

1  
2  
3  
4  
5  
6  
7

# Section III Asset Management

## Chapter 3 General Loan Oversight

### 3.0.0

### Introduction

8  
9 This chapter addresses details of loan servicing for projects insured under the Section 232  
10 Program covered by this Handbook, and the related necessary actions for the ~~Project~~project  
11 (consisting of the Borrower, Operator, Master Tenant (if applicable) and Management Agent),  
12 ~~Mortgagee/Servicee~~Lender and the Office of Residential Care Facilities' (ORCF) Account  
13 Executives (AE). For the purposes of this chapter, the term "~~Mortgagee/Servicee~~Lender" means  
14 the primary servicer responsible for servicing the mortgage loan, whether such party is the  
15 originating Lender or third-party servicer for the originating Lender.

16  
17 ORCF provides asset and risk management of all Section 232 insured projects; however  
18 ~~Mortgagee/Serviceers~~Lenders must also provide routine reviews of their portfolio, which includes  
19 quarterly and annual reviews of financial performance as discussed in Asset Management,  
20 Chapter 4, as well as special reporting to the AE when a project's performance is at risk. ~~This~~  
21 ~~chapter, as discussed in Section I, Chapter 2, Section 2.10. E. and in this Chapter, Section 3.10~~  
22 ~~below. This chapter also~~ provides guidance regarding performance benchmarks for each project,  
23 and also regarding the necessary actions to be taken by ~~the Mortgagee/Servicee~~theLender, AE  
24 and project in specific circumstances during the life of the FHA insured mortgage.

25  
26 Many tools and resources are posted on the Section 232 Program website, to include submission  
27 checklists, average processing times, and other helpful information that can provide  
28 supplemental guidance to this Handbook.

29  
30 This chapter concerns general loan oversight. In some instances, Section 232 loans may also be  
31 subject to project based rental assistance contracts or other Use Agreements. ORCF works in  
32 coordination with the Office of Multifamily Housing in oversight of these programs.  
33

## Section 3.1

# Servicing and Monitoring of Construction Projects

### 3.1.1

### Introduction

This section provides ORCF asset management guidance for Section 232 and 241(a) mortgage loans that include lease-up of units (new construction, substantial rehabilitation and Section 241(a)) (“Construction Projects”).

The risks inherent during the construction and lease-up processes necessitate heightened Mortgagee/ServiceeLender attention during those periods, as well as strong production/asset management coordination within the Mortgagee/Servicee’sLender’s organization. The risks also necessitate strong Mortgagee/ServiceeLender leadership and coordination with all involved parties.

~~Within ORCF, and in light of the unique risks inherent during construction and lease-up, a Construction Project will typically (though not invariably) be initially assigned to an AE on a servicing team focused on servicing such properties (a “lease-up” servicing team). Generally the lease-up AE will then service the property until it reaches sustaining occupancy (see Sec. 3.1.3.A.2.f). Although the AE will be the primary facilitator within ORCF, during the lease-up process the AE will, where appropriate, draw upon the participation of the ORCF Underwriter, Closer, Construction Manager, Appraiser and others within ORCF, as well as the assigned closing attorney from the HUD Office of General Counsel (OGC).~~

In its leadership role, and in close coordination with the lease-up AE, the Mortgagee/ServiceeLender is expected to assemble--and electronically convene frequently (typically at least monthly)--a resource team to assist the Mortgagee/ServiceeLender in project monitoring. This “Project Monitoring Team” shall include where appropriate and without limitation the Borrower, Operator, Management Agent and ORCF. Drawing upon the information and expertise thus available, the Mortgagee/ServiceeLender shall monitor the actual lease-up progress compared to the projected (underwritten) progress, and shall assure that its Borrower identifies and carries out steps to remedy unfavorable variations between projected and actual progress.

### 3.1.2

### Loan Committee Presentation and Initial Closing

Just as the Mortgagee/ServiceeLender coordinates its own production and asset management functions, so too does ORCF. In that regard, to ensure that the lease-up AE has the opportunity

73 to fully appreciate the issues, objectives and risks of the construction loan, the lease-up AE's  
74 assignment will typically begin with attendance and participation in the project's loan committee  
75 presentation. Then, upon issuance of a Firm Commitment, the ORCF Closer staff will facilitate  
76 many functions necessary for the Initial Closing, and the AE will work with the Closer and/or the  
77 ORCF Construction Manager where needed, leading up to Initial Closing.  
78  
79

### 3.1.3

## Asset Management Functions after Initial Closing

80  
81 ~~The lease~~Lease-up-AE's activity after Initial Closing varies according to the type of loan, which  
82 determines the asset management lead-time provided by construction.  
83

84 A. **Projects Having No Operations During Construction.** In the case of a Section 232  
85 construction loan where there are not existing operations that will continue during  
86 construction (new construction and some substantial rehabilitation projects), the project's  
87 construction phase will typically consume many months, during which time the ~~AE's~~  
88 ~~duties~~Lender's coordination with AE will be minimal. ~~When a project of this type~~  
89 ~~reaches minimal until~~ the point of 70% completion (calculated as a percentage of construction  
90 draws), ~~the AE will commence ORCF's pre-operations asset management functions.~~  
91

92 1. **Pre-Operations Activities.** When this type of project is scheduled to open within the  
93 following quarter, the ~~AE~~Lender will begin to work closely with ~~the~~  
94 ~~Mortgagee/Servicee~~the AE and , project participants ~~and ORCF colleagues~~ to help  
95 assure a successful transition and business start-up.

96 a. ORCF Staff Communications. The AE, the Construction Manager and the  
97 assigned Closer will communicate after Firm Commitment to ensure that all  
98 parties are aware of the project assignment. If project issues arise, the AE will  
99 participate as necessary to ensure appropriate resolutions. To keep the AE  
100 informed about construction progress, the Construction Manager will send an  
101 email notification to the AE when a new construction project reaches 70%  
102 completion.

103 b. Pre-Operations Meeting. When a new project reaches 70% completion, the ~~AE~~  
104 ~~will confer with the Mortgagee/Servicee regarding convening a Project~~  
105 ~~Monitoring Team (referenced above in the Introduction, 3.1.1).~~ ~~The~~  
106 ~~Mortgagee/Servicee~~Lender, in coordination with the AE, will arrange and  
107 facilitate a Pre-Operations Meeting of this Project Monitoring Team. Before  
108 doing so, however, the ~~Mortgagee/Servicee~~Lender will, in coordination with  
109 the AE, collect project status information as needed and determine the  
110 appropriate participants and agenda.

111 i. The agenda for this introductory Pre-Operations meeting will generally  
112 include, among other topics:  
113 1. Introductions  
114 2. Pre-opening checklist, which the Borrower and Operator can  
115 use for guidance during start-up (Please see the Section 232  
116 Program website.)

- 117 3. Borrower’s summary of the marketing plan and current project  
118 status  
119 4. Status of all state permits, i.e. Operating License,  
120 Medicaid/Medicare certifications  
121 5. Discussion of the Initial Operating Deficit (IOD) tracking  
122 worksheet (Please see the Section 232 Program website)  
123 6. Proper registration in the Business Partner Registration System  
124 (BPRS)  
125 7. Assurance of borrower, operator and management agent’s  
126 familiarity with the requirements of their respective regulatory  
127 agreements/certifications and other controlling documents  
128 ii. A suggested draft Pre-Operations Meeting agenda will be provided on  
129 the Section 232 Program website.  
130 c. Project Monitoring Strategy and Action Plan. The ~~Mortgagee/Servicee~~  
131 ~~should~~Lender needs to ensure that, upon completion of the Pre-Operations  
132 Meeting, all participants have a clear understanding of the  
133 borrower’s/operator’s plan/strategy to reach self-sustaining  
134 ~~operational~~performance, including problems identified, steps to address them,  
135 persons responsible, and benchmarks/timelines for follow-up. If  
136 necessaryapplicable, the ~~Mortgagee/Servicee~~may choose toLender shall  
137 memorialize in writing any conclusions, agreements, follow-up assignments,  
138 information requests, additional meetings ~~scheduled~~scheduled, etc.  
139

## 140 2. Ongoing Asset Management Activities (After Project Opening)

- 141 a. General. The ~~Mortgagee/Servicee~~Lender will monitor the project’s  
142 performance in accordance with the plan established, and will meet with  
143 project participants as scheduled. This includes facilitating the (monthly)  
144 Project Monitoring Team meetings, in which the ORCF AE and, where  
145 appropriate, other ORCF representatives, will participate, and in which actual  
146 progress is compared with projected progress, and any corrective steps are  
147 identified, along with persons responsible, target completion dates and  
148 benchmarks for progress..as appropriate.  
149 b. IOD tracking. The ~~AE~~Lender must approvehave any releases of IOD funds  
150 ~~and will seek to ensure that~~approved by the ~~funds~~AE. ~~These funds~~ are to be  
151 used judiciously by carefully tracking project performance and the availability  
152 of remaining funds. Further information regarding IOD funds is provided in  
153 the Escrow Accounts section of this chapter.  
154 c. IOD/Lease-up Tracking Worksheet. A project-specific IOD/Lease-up  
155 tracking worksheet, Initial Operating Deficit Escrw Calculation Template  
156 (Form HUD-91128-ORCF), will be generated based upon the assumptions  
157 regarding the project’s lease-up, and is to be completed on a cash basis. The  
158 AE will forward the IOD/Lease-up Tracking Worksheet to the  
159 ~~Mortgagee/Servicee~~Lender to be forwarded to the Borrower with other  
160 materials for the Pre-Operations Meeting. ~~Mortgagee/Servicee~~Lenders must  
161 instruct Borrowers to complete and submit the Worksheet on a monthly basis  
162 to the ~~Mortgagee/Servicee~~Lender, who will review and promptly make

163 available to the ORCF AE. The Worksheet will provide the AE with the  
164 project performance documentation and justification necessary for releasing  
165 funds from the IOD escrow account. This worksheet should be addressed  
166 during the Project Monitoring Team meetings. Note that this worksheet is  
167 important in lease-up transactions even when an IOD is not used; the  
168 worksheet serves as an important tool for tracking actual versus projected  
169 performance.

- 170 d. Operating Reports. The ~~Mortgagee/Service~~Lender and AE need regular  
171 project performance data to assess the overall health of the project. The IOD  
172 Tracking Sheet will provide them with a trended summary of monthly  
173 occupancy, revenue and expenses. The AE might also require that periodic  
174 financial statements (e.g., Balance Sheet, Statements of Profit/Loss, Cash  
175 Flows, Retained Earnings, Computation of Surplus Cash, AP and AR Aging  
176 Analysis) be submitted depending on how the project is performing. The  
177 HUD Monthly Accounting Reports (MAR) can provide valuable data as well.
- 178 e. Performance on surveys, inspections and certifications. Projects must survive  
179 initial regulatory scrutiny. Skilled Nursing Facilities (SNF) in all states  
180 undergo initial CMS compliance surveys in addition to Medicare and  
181 Medicaid certification reviews. Assisted Living Facilities (ALF) and Board &  
182 Care Facilities (B&C) are inspected in accordance with respective state rules.  
183 Issues with surveys and inspections can lead to lost or delayed revenues at a  
184 point where a new project's financial base is fragile. The  
185 ~~Mortgagee/Service~~Lender must communicate closely with Borrowers and  
186 Operators to remain abreast of progress on early regulatory reviews and must  
187 keep the AE informed.
- 188 ~~f. iREMS updates to the project record. The AE must carefully track and~~  
189 ~~summarize project start-up status in iREMS. Monthly entries are~~  
190 ~~appropriate. Achievement of Sustaining Occupancy. For servicing purposes, a~~  
191 ~~project of this type attains Sustaining Occupancy when all escrows established~~  
192 ~~at closing (other than long-term escrows) are released but then only if the~~  
193 ~~project also demonstrates, over a six (6) consecutive month period:~~
- 194 ~~f. An average Debt Service Coverage Ratio (from operations) equal to or greater~~  
195 ~~than 1.45 (Achievement of Self-Sustaining Performance. A Section 232 NC~~  
196 ~~project attains self-sustaining performance when it is a Finally Endorsed loan~~  
197 ~~and demonstrates six (6) months of:~~
- 198 i. ~~Positive net operating income (NOI) including funding of all~~  
199 ~~required escrows),~~
  - 200 ii. ~~Timely and full mortgage payments on a Finally Endorsed~~  
201 ~~loan, and~~
  - 202 iii. ~~No regulatory issues~~

203  
204 When ~~Sustaining Occupancy~~self-sustaining performance is acknowledged by  
205 the AE, the project, if serviced by a lease-up AE, (see B below), will  
206 generally be transferred to an AE on a regular servicing team for routine  
207 monitoring and servicing.  
208

209 B. **Projects Continuing Existing Operations During Construction.** For Section 232 and  
210 241(a) construction loans where existing operations will continue during construction  
211 (including some substantial rehabilitation projects), the AE ~~must begin~~begins asset  
212 management duties with respect to the new loan immediately after Initial Closing. Typically  
213 the ORCF servicing (for both the new loan and, if applicable, the existing loan) will be  
214 assigned to an AE on the “lease-up” servicing team for these transactions. ~~However, on~~  
215 ~~241a, with the exception of some 241(a) transactions in which the debt service coverage~~  
216 ~~ratio for both loans exceeds 1.45 based on current revenue, the project will not likely be~~  
217 ~~transferred to a lease-up AE for servicing.~~

- 218
- 219 1. General. Servicing of these loans generally involves all the elements and challenges  
220 of a new construction transaction, *plus* all the requirements related to ongoing  
221 servicing of a project currently in operation. Additionally, the element of  
222 construction itself can create risk to the project due to resident, visitor and staff safety  
223 issues. Furthermore, renovating existing projects often uncovers project issues that  
224 were unknown at the time of underwriting, and the scope, duration and cost of  
225 construction sometimes changes. Those unexpected changes may raise asset  
226 management issues that require the the ~~Mortgagee/Servicer’s~~Lender’s and AE’s  
227 attention.  
228
  - 229 2. Timing. Upon Initial Closing of the loan the ~~AE, having participated in Loan~~  
230 ~~Committee and gained information about the transaction, will promptly initiate~~  
231 ~~project~~Lender should expect to commence communications ~~and commence project~~  
232 ~~monitoring and servicing functions related to the new loan. with the AE.~~  
233
  - 234 3. Initial Meeting. Although not a “Pre-Operations” meeting (as was the case above  
235 involving a completely new facility), the ~~AE~~Lender will confer with the  
236 ~~Mortgagee/Servicer~~AE regarding first convening an initial meeting (conference call)  
237 of the Project Monitoring Team (referenced above in the Introduction, 3.1.1). The  
238 ~~Mortgagee/Servicer~~Lender, in coordination with the AE, will arrange and facilitate  
239 this initial meeting. Before doing so, however, the ~~Mortgagee/Servicer~~Lender will, in  
240 coordination with the AE, collect project status information as needed and determine  
241 the appropriate participants and agenda. That initial meeting will typically cover,  
242 without limitation: Review of issues and plans for resolution
    - 243 a. Borrower’s summary of the plan to continue operations during construction
    - 244 b. Review of issues and plans for resolution, if any
    - 245 c. Review the status of all permits (e.g., Certificate of Occupancy, operating  
246 license, etc.)
    - 247 d. Discussion of working capital and IOD/Lease-up tracking, as applicable
    - 248 e. Confirmation or discussion to ensure registration in the BPRS
    - 249 f. Assurance of borrower, operator and management agent’s familiarity with the  
250 requirements of their respective regulatory agreements/certifications and other  
251 controlling documents, such as quarterly financial reporting
    - 252 g. Status of progress toward final closing
    - 253 h. Scheduling of the subsequent (monthly) meeting of the Project Monitoring  
254 Team

255  
256  
257  
258  
259  
260  
261  
262  
263  
264  
265  
266  
267  
268  
269  
270  
271  
272  
273  
274  
275  
276  
277  
278  
279  
280  
281  
282  
283  
284  
285  
286

4. Project Monitoring Strategy and Plan. The ~~Mortgagee/Servicer~~ Lender needs to ensure that, upon completion of the initial meeting, all participants have a clear understanding of the borrower's/operator's plan/strategy to reach self-sustaining occupancy performance, including problems identified, steps to address them, persons responsible, and benchmarks/timelines for follow-up. The ~~Mortgagee/Servicer~~ Lender should memorialize in writing promptly after this meeting (and subsequent monthly Project Monitoring Team meetings) any conclusions, agreements, follow-up assignments, information requests, additional meetings scheduled, etc. The ~~Mortgagee/Servicer~~ Lender should ensure that IOD/Lease-up Tracking Worksheet is updated for these meetings, as a tool for comparing actual versus projected progress.
5. Achievement of Self-Sustaining Occupancy Performance. See definition in Sec. A.2.f above. ~~When Sustaining Occupancy is reached, If the project, if it had~~ has been ~~with~~ assigned to a lease-up AE, when self-sustaining performance is reached, it will typically be assigned/reassigned to an AE on a ~~regular~~ routine servicing team for ~~routine monitoring and servicing.~~

C. **Projects Having Early Start of Construction.** With projects that are approved for early start of construction, the AE will be alerted to the project by the Underwriter, and the Construction Manager will monitor the construction activities. If a Firm Commitment is issued, the AE will immediately initiate asset management functions. Similar to other construction loans, the AE will work with the ~~Mortgagee/Servicer~~ Lender, who will, drawing on the Project Monitoring Team, make an initial risk assessment, define a monitoring plan, and specify reports requirements.

After Firm Commitment, projects that have been previously approved for early start will thereafter be monitored in accordance with the asset management guidelines above for the specific type of construction loan until the project attains Self-Sustaining Occupancy Performance (as discussed above).

287  
288  
289  
290  
291  
292  
293  
294  
295  
296  
297  
298  
299  
300  
301  
302  
303  
304  
305  
306  
307  
308  
309  
310  
311  
312  
313  
314  
315  
316  
317  
318  
319  
320  
321  
322  
323  
324  
325  
326

## Section 3.2

---

# Escrow Accounts

### 3.2.1 Introduction

A. **Residential Care Facilities:** An FHA-insured project will typically have one or more of the following types of escrow accounts (each one, hereinafter referred to individually, as an “Escrow Account” and collectively, as the “Escrow Accounts”):

- 1. Reserve for Replacement (Refer to 3.2.2 below)
- 2. Residual Receipts (Refer to 3.2.3 below)
- 3. Non-Critical Repairs (Refer to 3.2.4 below)
- 4. Sinking Fund (Refer to 3.2.5 below)
- 5. Mortgage Reserve/Debt Service (Refer to 3.2.6 below)
- 6. Initial Operating Deficit (Refer to 3.2.7 below)
- 7. Working Capital Escrow (Refer to Production, Chapter 2)

B. **Escrow Accounts:** Each Escrow Account has a specific purpose, but all such accounts are intended to protect the interest of the Borrower and FHA mortgage insurance fund. Escrow Accounts are either required by Federal regulations, Regulatory Agreements, contractual agreements established during the underwriting of a project loan or contractual agreements executed subsequent to an initial loan closing. The Escrow Accounts are required to be used for specific purposes as outline in this chapter or in the escrow agreement. The disbursement process requires cooperation between ORCF, the Borrower and the Mortgagee/Service Lender. This chapter sets forth the general requirements for the maintenance of Escrow Accounts and the procedures to request a withdrawal or disbursement from each of the accounts.

C. **Pending Loan in Review:** If an existing FHA-insured project has a pending application for a 223(a)(7) loan refinance or for any other FHA program, the Borrower must disclose information to the Mortgagee/Service Lender and AE on a pending loan application of any request for a disbursement from an Escrow Account. Large unanticipated withdrawal requests may affect the financial information required for ORCF to process the pending loan application.

D. **Specific Escrow Requirements:** ORCF may determine that a requirement that applies to one type of Escrow Account is also applicable to another Escrow Account.



