



# CAMBRIDGE

Realty Capital Companies

125 SOUTH WACKER DRIVE | SUITE 1800 | CHICAGO, IL 60606 | M 312-357-1601 | F 312-357-1611  
WWW.CAMBRIDGECAP.COM

## HUD 232 Lean PROCESSING

### Frequently Asked Questions

The Department of Housing and Urban Development has recently modified their underwriting and processing of HUD 232 financing of 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 of Toyota Corporation. 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 will Cambridge be impacted by the new HUD Lean process?**

Cambridge expects the Lean process to have only a positive impact. 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. Will Cambridge be effective with the new Lean process?**

Cambridge will 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.

**6. Has Cambridge closed any deals under the Lean process?**

The refinancing of the Beaver Dam Nursing & Rehab Center in Beaver Dam, KY is Cambridge's first closed Lean deal and we are currently processing numerous Lean transactions.

**SECTION 2: Lean BASICS**

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

Lean is the new 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 pioneered by Toyota Motor Corp. 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 will begin submitting applications electronically via Oracle Application Server Portal. This will allow 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 be 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 will 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?**

HUD Lean primarily finances 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, so long as the number of these types of units is less than 25% of the total units in the facility.

**7. How many deals are closed under the Lean process?**

To date, there have been 32 refinance deals, 1 construction deal, and 2 a(7) deals closed under the new HUD Lean program.

**8. 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 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 will remain at 85% for for-profit mortgagors and 90% for nonprofit mortgagors. Minimum debt service requirements will 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 facilities 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 it is 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 is underwriting going to be changed?**

The two major changes to HUD underwriting are:

1. Elimination of proprietary earnings adjustment. Lenders and appraisers will no longer deduct proprietary earnings from a facility's NOI.
2. Inclusion of Risk Analysis. The Lean underwriting will be 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. Will the same due diligence process still apply (i.e. appraisal, Phase I, PCNA, etc.)? HUD Lean projects will still require the same third party reports.**

#### **SECTION 4: PROCESSING**

**1. How will Lean applications be submitted and reviewed?**

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

**2. How is the Lean process different from the existing 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 will now be acceptable.
- d. Elimination of proprietary earnings adjustment.
  - i. Elimination of proprietary earnings adjustment will make 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) will be processed with our new LEAN process.

**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 will begin 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 will 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 will save 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.

#### **FOR FURTHER DETAILS CONTACT:**

Financing Information Group  
CAMBRIDGE REALTY CAPITAL COMPANIES  
125 South Wacker Drive – Suite 1800  
Chicago, Illinois 60606  
Telephone 312-357-1601 — Fax 312-357-1611  
Email: [info@cambridgecap.com](mailto:info@cambridgecap.com)  
<http://www.cambridgecap.com>

**Western Regional Office:**  
Hymie Barber  
CATALYST/CAMBRIDGE HEALTHCARE FINANCE  
6310 San Vicente Blvd. - Suite 360  
Los Angeles, CA 90048  
(818)610-0750 x103  
(818)692-0750 Cell  
(818)610-0755 Fax  
[hbarber@crgcorp.com](mailto:hbarber@crgcorp.com)

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