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Department of Housing and Urban Development

24 CFR Parts 200 and 242
Revisions to the Hospital Mortgage Insurance Program; Proposed Rule

DEPARTMENT OF HOUSING AND URBAN DEVELOPMENT

24 CFR Parts 200 and 242

[Docket No. FR–4927–P–01; HUD–2004–0011]

RIN 2502–AI22

Revisions to the Hospital Mortgage Insurance Program

AGENCY: Office of the Assistant Secretary for Housing—Federal Housing Commissioner.

ACTION: Proposed rule.

SUMMARY: This proposed rule would revise the regulations governing the Federal Housing Administration (FHA) mortgage insurance program for hospitals. The rule would update and incorporate some earlier provisions that currently are not published as part of the FHA regulations. Further, the rule would add new provisions to make them consistent with current industry practices. The rule also would codify the relevant regulations that address hospital mortgage insurance in one part, and therefore make the regulations more user-friendly.

DATES: *Comment Due Date:* March 11, 2005.

ADDRESSES: Interested persons are invited to submit comments regarding this rule to the Regulations Division, Office of General Counsel, Room 10276, Department of Housing and Urban Development, 451 Seventh Street, SW., Washington, DC 20410–0500. Interested persons may also submit comments electronically through either:

- The Federal eRulemaking Portal at: *http://www.regulations.gov;* or
- The HUD electronic Web site at: *http://www.epa.gov/feddocket.* Follow the link entitled ''View Open HUD Dockets.'' Commenters should follow the instructions provided on that site to submit comments electronically.

Facsimile (FAX) comments are not acceptable. In all cases, communications must refer to the docket number and title. All comments and communications submitted will be available, without revision, for public inspection and copying between 8 a.m. and 5 p.m. weekdays at the above address. Copies are also available for inspection and downloading at *http://www.epa.gov/feddocket.*

FOR FURTHER INFORMATION CONTACT: Christopher D. Boesen, Director, Office of Insured Health Care Facilities, Department of Housing and Urban Development, Room 9224, 451 Seventh Street, SW., Washington, DC 20410–8000; telephone (202) 708–0599 (this is not a toll-free number). Hearing- and speech-impaired persons may access this number through TTY by calling the Federal Information Relay Service at 800–877–8339 (this is a toll-free number).

SUPPLEMENTARY INFORMATION:

I. Background

Section 242 of the National Housing Act (the Act), codified at 12 U.S.C. 1715z–7 (section 242), most recently amended in 2003 by the Hospital Mortgage Insurance Act of 2003 (Pub. L. 108–91, approved October 3, 2003) (HMI Act), authorizes HUD to insure mortgages on hospitals in accordance with the terms of the section and upon such conditions as HUD may prescribe. The purpose of the law is to ''assist the provision of urgently needed hospitals for the care and treatment of persons who are acutely ill or who otherwise require medical care and related services of the kind customarily furnished only (or most effectively) by hospitals.'' (See 12 U.S.C. 1715z–7(a).) Another aspect of the statutory purpose is to encourage programs to provide comprehensive health care, including outpatient and preventive care as well as hospitalization. In the case of public hospitals, the statute is designed to encourage programs to provide health care services to all members of a community regardless of ability to pay. (*See* 12 U.S.C. 1715z–7(f).)

The statute defines the hospitals that are eligible for insurance as those that: (a) Provide community service for inpatient medical care of the sick or injured, including obstetrical care; (b) have not more than 50 percent of their total patient days customarily assignable to the specified categories of convalescent rest, drug and alcoholic, epileptic, mentally deficient, nervous and mental health, and tuberculosis, with the exception, introduced in the 2003 amendment, of critical access hospitals; and (c) are a public facility, proprietary facility, or facility of a private nonprofit corporation or organization. The statute encourages programs that are undertaken to provide essential health care services to all members of a community regardless of ability to pay. (*See* 12 U.S.C. 1517z–7(f).) The 2003 exception to the 50 percent patient day requirement for critical access hospitals lasts until 2006; HUD is to report to Congress no later than July 31, 2006, on the effect of the exception for critical access hospitals on section 242 hospital mortgage insurance and on the General Insurance Fund. (*See* 12 U.S.C. 1715z–7(b).)

The statute authorizes mortgage insurance for new and rehabilitated hospitals, including equipment. The insured mortgage may involve a principal obligation of up to 90 percent of the estimated replacement cost of the property or project, including equipment to be used in the operation of the hospital when the proposed improvements are completed and the equipment is installed and systems to conserve energy where the Secretary determines that the systems will be cost-effective. The Secretary may exercise regulatory control over the mortgagor's charges and methods of financing, corporate entity, capital structure, and rate of return. (*See* 12 U.S.C. 1715z(d)(1)–(2).)

The statute provides for HUD to take steps to ensure that a hospital supported by HUD mortgage insurance is properly established and responds to a real need. As to hospital operation, HUD must require, before insuring, that satisfactory evidence be provided that the hospital will be located in an area with reasonable minimum standards of licensure and methods of operation of hospitals. HUD also must require a satisfactory assurance that such standards will be applied and enforced with respect to the hospital for which mortgage insurance is being sought. (*See* 12 U.S.C. 1715z(d)(4)(A).)

As to need, the revised statute requires that HUD establish the means for determining the need for, and feasibility of the hospital if the State does not have an official procedure for making this determination. If the State does have a procedure, HUD must require that the procedure be followed and documented and that need has ''also been established under this procedure.'' (*See* 12 U.S.C. 1715z–7(d)(4).) HUD therefore contemplates that in cases where the State has a procedure, both the State procedure and HUD's criteria for determining need must be followed, which has been the historical practice. The need documentation provision was changed in the 2003 revision made by the HMI Act. Prior to that revision, the statute had provided that where the State has no procedure for assessing need, the State commission must conduct an independent study following certain procedures and standards.

The statute also contains some technical provisions regarding mortgage insurance. Section 242(d)(5) of the Act, 12 U.S.C. 1715z–7(d)(5), places restrictions on mortgage insurance under part 242 on mortgages that back Government National Mortgage Association (GNMA) securities. The statute provides that in the case where

HUD requires a private nonprofit organization or public facility mortgagor to provide cash money in excess of the amount of the mortgage, the mortgagor shall be entitled to use a letter of credit instead of cash. In such an event, mortgage proceeds may be advanced to the mortgagor prior to any demand being made on the letter of credit. (*See* 12 U.S.C. 1715z–7(d)(6).)

The statute also gives HUD authority to approve a partial release of lien for any insured section 242 mortgage. Accordingly, if a hospital wanted to dispose of some of its equipment or some surplus property, for example, the lien as to those particular items could be released under such terms and conditions as HUD may prescribe. (*See* 12 U.S.C. 1715z–7(e).)

The statute makes applicable certain provisions of section 207 of the Act, 12 U.S.C. 1713, entitled ''Rental Housing Insurance.'' These applicable provisions are the following sections: 1713(d) (Premium, appraisal, and inspection charges); 1713(e) (Adjusted premium charges on payment of a mortgage prior to the maturity date); 1713(g) (Payment of insurance after default); 1713(h) (Certificate of claim and division of excess proceeds); 1713(i) (Debentures); 1713(j) (Form and amounts of debentures); 1713(k) (Acquisition of property by conveyance or foreclosure); 1713(l) (Handling and disposal of property; settlement of claims); and 1713(n) (Default and the rights of parties).

HUD's current regulations for hospital mortgage insurance authorized by section 242, codified in 24 CFR part 242, are extremely brief and rely mostly on cross-references to the general regulatory provisions applicable to Federal Housing Administration (FHA) programs, codified in 24 CFR part 200, and the multifamily housing mortgage insurance regulations codified in 24 CFR part 207. The only statutory provisions that are reflected in the current part 242 regulations are the licensing provisions of 12 U.S.C. 1715z(d)(4)(A) (see 24 CFR 242.2) and the provisions on eligible hospitals at 12 U.S.C. 1715z(d) (see 24 CFR 242.3).

The last detailed stand-alone regulation for part 242 insurance was codified in the April 1, 1995, edition of the Code of Federal Regulations (CFR). Where relevant, part II of this preamble entitled ''This Notice of Proposed Rulemaking'' will reference those prior regulations.

II. This Notice of Proposed Rulemaking (NPRM).

Overall, this NPRM provides more detailed regulations for hospital mortgage insurance than either the current streamlined 24 CFR part 242, or the detailed section that existed prior to the 1996 edition of the CFR. Experience has shown that certain sections of the 1995 regulations are still pertinent to the program, while changes in the hospital industry, including the increase in applicants for insurance and new forms of ownership including mergers and physician participation, require some changes. This regulation proposes new details, described below, which respond to HUD's actual experience with hospital mortgage insurance and to changes in the hospital industry, which have dramatically increased every year.

The hospital mortgage insurance is a unique program (the section 242 program), unlike the multifamily housing programs in many respects. It is believed to be more helpful to the public to include all the necessary material in a single part, rather than relying heavily on cross-references to the general provisions at 24 CFR part 200. Therefore, this NPRM proposes to take a comprehensive approach.

There has been an overall increase in applications for insurance and preapplication contacts. Often, these section 242 applicants are new and inexperienced in this program, requiring greater guidance from HUD for mortgagees and greater regulatory supervision of mortgagors. This regulation provides this greater level of guidance. In addition, this regulation provides for a preapplication procedure whereby issues and problems can be addressed early in the process, or an application that has deficiencies can be identified early in the process before an applicant expends substantial resources on preparing it.

Changes to Part 200

This NPRM proposes to remove references to the hospital program from 24 CFR part 200 so that users of the regulation can find everything they need in one location and to avoid unnecessary repetition. Specifically, 24 CFR 200.24 and 200.25 are revised to remove references to 24 CFR part 242, and 24 CFR 200.40 is revised to remove material concerning application and commitment fees that would be contained entirely in 24 CFR part 242.

Proposed Part 242

Subpart A—General Eligibility Requirements

In accordance with the more detailed guidance being provided in this regulation, this NPRM proposes to introduce an expanded section on pertinent definitions in proposed 24 CFR 242.1. Among the more significant definitions that would be added are definitions for *affiliate; hospital,* which essentially tracks the statutory definition in 12 U.S.C. 1715z–7(b)(1); *personalty*, which includes hospital equipment and which in many cases will be covered by the insured mortgage; *preliminary review letter,* a proposed new element to assist in the application process; *surplus cash; debt service coverage ratio;* and *working capital.* The definition section would also include definitions of a variety of other commonly used terms related to mortgage insurance.

The definition of ''hospital'' differs from the definition in the 1995 and earlier versions of the regulation primarily by adding the exemption for critical access hospitals to the 50 percent-of-patient-days cap on certain forms of care (chronic convalescent and rest, drug and alcoholic, epilepsy, mentally deficient, mental and nervous, and tuberculosis). This critical access hospital exemption was introduced in 2003, and sunsets on July 31, 2006 (*see* HMI Act).

Proposed section 242.2 makes explicit that HUD has an obligation to protect the soundness of the mortgage insurance fund. Therefore, this NPRM proposes to require as an overall principle that HUD seek to avoid defaults and claims for insurance and promote the program's financial self-sufficiency and actuarial soundness.

Proposed section 242.3 is similar to 24 CFR 242.2 from the 1995 stand-alone regulation (24 CFR 242.2, April 1, 1995 edition) (1995 regulation), and reflects the overall purpose of the statute to encourage comprehensive health care (*see* 12 U.S.C. 1715z–7(f)). This NPRM proposes to add an additional sentence to emphasize the intent to insure mortgages for public and certain nonpublic hospitals that serve a public purpose by providing a substantial amount of care to those who have no ability, or limited ability, to pay.

A number of sections in proposed subpart A establish basic eligibility requirements. Sections 242.4, 242.5, 242.6, 242.7, and 242.10 relate, respectively, to eligible hospitals, eligible mortgagees, property requirements, maximum mortgage amounts, and eligible mortgagors. Similar material is contained in the 1995 regulation; this proposed rule would reorganize this material more logically at the beginning of the rule. The maximum mortgage amount is up to 90 percent of the estimated replacement cost, is statutory (*see* 12 U.S.C. 1715z–7(d)(2)), and has not changed since the 1995 regulation, where the analogous

section is 24 CFR 242.27. Eligible activities are the same as stated in the 1995 regulation in 24 CFR 242.12, ''Eligible hospitals,'' and include the new construction or substantial rehabilitation or replacement of a hospital (*see* 12 U.S.C. 1715z–7(d)). The section on ''eligible mortgagees'' simply clarifies that the requirements in 24 CFR part 202 apply, and is similar to 24 CFR 242.25 from the 1995 regulation. The property requirements are the same as found in the 1995 regulation at 24 CFR 242.87 and provide assurance of long-term ownership.

Proposed 24 CFR 242.8, ''Standards for licensure and methods of operation,'' implements 12 U.S.C. 1715z(d)(4)(A). The same material was contained within a larger section dealing with certification requirements in the 1995 regulation at 24 CFR 242.5.

Proposed 24 CFR 242.10, ''Eligible mortgagors,'' is similar to 242.23 of the 1995 regulations. The proposed rule would give greater specificity to the types of for-profit mortgagors that would be eligible, specifically excluding joint ventures, natural persons, and general partnerships. These entities are specifically excluded because of an increased exposure to liability caused by the continuity problems which can arise with these specific entities. HUD needs assurance that the hospital will remain in existence for the duration of the insured mortgage loan and that the mortgagor will not be engaging in other business activities that could affect the ability of the mortgagor to make timely payment under the terms of the insured loan.

Proposed 24 CFR 242.9, ''Physician ownership,'' is a new provision that is designed to recognize the reality of increased physician participation in the ownership of hospitals, within certain limits. Under current HUD Handbook guidelines, ''a proposal in which the mortgagor is controlled in any manner by the professionals practicing in the hospital will not be eligible.'' (Handbook 4615.1, ''Mortgage Insurance for Hospitals,'' ¶ 1–4(b).) HUD has been administratively waiving this prohibition under certain conditions. These are: a determination that the proposed mortgagor will be at low risk for violations of regulations of the Department of Health and Human Services and other Federal and State regulations governing kickbacks; self-referrals; and other issues that could increase the risk of default. HUD proposes to codify this standard for approval of physician ownership in the new regulation.

Proposed 242.11, ''Regulatory compliance required,'' would set an eligibility criterion that hospitals be in substantial compliance with government regulations. Hospitals under investigation would generally not be eligible for the program, unless the Commissioner determines that the investigation is minor in nature, that is, unlikely to result in substantial liability or otherwise harm the creditworthiness of the hospital.

Proposed 242.13, ''Parents and affiliates,'' recognizes the increase in mergers, affiliations, and multi-provider systems in the hospital industry. This section gives HUD express authority to take actions to mitigate the insurance risks posed by these arrangements.

