



# CAMBRIDGE

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## HUD 232 LEAN PROCESSING

### Frequently Asked Questions

The Department of Housing and Urban Development recently modified their underwriting and processing of HUD 232 financing for senior housing and long-term care properties. In a historic move, the agency has moved from the Multifamily Accelerated Processing (MAP) and has embraced the LEAN management process. The goal of the new “HUD 232 LEAN” program is to simplify the application process and substantially reduce the time it takes qualified borrowers to obtain funding. Cambridge embraces and supports these goals. The following questions were developed to help interested parties better understand the new underwriting and loan processing program and explain how the new HUD LEAN program and Cambridge can assist them in obtaining their financial goals.

#### **SECTION 1: CAMBRIDGE & HUD LEAN**

**1. What steps is Cambridge taking to comply with new LEAN requirements?**

Cambridge’s HUD team is intimately involved with the new LEAN processing and has been asked for recommendations on multiple key aspects of the program.

**2. How is Cambridge impacted by the HUD LEAN process?**

Cambridge has had a positive experience with LEAN thus far. Several examples include:

1. Ability to close deals in a shorter period of time. We can move from application to closing in 40 days, compared with the previous four-to six-month timetable.
2. Electronic submission of applications. This will significantly reduce the time in which it previously took our HUD team to assemble paper applications, allowing additional time to be spent on new LEAN applications.
3. Ability to strategize and formulate the LEAN program.
4. Our expertise and knowledge of the senior housing lending and HUD lending process.

**3. Did Cambridge have any rule or input in drafting the changes in LEAN?**

The OIHCf requested Cambridge’s team to make recommendations for improving LEAN processing. Several recommendations that Cambridge’s team made were:

1. Revise asset management procedures in order to expedite replacement reserve withdrawals.
2. Decrease frequency of financial statement reporting requirements.
3. Find an alternative for or eliminate REAC inspections. If REAC inspections cannot be eliminated, Cambridge recommended replacing the system with a third-party monitor of state reporting such as Life Safety reports.

**4. Has Cambridge been effective with the new LEAN process?**

Cambridge has been and will continue to be very effective under the LEAN process. With the introduction of the “Super Certifications” and clearly defined underwriting requirements, Cambridge’s HUD team will be able to focus on processing and funding even

more deals.

**5. Does Cambridge foresee any negative aspects with the LEAN Process?**

We feel that the LEAN processing only means good things for both borrowers and lenders. Paperwork requirements have been reduced, processing has been made more efficient, and underwriting guidelines have been clearly defined.

**SECTION 2: LEAN BASICS**

**1. What is HUD LEAN? How was it developed?**

LEAN is the processing system for all HUD 232/223(f) loans. The LEAN system was developed when FHA Commissioner Brian Montgomery made the decision to insert the highly touted “LEAN” management concept into the HUD system of processing and approving loan applications. The “LEAN” management process is driven by a few simple rules: all work should be highly specified as to content, sequences, timing and outcome, and every customer-supplier connection must be direct. Also, there needs to be an unambiguous “yes or no” way to send requests and receive responses. The pathway for every product and service must be simple and direct, and any improvements must be made in accordance with the scientific method under the guidance of a teacher at the lowest possible level in the organization. LEAN is aimed to eliminate historical inefficiencies in the processing and approval of HUD applications.

**2. I hear the process will be more electronic. What does this mean?**

HUD LEAN lenders submit applications electronically via Oracle Application Server Portal. This allows the application documents to be more accessible to the HUD underwriting team and for processing to be expedited.

**3. Can I get cash out under LEAN?**

The same rules still apply under LEAN as they did for MAP: cash-out is not immediately available to borrower. However, borrowers can receive additional funds to make capital improvements to the facility being financed by HUD. Cash-out can be obtained in conjunction with a bridge loan after 24 months of seasoning.

**4. Will my local HUD office still exist?**

Effective September 1, 2008, Multifamily Hubs and Program Centers no longer accept Section 232/223(f) applications.

