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BY THE COMPTROLLER GENERAL



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Report To The Congress

OF THE UNITED STATES

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Hospital Loan Assistance Programs: Actions Needed To Reduce Anticipated Defaults

Many hospitals with federally assisted loans have been experiencing serious financial problems that could lead to defaults, closures of modern hospitals, and substantial losses to the Government. The Department of Health, Education, and Welfare needs to

- make comprehensive risk assessments to identify the risk of default on all loans,
- advise the Congress of the potential losses and adequacy of loan default funds,
- issue additional loan monitoring guidance and implement a viable loan monitoring program,
- closely monitor the financial status of loans secured with inadequate collateral, and
- determine and monitor the status of hospital sinking funds.



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HRD-79-64
JUNE 27, 1979



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

B-164031(5)

To the President of the Senate and the
Speaker of the House of Representatives

This report discusses hospital loan assistance programs administered by the Department of Health, Education, and Welfare. Many hospitals with federally assisted loans have been experiencing serious financial problems that could lead to defaults, closures of modern hospitals, and substantial losses to the Government. Several problems regarding administration of the programs need correction.

We made our review because of the Government's significant investment in hospitals across the country and the potential adverse effects if hospitals having federally assisted loans are unable to meet their financial obligations.

Copies of this report are being sent to the Secretary of Health, Education, and Welfare; the Secretary of Housing and Urban Development; and the Director, Office of Management and Budget.

A handwritten signature in black ink, reading "James R. Stacks".

Comptroller General
of the United States

D I G E S T

ASSESSMENT OF FINANCIAL
CONDITION OF HOSPITALS

Two major loan assistance programs--the Department of Health, Education, and Welfare (HEW) Hill-Burton and Department of Housing and Urban Development (HUD) Section 242 Mortgage Insurance programs--assist hospitals in constructing new or modernizing existing facilities.

Many hospitals with loans guaranteed under the Hill-Burton program or insured under the Section 242 Mortgage Insurance program have been experiencing serious financial problems, but neither HEW nor HUD knew the extent or severity of the problem.

In response to GAO's questionnaire to the 380 hospitals participating in these programs, 44 hospitals with loans of about \$326 million said their financial condition was poor or very poor. The financial problems at these hospitals could lead to defaults, closures of modern facilities, and substantial losses to the Federal Government. Six hospitals have already defaulted on their loans.

Between July 1970 and September 1976, HEW made direct loans to public and guaranteed loans to private nonprofit health facilities under the Hill-Burton program. On guaranteed loans, HEW also pays the lender an interest subsidy of 3 percent of the loan balance on behalf of the hospital.

HEW made direct and guaranteed loans of about \$1.5 billion to 352 facilities. New loans and interest subsidies have been

authorized, but not yet funded, under the National Health Planning and Resources Development Act of 1974. Program regulations were being developed at the conclusion of our review, but HEW could not estimate when additional loan assistance would be available.

Since August 1968, HUD has insured loans for construction and rehabilitation of nonprofit hospitals and, since 1970, proprietary (profit-motivated) hospitals under the Section 242 program. HUD has insured mortgages totaling about \$1.7 billion for 140 hospitals. The Section 242 program continues to be available to finance hospital construction and rehabilitation.

Since January 1969, HEW, by agreement with HUD, has administered the Section 242 program.

LOAN MONITORING

Under the loan assistance programs, several methods are available to assist financially troubled hospitals, including temporarily waiving or reducing sinking fund payments, insuring additional construction and operating-loss loans, and continuing principal and interest payments to the lender on behalf of the hospital.

But, if financially troubled hospitals are to be identified and assisted and the adequacy of program default funds determined, the loans must be monitored. Although HEW recognizes the need for routine monitoring, not enough is being done. HEW regional officials claimed they had inadequate guidance and in some cases lacked sufficient staff to do an effective monitoring job.

Since January 1973, the Hill-Burton and Section 242 programs have required that hospitals establish restricted savings accounts--called sinking funds--to assure

that funds are available to repay loans, thus reducing the risk of loan default. Despite the importance of sinking funds, HEW has not monitored hospital compliance with the requirement and, consequently, does not know if hospitals have adequate sinking funds.

COLLATERAL SECURING
HOSPITAL LOANS

The Hill-Burton and Section 242 loan programs require HEW and HUD to protect the Government's financial interests by getting adequate collateral on their loans. There are problems with the collateral on some loans, and regional staffs need additional guidance in this area. The inadequately secured loans should be closely monitored because of the added risk in the event of default.

UNNECESSARY MORTGAGE
INSURANCE COVERAGE

To provide the Hill-Burton interest subsidy to a few hospitals that otherwise would not be eligible to receive one, HEW guarantees repayment of a portion of the loan already insured by HUD--a double Federal guarantee called an overlay. The hospitals, however, are not receiving the full benefit of the interest subsidy because they must pay mortgage insurance premiums (for insurance they don't need) of about \$3.7 million over the life of these loans.

RECOMMENDATIONS

The Secretary of HEW should:

- Make comprehensive risk assessments to identify the risk of default on loans made under the programs.
- Advise the Congress of the potential losses and adequacy of loan default funds.

- Issue additional guidance for monitoring loans and implement a viable loan monitoring program.
- Closely monitor the financial status of hospitals with loans secured with inadequate collateral because of the added risk in the event of default.
- Determine and monitor the status of hospital sinking funds to assure that payments are current and sufficient to insure loan repayment, and encourage hospitals without a sinking fund to establish one.

The Secretaries of HEW and HUD should:

- Determine whether HUD should retain the unnecessary mortgage insurance premiums paid to date by the hospitals.
- Review their loan portfolio to determine the adequacy of the Government's collateral position.
- Provide regional staff additional guidance on the circumstances in which the various forms of collateral should be accepted.

The Congress should amend Section 242 of Title II of the National Housing Act to eliminate the mortgage insurance premium on portions of loans also guaranteed by HEW under Title VI of the Public Health Service Act and to preclude such practices on loans guaranteed and made under Title XVI of the Public Health Service Act.

HUD fully concurred in GAO's recommendations and outlined actions taken or planned to implement them. HEW also fully concurred in GAO's recommendations, except with the need to advise the Congress of the potential losses and adequacy of loan default funds. HEW said it would notify the Congress in a timely manner if the fund becomes sufficiently depleted to require replenishment. GAO continues to believe that, once HEW completes its comprehensive risk assessment, it should then advise the Congress of the total extent of the problem.

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ABBREVIATIONS

GAO	General Accounting Office
HEW	Department of Health, Education, and Welfare
HUD	Department of Housing and Urban Development

CHAPTER 1

INTRODUCTION

To assist hospitals with constructing new or modernizing existing facilities, the Congress established two major loan assistance programs--the Department of Health, Education, and Welfare (HEW) Hill-Burton program and the Department of Housing and Urban Development (HUD) Section 242 Mortgage Insurance program. Under the Hill-Burton program, the Federal Government guaranteed loans made by commercial lenders or made direct loans to hospitals and other medical facilities. This program ended in September 1976, but HEW is responsible for monitoring the loans until they are repaid. Under the Section 242 program HUD insures loans made to hospitals by commercial lenders and continues to provide assistance under the program.

THE HILL-BURTON PROGRAM

The Hill-Burton program was enacted in 1946 as the Hospital Survey and Construction Act (Public Law 79-725) under Title VI of the Public Health Service Act (42 U.S.C. 291). It was originally to provide grants for constructing and modernizing hospitals and other health facilities. The Medical Facilities Construction and Modernization Amendments of 1970 (Public Law 91-296) continued the grant program and authorized HEW to make direct loans to public nonprofit health facilities and to guarantee loans made by commercial lenders to private nonprofit health facilities. Guaranteed or direct loans were made to hospitals, public health centers, outpatient clinics, and long-term care and rehabilitation facilities. Guaranteed or direct loans to hospitals represent 96 percent of the total dollar volume of Hill-Burton program loans. Loan assistance under the Hill-Burton program was available between July 1970 and September 1976.

In addition to guaranteeing the repayment of loan principal and interest, HEW pays the lender (on behalf of the hospital) an interest subsidy of 3 percent of the outstanding loan balance. HEW estimates that it paid \$34 million in interest subsidy benefits during fiscal year 1978 and will pay about \$610 million over the life of the outstanding loans.