Proposed 242.14, ''Mortgage reserve fund,'' adapts the reserve requirements to current industry conditions. The Section 242 program long required that the mortgagor contribute to a depreciation reserve fund, and in some cases, contribute additional reserve funds. The depreciation reserve fund was designed for the era when insurers reimbursed hospitals for their costs, including capital costs. The fund was available in the later years of the mortgage to provide cash flow to the hospital as depreciation and interest expense declined. Also, the fund was available to help the hospital through unexpected cash flow difficulties at any time during the mortgage term. With the shift from cost reimbursement to reimbursement by case, the rationale for the depreciation reserve fund is no longer valid. However, a reserve fund is still needed to provide a cushion in times of financial difficulty to help the hospital and the Commissioner avoid mortgage defaults. Beginning in 2000, hospitals coming into the program were required to maintain a Mortgage Reserve Fund (MRF) instead of a depreciation reserve fund and hospitals with existing insured mortgage loans were permitted to convert their depreciation reserve fund to an MRF if they met certain conditions. The contribution requirements of the MRF are lower than those for the depreciation reserve fund. The language in § 242.14 permits variation in fund requirements on a case-by-case basis, especially for critical access hospitals and others that receive partial cost-based reimbursement.

Finally, proposed 24 CFR 242.15 provides that some preexisting long-term debt may be refinanced under the Section 242 program; however, the ''hard costs'' of construction and equipment must represent at least 20 percent of the total mortgage amount. The types of loans that may be refinanced under this provision may or may not be HUD-insured.

Subpart B—Application Procedures and Commitments

Proposed 24 CFR 242.16, ''Applications,'' includes new material along with elements of the application procedures that have been in place in the program. For example, the requirement that the approval process entails a determination of market need in proposed § 242.16(a) is statutory (12 U.S.C. 1715z–7(d)(4)(B)) and also was found in the 1995 regulation in § 242.3(a). Both proposed § 242.16(c) on the application fee and § 242.16(d) on filing are unchanged from §§ 242.3(b) and 242.3(c) of the 1995 regulation.

The NPRM also proposes some important new elements in the application procedure. In many cases, these are codifications of procedures the Department is currently using.

The rule proposes, at 24 CFR 242.16(a)(1)(ii), a list of relevant factors in determining market need. These factors include matters such as the service area definition; current and projected future population; the occupancy rates of the applicant and competing hospitals; outpatient volume; and other factors related to assessing the need for the hospital and the services it would provide in the area. These factors are to be addressed, as applicable. This is in addition to the State's procedure, if any, for determining market need. In cases where the State has such a procedure, the State's procedure must be followed prior to application submission (proposed 24 CFR 242.16(a)(1)(i)), and HUD's own determination of need must also be made. Also, the rule clarifies that for start-up hospitals or major expansions, it generally must be demonstrated that existing hospital capacity or services are not adequate to meet the needs of the population in the service area.

The NPRM would also change long-standing policy for operating margin and financial feasibility. These standards are necessary to protect the soundness of the insurance fund. Proposed § 242.16(a)(2) would require a positive three-year aggregate operating margin, with discretion for HUD to find eligibility on the basis of a financial turnaround in the most recent year, and a debt service coverage ratio of 1.25 in the three most recent audited years, unless the Commissioner finds a financial turnaround, based on the audited financial data, resulting in a debt service coverage ratio of at least 1.40 in the most recent year. Proposed § 242.16(a)(3) contains detailed factors for determining whether the project is financially feasible; that is, whether it will be able to meet its debt service

obligations over the life of the mortgage that is proposed to be insured. Among the factors included are a current debt service coverage ratio of 1.25 or higher and a projected debt service coverage ratio of 1.40 or higher, and a balance sheet that shows the resources to withstand a short period of net operating losses without jeopardizing financial viability.

Because of the overall increase in applications for the Section 242 program, and an increase in the number of new applicants, the rule would codify in § 242.16(a)(4) the preliminary review process that HUD has used in recent years. This process is designed to forestall problems and provide guidance to applicants early in the process. The preliminary review is performed at the request of a hospital, a hospital's financial consultant, or a HUD-approved lender for the purpose of identifying any factor that would likely cause an application to be rejected before the applicant spends substantial resources on the application. The applicant submits a preliminary information package to the Commissioner, and, on that basis, the rule proposes that the Commissioner would issue a preliminary review letter stating either that the application would likely result in a rejection, or that there appears to be no bar to proceeding to the next step in the application process. The rule specifies that this latter determination is not to be construed to imply that the application will necessarily be approved.

If a finding is made of probable rejection, the applicant may not seek another preliminary review for one year from the date of notification, unless the Commissioner grants an exception based on a determination that the circumstances which led to the conclusion of a likely rejection have changed. If a finding is made that the application may go forward, the complete application should be submitted within one year from the date of notification, or a new preliminary review may be required.

Section 242.16(a)(5) provides that the next step in the application process is a preapplication meeting between the applicant and HUD. The result of this meeting will be either a determination that there is no bar to further process, or that there are issues that must be resolved before an application should be submitted.

The remainder of § 242.16 contains administrative components of application processing. Section 242.16(b) specifies the application contents. Section 242.16(e) provides that only technically complete applications will be processed and that the Commissioner, upon determination that an application is complete, issue a Completeness Letter to the applicant stating that the application is complete. Completeness letters generally are endeavored to be issued three weeks from the date that the application is determined to be complete. Section 242.16(f), ''Application review,'' gives the Commissioner broad discretion to consider any relevant factors in determining whether to grant an application, to solicit the advice of experts within and outside of government, and to request additional information from the applicant. At a minimum, HUD will consider eligibility, market need, financial feasibility, and compliance with applicable regulations. Section 242.16(f) also states that the Commissioner will render a decision within 12 months of the date of the completeness letter, unless the Commissioner for good cause extends the period of review. The review period could also be shorter than 12 months, depending generally on when the necessary information and materials are received and on the completeness of the materials.

The remainder of subpart B concerns commitments to insure the mortgage. Much of this portion of the regulation—including inspection fees (proposed § 242.18); fees in increases in commitments prior to endorsement (§ 242.19(a)) and increases between initial and final endorsement (§ 242.19(b)); reopening of expired commitments (§ 242.20); refund of fees (§ 242.21); adjusted and reduced mortgage amounts (§ 242.23(a) and (b))—are similar to the analogous sections in the 1995 regulations. In other cases, technical changes are proposed. For example, where the 1995 regulations provide that insurance on advances may be made, this proposed rule would require such insurance on advances and specifies that they reflect the mortgage amount, interest rate, mortgage term, date of commencement of amortization, and other requirements (proposed § 242.17(a)). The proposed regulation would also change the term of the commitment from 180 days stated in the 1995 regulation to 90 days, subject to extensions not to exceed 180 days (proposed § 242.17(c)).

There are also proposed changes from the 1995 provisions to the lender's maximum fees and charges (proposed § 242.22) to include a 3½ percent permanent financing fee, and technical changes to regulations dealing with the Commissioner's discretion to evaluate the amount of cash equity that any mortgagor must supply, as well as discretion as to whether a nonprofit or public entity mortgagor may use a letter of credit in lieu of cash. (See proposed § 242.23(c).) The latter section requires that the loan-to-value ratio not exceed 90 percent, although it may be less than 90 percent. In no case may the equity contribution be proceeds from a loan. Finally, proposed § 242.24 would give the Commissioner discretion to evaluate, on a case-by-case basis, the amount of working capital that must be available to the new hospital at the commencement of operations. Minimum working capital is required to ensure that hospitals, especially new hospitals, have sufficient operating cash on hand pending the receipt of income from operations. Generally, the working capital shall not be borrowed funds, unless the Commissioner determines that there are offsetting financial strengths to compensate for the risks associated with borrowing.

Subpart C—Mortgage Requirements

Many of the requirements in this subpart are adopted without change from the 1995 regulations, and have been ongoing features of the program. This section of the preamble focuses on new or changed requirements proposed to be introduced in this NPRM. The following table shows the substantially equivalent sections:

SUBSTANTIALLY EQUIVALENT SECTIONS

1995 Regulation	Proposed rule
242.31(a)	242.25(a)(1)
242.31(b)	242.25(b)
242.33(a)	242.26(a)
242.33(b)	242.26(b)
242.35	242.27
242.37	242.29
242.39	242.30
242.41(a)	242.31(a)
242.41(b)	242.31(b)
242.51(b)	242.37(b)
242.51(b)(1)	242.37(b)(1)
242.51(b)(2)	242.37(b)(2)

Proposed § 242.32 is a covenant against liens other than the insured mortgage, with an exception for other liens that the Commissioner may approve. This section codifies a policy that has been part of the standard regulatory agreement. In HUD mortgage insurance programs generally, the insured loan must have priority over other liens. Permitting the Commissioner to approve additional secondary liens for hospitals may enable hospitals to benefit from programs offered by the Department of Health and Human Services and States.

The mortgage lien certifications proposed in § 242.35 would add a new element to the 1995 equivalent section, 24 CFR 242.49, that is, a certification

that the security agreement and Uniform Commercial Code (UCC) financing statements establish a first lien on the personalty of the mortgagor. ''Personalty'' would be defined in this regulation as well.

The 1995 regulations generally grant a prepayment privilege except in the case of mortgage loans that have been funded by the issuance and sale of bonds or bond anticipation notes (24 CFR 242.51(a) and (c)), in which case the mortgage may contain a prepayment restriction. Proposed § 242.37(a), however, would allow the Commissioner to establish additional exceptions to the prepayment privilege. Proposed § 242.37(c) would allow for prepayment restrictions in the case of bond funding as in the 1995 regulation, as well as where the mortgage secures GNMA mortgage-backed securities, in those cases where the statute allows such mortgages to be insured under this part (*see* Section 242(d)(5) of the Act, 12 U.S.C. l715z–7(d)(5) for the restrictions on insuring mortgages that are used to collateralize GNMA securities). Proposed § 242.37(d) would provide that in the event of a default, the Commissioner could override any prepayment penalty in order to facilitate a refinancing of the property to avoid a claim on the insurance fund.

There is a change from the 1995 regulations in the area of late charges. Where the 1995 regulation imposed a limitation on the amount of late charges, the proposed rule would be flexible in this area, allowing the Commissioner to establish the terms and conditions for late charges. (Compare 24 CFR 242.52 of the 1995 regulation with proposed § 242.38.) This aligns the current rule with HUD's regulations in other insurance programs on this subject, as codified in 24 CFR 200.88.

Subpart D—Endorsement for Insurance

The proposed sections on endorsement for insurance essentially track similar requirements in 24 CFR part 200. This proposed rule would add to those typical insurance provisions specific requirements as to the application of cost savings in proposed §§ 242.41(b) and 242.43. These requirements for the application of cost savings codify current program practice.

Subpart E—Construction

Proposed §§ 242.44 through 242.53 would establish construction standards for the hospital mortgage insurance program. Proposed § 242.44 would codify as the minimum standard the Guidelines for Construction and Equipment of Hospital and Medical Facilities published by the American Institute of Architects, which is the standard currently being used in the program.

Proposed § 242.45 would codify the practice of approving, for good cause shown and with the concurrence of the Commissioner, early commencement of work; that is, commencement of certain preliminary work before the commitment to insure the mortgage. In such cases, the inspection fee must be prepaid before the commencement of the early work. Section 242.45 also makes clear the fact that no preliminary site work may be started prior to HUD doing an environmental review under 24 CFR part 50 and indicating its approval of the proposed work.

Proposed § 242.46, ''Insured advances—building loan agreement,'' and 242.47, ''Insured advances for building components stored off-site,'' would simply recodify similar sections of the 1995 regulations. (*See* §§ 242.53 and 242.54 of the 1995 regulations.) Proposed § 242.46 would provide for progress payments during construction. Proposed § 242.47 would allow for insured advances for building components stored off-site if certain requirements are met. On-site storage must be impractical because of size or weight or the threat of weather damage or other adverse conditions at the site. This section also contains certain storage and labeling requirements, and places responsibility for storage, transportation, and insurance of the components on the general contractor.

Proposed § 242.48 would provide for insurance of ''long lead items,'' that is, items for which an interim payment is needed in order to insure the timely production and delivery to the project site of the item. This provision for such items is a codification of existing program practice.

Proposed § 242.49 would provide that the Commissioner may require the mortgagor to make a deposit of cash or securities. The Commissioner may also permit the use of a letter of credit instead of cash or securities. This provision would be similar to 24 CFR 242.55 of the 1995 regulation, the primary difference being that if a letter of credit is used, it must be issued by an institution with a Standard & Poor's rating of AA or equivalent.

Proposed § 242.50, ''Funds and finances—off-site utilities and streets'' would recodify 24 CFR 242.59 of the 1995 regulations. This section requires assurance of completion of off-site public utilities and streets except in cases where a municipality or other local governmental body agrees to install streets and utilities without cost to the mortgagor.

Proposed § 242.51 provides for assurances of completion in the form of surety bonds, and would abbreviate 24 CFR 242.61 of the 1995 regulation to remove references to Hill-Burton grants and costs of less than $500,000. It is HUD's experience that these elements are not needed for hospitals now applying for loans. The section also provides that its requirements are a minimum, and that the mortgagee may require more stringent sureties of completion. Proposed § 242.52, ''Construction contracts,'' would require the mortgagor to enter into a construction contract with a builder selected by competitive bidding procedures. Proposed § 242.52(b) would allow for such a contract to take a variety of forms, including a lump sum contract; a construction management contract with a guaranteed maximum price, the final costs of which are subject to a certification acceptable to the Commissioner; a design-build contract; or such other contract as the Commissioner may approve. This section would differ from a similar section of the 1995 regulation by not providing for a waiver of competitive bidding, and by expanding the types of contracts that may be used (formerly, only a lump sum contract was allowed). By doing so, the rule would allow for a wider variety of participants who may wish to use a variety of contracting methods.

Proposed § 242.53 would require that contracts relating to construction of the project not be made with any firm that has been found to be ineligible to participate by HUD or the Department of Labor. These restrictions on ineligible contractors are similar to those found in 24 CFR 242.71 of the 1995 regulation, with an additional provision prohibiting identity of interest contracts, as determined by the Commissioner, between the applicant and the general contractor.

Subpart F—Nondiscrimination and Wage Rates

Proposed §§ 242.54 and 242.55 would reference the basic nondiscrimination and Davis-Bacon wage rate requirements applicable to this program as well as the special requirement for payment of overtime to laborers and mechanics that applies to this program under section 212 of the Act.

Subpart G—Regulatory Agreement, Accounting and Reporting, and Financial Requirements

Proposed §§ 242.56–242.93 would primarily focus on improved HUD supervision of the insured mortgagor, as well as on administrative provisions

necessary to run the program. Overall, HUD will exercise financial supervision over its insured mortgagors to minimize the risk to the insurance fund.

