

*Lean 2017: **Healthcare** Update*

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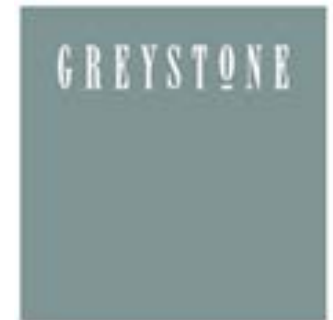
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Lean Production



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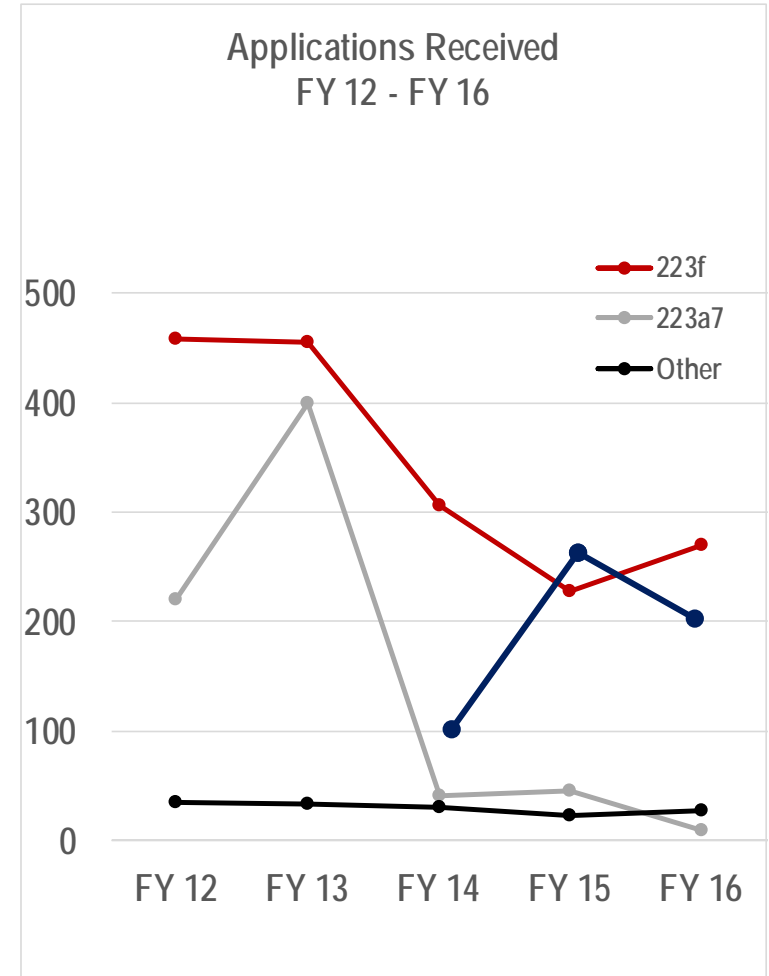
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Lean Production: Applications Received FY 2012 - 2016

Volumes Consistent with 2015

- The number of applications has declined since highly active 2012 and 2013
- 223f applications accounted for 88% of applications received in 2016
- A7 applications accounted for 3% of applications received in 2016
- A7 activity has been replaced by Loan Modification (IRR) applications
 - Loan Modification program rolled out in 2014
 - Efficient processing timeline
 - 2014: 80 closings
 - 2015: 254 closings
 - 2016: 184 closings