To minimize losses under the Hill-Burton program, HEW

--secures collateral (assets that can be claimed in the event of loan default) that the Secretary finds reasonably sufficient to insure repayment and

--requires borrowers to make payments to a restricted savings account, or sinking fund, to assure that money will be available to repay the loan principal.

If a facility experiences financial problems, HEW can also temporarily waive sinking fund payments, make principal and interest payments on behalf of the borrower, and provide technical assistance. The Congress has appropriated \$50 million to cover loan defaults under the program.

Between July 1970 and September 1976 (when loan assistance expired), HEW guaranteed loans or made direct loans to 352 facilities--the loans amounted to about \$1.5 billion. The schedule below summarizes the loan activity under the program.

	<u>Number of facilities</u>	<u>Loan value</u>
	(millions)	
Guaranteed loans	271	\$1,251
Direct loans	<u>81</u>	<u>210</u>
Total (note a)	<u>352</u>	<u>\$1,461</u>

a/Included in these totals are 35 loans--27 guaranteed and 8 direct--amounting to about \$52 million that HEW made to health care facilities other than hospitals. Further, 65 of the 352 facilities also received insured loans under the HUD Section 242 program.

As a condition for receiving loan assistance, the borrower must agree to provide a reasonable amount of uncompensated care to persons unable to pay. In addition, each hospital must agree to provide a community service which includes the provision that individuals served by Federal Government third-party programs, such as Medicare and Medicaid, will not be denied admission to any facility because of these reimbursement mechanisms. These requirements exist until the loans are repaid.

In January 1975, the Congress enacted the National Health Planning and Resources Development Act (Public Law 93-641), which combined the Hill-Burton program with two other health programs (the Comprehensive Health Planning and Regional Medical programs). The act added two new titles to the Public Health Service Act. Title XV established a new program for health planning, and Title XVI revised the existing programs for the construction and modernization of health care facilities (the former Hill-Burton program). In addition to construction and modernization grants, HEW is authorized under Title XVI to make direct loans and to guarantee loans with interest subsidies. To date, HEW has concentrated its efforts on implementing Title XV. Title XVI program regulations were being developed as of January 1979, and HEW could not estimate when additional loan assistance would be available.

THE SECTION 242 MORTGAGE INSURANCE PROGRAM

The Housing and Urban Development Act of 1968 (Public Law 90-488) added Section 242 to Title II of the National Housing Act. This section authorized HUD to insure loans for the construction and rehabilitation of nonprofit hospitals. In 1970 the Section 242 program was amended to include proprietary (profit-motivated) hospitals. The program provides mortgage insurance for loans to hospitals from commercial lenders. The program's administrative and default costs are offset by hospital payments to HUD for mortgage application fees (\$8 per \$1,000 of mortgage insurance) and insurance premiums (a yearly premium of 0.5 percent of the average outstanding principal balance).

Because of HEW's long-term involvement in hospital construction, HEW and HUD agreed that HEW would be responsible for certain HUD program activities. A January 1969 agreement, as amended, makes HEW responsible for (1) determining project feasibility, (2) making construction inspections, and (3) monitoring loans. To perform these services, HEW receives \$6.50 of the \$8.00 mortgage application fee rate. HUD approves or disapproves the mortgage insurance coverage after receiving HEW's recommendation.

HUD uses methods similar to HEW methods to minimize losses. (See pp. 1 and 2.) HUD also can insure an additional loan to offset a hospital's first 2 years' operating losses.

Between August 1968 (when the program was authorized) and March 1978, HUD insured mortgages for 140 hospitals. The mortgages totaled about \$1.7 billion, and the program continues to be available. Through March 1978, 65 hospitals have received assistance under both the Hill-Burton and Section 242 programs.

PROGRAM MANAGEMENT

At the time of our fieldwork, HEW's Division of Facilities Development (Bureau of Health Planning and Resources Development, Health Resources Administration) was responsible for administering the Hill-Burton program and performing functions delegated by HUD under the Section 242 program. 1/ The Facilities Development Division was responsible for developing regulations, policies, and procedures to administer the program and for assisting the regional offices on request.

At the regional level, the 10 regional health administrators were responsible for (1) determining a project's feasibility and approving loan applications, (2) making inspections during construction, and (3) monitoring loans after completing construction.

SCOPE OF REVIEW

We reviewed the administration of the two hospital loan assistance programs at HUD headquarters in Washington, D.C.; HEW's Health Resources Administration in Hyattsville, Maryland; and five HEW regional offices--Boston, Chicago, Dallas, New York, and San Francisco. We reviewed applicable legislation, regulations, program guidelines, and instructions and HEW and HUD project files. We also reviewed in depth the financial condition of 13 hospitals. Because most guaranteed and direct loans were made to hospitals, our review excluded guaranteed or direct loans to public health centers, outpatient clinics, long-term care centers, and rehabilitation facilities.

To assess the extent and causes of hospitals' financial problems, in March 1978 we sent a questionnaire (see app. I)

1/In September 1978, HEW reorganized the Health Resources Administration; a new Bureau of Health Facilities Financing, Compliance, and Conversion is now responsible for program activities.

to 380 hospitals with loans insured or guaranteed under these programs (see app. II). We received responses from 340 (about 90 percent) of the hospitals.

CHAPTER 2

OUR ASSESSMENT OF THE FINANCIAL

CONDITION OF HOSPITALS

Many hospitals with loans guaranteed or insured under the Hill-Burton and Section 242 programs have been experiencing serious financial problems. The problems could lead to defaults, substantial financial losses to the Federal Government, and closures of modern hospitals. HEW and HUD did not know the extent or severity of the problem.

FINANCIAL PROBLEMS AT HOSPITALS WITH INSURED OR GUARANTEED LOANS

As of March 1978, HEW and HUD had guaranteed or insured loans amounting to about \$3 billion at 380 hospitals. HEW has not routinely monitored these hospitals' financial status (see ch. 3) and, accordingly, did not know the magnitude of their financial problems.

Many hospitals with guaranteed or insured loans under these programs were experiencing serious financial problems. Officials of 44 hospitals with loans totaling about \$326 million stated that their financial condition was very poor or poor. Four hospitals with loans totaling \$30.5 million had already defaulted as of the completion of our fieldwork. 1/ The financial status of the 341 hospitals 2/ that responded to our questionnaire is:

1/After the completion of our fieldwork, two additional hospitals defaulted on their loans--one was classified as in very poor financial condition, while the other failed to respond to our questionnaire.

2/Includes one hospital (case A, p. 8) that defaulted on its loans and went bankrupt before we issued our questionnaire.

<u>Financial condition</u>	<u>Hospitals responding</u>	
	<u>Number</u>	<u>Percent</u>
In default	4	1
Very poor	12	4
Poor	32	9
Fair	124	36
Good	132	39
Very good	<u>37</u>	<u>11</u>
Total	<u>341</u>	<u>100</u>

The 48 financially troubled hospitals (in default, very poor, and poor) were mostly private nonprofit hospitals in 21 States. Most of these hospitals had experienced relatively significant financial losses; many of their officials anticipated serious problems with making the required loan payments.

The causes of financial problems

Officials at hospitals in very poor or poor financial condition indicated that the following factors, singularly or jointly, significantly affected their financial condition:

- Reimbursement limitations mandated by Medicare, Medicaid, and State regulatory agencies.
- The timeliness of reimbursements from third-party insurers.
- Bad debts and uncompensated care provided to persons unable to pay their hospital bills. Recipients of Hill-Burton assistance are required to provide a reasonable amount of uncompensated care to persons unable to pay.
- Substantial debt repayment from upgrading facilities to meet safety requirements.
- Unreimbursed inflation costs in the health care industry.
- Lower than anticipated occupancy rates.

We did not assess the extent that inefficiency contributed to the hospitals' financial problems. Improving hospital efficiency is the subject of a separate review by our office.

HOSPITALS WITH FINANCIAL
PROBLEMS: CASE STUDIES

To understand hospitals' financial problems, we reviewed in detail the financial conditions of 13 hospitals in five HEW regions. The following examples describe the financial problems of five hospitals--one in default, one in very poor financial condition (which was in the preliminary stages of default at the completion of our review), and three in poor condition.

Hospital A: in default

Hospital A, located in the Southwest, opened in May 1973 and went bankrupt in September 1974. The 130-bed hospital defaulted on its HUD-insured \$7 million construction loan and \$1.1 million operating-loss loan. Hospital construction was also financed by a \$1.1 million grant under the Hill-Burton program.

