

To HUD and Back – Overview and Updates

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Overview of HUD Loans

Structure

- Permanent loans
 - Fixed interest rates – currently 3 – 4 percent
 - Long terms – 25 – 40 years
- No guaranty or other recourse requirements
- Private lender
 - Lender qualifies as FHA lender
 - FHA issues mortgage insurance to lender
 - upon default, lender may assign loan to HUD and receive almost 100% of outstanding loan under mortgage insurance

Overview of HUD Loans – Participant Clearance

All “principals” require clearance under HUD 2530 program to determine no prior defaults/flags under gov’t insured programs

- Owner
- Operating lessee
- Manager
- Shareholders (10 percent or more)
- Any general partner of Owner, Operator
- LLC members (25 percent or more) of Owner, Operator
- Controlling officers and directors
- For Nonprofits – Directors are principals

Clearance by APPS filing online or paper submission of 2530 form

- HUD prefers APPS on line

Overview of HUD Loans – Regulatory Agreement

All FHA insured loans require borrower and lessee (if any) to sign Regulatory Agreement

- Limits project use
- Single asset Borrower
- Single asset Lessee unless HUD grants waiver
- No transfer w/o HUD consent
- Reserves for replacement
- Record-keeping and accounting requirements
- No discrimination in residents
- Violation - HUD can take over Note and foreclose
- Controls distributions of surplus cash (profit-motivated owners) or residual receipts (nonprofit owners)

Overview of HUD Loans – MAP

- MAP (Multifamily Accelerated Processing)
 - Multifamily projects – affordable or market rate
 - New construction or substantial rehab – Section 221(d)(4)
 - Substantial rehab: \$15,000/unit or two major building components
 - Sizing - LTV 85% (market); 87% (affordable); 90% (rental assistance) or DSCR 1.176 (mkt); 1.15(affordable); 1.11 (rental assistance)
 - Section 220 – applies to certain elevator buildings, mixed use housing in urban renewal areas, other revitalization zones – allows higher loan limits
 - Section 231 – age restricted: all residents 62 or older
 - Acquisition or refinance – Section 223(f)
 - 3+ yrs old; 85%+ occupancy;
 - Sizing - LTV 85% (market); 87% (affordable); 90% (rental assistance) or DSCR 1.176 (mkt); 1.15(affordable); 1.11 (rental assistance)
 - Cash out limits loan to 80% of eligible costs. 100% if no cash out

Overview of HUD Loans – LEAN

LEAN Program – Section 232

- Health care projects
 - Skilled nursing
 - Intermediate care
 - Assisted living
 - Board and care
 - Up to 25 percent of beds may be independent (non-licensed) with possible waiver of up to 30 percent
 - Lease to operator very common
 - rental at least 1.05x debt service + annual insurance + reserve deposits
- Processed under Section 232 rules

HUD LEAN Loans

New construction – Section 232

- up to 90 percent of hard and soft costs
- interest only during construction, 40 year term and amortization

Substantial Rehab – Section 232

- More than 15 percent of estimated project value or \$15,000 unit or two more major building components substantially replaced

Refinancing – Section 232/223(f)

- Refinance prior debt – must be eligible debt to be refinanced, no equity take-out
- May include rehab so long as not substantial rehab
- Up to 85% LTV, 90% for nonprofit – actual limits mostly lower

Refinancing FHA Insured Debt – Section 232/223(a)(7)