Proposed § 242.56 would provide for regulation by a Regulatory Agreement which can be flexible and include such clauses as the Commissioner deems necessary on a case-by-case basis. This section also makes clear that the mortgagor will be subject to continuing supervision by government agencies and their contractors and agents for the life of the insured loan. The purpose of this provision is to ensure financial soundness and prevent program abuse.

Proposed §§ 242.57 and 242.59 would restate, respectively, 24 CFR 242.77 and 242.81 from the 1995 regulation. These sections require the mortgagor to maintain the property in good repair and allow for HUD to inspect the property, and the mortgagor's books and records, at reasonable times. In addition to these provisions, proposed § 242.58, ''Books, accounts, and financial statements,'' expands on the parallel 1995 regulation, 24 CFR 242.79, by specifying details of financial reports and when these reports must be filed with the Commissioner. This section also expands on the auditing requirements of the 1995 regulation. The purpose of these changes is to improve on the financial oversight of the mortgagor and reduce risk to the insurance fund.

Proposed § 242.61, ''Management,'' would provide that the Commissioner must approve any management contract for the hospital insured under this section. Furthermore, HUD could require that the principals of the mortgagor and key management employees could be removed, substituted, or terminated for cause by written request of the Commissioner. Experience has shown that there is a need to ensure appropriate management of hospitals insured under this program.

Under proposed § 262.64, all current and future property and equipment will become subject to the HUD-insured mortgage unless the Commissioner, for cause, approves otherwise. Given the importance of the security for the insured loan, proposed § 242.62, ''Release of lien,'' and § 242.65, ''Distribution of assets,'' would contain important concepts. Under § 242.62, the mortgagor would not be able to dispose of any non-cash assets secured by the mortgage without the approval of the mortgage lender and the Commissioner. If such disposal of assets involves a partial release of the lien, the lender, subject to review by the Commissioner, must make a determination that the remaining lien is sufficient to cover the remaining property.

Proposed § 242.65 would provide for the distribution of assets, including surplus cash. Cash, to be considered surplus and available for distribution, must either meet the terms of the definition of ''surplus cash'' in proposed 24 CFR 242.1 or be approved for distribution by the Commissioner. This section clarifies to whom distributions may occur.

Two proposed sections would regulate affiliate transactions. Proposed § 242.66 would prohibit transactions with affiliates except with prior written approval of the Commissioner. Proposed § 242.67 would prohibit acquisition, development, organization, or acquisition of a significant interest in any corporation, subsidiary, or affiliate other than those with which the mortgagor was affiliated with as of the date of application, without the prior written approval of the Commissioner.

Subpart H—Miscellaneous Requirements

This subpart contains a number of requirements that do not fit under other categories of 24 CFR part 242. For example, § 242.68 refers to disclosure and verification of Social Security and Employer Identification numbers. Section 242.69 relates to fees for transfers of physical assets.

Although the program has generally prohibited the leasing of an entire hospital, proposed § 242.72 would permit leasing of the hospital in two limited instances. One is where there is a State law prohibition against State entity mortgaging of health care facilities. Another is where the Commissioner determines that leasing is necessary to reduce the risk of default by a financially troubled hospital with an existing loan under 24 CFR part 242.

Proposed § 242.73 provides for the waiver of eligibility requirements for insurance under the part of a mortgage assigned to the Secretary or acquired by the Secretary subsequent to a payment of claim. This provision would help to enable the Secretary to dispose of such mortgages after such assignment or acquisition, thereby recouping losses to the insurance fund.

Proposed §§ 242.74 (smoke detectors), 242.75 (title requirements), and 242.76 (title evidence) would restate, without substantive change, 1995 §§ 242.87, 242.89, and 242.91, respectively. Proposed § 242.77 would provide that the hospital must be free and clear of all liens other than the insured mortgage, except for certain categories of liens as the Commissioner may provide.

Proposed § 242.89, ''Supplemental loans,'' would provide for a loan or advance of credit for financing improvements or additions to a hospital covered by this part. This section implements section 241 of the Act (12 U.S.C. 1715z–6), for the hospital mortgage insurance program.

Proposed § 242.90, ''Eligibility of mortgages covering hospitals in certain neighborhoods,'' restates 24 CFR 242.94 from the 1995 regulation. The purpose of this section is to provide for hospital care in older or declining neighborhoods, subject to certain conditions, such as ensuring that the area is reasonably viable and the mortgage is an acceptable risk.

Proposed § 242.91, ''Eligibility of refinancing transactions,'' restates 24 CFR 242.96 from the 1995 regulations. Proposed §§ 242.92 (minimum principal loan amount), 242.93 (amendment of regulations), and 242.94 (cross reference) restate 24 CFR 242.97, 242.249, and 242.251 of the 1995 regulations, respectively.

Findings and Certifications

Information Collection Requirements

The information collection requirements contained in this proposed rule are found in §§ 242.8, 242.13, 242.16, 242.20, 242.25, 242.33, 242.35, 242.40, 242.41, 242.42, 242.46, 242.52, 242.57, 242.58, 242.61, 242.68, and 242.76. As discussed in the preamble of this rule, the information collection requirements in these sections are largely unchanged from those already in place for the Section 242 program, and found in the existing regulations in 24 CFR parts 200, 207 and 242, and documents such as form, HUD–92013–HOSP (Application for Hospital Project Mortgagee Insurance) and Mortgagee Letter 04–08 (issued February 23, 2004), which details the requirements for the market need study and financial feasibility study. The existing information collection requirements were approved by the Office of Management and Budget (OMB) under the Paperwork Reduction Act of 1995 (44 U.S.C. 3501–3520), and assigned OMB approval number 2502–0518.

The existing information collections, which remain unchanged by this proposed rule, are found in the following sections: §§ 242.8 (requiring evidence that the hospital is located in a State or a political subdivision of a State with reasonable minimum standards for licensure and methods of operation), 242.13 (concerning financial and operational information about parents and affiliates), 242.20 (concerning request for reopening

expired commitment), 242.25 (form of the mortgage), 242.33 (maintenance of adequate malpractice liability, fire, and extended coverage insurance on the property), 242.40 (form of mortgagee certificate), 242.41 (concerning agreement precluding excess of mortgage proceeds over statutory limitations), 242.42 (mortgagor's certificate of actual cost), 242.46 (building loan agreement), 242.50 (assurances of completion of off-site public utilities and streets), 242,51 (assurance of completion of construction or rehabilitation where cost is more than $500,000), 242.52 (a contract for construction or rehabilitation of a hospital), 242.56 (execution of regulatory agreement), and 242.75 (marketable title requirements), and 242.76 (evidence of title).

The Department has estimated the total burden for the information collection currently in place for the Section 242 program, which includes the Application for Hospital Project Mortgage Insurance (HUD–92013–HOSP), the market need and feasibility studies, and the requirements set forth in the regulations, as a total of 17,280 hours. This total is based on an estimate of 18 applicants a year and 960 hours per response.

The additional information collection set forth in this proposed rule can be found in the following regulatory sections. Several of these sections, such as 242.16 (the application requirements) contain the existing requirements, and these requirements have been expanded upon by the proposed rule, particularly with respect to the market need and feasibility study. In § 242.16(a)(1)(ii), HUD proposes a list of additional relevant factors in determining market need, and § 242.16(a)(3) contains detailed factors for determining whether a project is financially feasible. Section 242.35 proposed to add to the existing mortgage lien certification a certification that the security agreement and UCC financing statements establish a first line on the personalty of the mortgagor. Section 242.58 expands upon the recordkeeping requirements currently in place. Section 242.61 provides for a management contract for the hospital and § 242.68 requires a disclosure and verification of Social Security and employer identification numbers. The additional burden of the information collections in this proposed rule is estimated as follows:

REPORTING AND RECORDKEEPING BURDEN

Section reference	Number of parties	Number of responses per respondent	Estimated average time for requirement (in hours)	Estimated additional annual burden (in hours)
§ 242.16	18	1	5	90
§ 242.35	18	1	2	36
§ 242.58	18	1	1	18
§ 242.61	18	1	3	54
§ 242.68	18	1	1	18
Total Additional Annual Burden Presented by Proposed Rule				216
Total Estimated Annual Burden: 17, 280 hrs + 216 hrs				17,416

The changed collection of information is being submitted to OMB for review and approval. In accordance with 5 CFR 1320.8(d)(1), HUD is soliciting comments from members of the public and affected agencies concerning this collection of information to:

(1) Evaluate whether the proposed collection of information is necessary for the proper performance of the functions of the agency, including whether the information will have practical utility;

(2) Evaluate the accuracy of the agency's estimate of the burden of the proposed collection of information;

(3) Enhance the quality, utility, and clarity of the information to be collected; and

(4) Minimize the burden of the collection of information on those who are to respond, including through the use of appropriate automated collection techniques or other forms of information technology; *e.g.*, permitting electronic submission of responses.

Interested persons are invited to submit comments regarding the information collection requirements in this rule no later than February 9, 2005. This time frame does not affect the deadline for comments to the agency on the rule, however. Comments on information collection 2502–0518 must refer to the proposed rule by name and docket number (FR–4927–P–01) and must be sent to:

Mark D. Menchik, HUD Desk Officer, Office of Management and Budget, New Executive Office Building, Washington, DC 20503, Fax number: (202) 395–6947, E-mail: *Mark_D._Menchik@omb.eop.gov;*

and

Kathleen McDermott, Reports Liaison Officer, Office of Housing-Federal Housing Commissioner, Department of Housing and Urban Development, 451 Seventh Street, SW., Room 9116, Washington, DC 20410–8000.

In accordance with the Paperwork Reduction Act, an agency may not conduct or sponsor, and a person is not required to respond to, a collection of information unless the collection displays a currently valid OMB control number.

Environmental Impact

A Finding of No Significant Impact with respect to the environment for this rule has been made in accordance with HUD regulations at 24 CFR part 50, which implement section 102(2)(C) of the National Environmental Policy Act of 1969 (42 U.S.C. 4332(2)(C)). The Finding of No Significant Impact is available for public inspection between 8 a.m. and 5 p.m. weekdays in the Regulations Division, Office of the General Counsel, Department of Housing and Urban Development, Room 10276, 451 Seventh Street, SW., Washington, DC 20410–5000.

Unfunded Mandates Reform Act

The Unfunded Mandates Reform Act of 1995 (2 U.S.C. 1531–1538) (UMRA) establishes requirements for Federal agencies to assess the effects of their regulatory actions on State, local, and tribal governments and on the private sector. This rule does not impose a Federal mandate on any State, local, or tribal government, or on the private sector, within the meaning of UMRA.

Regulatory Flexibility Act

The Regulatory Flexibility Act (RFA) (5 U.S.C. 601 *et seq.*), generally requires an agency to conduct a regulatory flexibility analysis of any rule subject to notice and comment rulemaking requirements unless the agency certifies that the rule will not have a significant economic impact on a substantial number of small entities.

There are no anti-competitive discriminatory aspects of the rule with regard to small entities, and there are not any unusual procedures that would need to be complied with by small entities. The rule revises the regulations under the mortgage insurance program for hospitals to update and improve the efficiency of the program.

Therefore, the undersigned certifies that this proposed rule will not have a significant economic impact on a substantial number of small entities, and an initial regulatory flexibility analysis is not required.

Notwithstanding the determination that this rule would not have a significant economic impact on a substantial number of small entities, HUD specifically invites comments regarding less burdensome alternatives to this rule that will meet HUD's objectives as described in this preamble.

Executive Order 13132, Federalism

Executive Order 13132 (entitled ''Federalism'') prohibits an agency from publishing any rule that has federalism implications if the rule either imposes substantial direct compliance costs on State and local governments and is not required by statute, or the rule preempts State law, unless the agency meets the consultation and funding requirements of section 6 of the Executive Order. This rule does not have federalism implications and does not impose substantial direct compliance costs on State and local governments nor preempt State law within the meaning of the Executive Order.

Regulatory Planning and Review

The Office of Management and Budget (OMB) reviewed this rule under Executive Order 12866, *Regulatory Planning and Review*. OMB determined that this rule is a ''significant regulatory action'' as defined in section 3(f) of the order (although not an economically significant regulatory action under the order). Any changes made to this rule as a result of that review are identified in the docket file, which is available for public inspection in the Regulations Division, Office of the General Counsel, Room 10276, 451 Seventh Street, SW., Washington, DC 20410–0500.

List of Subjects in 24 CFR Part 200

Administrative practice and procedure, Claims, Equal employment opportunity, Fair housing, Home improvement, Housing standards, Lead poisoning, Loan programs—housing and community development, Mortgage insurance, Organization and functions (Government agencies), Penalties, Reporting and recordkeeping requirements, Social security, Unemployment compensation, Wages.

Catalog of Federal Domestic Assistance

The Catalog of Federal Domestic Assistance number is 14.128.

List of Subjects in 24 CFR Part 242

Hospitals, Mortgage insurance, Reporting and record keeping requirements.

Accordingly, for the reasons described in the preamble, HUD proposes to amend 24 CFR parts 200 and 242 to read as follows:

PART 200—INTRODUCTION TO FHA PROGRAMS

1. Section 200.24 is revised to read as follows:

§ 200.24 Existing projects.

A mortgage financing the purchase or refinance of an existing rental housing project under section 207 of the Act, or for refinancing the existing debt of an existing nursing home, intermediate care facility, assisted living facility, or board and care home, or any combination thereof, under section 232 of the Act, may be insured pursuant to provisions of section 223(f) of the Act and such terms and conditions established by the Commissioner.

2. Section 200.25 is revised to read as follows:

§ 200.25 Supplemental loans.

A loan, advance of credit or purchase of an obligation representing a loan or advance of credit made for the purpose of financing improvements or additions to a project covered by a mortgage insured under any section of the Act or Commissioner-held mortgage, or equipment for a nursing home, intermediate care facility, board and care home, assisted living facility, or group practices facility, may be insured pursuant to the provisions of section 241 of the Act and such terms and conditions established by the Commissioner.

3. 24 CFR 200.40 is amended by revising paragraphs (c), (d), and (f) to read as follows:

§ 200.40 HUD fees.

The following fees apply to mortgages to be insured under this part.

* * * * *

(c) *Application fee—conditional commitment.* For a mortgage being insured under section 223(f) of the Act (12 U.S.C. 1715n), an application-commitment fee of $3 per thousand dollars of the requested mortgage amount shall accompany an application for conditional commitment.

(d) *Application fee—firm commitment: General.* An application for firm commitment shall be accompanied by an application-commitment fee which, when added to any prior fees received in connection with applications for a SAMA letter or a feasibility letter, will aggregate $5 per thousand dollars of the requested mortgage amount to be insured. The payment of an application-commitment fee shall not be required in connection with an insured mortgage involving the sale by the government of housing or property acquired, held, or contracted pursuant to the Atomic Energy Community Act of 1955 (42 U.S.C. 2301 *et seq.*).

