

FHA Section 242

Eligibility:

To qualify for the Sec. 242 program, a facility must principally be an acute care hospital with no more than 50% of revenues attributable to the following services: chronic convalescence and rest, drug and alcohol, epileptic, nervous and mental deficiency and tuberculosis. Through the end of the project and for two fiscal years thereafter, the hospital must anticipate revenues earned by the above services will not exceed 50% of total revenues.

Over the last three full fiscal years, the average operating margin must be positive, and the average debt-service coverage ratio must be equal to or greater than 1.25.

Maximum Loan Amount:

There is no limit on the amount that can be financed. However, the loan-to-value ratio may not exceed 90%. In meeting the 90% loan-to-value test, a hospital may include as equity the net remaining value of its existing property, plant and equipment.

Maximum Term:

The maximum term is 25 years from initial principal payment after construction is complete. Principal amortization is calculated to produce level principal and interest payments. The construction period is interest only.

Interest Rate:

The interest rate is fixed, subject to market conditions at rate lock for taxable debt or at closing for tax-exempt bonds.

Liability:

Loans insured by the 242 program are secured by a mortgage and pledge of revenues related directly to the project. Collateral pledged for 242 program loans may not be part of an obligated group or be used as collateral for other debt. Subject to attainment of certain debt service coverage and liquidity levels, hospitals utilizing the 242 program may transfer excess cash flow to parent health systems or hospitals.

Funding Options:

Nonprofit hospitals can utilize mortgage insurance as credit enhancement to issue tax-exempt bonds. Depending on market conditions, a commercial bond insurer may be utilized to achieve an "AAA" bond rating. Of note, nonprofit organizations may elect to issue taxable notes in conjunction with GNMA mortgage insurance to achieve the equivalent of an "AAA" bond rating.

For-profit hospitals can utilize mortgage insurance in conjunction with GNMA mortgage insurance to issue collateralized securities.

Security:

The hospital must grant the 242 program lender a first mortgage on the entire hospital, including all real estate and improvements being financed. (Note: Exceptions may include leased equipment, off-site property, capital associated with affiliations, city- and/or county-owned facilities, etc.)

Escrows:

Standard monthly escrow deposits are required for all insurance, real estate taxes and mortgage insurance premiums.

Over the initial five years of principal amortization, the 242 program requires that participants accumulate a mortgage-reserve fund balance equal to one year's annual net debt service. From year six to year 10, the hospital must build the mortgage reserve fund balance to two year's annual net debt service.

If tax-exempt bonds are issued, rating agencies and investors will require a debt-service reserve fund equal to one year's annual net debt service, as well as sufficient cash escrows and/or letters of credit to cover negative arbitrage during the construction period.

Costs & Expenses:

Fixed closing costs include:

- 0.30% FHA application fee, one-half paid with application, one-half at closing
- 0.50% FHA inspection fee

Variable closing costs include:

- 2.00% to 5.50% for financing expenses (including mortgage bankers, investment bankers, attorneys and rating agencies)
- \$25,000 to \$100,000 for an examined financial forecast

Annual expenses (based on outstanding principal amount):

- 0.50% annual FHA mortgage insurance premium, first year paid at closing

Construction Guidelines:

Davis-Bacon prevailing wage rates apply to new construction, additions and substantial rehabilitation projects.

Timing:

The entire process can be completed in as little as six to nine months and is divided into four phases outlined in the table below. Actual processing times vary depending on the project.

Stage	Purpose	Estimated Time
Pre-assessment Phase	Provide HUD with basic information on project.	Third month
Pre-application Phase	Arrange visit to HUD's headquarters for half-day meeting to present and discuss further detail about the project.	Fourth month
Application Phase	Complete full application for HUD's review, including a financial examination. After submission, HUD's goal is a 60-day application processing period.	Fifth and sixth months
Closing Phase	Complete funding documentation and issue debt.	Seventh and eighth months