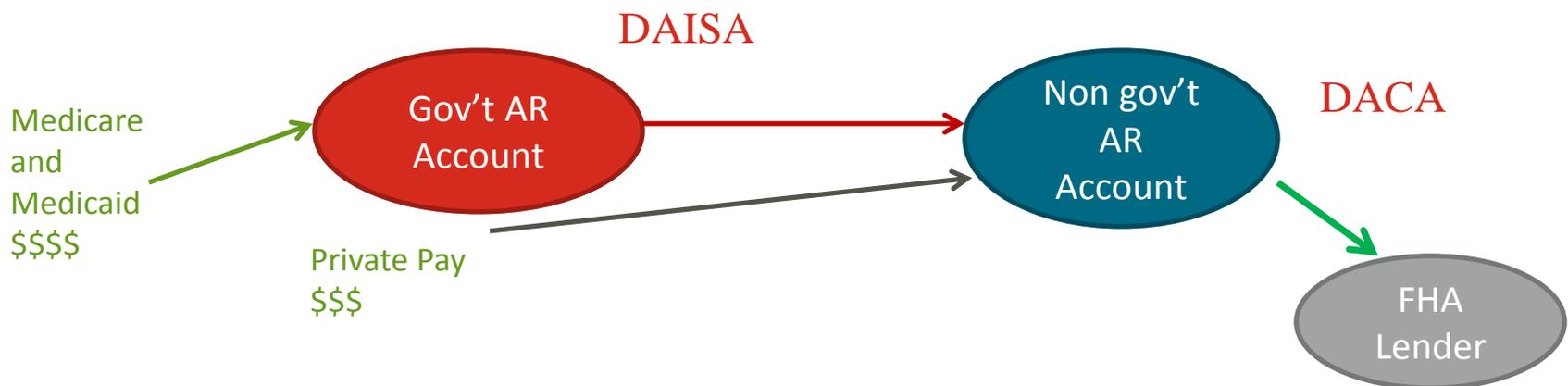
- Same loan amount, same maturity or extend to original maturity

HUD LEAN Loans (continued)

- Eligible Borrower – must be single purpose, single asset
- Lease to operator
 - Operator must be SPE lessee although waiver possible
- Eligible Costs:
 - acquisition price
 - refinance of “eligible debt”
 - repairs/rehab costs
 - certain closing costs
 - in general – no equity takeout allowed (compare to MAP where equity takeout is allowed but reduces total loan amount to 80% of eligible costs)

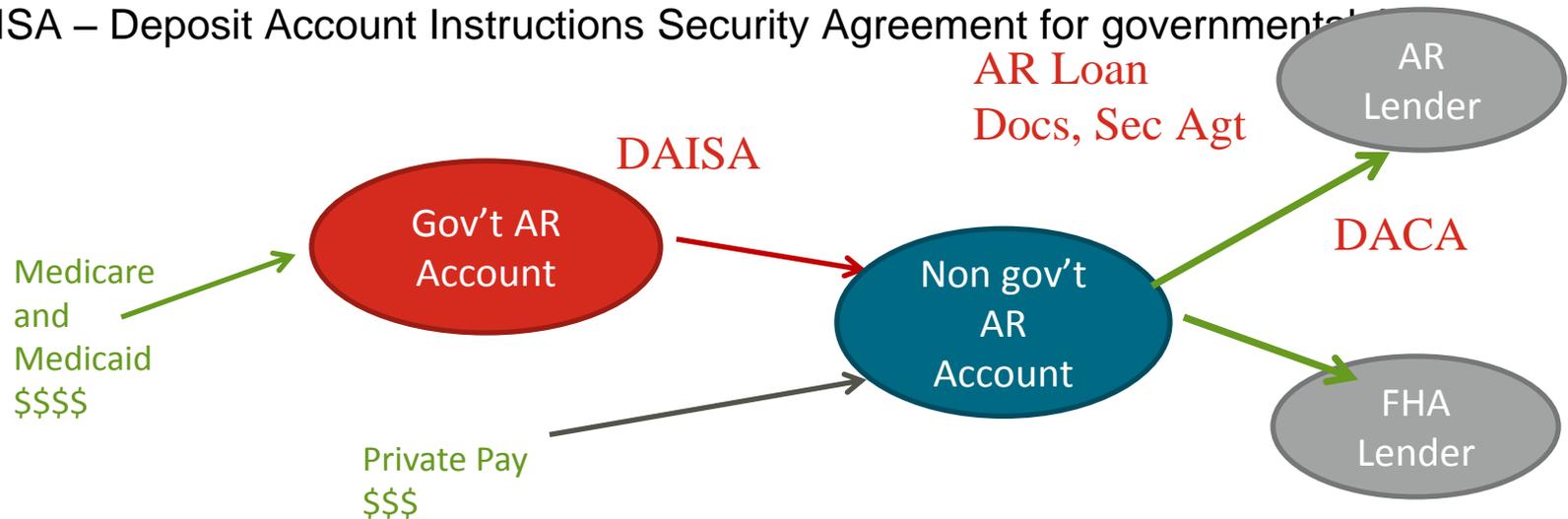
Cash Controls in HUD LEAN Loans – no AR lender

