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*REPORT TO THE
HOUSE COMMITTEE ON
BANKING, CURRENCY, AND HOUSING*

*BY THE COMPTROLLER GENERAL
OF THE UNITED STATES*

Circumstances Surrounding
Approval Of Mortgage
Insurance For Cedars
Of Lebanon Hospital

Departments of Health, Education, and Welfare
and Housing and Urban Development

This report describes events which took place from the first application, in 1969, for mortgage insurance by Cedars of Lebanon Hospital to final approval in mid-1971. Questionable procedures and decisions in two Federal Departments, apparently influenced by political interest, led to the approval of \$62 million of mortgage insurance.





COMPTROLLER GENERAL OF THE UNITED STATES
WASHINGTON, D.C. 20548

B-164031(5)

The Honorable Henry S. Reuss
Chairman, Committee on Banking,
Currency, and Housing
House of Representatives

Dear Mr. Chairman:

This report is in response to a May 24, 1974, letter from the Chairman of the Committee on Banking and Currency asking us to investigate why the Federal Housing Administration deemed it proper to provide mortgage insurance for Cedars of Lebanon Hospital and whether there was any undue political pressure related to the approval. This report discusses the events that took place from the time of the initial application for mortgage insurance to final approval.

As requested, we did not obtain written comments from the Departments of Health, Education, and Welfare and Housing and Urban Development. However, we did discuss this report informally with present and former officials of both Departments and their comments were considered in preparing it.

Subsequent to completing our field work, we were advised by an official in the FHA Insuring Office in Coral Gables, Florida, that in June 1975 Cedars of Lebanon Hospital had been provided with an additional \$6.4 million of mortgage insurance on loans to be used primarily for the purchase, rather than lease, of equipment for the new hospital building and to cover cost overruns. We did not investigate the circumstances surrounding the approval of the additional mortgage insurance.

A copy of this report is being sent to Congressman Wright Patman.

Sincerely yours,
James A. Strick

Comptroller General
of the United States

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ABBREVIATIONS

FHA	Federal Housing Administration
GAO	General Accounting Office
HCFS	Health Care Facilities Service
HEW	Department of Health, Education, and Welfare
HSMHA	Health Services and Mental Health Administration
HUD	Department of Housing and Urban Development
PHS	Public Health Service

COMPTROLLER GENERAL'S REPORT
TO THE HOUSE COMMITTEE ON
BANKING, CURRENCY, AND
HOUSING

CIRCUMSTANCES SURROUNDING
APPROVAL OF MORTGAGE INSURANCE
FOR CEDARS OF LEBANON HOSPITAL
Departments of Health, Educa-
tion, and Welfare and Housing
and Urban Development

D I G E S T

Cedars of Lebanon Hospital in Miami, Florida, applied several times between May 1969 and December 1971 for Federal mortgage insurance on loans to expand its facilities. These applications were processed several times either by the Department of Health, Education, and Welfare (HEW) or by the Federal Housing Administration of the Department of Housing and Urban Development.

A total of about \$62 million of mortgage insurance ultimately was approved for three projects, referred to as the "Hospital," "Professional Tower," and "Care Center."

By letter dated May 24, 1974, the Chairman, House Committee on Banking and Currency, asked GAO to investigate why it was deemed proper to provide mortgage insurance for the three projects and if there was any undue political pressure related to the approvals.

FIRST APPLICATION

Cedars' first application, in May 1969, was for \$25 million of mortgage insurance to renovate and expand its hospital facilities. (See p. 5.)

Cedars' planned expansion included increasing its bed capacity from 252 to about 750. Local health planning agencies recommended to the appropriate State agency expansion to only 500 beds. Cedars appealed this recommendation.

In October 1969 the State agency issued a Certificate of Need, required by the Federal Housing Administration, for 700 beds--500 acute-care and 200 long-term-care beds. (See pp. 7 and 11.)

The chief of the State agency told GAO that its position did not conflict with the local agency's. The local agency's executive director disagreed, stating the local agency did not believe there was a need for additional beds in the area where Cedars was located. (See p. 11.)

Consideration of Cedars' application by HEW included a review by a consultant. Cedars was notified in December 1969 that its proposal had been approved and that it should apply formally to the Federal Housing Administration through its lenders for mortgage insurance in the amount of \$25 million, the maximum authorized at that time. (See p. 12.)

From January to June 1970, the Federal Housing Administration rejected several proposals by Cedars to finance the difference between the amount of authorized mortgage insurance and the estimated construction cost--about \$10 million. (See p. 13.)

HEW and Department of Housing and Urban Development headquarters officials, a Member of Congress and his administrative assistant, and a member of the White House congressional staff were involved in these discussions. (See p. 13.)

GAO could not conclude that there was undue influence brought to bear on the Federal officials involved; however, the events which led to the approval of the mortgage insurance on the three properties indicate that the applications were not handled in a normal manner.

REVISED APPLICATION - HOSPITAL

On December 31, 1970, the Housing and Urban Development Act was amended to increase the maximum insured mortgage available to \$50 million. (See p. 14.) To obtain additional insurance, Cedars split the first project into three projects.

Eight days later, Cedars submitted a revised application for mortgage insurance showing total project costs of about \$55.6 million. (See p. 14.)

HEW submitted the revised application to the same consultant hired to perform the first feasibility review. He said of the new project: "I am firmly convinced that this concrete structure is built on a matchstick foundation." (See p. 14.)

The Department's acting regional program director concluded that the project could be classified as feasible for not more than a \$35 million loan guarantee--\$20.6 million less than Cedars' estimated total cost.

According to a May 5, 1971, Department memorandum a Cedars representative contacted "influential member(s) of the Executive Branch" complaining about the small amount of mortgage insurance that was being recommended.

Subsequently, the Administrator of the Health Service and Mental Health Administration directed that Cedars be contacted to get from it an appeal of the amount of mortgage insurance and, if such an appeal were made, that another consultant review the application and provision be made for a rehearing under the aegis of the Office of the Administrator. (See p. 16.)

The acting regional program director said it was not HEW's usual practice to hire a second consultant. The first consultant told GAO that

--he had made about a dozen other feasibility reviews for the Department and that this was the only one when the Administrator, Health Services and Mental Health Administration, became directly involved and a second consultant was hired and

--these actions indicated to him that pressure was being applied on someone in the Department.

The Director of the Department's Health Care Facilities Service agreed that this was the only case when a second consultant was used. He also pointed out that this was the only case where the positions of a consultant and

the agency had been challenged. The Administrator said that he decided to bring in another consultant because he wanted to "clear the air" surrounding this project. (See p. 16.)

The second consultant reported that, under certain conditions, Cedars should be able to repay a debt of between \$36 million and \$47 million and that a cash contribution of about \$10 million would be required.

Following a meeting between Cedars, HEW, and Federal Housing Administration officials, a revised application was submitted on August 30, 1971, requesting mortgage insurance for \$48,109,500, with an understanding that HEW's requirement that major movable equipment be purchased rather than leased would be waived. (See p. 18.)

On November 10, 1971, HEW's acting regional program director approved Cedars' application for \$48,109,500 in mortgage insurance. He told GAO that:

- He was very much against the project from the start because cost estimates seemed low and revenue projections high.
- However, after the second consultant was brought in, and because of pressure from Washington superiors who apparently had been similarly pressured, he simply gave up and signed the Certificate of Approval.

GAO could not ascertain how the figure of \$48.1 million was determined after the second consultant had recommended no more than \$47 million. He, in turn, stated publicly that he sent a letter in November 1971 to the Administrator, Health Services and Mental Health Administration, withdrawing his approval because of Cedars' numerous changes in its proposal. (See p. 19.)

HEW officials said the consultant's letter was never received. His reports therefore were accepted as final. (See p. 19.)

According to the closing documents for the Hospital project, the only cash required of Cedars was about \$1.1 million representing a portion of the discount paid on the mortgage. Furthermore, Cedars was not required to meet any of the conditions suggested by the second consultant and the Administrator. (See p. 19.)