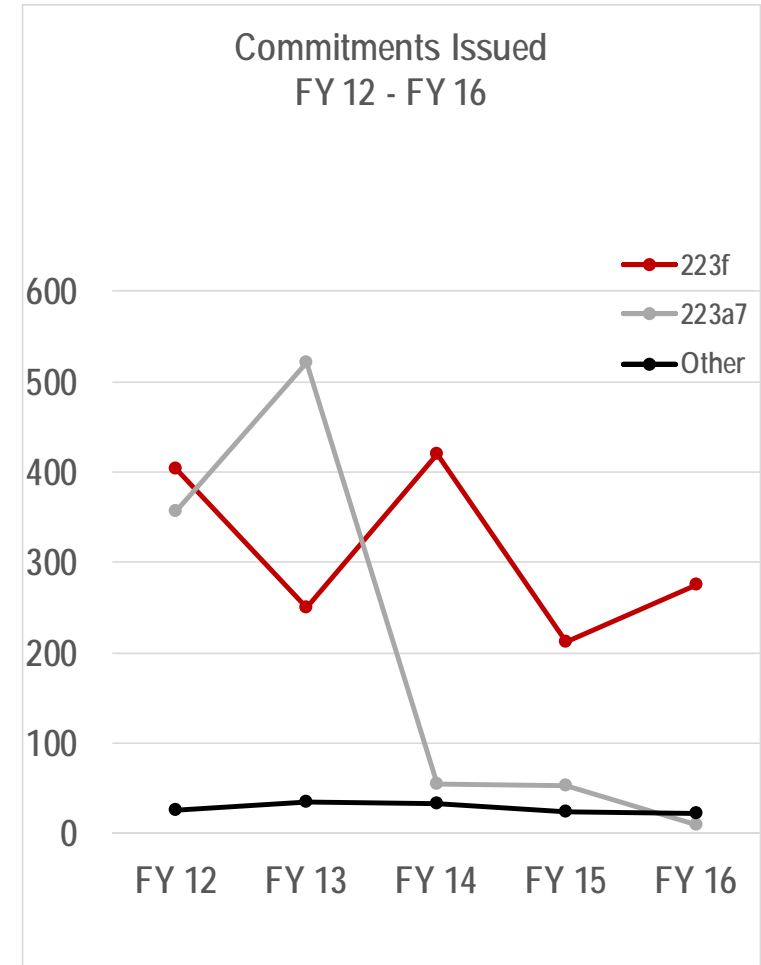


Lean Production: Commitments Issued FY 2012 - 2016

Trend Mirrors Applications

- 306 commitments issued in 2016
- \$2.84 Billion total commitment dollars
- Average loan size:
 - 223f: \$9.1MM
 - 223a7: \$10.8MM
 - Other: \$11.4MM

FY 2017 Firm Commitments Issued (1/27/17)	
223f	71
223a7	9
<u>Other</u>	<u>6</u>
Total	86

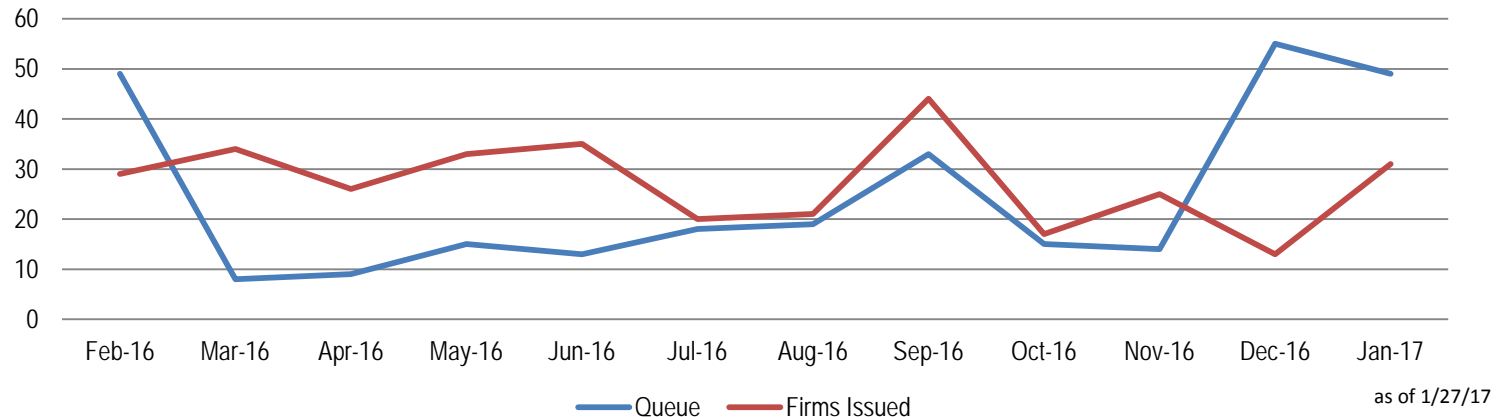


Lean Production: Queue Update

Return of the Queue

- Commitments outpaced Queue in 2016
- Process Improvements
 - Green Lane
 - Specialized teams/Contractors
- Queue increase in late 2016
- New UW contract not yet in place
 - Limited application assignment
 - 223f Non-Portfolio Queue (32)

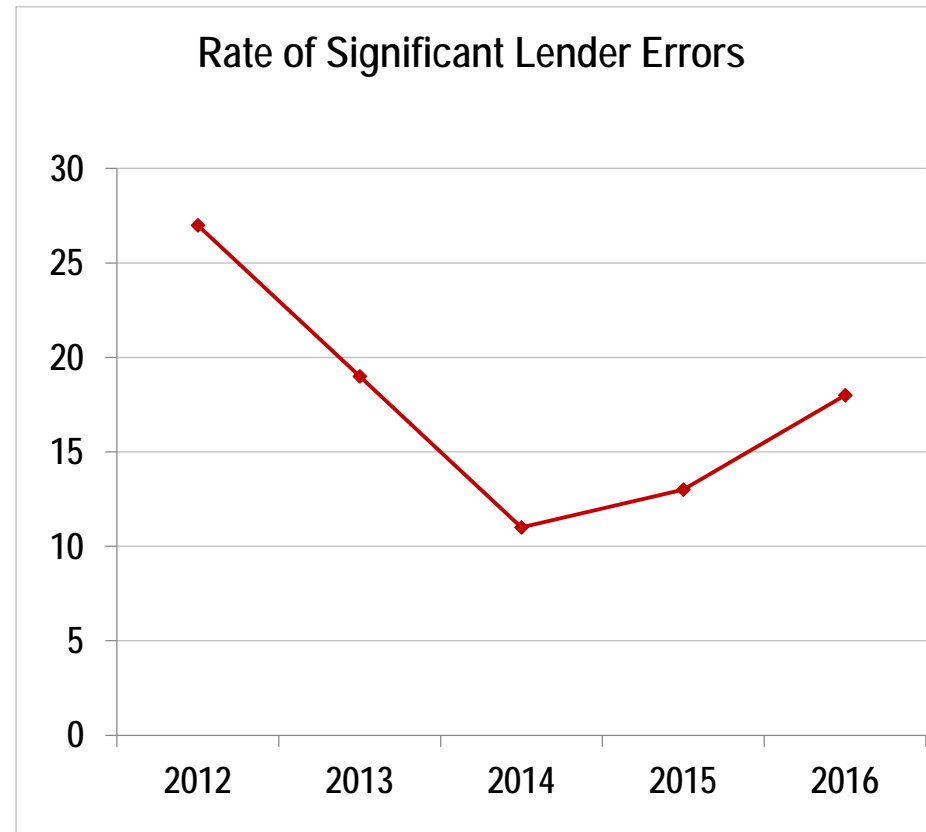
One Year Trend in Application Volume
Queue and Commitments Issued