## 3.2.2

## Reserve for Replacement (R4R) Account

327  
328  
329  
330  
331  
332  
333  
334  
335  
336  
337  
338  
339  
340  
341  
342  
343  
344  
345  
346  
347  
348  
349  
350  
351  
352  
353  
354  
355  
356  
357  
358  
359  
360  
361  
362  
363  
364  
365  
366  
367  
368  
369  
370  
371

### A. Introduction and Applicability.

The Regulatory Agreement for projects financed with FHA-insured mortgages provides that the Borrower must establish and maintain an account to help defray the costs of replacing a project's capital items (the "Reserve for Replacement Account" or "R4R Account"). The R4R Account is held as a separate account with the Mortgagee/Service Lender or in a safe and responsible depository designated by the Mortgagee/Service Lender. Initial deposits to the account are to be made in cash at the time of the loan closing, if required. The Borrower is required to begin making monthly deposits into the R4R Account on the date that the Borrower begins making payments to amortize the principal of the FHA-insured mortgage, or on such other date as may be approved by ORCF in writing. The monthly amount to be deposited in the R4R Account is set forth in the Regulatory Agreement which provides that the account is under the control of the Mortgagee/Service Lender.

Disbursements from the R4R Account, whether for the purpose of effecting replacement of structural elements or mechanical equipment of a project; to cure a mortgage default; or for any other approved purpose, may be made only with the prior written consent of ORCF (or under the provisions whereby HUD allows Mortgagee/Service Lenders to review R4R releases outlined in this chapter). ~~For HUD held mortgages, the Secretary will exercise control over the R4R Account pursuant to the authority granted under the National Housing Act.~~ The following are some of the key requirements for a R4R Account:

1. Custodial Escrow Account. The R4R Account must be maintained as a custodial escrow account. The funds in the R4R Account may be combined or commingled with other escrow accounts; however proper disclosures must be made (~~forming the~~ Master Agreement for Servicer's Escrow Custodial Account, (Form HUD-11720) and the requisite systems must be in place to properly account for each type of escrow.
2. Interest Earned on Account. ORCF encourages and in some cases requires that interest earned on the R4R Account remain in the account. Interest may never be disbursed directly to the Borrower of a project or directly to any individuals associated with the Borrower (except for approved releases pursuant to 3.2.2.H of this Chapter). All interest earned must flow through the accounts of the project and must be disclosed on the project's accounting records.
3. Mortgagee/Service Lender Charges for Handling Investments of the reserve fund. If a Mortgagee/Service Lender proposes to assess charges for investing the reserve fund, the fees or charges for making or accepting investments must be set forth in an agreement between the Mortgagee/Service Lender and the Borrower, and may only be collected according to said agreement.
4. Type of Account. Funds may be deposited with the Mortgagee/Service Lender in the form of cash. If funds in the R4R Account and all Escrow Accounts are invested, such funds must be invested in (a) an interest-bearing account insured or guaranteed by the Federal Deposit Insurance Corporation, National Credit Union Association, or

any United States of America insurance program, or (b) obligations of the Federal Government, including money market or other fund accounts limited to investments in such obligations. All funds, whether in the form of a cash deposit or invested in obligations of, or fully guaranteed as to principal by, the United States of America shall at all times be under the control of the Mortgagee/Service Lender. ORCF is not establishing specific liquidity requirements for the R4R Account. The Borrower, not the Mortgagee/Service Lender, is responsible for deciding the liquidity requirements of funds held in the R4R Account. The Borrower should maintain some portion of its reserves in the form of very liquid assets such as passbook savings accounts. As a guideline only, and depending on the specific project, \$1,000/unit should be enough to meet minimum liquidity requirements for some projects.

**NOTE: ALL MORTGAGORS SHOULD BE CAUTIONED.** If any principal is lost as a result of an early or premature liquidation of an investment that is caused by an owner's requested withdrawal from the R4R Account, the lost principal must be repaid to the R4R Account. This repayment must come from non-project funds and be made by the persons who own the borrower entity, by persons with a controlling interest in the project, or by such affiliated/related parties as the project's sponsors. This caution is particularly important for non-profit mortgagors. Accordingly, the terms and durations of investments should be selected prudently and with great care.

5. Regulatory Agreement Not Modified. Nothing contained in this Section 3.2 shall be deemed to modify the terms and conditions of the Regulatory Agreement.

**B. Realty vs. Non-Realty (a.k.a. Major Movable) R4R Funds.**

ORCF no longer recommends that FHA-insured projects maintain two R4R accounts (realty and non-realty). If the project has two R4R Accounts, the Mortgagee/Service Lender, with consent of the Borrower, may combine the two accounts into one account.

**C. Qualified Repair or Replacement Expenses.**

The purpose of the R4R Account is not to provide for a dollar for dollar ability to replace all building structural components and equipment as they wear out, but rather to provide a readily available source of capital to help defray the cost of replacing building structural components and equipment in the latter years of the project. The R4R Account shall not be considered as the primary source of funds for capital project ~~repairs and~~ replacements, but only as a supplemental source of funds to offset the replacement of capitalized assets that are part of the mortgaged security, commonly listed in the PCNA. Borrowers should also maintain a repair, maintenance and/or replacement fund in the annual operating budgets of Section 232 FHA-insured projects. The R4R account is also not for routine maintenance. The following are eligible uses ("Qualified Expenses") for the R4R Account:

1. Capital items including, but not limited to:
  - a. Replacement of windows in the project.
  - b. Extensive replacement of kitchen and bathroom sinks and counter tops, bathroom tubs, water closets, and doors (exterior and interior).

- c. ~~Major roof repairs~~Roof replacement, including major replacements of gutters, downspouts, and related eaves or soffits.
- d. ~~Major plumbing~~Plumbing and sanitary system ~~repairs~~replacement, preferably with water saving features.
- e. Replacement or major overhaul of central air conditioning and heating systems, including cooling towers, water chilling units, furnaces, stokers, boilers, and fuel storage tanks.
- f. ~~Overhaul~~Replacement or major overhaul of elevator systems.
- g. Major repaving/resurfacing/seal coating of sidewalks, parking lots, and driveways of the project.
- h. Repainting of the entire building exterior. Major painting of interior spaces, such as all common areas being repainted at one time, may be considered eligible. (Re-painting of individual rooms is considered routine maintenance, and not eligible.)
- i. Extensive replacement of siding.
- j. Extensive replacement of exterior (lawn) sprinkler systems.
- k. Major carpet replacement (e.g. multiple room replacements or entire common area of a project).

Generally, the following items are Qualified Expenses, provided that they are not a routine maintenance item: office/common area/unit equipment, appliances and furniture, nursing/patient care equipment, food service/laundry/housekeeping equipment and appliances, and maintenance equipment.

2. For certain projects, capital improvements or enhancements to the project may be considered as a Qualified Expense. For example, individual air conditioning units may be added to a project that was not air conditioned when it was built; gutters and downspouts may be added where necessary; or an initial purchase of a computer and some associated software may be purchased. However, routine repairs, maintenance and service fees, such as internet fees, web hosting, software-hardware maintenance/updates, proprietary software/vendor fees and related expenses are not Qualified Expenses.

Some improvements may be eligible if they can be justified to:

- a. result in enhancing the mortgage security, including making the project energy efficient,
- b. upgrade the project and place the project in a more favorable competitive position in the marketplace, and/or
- c. be necessary to comply with changes in local, state or Federal laws.

Certain capital improvement projects may require the use of a third-party professional, such as a design architect, engineer, etc. The AE may consider approval of such expenses in the context of an otherwise approvable project, not funding through other sources.

463 D. **Non-qualified Expenses:** Items traditionally contemplated as ineligible expenses that may  
464 not be paid for with funds from the R4R Account include, but are not limited to the following  
465 maintenance items:

- 466  
467 1. Repainting of interior areas of projects, including but not limited to, painting of  
468 residential units, hallways, community rooms, kitchens, offices, etc. A separate  
469 interior painting reserve for this kind of work may be established by mutual  
470 agreement and consent of the Borrower, Mortgagee/Service Lender and ORCF.
- 471  
472 2. Replacement or repairs of a part or a component of range burners, televisions,  
473 computers, routers, bibs, oven elements, controls, refrigerators, valves, wiring, etc.
- 474  
475 3. Minor replacements of dwelling unit air conditioning components such as fan motors  
476 and window unit compressors.
- 477  
478 4. Minor repairs to central air conditioning and heating systems such as valve  
479 replacements and the cleaning of boiler interiors.
- 480  
481 5. Minor roof repairs, including minor repairs to gutters and downspouts.
- 482  
483 6. Minor paving or repairs.
- 484  
485 7. Minor caulking and sealing. However, caulking or sealing of the entire project to  
486 improve energy efficiency is a Qualified Expense.
- 487  
488 8. Window and screen repairs.
- 489  
490 9. Purchase of minor equipment, furniture, appliances or fixtures or the purchase of  
491 maintenance tools and equipment, such as lawn mowers or snow blowers.
- 492  
493 10. Inspection/recharging/replacement of fire extinguishers.
- 494  
495 11. Minor carpet or flooring repairs. However, carpet or flooring replacement of multiple  
496 areas/units or the entire common area of a project is a Qualified Expense.

497  
498 E. **Adequacy of Reserve for Replacement Account.**

499 The Borrower must analyze the amounts in a project's R4R Account in the light of  
500 anticipated replacement needs (in certain cases ORCF may require that the Borrower perform  
501 an analysis of the account). A Borrower shall rely on its knowledge of the physical condition  
502 of the project, evaluations made by Operators or Management Agents, and physical  
503 inspection reports furnished by the Mortgagee/Service Lender and by ORCF, including the  
504 PCNA. In general, capitalized replacements anticipated in the Borrower's needs should  
505 mirror that of the last PCNA. If the Borrower's analysis indicates that it is necessary to  
506 increase the rate/amount of deposits into the R4R Account, the Borrower should contact the  
507 Mortgagee/Service Lender to request authorization to increase the monthly deposit

508 requirement. The Lender shall notify ORCF when the R4R is insufficient to meet capital  
509 needs or the minimum threshold, as noted in this Chapter, Section 3.10.

510  
511 **F. Recommended Minimum Threshold.**

512 Borrowers should ~~submit to~~ maintain a minimum recommended threshold equal to at least  
513 \$1000 per unit in the R4R Account. For example, the minimum R4R Account balance for a  
514 100-unit project is \$100,000. The purpose of the minimum threshold is to ensure that funds  
515 are available for an emergency, such as a major roof failure or a water or sewer main break.  
516 Failure to maintain the minimum threshold could trigger a discussion by the AE with the  
517 Mortgagee/ServiceeLender, and the Borrower to determine whether an increase in the deposit  
518 amount is appropriate given the reliance on the fund. If the account regularly falls below the  
519 recommended minimum, ORCF may decline to approve a request to withdraw funds from  
520 the R4R Account unless in an emergency situation.

521  
522 **G. Adjustments to Recommended Minimum Threshold.**

523 The Borrower, Mortgagee/ServiceeLender or ORCF may increase the recommended  
524 minimum threshold of \$1000 per unit under one or more of the following circumstances:

- 525  
526 1. Physical Condition. Projects in poor physical condition, as evidenced by a recent  
527 REAC Physical Inspection Score under 60, may require larger balances.
- 528  
529 2. Geographical Location. Exposure to severe or unusual weather conditions, as well as  
530 the widely varying costs of repairs and replacements.
- 531  
532 3. Immediate Replacement Needs. The project is in good physical condition but an  
533 unexpected large capital need arises.
- 534  
535 4. Changes in Replacement Items. If non-traditional items are to become eligible R4R  
536 Account items, the minimum to be held in the account may need to be increased.

537  
538 **H. Withdrawals from the Reserve for Replacement Account**

- 539  
540 1. Borrowers or Operators are to submit Reserve for Replacement (R4R) requests to  
541 ORCF through their Mortgagee/ServiceeLender (with the exception of those that can  
542 be directly reviewed and approved by the Mortgagee/ServiceeLender, as described in  
543 Section 3.2.2.H.5). A checklist of required exhibits to submit for R4R requests will  
544 be available on the Section 232 Program website.
- 545  
546 2. The Mortgagee/ServiceeLender is to receive the R4R requests, review them for  
547 completeness, accuracy and eligibility, and then forward them to ORCF with a  
548 recommendation for approval (with the exception of those that can be directly  
549 reviewed and approved by the Mortgagee/ServiceeLender, as described in Section  
550 3.2.2.H.5).
- 551  
552 3. Typically, R4R releases are made for reimbursement on work that is completed.  
553 However, advances may be approved in situations where upfront or partial payments

554 to the contractor(s) are required prior to the work being completed. At the  
555 Mortgagee/Servicer's Lender's discretion, the R4R may be used to allow for multiple  
556 draws or a single draw, depending on the scope of work and the availability of funds  
557 in the project operating account, R4R account and other sources (e.g. owner  
558 contributions, insurance proceeds). For example, draws may be established at 35  
559 percent, 65 percent and 100 percent completion for more substantive repairs.

- 560
- 561 4. **Additional Considerations.** The following factors will be considered by ORCF in  
562 processing a request to withdraw funds from the R4R Account:
- 563 a. Whether the expense is a Qualified Expense, as defined in Section 3.2.2.C.
  - 564 b. Adequacy of the funds in the R4R Account.
  - 565 c. If the project has an active or pending refinancing/financing application (i.e.,  
566 223(a)(7) or other loan program), the Borrower must disclose this information  
567 with the request to withdraw funds from the R4R Account.
  - 568 d. If the submittal proposes remodeling, adding to, subtracting from,  
569 reconstructing, or demolishing a portion of the mortgaged project (as  
570 discussed further in Section 3.4.4 of this chapter), an environmental review as  
571 required by 24 CFR Part 50 will be conducted.
  - 572 e. **Timing.** It is recommended that requests for withdrawals be made not more  
573 often than quarterly , or three months from the last approved request, unless  
574 an emergency exists. Additionally, requests for withdrawals shall be made no  
575 more than one year after the expenditure occurred. The borrower should  
576 presume that a withdrawal request for expenditures beyond 365 days will be  
577 denied; only in extraordinary circumstances and for good cause shown will  
578 ORCF consider approving such a request.
  - 579 f. **Invoices.** Copies of invoices are not required to be submitted to ORCF if the  
580 description of the work done or items replaced is sufficiently detailed to  
581 permit an inspection and verification; however, the Borrower must keep  
582 copies of the invoices on file for at least three years and have the invoices  
583 available for ORCF staff to review.
  - 584 g. **Temporary Hold.** In certain circumstances, a temporary hold on approvals  
585 of withdrawals from the R4R Account may be indicated, such as repeated  
586 requests for ineligible items, or other patterns of financial risk. In such cases,  
587 the AE may request additional information and/or also request a temporary  
588 removal of the Lender Delegated Authority, as discussed below.

589

590

591 5. **Optional Mortgagee/Servicer Lender Review and Delegated Approval of R4R**  
592 **Requests:**

593 In an effort to streamline operations, decrease response times, and allow ORCF staff  
594 to focus on more complex R4R or escrow review requests, there are certain requests  
595 that may be approved by the Mortgagee/Servicer Lender, as long as the criteria below  
596 are met. Special Requests (see Section 3.2.2.I below) must be submitted to ORCF for  
597 processing and approved only by the AE, and are not eligible for  
598 Mortgagee/Servicer Lender approval.

599

600 This Mortgagee/ServiceeLender review and delegated approval is not a requirement  
601 and is optional for those who agree to administer the review and approvals within the  
602 HUD and Section 232 guidelines.

- 603
- 604 a. **Delegated Approval Process.** A prerequisite for participation in this process  
605 is HUD approval of the Mortgagee/ServiceeLender to participate in this  
606 delegated review. If a Mortgagee/ServiceeLender has been approved by  
607 Multifamily Housing in accordance with their process related to delegated  
608 review of R4R requests, ORCF shall consider the Mortgagee/ServiceeLender  
609 approved to perform delegated review of R4R requests for all residential care  
610 facility loan types (provided the specifics of the transaction meet the below  
611 criteria). If a Mortgagee/ServiceeLender wishes to apply for approval solely  
612 to administer R4R Requests on Section 232 projects, the request must be  
613 submitted to the HUD (see procedures available on the Section 232 website)  
614 [LeanThinking@hud.gov](mailto:LeanThinking@hud.gov) email. The request must include a revised Quality  
615 Control Plan addressing the items in 5.b-f below. Quality Control oversight of  
616 the items in this Section and 5.b-f below. The Lender shall have sufficient  
617 full-time staff with the requisite experience to approve releases within the  
618 required guidelines. ORCF will retain responsibility for review of R4R  
619 requests in all cases where there is an identity of interest between the  
620 Borrower, the Mortgagee/ServiceeLender, or affiliates of either.
- 621 b. **Authority.** Delegated Authority is revoked if the project is serviced by  
622 ORCF's Risk Mitigation Branch. ORCF reserves the right to revoke  
623 Delegated Authority on individual or a portfolio of related projects, either  
624 temporarily or permanently, based on patterns of Owner non-compliance or  
625 other financial risk (such as prior to achieving self-sustaining performance).  
626 ORCF also reserves the right to either temporarily or permanently revoke the  
627 Lender's Delegated Section 232 R4R Approval Authority overall, based on a  
628 pattern of non-compliance with Program requirements or failure to comply  
629 with the Quality Control Plan.
- 630 c. **Reimbursements and Advances.** Typically, R4R releases are made for  
631 reimbursement on work that is completed. However, advances may be  
632 approved in situations where upfront or partial payments to the contractor(s)  
633 are required prior to the work being completed. At ~~the~~  
634 Mortgagee/Servicee'sLender's discretion, the R4R may be used to allow for  
635 multiple draws or a single draw, depending on the scope of work: and the  
636 availability of funds in the project operating account, R4R account and other  
637 sources (e.g. owner contributions, insurance proceeds). For example, draws  
638 may be established at 35 percent, 65 percent and 100 percent completion for  
639 more substantive repairs.
- 640 d. **Minimum Threshold.** The R4R account balance must be at a minimum level  
641 of \$1,000 per unit after the release.
- 642 e. **Modifying the Project.** If the R4R request is for a situation where there is a  
643 proposed remodeling, adding to, subtracting from, reconstructing, or  
644 demolishing of a portion of the mortgaged project (as discussed further in  
645 Section 3.4.4 of this Handbook), the R4R request is not eligible for this

646 optional ~~Mortgagee/Service~~Lender review. Such proposals must be  
647 submitted to ORCF for routine processing and approval.

- 648 f. **Qualifying Expenditures.** Only qualifying expenditures, as defined in  
649 Section 3.2.2.C above, and as eligible and reported on the Funds  
650 Authorization (Form HUD-9250-ORCF) ~~and Borrower Certification and~~  
651 ~~Request Detail (Form HUD-9250A-ORCF)~~ may be submitted for  
652 reimbursement.
- 653 g. **Delegated Approval.** ~~Mortgagee/Service~~Lender will review the request and  
654 determine eligibility, and may approve qualifying requests (as described  
655 above) by signing the form, noting their Name (also to include Title and  
656 Organization), ~~Signature,~~ City, State, and Date in the respective fields.
- 657 h. **Notification to ORCF.** Once completed, all Funds Authorizations signed by  
658 the ~~Mortgagee/Service~~Lender must then be submitted electronically to ORCF  
659 for record keeping. This must be received by ORCF, within seven (7)  
660 business days of ~~Mortgagee/Service~~Lender approval.
- 661 i. ~~Surcharges and Penalties.~~ ORCF will not surcharge or penalize  
662 ~~Mortgagee/Service~~s for approved R4R releases, ~~provided the instructions in~~  
663 ~~this handbook, and on designated HUD forms were followed.~~
- 664 i. **Recordkeeping.** Delegated Lenders must keep copies of all Funds  
665 Authorizations on file for the lifetime of the loan.

## 666 I. Special Requests.

- 667
- 668
- 669 1. Request to suspend or reduce monthly deposits into the R4R Account. Generally a  
670 request to suspend or reduce monthly deposits will be considered only when the  
671 project is in good financial, physical and regulatory standing, including consideration  
672 of future capital needs identified in the last PCNA. Absent compelling operational  
673 reasons for suspension, the recommendations made in the PCNA schedule for  
674 deposits shall apply for the first five years of the loan. The R4R Account balance  
675 must be equal to at least sixty (60) months of deposits. ~~Monthly~~No single request for  
676 suspension of monthly deposits ~~cannot be suspended for more than~~can exceed 12  
677 ~~months at a time.~~ The following items are completed Funds Authorization is  
678 required to be submitted to ORCF in connection with a request to suspend or reduce  
679 monthly deposits into the R4R Account:  
680 a. ~~Completed Funds Authorization;~~  
681 b. ~~Completed Borrower Certification and Request Detail.~~

682

683 If the request for suspension or reduction in the monthly R4R deposit is being  
684 requested because a project cannot currently fund the deposit, the  
685 ~~Mortgagee/Service~~Lender and AE will conduct a meeting to discuss the financial  
686 situation, cash flow problems and any other concerns leading to this request from the  
687 project.