**5. What is OIHCF?**

The Office of Insured Health Care Facilities (OIHCF) was created to oversee every HUD-insured healthcare facility financing that is funded. The OIHCF is comprised of individuals that are healthcare industry professionals hailing from several discipline backgrounds, i.e. valuation, architectural, mortgage credit, etc.

**6. What property types work for HUD LEAN?**

Licensed senior housing and long-term care facilities, licensed skilled nursing, assisted living, and board and care facilities are eligible for HUD LEAN 232/223(f) financing. Facilities containing unlicensed independent units are eligible, as long as the number of these types of units is less than 25% of the total units in the facility.

**7. Will there be any additional HUD fees under LEAN processing that were not applicable under MAP?**

There are no additional fees under LEAN processing, and all other HUD fees still apply to all 232/223(f) loans.

**SECTION 3: UNDERWRITING & DUE DILIGENCE**

**1. Have the terms of the program changed under the LEAN program? Are any other terms changing (LTV, DSCR, etc)?**

HUD's loan terms will not change under the LEAN program. Maximum loan-to-value remains at 80% for for-profit mortgagors and 85% for nonprofit mortgagors. Minimum debt service requirements remain the same at 1.1765 for for-profit mortgagors and 1.11 for nonprofit mortgagors.

**2. Are there any restrictions on the payor mix or vacancy rates?**

For existing properties, there is no change in the way that a facility's payor mix or vacancy rate is underwritten. Both conclusions must be supported by market data and the subject's operating history. The program still requires a minimum 5% vacancy and collection loss factor.

**3. Will appraisers utilize actual management fee expense or standard market management fee, which is typically 5.0% of revenues?**

According to the Appraisal Statement of Work, "A management fee must be included in the expenses for determining overall market value. It should be supported by expense comparables with arm's length management agreements." Upward or downward adjustments can be made to the management fee by the lender if they are justified and supported by market data. In cases where a management agent review is required, the management fee approved by the Lender should be consistent with and supported by the market for similar types and sizes of facilities. In these cases, the underwritten net operating income should reflect the higher of market and the contracted fee.

**4. Does every deal get underwritten centrally in Washington D.C.?**

No, all HUD deals are underwritten by HUD-approved LEAN lenders. The underwriting is submitted to HUD as part of the application.

**5. How has underwriting changed?**

The two major changes to HUD underwriting are:

1. Elimination of proprietary earnings adjustment. Lenders and appraisers no longer deduct proprietary earnings from a facility's NOI.
2. Inclusion of Risk Analysis. The LEAN underwriting is more focused on the operator. If the Risk Factors are identified, the lender must provide sufficient justification / mitigation to support the additional risk associated with the loan. These risk factors are:
  - a. If the loan exceeds 80% of the underwritten value.
  - b. If the debt service coverage of the loan is less than (a) 1.45 for skilled nursing; (b) 1.30 for assisted living; or, (c) 1.25 for independent or board and care facilities.

**6. FHA now will accept fair market value appraisals vs. FHA-specific appraisals. This should reduce costs to borrower? Can I use my old appraisal under LEAN?**

Expenses will not change for LEAN appraisals. The same appraisal standards that applied under MAP apply under LEAN. Also, a previous appraisal may be used if it is a LEAN-approved appraiser, and the date of valuation may not be more than 180 days prior to the date Lender makes application to HUD/FHA.

**7. Does the same due diligence process still apply (i.e. appraisal, Phase I, PCNA, etc.)?**

HUD LEAN projects still require the same third party reports.

**SECTION 4: PROCESSING**

**1. How are LEAN applications submitted and reviewed?**

Electronic applications are submitted to the OIHCF. Team members will access the applications remotely via Oracle platform. This creates a “virtual” office. All funding decisions are made by the OIHCF.