Lean Production: Lender Performance Metrics

Uptick in Significant Underwriting Issues

- Implemented FY 2012
- Measures Seven Metrics (2016 results)
 - Mathematical Calculations (10 apps)
 - Quality Control (23 apps)
 - Lender Responsiveness (19 apps)
 - Due Diligence (14 apps)
 - Program/Legal Requirements (13 apps)
 - Third Party Reports (17 apps)
- Declining Errors
 - 27% Error Rate in 2012
 - 11% Error Rate in 2014
 - 18% Error Rate in 2016



Lean Policy



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Lean Policy Topic: 2530 Final Rule (Notice 2016-15)

Controlling Participants and Specified Capacities

- Only **Controlling Participants** are required to file 2530 submissions
- Controlling Participant: Any individual or entity who exercises financial or operational control of a **Specified Capacity**. At least one natural person must be identified as a Controlling Participant for each Specified Capacity.
- Specified capacities, for ORCF's purposes, would include the Borrower/Owner entity, the Operator entity, the Management Agent, the General Contractor, and the Master Tenant/Master Landlord entities, as applicable.
- Those who are exempted from filing:
 - Wholly-owned entities
 - Shell entities
 - Tax Credit Investors
 - Passive Participants
 - Minor Officers
 - Board Members
 - Healthcare Facility Administrators
 - Publicly Traded Companies
 - Mortgagees
 - Public Housing Agencies
 - Non-Controlling Participants
 - Passive Participants with less than 25% shareholder interest in an entity

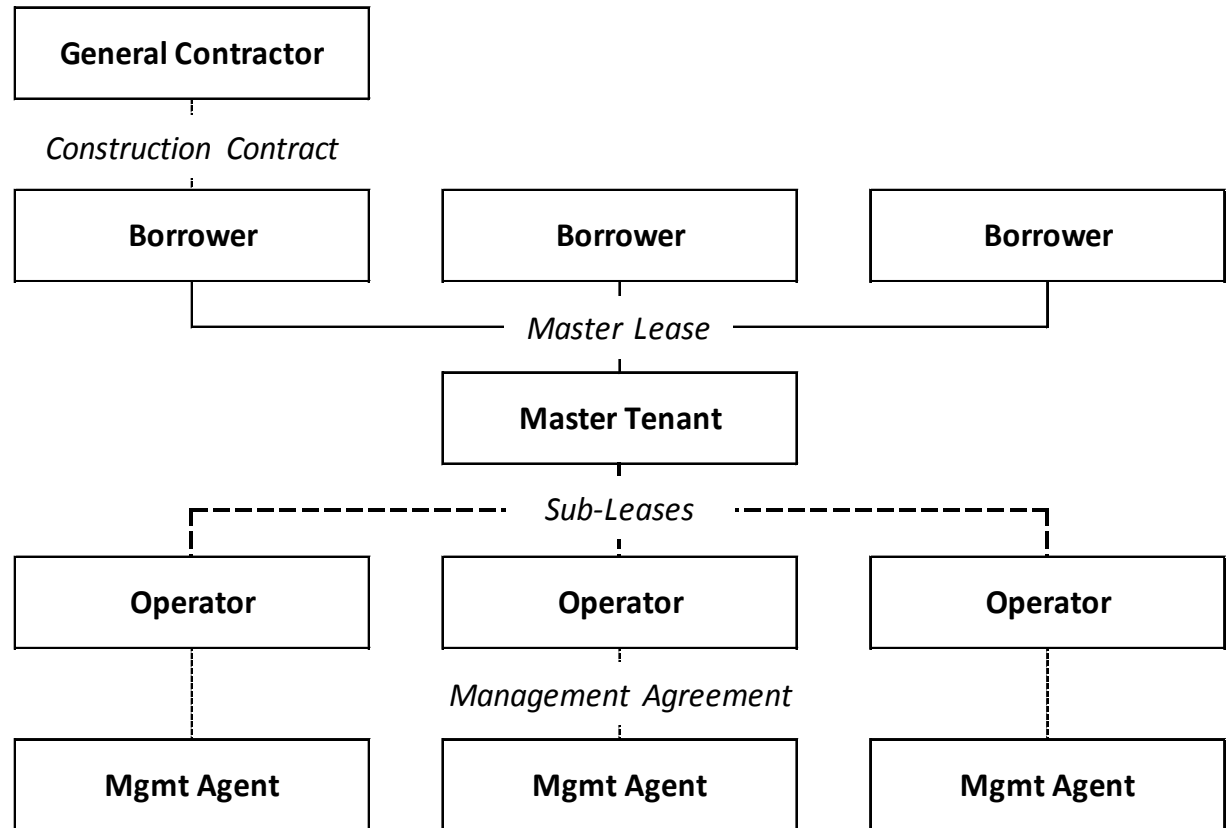
Lean Policy Topic: 2530 Final Rule

Section 232 Specified Capacities

- Specified Capacities:

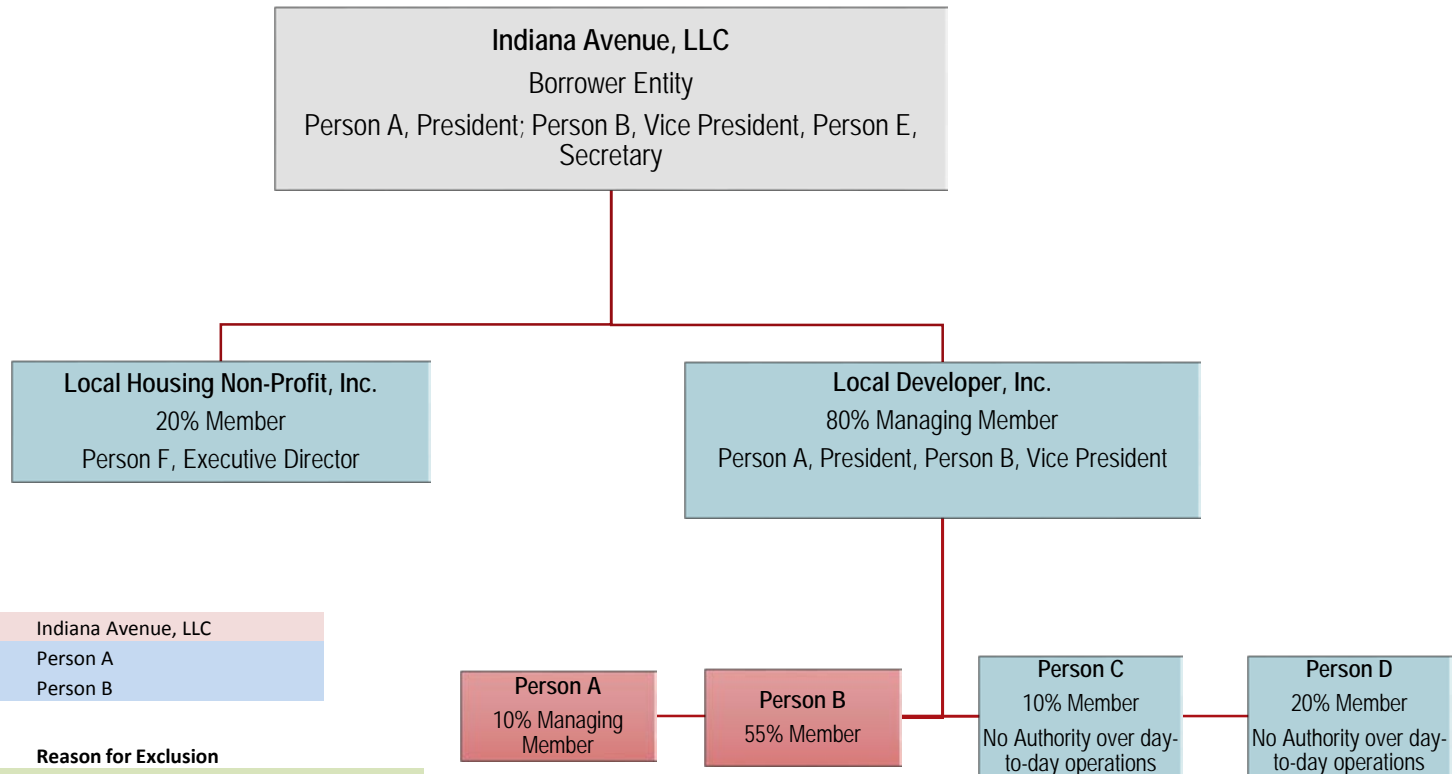
- Borrower
- Operator
- Management Agent
- Master Tenant
- General Contractor

- Controlling Participants must be disclosed for each Specified Capacity



Lean Policy Topic: 2530 Final Rule

Identifying Controlling Participants



Who Must File?

Specified Capacity: Indiana Avenue, LLC

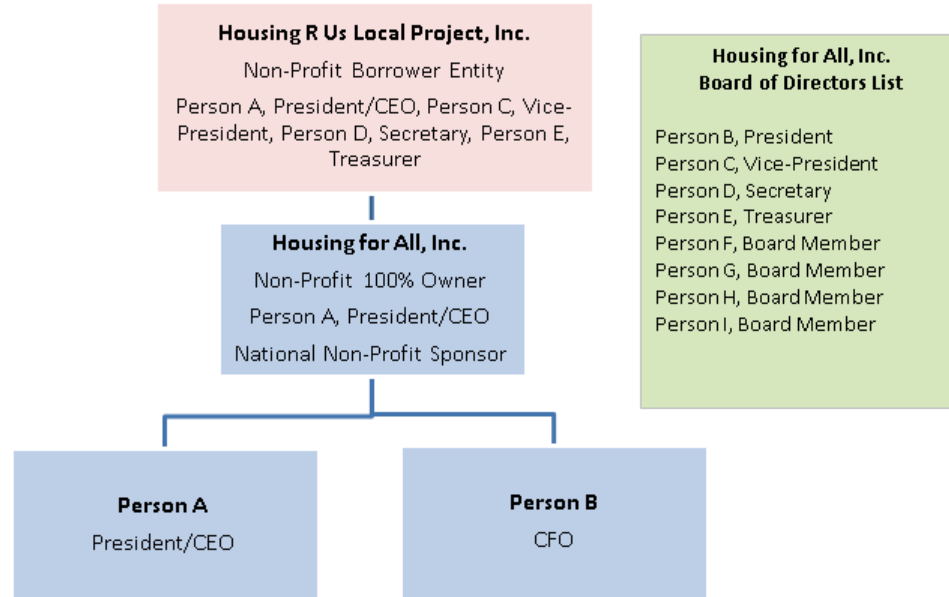
Controlling Participants: Person A
Person B