REVISED APPLICATIONS--
PROFESSIONAL TOWER
AND CARE CENTER PROJECTS

On July 26, 1971, the Federal Housing Administration Insuring Office in Coral Gables, Florida, issued firm commitments to Cedars for

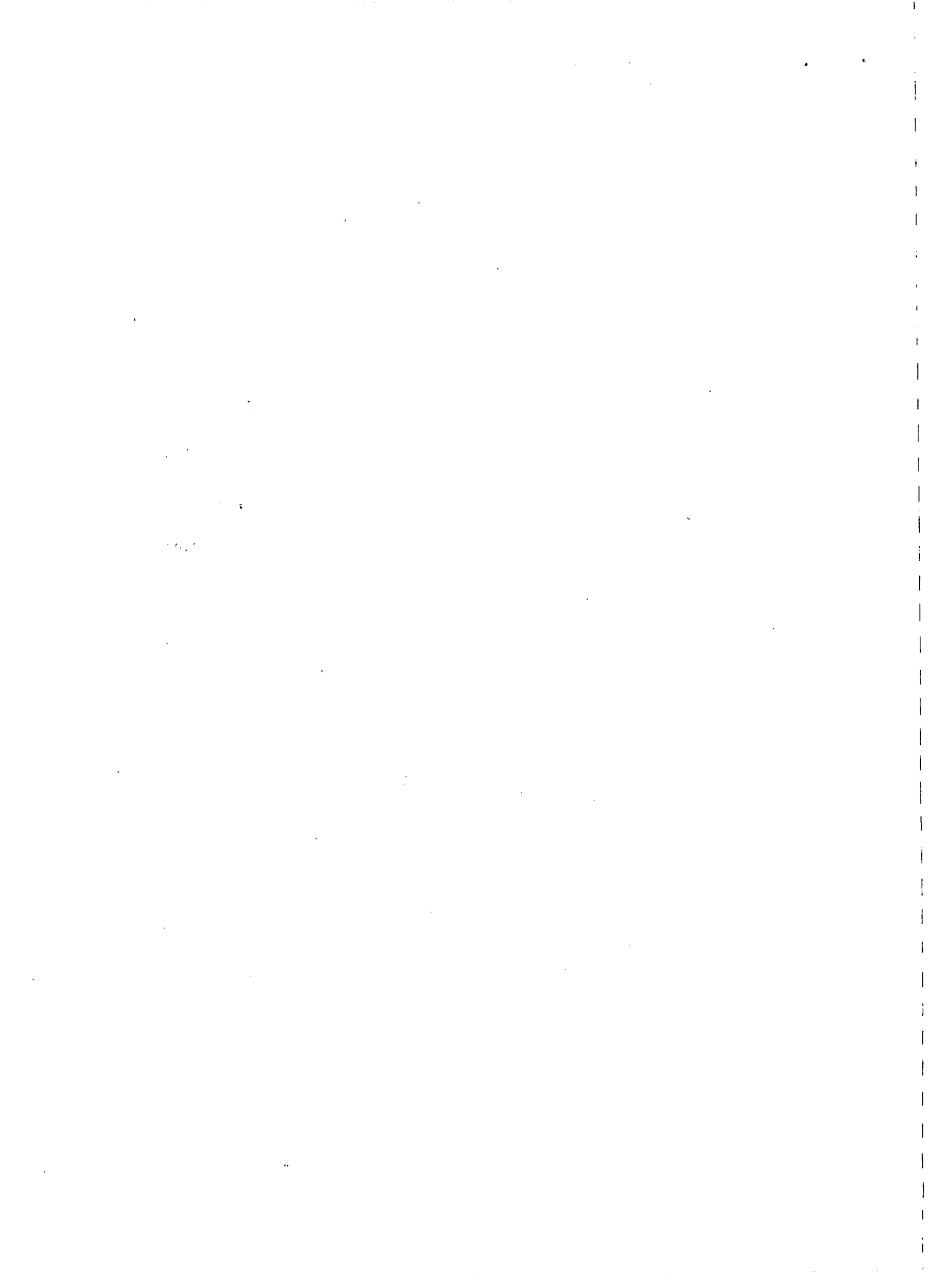
--\$10.9 million of mortgage insurance under section 221(d)(3) of the National Housing Act to construct the Professional Tower and

--\$2,924,100 of mortgage insurance under section 232 of the act to construct the Care Center. (See p. 21.)

Information at the Insuring Office indicated that the firm commitment amounts for the Professional Tower and Care Center were determined after the estimates of project income, expenses, and construction costs had been reconsidered by the Federal Housing Administration on several different occasions. (See p. 21.)

GAO was advised by the Insuring Office's deputy chief underwriter that the end result for the Professional Tower was a gross fabrication and that, as far as he was concerned, there was no support for the estimated income and expenses and that the debt service costs could not be met.

In addition, the Insuring Office never received a required Certificate of Need for the beds in the Care Center and several waivers of Federal Housing Administration requirements for nursing homes were obtained. (See p. 21.) Insuring Office personnel also told GAO about pressure put on them to complete their work on the Professional Tower and Care Center project applications. (See pp. 32, 33, and 34.)



CHAPTER 1

INTRODUCTION

Cedars of Lebanon Hospital is located in Miami, Florida, in an area heavily concentrated with health and hospital services. (See app. I for a listing and location of area health facilities.)

The hospital was incorporated under the name of Cedars of Lebanon Hospital Corporation in October 1959 as a non-profit entity to construct, establish, maintain, and operate a hospital. The hospital opened with 108 beds in 1961 and had 252 beds by 1964. Subsequently, a master site plan was developed calling for 569 beds by 1969 (later revised to 750 beds), additional ancillary facilities and parking, some staff housing, and a diagnostic clinic sufficient to serve at least 200 patients a day.

On November 13, 1970, Cedars of Lebanon Hospital Tower, Inc., and Cedars of Lebanon Hospital Care Center, Inc., were established. According to the articles of incorporation, the former was to provide:

"* * * auxiliary facilities for Cedars of Lebanon Hospital Corporation * * * including * * * buildings for staff housing or for ambulatory cases or accommodations which will be available to patients using the hospital as an outpatient facility; together with parking and other structures and offices as are deemed necessary for the operation of said hospital."

The Care Center was to provide:

"* * * nursing home facilities and services for the accommodation of convalescents and other persons who are not acutely ill and not in need of hospital care, where no adequate housing exists for such groups * * *."

Applications were submitted and sponsored by Cedars of Lebanon Hospital Corporation for Federal Housing Administration (FHA), Department of Housing and Urban Development (HUD), mortgage insurance on loans for three separate projects, hereafter referred to as the Hospital, Professional Tower, and Care Center. As the sponsor, Cedars initiated and promoted development of each project through the approval stages. However, after FHA approved the applications, Cedars became mortgagor for only the hospital

loan; mortgagors for the Professional Tower and Care Center loans are the Cedars of Lebanon Hospital Tower, Inc., and the Cedars of Lebanon Hospital Care Center, Inc., respectively. The applications provided for construction and/or renovation as follows:

--The Hospital--500 new single-occupancy rooms; renovation of the existing 252-bed hospital to one of 200 beds; and a new building including an automated health-testing laboratory, an educational department, medical diagnostic suites and parking facilities for 750 automobiles.

--The Professional Tower--188 apartments of various sizes, professional office suites, 512 parking spaces, restaurant, food market, pharmacy, and swimming pool.

--The Care Center--112 rooms (224 semiprivate beds) and 184 parking spaces.

The Professional Tower and Care Center buildings are separated by a common wall.

Details on the three projects follow on next the page.

FHA project number	Hospital 066-13006NP	Professional Tower 066-35070NP	Care Center 066-43050NP
Legislative authority-- section of the Na- tional Housing Act	242	221(d)(3)	232
Date of:			
Initial application submitted	5-15-69	10-16-70	10-16-70
Insurance commitment approved (note a)	12-13-71	7-26-71	7-26-71
Initial mortgage endorsement (note b)	3-13-72	1-25-72	1-25-72
Final mortgage endorse- ment (note c)	Pending as of 5-30-75	1-31-75	1-31-75
Amount of mortgage insur- ance	\$48,109,500	\$10,900,000	d/\$2,924,100
Interest rate	7 percent	7 percent	7.5 percent
Period of mortgage (note e)	25 years	40 years	20 years
Mortgage advances as of 6-16-75	\$45,741,793	\$10,900,000	\$2,833,400

a/Upon completion of processing, the mortgagee is issued a firm commitment to insure a mortgage which includes a statement of the financial requirements to be met by the mortgagor and the conditions under which advances of the mortgage proceeds will be made.

b/When a project involves insurance of advances during construction, an initial endorsement of the loan occurs before beginning such construction and after all financial and other requirements called for in the commitment have been met.

c/FHA places its final endorsement on the mortgage note after the project has been completed, all required closing documents have been submitted, and all commitment conditions have been met.

d/Reduced to \$2,833,400 on January 31, 1975, subsequent to cost certification work.

e/Includes payment deferment periods of 6 months to 2 years.

The Professional Tower and Care Center were completed in October 1973 and as of May 5, 1975, the Hospital was reported to be 96 percent complete. As of June 16, 1975, the 188 apartments in the Professional Tower were 95 percent occupied, but only 1 office suite (representing about 8 percent of available office space) was rented. Shortly after the Care Center was completed, it was used for several weeks as a motel; however, FHA ordered this use discontinued and as of June 16, 1975, none of the 112 rooms was occupied.

On April 5, 1974, all three corporations filed bankruptcy petitions which were subsequently consolidated under chapter XI of the Bankruptcy Act (11 U.S.C. 701 et. seq.). At the time of filing, Cedars' liabilities were estimated at \$9 million, of which about \$6 million was unsecured. Since April 1974, a court-appointed receiver has been operating the facilities.