* * * * *

(f) *Fees on increases—in general.* This section applies to all applications except applications involving hospitals, which are covered in 24 CFR part 242.

(1) *Increase in firm commitment before endorsement.* An application, filed before initial endorsement (or before endorsement in a case involving insurance upon completion), for an increase in the amount of an outstanding firm commitment shall be accompanied by a combined additional application and commitment fee. This combined additional fee shall be in an amount which will aggregate $5 per thousand dollars of the amount of the requested increase. If an inspection fee was required in the original commitment, an additional inspection fee shall be paid in an amount computed at the same dollar rate per thousand dollars of the amount of increase in commitment as was used for the inspection fee required in the original commitment. When insurance of advances is involved, the additional inspection fee shall be paid at the time of initial endorsement. When insurance upon completion is involved, the additional inspection fee shall be paid before the date construction is begun or if construction has begun, it shall be paid with the application for increase.

(2) *Increase in mortgage between initial and final endorsement.* Upon an application, filed between initial and final endorsement, for an increase in the

amount of the mortgage, either by amendment or by substitution of a new mortgage, a combined additional application and commitment fee shall accompany the application. This combined additional fee shall be in an amount which will aggregate $5 per thousand dollars of the amount of the increase requested. If an inspection fee was required in the original commitment, an additional inspection fee shall accompany the application in an amount not to exceed the $5 per thousand dollars of the amount of the increase requested.

(3) *Loan to cover operating losses.* In connection with a loan to cover operating losses (*see* § 200.22), a combined application and commitment fee of $5 per thousand dollars of the amount of the loan applied for shall be submitted with the application for a firm commitment. No inspection fee shall be required.

* * * * *

PART 242—MORTGAGE INSURANCE FOR HOSPITALS

4. Part 242 is revised to read as follows:

PART 242—MORTGAGE INSURANCE FOR HOSPITALS

Subpart A—General Eligibility Requirements

Sec.
242.1 Definitions.
242.2 Program financial self-sufficiency.
242.3 Encouragement of certain programs.
242.4 Eligible hospitals.
242.5 Eligible mortgagees.
242.6 Property requirements.
242.7 Maximum mortgage amounts.
242.8 Standards for licensure and methods of operation.
242.9 Physician ownership.
242.10 Eligible mortgagors.
242.11 Regulatory compliance required.
242.13 Parents and affiliates.
242.14 Mortgage reserve fund.
242.15 Limitation on refinancing of existing indebtedness.

Subpart B—Application Procedures and Commitments

242.16 Applications.
242.17 Commitments.
242.18 Inspection fee.
242.19 Fees on increases.
242.20 Reopening of expired commitments.
242.21 Refund of fees.
242.22 Maximum fees and charges by mortgagee.
242.23 Adjusted and reduced mortgage amounts.
242.24 Working capital.

Subpart C—Mortgagee Requirements

242.25 Mortgage form and disbursement of mortgage proceeds.
242.26 Agreed interest rate.
242.27 Maturity.
242.28 Alllowable costs for consultants.
242.29 Payment requirements.
242.30 Application of payments.
242.31 Accumulation of accruals.
242.32 Covenant against liens.
242.33 Covenant for malpractice, fire and other hazard insurance.
242.35 Mortgage lien certifications.
242.37 Mortgage prepayment.
242.38 Late charge.

Subpart D—Endorsement for Insurance

242.39 Insurance endorsement.
242.40 Mortgagee Certificate.
242.41 Certification of cost requirements.
242.42 Certificates of actual cost.
242.43 Application of cost savings.

Subpart E—Construction

242.44 Construction standards.
242.45 Early commencement of work.
242.46 Insured advances—building loan agreement.
242.47 Insured advances for building components stored off-site.
242.48 Insured advances for certain equipment and long lead items.
242.49 Funds and finances: Deposits and letters of credit.
242.50 Funds and finances: Off-site utilities and streets.
242.51 Funds and finances: Insured advances and assurance of completion.
242.52 Construction contracts.
242.53 Ineligible contractors.

Subpart F—Nondiscrimination and Wage Rates

242.54 Nondiscrimination.
242.55 Labor standards.

Subpart G—Regulatory Agreement, Accounting and Reporting, and Financial Reporting

242.56 Form of regulation.
242.57 Maintenance of hospital facility.
242.58 Books, accounts, and financial statements.
242.59 Inspection of facilities by Commissioner.
242.61 Management.
242.62 Releases of lien.
242.63 Additional indebtedness and leasing.
242.64 Current and future property.
242.65 Distribution of assets.
242.66 Affiliate transactions.
242.67 New corporations, subsidiaries, affiliations, and mergers.

Subpart H—Miscellaneous Requirements

242.68 Disclosure and verification of Social Security and Employer Identification Numbers.
242.69 Transfer fee.
242.70 Fees not required.
242.72 Leasing of hospital.
242.73 Waiver of eligibility requirements for mortgage insurance.
242.74 Smoke detectors.
242.75 Title requirements.
242.76 Title evidence.
242.77 Liens.
242.78 Zoning, deed, and building restrictions.
242.79 Environmental quality determinations and standards.
242.81 Lead-based paint poisoning prevention.
242.82 Energy conservation.
242.83 Debarment and suspension.
242.84 Previous participation and compliance requirements.
242.86 Property and mortgage assessment.
242.87 Certifications.
242.89 Supplemental loans.
242.90 Eligibility of mortgages covering hospitals in certain neighborhoods.
242.91 Eligibility of refinancing transactions.
242.92 Minimum principal loan amount.
242.93 Amendment of regulations.
242.94 Cross-reference.

Authority: 12 U.S.C. 1709, 1710, 1715b, and 1715u; 42 U.S.C. 3535(d).

Subpart A—General Eligibility Requirements

§ 242.1 Definitions.

As used in this subpart, the following terms shall have the meaning indicated: *Act* means the National Housing Act (12 U.S.C. 1701 *et seq.*).

Affiliate means a person or entity which, directly or indirectly, either controls or has the power to control or exert significant influence on the other, or a person and entity both controlled by a third person or entity, which may be a parent entity. Indicia of control include, but are not limited to: interlocking management or ownership, identity of interests among family members, shared facilities and equipment, common use of employees, or a business entity organized following the suspension or debarment of a person or entity which has the same or similar management, ownership, or principal employees as the suspended, debarred, ineligible, or voluntarily excluded person or entity or as defined in the Medicare reimbursement regulations.

Chronic convalescent and rest means skilled nursing services, intermediate care services, respite care services, hospice services, rehabilitation services, and other services of a similar nature.

Commissioner means the Assistant Secretary for Housing—Federal Housing Commissioner or his or her authorized representatives. (The operation of the hospital mortgage insurance program is centralized directly under the Commissioner.)

Debt service coverage ratio is a measure of a hospital's ability to pay interest and principal with cash generated from current operations. A high coverage ratio indicates that an institution is in good financial position to meet its long-term obligations (including its FHA-insured loan) and service its debt. Higher values are

preferable. Debt service coverage ratio is calculated as follows:

$$\text{Debt Service Coverage Ratio} = \frac{\text{Net Income} + \text{Depreciation Expense} + \text{Interest Expense}}{\text{Current Portion of Long-Term Debt (Prior Year)} + \text{Interest Expense.}}$$

Hospital means a facility that has been proposed for approval or has been approved by the Commissioner under the provisions of this subpart, and:

(1) Which provides community services for inpatient medical care of the sick or injured (including obstetrical care);

(2) Where not more than 50 percent of the total patient days during any year are customarily assignable to the categories of chronic convalescent and rest, drug and alcoholic, epileptic, mentally deficient, mental, nervous and mental, and tuberculosis, except that the 50 percent patient day restriction does not apply to Critical Access Hospitals (hospitals designated as such under the Medicare Rural Hospital Flexibility Program) between [effective date of final rule] and July 31, 2006.

(3) Which is a facility licensed or regulated by the State (or, if there is no such State law providing for such licensing or regulation by the State, by the municipality or other political subdivision in which the facility is located) and is:

(i) A public facility owned by a State or unit of local government or by an instrumentality thereof, or owned by a public benefit corporation established by a State or unit of local government or by an instrumentality thereof;

(ii) A proprietary facility; or

(iii) A facility of a private nonprofit corporation or association.

Identity of interest means a relationship that must be disclosed and may be prohibited pursuant to the requirements of the Regulatory Agreement.

Mortgage means such classes of first liens as are commonly given to secure advances on, or the unpaid purchase price of, real estate under the laws of the State in which the real estate is located, together with any credit instrument secured thereby. The mortgage may be in the form of one or more trust mortgages or mortgage indentures or deeds of trust securing notes, bonds, or other credit instruments; and by the same instrument or by a separate instrument, it may create a security interest in the personalty, including, but not limited to, the equipment whether or not the equipment is attached to the realty, and in the revenues and receivables of the hospital.

Mortgagee or lender means the original lender under a mortgage, and its successors and assigns, and includes the holders of credit instruments issued under a trust indenture, mortgage, or deed of trust pursuant to which such holders act by and through a trustee therein named. (All official contacts and actions by the Commissioner shall be with or through a HUD-approved lender.)

Mortgagor means the original borrower under a mortgage and its successors and assigns.

Mortgage Reserve Fund means a trustee-held account to which the mortgagor contributes and from which withdrawals must be approved by the Commissioner. The purpose of the fund is to provide the Commissioner a means to assist the hospital to avoid mortgage defaults and to preserve the value of the mortgaged property or the hospital's business.

Non-operating revenues and expenses are those revenues and expenses not directly related to patient care, hospital-related patient services, or the sale of hospital-related goods. Examples of items classified as non-operating are State and Federal income tax, general contributions, gains and losses from investments, unrestricted income from endowment funds, and income from related entities. Classification of items as operating or non-operating shall follow written guidance by the Commissioner.

Operating margin is operating income divided by operating revenue, where:

Operating revenue is the revenue from the core patient care operations of the hospital. It includes revenues from the provision of such items as patient care (including hospital-based nursing home and physicians' clinics); transfers from temporarily restricted accounts that are used for current operating expenses; and patient-related activities such as the operation of the cafeteria, parking facilities, television services to patients, sale of medical scrap or waste, etc. (Additional sources of revenue, which are classified as non-operating, are deliberately excluded from this measure.)

Operating income is operating revenue minus operating expenses, where operating expenses are the expenses incurred in providing patient care, including such items as salaries, supplies, and the cost of capital.

Parent means an organization or entity that controls or has a controlling interest in another organization or entity.

Personalty means all furniture, furnishings, equipment, machinery, building materials, appliances, goods, supplies, tools, books, records (whether in written or electronic form), computer equipment (hardware and software) and other tangible or electronically stored personal property (other than fixtures) which are owned or leased by the borrower or the lessee now or in the future in connection with the ownership, management or operation of the land or the improvements or are located on the land or in the improvements, and any operating agreements relating to the land or the improvements, and any surveys, plans and specifications and contracts for architectural, engineering and construction services relating to the land or the improvements, choses in action and all other intangible property and rights relating to the operation of, or used in connection with, the land or the improvements, including all governmental permits relating to any activities on the land. Personalty also includes all tangible and intangible personal property used for health care (such as major movable equipment and systems), accounts, licenses, bed authorities, certificates of need required to operate the project and to receive benefits and reimbursements under provider agreements with Medicaid, Medicare, State and local programs, payments from health care insurers and any other assistance providers (''Receivables''); all permits, instruments, rents, lease and contract rights, and equipment leases relating to the use, operation, maintenance, repair, and improvement of the hospital. Generally, intangibles shall also include all cash and cash escrow funds, such as but not limited to: depreciation reserve fund or mortgage reserve fund accounts, bank accounts, residual receipt accounts, all contributions, donations, gifts, grants, bequests and endowment funds by donors, and all other revenues and accounts receivable from whatever source paid or payable. All personalty shall be securitized with appropriate

UCC filings and any excluded personalty shall be indicated in the Regulatory Agreement.

Preapplication meeting means a meeting between HUD and a potential applicant for mortgage insurance where there has been a positive Preliminary Review of the proposed project. The preapplication meeting is an opportunity for the potential applicant to summarize the proposed project, for HUD to summarize the application process, and for issues that could affect the eligibility or underwriting of the proposed loan to be identified and discussed.

Preliminary Review Letter means a letter from the Commissioner to a potential applicant communicating the result of the Preliminary Review. The letter may state that an application for mortgage insurance would result in a rejection and provide the reasons for this determination, or state that no factors that would cause an application to be rejected have been identified, and therefore there appears to be no bar to the applicant proceeding to the next step in the application process.

Project means the construction, modernization, expansion, or renovation of an eligible hospital, including equipment, which has been proposed for approval or has been approved by the Commissioner under the provisions of this subpart, including the financing and refinancing, if any, plus all related activities involved in completing the improvements to the property.

Regulatory Agreement means the agreement under which all mortgagors shall be regulated by the Commissioner, as long as the Commissioner is the insurer or holder of the mortgage, in a published format determined by the Commissioner, and such additional covenants and restrictions as may be determined necessary by the Commissioner on a case-by-case basis.

Security instrument means a mortgage, deed of trust, and any other security for the indebtedness, and shall be deemed to be the mortgage as defined by the National Housing Act, as amended, implementing regulations, and HUD directives.

State includes the several States, Puerto Rico, the District of Columbia, Guam, the Trust Territory of the Pacific Islands, American Samoa, and the Virgin Islands.

Surplus Cash means any cash earned in the applicable fiscal period, including accounts receivable, remaining after the following have been achieved:

(1) Mortgage payments for the preceding 12 months have been made when due, including any grace period;

(2) There is a Debt Service Coverage Ratio greater than or equal to 1.50;

(3) Days in Accounts Receivable are less than or equal to 80;

(4) Days in Accounts Payable are less than or equal to 80;

(5) The Mortgage Reserve Fund is compliant with the scheduled balance;

(6) All income, property, and statutory employer payroll taxes and employee payroll withholding contributions have been deposited as required;

(7) The Current Ratio is greater than or equal to 1.50;

(8) Days of cash on hand are greater than or equal to 15 days; and

(9) The payment of:

(i) All sums due or currently required to be paid under the terms of the Mortgage Note and Regulatory Agreement due on the first day of the month following the end of the fiscal period, including, without limitation, in the Mortgage Reserve Fund or any other reserves as may be required by HUD; and

(ii) All other obligations of the hospital (accounts payable and accrued, unescrowed expenses), unless funds for payment are set aside or HUD has approved deferment of payment.

Secretary means the Secretary of Housing and Urban Development or his or her authorized representatives.

Working capital means the excess of current assets over current liabilities.

§ 242.2 Program financial self-sufficiency.

The Commissioner shall administer the Section 242 program in such a way as to encourage financial self-sufficiency and actuarial soundness; *i.e.*, to avoid mortgage defaults and claims for insurance benefits in order to protect the mortgage insurance fund.