- 688
- 689 2. Borrowing funds to cover mortgage payments or operating deficits. In extreme cases,  
690 ORCF may consider a Borrower's request for a short term loan of funds from the  
691 R4R Account. The purpose should be related to a condition or circumstance beyond



692 the normal control of the Borrower. A request for a loan from the R4R Account may  
693 trigger an enhanced analysis of the project. The following items are required to be  
694 submitted to ORCF in connection with a request for a short term loan of funds from  
695 the R4R Account:

- 696 a. Narrative explaining the proposed loan terms, expenses to be paid and the  
697 reason for the request (including an explanation of any outstanding ORCF  
698 and state compliance issues);
- 699 b. Completed Funds Authorization;
- 700 c. Completed Borrower Certification and Request Detail;
- 701 d. The three (3) most recent monthly financial statements for the project.

702  
703 All Special Requests are to be submitted via the Mortgagee/Service Lender, who must first  
704 review them for completeness, accuracy and eligibility, and then forward them to ORCF with  
705 a recommendation for approval.  
706  
707

---

### 3.2.3

### Residual Receipts Account

708

#### A. Definition.

709 During the life of an FHA insured mortgage, Residual Receipts are an asset of the Borrower  
710 held under the control of ORCF. If a Borrower is required to establish a Residual Receipts  
711 Account for a project, the requirement will be set forth in the Regulatory Agreement which  
712 will set forth the type of assets that are included in the definition of "Residual Receipts."  
713

714

715

#### B. Calculation of Residual Receipts.

716 The Borrower should use ~~Form HUD-93486-ORCF~~ Computation of Surplus Cash,  
717 Distributions, and Residual Receipts (Form HUD-93486-ORCF) either semi-annually or  
718 annually (depending on the Regulatory Agreement for the project) to calculate allowable  
719 distributions and any amounts that may be due for deposit in the Residual Receipts Account.  
720 Instructions for completing the form are shown on the back of the form and the calculation  
721 for distributions must be included in the audited annual financial statements filed with HUD.  
722

723

#### C. Depositing Residual Receipts.

724 Residual Receipts must be deposited in a separate Residual Receipts Account, except to the  
725 extent that the Non-profit Borrower's Regulatory Agreement may provide some limited right  
726 to retain Residual Receipts. Funds in the Residual Receipts Account may not be combined or  
727 commingled with other escrow accounts, including, but not limited to, the accounts listed in  
728 Section 3.2.1 above, without the prior written approval of ORCF. The Regulatory  
729 Agreement specifies when Residual Receipts are to be deposited into the Residual Receipts  
730 Account. The account must be maintained by the Mortgagee/Service Lender.  
731

732

733

734

735

#### D. Holding and Investing Funds.

Funds in the Residual Receipts Account for all projects with FHA-insured mortgages must be invested in, and all interest earned on the investments must be credited to, a financial vehicle that meets HUD approval. Funds in Residual Receipts Account are to be invested and safeguarded by Mortgagee/ServiceersLenders and Borrowers in the manner described in Section 3.2.2 of this chapter.

**E. Qualified Uses for the Residual Receipts Account.**

Borrowers may request disbursement of funds from the Residual Receipts Account for the following purposes:

1. To reduce operating deficits when legitimate cash flow deficits exist.
2. To make mortgage payments when a mortgage default has occurred or is imminent.
3. To make repairs or replacements to the project that are not covered by the R4R Account described in Section 3.2.2 above.
4. To provide additional project amenities such as air conditioning, a sprinkler system, fire or smoke detectors, or energy saving devices as well as office equipment such as computers and associated software.
5. For other expenses deemed necessary, and in the best interest of the project as determined by ORCF and the Mortgagee/Serviceer.Lender. Generally, all expenses which qualify for reimbursement under the R4R Account may also be reimbursed from funds in the Residual Receipts Account.

**F. Withdrawals from the Residual Receipts Account.**

**The Mortgagee/ServiceerLender must submit the following (provided by the Borrower):**

1. Required Documents. A checklist of required exhibits to submit to ORCF for withdrawals from the Residual Receipts Account will be available on the Section 232 Program website. Requests are to be submitted via the Mortgagee/ServiceerLender, who must first review them for completeness, accuracy and eligibility, and then forward them to ORCF with a recommendation for approval.
2. Additional Considerations. The following issues will be considered by ORCF in processing a request to withdraw funds from the Residual Receipts Account:
  - a. Whether the expenses are qualified items to be paid from the account.
  - b. If the submittal proposes remodeling, adding to, subtracting from, reconstructing, or demolishing a portion of the mortgaged project (as discussed further in Section 3.4.4 of this chapter), an environmental review as required by 24 CFR Part 50 will be conducted.

### 3.2.4

## Non-Critical Repair Escrow Account (NCRE)

- 782  
783  
784  
785  
786  
787  
788  
789  
790  
791  
792  
793  
794  
795  
796  
797  
798  
799  
800  
801  
802  
803  
804  
805  
806  
807  
808  
809  
810  
811  
812  
813  
814  
815  
816  
817  
818  
819  
820  
821  
822  
823  
824  
825  
826
- A. **Applicability:** Non-Critical Repair Escrow (“NCRE”) Accounts are established during the underwriting of a project and funded at Closing. The funds in the NCRE Account are intended to pay for repairs identified in the Escrow Agreement for Non-Critical, Deferred Repairs (the “NCRE Agreement”), (Form HUD-92476-ORCF). Generally, the repairs must be completed within 12 months from the date of the NCRE Agreement. The specific requirements and conditions for the completion of the repairs are set forth in the NCRE Agreement. For purposes of this Agreement, a Borrower elective repair shall be treated identically to a non-critical repair.
- B. **Depositing, Holding and Investing:** Funds in the NCRE Account must also be deposited, held and invested in accordance with the requirements set forth in Section 3.2.2 of this chapter. However, since the funds are intended to be disbursed within a 12 month period, they must be deposited in an account that can be withdrawn from or immediately accessed in the full amount. Depositing NCRE Account funds in a long-term investment account is not recommended.
- C. **Interim Draws and Closeout of the NCRE Account**
1. Interim Draws: At the Mortgagee/Servicee’sLender’s option, the NCRE Account may be established to allow for multiple draws or a single draw, depending on the scope of work. For example, draws may be established at 35 percent, 65 percent and 100 percent completion for more substantive repairs.
  2. Holdback/Retainage: HUD does not require a holdback/retainage on interim draw releases, however, the Mortgagee/ServiceeLender may require a holdback/retainage at their discretion.
  3. Advances: Typically, draws are approved for reimbursement on work that is completed. However, advances may be approved in situations where upfront or partial payments to the contractor(s) are required prior to the work being completed.
  4. Review of Proposed Draws and Closeout: When determining whether to approve a proposed interim draw or final draw (closeout) of the NCRE, the Mortgagee/ServiceeLender shall review the submission from the borrower to determine whether there is adequate documentation to evidence that the repairs/improvements associated with the requested release were completed (or there is evidence that an advance is required per Section 3.2.4.C.3. above). With the exception of NCRE accounts administered by the Mortgagee/ServiceeLender under Section 3.2.4.H, the requests are to be submitted via the Mortgagee/ServiceeLender, who must first review them for completeness, accuracy and eligibility, and then forward them to ORCF with a recommendation for approval (submitted electronically in accordance with the instructions on the Section 232 program website). A checklist of documents for review will be available on the Section 232 Program website.

827  
828  
829  
830  
831  
832  
833  
834  
835  
836  
837  
838  
839  
840  
841  
842  
843  
844  
845  
846  
847  
848  
849  
850  
851  
852  
853  
854  
855  
856  
857  
858  
859  
860  
861  
862  
863  
864  
865  
866  
867  
868  
869  
870  
871  
872

- D. **Latent Defects Deposit.** A Latent Defects Deposit is required when the total cost of the non-critical repairs is equal to or exceeds \$1,000,000. The Latent Defects Deposit is calculated at 2.5% of total amount of repairs and is held by the Mortgagee/Service Lender to be released to the borrower upon the later of : (i) 15 months from the completion of repair work, or (ii) at such time the latent defects have been corrected to the satisfaction of ORCF. In accordance with the Request for Approval of Advance/Release of Escrow Funds, Section 232 (Form HUD 92464-ORCF), the location of where excess funds from the Latent Defects Deposit may be released is determined by whether the funds were from loan proceeds or provided by the owner. If funds were funded by loan proceeds, then they must be deposited into the R4R, or as directed by HUD. Please see the Escrow Agreement for Non-Critical Deferred Repairs (HUD-92476-ORCF).
- E. **Change of Scope of Repairs.** The Mortgagee/Service Lender must request approval from ORCF for proposed revisions to the scope of the required repairs/improvements (submitted electronically by the Mortgagee/Service Lender, in accordance with the instructions on the Section 232 program website). For such a request, the following must be submitted:
1. A narrative detailing why a change of scope is requested; or the reason that some or all of the non-critical (and/or Borrower elective) repairs were not completed, as applicable.
  2. Copy of the original NCRE Agreement.
  3. Certification from an individual determined to be qualified by the Mortgagee/Service Lender (e.g. PCNA provider, lender construction analyst, architect, engineer). The individual providing the certification must have equal or greater qualifications as the individual who identified the required repair (typically the PCNA preparer) and similar level of independence. The certification must provide that: failure to complete the non-critical repairs will have no serious negative impact on the condition of the project; and the project, as completed, is in compliance with local building and zoning codes, and/or state regulations. The certification must also explain in detail how the PCNA comments and recommendations with regard to the repair in question were taken into consideration along with the recommendation. Changes to Borrower elective repairs will not require a certification.
  4. NCRE cost overruns must be funded by the Borrower, not the R4R Account.
- F. **Timing of Completion of Repairs and Extensions** – All repairs must be completed within the 12 month prescribed time period, unless otherwise provided in the NCRE Agreement. The Mortgagee/Service Lender may provide a six-month extension at their discretion without ORCF approval where the borrower demonstrates adequate justification. Notification of the six month extension must be submitted to ORCF (see procedures available on the Section 232 website). Any extension beyond six months requires Mortgagee/Service Lender review and recommendation to ORCF for approval (submitted electronically by the Mortgagee/Service Lender, in accordance with the instructions on the Section 232 program

873 website). Under no circumstances may an extension beyond 12 months be made for repairs  
874 necessary to correct accessibility deficiencies. All such repairs must be made within the time  
875 periods prescribed in the Accessibility Matrix for Section 232. Failure to complete repairs in  
876 the required time-frame is a violation of the Escrow Agreement, as is a failure to request an  
877 extension.

- 878
- 879 G. **Excess Funds at Closeout** - In cases where the actual cost of the repair work is less than  
880 estimated, any resulting excess funds in the escrow attributable to the Repair Estimate  
881 amount that were funded from loan proceeds may be used for the following purpose(s):  
882 a. to pay for additional repairs approved by Mortgagee/ServiceeLender and ORCF,  
883 b. to reduce the outstanding Loan balance; or  
884 c. to deposit in the R4R.

885

886 Excess funds in the escrow that were not funded from loan proceeds may be used to reduce  
887 the outstanding loan balance in the event of default or client request, pending GNMA  
888 approval. ORCF may also require that certain repairs be completed when the specified  
889 repairs are deemed necessary for the proper operation of the facility, for resident care and/or  
890 if the repairs are needed to comply with local and state regulations.

891

892 H. **Optional Process for Delegated NCRE Administration to Mortgagees/ServiceersLenders.**

893

894 1. **Purpose and Background.**

895 This optional process applies only to residential care facility transactions originated  
896 under Sections 223(f) and 223(a)(7). A prerequisite for participation is HUD  
897 approval of revisions to the Mortgagee/Serviceer'sLender's Quality Control Plan  
898 incorporating the requirements of this Handbook. The Lender shall have sufficient  
899 full-time staff with the requisite experience to approve releases within required  
900 guidelines.

901

902 2. **Mortgagee/Serviceer Approval Process**

903 If a Mortgagee/ServiceerLender is approved by Multifamily Housing in accordance  
904 with Notice H2013-14 for delegated NCRE administration, ORCF shall consider the  
905 Mortgagee/ServiceerLender approved to perform delegated NCFE administration for  
906 the loan types referenced in the previous paragraph. If a Mortgagee/ServiceerLender  
907 wishes to apply for approval solely to administer NCRE's on residential care  
908 facilities, the request must be submitted to HUD (see procedures available on the  
909 Section 232 program website).

910 ORCF will retain responsibility for release of non-critical repair escrow funds in all  
911 cases where there is an identity of interest between the Borrower, the  
912 Mortgagee/ServiceerLender, or affiliates of either.

913

914

915 Delegated Authority is revoked if the project is serviced by ORCF's Risk Mitigation  
916 Branch.

917

- 918 3. ORCF reserves the right to revoke Delegated Authority on individual or a portfolio  
919 of related projects, either temporarily or permanently, based on patterns of Borrower  
920 non-compliance or other financial risk (such as prior to achieving self-sustaining  
921 performance). ORCF also reserves the right to either temporarily or permanently  
922 revoke the Lender's Delegated Section 232 R4R Approval Authority overall, based  
923 on a pattern of non-compliance with Program requirements or failure to comply with  
924 the Quality Control Plan. **General Requirements.**

925 Should the Mortgagee/ServicerLender elect to take responsibility for this task (and  
926 receive HUD approval to do so), HUD will not charge an inspection fee on Section  
927 232, pursuant to Section 223(f), transactions. Section 223(a)(7) transactions do not  
928 require an inspection fee. ORCF has not established a minimum or maximum  
929 repair/improvement amount on which this delegated process may be used.

930  
931 This delegated authority allows the Mortgagee/ServicerLender to review and approve  
932 all interim draw requests and the close-out of the account. Under this delegated  
933 authority, the request to close-out the account must include a report from an  
934 individual determined to be qualified by the Mortgagee/ServicerLender (e.g. the  
935 PCNA provider, lender construction analyst, architect or engineer), indicating they  
936 have performed an inspection and all required repairs or improvements have been  
937 acceptably completed. No such inspection or report is required for interim draws;  
938 however, at the Mortgagee/Servicer'sLender's discretion, interim inspections may be  
939 conducted.

- 940  
941 4. Interim Draws and Closeout of the NCRE Account, Latent Defects Deposit, and  
942 Change of Scope of Repairs shall be addressed in accordance with the provisions  
943 above in Section 3.2.4.C through G of this section.
- 944  
945 5. The Mortgagee/ServicerLender is delegated to approve the final close-out of the  
946 NCRE. The request to close-out the account shall follow the same procedure as  
947 outlined above.
- 948  
949 6. If there is a Latent Defects Deposit remaining after the close-out of the account, such  
950 Latent Defects Deposit may be reviewed and released by the  
951 Mortgagee/ServicerLender after the required seasoning period has passed. No further  
952 documentation on this is required to be sent to ORCF.
- 953  
954 7. Copies of the final fully executed HUD-92464-ORCF and HUD-92117-ORCF  
955 (without attachments) and final inspection report must be submitted electronically to  
956 ORCF within seven (7) business days of the Mortgagee/Servicer'sLender's final  
957 approval.

958  
959 The Mortgagee/ServicerLender must keep electronic or hard copies of the  
960 documentation related to any NCRE accounts administered by the  
961 Mortgagee/ServicerLender under this delegated process for at least three years.

### 3.2.5

### Sinking Fund

964  
965  
966  
967  
968  
969  
970  
971  
972  
973  
974  
975  
976  
977  
978  
979  
980  
981  
982  
983  
984  
985  
986  
987  
988  
989  
990  
991  
992

- A. **The Sinking Fund Agreement** is the controlling document for the Sinking Fund. The Sinking Fund Account must remain in compliance with the Sinking Fund Agreement. ORCF must be promptly notified by the Mortgagee/Service Lender in the event of any breach by the Borrower of the Sinking Fund Agreement and the Mortgagee/Service Lender must further agree to seek specific performance or other injunctive relief for any breach.
- B. **Requests for Withdrawal from the Sinking Fund Account.** Withdrawals from the Sinking Fund Account may only be made for the specific purposes stated in the Sinking Fund Account Agreement. Requests are to be submitted via the Mortgagee/Service Lender, who must first review them for completeness, accuracy and eligibility, and then forward them to ORCF with a recommendation for approval. A checklist will be available on the Section 232 Program website.
- C. **Requests to close a Sinking Fund Account prior to expiration.** Generally a request to close the account prior to expiration of the mortgage is submitted when the state Medicaid provider, where the project is located, no longer requires the maintenance of a Sinking Fund Account, and the project is in good physical and financial condition. Since a Sinking Fund Account is beneficial to the interests of the Borrower, Mortgagee/Service Lender and HUD in the latter years of a mortgage, a state rule eliminating the Sinking Fund Account does not automatically modify or remove this requirement for FHA-insured projects. Requests are to be submitted via the Mortgagee/Service Lender, who must first review them for completeness, accuracy and eligibility, and then forward them to ORCF with a recommendation for approval. A checklist will be available on the Section 232 Program website.

### 3.2.6

### ~~Debt Service Escrow and Long-Term Debt Service Reserve Reserves and Short Term Debt Service Escrow Accounts~~

993  
994  
995  
996  
997  
998  
999  
1000  
1001  
1002  
1003

- A. **Applicability.** In specific instances, ORCF may have a Long-Term Debt Service Reserve account established at closing (See Production, Chapter 2). This account is a mortgageable item and is controlled by the terms of the Borrower Regulatory Agreement. This account is different from a Debt Service Escrow account, which is for a shorter term, is funded by the Borrower, and is governed by a separate escrow agreement. The Long-Term Debt Service Reserve Escrow Account, if required, is established during the underwriting of a project either at initial or final closing. Each of these accounts is intended to provide Borrowers with an extra "cushion" to meet debt service payments on the FHA-insured mortgage and thus, safeguard the project's financial viability; while maintaining quality of care. Funds in these accounts are to be used exclusively for payments of principal and interest on the Mortgage

1004 Note, or to meet project escrows such as insurance premiums, real estate taxes or special  
1005 assessments.

1006  
1007 **B. Holding and Investing Funds.** Generally, the requirements of Debt Service Escrow  
1008 ~~Account~~Accounts are set forth in the Escrow Agreement, and the requirements of the Long-  
1009 Term Debt Service Reserve ~~Account~~Accounts are set forth in the Borrower Regulatory  
1010 Agreement. The funds in these accounts are to be invested and safeguarded by  
1011 ~~Mortgagee/Service~~Lenders and Borrowers in the manner described in Section 3.2.2 of this  
1012 Handbook. The procedures and sanctions described in Section 3.2.2 also pertain to these  
1013 accounts.

1014  
1015 **C. Request for Withdrawal:** Requests are to be submitted via the ~~Mortgagee/Service~~Lender,  
1016 who must first review them for completeness, accuracy and eligibility, and then forward  
1017 them to ORCF with a recommendation for approval. Requests for withdrawal and close-out  
1018 of Short Term Debt Service Escrow Accounts are subject to the terms and conditions in the  
1019 Escrow Agreement, which may set forth a quality-of-care component. A checklist will be  
1020 available on the Section 232 Program website.

1021  
1022 **SPECIAL NOTE:** Any request deviating from the Mortgage Reserve/Debt Service  
1023 Reserve Agreement, or any amendments and schedules thereto, shall be closely  
1024 analyzed by ORCF. The approval will be conditioned with a full repayment of the  
1025 funds to the account within a reasonable time frame.

1026  
1027 **D. Additional Considerations.** The following issues will be considered by ORCF in  
1028 processing Mortgage Reserve/Debt Service Reserve Account.