On November 11, 1974, the Social Security Administration filed a preliminary claim against Cedars in the U.S. District Court for about \$2.7 million, representing overpayments for services provided to Medicare patients from October 1, 1970, through April 5, 1974.

By letter dated May 24, 1974, the Chairman, House Committee on Banking and Currency, asked us to investigate why FHA deemed it proper to provide mortgage insurance for the three projects and if there was any undue political pressure related to the approvals.

We visited HEW and FHA headquarters; the HEW regional office in Atlanta, the FHA Insuring Office in Coral Gables, Florida; State and local health agencies in Tallahassee and Miami, Florida, respectively; and the three projects in Miami to examine the circumstances surrounding the approval of mortgage insurance. We specifically sought information on:

- The Certificates of Need issued for the Hospital and Care Center.
- The financial feasibility studies made of the three projects.
- Any political pressures related to approval of mortgage insurance.

CHAPTER 2

INITIAL APPLICATION

The Housing and Urban Development Act of 1968 added section 242 to title II of the National Housing Act (12 U.S.C. 1715z-7) which authorized the Secretary of HUD to insure mortgages not to exceed \$25 million on new or rehabilitated nonprofit hospitals.

On May 15, 1969, Cedars submitted its initial project application for mortgage insurance. The project involved (1) remodeling the existing 252-bed hospital to become a rehabilitation center and (2) an expansion program, which included construction of (a) a new hospital building with indoor parking facilities; (b) a building for ambulatory patients, staff housing, and indoor parking facilities; and (c) a service and mechanical building. Project cost, estimated at about \$34.9 million, was distributed as follows:

	(millions)
Construction contracts and contingencies	\$30.8
Movable equipment	2.4
Architect's fees, supervision, and inspection at the site	<u>1.7</u>
Total	<u>\$34.9</u>

Before Cedars submitted the application, a Member of Congress and representatives of Cedars, HEW, and HUD met on March 12, 1969, in Washington, D.C., to discuss mortgage insurance for Cedars' project. According to the meeting's minutes, the Congressman explained his interest in the project by stating that he had supported the aforementioned legislation and had discussed the matter with the President with a view toward making this either a pilot project or one of the first to be approved. During the meeting, agency officials explained that, although regulations, instructions, and forms were not yet in final form to implement section 242, they could proceed.

NEED FOR EXPANDED FACILITY

FHA could not insure mortgages for nonprofit hospitals under the Housing and Urban Development Act of 1968 unless a Certificate of Need for the project had been obtained from a State agency designated in accordance with section

604(a)(1) of the Public Health Service (PHS) Act (42 U.S.C. 291d). The State agency administered the program for the construction and modernization of the State's health facilities.

In Florida, the Bureau of Community Medical Facilities, Department of Health and Rehabilitation Services, was the designated State agency responsible for (1) compiling the Florida State plan for construction of hospitals and medical facilities under the general provisions of title VI of the PHS Act and (2) issuing Certificates of Need. The State Advisory Council, appointed by the Governor, advised and consulted with the Bureau of Community Medical Facilities in implementing the State plan. The 12 appointed members included representatives of nongovernmental organizations or groups and of public agencies concerned with operating, constructing, or utilizing hospitals or other related facilities and an equal number of consumer representatives familiar with the need for services such facilities provide. The chief of the Bureau of Community Medical Facilities served as an ex officio member of the Advisory Council.

Although the Bureau of Community Medical Facilities ultimately decides whether to award a Certificate of Need, section 204 of the Federal Demonstration Cities and Metropolitan Development Act of 1966 requires that the local planning agency--in this case the Metropolitan Dade County Planning Department--comment on the need for additional hospital facilities. In addition, comments were to be solicited from the areawide health planning agency as defined under paragraph 314(b) of the Partnership for Health Amendments of 1967; the areawide agency was the Comprehensive Health Planning Council of South Florida.

On January 18, 1969, HUD delegated to HEW the authority to review proposals for mortgage insurance on hospitals under section 242. HEW, through the Health Care Facilities Service of the Health Services and Mental Health Administration (HSMHA), ^{1/} processes such proposals and determines approvability. FHA's decision to provide mortgage insurance is based on HEW's determination.

ACTIONS BY PLANNING AGENCIES AND COUNCILS

Several months before Cedars submitted a mortgage insurance application, the Metropolitan Dade County Advisory

^{1/}Effective July 1, 1973, this Administration was abolished and PHS was reorganized into six health agencies under the direction and control of the Assistant Secretary for Health.

Board (which advises the county commissioners on hospital matters) had reviewed and recommended approval of Cedars' plans to expand its facilities and bed capacity to about 750. However, when Cedars applied for mortgage insurance, the Metropolitan Dade County Planning Department and the Comprehensive Health Planning Council of South Florida recommended expansion to only 500 beds. Cedars appealed this recommendation to the Bureau of Community Medical Facilities and the matter was referred to the State Advisory Council. Based on the council's recommendation, Cedars was issued a Certificate of Need in October 1969 for 700 beds.

Actions taken by the local and State agencies and councils are discussed below.

Local agency and council

In September 1968 the Metropolitan Dade County Hospital Advisory Board issued a "to whom it may concern" recommendation that Cedars' bed capacity be expanded from 252 to approximately 750 in accordance with schematic drawings submitted at the board meeting. Cedars' administrator was a member of the board. The director of the Metropolitan Dade County Planning Department said the board's recommendation was merely an endorsement, in response to Cedars' administrator's efforts to obtain support for Cedar's expansion.

In May 1969 Cedars requested the Metropolitan Dade County Planning Department to review and comment on its application, which was described as follows in the request:

"This hospital proposes a new addition, plus renovation of the present facility, which would provide the following: A new 550-bed general acute hospital to encompass comprehensive services in all categories with special emphasis upon diagnostic services and preventive medicine. The present 252-bed facility to be renovated for use as a comprehensive 200-bed, short-term rehabilitation hospital with supporting facilities, as an integral part of the total complex."

The planning department invited the Comprehensive Health Planning Council of South Florida--the recognized areawide health planning agency--to participate in the application's review.

In response to this request, an eight-member study committee from the council's board of directors, assisted

by the associate director of the Health and Hospital Planning Council of Southern New York, prepared an "Analysis of Dade County's Hospital System and the Cedars of Lebanon 1969 Proposal," containing the following summary:

"The essence of this report is that there is not a critical shortage of general, acute care beds in this community at this time. * * * There are some hospitals that are running at an unusually high occupancy, of which Cedars is one. An attempt should be made to find the appropriate ways to relieve this pressure * * * but the construction of additional beds should come only if it is determined that such beds are in the best interests of the total community.

"The Cedars of Lebanon Hospital should have some additional beds but not 550 new beds. The number of additional beds which Cedars needs cannot be determined out of context with the Medical Center across the street. This number of beds should be determined through joint planning between Cedars and other components of the Medical Center. The number of beds at Cedars should not exceed 440 - 500 after future construction; and over a five year period there should not be a net addition of beds to the total beds now in the Medical Complex.

"An Ad Hoc Committee should be appointed by the Health Planning Council's Board to bring the Medical Center and Cedars together for the purpose of moving quickly to determine the additional beds which will relieve Cedars' need for additional beds and will move it toward becoming an integral part of the Medical Center." (Underscoring added.)

The committee's report was approved by the board of directors at its July 1969 meeting, by a vote of 18 to 1. Cedar's administrator, a board member, was present at the meeting.

Subsequently, the county's planning department informed Cedars that:

"It is our determination that the proposed project for which the Cedars of Lebanon Hospital has made application for Mortgage Insurance is

not consistent with comprehensive planning for health and medical services and facilities which is currently underway within the Dade County metropolitan area. * * *

"Although our review concludes that your application in its present form is not in accord with the ongoing comprehensive planning program, * * * a modification of your application based on coordination of plans with the Medical Center could result in an acceptable project that would be in accord. Therefore, it is our hope that you will participate in the Ad Hoc Committee which has been appointed by the President of the Health Planning Council and directed to report back to the Council at its August 21, 1969 meeting."
(Underscoring added.)

The Ad Hoc Committee of 11 included Cedars' administrator and 2 other Cedars' representatives. The Committee's report to the council's board at its August meeting contained the following recommendation:

"That the Health Planning Council Board recommend to the Hill-Burton agency that Cedars of Lebanon Hospital should proceed as rapidly as possible with the construction of 250 additional beds with appropriate supporting services and facilities." (Underscoring added.)

The board approved the report by a vote of 10 to 1.

In transmitting a copy of the Ad Hoc Committee's report to the Florida Bureau of Community Medical Facilities, the council's president stated, "I feel that this work represents the involvement and input of a representation of a broad segment of the Dade County Community and is sound."

State agency and council

Cedars appealed the Ad Hoc Committee's recommendation and the chief of the State's Bureau of Community Medical Facilities deemed it advisable to refer the matter to the State Advisory Council. The chairman of the Advisory Council appointed a subcommittee of four, including himself, to review the matter. The Chairman made two trips to Miami to discuss the project with Cedars and representatives of the Comprehensive Health Planning Council of South Florida.

