

2011 National Skilled Nursing Investment Forum

Still Taking Up the Slack: HUD / LEAN 2011

Moderator:

Leonard A. Lucas

First Vice President - Senior Loan
Originator

Love Funding Corporation

Panelists:

Roger M. Lukoff

Associate Deputy Assistant Secretary
for Healthcare Programs, Office of
Healthcare Programs, HUD

Michael Vaughn

Acting Director, Asset Management
and Lender Relations Division, Office
of Residential Care Facilities, HUD

Hyatt Regency Century Plaza
Los Angeles, California
March 9, 2011



BIOGRAPHIES

Biographies

- LEONARD A. LUCAS, First Vice President-Senior Loan Originator, Love Funding Corporation
 - ❖ Mr. Lucas joined Love Funding Corporation in 1998. He is a Vice President - Senior Loan Originator and is based in Boston, Massachusetts. Throughout the U.S., Mr. Lucas originates direct loans for Love Funding in its capacity as a FHA LEAN/MAP lender. He also advises borrowers in all sectors of the senior housing industry; age restricted apartments, independent living, assisted living and skilled nursing as to the type of financing vehicle best suited to meet the borrower's immediate needs. In those situations where an FHA execution is not the most appropriate he relies upon his extensive knowledge of senior housing financing vehicles and lenders to place the loan with the appropriate lender.
 - ❖ Mr. Lucas is a member of the Massachusetts Bar. He holds a J.D. from the New England School of Law and an A.B. (economics) from Kenyon College. He is an ASHA executive board member. He and his wife, Susan, reside in Cambridge, Massachusetts.



Biographies

- ROGER M. LUKOFF, Associate Deputy Assistant Secretary for Healthcare Programs, Office of Healthcare Programs, HUD
 - ❖ Mr. Lukoff is responsible for executing the Section 242 mortgage insurance for hospitals program and the Section 232 mortgage insurance for residential care facilities program. These programs support HUD's community development mission by providing affordable financing options for needed healthcare facilities in America, thereby improving access to quality healthcare nationwide. Roger Lukoff is the "alter ego" to Mr. Roger Miller the Deputy Assistant Secretary (DAS) for Healthcare Programs. As such, he shares managerial authority with the DAS to plan and direct program operations.
 - ❖ Mr. Lukoff is a Fellow, American College of Healthcare Executives and the former Associate Regional Administrator for the Northeast Consortium, Division of Survey, Certification, DHHS Centers for Medicare and Medicaid Services. He completed his undergraduate studies at the University of Massachusetts-Amherst and graduate degree at The George Washington University.



Biographies

- MICHAEL B. VAUGHN, Acting Director, Asset Management and Lender Relations Division, Office of Residential Care Facilities, HUD
 - ❖ Mr. Vaughn is directly responsible for Servicing and Asset Management Activities related to the \$16.6 billion portfolio of Section 232 Insured Mortgages. He has been involved in the LEAN Process Re-engineering effort which has enabled the program to reach higher levels of responsiveness, customer service and risk mitigation, both in Development (underwriting) and Servicing/Asset Management.
 - ❖ Previously, in the private sector, Mr. Vaughn was a Senior Vice President of the Bank of New York's Fannie Mae/Freddie Mac Multifamily lender, ARCS Mortgage. He was also a Vice President of Republic Realty Mortgage Corp., one of Berkadia's predecessors. In previous government service he has worked in the Office of Affordable Housing Preservation and the Office of Public Housing Investment at HUD, and as Chief Asset Officer of the Public Buildings Service at GSA. He received his bachelor's degree from Georgetown University and his MBA from Yale University's School of Public and Private Management.