- 1029     ▪ Financial and ~~Physical Condition~~physical condition of the ~~Project~~project.
- 1030     ▪ Open ORCF and State compliance Issues.
- 1031     ▪ Other relevant issues, information or documents as determined by ORCF.

---

### 3.2.7 Initial Operating Deficit (IOD) Escrow

1041  
1042 **A. Applicability.** Initial Operating Deficit (IOD) Escrow Accounts are restricted accounts that  
1043 are primarily designed to allow or assist the project in achieving ~~sustained occupancy~~self-  
1044 sustaining performance and adequate revenue. See Production, Chapter 2 and Appendix 2.1  
1045 for additional information.

1046  
1047 **A.B. Request for Withdrawal:** Disbursements from the IOD Escrow Account may be  
1048 authorized monthly, commencing upon the issuance of the Certificate of Occupancy, by



1049 ORCF to meet any cash deficit in the operation of a project for the period immediately  
1050 following substantial completion of construction. Requests are to be submitted via the  
1051 Mortgage/Service Lender, who must first review them for completeness, accuracy and  
1052 eligibility, and then forward them to ORCF with a recommendation for approval. Lenders  
1053 must use the Initial Operating Deficit Escrow Calculation Template (Form HUD-91128-  
1054 ORCF) for tracking the IOD releases.

1055  
1056 **B.C. SPECIAL NOTE:** The IOD Escrow Account is a part of the project’s necessary start-up  
1057 working capital. ORCF does not consider depreciation, officers’ salaries, and identity of  
1058 interest management fees to be reasonable operating expenses; therefore, funds in the IOD  
1059 Escrow Account may not be used cover those costs.  
1060

DRAFT

## Section 3.3

# Prepayment Provisions and Prohibitions

### 3.3.1

#### Introduction

**Applicability.** The Residential Care Facilities Program permits Lenders to insert prepayment lockouts and penalties into the FHA-insured Note for the benefit of the source of the financing in accordance with the guidelines set out in Production, Chapter 3. Prepayment request review procedures are as follows.

### 3.3.2

#### Prepayment Procedures

**HUDORCF** must receive notification in writing from the **Mortgagee/ServicerLender**, requesting to prepay a loan insured by FHA (or **to** voluntarily terminate its mortgage insurance). The **Mortgagee/ServicerLender** is to receive the requests, review for completeness, accuracy and eligibility, and then forward to ORCF with a recommendation for approval.

The following are the steps for processing a request for prepayment of an FHA-insured mortgage or a voluntary termination of mortgage insurance:

- A. **Mortgagee/ServicerLender** submits the Insurance Termination Request ~~for Multifamily Mortgage~~ form (Form HUD-9807-ORCF) (without Block 5 completed) to the **Multifamily Insurance-232 Healthcare Portal, linked on the ORCF website. ORCF will coordinate review and processing of the form with the Multifamily Operations BranchDivision** in HUD Headquarters. ~~That and HUD Office forwards a copy of the form and supporting documentation to the ORCF, which will verify that there are no prepayment restrictions for the particular project. In most cases, HUD of General Counsel review will not be required, but ORCF will coordinate, as necessary, needed.~~
- B. ~~The~~ If applicable, the following list of items (subject to update and available on the HUD website) must accompany the Insurance Termination Request for **MultifamilyHealthcare** Mortgage request from the **Mortgagee/ServicerLender**:

- Form HUD-9807-ORCF (with blocks 1, 2, 3, 4, 6, 7 & 17 completed),
- Copy of Current Finally Endorsed Note,
- Copy of Allonges and any prior Modifications to Endorsed Note,
- Supplemental Notes (if applicable),

- Recorded copy of Mortgage Instrument (including any prior modifications),
- Mortgage, Prepayment Rider,
- ~~Mortgage Note,~~
- ~~Deed of Trust,~~
- ~~Deed of Trust Note,~~
- ~~Riders,~~
- ~~Any Allonges or Amendments,~~
- Regulatory Agreement,
- Trust Indenture (*applicable if the ~~Project~~project is bond financed*),
- Any secondary financing and status,
- Use restrictions, and
- Any special requests from Lender Certification that the FHA loan is or is not part of a Master Lease

\*Note- Per Mortgagee/Servicee or Borrower Letter 2018-07 (Revision to Mortgagee Letter 2004-21 dated June 15, 2004-Revised Procedures for the Submission of Form HUD 9807, Insurance Termination Request (OMB Approval November 2502-0416) for Prepayment Approval), projects that are part of a Master Lease require an analysis of impact of the prepayment on the remaining projects in the Master Lease, (e.g trailing 12-month debt service coverage ratio on the operations of each remaining project). Eligibility to be removed from a Master Lease is dependent upon the Master Lease Analysis, which documents the lease coverage ratio for the projects currently under the Master Lease and provides a proposed lease coverage ratio after the release.

The following documents are only required if the property is part of a Master Lease: Lender Letter of Recommendation, to include:

- List of projects on Master Lease,
- Identify which projects are being removed,
- Identify the section of the Master Lease where the requirements are stated that a project can be released from the group,
- Recommendation,
- Prepayment Checklist.

For projects that are attached to an A/R line and a Master Lease, please see the ORCF Loan Servicing website for additional document requirements.

Review of the prepayment request by HUD cannot begin without the above information, along with the executed Insurance Termination Request for MultifamilyHealthcare Mortgage form- (Form HUD-9807-ORCF). The complete submission of the documents is the responsibility of the Mortgagee/ServiceeLender. Note that time limits may apply.

C. ORCF will ensure the following:

- 1142 1. Determine if prepayment falls within any lockout period;  
1143  
1144 2. Determine status of any secondary financing and review the HUD asset management  
1145 system (iREMS);  
1146  
1147 3. Determine status of any outstanding Departmental Enforcement Center (DEC) or  
1148 Office of Inspector General (OIG) investigations, ~~based on iREMS~~; if any exist,  
1149 obtain input from the appropriate Division on prepayment approval.  
1150  
1151 4. Determine the impact of the prepayment on the Master Lease, and remaining projects, if  
1152 applicable. See Section III, Asset Management, Chapter 9 for additional information.  
1153  
1154 4.5. Address any special requests the Mortgagee/Service Lender may have prior to closing.  
1155 Termination of the Borrower Regulatory Agreement would be deemed a special request,  
1156 and would need to be prepared by HUD's Office of General Counsel.  
1157  
1158 D. The ~~Office of Multifamily Insured Operation Branch Operations Division~~ will perform an  
1159 audit of the loan(s) to calculate the estimation of payoff (based on projected closing date) and  
1160 any refund due to the Project for overpayment of MIP, if applicable.  
1161  
1162 E. The Mortgagee/Service Lender must ensure the ~~Office of Multifamily Insured Operation~~  
1163 ~~Branch Operations Division~~ (via ORCF) is notified of the closing date that is scheduled by the  
1164 Project's counsel (and bond issuer, if applicable).  
1165  
1166 F. For closing and bond defeasance, the bond issuer defeases the bonds and sends HUD the  
1167 complete Form HUD-9807-ORCF. Prior to closing the Mortgagee/Service Lender must  
1168 coordinate with ORCF and the Multifamily ~~Insured Operation Branch Chief Operations~~  
1169 Division to ensure timely processing of the Form HUD-9807-ORCF.  
1170  
1171 ~~G. ORCF will reflect the prepayment once the Office of Multifamily Insured Operation Branch~~  
1172 ~~has confirmed that the payoff occurred. The AE must update iREMS to ensure the Project no~~  
1173 ~~longer is required to submit financial statements (if fully terminated from FHA insurance)~~  
1174 ~~and document that the prepayment has occurred. Special care must be taken to ensure the~~  
1175 ~~Project is fully terminated from FHA insurance prior to making updates to iREMS. For~~  
1176 ~~example, a refinance under Section 223(a)(7) involves a payoff of the existing loan, but the~~  
1177 ~~refinanced loan is still required to submit financial statements.~~  
1178  
1179  
1180 G. Once the Lender confirms all conditions noted in the prepayment approval have been met,  
1181 and prepayment is accepted, the Lender may then submit Form HUD-9807-ORCF, with all  
1182 blocks completed, along with a copy of the prepayment approval, to  
1183 Revised9807Terminations@hud.gov for review and processing of the termination of  
1184 mortgage insurance. After prepayment, it is critical that the fully completed form gets sent to  
1185 the Multifamily Operations Division or there may be a delay in the loan termination.  
1186

1187 H. ORCF will recognize the prepayment once the Multifamily Operations Division has  
1188 confirmed that the payoff occurred, for the purposes of updating HUD systems. .  
1189

1190 I. After termination of mortgage insurance through prepayment in full or mortgage maturity,  
1191 the Borrower can request a release of Regulatory Agreement. Any requests for release of  
1192 Regulatory Agreement for a Section 232 project must be sent, one FHA number at a time, to  
1193 OGCReleaseandSatisfaction@hud.gov for processing and/or response. Each request must  
1194 include the following documentation:  
1195

1196 1. A copy of the recorded Regulatory Agreement(s) including any amendment(s) with  
1197 legible recordation stamp(s), dates and signatures.

1198  
1199 2. Written evidence of Termination of Mortgage Insurance by HUD, if available. If  
1200 submitting a Form HUD-9807-ORCF as evidence, the bottom section titled “For  
1201 HUD Use Only” of Form HUD-9807-ORCF, must reflect cancellation of the HUD  
1202 insurance endorsement and be signed by a designated HUD Official. Prepayment  
1203 approval is not evidence of mortgage insurance termination.  
1204

1205 3. The FHA project name and number in the subject line (e.g. XYZ Nursing Home,  
1206 FHA No. 000-12345).  
1207

1208 Note, requests for satisfaction of HUD-held mortgages/deeds of trust and releases of associated  
1209 Regulatory Agreements must be sent to the Multifamily Notes Servicing Branch. Releases of  
1210 Uniform Commercial Code filings must be handled by the Lender.  
1211

### 3.3.3

## Prepayment Lock Outs and Penalties

1212  
1213 A. Language allowing HUD to override the prepayment lockout and/or penalty provisions in the  
1214 event of a default is included in the Healthcare Facility Note, (Form HUD-94001-ORCF), or  
1215 Supplemental Healthcare Facility Note (Form HUD-94001A-ORCF), as applicable. The  
1216 Mortgagee/Servicer/Lender is to receive the request/request, review for completeness,  
1217 accuracy and eligibility, and then forward to ORCF with a recommendation for approval.  
1218

1219 B. Where these restrictions exist, and the Mortgagee/Servicer/Lender does not waive its  
1220 optional prepayment or lockout penalty provisions, HUD may, in rare circumstance  
1221 HUD would/circumstances, consider exercising an override of a  
1222 Mortgagee/Servicer's Lender's prepayment lock-out or penalty provision in order to  
1223 avoid a full claim. Any override to the lockout must receive approval by the Deputy  
1224 Assistant Secretary for OHP. Generally speaking, these projects will be in, or  
1225 transferred to, the Risk Mitigation Branch portfolio due to the troubled nature of the  
1226 project. As part of the any workout necessary to avoid a claim, a background memo  
1227 is prepared from the Risk Mitigation AE, explaining the circumstances justifying the  
1228 request. Consideration must be given to all of the following, in providing such  
1229 justification:  
1230

1231  
1232  
1233  
1234  
1235  
1236  
1237  
1238  
1239  
1240  
1241  
1242  
1243  
1244  
1245  
1246  
1247  
1248  
1249  
1250  
1251  
1252  
1253  
1254

1. The Borrower has defaulted and HUD has received notice of such default as required by ~~the~~program regulations.
  2. HUD determines that the project has been experiencing a net income deficiency that was not caused solely by management inadequacy or lack of Borrower interest and that is of such a magnitude that the Borrower is currently unable to make required debt service payments, pay all project operating expenses, and fund all required reserves.
  3. HUD finds there is a reasonable likelihood that the Borrower can arrange to refinance the defaulted loan at a lower interest rate or otherwise reduce the debt service payments through partial prepayment.
  4. HUD determines that refinancing the defaulted loan at a lower rate or partial prepayment is necessary to restore the project to a financially sound condition and to avoid an insurance claim.
- C. ORFC must be satisfied that the Borrower in these circumstances did not intentionally cause a default in order to obviate prepayment penalties or lockout provisions.

DRAFT

1256  
1257  
1258  
1259  
1260  
1261

## Section 3.4

# Request to Release or Modify Original Loan Collateral

### 3.4.1

### Introduction

1262  
1263  
1264  
1265  
1266  
1267  
1268  
1269  
1270  
1271  
1272  
1273  
1274  
1275  
1276  
1277  
1278  
1279  
1280

- A. From time to time the collateral securing a FHA-insured mortgage needs to be modified or released. The Regulatory Agreement provides language requiring prior HUD approval of a revision to the security or collateral, including the following:
1. Reduction, Addition, or Sale of Beds (Please refer to 3.4.2 below)
  2. Easements, Eminent Domain, or Sale of Land or Other Security (Please refer to 3.4.3 below)
  3. Remodeling, Adding to, Subtracting From, Reconstructing, or Demolishing Portions of the Mortgaged Project (Please refer to 3.4.4 below)
- B. A checklist of required exhibits to submit to HUD in each situation will be available on the Section 232 Program website. Lenders must submit requests using the Lender Narrative-Requests to Release or Modify Original Loan Collateral Section 232 (Form HUD-90030-ORCF), as applicable.

### 3.4.2

### Reduction, Addition, Change in, or Sale of Beds or Units

1281  
1282  
1283  
1284  
1285  
1286  
1287  
1288  
1289  
1290  
1291  
1292  
1293  
1294  
1295

- A. **Applicability:** Licensed beds are valuable project assets securing the mortgage. Any time the number of licensed beds in the project are being reduced or increased, the value of the mortgaged project may be affected. Therefore, such changes, including changing beds/units from one license to another, must be reviewed and approved by HUD. In some States, even temporarily removing beds from service, sometimes known as “bed banking,” may result in a change to the license. Therefore, the Lender must ensure that Borrower/Operator actions such as reducing the number of occupied beds/units and/or physically reconfiguring beds/units do not impact the license.
- B. **Additional Considerations:** The following issues will be considered by ORCF in processing a Reduction or Increase of number of change in the licensed beds/units:
1. Financial and Physical Condition of the Project.



- 1296 2. Open HUD and State ~~Compliance Issues~~compliance issues.
- 1297
- 1298 3. Project's PCNA (~~Physical Condition and~~Project Capital Needs Assessment). If the
- 1299 PCNA is more than 10 years old, ORCF may require a new PCNA to be performed.
- 1300
- 1301 4. The value of the remaining project after approval will be unaffected or the value will
- 1302 still be sufficient to cover the remaining balance of the mortgage.
- 1303
- 1304 5. Other relevant issues, information or documents as determined by ORCF.
- 1305
- 1306 6. ORCF will engage the services of HUD OGC (and as needed, OHP Architecture &
- 1307 Engineering, Environmental, and/or Appraisal teams) to review all legal and technical
- 1308 issues.
- 1309
- 1310 7. In processing release of collateral requests in which funds are being received for the
- 1311 sale of beds, ORCF will expect to receive market value for the released collateral and
- 1312 the funds will be directly applied to the mortgage balance. Any deviation from this
- 1313 (including deposits into the R4R Account) must be expressly approved by ORCF.
- 1314
- 1315 8. An environmental review as required by 24 CFR Part 50 will be conducted on any
- 1316 proposal for remodeling, adding to, subtracting from, reconstruction or demolishing a
- 1317 portion of the mortgaged project. Environmental Review Requirements are described
- 1318 in further detail on Form HUD-90030-ORCF, including: Phase I, Radon and other
- 1319 Environmental concerns.
- 1320
- 1321 9. The project must retain program eligibility.
- 1322
- 1323 C. **Processing Time.** The concurrent reviews by HUD OGC and OHP Architecture &
- 1324 Engineering, Environmental and Appraisal, if required, will affect the length of processing
- 1325 time.
- 1326
- 1327 D. **Other ORCF Requirements.** It should be noted that in all ~~increase or reduction~~change of
- 1328 licensed bed requests, ORCF may require or request additional relevant documents or
- 1329 information. The ~~Mortgagee/Service~~Lender is to receive the requests, review for
- 1330 completeness, accuracy and eligibility, and then forward to ORCF with a recommendation
- 1331 for approval.
- 1332
- 1333

### 3.4.3

## Easement, Eminent Domain, or Sale of Land or Other Security

- 1334
- 1335 A. **Applicability.** The Regulatory Agreement provides that the Borrower shall not, without the
- 1336 prior written approval of HUD, convey, transfer, or encumber any of the mortgaged project.
- 1337 Generally, there are two types of partial release of security requests. Negotiated release is
- 1338 when the transaction is voluntarily negotiated between the parties. Involuntary or eminent
- 1339 domain action is when a state, municipality or other public agent exercises its function to use

1340 a project asset for public use. In both situations, the project must be compensated for the  
1341 asset appropriated or affected (Please see Section 232 Program website). The  
1342 ~~Mortgagee/Service~~Lender is to receive the requests, review for completeness, accuracy and  
1343 eligibility, and then forward to ORCF with a recommendation for approval.  
1344

1345 B. **Negotiated or Voluntary Partial Release of Security.** This can include the sale of a  
1346 portion of project land, part of a building, major assets, etc. Note: Although Easements and  
1347 Right of Ways are not technically a release of security, the approval requirement in this sub-  
1348 chapter will be applicable. Normally, ORCF will consider approving such requests when:  
1349

- 1350 1. The quiet enjoyment of the present tenancy will not be negatively affected.
- 1351
- 1352 2. The amount of the reimbursement (or sale) is greater than or equal to the ORCF-  
1353 determined value of the severed portion at the time of severance.
- 1354
- 1355 3. The value of the project will be unaffected by the partial release of security or the  
1356 value will increase as a result of it.
- 1357
- 1358 4. The terms of the sale are cash.
- 1359
- 1360 5. The security to be released is not in place to mitigate an environmental condition on  
1361 the site: and the proposal does not generate any other environmental concerns.
- 1362
- 1363 6. There are no unresolved Title issues, as evidenced by a date-down endorsement.
- 1364

1365 C. **Additional Considerations.** The following issues will be considered by ORCF in  
1366 processing a Partial Release of Security request:  
1367

- 1368 1. Financial and ~~Physical Conditions~~physical conditions of the ~~Project~~project.
- 1369
- 1370 2. Open HUD and State compliance ~~Issues~~issues.
- 1371
- 1372 3. Project's PCNA (~~Physical Condition and Needs Assessment~~). If the PCNA is more  
1373 than 10 years old, ORCF may require a new PCNA to be performed.
- 1374
- 1375 4. The value of the remaining project after approval will be unaffected by the partial  
1376 release of security or the value will still be sufficient to cover the remaining balance  
1377 of the mortgage.
- 1378
- 1379 5. Other relevant issues, information or documents as determined by ORCF.
- 1380
- 1381 6. ORCF may also engage the services of the HUD OGC, the OHP Architecture &  
1382 Engineering, Environmental, and/or Appraisal teams to review all legal and technical  
1383 issues.
- 1384

1385 6.—If Ginnie Mae securities are involved, the Mortgagee/ServiceeLender must ensure  
1386 compliance with Ginnie Mae.

1387 7.

1388 8. In processing Partial Release of Security requests in which funds are being received,  
1389 ORCF will expect to receive market value for the released collateral and the funds  
1390 will be directly applied to the mortgage balance. Any deviation from this (including  
1391 deposits into the R4R Account) must be expressly approved by ORCF.