Excluded Parties

Person/Entity	Reason for Exclusion
Local Housing Non-Profit, Inc.	No authority over day-to-day operations
Local Developer, Inc.	Shell entity
Person C	No authority over day-to-day operations
Person D	No authority over day-to-day operations
Persons G-N	No authority over day-to-day operations

Lean Policy Topic: 2530 Final Rule

Non-Profit Structure



Who Must File?

Specified Capacity: Housing R Us Local Project, Inc.

Controlling Participants: Housing for All, Inc.
Person A
Person B

Excluded Parties

Person/Entity	Reason for Exclusion
Persons B-I	No authority over day-to-day operations

Lean Policy Topic: 2530 Final Rule

Filing Options for Section 232

- Paper 2530s no longer accepted
- Submission Options:
 - APPS
 - Attachment 1 to Consolidated Certification
 - BPRS Registration

**[Attachment 1 to Principal of the Borrower's Consolidated Certifications:
Schedule of Previous Participation in HUD Insured & Other Government Agency Projects/Facilities**

Project/Facility (name, location)	Roles in Project/Facility	Loan Status
Name of Facility City, State	Role in Project/Facility (describe): Dates Participated in Project/Facility to Healthcare Facility YES <input type="checkbox"/> NO <input type="checkbox"/>	<input type="checkbox"/> HUD FHA Number: <input type="checkbox"/> Gov't Agency Financing other than HUD (indicate): <u>Loan Status during participation:</u> <input type="checkbox"/> Current <input type="checkbox"/> Default Assignment <input type="checkbox"/> Foreclosed

Lean Production



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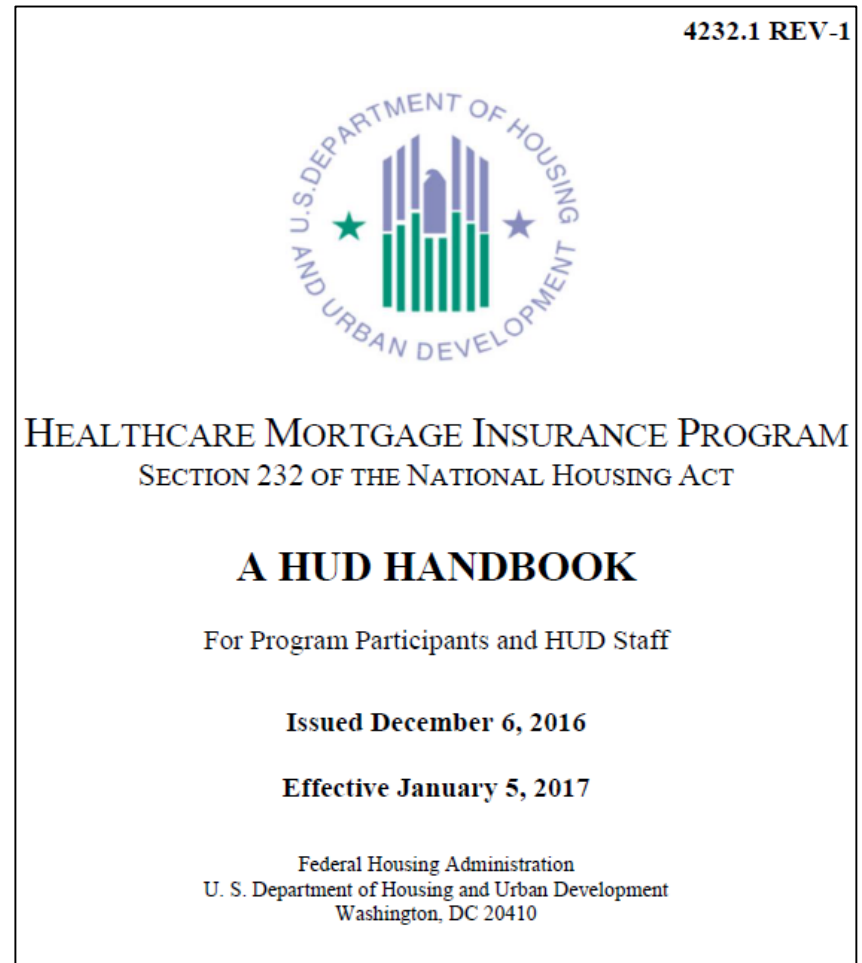
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Lean Production Topic: Handbook 4232.1-REV1