**2. How is the LEAN process different from the former MAP process?**

The most significant improvements:

- a. Shorter timeline to close. Cambridge can process and fund a HUD LEAN loan in 60-90 days.
- b. Improvements in underwriting. HUD LEAN underwriters are specifically focused on and have experience with senior housing and health care facilities.
- c. Simplified appraisal process. Fair market value appraisals are now acceptable.
- d. Elimination of proprietary earnings adjustment.
  - i. Elimination of proprietary earnings adjustment makes HUD lending more user-friendly.
  - ii. HUD previously required proprietary earnings adjustment of 15% – 25% for skilled nursing and 10 – 15% for assisted living. This adjustment was deducted from the NOI and could impact valuation.

**3. How does the new LEAN process affect construction projects? Is the construction program affected?**

Effective March 1, 2009, all other Section 232 loans (including new construction, substantial rehabilitation, supplemental loans, operating loss loans, and Section 223(a)(7) loans) are being processed under HUD LEAN.

**4. How are the offices set up for processing? Can I submit a loan directly to HUD?**

Presently, all LEAN applications are being submitted electronically to the OIHCF in Washington, D.C. Applications must be submitted to HUD using a HUD-approved mortgagee such as Cambridge; borrowers cannot submit loans directly to HUD.

**5. Potential closing dates will be identified upon receipt of the FHA firm commitment for mortgage insurance. Does this mean we will know the actual closing date at time of commitment?**

The legal review begins at the time an application is submitted to HUD, greatly expediting the closing process. This allows for closing dates to be identified and set at the time a firm commitment is issued.

**6. What does LEAN mean for acquisition deals? Can HUD fund in time to meet most sellers' timing needs?**

LEAN processing means that more borrowers can take advantage of HUD's long-term, fixed low rate when acquiring a facility. Cambridge has the ability to execute HUD LEAN loans within 60-90 days from engagement to closing, which is a reasonable time to execute a purchase and sale agreement and similar to conventional loan timing.

**7. Which processing steps are being modified?**

Several steps during the LEAN processing phase significantly improve turnaround time, resulting in a faster closing. A few of these major modifications include:

1. Legal review begins once the application is submitted to HUD. This step of the process historically took place later in the processing, and could significantly increase the time to set a closing date.
2. Many forms and certifications are now being combined as "Super Certifications." This saves the lender and borrower a significant amount time in filling out forms.

**8. What is the process for a loan to be approved? How many committees must sign off?**

Each LEAN application must be signed off at three levels: by the LEAN team, by the OICHF, and by Legal. The approval process is as follows:

1. Lender submits application to the OICHF via internet portal and two hard copies. Simultaneously, the legal review begins.
2. The application is reviewed by a LEAN Team, including Valuation; Environmental; Mortgage Credit; and Architectural and Engineering.
3. Members of the LEAN team approve and sign off on the application.
4. OICHF approves and signs off on the application and issues a Firm Commitment.
5. The legal review is finalized.
6. Closing takes place.

**SECTION 5: HUD LEAN – ONE YEAR LATER**

**1. What is HUD's "Risk Assessment" and how does it apply to my HUD application?**

HUD has developed two worksheets, one for skilled nursing and one for assisted living, which determine whether an additional review of the application by OICHF staff will be required. These worksheets are completed by your HUD underwriter prior to submitting your application to HUD, and derive information from the appraisal, such as capitalization rate, expenses, and census mix, in order to compare your facility's operational performance to comparable facilities in the market. If your facility exceeds these benchmarks that are based upon market competition, then your project passes HUD's Risk Assessment, and your HUD application will enter the "Green Queue" and receives expedited processing. Your application can still be submitted if your project does not pass the Risk Assessment; it will be processed in HUD's regular queue.

**2. I have heard that LEAN deals are taking just as long as MAP deals to close. What is HUD doing, if anything, to change this timing issue?**

Due to the overwhelming demand for HUD LEAN financing, the OICHF has hired several staff members that will help to alleviate the length of time between from application submission to the time of funding. Additionally, HUD has created a "Green Queue" for all LEAN applications which pass the Risk Assessment. This allows strong-performing projects to be given priority and be assigned to an underwriter more quickly after the application has been submitted.