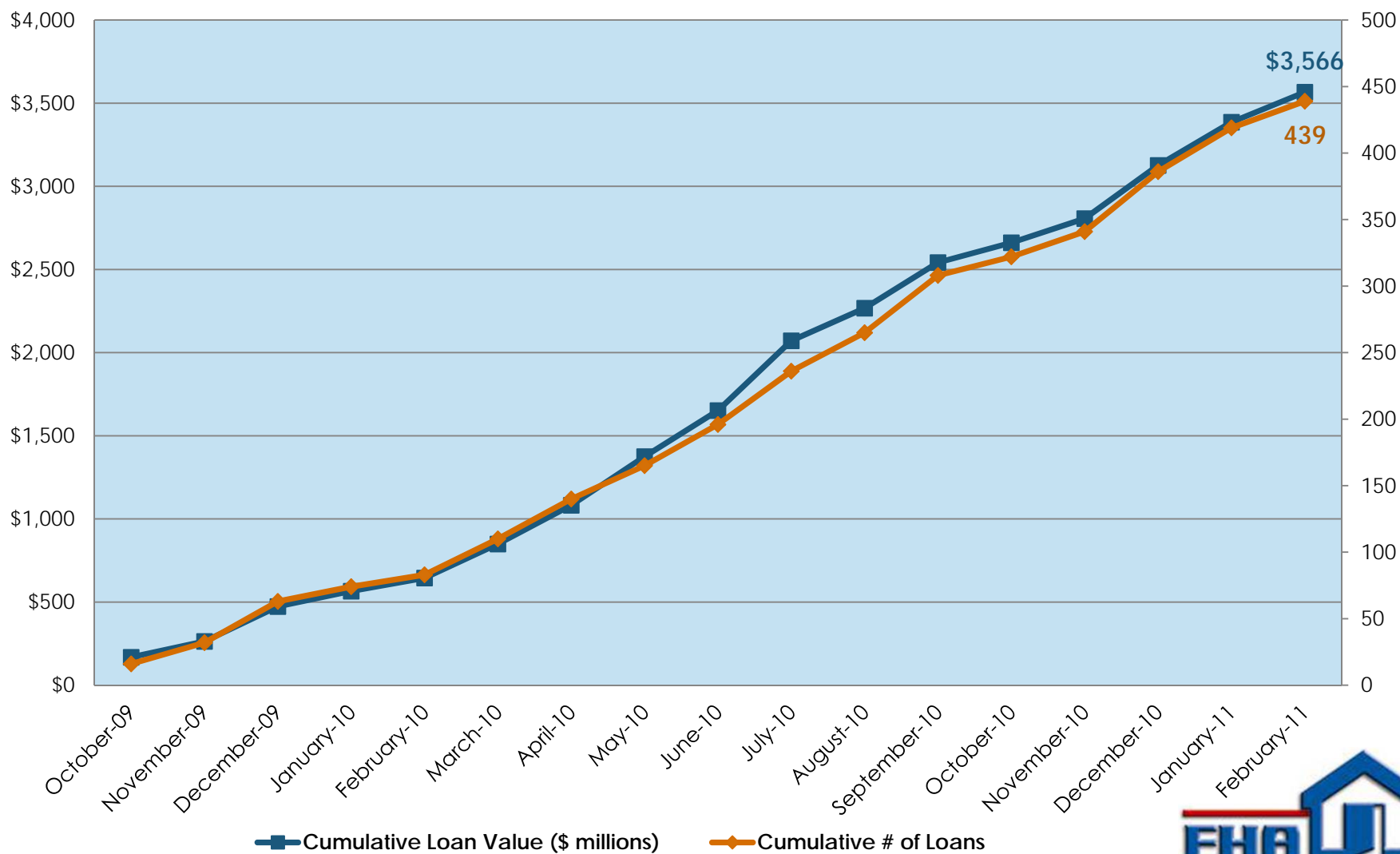


HISTORIC AND CURRENT
DEMAND FOR HUD 232
INSURED LOANS



Section 232 Loan Volumes

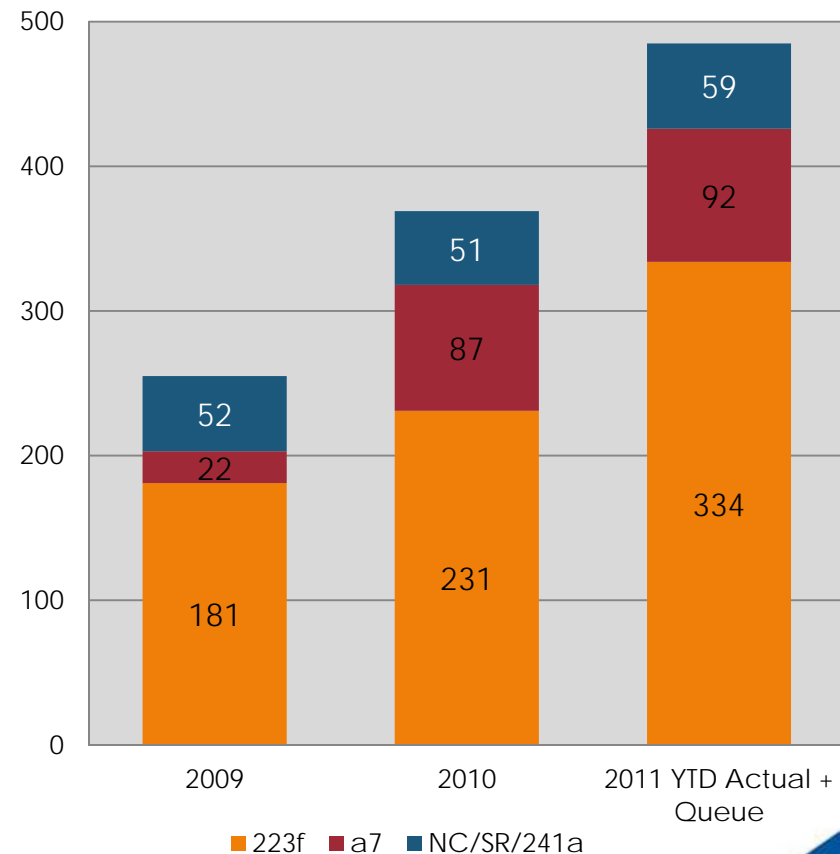
Past 17 Months of Cumulative Closed Loans & Loan Value



