Section 232--Eligibility of Psychiatric Hospital

Legal Opinion: GHM-0012

Index: 3.145
Subject: Section 232--Eligibility of Psychiatric Hospital

November 25, 1991

MEMORANDUM FOR: Linda D. Cheatham, Acting Director, Office of Insured Multifamily Housing Development, HMI

FROM: David R. Cooper, Assistant General Counsel, Multifamily Mortgage Division, GHM

SUBJECT: Hato Rey Psychiatric Hospital, Inc

This is in response to your memorandum of October 10, 1991, regarding the eligibility of Hato Rey Psychiatric Hospital ("Hato Rey") for mortgage insurance under section 232 of the National Housing Act ("Act"). As you indicated in your memorandum, on March 18, 1981, the Office of Multifamily Housing Development ("Office of Housing") approved the development of Hato Rey under section 232 of the Act. However, the Atlanta Regional Office and the Office of Inspector General now question its eligibility for mortgage insurance as a section 232 project.

We understand that at the time of the original eligibility determination, the proposal for Hato Rey envisioned a 450 bed facility designed to serve the needs of psychiatric patients. The facility was to include a 50 bed general hospital equipped to treat the surgical and medical problems of Hato Rey's long-term psychiatric patients.

There is an outstanding legal opinion on this facility. On February 10, 1981, we counseled that Hato Rey could not be insured pursuant to section 232 because it appeared to be a hospital. (See attachment A, legal opinion by John P. Kennedy dated February 10, 1981). We have attempted to ascertain whether additional facts may have arisen to explain, in view of our February 10, 1981 opinion, the Office of Housing's subsequent decision to approve Hato Rey as a section 232 project. However, the Office of Housing could not locate additional documentation on this matter. This may be explained by the fact that the transaction occurred over ten years ago. Nonetheless, we note that the Office of Housing's approval was contingent on the facility's obtaining an appropriate Certificate of Need, and otherwise complying with the statutory requirements of section 232. Therefore, we presume that Hato Rey obtained a Certificate of Need that described the types of beds and services that are acceptable under section 232.

In addition, upon review of the February 10, 1981 opinion, we find its analysis problematic. First, the opinion does not clearly set forth its basis for concluding that Hato Rey was a hospital. The opinion at page 2 appears to focus on two factors: (1) the fifty bed surgical hospital; and (2) the label, i.e. "hospital," used in describing the project. It provides that they "would have no problem in determining this proposal to be eligible except that they Hato Rey propose a fifty bed general hospital," and that the Office of Housing's and the Caribbean Area Office's incoming memoranda refer to the facility as a "hospital." The conclusion in the opinion, however, that insurance under section 232 is improper, is reached without consideration of the fifty bed issue (i.e., "we think it unnecessary to reach the question of whether the facility's eligibility under 232 is impaired by reason of its having a fifty-bed general hospital.") The only issue that appears to leave is the use of the label "hospital" in the incoming memoranda. In that regard, the opinion acknowledges that the decisive factor for eligibility under section 232 is not the label that is ascribed to a facility, but rather the actual use to which it is put, and the kinds of services it provides. However, the opinion does not analyze the nature and level of services provided by Hato Rey, and seems to accept the label "hospital" as determinative of the issue. The basis for the conclusion reached is, therefore, puzzling.

Furthermore, after this office issued its opinion on Hato Rey, we concurred in a determination that a section 232 project may contain ancillary uses that are compatible with residential care facilities. (See attachment B, letter from Linda D. Cheatham to Joseph B. Lynch dated August 23, 1990). That case involved the approval of a nursing home as a section 232 project even though it contained an ambulatory surgery and provided clinical, diagnostic and treatment-type services. The Office of Housing emphasized that ancillary facilities, such as those just described, may be included in a section 232 project so long as their use is compatible with the residential care facility.1 Accordingly, the Hato Rey hospital facility may not create a problem for section 232 eligibility because it could be an ancillary use that is compatible with the nursing home operations of Hato Rey. In this regard, it is important to note that we understand that Hato Rey's hospital beds and operating

1 This appears to follow the approach taken in connection with commercial space in section 232 nursing homes where, in accordance with an OGC opinion, the Department permitted commercial facilities in a nursing home "provided they are compatible with the character of the home or care facility." (See attachment C, legal opinion by Charles J. Bartlett dated March 9, 1982).

room were financed with UDAG funds, and not with money that was insured under section 232.

In any event, regardless as to whether the original decision

to insure Hato Rey's mortgage under section 232 was proper, it is not necessary to make such a determination at this time. Since the mortgage for Hato Rey has already been endorsed for insurance under section 232, its eligibility cannot now be challenged. Section 203(e) of the Act states:

> (e) Any contract of insurance heretofore or hereafter executed by the Secretary under this title shall be conclusive evidence of the eligibility of the loan or mortgage for insurance, and the validity of any contract of insurance so executed shall be incontestable in the hands of an approved financial institution or approved mortgagee from the date of the execution of such contract, except for fraud or misrepresentation on the part of such approved financial institution or approved mortgagee.

Thus, Congress decided that it would be unfair to set aside the insurance contract where a mortgagee that relied upon the Department's commitment to insure the mortgage had committed no wrongdoing. Therefore, even if Hato Rey's mortgage was improperly endorsed for insurance, the Department must honor the mortgage insurance contract because there is no allegation of fraud or misrepresentation on the part of the mortgagee.

The foregoing is consistent with the precedent of this office. In a previous legal opinion we determined that even if a mortgage were wrongfully endorsed for insurance under section 232, absent fraud or material misrepresentation by the mortgagee, the incontestability provision of section 203(e) prohibits the Department from setting aside the mortgage insurance contract. (See attachment D, legal opinion by John P. Kennedy dated October 30, 1981).

Finally, it is crucial to emphasize that Congress, in providing for the incontestability of the insurance contract, was not inviting the Department to ignore statutory requirements. Obviously, if program officials purposely do not follow the law, and endorse a mortgage where there does not exist requisite statutory authority, the Department would no doubt have a responsibility to take disciplinary action.