§ 242.3 Encouragement of certain programs.

The activities and functions provided for in this part shall be carried out so as to encourage provision of comprehensive health care, including outpatient and preventive care as well as hospitalization, to a defined population, and in the case of public and certain not-for-profit hospitals, to encourage programs that are undertaken to provide essential health care services to all residents of a community regardless of ability to pay.

§ 242.4 Eligible hospitals.

The hospital to be financed with a mortgage insured under this part shall involve the construction of a new hospital or the substantial rehabilitation (or replacement) of an existing hospital.

§ 242.5 Eligible mortgagees.

The lender requirements set forth in 24 CFR part 202 regarding approval, recertification, withdrawal of approval, approval for servicing, report requirements and conditions for supervised mortgagees, nonsupervised mortgagees, investing mortgagees, and governmental and similar institutions, apply to these programs.

§ 242.6 Property requirements.

The mortgage, to be eligible for insurance, shall be on property located in a State, as defined in § 242.1. The mortgage shall cover real estate in which the mortgagor has one of the following interests:

(a) A fee simple title.

(b) A lease for not less than 99 years that is renewable.

(c) A lease having a term of not less than 50 years to run from the date the mortgage is executed.

§ 242.7 Maximum mortgage amounts.

The mortgage shall involve a principal obligation not in excess of 90 percent of the Commissioner's estimate of the replacement cost of the hospital, including the equipment to be used in its operation when the proposed improvements are completed and the equipment is installed.

§ 242.8 Standards for licensure and methods of operation.

The Secretary shall require satisfactory evidence that the hospital will be located in a State or political subdivision of a State with reasonable minimum standards of licensure and methods of operation for hospitals, and satisfactory assurance that such standards will be applied and enforced with respect to the hospital.

§ 242.9 Physician ownership.

Ownership of an interest in the mortgagor by physicians or other professionals practicing in the hospital is permitted within limits determined by the Commissioner to avoid insurance risks that may be associated with such ownership. The Commissioner shall determine if the proposed mortgagor will be at low risk for violation of regulations of the U. S. Department of Health and Human Services, other Federal regulations, and State regulations governing kickbacks, self-referrals, and other issues that could increase the risk of eventual default. The Commissioner's determination shall be based on an unqualified legal opinion as to compliance with

applicable Federal law, among other considerations.

§ 242.10 Eligible mortgagors.

The mortgagor shall be a public mortgagor (*i.e.*, an owner of a public facility), a private nonprofit corporation or association, or a profit-motivated mortgagor meeting the definition of ''hospital'' in § 242.1. The mortgagor shall be approved by the Commissioner and shall possess the powers necessary and incidental to operating a hospital. Eligible proprietary or profit-motivated mortgagors may include for-profit corporations, limited partnerships, and limited liability corporations and companies, but may not include natural persons, joint ventures, and general partnerships. Any proposed mortgagor must demonstrate that it has a continuity of organization commensurate with the term of the mortgage loan being insured. For new organizations, or those whose continuity is necessarily dependent upon an individual or individuals, broad community participation is required.

§ 242.11 Regulatory compliance required.

An application for insurance of a mortgage under this part shall be considered only in connection with a hospital that is in substantial compliance with regulations of the Department of Health and Human Services and the various States governing the operation and reimbursement of hospitals. A hospital that is under investigation by any State or Federal agency for statutory or regulatory violations is not eligible so long as the investigation is unresolved, unless the Commissioner determines that the investigation is minor in nature, that is, the investigation has little chance of resulting in substantial liabilities or of otherwise substantially harming the creditworthiness of the hospital.

§ 242.13 Parents and affiliates.

As a condition of issuing a commitment, the Commissioner may require corporate parents, affiliates, or principals of the proposed mortgagor to provide assurances, guarantees, or collateral. The Commissioner may also require financial and operational information on the parent, other businesses owned by the parent, or affiliates of the proposed mortgagor and may also require a parent or affiliate to be regulated by the Commissioner as to certain actions which could impact on the insurance of a mortgage loan for the benefit of the hospital.

§ 242.14 Mortgage reserve fund.

As a condition of issuing a commitment, the Commissioner shall require establishment of a Mortgage Reserve Fund (MRF), a trustee-held account to which the mortgagor will contribute and from which withdrawals must be approved by the Commissioner. The mortgagor shall be required to make contributions to the MRF such that, with fund earnings, the MRF will build to one year of debt service at five years following commencement of amortization, increasing thereafter to two years of debt service on and after ten years according to a schedule established by the Commissioner, unless the Commissioner determines that a different schedule of contributions is appropriate based on the mortgagor's risk profile, reimbursement structure, or other characteristics. In particular, hospitals that receive cost-based reimbursement may be required to have MRFs that build to more than two years of debt service. Expenditures from the fund are made at the Commissioner's sole discretion or in accordance with the mortgagor's MRF Schedule. Upon termination of insurance, the balance of the MRF shall be returned to the mortgagor provided that all obligations to HUD have been met.

§ 242.15 Limitation on refinancing of existing indebtedness.

Some existing long-term debt may be refinanced with the proceeds of a section 242 insured loan; however, the hard costs of construction and equipment must represent at least 20 percent of the total mortgage amount.

Subpart B—Application Procedures and Commitments

§ 242.16 Applications.

(a) *Application process.* (1) *Market need.* The approval process entails a determination of the market need of the proposal and stresses, on a market-wide basis, the impact of the proposed facility on, and its relationship to, other health care facilities and services (particularly other hospitals with mortgages insured under this part and hospitals that have a disproportionate share of Medicaid and uninsured patients or provide a substantial amount of charity care); the number and percentage of any excess beds; and demographic projections. Generally, section 242 insurance may support start-up hospitals or major expansions of existing hospitals only if existing hospital capacity or services are clearly not adequate to meet the needs of the population in the service area.

(i) If the State has an official procedure for determining need for hospitals, the Commissioner shall require that such procedure be followed before the application for insurance is submitted, and that the application shall document that need has also been established under that procedure.

(ii) The following factors are relevant in evaluating market need for the project and should be addressed, as applicable, in the study of market need and feasibility submitted with the application. Because each hospital presents a unique situation, there is no formula or cutoff level that applies to all applications:

(A) Service area definition;

(B) Existing or proposed hospital;

(C) Designation as sole community provider, critical access hospital, or rural referral center;

(D) Community-wide use rates (discharges and days/1000);

(E) Statewide use rates (for benchmarking purposes);

(F) Current population and five-year projection by age cohort;

(G) Staffed vs. licensed beds;

(H) Applicant hospital's occupancy rate;

(I) Competitors' occupancy rates;

(J) Outpatient volume;

(K) Availability of emergency services;

(L) Teaching hospital status;

(M) Services offered by hospitals in the service area;

(N) Migration of patients out of the service area;

(O) Planned construction at other facilities in the region;

(P) Historical market share by major service category;

(Q) Disproportionate Share Hospital designation; and

(R) Distance to other hospitals.

(2) *Operating margin and debt service coverage ratio.* (i) Hospitals with an aggregate operating margin of less than 0.00 when calculated from the three most recent annual audited financial statements are not eligible for section 242 insurance unless the Commissioner determines, based on the financial data in those statements, that the hospital has achieved a financial turnaround resulting in a positive operating margin in the most recent year, calculated using classifications of items as operating or non-operating in accordance with guidance that shall be provided in written directives by the Commissioner.

(ii) Hospitals with an average debt service coverage ratio of less than 1.25 in the three most recent audited years are not eligible for section 242 insurance unless the Commissioner determines, based on the audited financial data, that the hospital has achieved a financial turnaround resulting in a debt service

coverage ratio of at least 1.40 in the most recent year. In cases of refinancing at a lower interest rate, the Commissioner may authorize the use of the projected debt service requirement in lieu of the historical debt in calculating the debt service coverage ratios for each of the prior three years. In cases where the Commissioner authorizes the use of the projected debt service requirement in lieu of the historical debt to determine the debt service coverage ratio, hospitals must have an average debt service coverage ratio of 1.40 or greater.

(3) *Financial Feasibility.* The approval process entails a determination of the financial feasibility of the proposal, *i.e.*, a determination that it is probable that the proposed mortgagor will be able to meet its debt service requirements during the life of the proposed mortgage. It includes analysis of the reimbursement structure of the proposed hospital (including patient/payer mix); actions of competitors; and the probable projected impact on the proposed hospital of general health care system trends, such as the development of alternative health care delivery systems and new reimbursement methods. In addition to historical operating margin, determination of financial feasibility includes, but is not limited to, evaluation of the following factors. The application must address, and HUD will review, each of the following factors:

(i) Current and projected gains from operations and a manageable debt load using reasonable assumptions;

(ii) Current debt service coverage ratio of 1.25 or higher and projected debt service coverage ratio of 1.40 or higher;

(iii) Cushion in the balance sheet sufficient to demonstrate the ability to withstand short periods of net operating losses without jeopardizing financial viability;

(iv) Patient utilization forecasts (including average length of stay, case intensity, discharges, area-wide use rates) that are consistent with the hospital's historical trends, future service mix, market trends, population forecasts, and business climate;

(v) The hospital's demonstrated ability to position itself to compete in its marketplace;

(vi) Organizational affiliations or relationships that help optimize financial, clinical, and operational performance;

(vii) Management's demonstrated ability to operate effectively and efficiently, and to develop effective strategies for addressing problem areas;

(viii) Systems in place to monitor hospital operations, revenues, and costs accurately and in a timely manner;

(ix) A Board that is appropriately constituted and provides effective oversight;

(x) Required licensures and approvals; and

(xi) Favorable ratings from the Joint Commission on Accreditation of Healthcare Organizations or other organization acceptable to the Commissioner.

(4) *Preliminary Review.* A Preliminary Review is a general overview of the acceptability of a potential mortgagor performed at the request of a hospital, a financial consultant representing a hospital, or a lender, to identify any factors that would likely cause an application to be rejected, should an application be submitted.

(i) The purpose of the preliminary review is for HUD to identify any obvious factors that would cause an application to be rejected, before the potential applicant expends the resources needed to prepare an application and before the Commissioner expends resources to review it. The hospital, financial consultant, or lender shall submit a preliminary information package to the Commissioner that provides evidence of statutory eligibility, market need, financial strength, and such other documentation as the Commissioner may require.

(ii) If the Commissioner identifies factors that would cause an application to be rejected, the Commissioner shall issue a Preliminary Review Letter notifying the potential applicant that an application for mortgage insurance would result in a rejection and providing the reasons for this decision. Also, no further request from the proposed applicant for a Preliminary Review shall be entertained for a period of one year from the date of the Commissioner's notification. The Commissioner may grant an exception to this one-year limitation if, during the year, there is a major change in the circumstances that caused the Commissioner to determine that the project would be rejected. For example, if the sole reason for the Commissioner's determination was the hospital's failure to meet the historical operating margin test, and a new audited annual financial statement contains results that would cause the hospital to meet the test, then the lender may request a new Preliminary Review within one year of the Commissioner's notification.

(iii) If the Commissioner does not identify any factors that would cause an application to be rejected, the Commissioner shall issue a Preliminary Review Letter advising the potential applicant that there appears to be no bar to the applicant's proceeding to the next step in the application process, provided that if a complete application is not received by the Commissioner within one year following the date of the Commissioner's letter, another Preliminary Review may be required, at the Commissioner's discretion, before the application process may proceed.

(iv) The Commissioner's determination in the preliminary review phase that no factors have been identified that would cause an application to be rejected shall in no way be construed as an indication that a subsequent application will be approved.

(5) *Preapplication meeting.* The next step in the application process is the preapplication meeting. At the Commissioner's discretion, this meeting may be held at HUD Headquarters in Washington, DC, or at another site agreeable to the Commissioner and the potential applicant. The preapplication meeting is an opportunity for the potential applicant to summarize the proposed project, for HUD to summarize the application process, and for issues that could affect the eligibility or underwriting of the project to be identified and discussed to the extent possible. Following the meeting, the Commissioner may:

(i) Advise the potential applicant that there appears to be no bar to submitting an application for mortgage insurance; or

(ii) Identify issues that must be resolved before a full application should be submitted for processing.

(b) *Application contents.* The application for mortgage insurance shall include exhibits that follow such guidance as to content and format that the Commissioner shall provide from time to time. The application shall include:

(1) A description of the proposed sources and uses of funds;

(2) A description of the mortgagor entity, its ownership structure, and its directors and managers;

(3) A description of the project, the business plan of the hospital, and how the project will further that plan;

(4) Historical audited financial statements and interim year-to-date financial results (for existing hospitals);

(5) A study of market need and financial feasibility, addressing the factors listed in paragraphs (a)(1)(ii), (a)(2) and (a)(3) of this section, with assumptions and financial forecast clearly presented, and prepared by a

certified accounting firm acceptable to HUD;

(6) Architectural plans and specifications;

(7) Evidence that the hospital will be located in a State or political subdivision of a State with reasonable minimum standards of licensure and methods of operation for hospitals and satisfactory assurance that such standards will be applied and enforced with respect to the hospital;

(8) If the State has an official procedure for determining need for hospitals, evidence that such procedure has been followed and that need has been established under that procedure;

(9) Evidence of compliance with Federal and State environmental regulations; and

(10) Such other exhibits as the Commissioner shall require based upon the facts pertaining to the particular case.

(c) *Fee.* An application fee of $1.50 per thousand dollars of the amount of the loan to be insured shall be paid to the Commissioner at the time the application is submitted to the Commissioner for approval.

(d) *Filing of application.* An application for insurance of a mortgage on a project shall be submitted on an approved FHA form by an approved mortgagee and by the sponsors of such project to the FHA Office of Insured Health Care Facilities.

(e) *Complete application.* Only technically complete applications will be processed. Partial applications cannot be processed. Upon determination that an application is complete, the Commissioner shall issue a Completeness Letter to the applicant stating that the application is complete.

(f) *Application Review.* Upon receipt of a complete application, the Commissioner shall evaluate the application to determine if eligibility, market need, financial feasibility, and compliance with applicable regulations (including but not limited to federal environmental regulations, wage rate regulations, and health care regulations) have been demonstrated, and to evaluate any other factors, including but not limited to risk to the Insurance Fund, that should be considered in determining if the application for mortgage insurance should be approved. As a part of this review, the Commissioner may solicit the advice of private consultants and expert staff in the Department of Health and Human Services and other Federal agencies. Based on review of the complete application, the Commissioner may request additional information from the applicant. The timeliness of the applicant's submission of the additional information may affect the approval or disapproval of the application. The Commissioner's decision shall be communicated in the form of a Commitment Letter or a Rejection Letter within 12 months of the date of the Completeness Letter, unless the Commissioner for good cause extends the period of review.

§ 242.17 Commitments.