Section 232 Loan Closing History

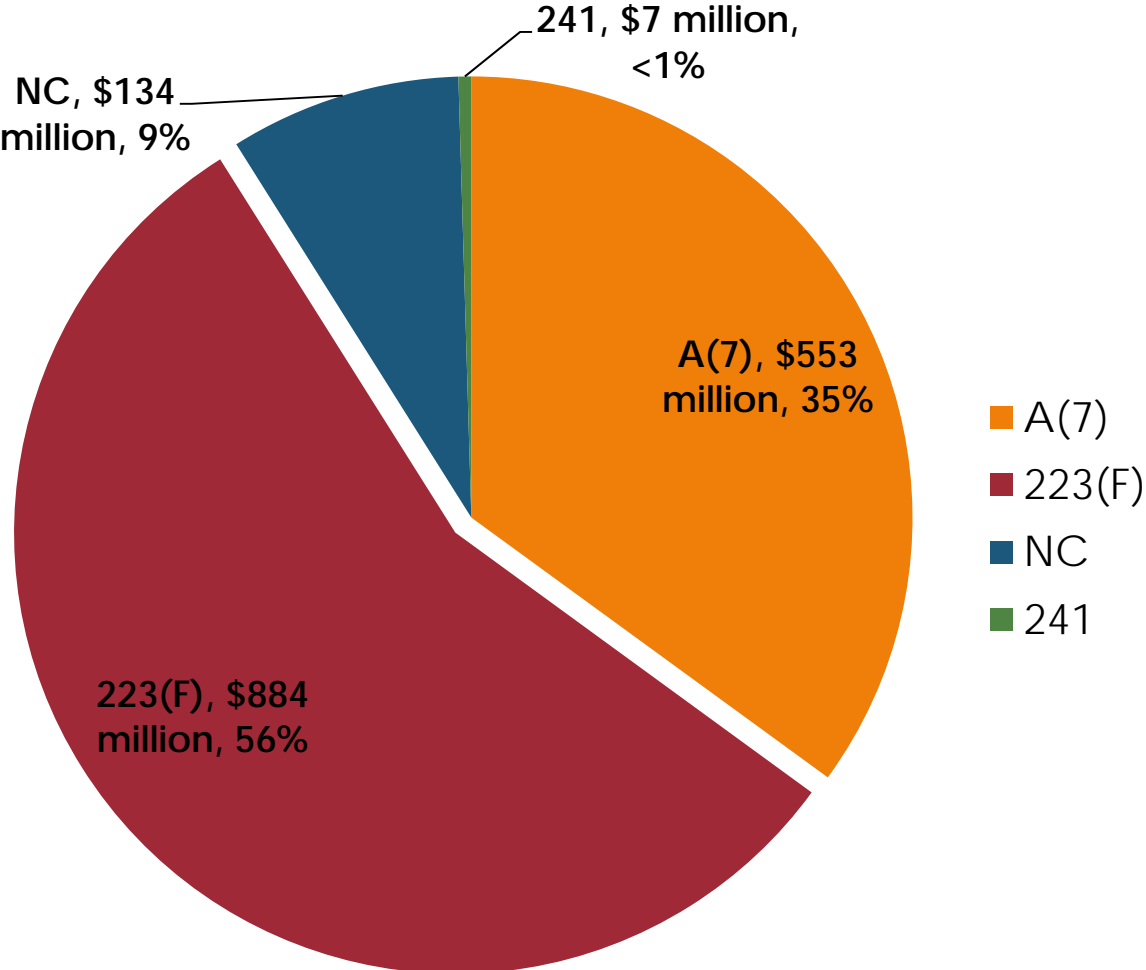
- 223f refinancings dominate the overall demand. This is fueled by increased volume of mid-size and large portfolios seeking FHA mortgage insurance.

