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Making the Most of HUD for Senior Living Construction

The pros, the cons, and why every Owner should assemble their HUD experienced project team early in the game.

By William A. Nicholson, CEO,
The Congress Companies



Much has been discussed about the pros and cons of the HUD 232 New Construction or Substantial Rehabilitation (sub-rehab) program for the financing of Skilled Nursing and Assisted Living construction. Although challenges do exist, there are certainly ways to make the program work effectively for health care projects.

The Advantages

While there is no “free lunch” with HUD, there are significant advantages to HUD 232 construction loans. **The HUD program is the only 40-year, fixed rate, non-recourse health care facility construction loan program.** The program’s interest rates are extremely competitive. The 232 program provides construction financing and permanent financing, so the risk of interest rate exposure is well managed. The fact that HUD loans are non-recourse loans is undoubtedly an attractive consideration.

HUD’s construction period plus 40-year amortization has a significant positive impact on the cash flows of the facility once it is built and operating. While HUD’s loan to values are not what they once were, 80% for nursing and 75% for assisted living (85% and 80% respectively for nonprofits) are certainly competitive in today’s environment. Also, the ability to use the project’s land at appraised value (vs. cost) in the loan underwriting often represents a significant positive impact on cash requirements in instances where sites are appraised at a value significantly higher than their original cost.

The Challenges

The challenges exist, but they can be addressed. Davis Bacon (federal prevailing) wages apply, increasing the hard costs of construction, particularly outside of urban areas. In states that allow wood frame construction of assisted living facilities, this has a particularly significant impact. The processing time has been a significant concern over the past two to three years, since the implementation of HUD’s LEAN process, which centralized nationwide the processing of nursing and assisted living projects in Seattle, WA. Fortunately, those with applications pending have seen significant improvement in process times very recently, since HUD has added and trained staff in an effort to reduce the queue of HUD loan applications.

The HUD process, to those unfamiliar with it, can be imposing. In order to file and receive full processing, an essentially completed application is required, including 100% Construction Documents (plans and specifications), environmental studies, market studies, appraisals, and third party reviews of all documents. Often, when a HUD application is filed, it is not certain when construction will actually start. Reprocessing the application for time-driven changes in costs is a never ending, circular, and ineffective strategy, so appropriate projections must be incorporated into the budgets when submitted.

HUD also imposes certain restrictions which can be challenging and expensive, including UFAS compliance, and other construction and design criteria. Wage and hour compliance during construction are time consuming, but nonetheless are a requirement in order to properly manage and close out construction with HUD.

Lastly, if the process of closing out the construction phase and converting to the permanent phase of the loan (“Final Endorsement” in HUD language) is mismanaged and not promptly or properly submitted by the project team, expensive and unnecessary financing penalties to the Owner may result.

These all represent significant challenges for the project team. Construction pricing and design must comply with HUD’s formal requirements as well as their expectations, policies, practices, and “how things are done.” This institutional knowledge has developed over decades of practice at HUD, pertaining to the pre-construction, construction, construction closeout and post-construction periods.

What does this mean to Owners planning to undertake an Assisted Living or Nursing construction project under the HUD 232 Construction Loan program?

In our opinion, it means first, that Owners are well-advised to assemble their design, construction, and HUD Lender team up front and very early on in the project, as design and concepts are being formulated. Second, Owners are well-advised to make sure the team is thoroughly HUD and product type experienced. These are critical factors and there are no substitutes.

Certainty of Cost

The HUD process requires accurate estimates of cost very early and then progressively through every stage of the HUD process. Without experienced professionals in every discipline (Architect, Engineers, General Contractor, and HUD Lender) during design and pre-construction phases, certainty of cost is impossible to achieve.

Certainty of cost is critical not only to the pre-construction phase, but through construction and close out. Certainty of cost speaks to the end of project cost at its completion, and must meet the Owner's and HUD's requirements. The most important concept, particularly in view of how contingencies are handled, is that the cost at the end, not just at the beginning, is what really matters. Getting the scope correct (that is, by meeting all of HUD's requirements and your operational requirements) is exponentially more important than the "low hanging fruit" of an unqualified low "cost per square foot" promise.

With the recent HUD LEAN two-stage submission, even the preliminary loan submission must be "sized" properly in order to avoid wild swings in equity and cash requirements to successfully close the loan. This simply underscores the need for certainty of cost, given HUD implications, at the beginning of the project's development.

All of the team members, including the General Contractor, the Architect, and the Engineers, HUD Lender, Appraisers and Market Study consultants, should be thoroughly experienced in HUD and in the particular building type under HUD 232 Loans. All of the team members must be prepared to participate in and contribute to proper scope analysis, cost projections, and planning from the initial concept of the project through the completion of construction and HUD Final Endorsement.

HUD's personnel really want to help our projects.

HUD's goal is not to obstruct projects, as inexperienced General Contractors, Architects or other team members often lament. Rather, HUD's goals are to expedite processing and work, and to ultimately ensure that a good building is built.

At the same time, in order for project Owners to make the most of HUD's advantages, the project team must be prepared for HUD's challenges, issues, processing, and experientially generated processes. If HUD procedures are not respected or followed properly in a HUD 232 project, the project will suffer. Everything from the initial application, managing all contingencies, changes, monthly advances, stored materials, FF&E management, working with HUD's inspecting CM's, closeout, and Davis Bacon compliance to a plethora of other issues simply must be done the HUD way.

On the other hand, a well-managed HUD project, executed with total HUD compliance, can be an excellent construction experience.

We have found HUD LEAN personnel in all departments to be extremely supportive. We've seen the personnel at HUD LEAN in Seattle go out of their way to assist, problem solve, and expedite projects for teams working within HUD's parameters. We have found that HUD personnel apply HUD regulations in a real world fashion with appropriate discretion. This results in properly functioning projects for the benefit of the Owner and the Project Team, while concurrently protecting HUD's and the Lender's interests appropriately.

While the HUD process does provide certain guidelines and challenges, with the right team in place early in the project, there certainly is a place for the HUD 232 Construction/Permanent loan program in the construction of Assisted Living and Skilled Nursing projects.

The Congress Companies has successfully completed construction under HUD's LEAN program on over 30 HUD insured and funded health care projects, including Assisted Living, Skilled Nursing, Board and Care, Independent Living, and other Senior Living projects. Congress enjoys a rewarding, valuable, and open relationship with the HUD LEAN team, and with most of the major HUD Lenders across the nation.