1392  
1393 9. An environmental review as required by 24 CFR Part 50 will be conducted on any  
1394 proposal for remodeling, adding to, subtracting from, reconstructing, or demolishing a  
1395 portion of the mortgaged project. Environmental Review Requirements are described  
1396 in further detail on Form HUD-90030-ORCF, including: Phase I, Radon and other  
1397 Environmental concerns.  
1398

1399 D. **Processing Time.** The concurrent reviews by HUD OGC and OHP Architecture and  
1400 Engineering, Environmental and Appraisal, if required, will affect the length of processing  
1401 time.  
1402

1403 Involuntary or Eminent Domain Partial Release of Security. As soon as an involuntary  
1404 partial release is known, the Borrower, Operator, Management Agent and/or

1405 E. ~~Involuntary or Eminent Domain Partial Release of Security.~~ As soon as an involuntary  
1406 partial release is known, the Borrower, Operator, Management Agent and/or  
1407 Mortgagee/ServiceeLender shall immediately notify ORCF. A copy of all received notices,  
1408 documents, plans, proposals, or documents related to the proceeding, shall immediately be  
1409 given or forwarded to ORCF. Urgency is required, because when a portion of the mortgaged  
1410 project is taken by a public authority through the use of condemnation proceedings, such  
1411 taking can be without the prior approval of either the Mortgagee/ServiceeLender or ORCF.  
1412

1413 If ORCF's field review indicates that the proposed condemnation has the potential to cause  
1414 default of the mortgage or negatively impact on the quiet enjoyment of the intended purpose,  
1415 as early as possible in the process, ORCF field staff must consult with the Director, Asset  
1416 Management and Lender Relations immediately.

### 3.4.4

## Remodeling, Adding to, Subtracting from, Reconstructing, or Demolishing Portions of the Mortgaged Project

1417  
1418  
1419  
1420  
1421  
1422  
1423  
1424  
1425  
1426  
1427  
1428  
1429  
1430  
1431  
1432  
1433  
1434  
1435  
1436  
1437  
1438  
1439  
1440  
1441  
1442  
1443  
1444  
1445  
1446  
1447  
1448  
1449  
1450  
1451  
1452  
1453  
1454  
1455  
1456  
1457  
1458

- A. **Applicability.** The various forms of Borrower and/or Operator Regulatory Agreements existing on residential care facility projects require written approval from HUD prior to remodeling, adding to, subtracting from, reconstructing, or demolishing a portion of the mortgaged project. The ~~Mortgagee/Service~~Lender is to receive the requests, review for completeness, accuracy and eligibility, and then forward to ORCF with a recommendation for approval. “Remodeling” for purposes of this Section is defined as repairs/improvements that constitute “Substantial Rehabilitation” – as defined in the Production, Chapter 2.6.B. This chapter provides instructions on submitting a request for partial release of security from the insured mortgage. (See Section 3.4.3 of this chapter - Easement, Eminent Domain, or Sale of Land or Other Security).
- B. **Prior Approval.** It is important that no major capital additions or reductions are performed without prior ORCF consent. However, in some instances when the additions or reductions were already completed without prior ORCF approval, a retroactive approval may be available. The same documents required in this section must be submitted. It should be noted although a retroactive approval is being processed, ORCF reserves the right to enforce its regulatory authority.
- C. **Additional Considerations.** The following issues will be considered by ORCF in processing a request for Major Capital Additions or Reductions of the mortgage security:
1. Financial and ~~Physical Condition~~physical condition of the ~~Project~~project.
  2. Open ORCF and State ~~Compliance Issues~~compliance issues.
  3. Project’s PCNA (~~Physical Condition and Needs Assessment~~). If the PCNA is more than 10 years old, ORCF may require a new PCNA to be performed.
  4. The value of the remaining project after approval will be unaffected by the Major Capital Addition or Reduction, or the value will still be sufficient to cover the remaining balance of the insured mortgage.
  5. Other relevant issues, information or documents as determined by ORCF.
  6. ORCF may also engage the services of the HUD OGC and OHP Architecture and Engineering, Environmental, and/or Appraisal teams to review all legal and technical issues.
  - ~~7. An environmental review as required by 24 CFR Part 50 will be conducted on any proposal for remodeling, adding to, subtracting from, reconstructing, or demolishing a portion of the mortgaged project.~~

1459 7. An environmental review as required by 24 CFR Part 50 will be conducted on any  
1460 proposal for remodeling, adding to, subtracting from, reconstructing, or demolishing a  
1461 portion of the mortgaged project. Environmental Review Requirements are described  
1462 in further detail on Form HUD-90030-ORCF, including: Phase I, Radon and other  
1463 Environmental concerns.

1464  
1465 D. **Processing Time.** The concurrent reviews by HUD OGC and OHP Architecture and  
1466 Engineering if required, will affect the length of processing time.  
1467  
1468

### 3.4.5

## **Surplus Cash Note or Secondary Financing Request**

1469 Borrowers and Operators may not use project funds for non-project related expenses, including  
1470 borrowing against the project. However, once Surplus Cash is distributed per the project  
1471 Regulatory Agreement, it is no longer considered part of the project. HUD understands that  
1472 Owners may want to borrow against this projected income stream, or parts thereof.  
1473 Nevertheless, HUD retains an interest in the financing of Borrower ownership interests and in  
1474 secured or unsecured private secondary financing. Per the Regulatory Agreement, Borrowers  
1475 may not enter into any contract, agreement or arrangement to borrow funds or finance any  
1476 purchase or incur any liability, direct or contingent, other than in accordance with the Loan  
1477 Documents and Program Obligations. Therefore, the Borrower shall seek prior HUD approval of  
1478 such arrangement, in accordance with the restrictions noted below. Similarly, when there is a  
1479 Borrower expectation of repayment of funds advanced to the project, repayment may also only  
1480 take place from Surplus Cash, although prior HUD approval to advance funds is not required,  
1481 subject to the limitations noted below.

1482  
1483  
1484 As Lenders become aware of new non-FHA secondary financing, they shall review the financing  
1485 in accordance with the Loan Documents and the Program Obligations. Upon receipt of a request  
1486 for a Surplus Cash Note or non-FHA secondary financing request from the Borrower, the  
1487 Mortgagee/Service Lender will review the request for completeness, accuracy and eligibility,  
1488 determine cause for the Note, and provide any necessary supporting information to the AE, along  
1489 with a recommendation for approval, modification or rejection. A checklist Checklists will be  
1490 made available on the Section 232 Program website.

1491  
1492 A. Requests for approval of a Surplus Cash Note must be made using the Surplus Cash Note  
1493 Section 232 (Form HUD-92223-ORCF).

1494  
1495 B. Payments on any Surplus Cash Note or any other non-FHA secondary financing are limited  
1496 to 75% of available Surplus Cash. The Borrower shall not take distributions prior to making  
1497 the Surplus Cash calculation and prior to making any payment thus due on the note. At the  
1498 time of such distribution is made, the Borrower shall apply the required percentage of said  
1499 distribution to reduce the balance owed on the note.

1500  
1501 C. Surplus cash notes or any other secondary financing, including mezzanine financing shall not  
1502 jeopardize the project or result in unauthorized changes of participant.

1503  
1504  
1505  
1506  
1507  
1508  
1509  
1510  
1511  
1512  
1513  
1514  
1515  
1516  
1517  
1518  
1519  
1520  
1521  
1522  
1523  
1524  
1525  
1526  
1527  
1528  
1529  
1530  
1531  
1532  
1533  
1534  
1535  
1536  
1537  
1538  
1539  
1540

D. The Lender must disclose if the Surplus Cash/Residual Receipts Note is being created with the intent of refinancing both the Surplus Cash/Residual Receipt Note and the FHA-insured loan into a new 223(f).

E. Secondary financing, such as mezzanine financing proposed after Final Endorsement, shall follow the same underwriting criteria as outlined in Production, Chapter 3.

1. Mezzanine Financing is provided by a private lending source and is usually secured by a pledge of partnership interests rather than by a secondary lien on the real estate. If a Borrower seeks post-closing mezzanine debt for any reason, the existence and terms of all mezzanine debt must be fully disclosed to and approved by HUD prior to its acquisition. As mezzanine debt of the property is considered private secondary financing, repayment of this debt can only be made from surplus cash. If acquisition of said debt is contemplated, it must be shown that the projected surplus cash may be reasonably expected to pay the interest due on the mezzanine loan. The mezzanine loan interest rate typically will be higher than the rate of the first mortgage, but must be reasonable, consistent with market rates for mezzanine debt, and must not be so high a rate that it jeopardizes the ownership stability of the property or that the interest due cannot reasonably expected to be repaid from 75% of surplus cash. Interest due or accruing on the mezzanine loan must be approved as reasonable by ORCF.

2. Any transfer of an ownership interest in the borrower entity or in its principals to the mezzanine Lender in the event of nonpayment or a default on the mezzanine debt must have prior written approval by ORCF through the Change of Participants (CHOP) process, or it will be invalid. The mezzanine Lender can exercise no enforcement remedies against the real estate or against the Borrower entity during the term of the mezzanine loan. Repayment of mezzanine financing, including interest, must be soft and be made solely from 75 percent of the available surplus cash or residual receipts. The Borrower's principals may elect to make additional payments from non-project funds, however, these payments must not be pledged or scheduled for repayment.

1541

1542

1543

1544

1545

---

## Section 3.5

### Nursing Home Surveys and Licensure

---

#### 3.5.1 Introduction

1546

1547 The ORCF insures mortgages for skilled nursing facilities. This type of project is licensed,

1548 highly regulated, and routinely monitored by the State in which the project is located.

1549 Maintaining ongoing compliance with the State is critical in ensuring the quality of care provided

1550 to the residents and the success of the project over the life of the mortgage.

1551

1552 ORCF does not intend to intervene between the State and another Federal agency. However,

1553 ORCF ~~monitors~~ does monitor the FHA-insured portfolio and when it is clear that the project is

1554 not able to expect Borrowers and/or Operators to come into compliance, the project will be turned

1555 over to the Risk Mitigation Branch provide notification and plans for correction of special

1556 servicing and work-out efforts circumstances related to nursing surveys and licensure, as detailed

1557 in Section 3.10 of this Chapter. Since the license is collateral for the FHA-insured mortgage, it is

1558 critical that the license remains intact and the residents of FHA-insured projects receive safe,

1559 sanitary, and decent housing.

1560

1561 This chapter will provide an overview of the inspection process and other tools the Center for

1562 Medicare and Medicaid Services (CMS) uses to rate and rank projects in order to help

1563 consumers, their families, and caregivers compare nursing homes in a specific area.

1564

1565

#### 3.5.2 State Licensure and Surveys Overview

1566

1567 CMS contracts with each State to provide nursing home surveys that ensure that minimum

1568 Medicare and Medicaid quality and performance standards are being met. CMS, a part of the

1569 Federal government, certifies projects to receive payments from Medicare and Medicaid. Once

1570 certified the project is then a nursing home provider for Medicare and Medicaid services. Each

1571 State government oversees the licensure process for each project with that State. There are over

1572 150 regulatory standards that nursing homes must meet at all times in order to ensure quality and

1573 performance standards. Meeting these minimum standards allows a project to receive Medicare

1574 and Medicaid payments and remain licensed with each State. If the regulatory standards are not

1575 being met, as shown through the survey process, then CMS can impose penalties, remedies or

1576 sanctions and possibly revoke all Medicare & Medicaid funding.

1577

1578

1579

1580

1581

### 3.5.3

## State Inspection Process

1582

1583

1584

1585

1586

1587

1588

1589

1590

1591

1592

1593

1594

1595

1596

1597

1598

1599

1600

1601

1602

1603

1604

1605

1606

1607

1608

1609

1610

1611

1612

1613

1614

1615

1616

1617

1618

1619

1620

Nursing Home State Surveys and Health Inspection are two terms that describes the nursing home State Inspection process and the terms are often used conterminously, in conjunction and/or separately from each other (e.g., State Survey, Health Inspection Survey, State Health Inspection, State Inspection, etc.). States contract with CMS to monitor nursing homes that provide care to individuals that receive Medicare and Medicaid. Health Inspections of nursing homes are conducted routinely, about every 9-15 months, by the State survey team. The State will perform more frequent survey inspections if there are complaints or the project is poorly performing. During the nursing home inspection process the State reviews many aspects of quality and performance standards. The survey is comprised of an inspection team that is normally made up of trained inspectors which include but are not limited to a registered nurse, a licensed or certified social worker and a certified life safety code inspector. Surveys are performed unannounced to the project and can be performed ~~24 hours a day and can fall at any time~~ on any ~~of the 365 calendar days~~ day. A survey generally lasts 3-5 days which can include non-business hours and/or weekends. The survey team routinely ensures residents are safe and free from immediate jeopardy. If severe deficiencies are found which has risen to the level of harm or immediate jeopardy then the survey may be extended. The survey team follows the survey process and evaluates whether the project is meeting individual resident needs and providing quality of care as defined by CMS. The survey covers various aspects of a resident's stay within a nursing home such as resident life, quality of care, safe and sanitary food preparation processes, staff/resident interactions, environment, policy and procedures and, among numerous others, abuse and neglect.

When an inspection team finds that a project does not meet a regulatory standard they issue a deficiency/citation. The State routinely allows 45 days from the date of the survey to correct deficiencies. The State also requires the project to provide a statement of correction to prevent the deficiency from occurring in the future. The State may follow up at the project by conducting another unannounced visit to the project or completing a desk review. If the deficiency is not corrected then the State recommends appropriate enforcement actions to the State Medicaid agency for Medicaid and to the regional office for Medicare. The CMS regional office determines a project's eligibility to participate in the Medicare program based on the State's survey results and the project's compliance. If the regulatory standards are not being corrected then CMS can, depending on the severity of the violation, take action against the nursing home including imposing various remedies and possibly revoking all Medicare and Medicaid funding.

Nursing home surveys are posted on the Medicare.gov website.

### 3.5.4

## State Inspection Process (Life Safety)

1621

1622

1623

To be eligible to be a Medicare & Medicaid Nursing Home Provider the project must be in compliance with the ~~2000~~2012 edition of Life Safety Code (LSC). Projects that have waivers of



1624 the health occupancy provisions of the LSC or an acceptable Plan of Correction (POC) are also  
1625 considered in compliance. The LSC is a set of fire protection requirements that provides a  
1626 reasonable degree of safety from fire.

1627  
1628 The LSC only uses qualified fire safety inspectors to perform the Life Safety Survey. The  
1629 nursing home must also meet the minimum Life Safety Code at all times and will receive  
1630 deficiencies for non-compliance of the Life Safety Code. The LSC inspectors will make reports  
1631 and recommendations to the State agency. The State routinely allows time to correct a  
1632 deficiency. If the regulatory standards are not being corrected then CMS can, depending on the  
1633 severity of the violation, take action against the nursing home including imposing various  
1634 remedies and possibly revoke all Medicare & Medicaid funding.

1635  
1636 The Life Safety Surveys are located on the [Medicare.gov](https://www.medicare.gov) website.

1637  
1638

---

### 3.5.5

### Quality of Care Provided to the Residents

1639  
1640 The survey process each project undergoes is an effort of CMS to oversee that quality of care is  
1641 being given to each resident. CMS has established Quality Measures that are used during the  
1642 survey. These Quality Measures are measurable, valid, reliable and are submitted to CMS on a  
1643 routine basis. The nursing home quality measures come from actual residents that stay within  
1644 each project. This data is routinely collected and measures the resident's physical and clinical  
1645 conditions and abilities, as well as preference and life care wishes. This data is further converted  
1646 to allow consumers to another source of information that shows how well nursing homes are  
1647 caring for their resident's physical and clinical needs. This data can be viewed on the  
1648 [Medicare.gov](https://www.medicare.gov) website.

1649  
1650 CMS may also establish certain quality performance measures, as detailed on the Medicare.gov  
1651 website, for the distribution of annual incentive payments.

1652  
1653

---

### 3.5.6

### Star Rating

1654  
1655 CMS created a Five-Star Quality Rating System. This system is intended to assist family  
1656 members, consumers and care givers to compare nursing homes more easily and help identify  
1657 questions that they may wish to ask. The Five-Star Quality Rating System is located on the  
1658 [Medicare.gov](https://www.medicare.gov) website. The website has a quality rating system that gives each of  
1659 the 4 categories between 1 and 5 stars. Nursing homes with 5 stars are considered to have "much  
1660 above average" quality and a nursing home with a 1 star rating is considered to have quality  
1661 "much below average". Though the categories and ~~descriptions~~ descriptions are subject to change,  
1662 and the Medicare website is the most current and accurate location to read about details, at the  
1663 time of publication, the four categories of the Star Rating are Overall, Health Inspections,  
1664 Staffing, and Quality Measures. The actual star rating is based on technical guidelines to  
1665 establish each star rating.

1666

1667 **Overall Star Rating:** Takes into account the other categories (e.g. Health Inspections, Staffing  
1668 and Quality Measures) and then gives an Overall Star Rating for the project.

1669  
1670 **Health Inspection:** The health inspection rating contains information from previous years of  
1671 onsite inspections, including both standard surveys and any complaint surveys. The most recent  
1672 survey findings are weighted more than the prior years, based on the technical guidelines.

1673  
1674 **Staffing:** The staffing rating has information about the number of hours of care on average  
1675 provided to each resident each day by nursing staff. This rating considers differences in the level  
1676 of need of care of residents in different nursing homes. The staffing rating can have a  
1677 proportionally greater impact on the overall Star Rating than the other factors.

1678  
1679 **Quality Measures:** The quality measure rating has information on different physical and  
1680 clinical measures for nursing home residents. This information is collected by the nursing home  
1681 for all residents. The Quality Measures offers information about how well nursing homes are  
1682 caring for their residents' physical and clinical needs.

1683  
1684 The Star Rating can be viewed on the [Medicare.gov](https://www.medicare.gov) website.

1685  
1686

### 3.5.7

### Special Focus Designation

1687  
1688 CMS has a Special Focus Facility ([SFF](#)) Initiative that places a nursing home, with a history of  
1689 serious quality issues, into a special program that is meant to stimulate the project to improve  
1690 their quality of care to residents (see also, Section 3.10.4). CMS may also publish an SFF  
1691 Candidates List. Most of the projects placed on the Special Focus Facility Initiative Program  
1692 have previously shown the following within the past three year survey history:

- 1693  
1694 A. Surveys have twice the amount of deficiencies as other nursing homes.  
1695  
1696 B. More serious survey deficiencies than most other nursing homes. These deficiencies would  
1697 include Harm and Injury experienced by the residents.  
1698  
1699 C. A pattern of problems that persisted over the past 3 years of surveys.

1700  
1701 These projects are visited twice as often as regular projects (twice per year). Enforcement  
1702 action becomes more stringent as more problems continue. There are three options after the  
1703 project has been in the program and within the 18-24 month timeframe:

- 1704  
1705 1. **Improvement and Graduation:** The project advances to an Improved Status and  
1706 eventually Graduates from the program. This project would resume annual surveys  
1707 and continue being a Medicare and Medicaid Provider.

1708

1709  
1710  
1711  
1712  
1713  
1714  
1715  
1716  
1717  
1718  
1719  
1720  
1721

2. **Termination:** This project has not met the criteria to graduate from the Special Facility Program, is not making progress and is terminated from providing services to Medicare and Medicaid recipients.
  
3. **Extension of Time:** An extension of time can be given to a project that is showing improved progress but not enough progress to advance to Improving/Graduated status. An extension of time could also be granted if there is a sale of the project.

Special Focus Designation can be found on the [www.CMS.gov](http://www.CMS.gov) and <http://www.medicare.gov/> website.