FHA Underwritten Section 232 Loans Closed by Program



FY11 Year-to-Date Activity

2011 YTD Commitments by Loan Type



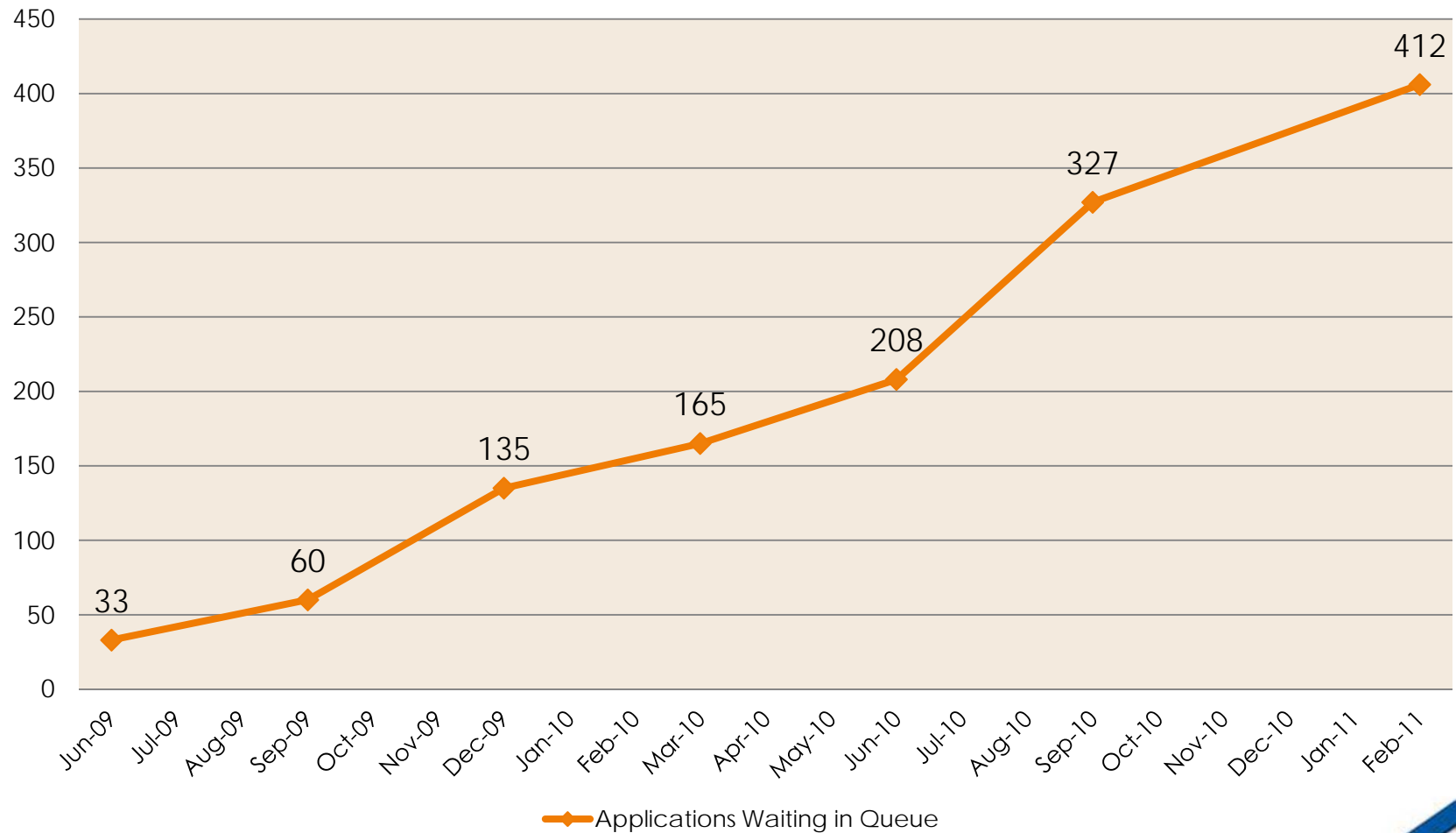
Total 232 Program Volumes (as of 2/25/11)

	FY2007	FY2008	FY2009	FY2010	FY2011 (YTD)
Applications	242	222	387	787	327
Closings	174	189	255	370	128
Commitments Issued	187	181	295	358	226
Commitments Rejected	27	41	29	35	6
Applications in Queue	n/a	n/a	60	327	412
Assigned to Underwriters	n/a	n/a	48	95	85

SECTION 232 QUEUE

Growth of Queue

From June 2009 to February 2011



Queue Types

1. 223f Regular Queue –all 232/223f projects that don't pass risk assessment, not part of a Large or Midsize Portfolio;
2. 223f Green Lane Queue –all 232/223f projects that pass the risk assessment, not part of a Large or Midsize Portfolio;
3. 223f Portfolio Queue – containing projects that are a part of a previously approved Large or Midsize Portfolio,
4. Other Program Queue –232 New Construction, Substantial Rehabilitation, 232/241a and 232 Blended Rate applications;
5. Section 223a7 Queue + Green Lane Queue

Current 232 Processing Timelines

	Average Days in Queue	Average Days in Underwriting	Average Days in Closing	Total Processing Time	# of Closings
223a7	126	42	59	227 days (8 months)	27
223f	175	37	61	273 days (9 months)	80
NC/SR	204	63	134	401 days (13 months)	6