- If no AR lender, then HUD lender will have first lien in receipts of an operating lessee.
- DAISA – Deposit Account Instructions Security Agreement for governmental AR – lessee owns account and directs the daily sweep
 - (Assignment of Govt AR prohibited, thus use DAISA)
- DACA – Deposit Account Control Agreement for non-governmental AR and proceeds of daily sweep – lender owns account, has perfected security interest



Cash Controls in HUD LEAN Loans – AR lender

- AR lender has first lien in receipts of an operating lessee, FHA lender has second lien.
- DACA – Deposit Account Control Agreement for non-governmental AR – may cover both AR lender (first) and FHA lender (second). Sometimes two separate agreements
- DAISA – Deposit Account Instructions Security Agreement for governmental



Considerations for Refinancing

HUD loans can be used for acquisition or new construction

Majority of HUD loans are used to refinance other debt

Bridge loans

- when deadlines are too tight for HUD
- when equity takeout is desired

New rules apply to use of proceeds to refinance debt

Bridge-to-HUD

Eligible Costs do not include return of equity

Bridge-to-HUD loan

- non-HUD loan, processed conventionally
- may include equity take-out
- prior rules applied “seasoning” period before eligible for refinancing under HUD
- proposed rule modifies “seasoning” and eligible debt

Proposed Rule – Debt Seasoning Changes

- Two year seasoning period to ensure project has sufficient cash flow for the increased debt service under the higher loan
- Under proposed rule, projects with lower LTV (loan to value) may not have seasoning period in two scenarios:
 - (1)
 - (a) more than 50 percent of the debt being refinanced was used for project purposes (*i.e.*, not for an equity distribution) AND
 - (b) the FHA-insured loan has LTV equal to or less than 70 percent
 - (2)
 - (a) less than 50 percent of the debt being refinanced was used for project purposes AND
 - (b) the FHA-insured loan has LTV equal to or less than 60 percent.

Proposed Rule – Other Changes to Eligible Debt

Licensed Operator Debt may qualify as “eligible debt”

- debt must have been incurred for project related costs

Certain defeasance costs may qualify as “eligible debt”

- up to 10 percent of loan amount may be used for
 - yield maintenance fees
 - swap termination fees
 - similar fees in connection with defeasance of bond financing

Loan Management Concerns

HUD loans have long term maturities

What happens if interest rates drop after the closing?

- interest rate reduction process

What happens if owner wants to sell its HUD-financed project?

- transfer of physical asset process allows buyer to assume loan and enjoy same low interest rates

HUD Loans – Interest Rate Reductions

In past, full refinance needed to lower interest rate

Now – Interest Rate Reduction program allows modification to reduce interest rate once prepayment is permitted

Documentation is minimal

- Borrower incumbency certificate
- Note modification
- Mortgage Modification
- Survey Affidavit of No Change
- No opinion letters

Interest Rate Reductions – LEAN

LEAN (Healthcare) Process

- Application (with executed Survey Affidavit and Incumbency) to HUD
- HUD issues preliminary approval letter (LEAN follows a two-step approval process)
- Remaining documents circulated to borrower for execution
- Rate is locked and documents, revised to include rate lock information, are sent to HUD for final approval
- HUD has six business days to approval final documents (approval usually received via email)
- Documents circulated to HUD for execution; HUD will return executed documents and final approval
- Transaction closed upon recording of Mortgage Modification

Interest Rate Reductions - MAP

MAP Process

- Application to HUD for review and approval (no executed documents)
- HUD issues approval letter (MAP follows a one-step approval process)
- Documents circulated to borrower for execution
- Rate is locked and documents are revised to include rate lock information
- Documents circulated to HUD for execution; HUD will return executed documents
- Transaction closed upon recording of Mortgage Modification