The hospital went bankrupt because its occupancy was substantially below the level needed to break even. We were advised that the hospital's board of directors alienated area physicians by limiting their input into the planning of the physical facilities and services. As a result, a number of area physicians opened a proprietary hospital nearby while hospital A was under construction. Additional hospital construction in the area also contributed to the occupancy problem.

Vacant since September 1974, the hospital was acquired by the Public Health Service in March 1978 to replace a hospital in Texas.

Hospital B: very poor

Hospital B, a 207-bed facility located in the East, modernized and expanded its facility for about \$12.9 million. About \$9.3 million of the construction cost was financed by a loan guaranteed under the Hill-Burton program.

Hospital B is experiencing financial problems due to (1) rate limitations imposed by the State on reimbursements for Medicaid and Blue Cross patients, (2) large amounts of bad debts and uncompensated care, (3) increased operating costs, and (4) to a lesser degree, reduced occupancy. A description of the financial losses and cash flow problems follows.

--Financial losses. Audited financial statements show net deficits of about \$251,000 in 1975, \$611,000 in 1976, and \$474,000 in 1977. Deficits could run an additional \$450,000 for 1977 if appeals to the State regarding Blue Cross and Medicaid reimbursements are denied. Interim financial statements show that these major deficits were continuing in 1978.

--Cash flow. The hospital had a severe cash flow problem. It had over \$1 million outstanding in accounts payable, and officials believe that bankruptcy could occur if creditors press for immediate payment. Further, the hospital owes \$500,000 to the employee pension fund, and it must also begin to repay a \$1.7 million loan obtained from a group of local banks.

At the conclusion of our fieldwork in July 1978, the hospital was in preliminary stages of default on its guaranteed loan because it failed to make four monthly principal and interest payments--the first was due in April 1978. Hospital officials indicated that they will be unable to make loan payments unless the current appeals for reimbursements for Medicaid and Blue Cross patients are upheld.

Hospital C: poor

Located in the Southwest, hospital C financed part of the cost of construction of an \$8 million hospital with a \$5 million loan guaranteed under the Hill-Burton program.

The 162-bed hospital was facing serious financial problems, and HEW officials believed that default was likely. Between June 1977 (when the hospital opened) and March 1978, the hospital incurred financial losses totaling over \$873,000; revenues amounted to \$2.3 million. Because of these losses hospital officials had to borrow about \$800,000 to sustain operations. The hospital had over \$425,000 in accounts payable more than 90 days old.

Construction of a number of hospitals in the area caused an excess supply of beds and an occupancy problem for the hospital. The hospital's financial problems were primarily due to low occupancy--only about 34 percent between June 1977 and March 1978. According to hospital officials, another factor contributing to low occupancy was that the hospital is not close to the offices of many staff physicians.

Hospital officials believed that occupancy will increase substantially after a nearby professional building is completed--although they questioned whether the hospital can avoid bankruptcy until construction is completed in the spring of 1979.

Hospital D: poor

An 80-bed facility in rural New England, hospital D was completed in January 1974. The hospital constructed a medical building shortly thereafter for physician offices, data processing equipment, and an outpatient clinic. The cost of both facilities was about \$6 million. The hospital financed most of the construction with a \$2 million loan guaranteed under the Hill-Burton program and about \$2.3 million in Federal grants. 1/

The hospital's financial status has worsened considerably since its first full year of operation. Financial statements show net deficits of about \$80,000 and \$140,000 in fiscal years 1976 and 1977, respectively. The hospital administrator believed that the deficits occurred because occupancy was lower than projected and the amount of uncompensated care was high. Further, he believed that default could occur in 2 years unless these problems were solved.

Medicare also determined that portions of certain hospital expenses--such as administrative, utilities, and maintenance--were allocable to the medical building and not subject to reimbursement. As a result, the hospital may have to repay Medicare about \$350,000 for fiscal years 1975-77. The administrator believed that, if its appeal to Medicare was denied, the hospital's demise would be imminent.

Hospital E: poor

Hospital E is a 249-bed nonprofit hospital located in a poor area of a major Midwest city. The board of directors financed construction and working capital requirements as follows:

1/Grants were provided by the Hill-Burton program (\$1,085,823), the Economic Development Administration (\$626,761), the Regional Medical program (\$500,000), and the New England Regional Commission (\$100,000).

	<u>Amount</u>
	(millions)
First mortgage bonds	\$3.9
HEW guaranteed loan	3.8
HEW grant	<u>1.1</u>
Total	<u>\$8.8</u>

A hospital official believed that the hospital had serious financial problems that would affect its ability to make the required loan payments. During fiscal years 1975, 1976, and 1977, the hospital incurred losses of about \$57,000, \$65,000, and \$75,000, respectively. Losses are projected to increase in fiscal year 1978. The hospital official expected to make next year's payments on the HEW guaranteed loan by borrowing additional funds. Should the hospital's financial problems remain unresolved, he expected the hospital to default on the HEW guaranteed loan.

Hospital officials attributed the poor financial condition mainly to the type of patients served by the hospital. The hospital served a large percentage of Medicaid and other welfare patients, for which the officials claimed it does not receive adequate reimbursement for services. The amount of bad debts and uncompensated care to patients unable to pay rose in each of the last 3 years. During fiscal year 1977 the hospital provided care costing over \$900,000 for which it was not reimbursed. Low occupancy and rising malpractice insurance premiums also contributed to the financial problems.

FINANCIAL PROBLEMS MAY BE
GREATER THAN REPORTED

For various reasons, some hospitals may be reluctant to report financial problems until the situation becomes critical. Consequently, the number of hospitals with financial problems may be greater than indicated by our questionnaire results.

Many of the 124 hospitals that described their financial condition as fair are having financial problems. For example, officials at 33 hospitals expected their financial condition to deteriorate or expected serious problems with making required loan payments. Many hospitals classified "fair" also showed relatively higher losses (by percent of losses to total revenues) than hospitals that classified themselves as being in poor financial condition.

Some of the 40 hospitals that failed to respond to our questionnaire could also be experiencing financial problems. For example, in June 1978 officials from a California hospital informed HEW that the hospital was experiencing a severe shortage of working capital. The officials stated that the hospital could not meet its next payroll, and HEW later learned that the hospital failed to make a guaranteed loan payment. According to hospital officials, the financial problems are so severe that the hospital may close.

CONCLUSIONS

Many hospitals with loans insured or guaranteed under the HEW Hill-Burton and HUD Section 242 programs were experiencing serious financial problems. HEW and HUD did not know the extent or severity of the problem. The financial problems could lead to default, closures of modern hospitals, and substantial losses to the Federal Government.

CHAPTER 3

LOAN MONITORING IS NEEDED TO IDENTIFY AND ASSIST FINANCIALLY TROUBLED HOSPITALS

HEW's monitoring of loans under the two hospital loan assistance programs has been inadequate, and efforts to improve it have been unsuccessful. HEW was generally not aware of which hospitals were experiencing financial problems until hospitals voluntarily reported the problems. An aggressive monitoring program is needed to provide HEW the opportunity to (1) determine the extent and severity of the problems, (2) provide assistance to financially troubled hospitals before financial problems become insurmountable, and (3) assess the adequacy of default funds.

HEW RECOGNIZES THE NEED FOR IMPROVED MONITORING

HEW has recognized for more than 2 years that a lack of loan monitoring has been a problem. In June 1976 a consulting firm advised HEW that the lack of monitoring was a serious problem which, unless corrected, could result in loan defaults and substantial financial losses. The consultant recommended that HEW immediately develop and implement a loan monitoring system that assures (1) contact with borrowers and lenders, (2) a review of a borrower's financial status, and (3) plans to assist problem hospitals. In October 1976 an HEW task force confirmed that no monitoring system existed; it made similar recommendations.

EFFORTS TO IMPROVE MONITORING HAVE BEEN UNSUCCESSFUL

In May 1977, in response to the reports of the consulting firm and internal task force, the Office of the Assistant Secretary for Health directed the regional offices to establish a loan officer position. The loan officer is responsible for performing the loan management functions--including loan monitoring--for all Public Health Service and Section 242 loan programs. However, at the time of our review, monitoring duties and responsibilities were not clearly defined.

Although the loan officer positions have been staffed, monitoring efforts as of June 1978 had not substantially improved in four of the five regional offices reviewed. Four regional offices were not routinely performing any of the above monitoring activities--although one of the four was making a limited review of some hospitals' financial statements for obvious problems. Monitoring in these regions

for the most part was done on an exception basis--after a hospital reported it was having a problem or needed assistance. The fifth regional office recently implemented a partial monitoring program, whereby the staff makes annual visits to a number of the hospitals, reviews their financial statements, and determines the status of loan and sinking fund payments.

