



U.S. DEPARTMENT OF HOUSING AND URBAN DEVELOPMENT
WASHINGTON, DC 20410-8000

OFFICE OF HOUSING

March 6, 2015

MEMORANDUM FOR: All Section 232 Lenders/Serviceicers, Borrowers and Operators

FROM: Tim Gruenes, Director of Asset Management,
Office of Residential Care Facilities

SUBJECT: Implementation of Quarterly Operator Financial Statements

Summary:

- Quarterly balance sheets and income statements are required for **all** Section 232 FHA-insured projects.
- If you operate on a calendar year, the reports must be sent to the Lender (via the online 232 Healthcare Portal or email) by May 31 for the first quarter of 2015.
- The financial statements should be quarterly fiscal year-to-date and reflect operations at the facility level.
- You will receive an email by March 9th to register for an online training about the 232 Healthcare Portal that may be used to submit the financial statements.

The purpose of this memorandum is to communicate the motivation and rationale behind this regulatory requirement, along with an explanation of the requirements for compliance. It is important for all new and existing Section 232 FHA-insured projects to fully understand these financial submission requirements, and to know that the Operator financial information must be provided by *all* Operators of projects with mortgages insured or held by HUD under Section 232, not just those that came into the Program after the Interim Rule was published. This also applies to entities that may refer to themselves by other designations (e.g., Management Agent), but that qualify as Operators based on HUD guidance.

The Strengthening Accountability Rule ([click here](#)) that was published on September 7, 2012 established the requirement for quarterly operator financials on Section 232 properties. This rule stated that operators would be required to comply with the operator financial statement provisions of the rule for project fiscal years commencing on or after the date that was 60 calendar days after the date on which HUD announced through Federal Register notice that it had issued guidance on the manner in which these reports will be transmitted to HUD. On October 3, 2014, HUD issued another Federal Register Notice ([click here](#)). This Federal Register Notice addressed the commencement of the requirement for quarterly operator financials and announced that HUD had issued guidance on the manner in which these reports will be transmitted to HUD (via ORCF's website, [here](#)). In accordance with this Federal Register Notice, the requirement for quarterly financial reporting begins for project fiscal years commencing on or after December 2, 2014.



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For the great majority of Section 232 projects (that are on a calendar year fiscal year), this reporting requirement begins with the first quarter of calendar year 2015. For these projects, the first quarter financials will be due at the end of May, 2015 (60 days from the 1st quarter end). Operators will be required to submit quarterly information via their income statement and balance sheet. The data must be provided in a YTD format. It is important that this information be provided at the facility operations level; therefore, in a master lease (or other portfolio) scenario, the information provided in the 232 Healthcare Portal must be for the facility operations only, and not for the other levels of the organization's structure above the facility.

The risk of a mortgage default on a residential care facility depends almost entirely on the facility's viability as an ongoing business enterprise, with census-related revenue exceeding all facility-related obligations including any operating lease or debt service obligations. The comparatively low claim rate that the Section 232 Program is currently maintaining does not itself reveal the enormous resources invested by HUD and lenders in "turnaround" efforts for mortgages that are in default—mortgages that might have avoided reaching such critical situations if more complete and timely data were available to the lender and HUD.

Even if related to the Borrower, a residential care facility Operator, is often legally distinct. Consequently, audited financials for the Borrower entity often do not shed much light on the financial viability of the facility as an ongoing business enterprise (e.g., expenses, income, and other financial information). This is primarily because they only provide information about the mortgage itself and/or the lease payments. Therefore, Operator financial statements are necessary. Additionally, operational problems often are not evident on the Borrower's financial statements until the Operator misses a lease payment and by this time, the facility's financial or operational problems may be acute or even irreversible. Moreover, *annual* reports are simply not sufficiently frequent given the nature of a residential care facility's operations, including:

- Licensure and funding issues that can immediately arise in connection with monitoring by state regulatory and funding agencies.
- The significant pace at which the census—and thus essential revenue—can unfavorably change due to numerous deaths or to publicized patient care/operational issues.

Per the Accountability Rule (5.801), these financial statements, at the Operator's option, may be operator-certified rather than audited, provided, however, if the Operator is also the Borrower, then that entity's obligation to submit an annual audited financial statement (in addition to its obligations as an Operator to submit financial information on a quarterly and YTD basis) remains and is not obviated. Further, HUD may, on a case-by-case basis, require audited financial statements from the Operator. This would only be a tool used in warranted situations, and would not be required unreasonably or unjustly by HUD.

Since the operational financial information is as important as the annual audited financial submissions provided by the Borrower, the same requirements for submission timing and failure to submit the information will apply. The requirements are regulatory, and as such, failure to provide



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the required information could result in the project being referred to HUD's Departmental Enforcement Center (DEC), a Notice of Violation could be put in place, and potentially civil money penalties could ensue.

If an Operator fails to submit the required financial information in the appropriate timeframes, the Borrower will ultimately be responsible for obtaining and submitting the documentation. Lender/Service involvement may be required to determine if there are any other ongoing circumstances preventing the submission, and to assist with efforts toward a solution for compliance.

An overview of the online submission process, as well as all instructions, authorizations, and a financial reporting template for the 232 Healthcare Portal can be found on the following Section 232 webpage:

http://portal.hud.gov/hudportal/HUD?src=/federal_housing_administration/healthcare_facilities/residential_care/Operator_Financial Stmt. **Each Lender must reach out to their portfolio of projects to establish the method for Operators to begin submitting the quarterly and YTD information.** Though some Lenders may already have established protocols for collecting quarterly financial information, and some Operators may already be submitting this data, these new requirements are for HUD to collect the data as well, and Lenders will be notifying you of what, if any, changes may need to occur in their information collection process.

An online training session will be provided by ORCF to discuss the Operator Financial requirement and introduce you to our 232 Healthcare Portal. The training is scheduled on the three consecutive days during the time listed below. Please note that each webinar session is the same, and it is only necessary to attend on one date.

Date: March 18-20, 2015

Time: 2:00 PM – 2:30 PM (Eastern)

By **March 9, 2015**, each Operator will receive an email address to register for this training. If you have not received the training invitation by this date, please send an email to hhcp@hud.gov. This email address may also be used for any other questions or concerns not addressed here or on the website.

As stated in the Accountability Rule (232.1015), the Healthcare Regulatory Agreement – Operator (form HUD-92466A-ORCF), and set forth in in the Section 232 Handbook 4232.1, Section III, Asset Management, Chapter 3.10.5, there are requirements for prompt notification of circumstances placing the value of the security at risk. This includes (but is not limited to) failure to comply with governmental requirements; any violations of (or default under) any of the permits and approvals or any governmental requirements applicable to the operation of the facility; any civil money penalties; and/or any investigations or inquiries involving fraud. These notifications must be provided within two (2) business days of the occurrence. Unless otherwise requested by HUD or Lender, the initial communication from the Operator pursuant to this requirement shall be a notice by email to the



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Lender describing the conduct cited, the scope and duration of remedy(ies) imposed, and the timelines for corrective actions. The section goes further to require that the Operator shall provide additional and ongoing information as requested by the Borrower, Lender or HUD, pertaining to matters related to such risks, and applies to *all Operators* as of October 9, 2012. Concerns relating to the financial operations of the facility, as well as failure to comply with the quarterly and YTD submissions would fall under this provision.