Consistent Improvement Continues

- Handbook 4232.1 REV-1
- Published for public comment in mid-May 2016
- Public comments due May 31, 2016
- Final Handbook issued December 6, 2016
- Effective Date: January 19, 2017
- Key Changes:
 - Redefines/Expands Eligible Debt
 - Eliminates Blended Rate program
 - Eliminates IL Waivers
 - Implements Radon Testing
 - Clarifies Asset Management practices



Lean Handbook Changes: Blended Rate Program

Vaya Con Dios, Blended Rate

- **ORCF's Blended Rate Program** combined the new construction of units/beds with a purchase/refinance under a single loan.
 - Existing units/beds did not require substantial rehabilitation
 - Blended the UW/LTV requirements from 232 New Construction and 232/223f
 - Davis-Bacon wages required
- Updated Handbook eliminates all references to Blended Rate
 - Borrower's options:
 - 1) 223f combined with 241a
 - 2) 232 New Construction
 - 3) 223f (if not tripping Sub Rehab)

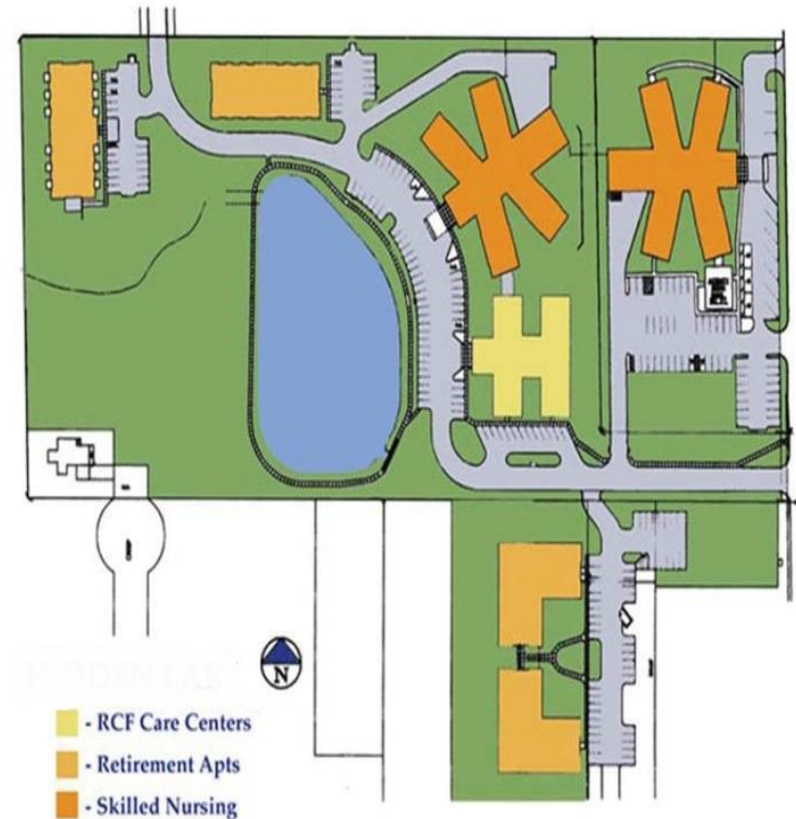


Lean Handbook Changes: Independent Living Units

Clarification on Threshold Calculation and if Waivers are Accepted

- ORCF will allow UP TO 25% of the beds/units to be for **Independent Living**
 - When to calculate based on Beds vs Units?
 - Facility license for the remaining (non-IL) beds/units
 - SNFs typically licensed based on Beds
 - ALF typically licensed based on Units
- Will HUD accept waivers where IL units exceed 25%?
 - Limited basis only (never over 30%)
 - Deviates from Program Intent
 - Options?
 - Two loans under separate programs

COMMUNITY LAYOUT



Lean Handbook Changes: Eligible Debt

Debt Seasoning

- **Debt Seasoning** is the minimally required period of time between the closing date of a loan and the date that an application to refinance the existing debt is submitted to HUD
- If existing debt does not meet eligibility requirements, then a 24-month seasoning period is required
- Exceptions based on three criteria:
 - 1) Proposed loan amount is $\leq 70\%$ LTV
 - 2) Pct. of existing debt used for Project is $> 50\%$
 - 3) Project demonstrates 3+ years of NOI which supports appraised value
- If LTV is $< 60\%$ LTV, then #2 can be $\leq 50\%$
- Enables immediate refinance of "cash-out" loans

% of Existing Debt Used for Project Purposes	$> 50\%$	$\leq 50\%$
Proposed Loan Amount $< 60\%$ LTV	Eligible	Eligible
Proposed Loan Amount $60\%-70\%$ LTV	Eligible	24-month Seasoning
Proposed Loan Amount $> 70\%$ LTV	24-month Seasoning	24-month Seasoning

Lean Handbook Changes: Eligible Debt

Other Key Changes

- **Operator Debt**
 - Tied directly to the Project
 - Identity-of-Interest with Borrower
 - Examples of Eligible Operator Debt:
 - Purchase of FF&E
 - Working capital during initial lease-up
 - Examples of Non-Eligible Operator Debt:
 - A/R Line of Credit financing
 - Acquisition of beds or Certificate of Need
- **Clarification on I-of-I Refinance**
 - 12 months of demonstrated NOI
 - For Turnarounds, proven track record of Operator