Why monitoring is not being done

Four of the five regional offices we visited said they lacked sufficient guidance to conduct a loan monitoring program. Two of the four regions added that they had insufficient staff to monitor loans, while the other two said that they will be better able to assess staff needs when they receive headquarters guidance on what specific monitoring tasks should be done.

In November 1978, after completion of our fieldwork, HEW amended the Public Health Service Loan Administration Manual by incorporating loan monitoring policies and procedures. This amendment provides loan monitoring guidance (including requiring the review of borrower financial statements) and establishes criteria by which the activities of loan officers can be evaluated. But we believe that HEW's loan monitoring policy should also include determinations of (1) the degree of risk on each loan, (2) compliance with sinking fund requirements and other loan conditions, and (3) the adequacy of the collateral. We also believe that annual site visits, as a minimum, should be required so that loan officers may obtain comprehensive information on the borrower's financial status and operating conditions.

EXAMPLES OF INADEQUATE MONITORING

Our review has revealed inadequate loan monitoring under the two loan assistance programs. Although 44 hospitals said their financial condition was either very poor or poor, HEW was aware of only 6 as having financial problems.

In another case, a hospital with a \$2 million loan failed to make four semiannual loan payments (totaling about \$180,000) before HEW became aware of the problem. The lender finally notified HEW about the delinquent payments in June 1977, and the hospital stopped operating 1 month later. The lender requested payment under the loan guarantee in October 1977, and the borrower filed for bankruptcy. With timely monitoring, HEW would have known of the hospital's financial problems and might have been able to help it avert bankruptcy.

Inadequate monitoring, however, limits HEW's ability to identify and assist hospitals with problems before conditions become critical. Similar problems were noted with HEW's monitoring of hospital compliance with sinking fund requirements.

HOSPITAL SINKING FUNDS

Since January 1973 the Hill-Burton and Section 242 Mortgage Insurance programs have required that hospitals establish restricted savings accounts (called sinking funds) to assure that funds are available, when needed, to repay loans--thus reducing the risk of loan default. Despite the importance of these funds, HEW did not know whether hospitals were making payments because HEW was not monitoring these activities. Many hospitals which were required to establish sinking funds had not done so.

The importance of sinking funds

Although mortgage payments generally remain the same throughout a mortgage's life, the principal portion of the payment continually increases while the interest portion decreases. Through reimbursement mechanisms, principal payments are recovered through annual depreciation expenses that are included in the fees charged by the hospital for services rendered. In the early years of the mortgage, the annual depreciation charge exceeds the principal payment by a considerable margin but, in later years, the reverse is generally true. The sinking fund is to be used to accumulate funds obtained through charges for depreciation expenses during the earlier years of the loan; this assures its availability for repayment of principal during later years (when principal payments exceed the depreciation charge). Thus, sinking funds are important for assuring mortgage payment.

The requirement to establish a sinking fund may be waived by HEW, but only if a hospital pledges sufficient unrestricted funds to loan repayment. HEW officials believe that fully funded sinking funds are critical for preventing loan default because, without the funds, many hospitals will spend the excess cash generated by charges for depreciation expenses. If this is done, a serious problem with meeting later mortgage payments could develop.

Hospitals that received loans before January 1973 were not required to establish sinking funds; also, some hospitals with financial problems may be temporarily unable to make sinking fund payments. In these cases, to minimize problems with repaying principal in later years, HEW should encourage

hospitals without sinking funds to establish such an account; HEW should also insure that hospitals later fund any temporarily reduced or postponed payments.

The status of sinking funds

As discussed on page 13, the HEW regional office staffs are not routinely monitoring loans, including the status of sinking fund payments. HEW regional office staff should review the hospitals' financial statements and make periodic site visits to monitor their status. As discussed below, our questionnaire results and fieldwork indicate that many hospitals are not complying with the sinking fund requirement.

- Our questionnaire. We asked hospital officials to indicate the status of their sinking fund payments. Twenty hospitals reported that they had not made any of the required payments or that some payments had been missed. These hospitals have guaranteed or insured loans amounting to over \$118 million.
- HEW regional audit report. A January 1978 report examined five hospitals for compliance with the sinking fund requirement. The auditors found that none of the hospitals were making the required payments. The delinquent payments for four of the five hospitals ranged from about \$29,000 to \$297,000. Although the auditors did not determine the amount of delinquent payment for the fifth hospital, officials of that hospital acknowledged that payments were past due.
- Consultant's report. In one HEW region a consultant reviewed seven hospitals for compliance with the sinking fund requirement and reported that five had not made the required payments. Delinquent payments ranged from \$22,000 to \$1.2 million. He concluded that few hospitals in that region were complying with the requirement.

In addition, 26 hospitals reported in our questionnaire that HEW waived the sinking fund requirement because the hospitals pledged other unrestricted funds to assure loan repayment. Six of these hospitals were located in the HEW regions we reviewed. The sinking fund requirement for four had not been waived, and HEW was unaware that the hospitals had not established sinking funds.

One hospital, for example, reported to us that its sinking fund requirement was waived. HEW officials, however, said that the hospital is required to have a fund. Although the hospital's former director of fiscal services told HEW in 1974 that a sinking fund would be provided, the hospital's board of directors had apparently never discussed or authorized such a fund.

The adequacy of sinking fund payments

One of the 13 hospitals we reviewed was not making sufficient payments to the sinking fund to assure repayment of the loan principal. The hospital financed construction with a \$1.6 million loan--about \$585,000 of which is federally guaranteed. This hospital was required to deposit \$1,250 per year in its sinking fund. HEW regional officials stated that, although they inadvertently approved the sinking fund schedule, it is inadequate for covering the \$1.6 million loan. The hospital should have been required to deposit about \$23,000 annually into the sinking fund.

HOW FINANCIALLY TROUBLED HOSPITALS ARE HELPED

HEW and HUD have various options available to assist hospitals identified as financially troubled. Although the severity of some situations may warrant no further investment by the Federal Government, in many instances assistance could give the hospital time to resolve its financial problems and avert default.

Methods to assist financially troubled hospitals varied, depending on whether the loan was guaranteed under the Hill-Burton program or insured under the Section 242 program. The available options by program are:

- Analyze financial problems (Hill-Burton and Section 242). HEW can hire consultants or use its internal staff to analyze hospital financial problems and recommend corrective actions.
- Waive sinking fund payments (Hill-Burton and Section 242). HEW and HUD can temporarily waive or reduce the payments. Cash that otherwise would be accumulated in a sinking fund can be used for working capital and other purposes.

- Insure additional loans during construction (Section 242 only). HUD can insure an additional loan if financial problems are encountered before the project is completed. The additional loan can be provided only if total loans for the project do not exceed the limits placed on Federal participation.
- Insure operating-loss loans (Section 242 only). HUD can insure an additional loan to a hospital equal to the operating deficit (less depreciation expenses) incurred during the first 2 years following the project's completion. A hospital is limited to one such loan.
- Make principal and interest payments (Hill-Burton only). By using default funds, HEW can continue to make principal and interest payments to the lender on behalf of the hospital rather than pay off the entire loan and acquire the facility or other collateral.

Loan monitoring is important if the methods to assist financially troubled hospitals are to be effective. The following example describes the timely assistance provided to one hospital before its financial problems became so severe that loan default could not have been prevented.

A 255-bed hospital located in a major Northeastern city replaced its facility between 1973 and 1976 at a cost of about \$44 million. The project was initially financed with a \$9.4 million Hill-Burton guaranteed loan and a \$27 million Section 242 insured loan. In February 1976, while construction was ongoing, hospital officials notified HEW and HUD that they were experiencing severe financial problems--the hospital needed \$3 million to complete construction and acquire needed equipment. Funds were also needed to offset anticipated operating deficits. The hospital attributed its financial problem to inadequate reimbursement due to Medicare and State agency hospital rate limitations.

HEW used a number of options to assist the hospital. A consultant was hired to review the hospital's financial problems. Based on the HEW staff's and the consultant's recommendations, HUD insured an additional \$4.5 million loan for the facility in October 1976. One condition of the loan was that the hospital had to permit HEW to have input into decisions affecting hospital operations. HEW established an internal regional committee to closely monitor loans to this hospital. HEW also met with hospital management, attended board meetings, and reviewed in depth its monthly financial

statements and budgets. HEW and HUD also reduced the hospital's sinking fund payments for 3 years, thereby providing the hospital an additional \$1.9 million in working capital during this critical period.