~~All Special Focus Facilities will be serviced by the Risk Mitigation Branch.~~

DRAFT

1722

1723

1724

1725

1726

## Section 3.6

---

# Approval to Participate in HUD Programs - APPS and BPRS

---

### 3.6.1

### Overview

- 1727
- 1728
- 1729
- 1730
- 1731
- 1732
- 1733
- 1734
- 1735
- 1736
- 1737
- 1738
- 1739
- 1740
- 1741
- 1742
- 1743
- 1744
- 1745
- 1746
- 1747
- 1748
- 1749
- 1750
- 1751
- 1752
- 1753
- 1754
- 1755
- 1756
- 1757
- 1758
- 1759
- 1760
- 1761
- 1762
- A. The Office of Healthcare Programs' Section 232 Program requires participants in a proposed transaction to submit certain types of forms containing information. This information is requested in order to demonstrate to HUD their experience and the team of people who are planning to own, operate or manage a project with a Section 232 FHA-insured mortgage. Application submission requirements are contained in the application exhibits for new endorsement in accordance with the appropriate Section of the Act, including but not limited to, resumes, credit reports, and project licenses. In addition to proposed applications for a FHA-insured mortgage, a proposed ~~change of Borrower (Transfer of Physical Assets),~~ Change of Participant (CHOP) requires approval by ORCF including changes in the Borrower, Operator, or ~~Change of Management Agent require approval by ORCF.~~ These requirements can be found in Asset Management, Chapter 7 and Chapter 8.
- B. Regardless of the proposed transaction or event that triggers participant approval (i.e. newly proposed FHA mortgage insurance requests or change of entity) approval as a Section 232 Program participant by ORCF is a HUD requirement. ORCF uses Active Partners Performance System (APPS) and the Business Partner Registration System (BPRS) to ensure proper clearance and up-to-date information on participants doing business with HUD. Additional information regarding participation and compliance requirements may be found in Housing Notice H 2016-15 (or successors thereto).
- C. The purpose of the Previous Participation certification review is to assure that controlling participants in ORCF projects are responsible parties with regard to their participation in other governmental housing transactions. Controlling participants in a proposed transaction must submit information regarding previous participation in governmental housing transactions either via the electronic Active Partners Performance System (APPS) or on the Consolidated Certification. APPS submissions and Previous Participation Certification submissions must be approved prior to issuance of a Firm Commitment. Should participants change, revised submissions must be completed and approved prior to closing. Additional information on the previous participation certification requirements can be found in Housing Notice H 2016-15 (or successors thereto).
- 1. Controlling Participants.** Controlling Participants are those entities serving in the specified capacity of Borrower, Management Agent, Operator, General Contractor, or Master Tenant. Controlling Participants are individuals and entities determined by HUD to exercise financial or operational control over the project. Housing Notice H 2016-15

1763  
1764  
1765  
1766  
1767  
1768  
1769  
1770  
1771  
1772

(or successors thereto) provides additional detail on who HUD considers to be a Controlling Participant for Previous Participation Review purposes.

- 2. Organization Charts.** Organization charts are a visual representation of the ownership structure of an organization. The organization chart must be clear enough so that a person unfamiliar with the project and the entities involved can understand the ownership and control structure. Housing Notice H0 2016-15 (or successors thereto) details the organization chart submission requirements.

DRAFT

## Section 3.7

### Physical Condition

#### 3.7.1

#### Introduction

The physical condition of every ORCF Section 232 FHA-insured facility is a critical factor in managing the overall risk to the FHA mortgage insurance fund to ensure the residents are residing in safe housing. ORCF strives to provide and promote the effective use of timely and reliable information to monitor and assess the condition of the ORCF Section 232 portfolio. Such assessment tools also provide valuable information to help ensure safe, decent and affordable housing is maintained throughout the ORCF Section 232 portfolio.

#### 3.7.2

#### Physical Condition Monitoring Tools

##### A. Real Estate Assessment Center (REAC) Physical Inspections.

1. **General Background.** ~~On September 1, 1998 (63 FR 35650), HUD published a final rule that~~ regulations at 24 CFR Part 5, Subpart G established uniform physical condition standards for housing insured- and or assisted under certain HUD programs. These standards are intended to ensure that this housing is decent, safe, sanitary and in good repair. The ~~September 1, 1998 final rule~~ regulations at 24 CFR 200.855 also established uniform physical inspection procedures by which HUD determines compliance with the physical condition standards. In certain cases, additional physical inspection regulations may apply (e.g. Section 232 projects with project-based rental assistance contracts). References to these requirements and other updates to HUD's physical inspection standards can be found on the REAC website (see Appendix 3.1).
2. **REAC and ORCF Section 232 Projects.** HUD's Real Estate Assessment Center (REAC) is charged with responsibility for assessing and scoring the condition of certain projects in which HUD has an interest, including FHA-insured projects under the Section 232 Program, in accordance with the physical conditions standards and procedures of 24 CFR part 5 subpart G.
  - a. **ORCF 232 Projects.** ORCF will continue to use the Real Estate Assessment Center (REAC) to schedule and physically inspect all projects in the ORCF Section 232 portfolio unless stated otherwise below.
  - b. **Skilled Nursing Facilities.** This provision (24 CFR 200.855)(c)(5) is now applicable and it limits the inspections on skilled nursing facilities. It provides in part that REAC will no longer routinely perform physical inspections on skilled nursing facilities (though HUD can direct on a case-by-case basis that one be conducted). if HUD determines that inspection of a

- 1813 [particular facility is needed to assure protection of their residents or adequate](#)  
1814 [preservation of the project](#)). In applying this provision, HUD has halted the  
1815 inspections on projects categorized in HUD's database as SNFs. This can  
1816 include skilled nursing facilities that do have some non-skilled nursing units,  
1817 but are predominantly providing skilled nursing care.
- 1818 c. **Other Non-SNF Exceptions.** The provision also gives HUD the authority to  
1819 determine that other (non-SNF) [232](#) projects in a particular jurisdiction do not  
1820 need REAC inspections if HUD finds that a particular jurisdiction provides  
1821 [reliable and](#) adequate inspections with readily available results. Action, if  
1822 any, with respect to that authority will be announced at a later date.  
1823
- 1824 3. **Administration of REAC Inspections.** REAC inspects only a random sampling of  
1825 the project to determine if the project is properly maintained. REAC conducts  
1826 physical inspections through the use of contracted inspectors trained by REAC. The  
1827 inspectors schedule on-site inspections with project Borrower's representatives. For  
1828 assistance, questions, clarification, guidance and or questions, on procedures  
1829 pertaining to REAC physical inspections, including scoring procedures and  
1830 procedures and timelines to appeal an inspection report, refer to REAC's website  
1831 [\(see Appendix 3.21\)](#).  
1832
- 1833 4. **Exigent Health and Safety Items.** At the conclusion of a REAC Inspection, the  
1834 inspector provides the Borrower, or designated contact, a list of all Exigent Health  
1835 and Safety (EH&S) items. Once an inspection is conducted, the Borrower is  
1836 responsible for mitigating all identified EH&S items within 72 hours, as verified by  
1837 submission of the completed and signed ~~certification~~[Certification of Exigent Health](#)  
1838 [and Safety \(EH&S\) \(Form HUD-93332-ORCF\)](#) to the assigned AE.  
1839
- 1840 5. **Issuance of REAC Inspection Report.** REAC is responsible for verifying  
1841 inspection data provided from the contracted inspector based on the on-site  
1842 inspection. REAC scores and issues the formal REAC inspection report to the  
1843 Borrower's contact, as verified at the on-site inspection.  
1844
- 1845 6. **ORCF Actions and Referrals to the DEC in Response to REAC Inspection**  
1846 **Report.** If the REAC inspection report score ~~falls under 60 (on a scale of a possible~~  
1847 ~~100 points)~~[is a failing score as defined by REAC](#) on two consecutive inspections, the  
1848 AE will refer a Borrower to the Departmental Enforcement Center (DEC) for further  
1849 review and possible enforcement action. Before referring to the Enforcement Center,  
1850 the AE will review both inspections and discuss the results with the  
1851 ~~Mortgagee/Service~~[Lender](#) to determine if the project make-up is causing improper  
1852 scoring (locked doors or windows, or other characteristics unique to certain  
1853 healthcare projects). ORCF will also flag the Borrower in APPS. See Housing  
1854 Notice H 2016-15 (or successors thereto), for additional information on APPS flags..  
1855 All REAC Inspections receiving a score of 30 and below are automatically referred to  
1856 the DEC for enforcement action.
- 1857 a. **DEC Actions.** The DEC may arrange a conference call to discuss the  
1858 inspection results with the Borrower and issue a Notice of Violation (NOV)

1859  
1860  
1861  
1862  
1863  
1864  
1865  
1866  
1867  
1868  
1869  
1870  
1871  
1872  
1873  
1874  
1875  
1876  
1877  
1878  
1879  
1880  
1881  
1882  
1883  
1884  
1885  
1886  
1887  
1888  
1889  
1890  
1891  
1892  
1893  
1894  
1895  
1896  
1897  
1898  
1899  
1900  
1901  
1902  
1903  
1904

demanding correction. Requirements of a Borrower that are included in the NOV include the following:

- i. Conduct and submit a 100% survey identifying the physical deficiencies in the project;
- ii. Correct the physical deficiencies at the project including but not limited to those deficiencies identified in the REAC Inspection; and
- ~~iii. Execute and provide a certification of corrections. Refer to: <http://portal.hud.gov/hudportal/documents/huddoc?id=10-04hsgnatt1.pdf>~~
- iii. Execute and provide a Certification Physical Condition in Compliance (Form HUD-93333-ORCF).

The DEC may take additional enforcement action and seek any and all available remedies including to but not limited to, acceleration of the outstanding principal indebtedness, foreclosure, or any other appropriate remedies.

- b. **Follow-up and Monitoring.** In addition to mitigating EH&S items as described in A.4 of this chapter, Borrowers are responsible for correcting all deficiencies noted on physical inspection reports.

Borrowers are required to ensure a complete (100%) inspection of the project is performed. This follow up inspection shall include the site, all building exteriors, all building systems, all common areas, and all units. For clarification purposes: all areas within a building that are not residential units are considered common areas for inspection purposes. All deficiencies identified on a REAC Report must be corrected. To verify compliance, the Borrower must complete and sign the certification and provide it to their Mortgagee/ServiceeLender and assigned - AE.

Mortgagee/ServiceersLenders play a critical role in ensuring the Borrower has met their obligation to correct deficiencies and are encouraged to monitor progress and performance. Since the REAC Inspection is just a sample of the physical condition of the project, the 100% inspection of the project is important.

Mortgagee/ServiceersLenders should encourage the Borrower to, at a minimum, perform the following on an ongoing basis:

- i. Review of Exigent, Health, and Safety (EH&S) problems identified in the REAC physical inspection. These items should be considered a priority and should assure that all EH&S deficiencies have been and remain corrected.
- ii. Review of units and common areas to verify that significant REAC physical inspection report deficiencies (other than EH&S) such as falling retaining walls, broken sidewalks, exterior painting, etc. have been corrected



~~A Mortgagee/Servicee~~A Lender or HUD may decide to perform a site review of a project, to ensure deficiencies are addressed, should there be issues of concern with regard to the physical condition of the project. Additional Lender notification requirements for physical inspections are discussed in Section 3.10.11 of this chapter.

Borrowers will be notified as subsequent REAC Inspections are scheduled by inspectors.

Any questions on REAC may be directed to the REAC Technical Assistance Center (TAC) at 1-888245-4860 or email at: [REAC TAC@hud.gov](mailto:REAC_TAC@hud.gov)

- B. **State Surveys.** As discussed in Section 3.5, part of the State inspection process includes a Life Safety Inspection. As this inspection focuses on the compliance with fire protection requirements, it may reflect concerns with the physical condition of the project as it impacts the residents. ORCF regularly reviews the Life Safety Inspection as well as the entire State Survey and Medicare Star Ratings, to determine if there may be issues pertaining to the physical condition of the project. For more information on Life Safety, State Surveys and Medicare Star Ratings, refer to ~~Section 3~~Sections 3.5 and 3.10.5.

### 3.7.3

## Resources for Addressing Physical Repairs and Improvements

- A. **Reserve for Replacement.** As discussed in Section 3.2.2 of this chapter, a R4R escrow exists for all FHA-insured and HUD-held mortgages, in accordance with the Regulatory Agreement. The R4R is established to help defray costs of replacing a project capital items. The R4R is a possible source of funding considered to help meet costs to maintain the physical condition of the project, in addition to the operating budget. A Borrower should work with their ~~Mortgagee/Servicee~~Lender and AE to seek approval of withdrawals from the R4R to address capital improvements and repairs. For more information on R4R, refer to Section 3.2.2 of this Chapter.
- B. **Other Resources.** As Borrowers are responsible for maintaining the project's physical condition, the Borrower may propose other resources of funding to be utilized to address needed physical repairs or proposed for capital improvements. Examples such as Borrower provided funding (not project funds); surplus cash notes, residual receipts are all potential sources to address physical repair needs. Compliance with regulatory and Section 232 Program requirements must also be ensured. Other resources may be required for elective improvements. For additional information, see Sections 3.2.3 and 3.2.4 of this Chapter.
- C. **Insurance Proceeds.** Lenders must work with Borrowers and Operators to ensure that insurance proceeds for project casualty losses are applied to the project in accordance with

1949 the provisions in 3.7.4.C. below. The Lender shall provide notification and documentation to  
1950 the AE about damages and ensure that project accounts and escrows are reimbursed, to avoid  
1951 duplication of payments.  
1952

### 3.7.4

## Physical Condition and Regulatory Compliance

1953 Borrowers and operators execute Regulatory Agreements under ORCF's Section 232 Programs.  
1954 Part of the regulatory requirements described in the Regulatory Agreement is to keep the project  
1955 in decent, safe and sanitary condition and in good repair. During any period in which HUD  
1956 insures the Loan or holds a security interest on the Mortgaged Projectmortgaged project, it is a  
1957 Regulatory Violation for an Borrower or Operator, without Mortgagee/Serviceer'sLender's and  
1958 HUD's express written consent, to proceed to impact the physical condition of the project in any  
1959 of the following ways:  
1960

- 1961
- 1962 A. Make physical change, or permits changes to, the Mortgaged Projectmortgaged project,  
1963 whether negligently or intentionally, in a manner that reduces its value;
  - 1964
  - 1965 B. Fail to maintain the Mortgaged Projectmortgaged project in decent, safe, and sanitary  
1966 condition and in good repair; or
  - 1967
  - 1968 C. Materially fail to comply with covenants in the Note, the Borrower's Security Instrument, the  
1969 Regulatory Agreement, or any of the Mortgage Insurance Documents respecting physical  
1970 care, maintenance, construction, abandonment, demolition, or insurance against casualty of  
1971 the Mortgaged Projectmortgaged project.  
1972  
1973

### 3.7.5

## Project Capital Needs Assessment

1974 The intent of the Project Capital Needs Assessment (PCNA) is to ensure the long term viability  
1975 of the project and ensure the proper deposit to the R4R account. When required by the project's  
1976 Regulatory Agreement, the existing PCNA must be updated every ten years. Updates to the  
1977 PCNA must follow the Statement of Work as set forth in Production, Chapter 4, for a Limited  
1978 Scope PCNA. Updated PCNAs must be submitted to the Project'sproject's AE every ten years,  
1979 as required (unless required prior to that date due to other circumstances), such as a change of  
1980 ownership). Unless otherwise specified in the Regulatory Agreement, the anniversary date of the  
1981 PCNA will be the latter of the Final Endorsement Date or the date of the last PCNA completed  
1982 for the property. The cost of each such PCNA may be requested for reimbursement from the  
1983 R4R account.  
1984  
1985

1986  
1987  
1988  
1989

**3.8.1**

**Introduction**

1990  
1991  
1992  
1993  
1994  
1995  
1996  
1997

This section provides guidance for Borrowers regarding the procedures for requesting permission from ORCF to lease an area of the FHA-insured project for communication towers and/or other telecommunications equipment. A checklist of required exhibits to submit to HUD when requesting approval for communication towers and/or other telecommunications equipment will be available on the Section 232 Program website.

**3.8.2**

**General**

1998  
1999  
2000  
2001  
2002  
2003  
2004  
2005  
2006  
2007  
2008  
2009  
2010

ORCF supports Borrowers of FHA-insured projects leasing space for communication towers to telecommunication providers for the purpose of increasing revenue for the project. Pursuant to the Regulatory Agreement, the Borrower must submit the required documents prior to execution of the lease, as HUD approval is required for these types of commercial leases. The Mortgagee/Service Lender is to receive the request and documentation, review for completeness, accuracy and eligibility, and then forward to ORCF with a recommendation for approval. A review of the documents will focus on issues regarding any effect on the project’s income and expenses, the Regulatory Agreement and Security Instrument. HUD closing attorneys and HUD engineering staff may review the required documents and provisions prior to the AE making a final determination.

**3.8.3**

**Requirements**

2011  
2012  
2013  
2014  
2015  
2016  
2017  
2018  
2019  
2020  
2021  
2022

A. **Contracts:** In the proposals for telecommunication contracts, the providers typically intend installing all necessary equipment on the project site at no cost to the project, and in return, the project receives lease payments. ORCF is supportive of these arrangements, provided that they bring a higher level of service to our communities in a more competitive atmosphere, increase project revenues, and enhance project marketability, and further provided that any associated physical, business, and legal risk involved with installation and maintenance of such towers is appropriately mitigated. Physical risks such as the stress on the roof structure and the connections to the roof structure will require a professional engineering (PE) certification. Additionally, a HUD environmental review may be required before HUD approves a contract or lease for telecommunications towers.

2023 B. **Engineered fall distance.** All structures shall be located outside the engineered fall distance  
2024 of any support structure for high voltage transmission lines, radio antennae, satellite towers,  
2025 cellular towers, etc., as discussed in Production, Chapter 7.5.K.2.— HUD expects that any fall  
2026 distance calculations will be prepared and certified by a professionally registered engineer.  
2027

2028 C. **Lease:** The following points are to be taken into consideration:  
2029

- 2030 1. The lease may not be modified, extended or terminated without the prior written  
2031 consent of the Mortgagee/ServiceLender.  
2032
- 2033 2. The lease may not be modified or extended without the prior written consent of HUD.  
2034
- 2035 3. The lease must be assignable by the Lessor to the Mortgagee/ServiceLender and/or  
2036 HUD (i.e., upon foreclosure or deed-in-lieu of foreclosure).  
2037
- 2038 4. The lease is subordinate to the HUD-held or FHA-insured Mortgage (Security  
2039 Instrument).  
2040
- 2041 5. The lease will not be automatically terminated by foreclosure or any other transfer of  
2042 the mortgaged project; and, that in the case of foreclosure or deed-in-lieu of  
2043 foreclosure, the Mortgagee/ServiceLender and/or HUD shall have the right to accept  
2044 or terminate the lease.  
2045
- 2046 6. The lease must contain a clause that states that the Lessee shall, upon receipt of notice  
2047 of default under the Mortgage (Security Instrument), pay all rents payable under the  
2048 lease to the Mortgagee/ServiceLender and/or HUD.  
2049
- 2050 7. The lease must contain the following information:
  - 2051 a. a comprehensive list of the equipment to be installed, including a list of any  
2052 proposed improvements to the FHA-insured project;
  - 2053 b. Lessee is responsible for the maintenance of the equipment;
  - 2054 c. maintenance schedule;
  - 2055 d. access information; and
  - 2056 e. where the equipment is located (i.e., roof) along with a drawing of the  
2057 location.
- 2058
- 2059 8. The lease shall contain a provision which conditions approval of the lease on the  
2060 Lessee obtaining all variances, permits, license or approvals required by applicable  
2061 law.  
2062
- 2063 9. The lease must contain a certification from the Lessee that it has performed its own  
2064 investigation of the project and has determined its suitability for use.  
2065
- 2066 10. The lease may contain a provision granting the Borrower, its successors and assigns  
2067 the right to relocate any equipment, wiring or cabling.  
2068

2069  
2070  
2071  
2072  
2073  
2074  
2075  
2076  
2077  
2078  
2079  
2080  
2081

11. The lease must contain a provision permitting the Borrower, its successors and assigns the right to terminate the lease should, 1) Lessee default in payments owed under the lease, 2) Lessee's authorized use of the premises materially interfere with Borrower's use and operation of the project and building, or, 3) it be determined that the Lessee's equipment constitutes a danger to the health and safety of the project's residents or poses a danger to the structural integrity of the building.
12. The lease must contain a provision mandating that hazardous waste materials will not be stored, used, generated, etc., on or in the FHA-insured project at any time.
13. Anti-Deficiency Provision: in no event shall HUD be subject to an indemnification provision in the lease, whether in the present or future (if it becomes Lessor to the lease).

DRAFT

2082 **Section 3.9**  
2083 **Commercial Space**  
2084  
2085

---

2086 **3.9.1 Introduction**

2087 **A. General Guidance**

2088 This section provides guidance pertaining to ORCF’s requirements related to additions or  
2089 alterations to commercial space on projects currently insured under any of the programs  
2090 covered by this Handbook.