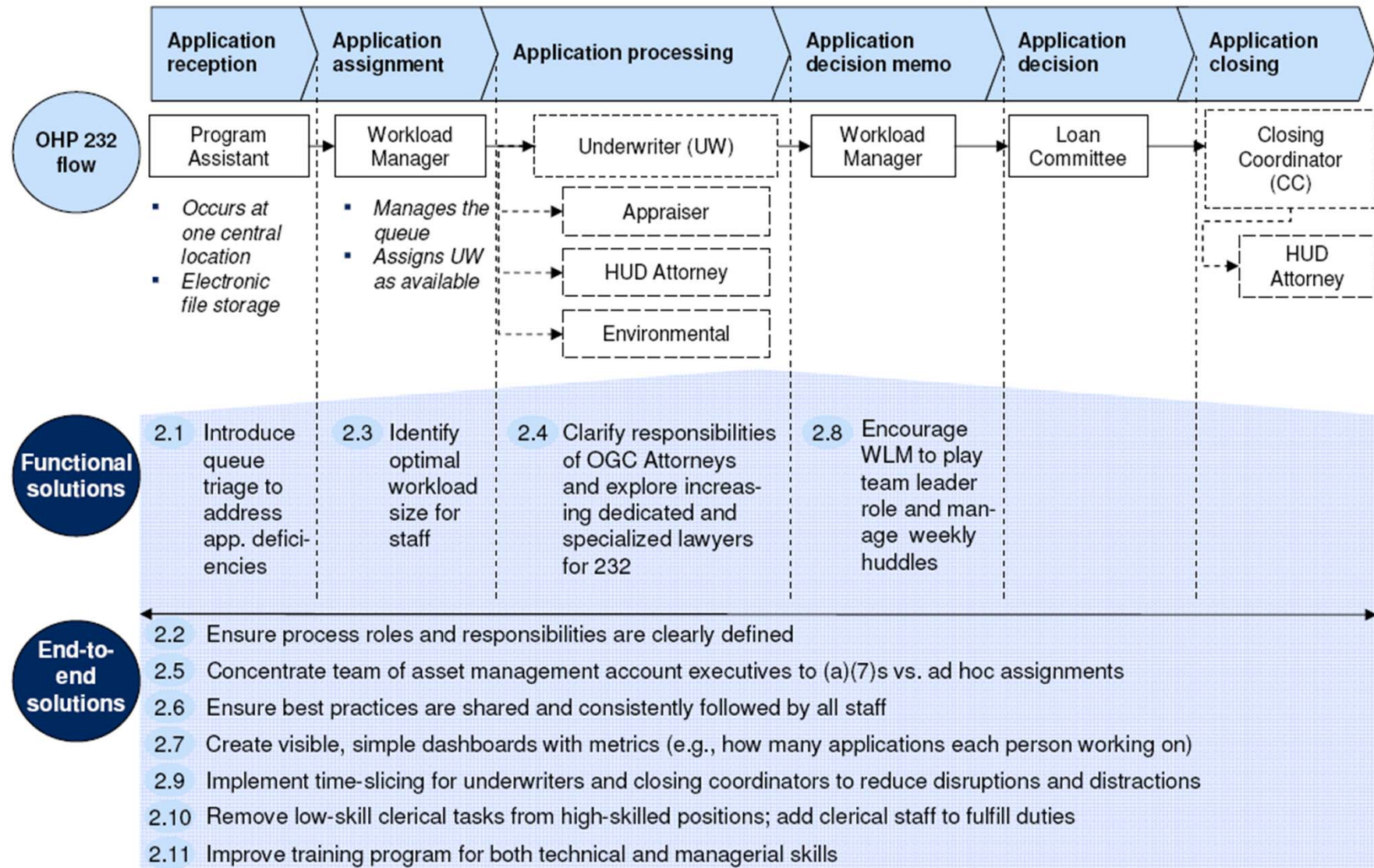
Closing Queue

- On issuance of a firm commitment project enters the closing queue. Projects are assigned to available closers by priority in the queue.
- Lender and lender counsel then have five days to deliver a complete closing package to the closing coordinator.
- If the package is incomplete or is not received, the project is put back to the closing queue and starts to move through the queue again once a complete package is received.
- Rate lock, as always, is at the borrower's risk, but we strongly suggest that the rate not be locked until it is confirmed that the closing is moving forward.
- The closing queue is new, so we have no additional data on timing.
- There are 17 in the A(7) queue and 38 in the 223(f) queue.

Staffing and Outsourcing

- 7 additional staff onboard Jan-Feb
- 19 additional selected, offers not made due to budget considerations
- Scope of work complete for outsourcing Due Diligence/Loan Analysis
- 4 firms interviewed, 2 identified for negotiation
- Firms have done extensive work for OAHP/Fannie/Freddie/232 Prequals
- Closing Coordinator is an optional step
- OGC working on contract for Closing Function

Productivity Improvement Opportunities



UNDERWRITING ISSUES

Current Issues - 223(f)

- Master Leases:
 - > 4 – 10 Properties (depending on credit quality)
 - Critical Concept: Under a Master Lease structure, a default under any single sublease triggers a default under the Master Lease
 - The “cross-defaulting” of the Subleases is the critical deterrent to “cherry picking” by a Master Tenant (and in related parties situations, by affiliated Mortgagors)
 - HUD Master Lease Addendum now under review for simplification
- Accounts Receivable Financing :
 - HUD will allow AR Lender a first Lien on AR subject to:
 - ❖ Intercreditor Agreement
 - ❖ Deposit and Control Agreement
 - ❖ AR Line may include other HUD financed properties, not non-HUD

Portfolio Approvals

- Large Portfolios > 50 projects or combined Mtg. amounts of > \$250 Million
 - ❖ Requires submission of Financial Analysis, and OHP HQ Mortgage Credit Review. Approval by Office of Risk Management and Commissioner
- Mid Sized Portfolios 11- 49 projects and Mtg. amounts of \$75 million to \$250 million
 - ❖ Financial Analysis reviewed at OHP HQ level, Approval by OHP DAS
- Small Portfolios – No Additional Requirements, but will be processed together
- Revision of Guidance is upcoming



Current Issues – a(7)s

- **Term Extensions :**
 - ❖ **Need Justification based on**
 - Age of Building
 - Deposits to Reserves
 - Strength of Operator/ Market
 - Demonstrable need to enhance cash flow
 - ❖ **Debt Service**
 - 1.1 Minimum
 - Willing to use A(7) as workout tool
 - ❖ **Payback period (for transaction costs)**
 - Maximum 10 years
 - Can use Market Premium for these costs

Current Issues – New Construction

❖ Key Factors:

- Experience of Developer/Owner/Operator
- Financial Strength of Developer/Owner/Operator
- Strength of Market
- HUD experience in Market

❖ Debt Service escrow :

- Demonstration of Financial Strength/Commitment
- Tailored to fit transaction
- 6 to 12 months
- Freed up after 12 months of underwritten DSC reached

❖ Initial Operating Deficit Reserve

- Based on conservative estimate of Lease-up
- Release: 3 consecutive prior months at > 1.45 dsc