State Advisory Council minutes of an October 7, 1969, meeting indicate considerable discussion questioning the expertise of the local council committees in this matter; the soundness of their reports; the advisability of further study by the local council; and the type of beds and services needed in the Miami area. According to the minutes, after a brief recess during which members of the subcommittee had a conference, the following statements were made:

The Chairman said,

"the fact finding committee found the following things to be of significance: (1) There is a real need for beds at the Cedars of Lebanon. (2) They also found that the hospital was well planned. They were ready to start construction immediately. * * * (3) Statements were made in the recent past by the Council itself that it felt itself young, inexperienced and unable to make major decisions until a thorough and complete study was made. We cannot agree with the Council's conclusion that no more new beds are needed * * * We should point out another thing that we did not recognize its importance at that time. But plans were suggested by the Cedars of Lebanon's administrative staff that the present 250 beds be converted to long term care." 1/

The Chief, Bureau of Community Medical Facilities, said,

"the comprehensive Health Planning Council of Dade County was established less than a year ago and has not had time to do complete studies in all phases of services at all types of medical facilities. They have concentrated mostly on acute facilities. The Cedars of Lebanon first proposed to establish a 500 acute bed addition to their facility. Then Cedars came back and said they had discussed it with the medical staff and they agreed to convert the old 250 bed hospital into an extended care facility and then

1/On September 20, 1969, Cedars sent the Bureau of Community Medical Facilities additional information pertaining to their application. The transmittal letter included the following: "Our present hospital of 252 beds will be converted to a hospital based extended care facility of approximately 200 beds * * *."

comply with the 500 acute bed limit set by the Comprehensive Health Planning Council. The Comprehensive Health Planning Council has never given us anything in writing approving or disapproving this. There were no studies made as to the number of nursing home or extended care beds needed in the area."

The Chairman said,

"this was our out. Everyone understands the Comprehensive Health Planning Council of Dade County has approved a total of 500 acute beds. If we feel the extended care unit is needed, then we can stipulate that the existing 250 beds must be converted to long term care."
(Underscoring added).

The Executive Director of the Florida Hospital Association said "there were no other extended care beds in the immediate area. * * *"

A subcommittee member moved that

"the Advisory Council agree to certify the need for 500 acute beds for the Cedars of Lebanon project as approved by the Comprehensive Health Planning Council of Dade County. This certification is contingent upon the conversion of the existing plant into a 200 bed long term care facility which is not to be used for acute medical care * * *."

The above motion carried and a Certificate of Need was issued on October 8, 1969, stating that there was a need for 500 acute beds and 200 long-term care beds at Cedars.

Comments by officials

The chief of the Bureau of Community Medical Facilities said the State Advisory Council's position did not conflict with that of the Comprehensive Health Planning Council of South Florida--the local council. He also implied that the local council lacked the expertise to make a hospital bed need study.

We discussed the above with the local council executive director who disagreed. He emphasized that the council did not believe there was a need for any additional beds in the Medical Center but, because some beds at the Jackson Memorial Hospital needed replacement and because Cedars was a good operation, it was agreed that an additional 250 beds would be recommended for Cedars provided a similar number at Jackson were eliminated. In response to a question on whether their study included long-term care beds, he replied that it was irrelevant since the Advisory Council had not made such a study and therefore had no reliable basis for its approval of the 200 long-term care beds. He also pointed out that, except for Cedars, the State's Bureau of Community Medical Facilities had approved all other local council recommendations.

The director and chief of the local council and Bureau of Community Medical Facilities, respectively, said that neither the 500 nor the 200 beds at Cedars has caused the overbuilt condition in the Miami area; rather, they attributed it to the many facilities constructed with private funds in the face of the agencies' disapproval.

FEASIBILITY REVIEW AND PROJECT APPROVAL

Because Cedars' original application, as described on page 5, was one of the first received, the HEW Atlanta regional office requested the assistance of HEW headquarters in Washington, D.C. HEW headquarters felt it lacked the expertise to determine the project's feasibility; therefore, the associate director and comptroller of the Massachusetts General Hospital was hired as a consultant to make a feasibility study. In his July 8, 1969, report to HEW's Director of Health Care Facilities Services (HCFS), the consultant summarized his findings as follows:

"The hospital has made an impressive financial record to date generating working capital and other capital funds through unorthodox procedures peculiar to the State of Florida and the financial policies of the institution.

"The ability to repay the loan in question is a definite possibility. If the current reimbursement practices of Blue Cross remain the same, the way is clear. If not, then, the Administration of the hospital must be ready to adjust to new circumstances.

"It is quite apparent to me that the principle consideration in evaluating this loan request is the competence of the management. If they are flexible enough to meet changing conditions as they arise, then the loan payments can be met. If the loan is granted, then the operating policies of the institution should be followed closely over the loan period."

The HEW Regional Program Director reported, on December 3, 1969, to his headquarter's office that,

"* * * Our analysis of the financial feasibility of the project is along the line of comments offered by (the consultant) who was asked to assist in the financial area. There appears no reason to believe that Cedars will not be able to meet its financial requirements."

The Director, HCFS, concurred with the region's determination and, on December 16, 1969, Cedars was notified that its proposal had been approved and that it should submit a formal application through its lenders to FHA for mortgage insurance of \$25 million--the maximum that FHA could insure at that time.

Efforts to finance the difference between the amount of authorized mortgage insurance and the estimated construction cost--about \$10 million--involved several telephone contacts and meetings between Cedars and HUD officials and at least two meetings between the Deputy Assistant Secretary of HUD and Cedars, during the period January to June 1970. A Congressman and a member of the White House congressional staff attended one of the meetings, and the Congressman's administrative assistant attended both. During this period, FHA rejected several proposals by Cedars on methods to finance the \$10 million, and during the following 7 months Cedars' expansion plans and requests for mortgage insurance were changed as described in the following chapters.

CHAPTER 3

REVISED APPLICATION--HOSPITAL

Between July and December 1970 the initial project was split into three projects--the Hospital, the Professional Tower, and the Care Center--as a means of obtaining additional mortgage insurance. Also, on December 31, 1970, the Housing and Urban Development Act was amended to increase the maximum insured mortgage under section 242 to \$50 million.

On January 8, 1971, Cedars submitted a revised application for \$50 million of mortgage insurance on the hospital project showing total project costs at about \$55.6 million. The principal changes in the revised application were:

1. The 550-bed general acute hospital was changed to a 500-bed general acute hospital.
2. One floor of the existing hospital would continue to be used for obstetrical patients and the remaining floors by postacute care patients.
3. A high-rise garage, apartment tower, postacute care center, and medical offices would be independent, separately financed structures.
4. Gross square footage was reduced from about 1.5 million to about 1 million.

FEASIBILITY REVIEW

The revised application was submitted by HEW to the associate director and comptroller of the Massachusetts General Hospital for a feasibility review.

In his April 14, 1971, report to the Director, HCFS, the consultant, noting that the hospital anticipated meeting its principal repayments from funds generated by depreciation and profits, concluded:

"* * * that this application is not feasible within the limits of protecting the interests of the Government for principal repayment within a twenty-five year period."

The consultant also reported that

--of the amount requested, \$35 million is for construction of the 500-bed hospital, amounting to about \$70,000 per bed without any allowance for movable equipment, architect's fee, or financing costs;

commonly used standards of bed costs are \$45,000 to \$50,000;

- occupancy projections were based on 88 percent by 1974 without any evidence to show such occupancy could be reached or maintained by that time; and
- per diem debt service would be approximately \$20, high compared to the usual \$10 to \$15.

In summary, the consultant stated:

"I am sorry that this report could not be more optimistic, but I am firmly convinced that this concrete structure is built on a matchstick foundation."

The report did not mention a feasible amount, or limit, for mortgage insurance.

In a supplement to the consultant's report, HEW's Acting Regional Program Director emphasized that:

- The project was one of the best total care systems in the Southeast, but a bit ambitious for the backup financing available.
- Debt service at 80-percent occupancy would be \$21.66 per patient day, whereas the average rate in the Miami area was about \$11.50.
- Construction costs for the acute care bed portion were estimated to be \$66.81 per square foot; comparable costs at other area hospitals were \$39.67..

In conclusion it was stated, "This project * * * could be classified as feasible for not more than a \$35 million loan guarantee." This information was communicated to Cedars on April 22, 1971.

According to a May 5 memorandum, prepared by the Assistant Administrator for Legislation, HSMHA, a Cedars' representative contacted influential members of the executive branch complaining about the relatively small amount of mortgage insurance HEW was recommending. In addition, Cedars' administrator wrote a letter, dated May 7, to the Administrator, HSMHA, stating that he had firm letters of interest from a syndicate of four prominent bond underwriters expressing their desire to secure \$48.5 million for the project. However, Cedars' administrator said that FHA financing would result in a more economical program of health care to the

community and, therefore, requested an immediate reconsideration of the project application. After receiving the letter from Cedars' administrator, HSMHA's Administrator sent the Director, HCFS, the following memorandum.

