitals).
Minimum Financial Requirements:	Over the last three years, an average operating margin of greater than or equal to 0.0% and an average debt service coverage ratio of greater than or equal to 1.25x (exceptions can be requested). Hospitals with less than three years of CAH status, may recast their prior financial statements to reflect cost-based reimbursement for the full three year period.
Benefits of the Program:	The full faith and credit of the U.S. Government is the ultimate security for loans, and guarantees each hospital's reimbursement obligation. This results in "AAA" caliber tax-exempt and taxable borrowing rates.
Maximum Loan Amount:	No limit on the amount that can be insured, subject to a loan-to-value ratio cap of 90%. Hospitals can pledge existing assets to meet the loan-to-value test.
Loan Terms:	Construction term, plus 25 year self amortizing permanent loan. Non-recourse except for standard lender carve-outs.
Interest Rates:	Taxable and tax-exempt fixed rates.
Financing Methods:	Tax-exempt bonds (for nonprofit and municipal hospitals only). GNMA collateralized mortgage loans.
Security:	Loans must be secured by a first mortgage on the entire hospital. In certain cases, a long-term lease may be substituted. Exceptions may include leased equipment, off-site property, capital associated with affiliations, etc.
Application Process:	HUD only permits FHA-licensed mortgage lenders to apply for FHA Section 242 Mortgage Insurance on behalf of candidate hospitals. FHA 242 applications submitted by InnoVative Capital are underwritten and credit decisions are made in Washington, D.C. by HUD's Office of Insured Health Care Facilities and its Division of Engineering Services.

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Secondary Financing:	Surplus cash flow notes for proprietary hospitals and residual receipts notes for nonprofit hospitals are permitted, but with no foreclosure rights.
Certificate of Need Requirement:	In states with applicable certificate of need (CON) laws, new construction and substantial renovation projects are required to have an approved CON.
Financial Feasibility Review:	As a part of the FHA Application, the hospital must: (1) commission an externally prepared financial feasibility report documenting the need for the proposed project and (2) generate standardized financial tables as specified under the FHA 242 Program, which benchmark the hospital's performance versus industry standards and representative peer groups.
Escrows:	<p><u>Mortgage Reserve Fund</u> - Hospitals must accumulate an amount equal to 1 year's debt service after 5 years and 2 year's debt service after 10 years.</p> <p><u>Taxes/Insurance</u> - Standard monthly escrow deposits are required for all insurance, real estate taxes and mortgage insurance premiums.</p> <p><u>Working Capital</u> - Liquidity may be required in the amount of 2% of the mortgage to be posted at initial closing. For a nonprofit facility, it can be requested that working capital be capitalized within the mortgage.</p> <p><u>Operating Deficit</u> - Liquidity in an amount determined by HUD may be required at initial closing to support the payment of operating expenses and mortgage payments until the hospital reaches sustaining utilization.</p>
Transaction Costs:	<p><u>Application/Closing (these costs may be included in the loan amount):</u></p> <ul style="list-style-type: none">- FHA Application Fee - 0.15% of the loan amount.- FHA Commitment Fee - 0.15% of the loan amount.- FHA Inspection Fee - 0.50% of the loan amount.- Financing and Placement Fees - negotiated with InnoVative Capital (the FHA Mortgagee) and the hospital based on the characteristics of each prospective financing. <p><u>Annual FHA Mortgage Insurance Premium</u></p> <ul style="list-style-type: none">- 0.50% of the outstanding loan balance.
Construction Guidelines:	Davis-Bacon prevailing wage rates are required. Contractors must obtain performance and payment bonds for 100% of the construction costs. Unless prohibited by state law, construction retainage is equal to 10% of each advance, up to 50% completion of construction.
Timing:	<p>HUD has attempted to expedite the application process for CAHs. The entire FHA process, from initial review by InnoVative Capital to loan closing may be completed within nine months for a CAH. Timing can be expected to vary due to the complexity and particulars of each transaction.</p> <ul style="list-style-type: none">- Pre-Assessment Stage - Month One.- Pre-Application Stage - Months Two to Three.- Application Stage - Months Four to Eight.- Loan Closing Stage - Months Eight to Nine.

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