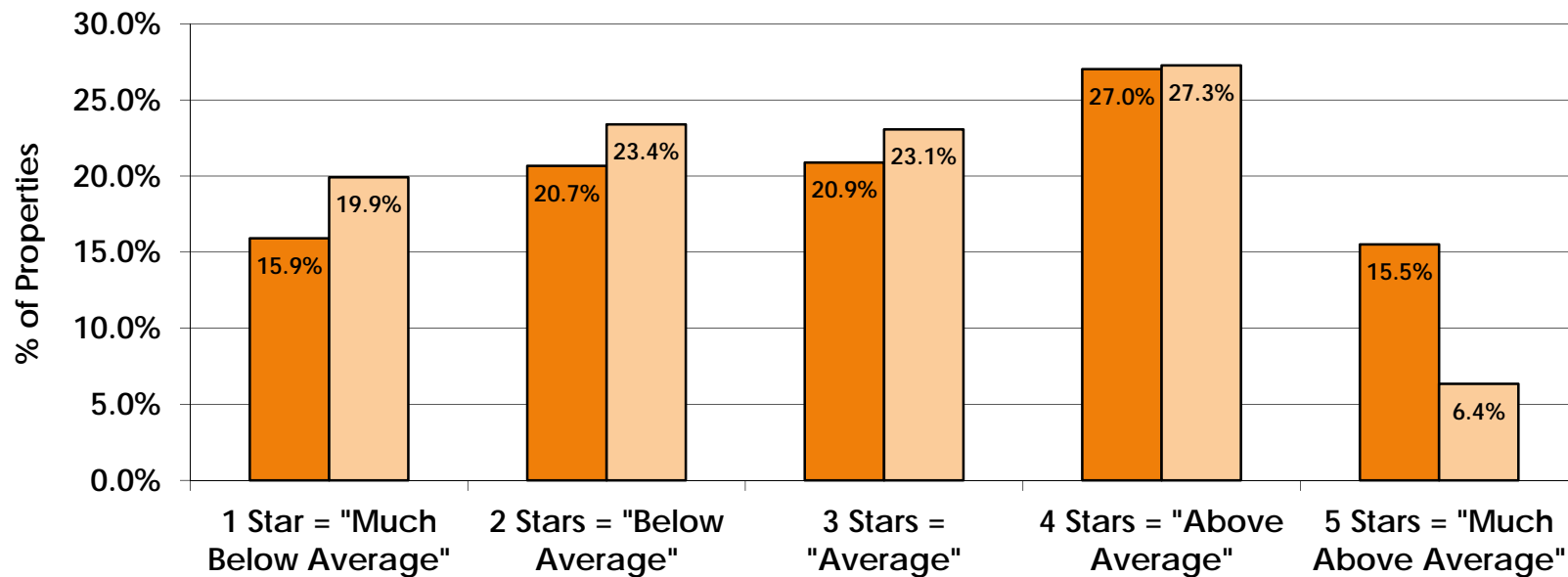
Future Underwriting Issues

- HUD's Management Goal: Utilize HUD assistance to improve health outcomes.
- OHP's Goal: Increase the average CMS quality rating of the FHA residential care facility portfolio by issuing FY2011 skilled nursing home commitments at an average CMS (the Centers for Medicare/Medicaid Services) quality rating greater than 2.2.
 - ❖ The current national average quality rating of proprietary skilled nursing facilities is 2.2, on a scale of 5.0, as of June 2010.

Nursing Home Comparison - "Overall"