"In accord with our conversation in my office would you proceed to make contact with the hospital to get from them a request, or essentially an appeal, from the ruling which we have given on the Mortgage Insurance problem.

"While I doubt very much that additional experts will come to any different kind of consideration, nevertheless, if they do write such a note of appeal I believe we should call in another person of equal stature and have a rehearing under the aegis of the Office of the Administrator to be sure that there is no interpretation of personality conflict here."

The Acting Regional Program Director said HEW did not usually hire a second consultant. The first consultant said he had made about a dozen feasibility reviews for HEW and this was the only one where the Administrator, HSMHA, became directly involved and the services of a second consultant were obtained. He further stated these actions indicated to him that pressure was being applied on someone in HEW although he himself was never pressured to change his conclusions. He believed HEW had engaged a second consultant because it had not received the answer it was looking for from him. The Director, HCFS, although agreeing this was the only case where a second consultant was used, pointed out that this was also the only case where the positions of a consultant and the agency had been challenged.

According to the Administrator, HSMHA, Cedars' officials were upset because their application was deemed feasible for only \$35 million of mortgage insurance and alleged that the amount was not objectively determined. The Administrator, HSMHA, said that he had brought in another consultant in order to "clear the air" surrounding this project. He added that he did not want to bring in the second consultant unless Cedars appealed; therefore, he sent the memorandum mentioned above.

SUBSEQUENT FEASIBILITY REVIEW AND PROJECT APPROVAL

HEW hired the controller of the Daughters of Charity Shared Services Association to review the financial feasibility

of Cedars' application and to recommend a feasible amount of mortgage insurance.

After evaluating Cedars' ability to amortize a debt of \$50 million over 25 years, he reported on July 19, 1971, that Cedars would be able to meet its debt service obligations under the following conditions:

- The project will result in new depreciable assets of approximately \$51 million.
- The actual lives of the new assets will not be significantly shorter than those shown and used in the report.
- Monthly contributions to a sinking fund equal to the depreciation on the new assets plus amortization of the financing fees. Disbursements from the fund to be made only for repayments of principal and replacement of new depreciable assets.
- Sinking fund to be invested in income producing securities to the maximum extent practicable.
- No payments on principal during the loan's first 3 years.
- Medicare regulations relative to interest expense and earnings on funded depreciation will remain unchanged and will be adopted by any national health insurance program.

The consultant's report showed that total project cost would be about \$60 million and that a cash contribution of about \$10 million would be required. The report stated that Cedars had furnished no information indicating the availability of such funds.

On July 28, 1971, the consultant stated in a second report that, if principal payments commenced during the first year and accelerated depreciation were not used, Cedars should be able to repay a debt of between \$46 and \$47 million.

The Administrator, HSMHA, subsequently wrote Cedars that:

"It is my understanding that upon advice from (the second consultant) the hospital has recalculated depreciation funding to reflect a more favorable picture as to funds available for amortization of the expected guaranteed loan.

"Based upon this recommendation of funded depreciation and the projected utilization rate for the hospital, it is the opinion of this office that Cedars of Lebanon Hospital would be able to amortize a loan of up to \$47 million over a 25 year period without any deferment of principal payments. As you are aware, this is a considerable increase over previously stated maximum mortgage amounts and was determined on the basis of recomputation of allowable depreciation. Approval of the feasibility for a maximum of \$47 million is subject to the following conditions:"

The first four conditions listed on page 17 were cited.

The Acting Regional Program Director, HCFS, in advising Cedars to submit to FHA a formal application through its mortgagee for \$47 million, restated the aforementioned conditions and added that Cedars' cash contribution to the project was computed to be between \$15.5 and \$19.3 million. He also advised that either the certification of a certified public accountant on the availability of the needed cash or an irrevocable letter of credit would be required.

As a result of a meeting between Cedars' administrator and HEW and FHA officials in Washington, a revised application was submitted on August 30, 1971, requesting mortgage insurance for \$48,109,500.

Noticeably missing from the estimated costs, but included in the project narrative, were estimated costs of \$5 million for equipment. Cedars wanted to lease this equipment but the Acting Regional Program Director informed it that the request for a waiver of purchase of movable equipment was denied because HEW could not authorize mortgage insurance for a hospital which did not own its equipment. However, this position was reversed by the Director, HCFS, who authorized Cedars to lease equipment provided that the contracts were awarded through competitive bidding procedures. He stated that, although it was desirable that equipment be purchased thereby assuring an operating facility in case of foreclosure, a waiver was granted so that Cedars could use equipment purchase money for construction in order to avoid further delay and increased construction costs.

On November 10, 1971, HEW's Acting Regional Program Director approved Cedars' application for mortgage insurance for \$48,109,500. He said he had opposed the project from the start because cost estimates seemed low and revenue projections high. He also stated that, left to the region, a maximum of \$25 million would have been approved, although even

this would have been borderline. However, after the second consultant was hired and because of pressure from Washington superiors who apparently had been similarly pressured, he said he gave up and signed the Certificate of Approval. We could not ascertain how the \$48.1 million figure was determined when the consultant recommended no more than \$47 million under the conditions stated on page 18.

The second consultant has publicly stated that he sent a letter, dated November 16, 1971, to the Administrator, HSMHA, advising him that:

"As of today, I have not received the data which would permit me to make a final recommendation to you. Since I first became involved in this project, the figures have been changed time and time again. * * *

"As you well know, this is a very borderline project. I am sure that you can understand my reluctance to the submitting of a recommendation until firm figures have been determined. Because of the numerous changes that have been made, the opinions expressed in my letters to you * * * are no longer of significance."

The Administrator, HSMHA; the Director, HCFS; and the Regional Program Director said that this letter was never received and that the July 28, 1971, report was therefore accepted as final. In our opinion, the report contained nothing to indicate that its conclusions were tentative. The Director, HCFS, stated the second consultant's conclusions were accepted because the latter discovered that the first consultant had not properly computed depreciation and as a result had reflected an unfavorable picture of Cedars' ability to amortize the loan.

Notwithstanding the many negative factors reported by the first consultant and the Acting Regional Program Director (see pp. 14 and 15) and the conditions contained in the second consultant's report, the Director, HCFS, advised FHA there were no unresolved problems regarding Cedars' application. On December 13, 1971, FHA advised Cedars and its mortgagee that the agency would endorse for insurance, under the provisions of section 242 of the National Housing Act, a mortgage note of \$48,109,500 to be secured by a mortgage on the property. On March 13, 1972, the initial mortgage and financial documents required for closing the project were executed. According to closing documents, the only cash required of Cedars was about \$1.1 million representing a portion of the discount paid on the mortgage. Furthermore, Cedars was not

required to establish a sinking fund or to meet any of the other conditions suggested by the second consultant and the Administrator. We could not locate a copy of the letter transmitting the Certificate of Approval to FHA and were informed by an HEW Regional Office Hospital Specialist that the Certificate of Approval apparently did not include the cited conditions so that FHA could have included them in either the mortgage commitment or regulatory agreement.

CHAPTER 4

REVISED APPLICATIONS--PROFESSIONAL

TOWER AND CARE CENTER

On July 26, 1971, the FHA Insuring Office in Coral Gables issued firm commitments to Cedars for \$10.9 million of mortgage insurance under section 221(d)(3) of the National Housing Act to construct the Professional Tower and for \$2,924,100 of mortgage insurance under section 232 of the act to construct the Care Center. Section 221(d)(3) was established to help private industry provide newly constructed or substantially rehabilitated rental housing for low- and moderate-income individuals and families. Section 232 authorizes a program for providing mortgage insurance for the construction and rehabilitation of proprietary and private nonprofit nursing homes and intermediate-care facilities.

Information from the Insuring Office indicated that the firm commitment amounts for the Professional Tower and Care Center were arrived at after the estimates of project income, expenses, and construction costs had been reconsidered by FHA on several different occasions. The Insuring Office's Deputy Chief Underwriter told us the end result for the Professional Tower was a gross fabrication and that, in his opinion, there was no support for the estimated income and expenses and that the debt service costs could not be met. In addition, the Insuring Office never received a required Certificate of Need for the beds in the Care Center and several waivers of FHA requirements for nursing homes were obtained.

The events leading to the firm mortgage insurance commitments are discussed below.

PROFESSIONAL TOWER

Initial feasibility processing

On October 16, 1970, Cedars submitted a feasibility application to the Coral Gable's Insuring Office for \$11 million of mortgage insurance to construct the 20-story Professional Tower. The Professional Tower was to have an apartment section with 182 family units for Cedars' moderate-income personnel; 88,000 net square feet of professional office space; 6 floors containing 562 parking spaces; and a restaurant, convenience store, pharmacy, and recreational facilities. Cedars estimated that its annual net income from Professional Tower operations would be about \$1.1 million and assumed that the Professional Tower would be exempt from all real estate, personal property, and payroll taxes.

