

# PUBLICATION

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## HUD Authorizes the Refinancing of Hospital Debt with FHA-Insured Loans

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The U.S. Department of Housing and Urban Development (HUD) recently issued a notice announcing the expansion of its hospital mortgage insurance program. Issued July 1, 2009, Notice H 09-05 advises that HUD has made a policy change permitting the refinancing of hospital mortgage debt with federally guaranteed loans under Sections 242 and 223(f) of the National Housing Act.

Section 242 of the National Housing Act was passed by Congress in 1968 to facilitate the construction and modernization of U.S. hospitals. Under Section 242, HUD, through the Federal Housing Administration (FHA), may provide certain qualified lenders with insurance against loss on defaults under loans to for-profit, not-for-profit and government-owned hospitals of all types, including acute care and critical access hospitals, large urban teaching hospitals and hospitals that are part of hospital systems. This program gives hospitals access to long-term, low-interest, fixed rate, nonrecourse loans backed by the full faith and credit of the United States government.

Under Section 223(f) of the National Housing Act, the FHA is authorized to insure 100% refinancing and acquisition loans for hospitals as well as for several types of health care and multifamily housing facilities. Many years ago, HUD implemented this authority for certain health care facilities, such as skilled nursing and assisting living facilities, and for several types of multifamily apartment projects. However, HUD has not exercised this authority with respect to hospitals until now. In other words, hospitals have not been able to refinance existing indebtedness with FHA insured loans under Section 242 unless 20% of the funding paid for capital improvement projects or the funding paid for new construction or substantial renovations. Therefore, in the last 10 years only about 65 hospitals nationwide have taken advantage of the Section 242 mortgage insurance program.

HUD's rationale for not previously implementing its power to insure 100% refinancing loans under Section 242 pursuant to Section 223(f) was that HUD believed the private capital markets provided sufficient financing options for hospitals without the need for federal loan guarantees. Due to the recent downturn in the economy and the limited options for hospitals in the private credit market to borrow funds, HUD has now determined that the time is right to implement the authority granted to it by Congress and permit 100% refinancing under the Section 242 program pursuant to Section 223(f).

HUD is now in the process of publishing official amendments to its Section 242 program regulations implementing this change. The text of the proposed amendments, which will be subject to public comment upon publication in the *Federal Register*, is contained in Notice H 09-05. The proposed amendments provide that a hospital must have maintained an aggregate operating margin of at least 0.33% and an average debt service coverage ratio of at least 1.80% for the last three years in order to be eligible for a Section 242/223(f) loan. In addition, the hospital must have experienced an increase in its interest rate of at least 1% since January 1, 2008 as a result of the credit crisis or must demonstrate that such an increase is imminent.

The maximum mortgage loan amount permitted under the new Section 242/223(f) program cannot exceed the cost to refinance the existing indebtedness, which includes the payoff amount, reasonable and customary legal, organizational, title and recording expenses, costs of any repairs totaling less than 20% of the new

mortgage amount, fees paid to the HUD-approved lender providing the loan and professional and inspection fees. The new proposed amendments to the regulations also contemplate that the Section 242/223(f) program may be used to finance the costs of acquiring a hospital.

If you have questions about these developments, please contact your Baker Donelson attorney.