CMS Star Rating

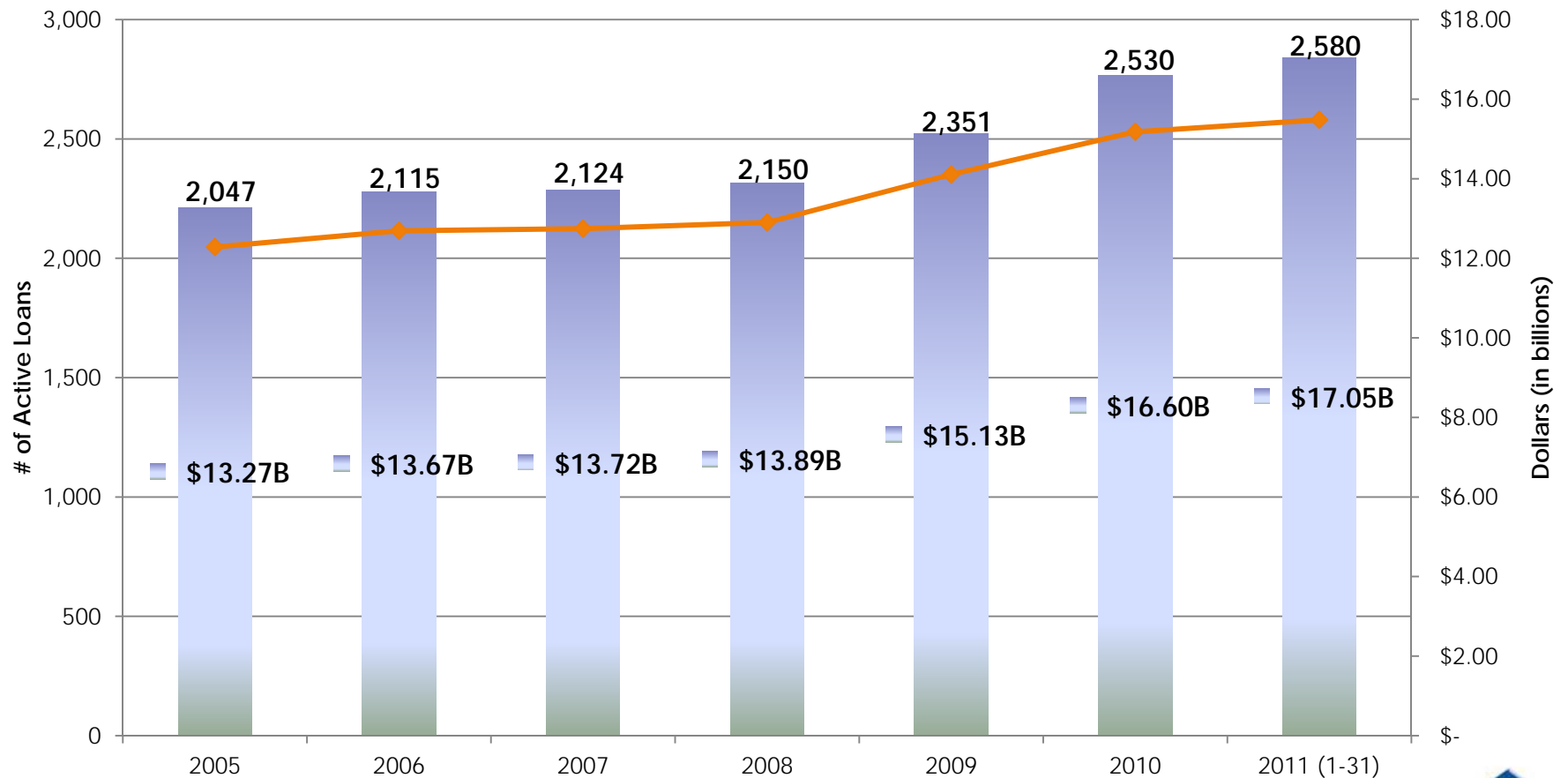
■ Nationwide = 15,536 W.A. Rating of 3.05 ■ 232 Program= 1,651 W.A. Rating of 2.77