The Deputy Chief Underwriter of the Coral Gables Insuring Office said that his office normally would have handled an application for mortgage insurance under section 221(d)(3) of the act but in Cedars' case the Insuring Office's Deputy Director designated another official (the Insuring Office's Multifamily Coordinator) to handle this application under the Deputy Director's personal supervision.

By memorandum, dated October 22, the Multifamily Coordinator was informed by an Insuring Office Design Representative that Cedars' application and related exhibits did not comply with FHA regulations for a section 221(d)(3) project and would require redesigning or waiving FHA requirements. It was stated that (1) living areas for the apartments were excessive and, if accepted, would distort the objective of the National Housing Act, (2) using a 1-parking-space per 1-apartment ratio, there are 395 excess parking spaces, (3) the amount of commercial space--46 percent of the total gross floor area--exceeds the 10 percent allowed, (4) the design is not in compliance for buildings constructed with common walls in that these walls are supposed to be constructed of noncombustible materials extending the full height of the building without openings--this would make the project inoperable since the auto traffic pattern penetrates this line twice on each of the first 6 floors, and (5) the project design is in non-compliance because the property cannot be used and maintained without trespass upon adjoining properties and the utilities and other facilities are dependent upon other properties.

In a letter to FHA's Assistant Commissioner for Unsubsidized Insured Housing Projects, the Acting Director of the Insuring Office stated that the feasibility of the Professional Tower proposal would be predicated upon his authorization to (1) permit 46 percent of the total gross floor area to be used for commercial income and 51 percent of annual gross rent to come from commercial space, (2) waive the requirement concerning solid common walls, and (3) have Cedars submit reciprocal easements to permit vehicular and pedestrian traffic between the Professional Tower and Nursing Home projects. The Acting Director's letter made no mention of the excess parking spaces or excessive living areas. The Acting Director's request was approved by HUD's Deputy Assistant Secretary on October 26, 1970.

On October 27 the Insuring Office sent Cedars a letter inviting it to submit an application for a commitment for mortgage insurance on the Professional Tower. Based on the feasibility processing, Cedars was advised that the maximum mortgage insurance available would be \$9,019,400 and that it would be expected to furnish about \$275,600 in cash at closing. Included among the special conditions attached to the

letter was a requirement that Cedars furnish evidence--before FHA issued any firm commitment--that it would be exempt from ad valorem real estate taxes (both city and county) and qualify for tax exemption under the Internal Revenue Code. The significance of this requirement was that these expenses were not included in the Insuring Office's calculations to arrive at the maximum amount of mortgage insurance and, as discussed on page 31, Cedars did become liable for Dade County taxes upon completion of the Professional Tower's construction.

Second feasibility processing

On November 3 Cedars sent the Insuring Office revised drawings for the Professional Tower and the feasibility application for mortgage insurance was reprocessed. This resulted in Cedars being advised, on January 6, 1971, that the maximum amount of mortgage insurance which could be granted for the project was \$8,647,300--about \$372,000 less than initially determined feasible. Cedars was advised that it would be expected to furnish about \$403,200 at closing--the difference between the Insuring Office's recomputation of the total estimated construction cost (\$9,050,500) of the Professional Tower and the amount to be covered by mortgage insurance.

The revised drawings showed that the number of apartments had been increased from 182 to 188, the number of parking spaces had been decreased from 562 to 504, and the amount of commercial space had been increased 95,700 to 116,270 square feet.

FHA's approval of the lesser amount of mortgage insurance resulted from a December 23, 1970, memorandum from the Director of the Insuring Office to the Deputy Assistant Secretary, HUD, in which authorization was requested to approve (1) mortgage insurance as revised with certain changes in the previously granted waivers (see p. 22) and (2) granting another waiver of requirements concerning construction cost limitations per family unit. The requested authorization was approved and the Office was permitted to use a higher per family unit cost. Without this waiver, we believe the maximum amount of mortgage insurance which could have been granted for the Professional Tower would have been \$8,426,929, rather than \$8,647,300, and Cedars' cash contribution would have been \$623,571, rather than \$403,200.

Third feasibility processing

After being advised of the Insuring Office's decision on its application, Cedars requested the Insuring Office to re-determine the amount of available mortgage insurance for the Professional Tower, giving consideration to the fact that the

mortgage interest rate had decreased to 7.5 percent and that construction would be delayed until about September 1971. This reprocessing resulted in Cedars being advised on February 26, 1971, that the maximum amount of mortgage insurance which could be granted was \$10,033,900--about \$1,014,500 more than initially determined feasible.

In addition to the estimated development costs being increased because of a delayed construction start date, the Insuring Office, at Cedars' request made other changes during the feasibility reprocessing resulting in the larger amount of mortgage insurance. These changes included (a) an increase in the number of parking spaces; (b) an increase in estimated rental income to be derived from parking spaces and apartments based on anticipated market rates when the project would be completed; and (c) a decrease in estimated operating expenses.

Fourth feasibility processing

We could not determine why, but on March 1, 1971, the Deputy Director of the Insuring Office instructed a cost analyst to amend his computations for the Professional Tower and include costs related to the parking garage under the Care Center project. This project is connected to the Professional Tower but was processed as a separate project. In a July 19 memorandum to the Insuring Office's Chief Underwriter, the Cost Analyst stated that costs for the garage and covered parking which were added to the Professional Tower project costs were not deducted from the Care Center. This reprocessing resulted in Cedars being advised on March 2, 1971, that the maximum amount of mortgage insurance that could be granted for the project was \$10.9 million. Cedars was advised that it would be expected to have about \$72,800 at closing--the difference between the Insuring Office's recomputation of the total estimated development cost of the Professional Tower of \$10,972,800 and the amount to be covered by mortgage insurance.

CARE CENTER

Initial feasibility processing

On October 16, 1970, Cedars submitted a \$2,268,000 application to the Coral Gable's Insuring Office under section 232 to construct the 18-story Care Center. The Care Center was to have a 192-bed nursing home on the top 12 floors, 6 lower floors of parking garages, and a ground-level lobby where the only nursing station was to be located.

In performing the feasibility study of Cedars' application, the Insuring Office gathered data on six nursing homes in the Miami area. Based on this data, the Insuring Office

estimated that Cedars' annual gross project income would be about \$1.5 million and that the net return from the Care Center's operations would be about \$314,544.

Cedars had estimated that total development cost (including carrying charges, financing, etc.) of the Care Center would be about \$2.4 million. However, during feasibility processing this cost increased to about \$2.7 million, primarily because of an increased estimate for carrying charges and finance fees.

By letter, dated October 23, 1970, the Acting Director of the Insuring Office advised the Assistant Commissioner for Unsubsidized Insured Housing Projects, FHA, that review of the Care Center proposal disclosed several areas which were not in compliance with the minimum FHA nursing home standards and, to approve the application, requested authorization for waivers or other actions. Areas of noncompliance and recommended actions were as follows:

- The auto entrance and exit ramp to parking spaces in the Professional Tower section was located in the Care Center section; it was recommended that authorization be given to accept FHA-approved easement agreements permitting this situation.
- No elevators were located in the Care Center and those in the Professional Tower were about 190 feet from the patient rooms; it was recommended that two elevators be required in the Care Center.
- The Care Center was separated from the Professional Tower section by a common wall and was to be served with heating and air-conditioning equipment located in that section; it was recommended that equipment in the Professional Tower be reduced in capacity and separate facilities be included in the Care Center section.
- Kitchen facilities were not included in the Care Center section and the sponsor proposed to use catered service from the hospital; it was recommended that a floor in the parking garage be roughed-in for future kitchen equipment and that, with proper safeguards, FHA accept the proposal for catered food service.
- No dining or recreational space was included except for an open sun deck over the garages which extended out from the building; it was recommended that the dining room and recreational space requirements be waived since they could be provided at a later date by using a number of garage spaces.

--A Certificate of Need for 192 beds had not been received from the State agency; it was recommended that FHA approval be withheld until the certificate was received and that Cedars be so advised.

--A nursing station was provided for only on the ground floor; it was recommended that Cedars be required to obtain a letter from the Florida board of health waiving its requirement for a station on each patient-floor.

HUD's Deputy Assistant Secretary concurred with the recommendations on October 26, 1970.

On October 27 the Insuring Office sent Cedars a letter inviting it to submit an application, through its mortgagee, for a mortgage insurance commitment on the Care Center. Cedars was advised that the maximum amount of mortgage insurance available would be \$2,291,600 and that it would be expected to furnish about \$391,800 in cash at closing. Information in the case file indicated that an estimated operating deficit of \$112,219 for the first 6 months was eliminated by the Multifamily Coordinator because he believed that the Care Center would be located in an excellent referral position for Cedars of Lebanon Hospital, then operating at "over-bed capacity."

Cedars was also advised that FHA approval would be subject to the following conditions.