2091  
2092 **B. Categorization of Space.**

2093 Commercial space in a Healthcare Facility can be categorized as a space within the project  
2094 that has been altered or converted for use other than residential purposes from which income  
2095 is derived or anticipated. In accordance with **24 CFR 200.73**, a project may include such  
2096 commercial and community facilities as the Commissioner deems acceptable. Commercial  
2097 space differs from community space or community facilities. The term “community  
2098 facilities” refers to project amenities, such as a pool, resident parking/parking garage,  
2099 business center or fitness center that are predominantly used by residential tenants, with or  
2100 without charging additional fees. Community facilities generally do not produce regular  
2101 income and any intermittent revenue is to be included as ancillary income.  
2102  
2103

---

2104 **3.9.2 Types of Commercial Space for Assisted  
2105 Living, Intermediate Care, and Skilled  
2106 Nursing Facilities**

2107 **Commercial Space vs. Community Space.** Generally speaking, due to the special nature of  
2108 these types of projects, commercial space is to be limited to commercial activities that benefit the  
2109 type of residents that live in the project. Unless the project has been constructed as a mixed use  
2110 building, the project shall include commercial activities that are consistent with the type of  
2111 project and type of residents served. Common Commercial Space areas in ALF, Intermediate  
2112 Care Facilities (ICF), SNF and Board and Care Facilities include, but are not limited to: hair  
2113 salons, convenience stores, specialized medical care provider spaces, ice cream parlors, coffee  
2114 shops, gift shops and non-resident parking. These are deemed “commercial” instead of  
2115 community spaces if they are income producing on a consistent basis and gain their revenue  
2116 from residents and customers on a “pay for service” basis separate from the monthly bed charge.  
2117 Residential parking, if a fee is charged to residents, is still considered community space and is  
2118 recorded as ancillary income, not commercial income for the purpose of the calculations and  
2119 limitations below.

### 3.9.3

## Space and Income Limitations

2120  
2121  
2122  
2123  
2124  
2125  
2126  
2127  
2128  
2129  
2130  
2131  
2132  
2133  
2134  
2135  
2136  
2137  
2138  
2139  
2140  
2141  
2142  
2143  
2144  
2145  
2146  
2147  
2148  
2149  
2150  
2151  
2152  
2153  
2154  
2155  
2156  
2157  
2158  
2159  
2160  
2161  
2162

This section provides guidance pertaining to when a Borrower wishes to change the intended use of part of a project to commercial space.

**A. Commercial Space and Income Limit Computations.** Commercial Space and Income is limited to 20 percent of the total gross floor area of the property and 20 percent of the Effective Gross Income of the project Commercial Space that is intended to exclusively serve the residents of the project is not counted toward the 20 percent limit.

**B. Non-Compliance and Retroactive Approval.** There may be instances in which residential space is converted to commercial use without the knowledge of HUD. ORCF shall inform the project Borrower, in writing, that such action is in violation of the Regulatory Agreement and that failure to correct this violation may result in HUD exercising its rights under the Regulatory Agreement, including denial of future participation in HUD programs. ORCF may approve the conversion retroactively, in its determination, provided all requirements are met.

**C. Parking.**

1. Parking income attributable to residential tenants is considered to be ancillary income and is not included in the limits contained in Section A, above. Commercial parking spaces reserved for use by motorists who are not project residents or are not parking to use the on-site commercial tenant's facilities, and the related non-tenant parking income, must be included in the Commercial Space and Income limitations. The income and space attributable to parking spaces reserved for non-residential or non-commercial tenants must be included in the limitations, based on applying the percentage of the total spaces that are reserved for non-tenant use. For existing projects that are to be acquired, refinanced or will undergo substantial rehabilitation, that provide parking for a monthly fee, the **Mortgagee/ServiceLender** must identify the percentage of monthly parkers who are non-tenants so as to include these in the commercial income limitations, above. The maximum occupancy factor to be applied to the parking income attributable to parkers who are not associated with either the project's residential or commercial tenants shall be the lower of:
  - a. The amount indicated by the market and by the historic performance of the subject, or
  - b. 50 percent.
2. If the Borrower operates a parking facility that provides parking for residential or commercial tenants of the project, the **Mortgagee/ServiceLender** must determine parking income based on an analysis of the past 3 years of operation and the trailing 12 month period prior to application.
3. If the parking facility is operated by a third-party, the **Mortgagee/ServiceLender** may use the amount of income collected under the contract if it is a fixed monthly

2163 payment. Parking contracts that specify a percentage rent in addition to or in place of  
2164 a fixed rent are not permitted without HUD approval.  
2165  
2166

---

### 3.9.4 Submission Requirements and HUD Review

2167  
2168 A. **Submission Requirements.** Please see the list of exhibits provided on the checklist posted on  
2169 the Section 232 Program website. The ~~Mortgagee/Service~~Lender is to receive any requests  
2170 for additions or alterations to commercial space, review them for completeness, accuracy and  
2171 eligibility, and then forward them to ORCF with a recommendation for approval.  
2172

2173  
2174 B. **Additional Considerations.** The following issues will be considered by ORCF in  
2175 processing Commercial Leased Applications:

- 2176  
2177 1. Current ~~Financial~~financial and ~~Physical Condition~~physical condition of the  
2178 ~~Project~~project.
- 2179  
2180 2. ~~2.~~—Open Federal, State, and local compliance ~~Issues~~issues.
- 2181  
2182 3. An environmental review as required by 24 CFR Part 50 will be conducted on any  
2183 proposal for remodeling, adding to, subtracting from, reconstructing, or demolishing a  
2184 portion of the mortgaged project. Environmental Review Requirements are described  
2185 in further detail on Form HUD-90030-ORCF, including: Phase I, Radon and other  
2186 Environmental concerns.

2187  
2188 C. **Decision on Request for Approval.** ORCF will notify the ~~Mortgagee/Service~~Lender, in  
2189 writing.  
2190



2191  
2192  
2193  
2194  
2195  
2196

## Section 3.10

# Special Circumstances Requiring the Notification of the Mortgagee/Service Lender and/or AE

2197

### 3.10.1 Introduction

2198 Throughout this portion of this chapter there are indicators that require a Borrower and/or  
2199 Operator either to notify the Mortgagee/Service Lender and the AE concurrently, or to notify  
2200 only the Mortgagee/Service Lender (who would in turn elevate the matter to the AE as  
2201 appropriate) -of a Project's project's risk, of an action plan or of progress on previously reported  
2202 situations. ORCF has created a sample format that Mortgagee/Service Lenders may use in reporting  
2203 this information; There are also circumstances where the sample may be found on Lender is  
2204 required to notify the Section 232 Program website. AE of its own volition.

- 2205
- 2206 A. The Operator's Notification to HUD of Threats to Permits and Approvals Section 232 (Form  
2207 HUD-93335-ORCF) and Service Lender's Notification to HUD of Risks to Healthcare  
2208 Project (Form HUD-93334-ORCF) are to be used in reporting this information, as applicable.
- 2209
- 2210 B. When risks to the FHA-insured security are present, ORCF requires Lenders/Service Lenders to  
2211 submit a HUD-93334-ORCF/93335-ORCF within 14 calendar days and establish an action  
2212 plan or corrective action plan within 30 calendar days, to improve deficiencies and remedy  
2213 the identified risk condition(s). HUD may accelerate or extend the deadline by such time as  
2214 HUD may determine is necessary. ORCF expects that Lenders will work with the Borrower  
2215 and Operator, as appropriate, to develop action plans for improving verified deficiencies. In  
2216 addition to items noted further in this chapter for specific circumstances, all action plans  
2217 must include the following components:

- 2218 1. Root cause analysis, with a description of the risk, its specific cause and discussion of  
2219 its effect on the project.
- 2220 2. A description of the action plan to be implemented.
- 2221 3. Measurable goals for each area of concern.
- 2222 4. Timeline for completion.
- 2223 5. Schedule for ensuring ongoing monitoring of an action plan.
- 2224 6. Description of potential risks, mitigants, barriers, financial resources required, with a  
2225 mechanism for revising a plan if the established plan is not proving effective.

2226

2227 OHP requires all owners/operators/management agents be in substantial compliance  
2228 HUD requirements and with CMS and State Surveys to ensure that they remain in good  
2229 standing for all programs/payor sources through CMS and each State. As payor

programs change over time, with an increasing focus on quality of care, HUD expects that quality of care be a priority. As such, corrective action plans should strive to achieve a goal of 3 Stars or higher in each star rating category; no scope and severity of G or higher; no special focus designation or graduation from special focus; no harm or immediate jeopardies to residents; no denial of payment; no Termination of Provider Agreement or Revocation of License; no Civil Money penalties over \$50,000 and or any civil money penalty that impacts financials to a DSCR below a 1.00. Failure to provide a corrective action plan can result in administrative action.

C. Notification types are as follows:

1. Failure to Make Lease Payment (Refer to 3.10.2)
2. Default of Master Lease (Refer to 3.10.3)
3. Special Focus Facility (Refer to 3.10.4)
4. State Inspections (Refer to 3.10.5)
5. Legal Judgements (Refer to 3.10.6)
6. Professional Liability Insurance (Refer to 3.10.7)
7. Fidelity Bond Coverage (Refer to 3.10.8)
8. Notification of Termination of Insurance (Refer to 3.10.9)
9. Threat to Abandon Project (Refer to 3.10.10)
10. REAC Inspections (Refer to 3.10.11)
11. Accounts Receivable Loans (Refer to 3.10.12)
12. Bankruptcy (Refer to 3.10.13)
13. Delinquent Mortgage Payments (Refer to 3.10.14)
14. Unauthorized Distributions (Refer to 3.10.15)
15. Failure to File Financial Statements (Refer to 3.10.16)
16. Financial Risks Metrics of Operator (Refer to 3.10.17)
17. Lender Assignment of the Note (Refer to 3.10.18)
18. Other Circumstances (Refer to 3.10.19)

### 3.10.2

### Failure to Make Lease Payment

- A. The Mortgagee/Service/Lender and AE must be immediately notified by the Borrower of a failure to make a Lease payment.
- B. The Mortgagee/Service/Lender and AE will work with Borrower and Operator to understand the financial or business circumstances that have resulted in the non-payment, and try to facilitate an action plan that will remedy the non-payment status.
- C. The Mortgagee/Service/Lender will continue to monitor the situation, to ensure timely payments continue in the future.
- D. Borrowers and Operators are strongly encouraged to work together with the Mortgagee/Service/Lender to facilitate remedies to any problems with the Lease payments because the Mortgagee/Service/Lender can be of assistance in such scenarios. If the Mortgagee/Service/Lender knows of the payment status early enough, they may be able to

work with the Projectproject to create an action plan and remedies with the parties before any non-payment penalties are incurred.

- E. In the event of a non-payment related to a Borrower/Operator dispute or other non-financial reason, the Mortgagee/ServiceLender must contact the AE to discuss the severity of the situation and whether it should be transferred to the Risk Mitigation Branch.

---

### 3.10.3

### Default of Master Lease

- A. Notification of Default of a master lease must be provided from Borrower to Mortgagee/ServiceLender and HUD within two (2) business days following the Borrower's receipt of the notification.
- B. Once notified, Mortgagee/ServiceLender will evaluate other projects within the master lease, to determine cash flows and the ability to cover the failing project(s). The Mortgagee/ServiceLender will collaborate with HUD.
- C. Default on a master lease will impact the Projectproject, legal documents, and potentially a default on the mortgage. The project may also need to be serviced by the Risk Mitigation Branch.

Additional details regarding master leases may be found in Production, Chapter 13: and Asset Management, Chapter 9.

---

### 3.10.4

### Special Focus Facility

CMS has a Special Focus Facility Initiative that places a nursing home, with a history of serious quality issues, into a special program that is meant to stimulate the project to improve their quality of care to residents (see also, Section 3.5.7).

- A. Notifications to HUD and the Mortgagee/ServiceLender are required to be submitted within two (2) business days after the date of receipt of notice of a Special Focus Facility ~~Focus~~ (SFF) designation from a state or federal regulatory agency, unless a longer time period is approved by HUD.

Failure by the Projectproject to notify HUD and the Mortgagee/ServiceLender of a SFF designation will be deemed a violation of federal regulation 24 CFR 232.1015 and may lead to the involvement of the HUD Departmental Enforcement Center (DEC).

2315 The Special Focus Facility list may be found at the following web address:  
2316 <http://www.cms.gov/Medicare/Provider-Enrollment-and->  
2317 [Certification/CertificationandCompliance/downloads/sfflist.pdf](http://www.cms.gov/Medicare/Provider-Enrollment-and-Certification/CertificationandCompliance/downloads/sfflist.pdf)

- 2318
- 2319 B. The **Mortgagee/Service Lender** and AE will work with the Operator (and, as applicable, the  
2320 Borrower and Management Agent) to establish an action plan for being removed from the  
2321 SFF list.
- 2322
- 2323 C. The AE will reassign the project to the Risk Mitigation Branch for ongoing servicing.
- 2324
- 2325 D. Each **Projectproject** and situation is unique; some may show improvement and move off the  
2326 SFF list faster than others. The **Mortgagee/Service Lender** and AE (Risk Mitigation Branch  
2327 member) will work with the **Projectproject** to establish an action plan.
- 2328
- 2329

### 3.10.5

## State Inspections

- 2330
- 2331 A. **Reporting Requirements.** Keeping the **Mortgagee/Service Lender** and ORCF informed of  
2332 problematic surveys and of any actions that could threaten the licensure or provider payments  
2333 for a project is crucial, since such matters can threaten the viability of operations that are  
2334 needed to meet operating expenses and make mortgage payments.
- 2335
- 2336 1. Except as limited in 3.10.5.A.2, HUD requires reporting when the Operator **and/or**  
2337 **Borrower** receives a notice, report, survey or other correspondence (regardless of  
2338 form) from any governmental entity that includes any statement, finding or assertion  
2339 that:
    - 2340 a. Operator (or any principal, officer, director or employee of Operator), any  
2341 Management Agent, the **Projectproject**, or any portion of the **Projectproject** is  
2342 or may be in violation of or default under any of the Permits and Approvals or  
2343 any governmental requirements applicable to the operation of the  
2344 **Projectproject**, or
    - 2345 b. Any of the Permits and Approvals are to be terminated, limited in any way, or  
2346 not renewed; or
    - 2347 c. Any civil money penalty (other than a de minimis amount) is being imposed  
2348 with respect to the **Projectproject**, or
    - 2349 d. Operator (or any principal, officer, director or employee of Operator), any  
2350 Management Agent, the **Projectproject**, or any portion of the **Projectproject** is  
2351 subject to any governmental investigation or inquiry involving fraud.
  - 2352 2. Reporting **from the Borrower and/or Operator** is only required with relation to  
2353 Licensed Nursing Facility surveys when a survey has any findings higher than a “G”  
2354 level or any repetitive “G” level or higher findings from prior surveys (pursuant to  
2355 CMS State Operations Manual, Chapter 7, as may hereafter be edited or updated, or  
2356 any successor guidance). “Repetitive” is defined as “unresolved from the two most  
2357 recent consecutive surveys or a repeat violation having the same citation number”.  
2358 **However, ORCF may require an action plan from the Lender on additional**  
2359 **Projectproject**

2360 conditions, including placement of the project on the SFF candidates list, a drop of 2  
2361 Star Levels in one year, receipt of a 1 Star rating (for either Overall or for a Health  
2362 Inspection or Infection Control Inspection).  
2363

2364 3. **Reporting Logistics.** Unless otherwise requested by HUD or the  
2365 Mortgagee/Service Lender:

- 2366 a. The *initial* communication from the Operator and/or Borrower pursuant to this  
2367 Section shall be a notice by email to the Mortgagee/Service Lender (not to  
2368 HUD) describing the conduct cited, the scope and duration of remedy(ies)  
2369 imposed, and the timelines for corrective actions (not the survey or other  
2370 extensive communication itself). Such email notice shall be sent within two  
2371 (2) business days of receipt of the notice, report, survey, or other  
2372 correspondence from the governmental entity, using the Operator's and/or  
2373 Borrower's Notification to HUD of Threats to Permits and Approvals Section  
2374 232.
- 2375 b. The *next* communication from the Operator and/or Borrower shall be email  
2376 notification to the Mortgagee/Service Lender that the issue(s) have been  
2377 addressed to the satisfaction of the issuing regulatory agency.
- 2378 c. The Mortgagee/Service Lender shall notify the AE immediately when a  
2379 matter listed in Section 3.10.5.A.1 is reported by the Operator and/or  
2380 Borrower that is not expected to be readily resolved or poses an immediate  
2381 threat to licensure or funding. If necessary, the Mortgagee/Service Lender  
2382 should work proactively with the operator to ensure the issue(s) are addressed  
2383 to the satisfaction of the issuing regulatory agency. ~~The Mortgagee/Service~~  
2384 ~~may use an optional reporting form made available by ORCF for reporting~~  
2385 ~~these or other matters of concern regarding the financial or operational~~  
2386 ~~performance.~~
- 2387 d. The Servicer's Notification to HUD of Risks to Healthcare Project and  
2388 Action Plan for Remedy Section 232 will document the Action Plan.  
2389

2390 B. The receipt by HUD and/or Mortgagee/Service Lender of notices, reports, surveys,  
2391 correspondence and other information shall not in any way impose any obligation or liability  
2392 on HUD, Mortgagee/Service Lender or their respective agents, representatives or designees  
2393 to third parties to take (or refrain from taking) any action, and HUD,  
2394 Mortgagee/Service Lender and their respective agents, representatives and designees shall  
2395 have no liability to third parties for any failure to act thereon or as a result thereof.  
2396

2397 C. Failure to notify the AE and the Mortgagee/Service Lender of such inspection reports, Plans  
2398 of Correction, approval reports or other qualifying communications, will be a violation of  
2399 federal regulation 24 CFR 232.1015, as well as the operator regulatory agreement, and may  
2400 lead to the involvement of the HUD Departmental Enforcement Center (DEC).  
2401  
2402

## 3.10.6

## Legal Judgments

2404 The Borrower and the Operator must each notify their Mortgagee/ServiceeLender within two (2)  
2405 business days of receiving a legal judgment, penalty or fine against the Projectproject, in excess  
2406 of \$50,000.

- 2407
- 2408 A. The ability to cover a judgment/penalty/fine will vary based on the size of the project, the  
2409 available cash, etc. The Mortgagee/ServiceeLender will work with the Projectproject to  
2410 discuss reasons for the judgment and impacts on the financial status of the Projectproject,  
2411 notifying the AE of outcomes. The Operator must provide the Mortgagee/ServiceeLender  
2412 with an action plan (seeking the Mortgagee/Servicee'sLender's guidance, as necessary and  
2413 appropriate), and must work with Mortgagee/ServiceeLender to analyze the impact of the  
2414 judgment, providing information to the AE of the status, until financial stability is regained.  
2415
- 2416 B. Depending on the financial position of the Projectproject and its ability to absorb the imposed  
2417 judgment, it may require a change to "Potentially Troubled" status in the HUD system, by  
2418 the AE.  
2419  
2420

---

### 3.10.7

### Professional Liability Insurance

2421  
2422 On an annual basis, the Mortgagee/ServiceeLender must verify that each Projectproject has the  
2423 required Professional Liability Insurance (PLI) coverage, as approved during the  
2424 Project'sproject's underwriting. This review must include a current copy of the insurance  
2425 ACORD, PLI policy, certificate or memorandum of insurance or other evidence of the required  
2426 insurance coverage, as well as review of the updated loss history, consistent with the  
2427 underwriting review standards (Section II, Production, Appendix 14.1.VII.D )  
2428

- 2429
- 2430 1. If coverage is less than required, then the Mortgagee/ServiceeLender must work  
2431 directly with the Projectproject to resolve the coverage deficiency.
  - 2432 2. If the coverage deficiency is not readily resolved, then the Mortgagee/ServiceeLender  
2433 must notify the AE and monitor the Projectproject until the coverage is adequately  
2434 provided.  
2435
  - 2436 3. --If the review of loss history indicates a negative trend in claims, the  
2437 Mortgagee/ServiceeLender must evaluate the situation, discuss with the Operator any  
2438 financial or operational changes that may be warranted, and discern the  
2439 Project'sproject's financial ability to absorb any ramifications imposed by the  
2440 claim(s). If appropriate, the Operator must establish an action plan. The  
2441 Mortgagee/ServiceeLender will involve the AE as they deem appropriate.  
2442  
2443

---

### 3.10.8

### Fidelity Bond Coverage

2444

2445 On an annual basis, the Mortgagee/Service Lender must verify that each Project project has the  
2446 required Fidelity Bond/Employee Dishonest coverage, as approved during the Project's project's  
2447 underwriting.