The hospital's financial condition has improved considerably. Its interim financial statements show a net income of \$234,000 for the first 9 months of fiscal year 1978--compared to a \$51,000 deficit for the same period in fiscal year 1977. HEW and hospital officials believe that default is now unlikely.

RISK ASSESSMENTS AND THE ADEQUACY OF DEFAULT FUNDS

As previously discussed, HEW contracted with a private consulting firm to study the administration of the loan assistance programs. The firm recommended in June 1976 that risk assessments--a review of the hospital's debt structure, credit record, strength of management, financial status, and other characteristics--be made on each loan. In July 1976 the Associate Administrator, Health Resources Administration, formed a task force to further analyze various administrative problems under these programs and recommended that risk assessments be performed as quickly as possible. Risk assessments had not been made as of September 1978.

HEW and HUD have established default funds to pay to lenders in case of a loan default. HEW and HUD did not know whether these funds were adequate because they had not determined the risk of default on hospitals with program loans. Although lacking specific data, HEW officials expected a large number of defaults in the future. Default experience to date has been minimal because many hospitals are still under construction or have only recently begun loan repayment. (As of May 1978 about 25 percent of the assisted hospitals were still under construction.) Program officials believed that financial problems are far more likely to develop when repayment begins.

The Hill-Burton program

The Congress has appropriated \$50 million to cover defaulted loans under the program. To date, HEW has expended about \$630,000 1/ to continue principal and interest payments

1/Excludes about \$135,000 in default payments relating to a nursing home which was not the subject of this review.

to lenders on behalf of two defaulted hospitals. HEW has decided to continue payments rather than pay off all loans (about \$3.4 million) and acquire these facilities.

HEW has guaranteed loans worth about \$132 million to 37 of the 48 financially troubled hospitals (hospitals that defaulted or whose financial condition was very poor or poor). The largest of the 37 guaranteed loans was \$14.4 million; the average was \$3.5 million.

HEW has not made risk assessments to determine the degree of loan default risk for each loan guaranteed under the Hill-Burton program and, consequently, did not know if its loan default fund was adequate.

The Section 242 program

HUD's General Insurance Fund is used for insuring mortgages under various programs--including the Section 242 program. Income to the fund includes insurance premiums, program fees, and interest income derived from investments. The expenses include insurance losses, interest on debenture bonds, and administrative expenses. Provision is also made for estimated future losses on acquired properties and mortgage notes.

As of September 1977 the General Insurance Fund had a deficit balance of over \$2 billion; the Section 242 program's portion of the deficit was about \$11.9 million. A HUD official explained that, under the Section 242 program, interest and administrative expenses exceeded income by about \$2.1 million, and estimated losses on two defaults amount to about \$9.8 million. The two Section 242 hospital defaults amount to about \$27 million.

HUD estimates that, after considering proceeds for liquidation of assets and other factors, its loss to be charged to the General Insurance Fund is \$9.8 million. HUD issued negotiable Government debenture bonds to pay off lenders in both instances. One hospital was still operating and making principal and interest payments to HUD. The second hospital (p. 8, case A) went bankrupt.

HUD has insured loans amounting to about \$224 million to 18 of the 48 financially troubled hospitals.

THE DEFAULT STRATEGY

The November 1978 amendment to the Public Health Service Loan Administration Manual included policies and procedures on handling loan defaults. This amendment, however, does not identify factors that should be considered when formulating a plan of action, including (1) whether HEW should continue principal and interest payments or pay off the loan, (2) whether to foreclose and sell off the acquired hospital facility or operate it through a hospital management firm, or (3) whether the acquired properties should be initially offered to other Government agencies or sold on the open market. Although few defaults have occurred to date, our review indicates that the situation is likely to worsen.

In commenting on a draft of this report, HEW indicated that new chapters of the Public Health Service Loan Administration Manual issued in November 1978 identify the key factors in formulating an action plan for handling defaults. HEW said that individual defaults vary sufficiently to require solutions on a case-by-case basis. HEW did indicate, however, that it will continuously monitor its default strategy and, as appropriate, issue additional guidance--including criteria for ownership and disposition of property acquired through foreclosure actions.

CONCLUSIONS AND RECOMMENDATIONS

Despite prior recommendations, HEW was not routinely monitoring loans under the Hill-Burton and Section 242 programs. Consequently, program officials could not identify many financially troubled hospitals, provide assistance to such hospitals before problems became insurmountable, or assess the adequacy of default funds. Although HEW believed that sinking funds were important for reducing the risk of loan default, it was not monitoring hospitals' compliance with the requirement for such funds. As a result, HEW did not know if hospitals were making the required payments, and many hospitals had not established the required sinking funds.

We recommend that the Secretary of HEW:

- Issue additional guidance for monitoring loans and implement a viable loan monitoring program.
- Determine and monitor the status of hospital sinking funds to assure that payments are current and sufficient for insuring loan repayment, and encourage hospitals without a sinking fund to establish one.

--Make comprehensive risk assessments to identify the risk of default on program loans.

--Advise the Congress of the potential losses and adequacy of loan default funds.

HEW COMMENTS AND OUR EVALUATION

HEW concurred in our recommendations about the need for issuing additional guidance for loan monitoring and implementing a viable loan monitoring program. To reduce the possibility of future defaults, HEW said that it has initiated a rigorous loan monitoring system. HEW noted that the loan programs have been increased in status and visibility through placement in a new Bureau of Health Facilities Financing, Compliance, and Conversion and that additional staff has been acquired. HEW also said that additional loan monitoring guidance is being developed.

HEW also concurred in our recommendations on the need for determining and monitoring the status of hospital sinking funds and the need for comprehensive risk assessments. Recent additions to the Public Health Service Loan Administration Manual provide guidance for loan officers on these subjects.

HEW did not fully concur in our recommendation on the need to advise the Congress of the potential losses and adequacy of loan default funds. HEW said the default fund is currently adequate and that it will notify the Congress in a timely manner if the fund becomes sufficiently depleted to require replenishment. Our review, however, indicated that a significant number of hospitals readily admitted that they are experiencing serious financial problems and that many others may be having similar problems. Thus, we believe HEW should inform the Congress of the total extent of this problem when it completes its comprehensive risk assessment for all loan recipients so that the Congress will be aware of the total potential default fund need.

CHAPTER 4

THE COLLATERAL THAT SECURES

HOSPITAL LOANS IS INADEQUATE

The Hill-Burton and Section 242 loan programs require HEW and HUD to protect the Federal Government's financial interests by securing adequate collateral--assets that can be claimed in case of loan default. Program regulations do not provide adequate guidance on collateral. HEW and HUD generally get a first mortgage on a property as security for a loan, but they occasionally accept other less desirable forms of collateral, such as leases and claims on a hospital's gross or net revenues. The collateral that secured loans to the 13 hospitals reviewed supports an earlier internal HEW study, which concluded that many loans have inadequate collateral to protect the Government's financial interests.

THE INADEQUACY OF COLLATERAL SECURING DIRECT LOANS

In the summer of 1977, HEW regional health administrators were notified of a problem with the collateral that secures many direct loans to hospitals. An HEW report showed that 25 of 73 public hospitals had direct loans secured only by a claim on the hospital's gross or net revenues. HEW program officials stated that this is inadequate collateral because, in case of loan default, HEW would have no claim on the hospital's building and equipment. It is also unlikely that a defaulted hospital would have sufficient gross or net revenues to enable HEW to recover its investment. For this reason, HEW program officials believe that loans having inadequate collateral should be closely monitored because of the Government's added risk of loss in case of default. The loans to the 25 hospitals mentioned above totaled almost \$63 million.

Because most State and local laws do not permit the mortgaging of public facilities, HEW accepts other forms of collateral (such as a claim on revenues). An HEW program official stated, however, that more adequate collateral than a claim on revenues should be obtained. For example, on direct loans, HEW could purchase general or special obligation bonds from the public body that owns the hospital. General obligation bonds are a debt of the public body; repayment does not depend on the hospital's financial condition. A special obligation bond is usually backed by the proceeds

of a special tax levy specifically pledged to repay the bonds. The official believed that general or special obligation bonds provide the best collateral that HEW can obtain when making direct loans to public hospitals.

