

Health Law Alert

A report
for clients
and friends
of the Firm July 2009

FHA Announces New Capital Access Program for Hospitals

On July 1st, the Federal Housing Administration (FHA) announced that it was taking immediate steps to implement a statutorily authorized, but previously unused, capital financing program for hospitals. Specifically, FHA said it was using its authority under section 223(f) of the National Housing Act (the “223(f) Refinancing Program”) to approve the refinancing of hospital debt, in conjunction with financing under its section 242 hospital mortgage insurance program (the “242 Program”), without conditioning such refinancing on new construction or renovation, as is currently required under the 242 Program.

In its notice, FHA said it was taking this action because “the downturn in the economy, which has adversely affected the availability of credit for consumers and homeowners and businesses, is increasingly affecting the financing needs of hospitals and other health care facilities.” The FHA statement concludes that “at a time when the demand for health care services are on the rise, the lack of access to capital has made it difficult for hospitals to obtain financing for facility, equipment, and technology needs, as well as meet obligations on existing debt.”

In May of this year, the American Hospital Association (AHA) had urged the federal government to enhance the 242 Program to ease access to capital. In a letter to the House Financial Services Committee, the AHA said “hospitals’ inability to refinance existing debts has forced many to divert needed patient care resources to pay down current obligations, often at accelerated rates.”

FHA’s action offers the prospect of relief to hospitals facing debt repayment balloons on commercial debt or increases in interest rates under current loans. Significantly, under FHA’s proposed 223(f) Refinancing Program, there is no requirement for construction or renovation. The 242 Program’s requirement for hard costs of construction and equipment to represent at least 20% of the total mortgage amount has been a deterrent to some hospitals seeking to refinance existing debt. Also of benefit to hospitals, FHA may waive the preapplication meeting that is required under the 242 Program and also may waive the market need study, which under the 242 Program is a substantial up-front cost for hospitals that also can delay the application process. In theory, at least, applications under the 223(f) Refinancing Program could get to a firm commitment sooner than applications under the 242 Program, because 223(f) eliminates many of the requirements associated with construction and renovation underwriting.

In its notice, FHA also said that applicants must demonstrate that they have experienced an increase in interest rates of at least 1% since January 2008, as a result of the credit crisis, or must demonstrate that such an increase is imminent. FHA also indicated that applicants must demonstrate that they have operated over the past three years with an operating margin of at least 0.33% and a debt service coverage ratio of not less than 1.8%. These tests are somewhat more restrictive than the margin and debt service coverage minimums of 0% and 1.5%, respectively, for financing under the current 242 Program. However, some FHA lenders have already suggested to us that it is possible that these more difficult tests will be relaxed following public comment on the notice and, in addition, FHA’s notice states that it may use estimates of projected interest rates, in lieu of the historical interest rates, to calculate the operating margin and debt service coverage ratios for prior periods.

The 223(f) Refinancing Program will continue to require a maximum 90% loan-to-value; a minimum of 50% of a hospital's patient days must acute care days; first liens are required on property, plant and equipment; and a mortgage reserve fund must be established. These are all features of the current 242 Program. Although not required, projects under the 223(f) Refinancing Program may include new construction or equipment elements, but if included, the hard costs of construction and equipment must not exceed 20% of the total mortgage amount. If mortgage proceeds are to be used for an acquisition of a hospital, which is permitted, then the maximum mortgage amount must not exceed the cost to acquire the hospital and other related transaction and project costs.

The U.S. Department of Housing and Urban Development (HUD), the administrator of FHA, plans on publishing a rule, with a 60-day public comment period, to amend the applicable regulations in 24 C.F.R. Part 242 to incorporate the provisions relating to the Section 223(f) Refinancing Program. Nonetheless, FHA is inviting hospital refinancing applications, and pre-application meetings, before the rule is published and during the pendency of the public comment period.

Proskauer Rose LLP is closely monitoring developments in connection with the 242 Program as well as the new 223(f) Refinancing Program, and is representing hospital clients in connection with this important, new capital access initiative. If you have further questions concerning either Program, or debt refinancing generally, please contact either Richard J. Zall at 212.969.3945, or Julia McMillen at 212.969.3793.

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