(a) *Issuance of commitment.* Upon approval of an application for insurance, a commitment shall be issued by the Commissioner setting forth the terms and conditions under which an insurance endorsement shall be issued for the hospital. The commitment shall include the following:

(1) A commitment for insurance of advances reflecting the mortgage amount, interest rate, mortgage term, date of commencement of amortization, and other requirements pertaining to the mortgage and construction project;

(2) HUD's computation of the replacement cost and maximum insurable mortgage amount;

(3) Financial requirements for closing;

(4) Approval covenants, including any special conditions that must be satisfied prior to initial endorsement;

(5) Mortgage Reserve Fund Agreement.

(b) *Type of commitment.* The commitment will provide for the insurance of advances of mortgage funds during construction.

(c) *Term of commitment.* (1) The initial commitment shall be issued for a period of 90 days.

(2) The term of a commitment may be extended in such manner as the Commissioner may prescribe, provided, however, that the combined term of the original commitment and any extensions do not exceed 180 days.

(d) *Commitment fee.* A commitment fee which, when added to the application fee, will aggregate $3.00 per thousand dollars of the amount of the loan set forth in the commitment, shall be paid within 30 days of the date of issuance of the commitment. If such fee is not paid within this 30-day period, the commitment shall automatically terminate.

§ 242.18 Inspection fee.

The commitment may provide for the payment of an inspection fee in an amount not to exceed $5 per thousand dollars of the commitment. The inspection fee shall be paid at the time of initial endorsement.

§ 242.19 Fees on increases.

(a) *Increase in commitment prior to endorsement.* An application, filed prior to initial endorsement, for an increase in the amount of an outstanding commitment, shall be accompanied by an additional application fee of $1.50 per thousand dollars computed on the amount of the increase requested. Any increase in the amount of a commitment shall be subject to the payment of an additional commitment fee which, when added to the additional application fee, will aggregate $3.00 per thousand dollars of the amount of the increase. The additional commitment fee shall be paid within 30 days after the date of the amended commitment. If the additional commitment fee is not paid within 30 days, the commitment novation providing for the increased amount will automatically terminate and the previous commitment will be reinstated. If an inspection fee was required in the original commitment, an additional inspection fee shall be paid in an amount not to exceed $5.00 per thousand dollars of the amount of increase in commitment. The additional inspection fee shall be paid at the time of initial endorsement.

(b) *Increase in mortgage between initial and final endorsement.* Upon an application, filed between initial and final endorsement, for an increase in the amount of the mortgage, either by amendment or by substitution of a new mortgage, an additional application fee of $1.50 per thousand dollars computed on the amount of the increase requested shall accompany the application. The approval of any increase in the amount of the mortgage shall be subject to the payment of an additional commitment fee which, when added to the additional application fee, will aggregate $3.00 per thousand dollars of the amount of the increase granted. If an inspection fee was required in the original commitment, an additional inspection fee shall be paid in an amount not to exceed $5.00 per thousand dollars of the amount of the increase granted. The additional commitment and inspection fees shall be paid within 30 days after the date that the increase is granted.

§ 242.20 Reopening of expired commitments.

An expired commitment may be reopened if a request for reopening is received by the Commissioner no later than 90 days after the date of expiration of the commitment. The reopening request shall be accompanied by a fee of 50 cents per thousand dollars of the amount of the expired commitment. A commitment which has expired because of failure to pay the commitment fee

may be reopened only upon payment of the commitment fee and the reopening fee. If the reopening request is not received by the Commissioner within the required 90-day period, a new application, accompanied by an application fee, must be submitted. If a commitment for an increased amount has expired because of failure to pay an additional commitment fee based on the amount of the increase, the reopening fee shall be computed on the basis of the amount of the commitment increase rather than on the amount of the original commitment.

§ 242.21 Refund of fees.

Commitment, inspection, and reopening fees (but not application fees) may be refunded, in whole or in part, if the Commissioner determines that the construction or financing of the project has been prevented because of condemnation proceedings or other legal action taken by a government body or public agency, or in such other instances as the Commissioner may determine as being beyond the control of the applicant and resulting from no fault of the applicant. A transfer fee may be refunded only in such instances as the Commissioner may determine.

§ 242.22 Maximum fees and charges by mortgagee.

The mortgagee may collect from the mortgagor the amount of the fees provided for in this subpart. The mortgagee may also collect from the mortgagor an initial service charge not to exceed two percent of the original principal amount of the mortgage to reimburse the mortgagee for the cost of closing the transaction. A permanent financing fee not to exceed three and one-half percent may be collected from the mortgagor; however, the combined initial service charge and permanent financing fee may not exceed five and one-half percent in bond transactions and three and one-half percent in all other transactions. Any additional charges or fees collected from the mortgagor shall be subject to prior approval of the Commissioner and shall be clearly disclosed in the Mortgagee's Certificate.

§ 242.23 Adjusted and reduced mortgage amounts.

(a) *Adjusted mortgage amount-rehabilitation projects.* A mortgage financing the rehabilitation of an existing hospital shall be subject to the following limitations, in addition to those set forth in § 242.7:

(1) *Property held unencumbered.* If the mortgagor is the fee simple owner of the property and the ownership is not encumbered by an outstanding indebtedness, the mortgage shall not exceed 100 percent of the Commissioner's estimate of the cost of the proposed rehabilitation.

(2) *Property subject to existing mortgage.* If the mortgagor owns the property subject to an outstanding indebtedness, which is to be refinanced with part of the insured mortgage, the mortgage shall not exceed the total of the following:

(i) The Commissioner's estimate of the cost of rehabilitation, plus

(ii) Such portion of the outstanding indebtedness as does not exceed 90 percent of the Commissioner's estimate of the fair market value of such land and improvements prior to rehabilitation.

(3) *Property to be acquired.* If the property is to be acquired by the mortgagor and the purchase price is to be financed with a part of the insured mortgage, the mortgage shall not exceed 90 percent of the total of the following:

(i) The Commissioner's estimate of the cost of rehabilitation, plus

(ii) The actual purchase price of the land and value of improvements or the Commissioner's estimate (prior to rehabilitation) of the fair market value of such land and improvements, whichever is the lesser.

(b) *Reduced mortgage amount—leaseholds.* In the event the mortgage is secured by a leasehold estate rather than a fee simple estate, the value or replacement cost of the property described in the mortgage shall be the value or replacement cost of the leasehold estate (as determined by the Commissioner), which shall in all cases be less than the value or replacement cost of the property in fee simple.

(c) *Cash equity.* The Commissioner shall have the discretion to evaluate, on a case-by-case basis, the amount of equity that a mortgagor must supply depending upon the financial circumstances of each hospital facility. Exercise of this discretion shall never cause loan-to-value to exceed 90 percent, although it may cause it to be less than 90 percent. A private mortgagor must supply equity in cash. The equity contribution may not be made from borrowed funds. A nonprofit or public mortgagor, in the Commissioner's discretion and subject to 24 CFR 242.49, may supply equity in the form of a letter of credit.

§ 242.24 Working capital.

In the case of a new hospital or a hospital expansion, the Commissioner shall establish, on a case-by-case basis, the amount of working capital that must be deposited in cash or a letter of credit (or combination) to be available to the new hospital upon commencement of operations. Generally, the working capital shall not be borrowed funds unless the Commissioner determines that there are offsetting financial strengths to compensate for the risk associated with borrowing.

Subpart C—Mortgage Requirements

§ 242.25 Mortgage form and disbursement of mortgage proceeds.

(a) *Mortgage form.* The mortgage shall be:

(1) Executed on a form approved by the Commissioner for use in the jurisdiction in which the property covered by the mortgage is situated, which form shall not be changed without the prior written approval of the Commissioner.

(2) Executed by an eligible mortgagor.

(b) *Disbursement of mortgage proceeds.* The mortgagee shall be obligated, as a part of the mortgage transaction, to disburse the principal amount of the mortgage to (or for the account of) the mortgagor or to his or her creditors for his or her account and with his or her consent.

§ 242.26 Agreed interest rate.

(a) The mortgage shall bear interest at the rate agreed upon by the mortgagee and the mortgagor.

(b) The amount of any increase approved by the Commissioner in the mortgage amount between initial and final endorsement in excess of the amount that the Commissioner had committed to insure at initial endorsement shall bear interest at the rate agreed upon by the mortgagee and the mortgagor.

§ 242.27 Maturity.

The mortgage shall have a maturity not to exceed 25 years from the date amortization begins.

§ 242.28 Allowable costs for consultants.

Consulting fees for work essential to the development of the project may be included in the insured mortgage. Allowable consulting fees include those for analysis of market demand, expected revenues, and costs; site analysis; architectural and engineering design; and such other fees as the Commissioner may determine to be essential to project development. Fees for work performed more than one year prior to application are not allowable. Fees for work performed by any party with an identity of interest with the proposed mortgagor or mortgagee are not allowable.

§ 242.29 Payment requirements.

The mortgage shall provide for payments on the first day of each month in accordance with an amortization plan agreed upon by the mortgagor, the mortgagee and the Commissioner.

§ 242.30 Application of payments.

All payments to be made by the mortgagor to the mortgagee shall be added together and the aggregate amount thereof shall be paid by the mortgagor each month in a single payment. The mortgagee shall apply each payment received to the following items in the following order:

(a) Premium charges under the contract of mortgage insurance;

(b) Ground rents, taxes, special assessments, and fire and other hazard insurance premiums;

(c) Interest on the mortgage; and

(d) Amortization of the principal of the mortgage.

§ 242.31 Accumulation of accruals.

(a) The mortgage shall provide for payments by the mortgagor to the mortgagee on each interest payment date of an amount sufficient to accumulate in the hands of the mortgagee one payment period prior to its due date, the next annual mortgage insurance premium payable by the mortgagee to the Commissioner. Such payments shall continue only so long as the contract of insurance shall remain in effect.

(b) The mortgage shall provide for such equal monthly payments by the mortgagor to the mortgagee as will amortize the ground rents, if any, and the estimated amount of all taxes, water charges, special assessments, and fire and other hazard insurance premiums, within a period ending one month prior to the dates on which the same become delinquent. The mortgage shall further provide that such payments shall be held by the mortgagee, for the purpose of paying such items before they become delinquent. The mortgage shall also make provision for adjustments in case such estimated amounts shall prove to be more, or less, than the actual amounts so paid therefore by the mortgagor.

§ 242.32 Covenant against liens.

The mortgage shall contain a covenant against the creation by the mortgagor of liens against the property superior or inferior to the lien of the mortgage except for such liens as may be approved by the Commissioner.

§ 242.33 Covenant for malpractice, fire and other hazard insurance.

The mortgage shall contain a covenant binding the mortgagor to maintain adequate malpractice liability, fire, and extended coverage insurance on the property.

§ 242.35 Mortgage lien certifications.

The mortgagor shall certify at the final endorsement of the mortgage for insurance as to each of the following:

(a) That the mortgage is the first lien upon and covers the entire hospital, as *hospital* is defined in § 242.1.

(b) That the property upon which the improvements have been made or constructed and the equipment financed with mortgage proceeds are free and clear of all liens other than the insured mortgage and such other secondary liens as may be approved by the Commissioner.

(c) That the Security Agreement and Uniform Commercial Code financing statements establish a first lien on the personalty of the mortgagor, including but not limited to equipment, either acquired with mortgage proceeds or otherwise before or after initial endorsement of the mortgage, and on the personalty of the hospital all as defined in the Regulatory Agreement between the Commissioner and the hospital.

(d) That the certificate sets forth all unpaid obligations in connection with the mortgage transaction, the purchase of the mortgaged property, the construction or rehabilitation of the project, or the purchase of the equipment financed with mortgage proceeds.

§ 242.37 Mortgage prepayment.

(a) *Prepayment privilege.* Except as provided in paragraph (c) of this section or otherwise established by the Commissioner, the mortgage shall contain a provision permitting the mortgagor to prepay the mortgage in whole or in part upon any interest payment date, after giving the mortgagee 30 days notice in writing in advance of its intention to so prepay.

(b) *Prepayment charge.* The mortgage may contain a provision for such charge, in the event of prepayment of principal, as may be agreed upon between the mortgagor and the mortgagee, subject to the following:

(1) The mortgagor shall be permitted to prepay up to 15 percent of the original principal amount of the mortgage in any one calendar year without any such charge.

(2) Any reduction in the original principal amount of the mortgage resulting from the certification of cost, which the Commissioner may require, shall not be construed as a prepayment of the mortgage.

(c) *Prepayment of bond-financed or GNMA-securitized mortgages.* Where the mortgage is given to secure GNMA mortgage-backed securities or a loan made by a lender that has obtained the funds for the loan by the issuance and sale of bonds or bond anticipation notes, or both, the mortgage may contain a prepayment restriction and prepayment penalty charge acceptable to the Commissioner as to term, amount, and conditions.

(d) *HUD override of prepayment restrictions.* In the event of a default, the Commissioner may override any lockout, prepayment penalty, or combination of penalties in order to facilitate a partial or full refinancing of the mortgaged property and avoid a claim.

§ 242.38 Late charge.

The mortgage may provide for the collection by the mortgagee of a late charge in accordance with terms, conditions, and standards of the Commissioner for each dollar of each payment to interest or principal more than 15 days in arrears to cover the expense involved in handling delinquent payments. Late charges shall be separately charged to and collected from the mortgagor and shall not be deducted from any aggregate monthly payment.

Subpart D—Endorsement for Insurance

§ 242.39 Insurance endorsement.

Initial endorsement of the credit instrument shall occur before any mortgage proceeds are insured and the time of final endorsement shall be as set forth in paragraph (b) of this section.

(a) *Initial endorsement.* The Commissioner shall indicate the insurance of the mortgage by endorsing the original credit instrument and identifying the section of the Act and the regulations under which the mortgage is insured and the date of insurance.

(b) *Final endorsement.* When all advances of mortgage proceeds have been made and all the terms and conditions of the commitment have been met to the Commissioner's satisfaction, the Commissioner shall indicate on the original credit instrument the total of all advances approved for insurance and again endorse such instrument.

(c) *Contract rights and obligations.* The Commissioner and the mortgagee or lender shall be bound from the date of initial endorsement by the provisions of the Contract of Mortgage Insurance set forth in subpart B of this part.

§ 242.40 Mortgagee Certificate.

At initial endorsement the mortgagee shall execute a Mortgagee Certificate in a form prescribed by the Commissioner.

§ 242.41 Certification of cost requirements.

Before initial endorsement of the mortgage for insurance, the mortgagor, the mortgagee, and the Commissioner shall enter into an agreement in form and content satisfactory to the Commissioner for the purpose of precluding any excess of mortgage proceeds over statutory limitations. Under this agreement, the mortgagor shall disclose its relationship with the builder, including any collateral agreement, and shall agree:

(a) To execute a Certificate of Actual Costs, upon completion of all physical improvements on the mortgaged property.

(b) To apply any cost savings in accordance with the provisions below.

§ 242.42 Certificates of actual cost.