THE INADEQUACY OF COLLATERAL SECURING
GUARANTEED AND INSURED LOANS

HEW had not assessed the adequacy of collateral securing guaranteed or insured loans. We believe the collateral accepted by HEW was inadequate for 3 of the 13 hospitals reviewed in depth. In two cases, HEW or HUD accepted a lease (the right to operate the hospital) as collateral. In the third case, HEW accepted a second lien even though most of the construction funding was provided by the Hill-Burton program. One hospital defaulted on its loan, and the other two were in poor financial condition. A description of the collateral problems involved in the three case studies follows.

The first case involves a 75-bed hospital, which is owned by a county government, but operated by a nonprofit corporation under a lease arrangement. The corporation renovated the facility between January 1975 and March 1977 with the aid of a \$2 million Hill-Burton guaranteed loan. After experiencing financial problems, the corporation defaulted on its loan, filed for bankruptcy, and discontinued operating the hospital. The county later hired a management consulting firm to operate the hospital. As of August 1978 HEW had made principal and interest payments on behalf of the hospital totaling about \$415,000.

HEW officials stated that they had a collateral problem on this loan because the county government (the owner) was not involved in the loan transaction. HEW accepted the corporation's lease with the county as security for the loan to the corporation. In case of default, HEW's security, in effect, is the right to operate the hospital--a practice not intended under the Hill-Burton program. After default payment, HEW has no claim against the hospital building or fixed equipment. An HEW regional attorney stated that, although HEW could sell the lease, it is unlikely that anyone would be interested in purchasing the lease of a financially troubled hospital. The attorney said that HEW could have made a direct loan to the county and secured adequate collateral by requiring the county to issue general or special obligation bonds.

The county will not assume responsibility for the bankrupt corporation's debts--including the guaranteed loan. County officials proposed that HEW (1) continue operating the hospital under the existing lease or (2) pay off the loan and the county will operate the hospital without any obligation to repay the loan. The matter was unresolved as of August 30, 1978.

A similar collateral situation existed at a second hospital. In this case, the hospital is also owned by a county government, but it is operated by a corporation under a lease arrangement. The county did not participate in the loan transaction, and HUD accepted a lease as its collateral for the \$2.5 million loan insured under the Section 242 program. A hospital official stated that default could occur within a few years if the hospital's financial problems are not resolved. The HEW regional attorney was concerned that similar problems to the above case may cause default.

The third case involves a \$6 million 80-bed hospital constructed between August 1971 and January 1974. As discussed on page 10 (case D), this hospital was experiencing serious financial problems that officials believed could result in default in 2 years.

The Federal Government has a second lien on the hospital's land, buildings, and equipment, even though it provided or guaranteed \$4.3 million of the \$6 million used to construct the project (about \$2.3 million in grants and \$2.0 million in long-term notes guaranteed under the Hill-Burton program). Some of the hospital construction funds were obtained by issuing \$950,000 in bonds. These bondholders have the first lien on the hospital's property and, in case of default, would be paid before the Government could claim any of the hospital's assets.

Hill-Burton policy guidance requires HEW to secure a first lien--the first claim on the collateral securing the loan--when the guaranteed loan represents more than 50 percent of the hospital's long-term debt. A waiver of this requirement requires headquarters approval. Although the above guaranteed loan amounted to 67 percent of the hospital's long-term debt, HEW accepted only a second lien; we could find no waiver of the lien requirement.

HEW PROBLEMS WITH PROGRAM
REGULATIONS AND GUIDANCE

Hill-Burton program regulations require that guaranteed and direct loans be secured by collateral that the Secretary of HEW finds reasonably sufficient to insure repayment. The regulations specify that the collateral could be one or more of the following: (1) a first mortgage on a facility, (2) negotiable stocks and bonds, (3) a pledge of unrestricted or unencumbered funds from an endowment or other trust funds, (4) a pledge of annual or special revenues, (5) full faith and credit (tax supported) of the State or local public body, or (6) such other security as the Secretary of HEW finds acceptable. HUD program regulations require that the collateral for a loan be the first lien on the property or a first lien on the lease.

Officials at HEW headquarters and three regional offices said that guidance is needed to determine when, and under what circumstances, the various forms of collateral should be accepted. The regional health administrator in one region said HEW did not have guidelines for what constitutes adequate collateral--without such guidelines, he had no criteria for judging the adequacy of collateral used by hospitals to secure future loans under Title XVI of the National Health Planning and Resources Development Act of 1974. Another regional official also commented on the absence of guidance--particularly guidance on the adequacy of leases and claims on hospital revenues as collateral. A headquarters program official also confirmed this need--particularly now, because HEW plans to make loans and loan guarantees available under the new act.

CONCLUSIONS AND RECOMMENDATIONS

Program guidance requires HEW and HUD to obtain sufficient collateral for protecting the Government's financial interests. Indications are that both actual and potential problems exist with the Government's collateral position on some loans. These loans should be identified and closely monitored because of the Government's added risk in case of foreclosure. Additional guidance is needed to assist regional staff in obtaining acceptable collateral on future HEW and HUD loans.

We recommend that the Secretaries of HEW and HUD

- review their loan portfolio to determine the adequacy of the Government's collateral position and
- provide regional staff additional guidance on the circumstances in which the various forms of collateral should be accepted.

We also recommend that the HEW Secretary closely monitor the financial status of loans secured with inadequate collateral because of the added risk in case of default.

HEW AND HUD COMMENTS AND OUR EVALUATION

Both HEW and HUD concurred in our recommendations. HUD said that it will cooperate with HEW in reviewing the loan portfolio but pointed out that collateral on loans made under its Section 242 program is dictated by law. Regarding the need for additional collateral guidance, HUD said that HEW regional personnel who process the Section 242 loans may be somewhat confused about the HUD requirements. HUD said it would discuss the need for clarification of its requirements with HEW.

HEW said that, in its monitoring of all loans, special consideration will be given to collateral. HEW also said that three new chapters to the Public Health Service Loan Administration Manual to be issued soon will set forth requirements for obtaining acceptable collateral for each loan. These requirements will specifically restrict the use of intangible collateral, such as leases or revenues.

CHAPTER 5

CONCURRENT MORTGAGE INSURANCE AND

LOAN GUARANTEES MADE FOR SOME LOANS

HEW developed an unusual financial arrangement (termed an overlay) to provide a Hill-Burton interest subsidy to several hospitals that otherwise would not be eligible to receive one. On overlays, HEW guarantees the repayment of part of a loan that has already been insured by HUD--this is a double Federal guarantee on the loan. The hospitals, as a result, are not receiving the full benefit of the Federal interest subsidy because they are unnecessarily paying mortgage insurance premiums amounting to about \$3.7 million for the double coverage over the life of these loans.

OVERLAYS REDUCE INTEREST SUBSIDY BENEFITS

An overlay is a financial arrangement whereby HEW guarantees the repayment of part of a loan already covered by HUD mortgage insurance. For example, a hospital obtains a \$2 million loan insured by the HUD Section 242 program to finance construction. Later, HEW, in order to provide the hospital with a Hill-Burton interest subsidy, guarantees the lender that, in case of default, it will repay \$1 million of the \$2 million loan. Thus, the lender is assured repayment of the \$1 million from two sources--the HUD mortgage insurance and the HEW guarantee. The hospital has duplicate coverage, but it must pay the mortgage insurance premium of 0.5 percent to HUD for the unneeded coverage. In effect, HUD accepts the premium without any risk because HEW is responsible for default payment under the overlay arrangement. Because the hospital has to pay a 0.5-percent premium on overlaid projects, the 3-percent interest subsidy that accompanies Hill-Burton guaranteed loans is reduced to 2-1/2 percent.

For example, HUD insured a \$6 million loan to finance construction of a new regional hospital. Upon construction completion in 1976, HEW guaranteed repayment of \$3.4 million of the \$6 million insured loan in order to grant the Hill-Burton interest subsidy. Between November 1976 and June 1978 HEW paid an interest subsidy of \$177,000, while the hospital paid about \$28,000 in mortgage insurance premiums to HUD on the loan's overlaid portion. HEW will eventually pay over \$1.7 million in interest subsidy benefits over the life of the loan, while HUD collects unnecessary mortgage

insurance premiums from the hospital of about \$283,000. Thus, the hospital receives a subsidy on the Hill-Burton guaranteed portion of the loan amounting to about 2-1/2 rather than the intended 3 percent.