Transfer/Assumption – The TPA Process

- Unlike traditional commercial loans, FHA insured loans may be assigned and assumed as part of the purchase of the collateral project or an interest in the collateral project
- Assignment and assumption requires consent by HUD to the “Transfer of Physical Assets” – TPA
- Process:
 - Application to FHA lender and HUD (expect 45 – 90 day review)
 - HUD issues Preliminary TPA Approval (45 days to close)
 - Transaction Closes; documents sent to HUD
 - HUD issues Final TPA Approval
- Key form and handbook:
 - LEAN: HUD 92266-ORCF, Section 232 Handbook Chapters 6 – 9
 - MAP: HUD Handbook 4350.1 Chapter 13

TPA Transactions – Full TPA

Full TPA Defined:

- Transfer of title from the original borrower, to a new entity;
- Transfer of any interest in a borrower which is a partnership which causes a dissolution of the partnership, under applicable state law; or
- Transfer of the beneficial interest in a passive trust, which results in a change in control and management of the asset even though legal control remains in the trustee

This is usually a purchase and sale transaction

TPA Transactions – Modified TPA

- Modified TPA Defined:
 - Transfer of more than 50% stock in a corporate borrower, or change in control of the borrower
 - Transfer of stock of the corporate GP of a partnership with one shareholder owning more than 50 percent of the stock, or a change of control of the corporate GP
 - Transfer of more than 50% of a partnership which does not cause partnership dissolution
 - Addition/substitution of managing, controlling or special member of LLC;
 - Substitution of one or more GPs in a limited partnership which does not cause dissolution of the partnership
 - Transfer of beneficial interest in a passive trust that does not result in change in control of the property

TPA Transactions – Other Changes

Other Transactions Requiring TPA:

- Change in control of the Lessee/Operator
- Change in control of the Management Agent
- Transactions that do not fit exactly with the preceding situations but for which there is a significant sum of money changing hands in conjunction with the transaction
- Transfers of ownership in upper tier entities that own all or a portion of the equity in the project owner need to be analyzed to determine if they result in a TPA, may require HUD review to determine if the transaction requires a TPA review or just an Organizational Change in the APPS System

Future Outlook: Large Inventory of HUD Insured Loans

Large numbers of FHA insured loans (multifamily and health care) have closed in past five years, due to historic low interest rates and continuing effect of recession

If interest rates rise in the future – strong incentive to preserve below-market interest for the long term

Expect growth in transactions that include the assumption of FHA insured debt.

Innovative forms of second priority financing or Seller financing can be expected

Third Party Operator – HUD Requirements

HUD Requirements:

- Operator must be single purpose entity (or request waiver)
- Operator is required to sign HUD documents
 - Operator HUD Regulatory Agreement
 - Operator security agreement – grants security interest in operator's project assets and AR
- Operating Lease with HUD Addendum
 - Rent 1.05 x debt service
 - HUD rights in the Addendum
 - SNDA subordinates lease to HUD loan documents
- Operator must agree to Deposit Account Control Agreement

Third Party Operator – Operator Concerns

- Single asset/single purpose operator
- Requirement to submit financial reports quarterly and annually
- No distributions to operator's owners if negative working capital
- Must get written cost estimates if less than 5 percent of gross annual revenue
- Liability insurance (\$1M/\$3M) required
- Risk Management Program required
- HUD can terminate lease, replace operator upon default in HUD loan
- HUD can require management consultant if Project Operating Deficiency
- No change or termination of any project license without HUD approval
- **Practice Pointer:**
 - **Draft Lease to require cooperation with HUD loan process**

Considerations for REIT Transactions

Standard structure is for REIT to own a project and lease to third party operator

- Third party operator issues arise since it has a lease to an unrelated third party operator
- REIT lease must have HUD provisions
- Master Lease for portfolio of multiple projects

REIT ownership structure is often complicated with multiple tiers of ownership

- Careful 2530 analysis is needed

Conclusion

Questions?



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