- 2448  
2449
- 2450 A. If coverage amount is less than required (at least two months annualized potential effective  
2451 gross income receipts, as required at the time of HUD Project project approval), then the  
2452 Mortgagee/Service Lender must work directly with the Project project to resolve the coverage  
2453 deficiency.
- 2454
- 2455 B. If the coverage deficiency is not readily resolved, then the Mortgagee/Service Lender must  
2456 notify the AE.
- 2457
- 2458 C. The Mortgagee/Service Lender must monitor the Project project until the coverage is  
2459 adequately provided.  
2460  
2461

---

### 3.10.9

### Notification of Termination of Insurance

- 2462
- 2463 A. A project cannot be uninsured in the Section 232 Program. The Project project must notify  
2464 their Mortgagee/Service Lender and AE within two (2) business days of its receiving  
2465 notification of any termination of insurance.
- 2466
- 2467 B. The Operator must provide the Mortgagee/Service Lender with an action plan (seeking the  
2468 Mortgagee/Service Lender's guidance, as necessary and appropriate), and must work with  
2469 Mortgagee/Service Lender to resolve the circumstances surrounding the notification,  
2470 providing information to the AE of the status, until resolution is reached. In the absence of a  
2471 long-term resolution, as part of the action plan, the Lender must keep adequate property  
2472 insurance in force. As noted in Production, Chapter 14, "The Lender will be liable to HUD if  
2473 a binder expires, the Borrower has not provided sufficient evidence of permanent coverage,  
2474 and an uninsured loss occurs.
- 2475
- 2476 C. Termination of insurance or the formal notification of a potential termination of insurance  
2477 will immediately warrant a change to "Troubled" status in the HUD system until the issue is  
2478 resolved.  
2479

2480 ~~Failure to notify the AE and the Mortgagee/Service of such notifications will be a violation of~~  
2481 ~~federal regulation 24 CFR 232.1015, and may lead to the involvement of the HUD Departmental~~  
2482 ~~Enforcement Center (DEC).~~  
2483  
2484

---

### 3.10.10

### Threat to Abandon Project

- 2486 A. The Borrower must notify their Mortgagee/ServiceeLender within two (2) business days of  
2487 any threat to abandon the Projectproject, when initiated by the Borrower or Operator. This is  
2488 separate from an inspection/ survey decertification.  
2489
- 2490 B. The Mortgagee/ServiceeLender must investigate the threat to abandon the project, and  
2491 attempt to mediate a resolution. The Mortgagee/ServiceeLender must escalate the threat to  
2492 the AE if it becomes more imminent and/or cannot be resolved quickly without HUD  
2493 involvement.  
2494  
2495

### 3.10.11

### REAC Inspections

- 2496
- 2497 A. The Borrower must notify their Mortgagee/ServiceeLender within two (2) business days of  
2498 receiving a REAC score of 30 or below or a second REAC inspection score below 60.  
2499
- 2500 1. A score of 30 and below creates an automatic REAC referral to the DEC and must be  
2501 addressed immediately.  
2502
  - 2503 2. A second consecutive score of below 60 will warrant a referral to the DEC and must  
2504 be addressed immediately.  
2505
  - 2506 3. The Mortgagee/ServiceeLender must assist the Projectproject in determining if an  
2507 appeal of the inspection score is appropriate, and provide assistance in preparing the  
2508 appeal to REAC.  
2509  
2510 Appeals to REAC have extremely time-sensitive deadlines which must be met.  
2511 Please reference the Physical Condition portion of this chapter for more details on the  
2512 REAC appeals process.  
2513
  - 2514 4. The Mortgagee/ServiceeLender must review the inspection report to ensure repetitive  
2515 findings are being addressed and physical plant items are taken care of immediately.  
2516  
2517



### 3.10.12

## Accounts Receivable Loans

As further defined in the Production, Chapter 15 and Asset Management, Chapter 10:

- A. When a Project proposes to add or amend an Accounts Receivable (ARA/R) loan, it must be reviewed with the same scrutiny that such a loan would be reviewed during the initial underwriting process. The Project must submit the required documentation to the Mortgagee/Service Lender, who will review the information for completeness, accuracy and eligibility, and then forward the submission to ORCF with a recommendation for approval.

A change in the ARA/R loan status initiated due to extenuating circumstances that have adversely impacted the Project (rather than straightforward changes in business) should be evaluated by the Mortgagee/Service Lender and brought to AE's attention for particular scrutiny. If the ARA/R loan change is a straightforward change in the loan, there would be less of a concern than the need for a new loan due to a change in provider payments or other financial burdens.

- B. The Project must notify their Mortgagee/Service Lender within two (2) business days of any notification of default on its Account Receivable (ARA/R) loan.

1. Default on an ARA/R loan may be an indicator of potential default on the mortgage. Therefore, once notified, the Mortgagee/Service Lender must evaluate why the ARA/R Loan has defaulted, reviewing cash flows and the ability to cover the failing loan, and work with the Project to create an action plan for moving the loan out of a default status.
2. The Mortgagee/Service Lender must collaborate with AE (and Risk Mitigation Branch, if assigned) as necessary until the remedies are put in place and the action plan has been fully implemented. The Mortgagee/Service Lender must also monitor the Project closely to ensure financial and operational viability are restored.

### 3.10.13

## Unauthorized Distributions – Bankruptcy

~~A. The Borrower must notify their Mortgagee/Service within two (2) business days of receiving a Notification of Unauthorized Distribution by the HUD Financial Assessment Subsystem (FASS).~~

- ~~1. The notification also includes a designated cure period which must be adhered to.~~
- ~~2. This notification is sent automatically to the email the Project registered in the system when an unauthorized distribution has been determined by FASS, as well as to the AE. The AE must also immediately notify the Mortgagee/Service of the violation.~~

2560  
2561 ~~3.1. The Borrower and, where applicable, the Operator, must provide the~~  
2562 ~~Mortgage/Servicer with an action plan (seeking the Mortgage/Servicer's guidance,~~  
2563 ~~as necessary and appropriate), and must work with Mortgage/Servicer to ensure the~~  
2564 ~~cure period will be met to resolve the violation, and to further review the~~  
2565 ~~circumstances leading to the violation. The unauthorized distribution may be a sign~~  
2566 ~~of financial distress that needs to be closely monitored, and an action plan may need~~  
2567 ~~to be put in place to do so.~~

2568  
2569 ~~4. The Mortgage/Servicer must notify the AE if there are extenuating circumstances~~  
2570 ~~that are preventing the immediate submission of the action plan, and provide the AE~~  
2571 ~~with the action plan expeditiously, and assure that the funds are repaid within the cure~~  
2572 ~~period.~~

2573  
2574 ~~B. There are times when REAC/FASS findings trigger contact from the DEC directly to the~~  
2575 ~~Project. Although the AE is also copied on such the notification, and must notify the~~  
2576 ~~Mortgage/Servicer, the Borrower is responsible for notifying the Mortgage/Servicer within~~  
2577 ~~two (2) business days of receipt of a REAC/FASS notification from the DEC.~~

2578  
2579 ~~The Mortgage/Servicer will then work with the Project to cure the violation or devise an~~  
2580 ~~action plan to cure the finding(s), including the AE as appropriate, and communicating with~~  
2581 ~~the DEC during the process.~~

### 3.10.14

### Bankruptcy

2584  
2585 A. ~~The Borrower and Operator~~ must notify their Mortgage/Servicer Lender within two (2)  
2586 business days of any bankruptcy petition related to any of the Project/project participants who  
2587 may file for bankruptcy (i.e. Borrower, Operator, or Management Agent).

2588  
2589 B. ~~The Mortgage/Servicer must review the bankruptcy status and circumstances, and~~  
2590 ~~within~~ Within two (2) business days of being notified by the Project, Borrower/Operator of the  
2591 bankruptcy filing, the Lender must provide the AE with the specifies of those  
2592 circumstances relevant information related to the bankruptcy, including, but not limited to:  
2593 bankruptcy type, contact information of the participants and their respective legal counsels,  
2594 the reason for petition, and whether the petition is voluntary or involuntary.

2595  
2596 1. A copy of the bankruptcy notice must also be provided to the AE at this time.

2597  
2598 ~~2. Generally speaking, a bankruptcy status will warrant transfer to the Risk Mitigation~~  
2599 ~~Branch portfolio due to the troubled nature of the project..~~

2600  
2601 2. The Project-The Lender shall document the Action Plan for Remedy using the  
2602 Servicer's Notification to HUD of Risks to Healthcare Project and Action Plan for  
2603 Remedy form, in coordination with the Borrower.

2604  
2605 C. The project Participant must notify their Mortgagee/Service Lender of any imminent  
2606 bankruptcy proceedings of which it is aware. The Mortgagee/Service Lender must notify the  
2607 AE of the imminent bankruptcy within two (2) business days of obtaining such knowledge.

- 2608
- 2609 1. ~~Until an FHA insurance claim is filed, HUD expects the~~The Mortgagee/Service  
2610 ~~to~~must fully participate in the bankruptcy proceedings; until it no longer has a lien or  
2611 security interest in the collateral. Unless, and until, HUD intervenes in the  
2612 proceedings, the Mortgagee/Service Lender is expected to ~~guard HUD's~~sensure  
2613 ~~that~~HUD's interests are protected and keep HUD fully informed as to the case's  
2614 progress and major developments, as outlined in 3.g. below.
- 2615
- 2616 2. The AE will assign the Project to the Risk Mitigation Branch, if warranted.
- 2617
- 2618 3. The ~~Mortgagee/Service~~should be reviewingLender must monitor the bankruptcy  
2619 proceedings to ensure:
- 2620 a. The nursing home license, certificate of need, and provider agreements remain  
2621 with the project;
- 2622 b. Rights to the operator's account receivables ("ARA/R") remain with the  
2623 Project or are paid towards ARA/R financing approved by HUD for the  
2624 Project's benefit;
- 2625 c. Lease payments are ~~be~~sufficient to cover debt and R4 requirements;
- 2626 d. ~~Compliance~~There is continued compliance with all ~~covenant~~remains  
2627 intact covenants;
- 2628 e. ~~Mortgage Security Agreements~~ and ~~security instruments~~Security Instruments  
2629 remain enforceable in accordance with their terms;
- 2630 f. All Regulatory Agreements pertaining to the Project remain in effect  
2631 and the parties to these agreements are complying with the requirements  
2632 contained therein; and
- 2633 ~~g. All actions required of the Mortgagee/Service under Mortgage Letter 91-17.~~
- 2634
- 2635 g. The Borrower does not use project assets to pay attorney fees for legal service  
2636 in connection with any aspect of the bankruptcy action without HUD  
2637 approval.

2638

2639 D. The Lender takes necessary actions to protect its interest and to preserve the collateral,  
2640 including filing the appropriate documents. (Note that project rents are part of the loan  
2641 security and are denoted as cash collateral under the Bankruptcy Code. Therefore, the  
2642 Lender shall petition the bankruptcy court for an Order recognizing its entitlement to the  
2643 rents under the assignment of rents clause and restricting use of the rents in accordance with  
2644 the rules governing cash collateral).

2645

2646 D.E. Particularly for Projects under a master lease, it ~~will~~is not ~~be~~unusual for a  
2647 Project to be ~~involved~~named in the bankruptcy proceedings without there being a  
2648 monetary default; ~~however it is still necessary for the Mortgagee/Service.~~ In such cases, the  
2649 Lender is required to work closely with the representatives for the troubled Project,

and other projects within the master lease, to ensure that the bankruptcy has as minimal ~~ana~~ negative impact as possible on ~~the other projects, its project(s)~~, and to avoid further financial disruption in the ~~other remaining~~ projects in the master lease.

E.F. The Mortgagee/ServiceeLender must provide routine bankruptcy status updates to the assigned AE and/or their designee. The Mortgagee/ServiceeLender may also be responsible for working with the Risk Mitigation Branch, OGC, DEC and/or a Department of Justice (DOJ) legal team.

### **3.10.1514**

## **Delinquent Mortgage Payments**

- A. Delinquent mortgage payments are not only a violation of legal obligations by the Borrower, but are also a sign of financial distress for a Projectproject and are to be closely monitored by the Mortgagee/ServiceeLender. The Borrower is required to notify the Mortgagee/ServiceeLender if the mortgage payment is delinquent as of the 16<sup>th</sup> of the month.
- B. The Multifamily Delinquency and Default Reporting (MDDR) System will notify the AE of a delinquency after the 16<sup>th</sup> of the month. The AE will reach out to the Mortgagee/ServiceeLender for a status of the delinquency and expectations of when the payment will be made.
- C. Upon notification of a delinquency, the Mortgagee/ServiceeLender must work with the Borrower (and Operator, if applicable) to ascertain the financial, operational and/or other circumstances leading to the non-payment, including, but not limited to evaluating the ability of the Borrower to pay the mortgage, any anticipation of payments to be made, the financial strength of the Borrower (and Operator), recent state survey results, extenuating circumstances and other concerns potentially leading to the delinquency.
- D. The Borrower (and Operator, if applicable) must provide the Mortgagee/ServiceeLender with an action plan (seeking the Mortgagee/ServiceeLender's guidance, as necessary and appropriate). The Mortgagee/ServiceeLender must then notify the AE of situation, and provide the AE with an action plan to remedy the delinquency.
- E. The Mortgagee/ServiceeLender and AE may also, at this time, request and review financial reports from the Projectproject to determine an action plan.
- F. Once notified of the delinquency, if no action from the Borrower or Mortgagee/ServiceeLender has taken place by the end of the month, the AE will work directly with the Mortgagee/ServiceeLender and Borrower to escalate the action plan.
- G. The Mortgagee/ServiceeLender will monitor any mortgage payment that is over 30 days delinquent until it is paid.
- H. Once a non-payment has aged between 45 to 60 days, and no evidence of payment is anticipated, the Mortgagee/ServiceeLender must again notify the AE and provide additional

2695 information regarding cash flow problems or other circumstances within the Project  
2696 project that have led to the delinquency.

2697  
2698 At this stage, the project will be evaluated to determine if a transfer to the Risk Mitigation  
2699 Branch is warranted and/or to escalate the HUD involvement with the Borrower (and  
2700 Operator) in an effort to avoid default of the loan. The Project  
2701 project will also be monitored until the financial status and mortgage payments return to a stable level.  
2702

- 2703 I. For systemic late fees and delinquencies, but not beyond 30 days, the  
2704 Mortgagee/Service Lender may use discretion in involving the AE, but must notify HUD if  
2705 this occurs more than 6 out of 12 months. These systemic delinquencies may not necessarily  
2706 warrant transition to the Risk Mitigation Branch nor indicate a "Troubled" project, but further  
2707 evaluation will be required.  
2708  
2709

### 3.10.15

### Unauthorized Distributions

2710  
2711 A. The Borrower must notify their Lender within two (2) business days of receiving a  
2712 Notification of Unauthorized Distribution by the HUD Financial Assessment Subsystem  
2713 (FASS).

- 2714  
2715 1. The notification also includes a designated cure period which must be adhered to.  
2716  
2717 2. This notification is sent automatically to the email the project registered in the system  
2718 when an unauthorized distribution has been determined by FASS, as well as to the  
2719 AE.  
2720  
2721 3. The Borrower and, where applicable, the Operator, must provide the Lender with an  
2722 action plan (seeking the Lender's guidance, as necessary and appropriate), and must  
2723 work with Lender to ensure the cure period will be met to resolve the violation, and to  
2724 further review the circumstances leading to the violation. The unauthorized  
2725 distribution may be a sign of financial distress that needs to be closely monitored, and  
2726 an action plan may need to be put in place to do so.  
2727  
2728 4. The Lender must notify the AE if there are extenuating circumstances that are  
2729 preventing the immediate submission of the action plan, and provide the AE with the  
2730 action plan expeditiously, and assure that the funds are repaid within the cure period.

2731  
2732 B. There are times when REAC/FASS findings trigger contact from the DEC directly to the  
2733 project. The Borrower is responsible for notifying the Lender within two (2) business days  
2734 of receipt of a REAC/FASS notification from the DEC.

2735  
2736 The Lender will then work with the project to cure the violation or devise an action plan to  
2737 cure the finding(s), including the AE as appropriate, and communicating with the DEC  
2738 during the process.  
2739

### 3.10.16

## Failure to File Financial Statements

A. The Borrower must notify their Lender within two (2) business days of receiving a Notification of Failure to File Financial Statements by the HUD Financial Assessment Subsystem (FASS).

1. This notification is sent automatically to the email the project registered in the system when an unauthorized distribution has been determined by FASS, as well as to the AE.
2. If there are extenuating circumstances preventing the immediate submission, the Lender will then work with the project to cure the violation or devise an action plan to cure the finding(s), including the AE and the DEC, as appropriate, during the process.
3. Additional information about FASS due dates is located in Asset Management, Chapter 4.

B. Operators are required to submit, on a quarterly and year-to-date basis (or more frequently if specified by HUD), financial statements no later than sixty (60) days after the period covered by the reports, except for reports relating to the final quarter of each year, which shall be submitted no later than ninety (90) days after end of the fiscal year.

1. Operator financial statement data is submitted to ORCF by the Lender using the Healthcare Portal.
2. The Lender must advise the AE of extenuating circumstances that are preventing submission.
3. The Lender will then work with the project to cure the violation or devise an action plan to cure the finding(s), including the AE and the DEC, as appropriate, during the process

### 3.10.17

## Financial Risk Metrics of Operator

A. Key indicators of the Operator financial statements will be used to monitor performance and to measure against future routine reviews. Key indicators include (but are not limited to) the following:

1. Debt service coverage ratio (DSCR) under 1.00 for two or more consecutive quarters.
2. Receipt of notification of a payment reduction and/or delay from the State (i.e. Medicaid, Medicare, etc.).
3. Request for a reduction or suspension of the R4R deposits due to inability to fund.

### 3.10.18

## Lender Assignment of the Note

2782  
2783 Elections by the Lender to assign the note must comply with 24 CFR Section 207.258 and do not  
2784 impact the Lender’s responsibilities for entry in the MDDR system or the assignment/claim  
2785 requirements in 24 CFR Sections 207 and 232.  
2786  
2787

2788  
2789  
2790  
2791  
2792  
2793  
2794  
2795  
2796  
2797  
2798

---

**3.10.19**

**Other Circumstances**

The Operator and/or Borrower must notify the Lender of any circumstance not addressed above that would place the financial viability of the facility at substantial and imminent risk. The Lender must notify the AE about any circumstances that have negatively impacted the project. Examples include property damage from natural disasters, failure to meet Home and Community Based Settings Rule requirements and project quarantines.

**Section 3.11**  
**Changes in Flood Insurance**

2799  
2800  
2801  
2802  
2803  
2804  
2805  
2806  
2807  
2808  
2809  
2810  
2811  
2812  
2813  
2814  
2815  
2816  
2817  
2818  
2819  
2820

---

**3.11**

**Change in Flood Insurance**

- A. Life-of-loan monitoring for a change in floodplain status is required for every Section 232 mortgage. Because floodplain conditions may change over time, the status of a zone may change. As a result, unless HUD already requires flood insurance for improvements outside the Special Flood Hazard Area for the life of the mortgage, the Lender must obtain from its flood zone determination firm "life-of loan" monitoring and coverage. Life-of-loan monitoring coverage means that the monitoring company will notify the Lender if and when flood insurance is required regardless of whether it was initially required at the time of loan inception. The Lender must ensure that the monitoring company agrees to continue monitoring for all of the covered Properties in the event the Lender sells or otherwise transfers its servicing rights to another Mortgage Loan servicer.
- B. The Lender must ensure that flood insurance is promptly obtained if any property improvements are determined to lie within a re-mapped Special Flood Hazard Area (SFHA), at any time during the course of the loan. Flood insurance must comply with the requirements in Production, Chapter 14.
- C. The Lender must promptly notify the AE of any change in Flood Hazard Insurance requirements as a result of the life-of-loan monitoring and provide evidence that flood hazard insurance has been obtained, if required as a result of a re-mapping change, in accordance with requirements for flood hazard insurance as stated in Production, Chapter 14.