HEW'S USE OF OVERLAYS

HEW initiated the overlay arrangement to provide an interest subsidy to some hospitals that otherwise would not have received one. Without the overlay arrangement, the hospitals would not have been able to obtain the interest subsidy because (1) the hospitals had already secured permanent loans under the HUD Section 242 program before HEW-guaranteed loan funds became available and (2) the act does not allow HEW to provide an interest subsidy without also guaranteeing the loan. Thus, to secure the interest subsidy, HEW had to guarantee repayment of a loan that HUD had already insured under the Section 242 program.

Nationwide, 10 projects have received overlays totaling over \$44 million. The overlays range from \$250,000 to \$11.6 million. We estimate that the 10 hospitals will pay about \$3.7 million in unnecessary mortgage insurance premiums over the life of these loans.

MORTGAGE INSURANCE COVERAGE FOR TITLE VII PROJECTS

The Housing and Community Development Act of 1977 amended the Section 242 program to eliminate mortgage insurance premiums on overlaid projects that HEW and HUD had jointly guaranteed under Title VII of the Public Health Service Act. Under Title VII, HEW guaranteed loans to construct facilities to teach health professionals. Although a HUD official stated that it was an oversight that Title VI was not included in this amendment, HUD had not acted, as of January 1979, to remedy the overlay situation on Title VI loans.

CONCLUSIONS AND RECOMMENDATIONS

HEW guaranteed the repayment of a portion of several loans that had already been insured by HUD. Because these hospitals will pay mortgage insurance premiums on the doubly covered portion of the loans, the full Hill-Burton interest subsidy benefit will not be realized.

We recommend that the Secretaries of HEW and HUD determine whether HUD should retain the unnecessary mortgage insurance premiums paid to date by the hospitals.

We recommend that the Congress amend Section 242 of Title II of the National Housing Act to eliminate mortgage insurance premiums on portions of loans also guaranteed by HEW under Title VI of the Public Health Service Act and to preclude such practices on loans guaranteed and made under Title XVI of the Public Health Service Act.

HEW AND HUD COMMENTS AND OUR EVALUATION

HEW said that unnecessary mortgage insurance premiums are no longer permitted for new projects and that efforts are being made to eliminate such premiums on past loans. HEW added that HUD must determine if unnecessary premiums collected in the past should be retained.

HUD advised us that it is investigating the legality and fiscal feasibility of refunding the unnecessary mortgage insurance premiums already collected from hospitals. It said that, if it is legally possible and fiscally sound, the excess premiums would be refunded. HUD endorsed our recommendation to the Congress to amend the National Housing Act to eliminate mortgage insurance premiums on portions of loans also guaranteed by HEW.

**U.S. GENERAL ACCOUNTING OFFICE
SURVEY OF MEDICAL FACILITY FINANCIAL CONDITIONS**

INSTRUCTIONS

Please answer each of the following questions as frankly and completely as possible.

There is space at the end of the questionnaire for any comments you may wish to make concerning the questionnaire or any other related topics.

The questionnaire is numbered only to permit us to delete your name when we receive your completed questionnaire and thus avoid sending you an unnecessary follow-up request.

Throughout this questionnaire, there are numbers printed within parentheses to assist our keypunchers in coding responses for computer analysis. Please disregard these numbers. If you have any questions, please call Mr. Ken Croke or Mr. Ken Graffam at (617) 223-6536.

RESPONDENT INFORMATION:

NAME: _____

TELEPHONE: (_____) _____
(Area Code) (Number)

TITLE: _____

1. How would you characterize the current financial condition of your hospital? *(Check one.)* (6)

- Very good financial condition
- Good financial condition
- Fair financial condition
- Poor financial condition
- Very poor financial condition

2. What change, if any, is likely to occur in the financial condition of your hospital over the next three years? *(Check one.)* (7)

- Significant improvement
- Some improvement
- Little or no change
- Some deterioration
- Significant deterioration

3. Currently, what impact, if any, are each of the following having on your hospital's financial condition? *(Check one box for each row.)*

	Significant Positive Impact	Positive Impact	Little or no Impact	Negative Impact	Significant Negative Impact	Not Applicable
	(1)	(2)	(3)	(4)	(5)	(6)
1. Reimbursement for Medicare patients and/or routine cost ceiling (8)						
2. Reimbursements for Medicaid patients (9)						
3. Repayment of debt (principal and interest) (10)						
4. Present occupancy rate (11)						
5. Increased operating costs due to inflation (12)						
6. Conforming to safety requirements (13)						
7. Uncompensated care (14)						
—inpatient (15)						
—outpatient (16)						
8. Timeliness of third party reimbursement (17)						
—Medicare (18)						
—Medicaid (19)						
—Blue Cross (20)						
—Other Private Insurance (21)						
9. State or other rate regulation (22)						
10. Other <i>(Please specify)</i> (21)						
_____ (22)						

4 How would you characterize HEW's monitoring of the status of your loan? (Check one.) (23)

- Little or no monitoring
- Some monitoring
- Extensive monitoring

5. Which of the following types of assistance, if any, have been provided by HEW or HUD in addition to your original direct, guaranteed, or insured loan? (Check all that apply)

- HUD has insured an additional loan on the mortgage of the property (24)
- HUD has insured a loan to cover operating losses (25)
- HEW or HUD have waived sinking fund payments (26)
- HEW or HUD are making interest and/or principal payments (27)
- HEW and/or HUD have granted a moratorium (temporary suspension of payment) on the loan (28)
- HEW has provided an overlay to the HUD loan (a portion of a HUD loan that is also insured by HEW--double covered) (29)
- None of the above (30)
- Other (Please specify) _____

_____ (31)

6. Does your hospital anticipate serious problems making required payments on any direct, guaranteed, or insured loan(s)? (Check one)

- No (32)
- Yes

7. Please enter checks in the following table to indicate the current status (principal and interest) of your HEW direct, HEW guaranteed, and/or HUD insured loan(s). (Please check the applicable boxes or enter NA where appropriate.)

	HEW guaranteed		HEW direct		HUD insured		
	(1) Prin.	(2) Int.	(1) Prin.	(2) Int.	(1) Prin.	(2) Int.	
Payment current							(33-38)
One or more payments delinquent							(39-44)

8. HEW and HUD frequently require that hospitals make cash payments to a sinking fund to assure that sufficient funds will be available to retire the debt and replace equipment. Did HEW/HUD require you to establish a sinking fund? (Check one.)

- Yes -- If yes, skip to Question 10 (45)
- No

9 If a sinking fund is not required, check one of the following, and skip to Question 11. (46)

- HEW waived the sinking fund requirement because the hospital pledged other unrestricted funds to assure loan repayment
- The hospital has not closed on its loan(s)
- Other (Please explain) _____

<p>10 Which of the following statements best describes the current status of your sinking fund payments? <i>(Check one)</i></p> <p><input type="checkbox"/> First payment is not due (47)</p> <p><input type="checkbox"/> Payments are current (48)</p> <p><input type="checkbox"/> One or more payments have been made, but other payments are past due (49)</p> <p><input type="checkbox"/> No payments have been made (50)</p> <p><input type="checkbox"/> Other <i>(Please specify)</i></p> <p>_____</p> <p>_____ (51)</p> <p>11. Did your hospital experience a net loss (total expenses exceeded total revenues) for your fiscal 1977 year? <i>(Check one)</i></p> <p><input type="checkbox"/> No (52)</p> <p><input type="checkbox"/> Yes - If yes, please enter</p> <p style="padding-left: 40px;">Amount of net loss \$ _____ (53-60)</p> <p style="padding-left: 40px;">Amount of total revenues \$ _____ (61-68)</p> <p>12. Does your hospital anticipate a net loss for fiscal year 1978? <i>(Check one.)</i></p> <p><input type="checkbox"/> No (6)</p> <p><input type="checkbox"/> Yes - If yes, please enter</p> <p style="padding-left: 40px;">Estimated net loss: \$ _____ (7-14)</p> <p style="padding-left: 40px;">Estimated total revenues: \$ _____ (15-22)</p>	<p>13. If you have any additional comments, please include them in the space below. Feel free to include any ideas on what, if anything, the Federal Government could do to improve the financial condition in hospitals?</p> <p style="text-align: right;">(23-26)</p>
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NUMBER OF HOSPITALS RECEIVING
HILL-BURTON OR SECTION 242 LOAN ASSISTANCE
AS OF MARCH 1978

Hospitals receiving Hill-Burton loan assistance:	
Facilities with:	
Guaranteed loans	271
Direct loans	<u>81</u>
	352
Less: nonhospitals (note a)	<u>35</u>
	317
Hospitals with Section 242 insured loans	<u>140</u>
	457
Less: hospitals which received loans under both programs or refinanced their loans	<u>77</u>
Total participating hospitals	<u>380</u>

a/Nonhospitals include public health centers, outpatient clinics, and long-term care and rehabilitation facilities.