### **3. Is my debt eligible to be refinanced with a HUD loan?**

Debt that is eligible to be refinanced by a HUD loan includes:

- A. Any outstanding mortgage(s), including debt incurred in connection with the construction of the project, or with capital improvements made to the property.
- B. Other recorded indebtedness such as mechanic's liens and tax liens, provided they did not result from personal obligations of the borrower.
- C. Unrecorded debt directly connected with the project, supported by documentation from the borrower. In this case, the borrower must provide the lender with documentation that the debt is directly connected to the project. This includes indebtedness incurred from capital improvements or from advances made to cover operating deficits.
- D. Must pass the two-year rule. This means that any recorded debt that is less than two years old will need to be investigated by HUD. Existing debt that provided the borrower with any cash-out must be seasoned for two years. No investigation is required for debt that is at least two years old.

### **4. What is HUD LEAN's "queue" and how does it affect my deal?**

Once a HUD LEAN application is received by the OIHCF, it is placed in line behind the applications that were received before it. The applications in queue are waiting to be assigned to an OIHCF underwriter. The underwriters take on the application in the order in which they are received, with the exception of projects that pass the Risk Assessment, and 223(a)(7) applications. Once your HUD LEAN application has been submitted, your HUD lender has no control over the time to close. Projects that pass the Risk Assessment and 223(a)(7) applications are put into the "Green Queue" and are more quickly assigned to an underwriter. Cambridge's priority is to make sure that our LEAN applications are entered into the Green Queue so we can deliver a prompt turnaround to our clients.

### **5. What is the "Green Queue"?**

The Green Queue was created by the OIHCF to separate the lower-risk projects from higher-risk projects. Low-risk projects are refinancings which have a low loan-to-value, and have a strong historical cash flow. High-risk projects include construction, and projects that have a higher loan-to-value ratio. Projects enter the Green Queue upon passing the Risk Assessment, and are given priority in processing.

### **6. How many HUD LEAN deals have been closed? What has been Cambridge's success rate with HUD LEAN?**

Cambridge completed 24 HUD-insured financings in 2009, totaling more than \$320 million. Three of these transactions, totaling more than \$28 million, were processed under LEAN; the remainder were processed under the former MAP or TAP processing. Cambridge currently has multiple projects in the HUD LEAN pipeline, and expects 2010 to be an equally strong year for HUD LEAN closings. As of March 31, 2010, there have been a total of 196 HUD LEAN transactions funded.

**7. Can I refinance my existing HUD mortgage with a lower interest rate? What are the benefits to the HUD 223(a)(7) program and will my deal be processed with all other HUD deals?**

HUD 223(a)(7) transactions are being processed under the LEAN program, along with all other 232 deals. However, applications for (a)(7) financing are being given priority over all other 232 applications, and are put into their own, separate queue. With interest rates being historically low, the (a)(7) program is ideal for borrowers that are past their lockout period. Your HUD loan can be refinanced in a very short period of time with little to no out-of-pocket cash required from you.

**8. Have the insurance requirements changed under the HUD LEAN program?**

Insurance requirements have remained the same under HUD LEAN, including:

- Property coverage for the lesser of the mortgage loan amount or 80% of property's insurable value.
- Professional and commercial liability policy which covers the following:
  - Minimum \$1,000,000 per occurrence per location.
  - Minimum \$3,000,000 in aggregate per location. (blanket coverage permissible).
  - Maximum \$100,000 deductible if the borrower has fewer than 50 properties.
  - Insurance issuer maintaining either an A.M. Best Company rating of BB+ or better or Demotech Inc. rating of A or better.
  - Insurance issuer needs to be licensed as a surplus lines carrier in the state of property.
- Vehicle Liability Insurance
  - Minimum \$300,000 for one person.
  - Minimum \$500,000 for more than one person.
  - Minimum \$100,000 against claims for damage to property of others.
- Additional insurance requirements may exist regarding history of coverage and annual reviews.

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