August 13, 2024

The Honorable Adrianne Todman
The Honorable Damon Smith
The Honorable Julia Gordon
U.S. Department of Housing & Urban Development
451 7th Street SW
Washington, DC 20410

Dear Acting Secretary Todman, Acting Deputy Secretary Smith and Assistant Secretary & FHA Commissioner Gordon:

The Healthcare Mortgagee Advisory Council (HMAC), its Section 232 lender members, the MBA and trade groups representing the nursing home and senior living industry, would like to acknowledge the highly valued partnership we have had with HUD since the creation of the 232 program. It is because of this history of partnership that we want to bring to your attention an issue causing great concern for Section 232 lenders and for the industry partners jointly signing this letter.

HMAC and its Section 232 lender members have been made aware of an Office of General Counsel (OGC) legal opinion circulated internally to direct the Office of Residential Care Facilities (ORCF) and the Office of Healthcare Programs (OHP) that current Section 232 Handbook Guidelines and Section 232 Program Regulations that allow for non-critical repairs to be mortgageable costs, conflict with the statutory language in The National Housing Act. The legal opinion has had a surprising and immediately alarming detrimental impact to the 232 lending industry, our healthcare provider clients, and other industry partners, all of whom share the ultimate goal of providing quality care to seniors and residents with intellectual or developmental disabilities in a comfortable and well-maintained setting. The adverse impact is noted below:

- Transactions with Firm Commitments issued, and in many cases rate locked, are in jeopardy of not closing. The uncertainty of execution that has been created by the internal memorandum is unprecedented and extremely detrimental to the program.

- ORCF is advising Lenders that Firm Commitments cannot be issued for loans under review, unless non-critical repairs are removed as a mortgageable cost of the refinancing. This is a significant change from long standing policy and is being implemented without public disclosure of the new policy and the rationale for the change.

While the industry has not been provided with a copy of the legal opinion, HMAC, its industry partners and those they serve, find these immediate impacts unacceptable for the following reasons:

- Firm Commitments issued by HUD and fully executed by borrowers constitute a binding contract. Additionally, the Firm Commitment specifically speaks to non-critical repairs and the allowance of mortgage proceeds to fund the cost. Requiring changes to the mortgageable costs as a condition to close is a violation of that contractual agreement.
- For transactions already rate locked, removing costs associated with non-critical repairs from the loan amount could put the revised loan amount outside of the margin of change allowed as part of the rate lock agreement. This adds the immediate risk of litigation from the GNMA investors who agreed to the rate lock. Borrowers, lenders, and HUD would be the probable targets of such litigation.
- While the legal opinion presumably asserts that the cost for non-critical repairs is not mortgageable, it is silent on current program regulations and guidance that require the repairs to be completed. The result of this is that borrowers are simultaneously required to complete the repairs and also prevented from financing the cost of the repairs, unacceptably weakening the cash position of borrowers and negatively impacting the credit risk profile.

Beyond the immediate detrimental impact this legal opinion has on the 232 program, HMAC and our industry partners are also deeply concerned about the longer-term ramifications if this legal opinion is allowed stand. Please consider the following:

Utilizes an Inexplicably Narrow Interpretation of Statutory Language

While not having a copy of the legal opinion, it is our understanding that the crux of the opinion hinges on the interpretation of statutory language included in Section 223 of The National Housing Act (12 U.S.C. 1715n(f)(4) and, in particular, item (B) in bold and excerpted below:

(4) In the case of refinancing of an existing hospital (or existing nursing home, existing assisted living facility, existing intermediate care facility, existing board and care home, or any combination thereof) the Secretary shall prescribe such terms and conditions as the Secretary deems necessary to assure that—

> *(A) the refinancing is employed to lower the monthly debt service costs (taking into account any fees or charges connected with such refinancing) of such existing hospital (or existing nursing home, existing assisted living facility, existing intermediate care facility, existing board and care home, or any combination thereof);*
>
> ***(B) the proceeds of any refinancing will be employed only to retire the existing indebtedness and pay the necessary cost of refinancing on such existing hospital (or existing nursing home, existing assisted living facility, existing intermediate care facility, existing board and care home, or any combination thereof);***
>
> *(C) such existing hospital (or existing nursing home, existing assisted living facility, existing intermediate care facility, existing board and care home, or any combination thereof) is economically viable; and*
>
> *(D) the applicable requirements for certificates, studies, and statements of section 232 (for the existing nursing home, existing assisted living facility, intermediate care facility, board and care home, or any combination thereof, proposed to be refinanced) or of section 242 (for the existing hospital proposed to be refinanced) have been met.*

