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Buying and Selling Your HUD-Financed Long Term Care Project: Navigating the TPA Process

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So you have refinanced your long term care facility with Federal Housing Authority (FHA)-insured financing – a nonrecourse, 30-year (or longer) loan at an amazingly low fixed interest rate. Yes, the process may have been painful, but now you are enjoying that nice low debt service. So low, in fact, that your facility has never been more attractive in the marketplace. What's next?

You recall that these loans are assumable, which is very unusual in the financing market today, and realize that you can sell your facility to a buyer who can assume your FHA-insured loan and free up equity for your next business adventure. In fact, the ability to pass along such a nice low interest loan may enhance the overall value you can receive in the sale.

Or, in the alternative, while your refinanced facility is doing well, perhaps you need to bring in a different management agent, or you are going through internal organizational changes with some principals departing and others joining your organization. You realize that you may need to go back to your FHA lender and HUD to get permission for your restructure, but may be a little unsure about the process.

In yet another alternative, you realize that a sale-leaseback of your project to a REIT might be just the ticket to free up financial resources for the future. You would like to benefit from the value inherent in your low interest FHA-insured financing and you realize that the REIT could assume your existing great loan and those terms might support a higher valuation.

Any of these scenarios is possible by navigating the Transfer of Physical Assets (TPA) process, the HUD approval process for changes and assumptions of existing loans.

What is a TPA?

- Full TPA: Transfer of title from the original borrower to a new entity – HUD underwrites the new borrower but not the project since it already has approved (and insured) the project as suitable for the 232 program in the initial closing.
- Modified TPA: Change of lessee, change of management agent, or change of controlling parties such as:
  - Transfer of more than 50 percent of a partnership (without causing partnership dissolution – if it is a dissolution, it is a Full TPA)
  - Addition or substitution of a managing, controlling or special member in an LLC
  - Substitution of one or more general partners in a limited partnership (without causing partnership dissolution)
  - Transfer of stock of the corporate general partner of a partnership where the transfer results in one owner of 50 percent of the stock, or the transfer results in change of control of the corporate general partner
  - Transfer of stock in a corporate borrower which results in a change of more than 50 percent of the stock, or change in control of the borrower

- Transfer of beneficial interest in a passive trust that does not result in change in control of the property
- Change in control of the project's operating lessee or management agent
- Other transactions that result in changes of ownership in the second, third or even higher levels need to be reviewed with HUD to determine if the transaction requires a review.

A Full TPA will require a higher level of review than a Modified TPA. In any of these situations, however, you start the process by contacting your FHA lender that made the original loan and explaining the transaction.

The Process

- Borrower contacts the FHA lender and starts the process. Some lenders require the deposit of a processing fee. Some lenders rely on the borrower and its counsel to prepare the bulk of the documents and assemble the packages, while other lenders will use their own counsel to a greater extent.
- Lender submits the application package to HUD, using a checklist with up to 45 items (not all will apply to any single transaction). Depending on the type of TPA, HUD collects a processing fee.
- HUD reviews the application. If either the loan or the project has been the focus of HUD concern on an ongoing basis, HUD is likely to use the TPA review process as a chance to correct outstanding issues and get the project back into compliance. HUD is particularly concerned if it sees what it deems "unworthy sellers" getting a big payday at a closing.
- HUD issues a Preliminary Approval Letter.
- Parties can close their transaction and have 45 working days to complete their transaction and submit copies of the final project documents, which must conform with the documents submitted in the initial application.
- HUD issues its Final Approval.

Ongoing Issues

- The new HUD Handbook requires that operating lessee be a single-purpose entity. This is a change from prior rules.
- If you have an operating lessee, it will need to execute the HUD operator documents on the new HUD forms, which impose a higher level of reporting requirements.
- Your contract for purchase needs to include a closing contingency for receipt of the Preliminary TPA approval before closing. It is very difficult to know how long to allow for the process. Unfortunately, TPA applications do not appear to enjoy a high priority with HUD and even some FHA lenders, perhaps due to the lower fees for TPA transactions as compared to new loans.
- Most purchase transactions will be for purchase prices that are larger, sometimes substantially larger, than the principal amount of the HUD-insured mortgage being assumed. At minimum, even if the project has not appreciated in value at all, there will be the same amount of equity that the seller provided when it closed its loan. More likely, the project will have increased in value and thus the amount of purchase price that the buyer must pay, above and beyond the amount of the HUD-insured mortgage being assumed, may be quite substantial. If the buyer wants to finance some of that additional purchase price with a note payable to the seller, the existing HUD rules about subordinate debt will apply, and those rules can be challenging to meet. It is important to recognize this issue at the front end while the deal is being structured by the parties, so that your closing is not delayed at the end when HUD objects to the form of seller financing.

In conclusion, TPA transactions are on the increase, and this trend will continue. If your transaction involves subordinate financing or seller financing, it is even more important to address these issues early, while your deal is being structured. In any event, if you can assemble an experienced team familiar with the TPA program requirements, the process will be easier overall, but the first ingredient for success is always a high level of patience and attention to detail.