(a) The mortgagor's certificate of actual cost, in a form prescribed by the Commissioner, shall be submitted upon completion of the physical improvements to the satisfaction of the Commissioner and before final endorsement, except that in the case of an existing hospital that does not require substantial rehabilitation and where the commitment provides for completion of specified repairs after endorsement, a supplemental certificate of actual cost will be submitted covering the completed costs of any such repairs. The certificate shall show the actual cost to the mortgagor, after deduction of any kickbacks, rebates, trade discounts, or other similar payments to the mortgagor, or to any of its officers, directors, stockholders, partners or other entity member ownership, of construction and other costs, as prescribed by the Commissioner.

(b) The Certificate of Actual Cost shall be verified by an independent certified public accountant or independent public accountant in a manner acceptable to the Commissioner.

(c) Upon the Commissioner's approval of the mortgagor's certification of actual cost, such certification shall be final and incontestable except for fraud or material misrepresentation on the part of the mortgagor.

§ 242.43 Application of cost savings.

Any cost savings identified through the cost certification process shall be used to:

(a) Reduce the principal amount of the mortgage and the mortgagor's cash equity contribution proportionally, and/or

(b) Fund any additional construction, modernization, rehabilitation, or purchase of equipment approved by the Commissioner.

Subpart E—Construction

§ 242.44 Construction standards.

Work designed and performed under this section shall conform to the standards adopted by the Commissioner, which as a minimum, shall include the ''Guidelines for Construction and Equipment of Hospital and Medical Facilities,'' which is regularly updated and published by the American Institute of Architects.

§ 242.45 Early commencement of work.

(a) *Pre-commitment work.* Prior to the issuance of a commitment by the Commissioner, the mortgagor may request for good cause the commencement of certain necessary preliminary site work of the project within legal guidelines and State law. Such work can commence only after the review and concurrence of the work by the Commissioner, including the environmental review under 24 CFR 242.79, and the agreement to certain conditions by the applicant. The work must meet all requirements and guidelines as if it were approved for mortgage insurance and is accomplished at the sole risk of the applicant prior to the initial endorsement.

(b) *Early Start.* Subsequent to the issuance of a commitment, if the mortgagor requests the commencement of the project, the work may commence after the review of the request by the Commissioner, including the environmental review under 24 CFR 242.79, and the agreement to certain conditions by the applicant. Prior to the initial endorsement, the work is accomplished at the sole risk of the applicant.

(c) *Prepayment of inspection fee.* The applicant shall pay the inspection fee to HUD before pre-commitment or early start work commences.

(d) *Work started prior to application submission.* The Commissioner has the sole discretion to allow certain initial site preparation to be incorporated into the application if HUD has reviewed and approved the drawings and specifications and has inspected the work.

(e) *No expressed or implied intent.* Approval to proceed under paragraphs (a) and (b) of this section shall in no way be construed as indicating any intent, expressed or implied, on the part of the Commissioner to approve, disapprove, or make any undertaking or promise whatsoever with respect to the application or with respect to any commitment for mortgage insurance. Any work under paragraphs (a) and (b) of this section shall be accomplished at the sole risk and responsibility of the applicant.

§ 242.46 Insured advances—building loan agreement.

Prior to the initial endorsement of the mortgage for insurance, the mortgagor and mortgagee shall execute a building loan agreement, approved by the Commissioner, setting forth the terms and conditions under which progress payments may be advanced during construction. To be covered by mortgage insurance, or to be included as an eligible cost, each progress payment involving mortgage proceeds and the owner's equity requirement shall be approved by the Commissioner.

§ 242.47 Insured advances for building components stored off-site.

(a) *Building components.* In insured advances for building components stored off-site, the term building component shall mean any manufactured or pre-assembled part of a structure which the Commissioner has specifically identified for incorporation into the property and has designated for off-site storage because it is of such size or weight that:

(1) Storage of the number of components required for timely construction progress at the construction site is impractical, or

(2) Weather damage or other adverse conditions prevailing at the construction site would make storage at the site impractical or unduly costly.

(b) *Storage.* (1) An insured advance may be made for up to 90 percent of the invoice value (to exclude costs of transportation and storage) of the building components stored off-site if the components are stored at a location approved by the mortgagee and the Commissioner.

(2) Each building component shall be adequately marked so as to be readily identifiable in the inventory of the off-site location. Each component shall be kept together with all other building components of the same manufacturer intended for use in the same project for which insured advances have been made and separate and apart from similar units not for use in the project.

(3) Storage costs, if any, shall be borne by the contractor.

(c) *Responsibility for transportation, storage, and insurance of off-site building components.* The general contractor of the insured mortgaged property shall have the responsibility for:

(1) Insuring the components in the name of the mortgagor while in transit and storage; and

(2) Delivering or contracting for the delivery of the components to the storage area and to the construction site, including payment of freight.

(d) *Advances.* (1) Before an advance for a building component stored off-site is insured:

(i) The mortgagor shall:

(A) Obtain a bill of sale for the component;

(B) Give the mortgagee a security agreement, and

(C) File a financing statement in accordance with the Uniform Commercial Code, and

(ii) The mortgagee shall warrant to the Commissioner that the security instruments are a first lien on the building components covered by the instruments except for such other liens or encumbrances as may be approved by the Commissioner.

(2) Before each advance for building components stored off-site is insured, the mortgagor's architect shall certify to the Commissioner that the components, in their intended use, comply with HUD-approved contract plans and specifications. Under those circumstances permitted by the Commissioner in which there is no architect, compliance with the HUD-approved contract plans and specifications shall be determined by the Commissioner.

(3) Advances may be made only for components stored off-site in a quantity required to permit uninterrupted installation at the site.

(4) At no time shall the invoice value of building components being stored off-site, for which advances have been HUD insured, represent more than 50 percent of the total estimated construction costs for the insured mortgaged project as specified in the construction contract. Notwithstanding the preceding sentence and other regulatory requirements that set bonding requirements, the percentage of total estimated construction costs insured by advances under this section may exceed 25 percent but not 50 percent if the mortgagor furnishes assurance of completion in the form of a corporate surety bond for the payment and performance each in the amount of 100 percent of the amount of the construction contract. In no event will insurance of components stored off-site be made in the absence of a payment, and a performance bond.

(5) No single advance which is to be insured shall be in an amount less than ten thousand dollars ($10,000).

§ 242.48 Insured advances for certain equipment and long lead items.

The Commissioner may allow advances for certain pieces of equipment or other construction materials for which a manufacturer, fabricator, or other source requires an interim payment(s) in order to assure the timely manufacture or fabrication and delivery to the project site. Such advances can be made only if a bill of sale or invoice describes the material or equipment and its completion and delivery dates in no uncertain terms, and that such displayed timetable is necessary to meet the requirements of the overall construction schedule cited in the construction contract.

§ 242.49 Funds and finances: deposits and letters of credit.

(a) *Deposits.* Where the Commissioner requires the mortgagor to make a deposit of cash or securities, such deposit shall be with the mortgagee or a depository acceptable to the mortgagee. The deposit shall be held by the mortgagee in a special account or by the depository under an appropriate agreement approved by the Commissioner.

(b) *Letter of credit.* Where the use of a letter of credit is acceptable to the Commissioner in lieu of a deposit of cash or securities, the letter of credit shall be issued to the mortgagee by a banking institution with a Standard & Poor's credit rating of at least AA or equivalent or by another entity acceptable to the Commissioner and shall be unconditional and irrevocable. The mortgagee shall be responsible to the Commissioner for collection under the letter of credit. In the event a demand for payment thereunder is not immediately met, the mortgagee shall forthwith provide a cash deposit equivalent to the undrawn balance of the letter of credit.

(c) *Mortgagee not issuer.* The mortgagee of record may not be the issuer of the letter of credit without the prior written consent of the Commissioner.

§ 242.50 Funds and finances: off-site utilities and streets.

The Commissioner shall require assurance of completion of off-site public utilities and streets in all cases, except where a municipality or other public body has by agreement (acceptable to the Commissioner) agreed to install such utilities and streets without cost to the mortgagor. Where such assurance is required, it shall be either in the form of a cash escrow deposit or the retention of a specified amount of mortgage proceeds by the mortgagee. If a cash escrow is used, it shall be deposited with the mortgagee or with an acceptable trustee or escrow agent designated by the mortgagee. If mortgage proceeds are used, the mortgagee shall retain under terms approved by the Commissioner, rather than disburse at the initial closing of the mortgage, a portion of the mortgage proceeds allocated to land in the project analysis. As additional assurance, the Commissioner may also require a surety company bond or bonds.

§ 242.51 Funds and finances: insured advances and assurance of completion.

(a) Where the estimated cost of construction or rehabilitation is more than $500,000, the mortgagor shall furnish assurance of completion in the form of corporate surety bonds for payment and performance, each in the minimum amount of 100 percent of the accepted bid prices.

(b) All types of assurance of completion shall be on forms approved by the Commissioner. All surety companies executing a bond and all parties executing a personal indemnity agreement must be satisfactory to the Commissioner.

(c) A mortgagee may prescribe more stringent requirements for assurance of completion than the minimum requirements provided for in this section.

§ 242.52 Construction contracts.

(a) *Awarding of contract.* A contract for the construction or rehabilitation of a hospital shall be entered into by a mortgagor with a builder selected by a competitive bidding procedure acceptable to the Commissioner.

(b) *Form of contract.* The construction contract shall be a lump sum form providing for payment of a specified amount; a construction management contract with a guaranteed maximum price, the final costs of which are subject to a certification acceptable to the Commissioner; a design-build contract with terms and certification requirements acceptable to the Commissioner; or such other form of contract as may be acceptable to the Commissioner.

(c) *Competitive bidding.* A competitive bidding procedure acceptable to the Commissioner must be used in the selection of bidders to perform work or otherwise provide service to the project, the costs of which are included in any form of construction contract cited in paragraph (b) of this section. Fixed equipment not included in the construction contract, and movable equipment, may be purchased by securing quotations or by using competitive bidding procedures.

§ 242.53 Ineligible contractors.

(a) Contracts relating to the construction of the project shall not be made with a general contractor, a subcontractor, or construction manager (or any firm, corporation, partnership, or association in which such contractor, subcontractor, or construction manager has a substantial interest), the name of which is on the list of ineligible contractors, subcontractors, or construction managers established by the Commissioner, or by the Comptroller General under the applicable regulations of the Secretary of the U.S. Department of Labor.

(b) Contracts relating to the construction of the project shall not be made with a general contractor that has an identity of interest, as defined by the Commissioner, with the applicant.

(c) If the Commissioner determines that a contract has been made contrary to the requirements of paragraphs (a) or (b) of this section and so notifies the mortgagee, the Commissioner may refuse to insure any subsequent advances of mortgage proceeds.

Subpart F—Nondiscrimination and Wage Rates

§ 242.54 Nondiscrimination.

Hospital facilities financed with mortgages insured under this part must be made available without discrimination as to race, color, religion, sex, age, disability, or national origin. Hospitals must be operated in compliance with all applicable civil rights laws and regulations, including 24 CFR part 200, subpart J (Equal Employment Opportunity), and the Americans with Disabilities Act (42 U.S.C. 12101 *et seq.*). Racially restrictive covenants are per se illegal and their use is prohibited.

§ 242.55 Labor standards.

Projects financed under this part (except under 24 CFR 242.91) must comply with the prevailing wage standards under the Davis-Bacon Act (40 U.S.C. 3141 *et seq.*), and implementing U.S. Department of Labor regulations.

(a) The requirements set forth in 29 CFR parts 1, 3, and 5 for compliance with labor standards laws apply to projects under this program to the extent that labor standards apply as provided in section 212 of the Act, provided that:

(1) Supplemental loans under section 241 of the Act made in connection with loans insured under this part are subject to the provisions of section 212 applicable to mortgages insured under section 242 of the Act.

(b) The requirements stated in 24 CFR part 70 governing HUD waiver of Davis-Bacon prevailing wage rates for volunteers apply to hospitals with mortgages insured under this part.

(c) Each laborer or mechanic employed on any facility covered by a mortgage insured under this part (except under 24 CFR 242.91) shall receive compensation at a rate not less than one and one-half times the basic rate of pay for all hours worked in any workweek in excess of eight hours in any workday or 40 hours in the workweek.

(d) Project commitments, contracts, and agreements, as determined by the Commissioner, and construction contracts and subcontracts, shall include terms, conditions, and standards for compliance with applicable requirements set forth in 29 CFR parts 1, 3, and 5 and section 212 of the Act.

(e) No advance under a loan or mortgage that is subject to the requirements of section 212 shall be eligible for insurance unless there is filed with the application for the advance a certificate as required by the Commissioner certifying that the laborers and mechanics employed in construction of the project have been paid not less than the wage rates required under section 212.

Subpart G—Regulatory Agreement, Accounting and Reporting, and Financial Requirements

§ 242.56 Form of regulation.

As long as the Commissioner is the insurer or holder of the mortgage, all mortgagors shall be regulated by the Commissioner through the use of a regulatory agreement in a published format determined by the Commissioner and such additional covenants and restrictions as may be determined necessary by the Commissioner on a case-by-case basis. In addition, all mortgagors shall be subject to the provisions of 24 CFR part 24 and such other enforcement provisions as may be applicable. The mortgager shall be subject to monitoring by HUD and the U.S. Department of Health and Human Services, and their agents, employees, and contractors, on an ongoing basis for the life of the insured mortgage to ensure against the risk of default, and the mortgagor must make its financial records available to the monitoring agencies upon request.

§ 242.57 Maintenance of hospital facility.

The mortgagor shall maintain the hospital's grounds and buildings and the equipment financed with mortgage proceeds in good repair and shall promptly complete such repairs and maintenance as the Commissioner considers necessary.

§ 242.58 Books, accounts, and financial statements.

(a) *Books and accounts.* The mortgagor's books and accounts relating to the operation of the physical facilities of the hospital shall be established in a manner satisfactory to the Commissioner, and shall be kept in accordance with the requirements of the Commissioner as long as the mortgage is insured or held by the Commissioner.

(b) *Financial reports.* The mortgagor shall file with the Commissioner:

(i) Annual audited financial statements in accordance with the guidance below,

(ii) Quarterly unaudited financial reports, within 40 days following the end of each quarter of the mortgagor's fiscal year,

(iii) If requested by the Commissioner, monthly financial reports within 40 days following the end of each month,

(iv) Board-certified annual financial results within 120 days following the close of the fiscal year (if the annual audited financial statement has not yet been filed with the Commissioner) and at such other times as the Commissioner may designate on a case-by-case basis, and

(v) Such other financial and utilization reports as the Commissioner may require.

(c) *Audits.* (1) Not-for-profit organizations shall conduct audits in accordance with the Consolidated Audit Guide for Audits of HUD Programs (Handbook 2000.04) and OMB Circular A–133 (Audits of States, local governments and nonprofit organizations).