Presumably, the opinion is that non-critical repairs do not meet the definition of a "necessary cost of refinancing". It is HMAC's assumption that in the absence of a statutory definition for

necessary cost in item "(B)" or elsewhere in the statute, the opinion has conflated "necessary" with the program usage of the word "critical" and subsequently come to the conclusion that critical repairs are necessary while non-critical repairs are not. Since regulations are intended to implement and interpret statutes, the inclusion of repairs in the regulations should also be given significant weight in interpreting what necessary means. Those repairs were also then included in the various iterations of the Handbook, further evidencing them as programmatically determined necessary costs. Regulations that have been promulgated with OMB approval, include industry input as well as multiple level of OGC comment, approval and concurrence supporting the inclusion of repair costs in the loan should not be altered or redefined with no notice to stakeholders. It is unwarranted and highly improper.

This extremely detrimental leap in interpretation is further without merit, considering that it ignores the additional requirements established in subsequent sections C and D which require the healthcare project to be "economically viable" and that "applicable requirements for certificates, studies, and statements of Section 232…have been met".

Considered in its entirety, HMAC asserts this section could be interpreted as supporting the 30-year-old programmatic interpretation of "necessary costs" as costs incurred to meet the regulatory and programmatic requirements of the 232 program, comply with federal and state statutes and licensure requirements, and maintain the economic viability of the project for the term of the loan. Clearly, the funding of repairs, as identified in a required CNA study, to maintain the physical condition of the project, meet federal and state licensing requirements, and ensure the safety of residents, are "necessary costs" to meet the full breadth of the requirements in this section of the statute. Additionally, ORCF is in the best position, having reviewed all the application documents and completing their underwriting review, to determine what are "necessary costs" to support their underwriting approvals on any one project.

Program precedence on the inclusion of non-critical repair costs spans at least five Presidential Administrations and the 103rd-118th Congresses. If this internal memorandum is allowed to upend 30+ years of practice, it would open the door to continued reinterpretation of statute language and create an inability to rely on published rules which would ultimately damage the program beyond repair.

Eliminates a Primary Benefit of the 232f Refinance Program

The 232 program is particularly important for skilled nursing providers; providing long term financing for 2,491 skilled nursing facilities, representing 15% all of skilled nursing facilities in the country, and about 70% of the FHA 232 portfolio. This importance is driven by the lack of other options for long-term financing. Most national banks do not finance skilled nursing facilities and significant limitations for FNMA (Fannie Mae) and FHLMC (Freddie Mac) effectively eliminate those programs as an option.

Although repairs are routinely mortgaged as a standard lending practice across the industry, the 232 program's fixed-rate and longer amortization period spread the cost of those repairs over a longer period at a fixed amount. That is very appealing to healthcare owners and operators because they can fund long-term improvements to their properties, which benefit the residents they serve by improving comfort and safety. For many healthcare facilities, in particular those who care for a high percentage of Medicaid residents where the reimbursement they receive may not provide much cover over cost, the Section 232 program is the best option available to fund repairs and improvements. This fits squarely within HUD's mission to promote and preserve well-maintained and appealing affordable housing options. Eliminating this program benefit would greatly reduce utilization of the program, in direct opposition to HUD's mission.

Puts Green MIP and Other Modernization Efforts at Risk

Mortgagee Letter 2022-13 allowed for 232 transactions to be eligible for green MIP which not only benefited borrowers from an overall debt service perspective, but also created a vehicle to complete enhancements to existing facilities that aid in the conservation of energy and water. These types of repairs not only represent an environmental betterment, but they also align with the environmental initiatives of the current Administration. Depending on the extent of the repairs needed to meet standards, the costs can become extremely expensive. With the new interpretation of the statute, these repairs would no longer be considered eligible, and with that, eliminate usage of the program in total.