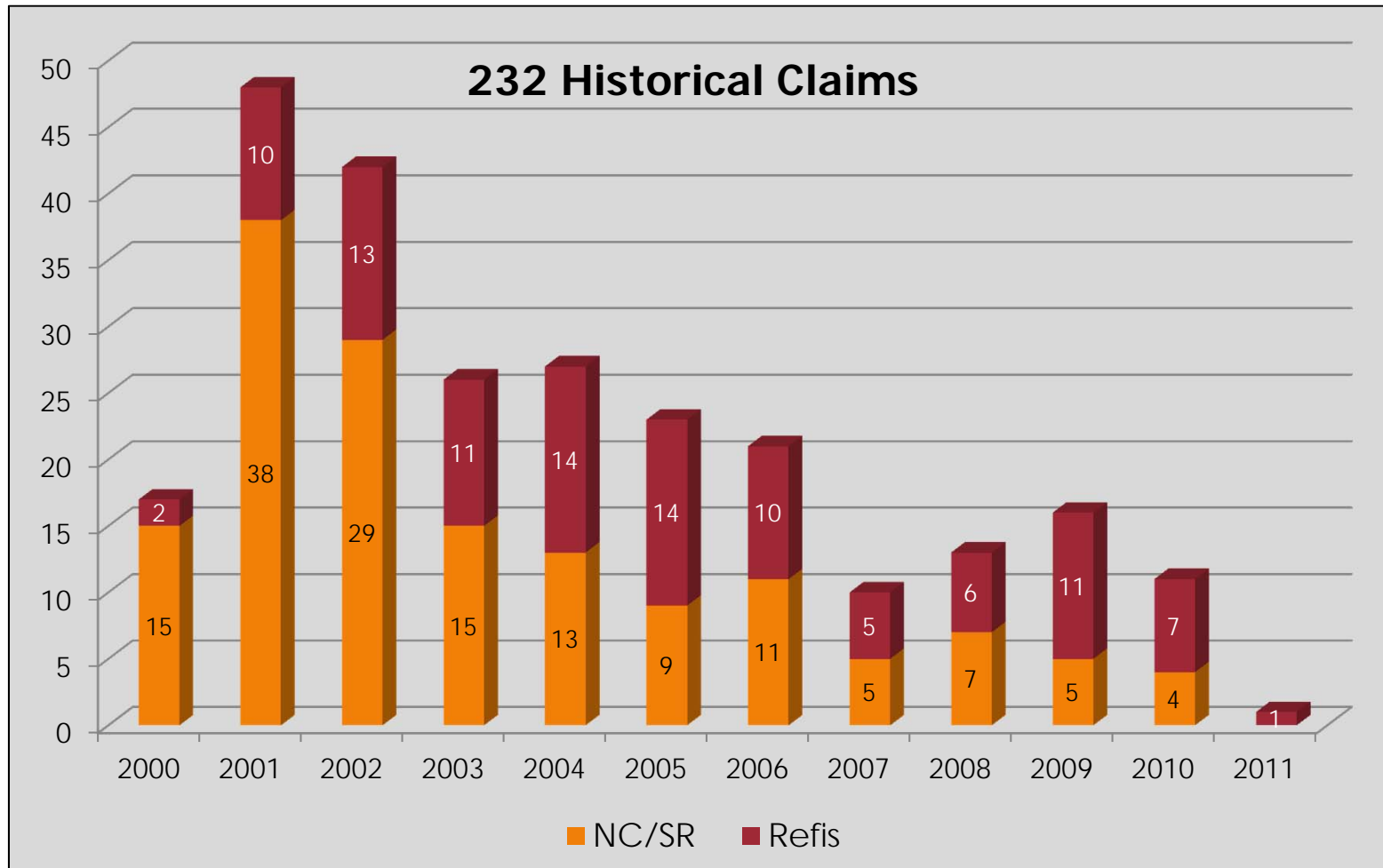
ASSET MANAGEMENT

Section 232 Portfolio

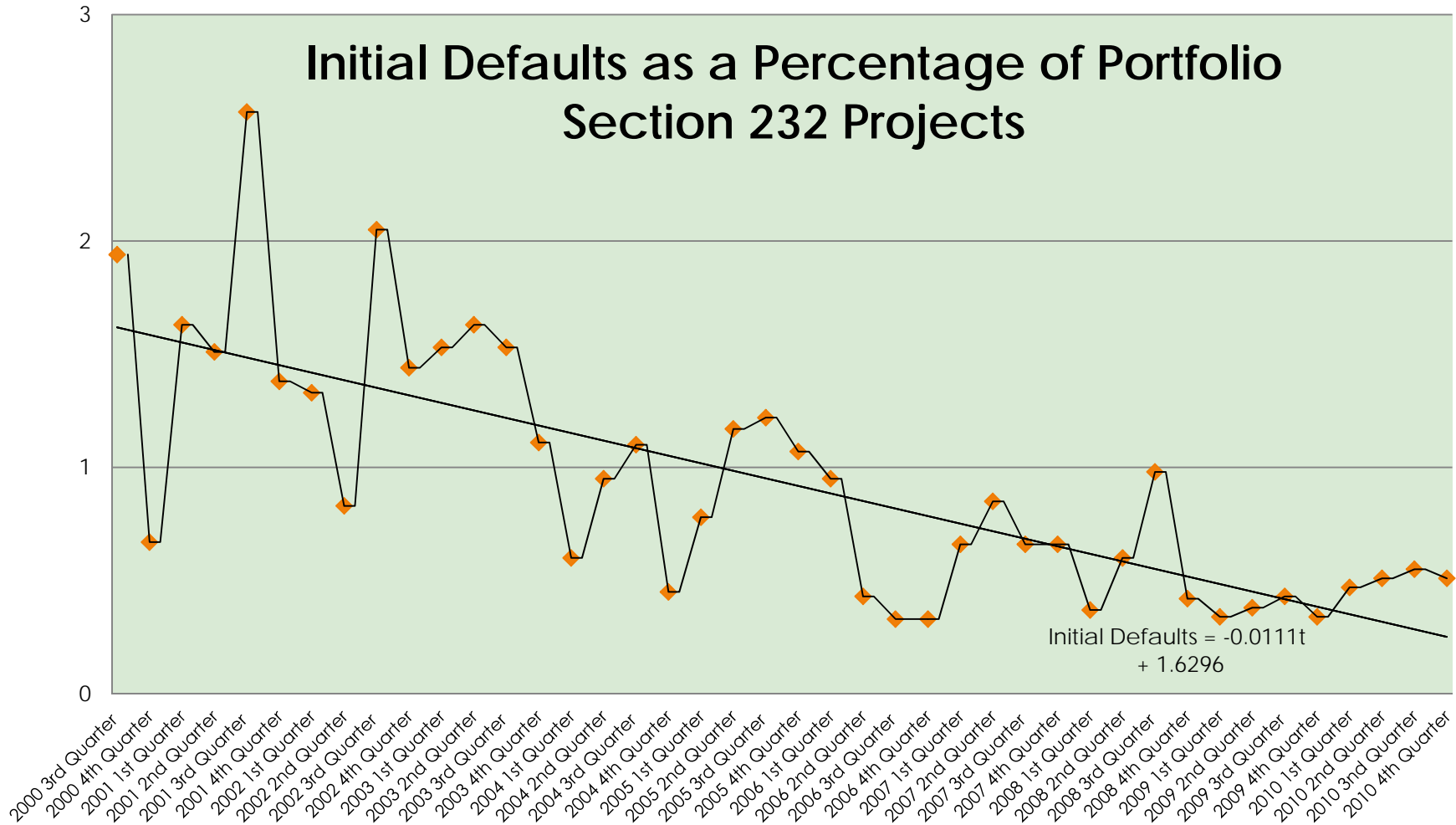
Growth of Portfolio from 2005 to 2011



232 Risk Analysis and Claims



Defaults on the Decline



Initial Default = 31 days past 1st of month due date, non-cumulative within one-year time frame, by quarter

Future of 232 Asset Management

- Servicers will have more responsibility for Risk Monitoring – Minimum Servicing Fees will be adjusted
- Analysis of Operator Financial Statements (similar to FNMA system)
- Strengthened Regulatory Agreements
- Address Problems with REAC
- Enhanced Relationship with Departmental Enforcement Center and CMS
 - ❖ Partial payment of claims – Mortgagee Letter for Section 232 in Publication



THANK YOU

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