Lean Handbook Changes: Non-Profit Valuation

Chapter 5 Appraisals and Market Studies, Section 5.7

- Lean seeks **As-Is Market Value** assuming all repairs completed
- Non-profit operators do not always maximize Project cash flows
- Lean believes it appropriate for Appraisers to adjust staffing ratios, employee benefits, food service, etc. to assume Market Value
- If Appraiser believes operations would change via a market-based sale, then additional costs/risks must be considered:
 - Lower Capitalization Rate
 - Reduction in Market Value
 - Discounted Cash Flow Analysis
- **Restricted Value** must also be developed by Appraiser



Lean Handbook Changes: Other Changes

Other Notable Changes

- **Facility Requirements for ALF, ILF and B&C projects** changed from a minimum of 5 units to a minimum of 20 beds
- **232/223(a)(7) Application Fees** reduced to a single up-front fee of 0.15% with no post-closing refund
- **232 New Construction R4R Calculation** no longer based on $0.0060 \times \text{Structures} + 0.10 \times \text{MME}$
- **PCNA reports** must now be dated within 180 days of application submission
- **3-year lookback on state surveys** completed for Operator's portfolio now limited to only SNFs
- **Insurable Value (Property)** based on 90% of Replacement Cost. If not included in PCNA, then use industry-recognized software (Marshall & Swift, etc.)
 - The Appraiser's Replacement Cost New should not be used to determine Replacement Cost

Lean Environmental



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Lean Handbook Changes: Radon Testing

Chapter 7 Environmental Review, Section 7.8

- **Radon Testing** now required for all Section 232 loan applications
 - Includes A7 and 223f refi of existing HUD loan
- HUD environmental review panel determined that EPA's advisory notes there can be elevated radon levels regardless of geographic location- therefore, the former approach is no longer valid
- The existing EPA maps were created to assist in development of building codes and do not necessarily reflect actual radon concentrations
- There is an exception to this, where the loan may be approved without testing provided the environmental consultant (radon professional) can demonstrate successfully that the property is in Zone 3 and data shows low

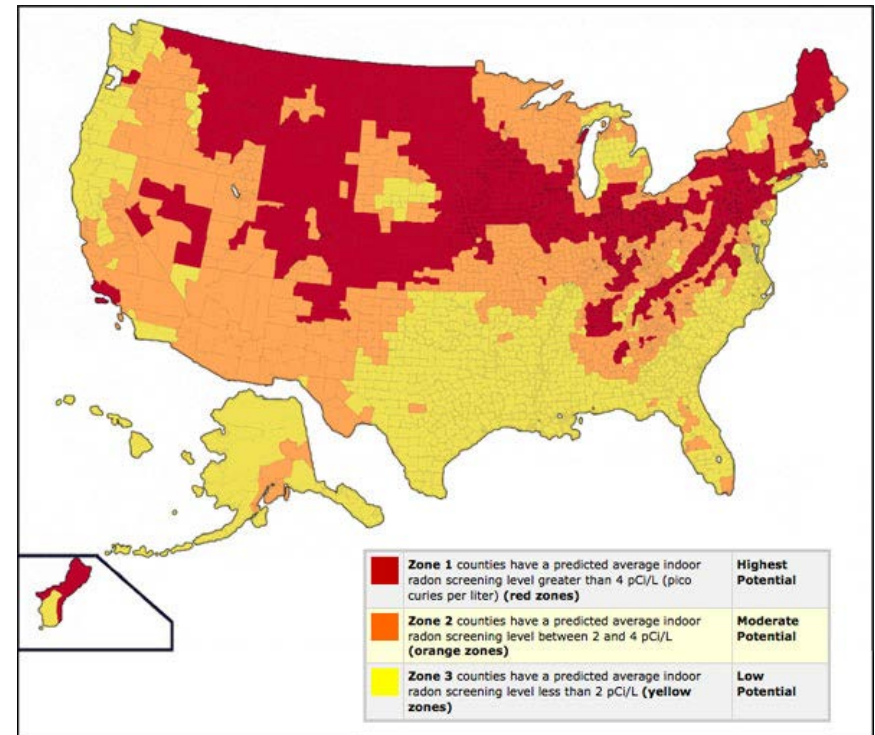


Lean Handbook Changes: Radon Testing

Testing Protocols

Radon Testing Protocols

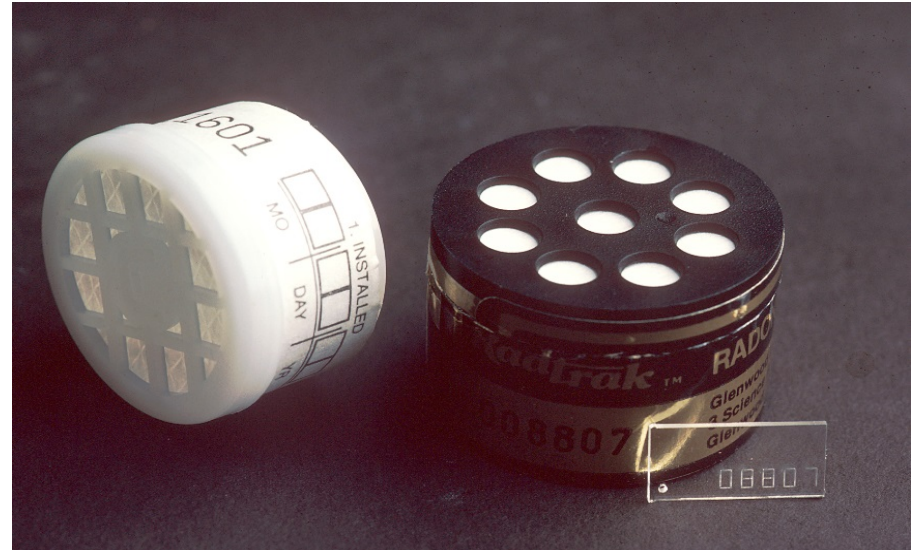
- Must follow the protocols set by the American Association of Radon Scientists and Technologists, Protocol for Conducting Measurements of Radon and Radon Decay Products in Schools and Large Buildings (ANSIAARST MALB-2014)
- Test 25% of ground level units/rooms in each building within one year of submission
- If any of the tests exceed EPA action level, then you must either perform mitigation or test 100% ground level units/rooms
- If after the 100% ground level testing any units/rooms test above 4.0 pCi/L level, then mitigate the units with high test results.