Similarly, 232 program usage for other modernization efforts, including those directed at infection control and improving living conditions for seniors, will be dramatically impacted. Skilled nursing and assisted living providers very often include such projects in HUD financing as they can be paid for over a longer period of time at a lower cost. It is important to note that a majority of the FHA 232 portfolio is comprised of facilities receiving Medicaid and Medicare reimbursement. The 232 program reduces annual costs for operators, by lowering debt service payments and spreading repair costs over a longer term. Those operator expense savings are reflected in the CMS cost reports that dictate reimbursement rates. Reduced utilization of the 232 program as an effect of this new interpretation of statute language will result in higher costs to CMS programs which will be borne by taxpayers.

Creates Long Term Risk for the Insurance Fund

The funding of repairs in mortgage lending is a routine industry practice across all lending products and all property types because it mitigates risk by ensuring that the economic viability of collateral pledged for the loan is maintained.

The ramifications of this legal opinion would, over time, increase risk to the insurance fund. It is critical that ORCF has the ability to ensure that insured projects maintain economic viability throughout the life of loan (which averages 30-35 years) so that they are able to pay debt service. This policy would disincentivize healthcare owners from undertaking improvement projects as part of the refinance transaction. Over time, the result would be that projects entering the insurance fund portfolio are less maintained, have less market appeal, and therefore have a shorter period of economic viability in which to generate income to pay debt service.

It is important to note that the 232 program, as overseen by ORCF, has consistently been successful at maintaining a historical claim rate lower than the mortgage insurance premiums received. In comparison to many other government programs that is a significant achievement. This decision, which would decrease demand for the program and eliminate one of the primary tools ORCF has for maintaining the economic viability of its portfolio, puts that history of success at risk.

Directly Conflicts with HUD's Mission

By removing the funding mechanism for repairs and long-term facility improvements, this new interpretation of the statute legal opinion conflicts with HUD's mission to "create strong, sustainable, inclusive communities and affordable homes for all." The determination that non-critical repairs should not be considered mortgageable will ultimately deter borrowers from completing work that will enhance the long-term marketability and viability of the asset, which negatively impacts the housing and care of seniors, a major focus of the current Administration.

Further, we have grave concerns about the lasting impact implementation of this legal opinion will have on our nation's long-term care residents served by the skilled nursing and assisted living providers who work with and are members of our respective organizations. It is our hope there has simply been confusion around the interpretation of the memo and that, as a result, our understanding of the opinion is flawed.

Importantly, we are disheartened by the lack of transparency in relation to this issue and the unwillingness to engage with the 232 lending industry ahead of time to fully consider the potential impact this significant program change would have to our clients and the residents under their care. The reliability of the 232 program and the certainty of execution that has historically been a program highlight has been called into question, putting decades of precedence and a clearly successful public-private partnership at risk.

We urgently request that you address our concerns, reconsider this change in policy, and engage with us in a constructive dialogue on these issues that are critical to our ability to house and care for our nation's seniors.

Respectfully,

AEI Consultants
American Health Care Association (AHCA)
American Seniors Housing Association (ASHA)
Argentum
Berkadia Commercial Mortgage LLC
Bureau Veritas
CBRE HMF
Dominion Due Diligence Group
Dwight Capital
EnviroBusiness Inc. (dba EBI Consulting)
Forbright Bank
Greystone Funding Company LLC
Healthcare Mortgagee Advisory Council (HMAC)
HealthTrust
JLL Real Estate Capital, LLC
Kantor Taylor PC
KeyBank
Krooth & Altman LLP
Lument
Mortgage Bankers Association (MBA)
M&T Realty Capital Corporation
National Center for Assisted Living (NCAL)
Newpoint Real Estate Capital
OHC Advisors
Partner Engineering And Science, Inc
Partner Valuation Advisors
VIUM Capital
Walker & Dunlop, LLC
White Oak Healthcare Partners, LLC
X-Caliber

cc: Roger Lukoff, Deputy Assistant Secretary, Office of Healthcare Programs
Roger Lewis, Associate Deputy Assistant Secretary, ORCF
James Bartolotto, Associate General Counsel, Office of Litigation at OGC
David Jones, White House Liaison