(2) For-profit organizations shall conduct audits in accordance with the Consolidated Audit Guide for Audits of HUD Programs (Handbook 2000.04).

(d) *Changes in accounting policies.* The annual audited financial statements shall identify any changes in accounting policies and their financial effect on the balance sheet and on the income statement.

(e) *Compliance reporting.* The mortgagor shall instruct the auditor of the annual financial statement to include in its report an evaluation of the mortgagor's compliance with the Regulatory Agreement.

(f) *Books of management agents.* The books and records of management agents, lessees, operators, managers, and affiliates, as they pertain to the operations of the project, shall be maintained in accordance with Generally Accepted Accounting

Principles (GAAP) and shall be open and available to inspection by HUD, after reasonable prior notice, during normal office hours, at the project or other mutually agreeable location. Every contract executed on behalf of the project with any of the aforesaid parties shall include the provision that the books and records of such entities shall be properly maintained and open to inspection during normal business hours by HUD at the project or other mutually agreeable location.

(g) *Medicare cost reports.* Upon request, the mortgagor shall provide to the Commissioner a copy of the Medicare Cost Report most recently submitted to the Centers for Medicare and Medicaid Services (an agency of the Department of Health and Human Services), along with related financial documents.

§ 242.59 Inspection of facilities by Commissioner.

The mortgaged property (including buildings and equipment) and the books, records, and documents relating to the operation of the physical facilities of the hospital shall be subject to inspection and examination by the Commissioner or his or her authorized representative at all reasonable times.

§ 242.61 Management.

The mortgagor shall provide for management of the hospital in a manner satisfactory to the Commissioner.

(a) *Contract management.* The mortgagor shall not execute a management agreement or any other contract for management of the hospital without the Commissioner's prior written approval. Any management agreement or contract shall contain a provision that it shall be subject to termination without penalty and with or without cause, upon written request by the Commissioner addressed to the mortgagor and management agent.

(b) *Principals.* HUD shall have the authority to require that any principals of the mortgagor, including but not limited to board members of a corporate entity, be removed, substituted, or terminated for cause upon written request by the Commissioner addressed to the mortgagor.

(c) *Employees.* HUD shall have the authority to require that any key management employees of the mortgagor (as defined and determined solely by HUD) be terminated for cause upon written request by the Commissioner addressed to the mortgagor.

(d) *Procedures upon receipt of request under paragraphs (a) through (c) of this section.* Upon receipt of such requests under paragraphs (a) through (c) of this section, the mortgagor shall immediately terminate said management agreement, principals or employees within the shortest applicable period the Commissioner determines appropriate and shall make arrangements satisfactory to the Commissioner for on-going proper management of the hospital.

§ 242.62 Releases of lien.

The mortgagor shall not sell, dispose of, transfer, or permit to be encumbered any security property without the prior approval of the lender and Commissioner, subject to thresholds the Commissioner may establish for the approval requirement. Where there is a partial release of lien, the lender must make a determination, subject to review by the Commissioner, that the remaining or replacement property subject to the first lien provides adequate security for the remaining principal indebtedness.

§ 242.63 Additional indebtedness and leasing.

The mortgagor shall not enter into any long-term debt, short-term debt, or equipment leases except in conformance with policies and procedures established by the Commissioner.

§ 242.64 Current and future property.

All current or future property or personalty (all as defined in the Regulatory Agreement) of the mortgagor on or off mortgaged real estate (except that specifically restricted by donors or specifically excluded by the Commissioner) will be considered as part of the HUD-insured hospital and subject to all provisions of the HUD regulatory agreement. All equipment acquired by the hospital following initial endorsement and at any time during the term of the loan shall become subject to the lien of the security agreement and any Uniform Commercial Code Financing Statements filed pursuant to the security agreement, unless the mortgagor specifically requests and the Commissioner for good cause approves, subordination of the lien of the insured mortgagee on specific personalty for specific periods of time. The first lien on the realty (as defined in the regulatory agreement and as identified in the security instrument) cannot be subordinated in whole or in part.

§ 242.65 Distribution of assets.

The Commissioner shall establish financial thresholds and procedures for the distribution of surplus cash and other assets. Surplus cash that meets the definition in 24 CFR 242.1, or cash that has been expressly approved for distribution by the Commissioner, may be distributed to other organizations formally affiliated with the mortgagor, a parent organization with which the mortgagor is also affiliated, partners, or stockholders, in accordance with those financial thresholds and procedures set forth in the regulatory agreement. Other assets may be distributed to other organizations formally affiliated with the mortgagor, a parent organization with which the mortgagor is also affiliated, partners, or stockholders, in accordance with those financial thresholds and procedures set forth in the regulatory agreement, and in accordance with the release of lien conditions in 24 CFR 242.62, if applicable.

§ 242.66 Affiliate transactions.

Transactions that are arms-length are permitted as specified in the Regulatory Agreement. Transactions with affiliates that are not arms-length are not permitted except with the prior written approval of the Commissioner in accordance with such policies and procedures as the Commissioner shall prescribe.

§ 242.67 New corporations, subsidiaries, affiliations, and mergers.

The mortgagor shall not establish, develop, organize, acquire, become the sole member of, or acquire an interest sufficient to require disclosure on the audited financial statements of the mortgagor, in any corporation, subsidiary, or affiliate organization other than those with which the mortgagor was affiliated as of date of application, without the prior approval of the Commissioner. The mortgagor shall obtain the Commissioner's written approval for all future mergers.

Subpart H—Miscellaneous Requirements

§ 242.68 Disclosure and verification of Social Security and Employer Identification Numbers.

The requirements set forth in 24 CFR part 5, regarding the disclosure and verification of social security numbers and employer identification numbers, and employer identification numbers by applicants and participants in assisted mortgage and loan insurance and related programs, apply to this program.

§ 242.69 Transfer fee.

Upon application for review of a transfer of physical assets or the substitution of mortgagors, a transfer fee of 50 cents per thousand dollars of the outstanding principal balance of the mortgage shall be paid to the

Commissioner. A transfer fee is not required if both parties to the transfer transaction are not-for-profit or public organizations.

§ 242.70 Fees not required.

The payment of an application, commitment, inspection, or reopening fee shall not be required in connection with the insurance of a mortgage involving the sale by the Secretary of any property acquired under any section or title of the Act.

§ 242.72 Leasing of hospital.

Leasing of a hospital in its entirety is prohibited. Notwithstanding this prohibition, any proposal in which leasing of the entire facility is a factor due to State law prohibitions against the mortgaging of health care facilities by State entities shall be considered on a case-by-case basis. Also, leasing of a hospital that has an existing Section 242 insured loan is permitted if the Commissioner determines that leasing is necessary to reduce the risk of default by a financially troubled hospital.

§ 242.73 Waiver of eligibility requirements for mortgage insurance.

The Secretary may insure under this part, without regard to any limitation upon eligibility contained in this subpart, any mortgage assigned to him or her in connection with payment under a contract of mortgage insurance, or executed in connection with a sale by him or her of any property previously insured under this part and acquired subsequent to a claim.

§ 242.74 Smoke detectors.

Each occupied room must include at least one battery-operated or hard-wired smoke detector in proper working condition. If the room is occupied by hearing-impaired persons, the smoke detector must have an alarm system designed for hearing-impaired persons, unless the smoke alarm is connected to a central alarm system that is monitored on a 24-hour basis, or otherwise meets industry standards.

§ 242.75 Title requirements.

In order for the mortgaged property to be eligible for insurance, the Commissioner shall determine that marketable title thereto is vested in the mortgagor as of the date the mortgage is filed for record. The title evidence shall be examined by the Commissioner and the endorsement of the credit instrument for insurance shall be evidence of its acceptability.

§ 242.76 Title evidence.

Upon insurance of the mortgage, the mortgagee shall furnish to the Commissioner a survey of the mortgage property, satisfactory to the Commissioner, and a policy of title insurance covering the property, as provided in paragraph (a) of this section. If, for reasons the Commissioner considers to be satisfactory, title insurance cannot be furnished, the mortgagee shall furnish such evidence of title in accordance with paragraph (b) or (c) of this section as the Commissioner may require. Any survey, policy of title insurance, or evidence of title required under this section shall be furnished without expense to the Commissioner. The types of title evidence are:

(a) A policy of title insurance issued by a company and in a form satisfactory to the Commissioner. The policy shall name as the insureds the mortgagee and the Secretary of Housing and Urban Development, as their respective interests may appear. The policy shall provide that upon acquisition of title by the mortgagee or the Secretary, it will continue to provide the same coverage as the original policy, and will run to the mortgagee or the Secretary, as the case may be.

(b) An abstract of title satisfactory to the Commissioner, prepared by an abstract company or individual engaged in the business of preparing abstracts of title, accompanied by a legal opinion satisfactory to the Commissioner as to the quality of such title, signed by an attorney-at-law experienced in the examination of titles.

(c) A Torrens or similar title certificate.

§ 242.77 Liens.

The hospital must be free and clear of all liens other than the insured mortgage, except that the property may be subject to a lien as provided by terms and conditions established by the Commissioner as follows:

(a) An inferior lien made or held by a Federal, State, or local government instrumentality;

(b) An inferior lien required in connection with a supplemental loan insured pursuant to section 241 of the Act;

(c) An inferior or superior lien on equipment as may be approved in connection with an equipment leasing program approved by the Commissioner;

(d) An inferior or superior lien on accounts receivable as approved by the Commissioner as collateral for a line of credit or other borrowing by a hospital insured under this part that has extraordinary needs such as cash flow difficulties; or

(e) Similar liens otherwise approved by the Commissioner.

§ 242.78 Zoning, deed, and building restrictions.

The project when completed shall not violate any material zoning or deed restrictions applicable to the project site, and shall comply with all applicable building and other governmental codes, ordinances, regulations, and requirements.

§ 242.79 Environmental quality determinations and standards.

Requirements set forth in 24 CFR part 50, Protection and Enhancement of Environmental Quality, 24 CFR part 51, Environmental Criteria and Standards, and 24 CFR part 55, Implementation of Executive Order 11988, Flood Plain Management governing environmental review responsibilities (as applicable) and as otherwise required by the Commissioner apply to this program.

§ 242.81 Lead-based paint poisoning prevention.

Requirements set forth in 24 CFR part 35 apply to this program.

§ 242.82 Energy conservation.

Construction, mechanical equipment, and energy and metering selections shall provide cost-effective energy conservation in accordance with standards established by the Commissioner.

§ 242.83 Debarment and suspension.

The requirements set forth in 24 CFR part 24, except subpart F, apply to this program.

§ 242.84 Previous participation and compliance requirements.

The requirements set forth in 24 CFR part 200, subpart H, apply to this program.

§ 242.86 Property and mortgage assessment.

The requirements set forth in 24 CFR part 200, subpart E, regarding the mortgagor's responsibility for making those investigations, analysis, and inspections it deems necessary for protecting its interests in the property apply to these programs.

§ 242.87 Certifications.

Any agreement, undertaking, statement, or certification required by the Commissioner shall specifically state that it has been made, presented, and delivered for the purpose of influencing an official action of the FHA, and of the Commissioner, and may be relied upon by the Commissioner as a true statement of the facts contained therein.

§ 242.89 Supplemental loans.

A loan, advance of credit, or purchase of an obligation representing a loan or advance of credit made for the purpose of financing improvements or additions to a hospital covered by a mortgage insured under this section of the Act or for a Commissioner-held mortgage, or equipment for a hospital, may be insured pursuant to the provisions of section 241 of the Act and under the provisions of this part as applicable and such additional terms and conditions as established by the Commissioner. See subpart B of 24 CFR part 241 with respect to the contract of mortgage insurance for all loans insured under section 241 of the Act. *See* 24 CFR part 241, subpart C, for energy improvements.

§ 242.90 Eligibility of mortgages covering hospitals in certain neighborhoods.

(a) A mortgage financing the repair, rehabilitation, or construction of a hospital located in an older declining urban area shall be eligible for insurance under this subpart subject to compliance with the additional requirements of this section.

(b) The mortgage shall meet all of the requirements of this subpart, except such requirements (other than those relating to labor standards and prevailing wages) as are judged to be not applicable on the basis of the following determinations to be made by the Commissioner.

(1) That the conditions of the area in which the property is located prevent the application of certain eligibility requirements of this subpart.

(2) That the area is reasonably viable, and there is a need in the area for an adequate hospital to serve low and moderate income families.

(3) That the mortgage to be insured is an acceptable risk.

(c) Mortgages complying with the requirements of this section shall be insured under this subpart pursuant to section 223(e) of the National Housing Act. Such mortgages shall be insured under and be the obligation of the Special Risk Insurance Fund.

§ 242.91 Eligibility of refinancing transactions.

A mortgage given to refinance an existing insured mortgage under section 241 or section 242 of the Act covering a hospital may be insured under this subpart pursuant to section 223(a)(7) of the Act. Insurance of the new, refinancing mortgage shall be subject to the following limitations:

(a) *Principal amount.* The principal amount of the refinancing mortgage shall not exceed the lesser of:

(1) The original principal amount of the existing insured mortgage, or

(2) The unpaid principal amount of the existing insured mortgage, to which may be added loan closing charges associated with the refinancing mortgage, and costs, as determined by the Commissioner, of improvements, upgrading, or additions required to be made to the property.

(b) *Debt service rate.* The monthly debt service payment for the refinancing mortgage may not exceed the debt service payment charged for the existing mortgage.

(c) *Mortgage term.* The term of the new mortgage shall not exceed the unexpired term of the existing mortgage, except that the new mortgage may have a term of not more than 12 years in excess of the unexpired term of the existing mortgage in any case in which the Commissioner determines that the insurance of the mortgage for an additional term will inure to the benefit of the FHA Insurance Fund, taking into consideration the outstanding insurance liability under the existing insured mortgage, and the remaining economic life of the property.

(d) *Minimum loan amount.* The mortgagee may not require a minimum principal amount to be outstanding on the loan secured by the existing mortgage.

§ 242.92 Minimum principal loan amount.

A mortgagee may not require, as a condition of providing a loan secured by a mortgage insured under this part, that the principal amount of the mortgage exceed a minimum amount established by the mortgagee.

§ 242.93 Amendment of regulations.

The regulations in this subpart may be amended by the Commissioner at any time and from time to time, in whole or in part, but such amendment shall not adversely affect the interests of a mortgagee or lender under the insurance on any mortgage or loan already insured and shall not adversely affect the interests of a mortgagee or lender on any mortgage or loan to be insured on which the Commissioner has issued a commitment to insure.

§ 242.94 Cross-reference.

All of the provisions of 24 CFR part 207, subpart B, relating to mortgages insured under section 207 of the Act, apply to mortgages on hospitals insured under section 242 of the Act, except § 207.259 (Insurance benefits).

Dated: November 19, 2004.

John C. Weicher,

Assistant Secretary for Housing-Federal Housing Commissioner.

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