Lean Handbook Changes: Radon Testing

Certified Professionals Required

- **Radon Professional Qualifications**
 - American Association of Radon Scientists and Technologists (AARST)
 - National Radon Proficiency Program (NRPP)
 - National Radon Safety Board (NRSB)
 - Licensed in the state (where applicable)
- A Radon Professional may conclude that neither testing nor mitigation is necessary based on a physical inspection of the property, the characteristics of the buildings, and other valid justifications. An example of a valid justification is having only a garage on the surface level that is open to the air and is fully ventilated



Lean Handbook Changes: New Floodplain Rule

Building to the Federal Flood Risk Management Standard (FFRMS)

- **FR-5717-P-01 Floodplain Management and Protection of Wetlands**
 - Minimum Property Standards for Flood Hazard Exposure
 - Building to the Federal Flood Risk Management Standard
- Requires a HUD assisted or financed project involving new construction or substantial rehabilitation that is situated in an area subject to floods be elevated or “floodproofed” between 2 and 3 feet above the base flood elevation



Lean Handbook Changes: New Floodplain Rule

Building to the Federal Flood Risk Management Standard (FFRMS)

- Revises a categorical exclusion available when HUD performs the environmental review under the National Environmental Policy Act (NEPA) and related Federal laws
- The new rule makes consistent with changes to a similar categorical exclusion that is available to HUD grantees or other responsible entities when they perform these environmental reviews.
- The new rule will make the review standard consistent, regardless of whether HUD or other federal grantee is performing the review.



Lean Asset Management



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Lean Handbook Changes – Asset Management

Production Changes Affecting Servicing and Asset Management

- **Facility Operator Single Asset Entity (SAE) Requirements**
 - Production, Section 2.5, Paragraph C
 - ORCF was previously willing to entertain waivers to the Operator SAE requirement for Change of Operator and TPA requests
 - Specific criteria for approval of an Operator entity that is not a SAE
 - Opportunity for an Operator to convert to a non-SAE entity during a TPA (Section 2.5.C.3)



Lean Handbook Changes – Asset Management

Production Changes Affecting Servicing and Asset Management

- **Initial Operating Deficit and Working Capital Escrows**
 - Clarification of when unused portions can be returned to the borrower after final endorsement
 - "12 months and..." instead of "the later of 12 months or..."
 - For IOD Escrow, decrease in number of months, but increase of DSC benchmark
 - Previously a "predetermined number" of months at "break-even"
 - Now 3 consecutive months of 1.45x
 - Escrow Agreement will still be the controlling document



Lean Production: Queue Update

Servicing and Asset Management Changes

- **Monitoring of Construction Projects**
 - Asset Management, Section 3.1
 - Formalizes the concept of a “Lease-Up Account Executive”
- The “Lease-Up AE” will service the property until sustaining occupancy
- Mortgagee/Servicer responsible for convening the “Project Monitoring Team” and monitoring progress during lease-up



Lean Handbook Changes – Asset Management

Servicing and Asset Management Changes

- **Reserve for Replacement Escrow (Section 3.2.2)**
 - Removal of \$500 minimum requirement
 - Clarification of items eligible/ineligible for R4R
 - Removal of requirement to obtain three bids for items in excess of \$50,000
 - Invoices do not need to be submitted to ORCF, but must be retained for three years
 - Approval of advances for delegated lenders



Lean Handbook Changes – Asset Management

Servicing and Asset Management Changes

- **Non-Critical Repairs (Section 3.2.4)**
 - No requirement for holdback/retainage on interim draws.
 - Mortgagee/Servicer may require at their discretion
 - Latent Defects Deposit
 - Only required when the total cost of NCR exceeds \$1,000,000
 - Timing of Completion of Repairs
 - Both delegated/non-delegated lenders may approve 6 month extensions. Extensions >6 months require ORCF approval
 - Options for excess NCR funds at closeout/final draw
 - Delegated lenders can approve **both** interim and final draws



Lean Handbook Changes – Asset Management

Servicing and Asset Management Changes

- **Transfer of Physical Assets (TPA)**
 - Asset Management, Chapter 7
 - Alignment of Handbook with new Previous Participation Rule
 - Clarification of a Full TPA vs. a Modified TPA
 - Clarification on TPA review fees
 - Substitution of principals (Modified TPA) that result in a change of control will be subject to the TPA review fee
 - No fee for transactions where both parties are non-profit



Questions *and* Answers



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