--The construction contract had to be "cost-plus."

--A Certificate of Need for 192 beds had to be received from the State Department of Health.

--A letter had to be obtained from the State Board of Health waiving its requirement of a nursing station on each patient-floor.

--Two elevators (one of which had to be a hospital type) would be required in the Care Center.

--Central air-conditioning and heating facilities (independent of the Professional Tower section) would be required in the Care Center section.

--No kitchen would be required; however, a parking garage floor had to be roughed-in for possible kitchen installation.

--An agreement for furnishing food service from Cedars of Lebanon Hospital to the Care Center had to be furnished.

--FHA's requirement for dining and recreational space was waived.

--Evidence had to be furnished before issuance of any firm commitment that the Care Center would be exempt from city and county real estate taxes and that it qualified for tax exemption under the Internal Revenue Code.

Second feasibility processing

On November 3, 1970, Cedars submitted revised drawings for the Care Center to the Insuring Office. The Care Center application for mortgage insurance was reprocessed and Cedars was advised on January 6, 1971, that the maximum amount of mortgage insurance which could be granted for the project was \$2,924,100 and that it would be expected to have about \$120,000 in cash at closing. This figure was the difference between the Insuring Office's recomputation of the estimated construction cost of the Care Center of \$3,032,000 and the amount to be covered by mortgage insurance. An estimated operating deficit of \$134,500 for the first 6 months of operation was again deleted by the Multifamily Coordinator and was not included in the estimated amount of cash required at closing on the project.

The principal changes resulting from the revised drawings and/or the Insuring Office's reprocessing which resulted in a larger amount of mortgage insurance included an increased number of nursing beds, from 192 to 224; a monthly rental rate of \$25 to each of the 184 parking spaces that had not previously been considered as revenue producing; and an increased estimate of the completed project's replacement cost.

FHA's issuance of the revised feasibility letter resulted from a memorandum dated December 23, 1970, from the Insuring Office's Director to the Deputy Assistant Secretary, HUD, in which authorization was requested to approve mortgage insurance for the project as revised, because the Care Center had been redesigned, eliminating the following areas of non-compliance: (a) the absence of elevators, (b) the lack of independent heating and air-conditioning facilities, and (c) the need for a floor in the parking garage to be roughed-in for possible future installation of kitchen equipment. The memorandum also stated that certain previously granted waivers and conditions (see p. 26) would still be required in order to process the revised feasibility letter but that a

Certificate of Need had been received from the State Department of Health. However, we noted that the only Certificate of Need in the Insuring Office files had been received on October 28, 1970, and, according to the State's transmittal letter, it was "* * * an extension of the Certificate of Need for the Cedars of Lebanon Hospital Addition, Miami, Florida." According to information in the files, the Insuring Office's Design Representative did not believe that the certificate was for the Care Center but he was instructed to accept it as such by the Multifamily Coordinator. The Assistant Chief, Bureau of Community Medical Facilities, said that, to the best of his knowledge, no Certificate of Need was ever requested or issued for the Care Center beds. After reviewing the certificate, we believe that it was definitely not issued for the Care Center, but for modernizing 200 beds in the existing hospital and an additional 500 new beds to be included in the new hospital addition. Also, there was no indication that any one questioned the need for the additional 32 beds created by the revised drawings.

FIRM COMMITMENT PROCESSING

On June 14, 1971, Cedars submitted to the Insuring Office, through its mortgagee, applications for firm commitments on (1) \$10.9 million of mortgage insurance under section 221(d)(3) for constructing the 19-story Professional Tower and (2) \$2.9 million of mortgage insurance for constructing the Care Center.

The Professional Tower was to have an apartment section with 188 family units; 104,000 square feet of professional office space; 509 parking spaces; and a food market, pharmacy, restaurant, and rooftop swimming pool. The Care Center was to have a 224-bed nursing home on the top 8 floors; 6 lower floors with 184 parking spaces; and a ground-level lobby where the nursing station was to be located.

Officials of the Insuring Office who worked on the applications wrote memorandums to the Insuring Office's Chief Underwriter expressing concerns about the projects. The Design Representative questioned whether a rooftop swimming pool should be included in a housing project for low- and moderate-income families. He also questioned whether more than one bath per living unit should be permitted, pointing out that the Insuring Office had been previously criticized for permitting more than one bath per living unit in a similar project.

The Assistant to the Chief Underwriter informed the Chief Underwriter that the feasibility processing of the Professional Tower project was based on Cedars obtaining a real estate tax abatement from Dade County and the city of

Miami but that, based on statements made by the Dade County Tax Assessor's office, the project could not obtain the commercial and parking income attributed to it in the feasibility processing and still receive a real estate tax abatement. According to the Assistant, not taking into account a tax assessment would cause a gross inaccuracy in the project's net income projection and have an impact on the maximum amount of mortgage insurance. He stated that the accuracy of a net income projection could not be verified because a review of the file did not indicate any data sheet justifying the income and expense reported in the feasibility processing.

The Insuring Office's Cost Analyst advised the Chief Underwriter that:

- Cost allocation between the two projects was done arbitrarily.
- Costs for the garage and covered parking space in the Care Center project were allocated to the Professional Tower's "cost not attributable to dwelling use" costs without a corresponding decrease in the Care Center project's costs; this was tantamount to arbitrarily increasing the maximum mortgage.
- The percentage of total construction cost not attributable to dwelling use was in excess of the 46 percent granted by a previous waiver.
- It would be almost impossible to require the contractor to maintain separate project cost records and, thus, cost certifications could not be properly completed and certified to by an accountant.

On July 20, 1971, the Insuring Office's Chief Underwriter wrote a memorandum to his Director and Deputy Director requesting guidance on processing the Professional Tower and Care Center projects. He stated that most processing for the Professional Tower project was done by the Multifamily Coordinator who had worked exclusively with the Unsubsidized Insured Housing Programs Office in Washington and stated that neither he nor regional office personnel were consulted. The Chief Underwriter pointed out that the Underwriting Section was now involved in processing both projects for firm commitment and asked the following questions about the applications.

- Whether the projects, woven together physically, functionally, and economically, should each be treated as a self-sustaining real estate entity.

--Whether a statement from the Dade County tax assessor--specifying something less than full abatement of real estate taxes would be granted--was an acceptable guarantee that the projects would not be liable for real estate taxes.

--Whether a first year estimated operating deficit of \$403,000 (\$314,835 for the initial 6 months) for the Professional Tower and an initial 6 months estimated operating deficit of \$134,500 for the Care Center should be waived as was apparently done during the feasibility stage processing by the former Multi-family Coordinator which presumed concurrence of the Washington office.

Although we did not locate a response to the above memorandum, the Insuring Office issued firm commitments for mortgage insurance on the Professional Tower and the Care Center subject to the following conditions:

--A performance and a payment bond, each amounting to 50 percent of the construction contract, were required before initial closing.

--Cedars had to execute an agreement for paying real property taxes in case the Professional Tower and/or Care Center projects did not obtain or were to lose their real estate tax exemption.

--An agreement providing certain easements between the two connected projects had to be furnished to FHA.

--Cedars would have funds to cover the anticipated operating deficits (\$100,000 for the Professional Tower and \$50,000 for the Care Center) for the first 6 months operations. We could not determine why the Insuring Office's Deputy Director reduced the deficits from the initial estimates for 6 months of \$314,835 and \$134,500, respectively.

For the Care Center, Cedars was required to

--install and equip a kitchen at the earliest possible time after receiving a written request from FHA requiring such installation and

--provide nurses' stations on each or every other floor by converting one patient room to such a station as may be required by the State Department of Health and Rehabilitative Services and/or the FHA Commissioner.

Although the requirements could have resulted in the Care Center having to install and equip a kitchen and provide additional nurses' stations at some future time, we found no indication that the Insuring Office considered the Care Center's ability to pay for such changes or absorb any resultant increase in expenses.

In recomputing the maximum amount of mortgage insurance for the Professional Tower at the time of firm commitment processing, a figure of \$17.50 per square foot was used for the cost not attributable to dwelling use. The Regional Cost Analyst instructed the Cost Analyst to use this figure, which represented the average square footage cost of a recently constructed eight-story apartment building. The Cost Analyst said he followed instructions even though he did not fully agree that an 8-story apartment building could be equated with the 19-story Professional Tower project. The recomputations, which did not include the cost for the Care Center's garage and carport space as discussed on page 24, resulted in \$10.9 million, the amount Cedars requested, as being the maximum insurable mortgage.

Not using the \$17.50 but using the latest data available at the time of final processing--furnished by the Cost Analyst and differing from that used during the third and fourth feasibility processings--and deleting the estimated cost for the Care Center project's garage and carport space, we determined that the maximum amount of mortgage insurance available would have been about \$9.5 million--about \$1.4 million less than the amount approved.

Regarding real estate taxes, we noted that HUD's Regional Counsel stated in a July 28, 1971, memorandum to the Insuring Office Director that he thought Cedars would be exempt from payment of such taxes. However, by memorandum dated February 16, 1972, HUD's Associate General Counsel was advised by the Chief of HUD's Rental Housing Section that the procedures to be followed for real estate tax exemption or abatement claims were not strictly observed. He stated that both the Professional Tower and Care Center projects were processed on the assumption that there would be no real estate taxes, but that this should only be done when the area counsel determines it is legally certain that the tax exemption or abatement would last the life of the mortgage. The Chief concluded by stating that a tax expense on the commercial space should have been considered in establishing the mortgage and that if a promise to pay the taxes could not have been obtained from some entity outside those comprising the Cedars' complex then the principal amount of the mortgage should have been reduced so that revenues could meet debt service requirements.

An appraiser in the Insuring Office's Valuation Section said that Dade County considered the Professional Tower and Care Center as becoming liable for real estate taxes upon completion of construction in October 1973. The appraiser told us that the 1973 and 1974 real estate taxes for the Professional Tower and Care Center totaled about \$207,100 and about \$120,100, respectively; as of May 30, 1975, these taxes had not been paid.

COMMENTS BY INSURING
OFFICE PERSONNEL

During our visit to the Insuring Office, we talked with employees who had been involved in the feasibility study and/or firm commitment processing of the Professional Tower and/or Care Center applications. They described problems encountered and pressure placed on them to complete the processing.

The Multihousing Project Appraiser said he did not perform the initial valuation processing of the Professional Tower and only became involved with the project when the Multifamily Coordinator left the office. According to the appraiser, an analysis was prepared during the feasibility stages to arrive at the desired end result (i.e., income was overstated and expenses were understated as necessary to support the loan request). He said when he became involved with the project he had certain reservations and questions concerning the determination of the maximum amount of mortgage insurance and the project's feasibility and that he had expressed his concerns in a memorandum to the Chief Underwriter. The appraiser told us that he was continuously pressured by the Insuring Office's Director and Deputy Director to increase the project's estimated net income and to complete his work. However, he said that, because he believed the estimated rental income was too high and the estimated expenses too low, he refused to sign off on the project until he received an authorization from his superiors concerning use of the questionable figures. The authorization was provided by an April 15, 1971, memorandum from the Deputy Director which included the following comments:

1. The project does not have to meet the requirements of economic soundness; however, it is an acceptable risk.
2. Because the sponsor claims that the project will receive exemption from real estate taxes, the manual provisions are waived.

3. Waiver of individual unit statutory construction cost limits and the limits involving the ratio of commercial use to cost not attributable to dwelling use have been granted by the Assistant Commissioner for Unsubsidized Insured Housing Programs, FHA.
4. The cost not attributable to dwelling use of the adjoining project and included in this project is approved.
5. You are authorized to accept the processing of the former Multifamily Coordinator and complete your processing using his estimates of rents, expenses, and land value.

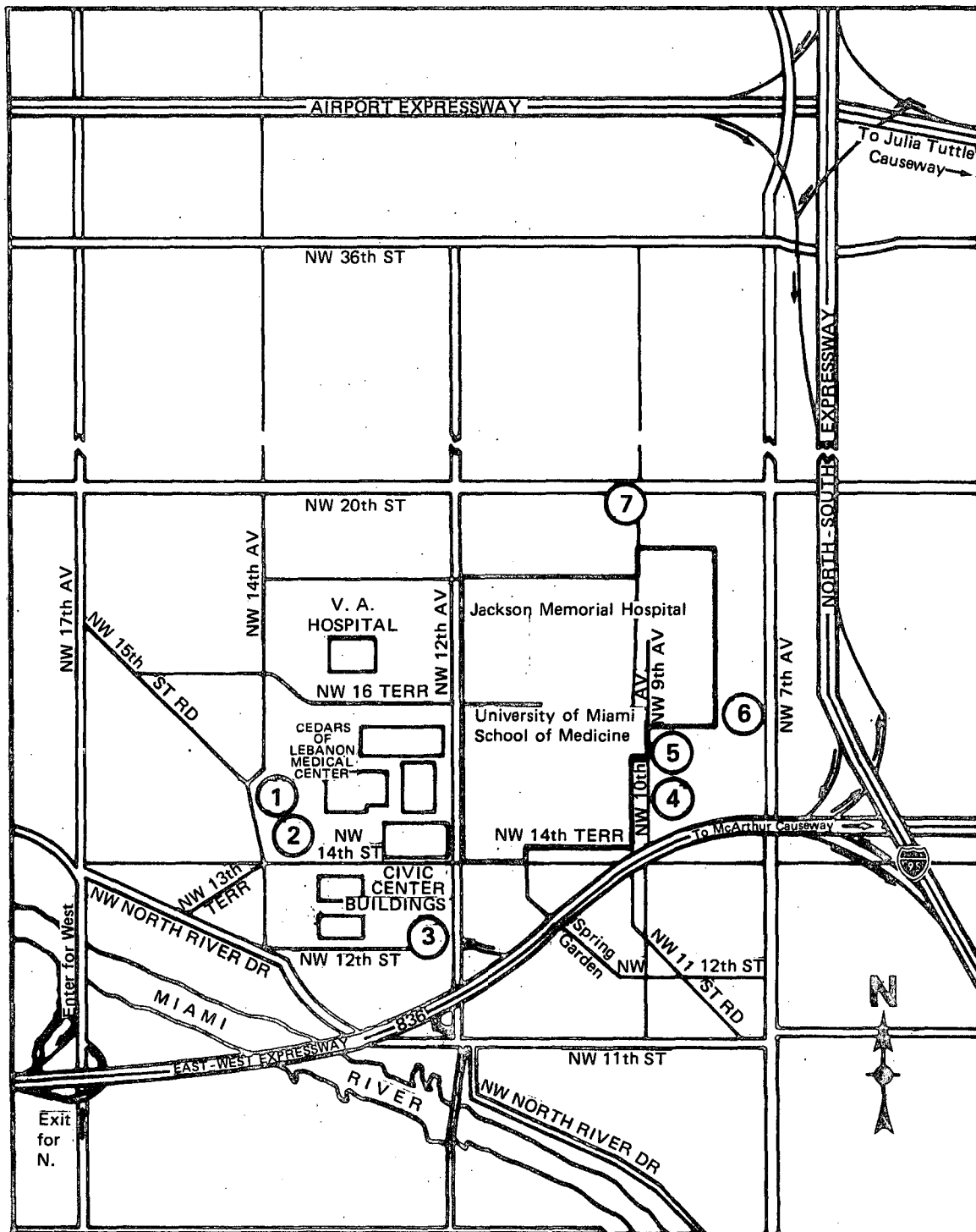
The Insuring Office's Multihousing Cost Analyst told us that, in considering mortgage insurance applications, he prepares an estimated construction cost budget based on costs of a comparable project. However, the Professional Tower project estimate was based on experience and costs from several different projects because there probably was no other structure in the country with an FHA insured mortgage that (1) had as much commercial space as the Professional Tower, (2) was covered by two different sections of the Federal Housing Act, or (3) shared the same commercial parking space and utilities with another project. He also told us that cost estimates must have been reprocessed on at least seven different occasions between the time the initial application was received and the project was initially endorsed in January 1972 and, based on his past experience, "this only occurred when an applicant or builder had influence up front."

The Cost Analyst said he and other members of the Insuring Office staff were constantly being pressured by the Multifamily Coordinator to complete their work. He said he performed his work as he believed his supervisors desired, because waivers were obtained or he was issued memorandums to disregard questions he raised concerning areas where the projects did not agree with the regulations.

The Insuring Office's Deputy Chief Underwriter said he refused to sign the final report on the Professional Tower because he believed that the end result was a gross fabrication and that the information in the report was inaccurate. As far as he was concerned, there was no support for the estimated income and expenses and that the debt service costs could not be met.

He told us that, in attempting to get him to sign the report, the Insuring Office's Deputy Director made some compelling statements to him; i.e., that people in "high places" were interested in the processing and that he (the Insuring Office's Deputy Director) would take full responsibility. He still refused to sign the report because he believed his signature would indicate concurrence with the report's findings and he knew for a fact that the income and expense estimates were inaccurate. He stated that the Deputy Director signed the report instead of him.

An Insuring Office Architectural Processor said that the processing of the nursing home was a "pressure play" in that, even though the design did not meet all the nursing home requirements, the Multifamily Coordinator pushed to get the project approved through Washington. He further said the Multifamily Coordinator was constantly pressuring him to complete his portion of the processing and seemed to know where to go to get around any design deviations brought to his attention. Because of the above situation, the Architectural Processor believed that the project was going to be approved regardless of his opinion and he signed the final version of the project analysis and appraisal form for firm commitment without reading it.



1. Crippled Children's Society
2. United Cerebral Palsy
3. Health Department, Dade County
4. National Parkinson's Institute
5. John Elliott Blood Bank
6. Highland Park General Hospital
7. Miami-Dade Community College