DEPARTMENT OF HEALTH, EDUCATION, AND WELFARE
OFFICE OF THE SECRETARY
WASHINGTON, D.C. 20201

APR 27 1973

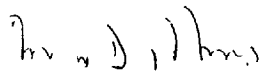
Mr. Gregory J. Ahart
Director, Human Resources
Division
United States General
Accounting Office
Washington, D.C. 20548

Dear Mr. Ahart:

The Secretary asked that I respond to your request for our comments on your draft report entitled, "Hospital Loan Assistance Programs: Actions Needed to Reduce Anticipated Defaults." The enclosed comments represent the tentative position of the Department and are subject to reevaluation when the final version of this report is received.

We appreciate the opportunity to comment on this draft report before its publication.

Sincerely yours,


Thomas D. Morris
Inspector General

Enclosure

COMMENTS OF THE DEPARTMENT OF HEALTH, EDUCATION, AND WELFARE ON THE
COMPTROLLER GENERAL'S DRAFT REPORT ENTITLED "HOSPITAL LOAN ASSISTANCE
PROGRAMS: ACTIONS NEEDED TO REDUCE ANTICIPATED DEFAULTS"

GENERAL COMMENTS

Eighty-six percent of the facilities surveyed by the General Accounting Office report that they are in "fair" or better financial condition and 50 percent report that they are in the "good" or better category. The current one percent financial default rate for the program is within accepted industry experience. It is recognized that as the loans age, there is danger of future financial deterioration due to such factors as overbedding, inflation, expensive technological advances and restrictive reimbursement. To reduce the possibility of future defaults, HEW has initiated a rigorous loan monitoring system. Because of the existence of excess hospital beds and because of the continuation of the HUD Section 242 mortgage insurance program for hospitals, HEW is not requesting further loan and loan guarantee authority.

Unnecessary mortgage insurance premiums are no longer permitted for new projects, and efforts are being made to eliminate such premiums on loans made in the past. The question concerning the retention of unnecessary premiums collected in the past must be determined by HUD.

Within the last year a number of significant organizational and administrative changes have been made in order to improve the management of the loan portfolio and to facilitate loan monitoring. The loan programs have been increased in status and visibility through placement in a new Bureau of Health Facilities Financing, Compliance, and Conversion and additional staff has been acquired. In addition, the Administrator, HRA, has personally assumed responsibility for initial loan approval and other loan functions. A work planning system has been established and the functions of regional offices and responsibilities of loan officers are being clarified.

GAO RECOMMENDATION

We recommend that the Secretary of Health, Education, and Welfare:

- Issue additional guidance for monitoring loans and take the necessary action to implement a viable loan monitoring program.
- Determine and monitor the status of hospital sinking funds to assure that payments are current and sufficient for insuring loan repayment, and encourage those hospitals without a sinking fund to establish one.
- Perform comprehensive risk assessments to identify the risk of default on program loans.
- Advise the Congress of the potential losses and adequacy of loan default funds.

DEPARTMENT COMMENT

We concur with the recommendation that additional loan monitoring guidance is needed and work on such guidance is now in progress. Chapter 140 of the PHS Loan Administration Manual, issued November 8, 1978, stresses the importance of effective loan monitoring and prescribes the general policies to be observed by loan officers in meeting their loan monitoring responsibilities. We concur, also, with the need for determining and monitoring the status of hospital sinking funds and with the need for comprehensive risk assessments, although we have no effective sanctions to enforce sinking fund requirements. Chapter 141 of the PHS Loan Administration Manual, issued November 8, 1978, requires loan officers to: analyze the annual audited financial statements and other reports of each borrower; assess the risk of a default on each loan; and, where difficulties are identified, pursue additional steps to monitor the loan more closely and assist the borrower in resolving the difficulties. The loan officer's analysis must specifically include the borrower's compliance with reserve and sinking fund requirements. We do not fully concur with the need to advise the Congress of the potential losses. The default fund is presently adequate. HEW will, of course, notify Congress in a timely manner if the fund becomes sufficiently depleted to require replenishment.

GAO RECOMMENDATION

We recommend that the Secretaries of Health, Education, and Welfare and Housing and Urban Development:

- review their loan portfolio to determine the adequacy of the government's collateral position, and
- provide regional staff additional collateral guidance on the circumstances in which the various forms of collateral should be accepted.

We also recommend that the HEW Secretary closely monitor the financial status of those loans secured with inadequate collateral because of the added risk in case of default.

DEPARTMENT COMMENT

We concur with the need for a review of loan portfolios and the financial status of loans. Our work plans involve monitoring of all loans. In doing this, special attention will be given to the collateral situation. Although the very specific guidance provided by HUD normally is adequate, Chapters 200, 203, and 205 of the PHS Loan Administration Manual, which will be issued in the near future, will set forth PHS requirements for obtaining acceptable security (or collateral) for each loan. These PHS requirements will specifically restrict the use of intangible collateral such as leases or percent of revenues.

TECHNICAL COMMENTS

On pages 32 and 33, the report suggests the need for standardized default strategy. HEW has issued written policies and procedures for reporting and managing defaults. Chapters 160, 162, 163, 165, 168 and 183 of the PHS Loan Administration Manual, issued November 8, 1978, clearly identify the key factors to be considered when formulating a plan of action to handle a loan default, including, if necessary, the exercise of default remedies such as foreclosure, under all loan programs administered by PHS. However, under the hospital loan assistance programs, individual defaults vary sufficiently to require solutions on a case-by-case basis. HEW will continually monitor this problem, and as appropriate, additional guidance will be issued, including criteria for the ownership and disposition of property acquired as a result of foreclosure actions.

The statement on page two of the report which states "Guaranteed or direct loans to hospitals represent 96 percent of the total dollar volume of program loans" appears to be incorrect. This statement should read "96 percent of the total dollar volume of PHS loans."

The paragraph concerning conditions for loan assistance (top of page 4) should include the following: "In addition to providing Uncompensated Care, each hospital that receives a Hill-Burton direct loan or loan guarantee must agree to provide a Community Service which includes the following provision: Individuals served by Federal Government third-party programs such as medicare and medicaid will not be denied admission to any facility because of these reimbursement mechanisms."

The word "nonprofit" appearing on page 35 (third line from the bottom) should be changed to "public." Direct loans can only be made to public facilities.

GAO note: Page references in this appendix may not correspond to page numbers in the final report.



DEPARTMENT OF HOUSING AND URBAN DEVELOPMENT
WASHINGTON, D.C. 20410

May 2, 1979

OFFICE OF THE ASSISTANT SECRETARY FOR
HOUSING—FEDERAL HOUSING COMMISSIONER

IN REPLY REFER TO:

Mr. Henry Eschwege
Director, Community and Economic
Development Division
United States General Accounting Office
Washington, D. C. 20548

Dear Mr. Eschwege:

Secretary Harris has asked me to respond to your letter of March 27, 1979 transmitting a draft of a proposed report to the Congress entitled: "Hospital Loan Assistance Programs: Actions Needed to Reduce Anticipated Defaults," for this Department's review and comment. Much of the proposed report relates specifically to policies and procedures of the Department of Health, Education and Welfare which, in addition to its own programs, principally administers this Department's Section 242 hospital loan insurance program. However, three of the recommendations contained in the report are addressed jointly to the Secretaries of Health, Education and Welfare, and Housing and Urban Development. I am responding to each of these three recommendations as they relate to this Department in the order they are presented in the report.

Recommendation Number 1: The Secretaries of HEW and HUD should determine whether HUD should retain the unnecessary mortgage insurance premiums paid to date by hospitals.

Reply: This recommendation refers to those hospital mortgages insured under Section 242 which also received HEW overlay guarantees under Title VI on a portion of the mortgage debt. We are looking into the legality and fiscal feasibility of refunding that portion of the mortgage insurance premium already collected which, in effect, covered a part of the mortgage also guaranteed by HEW. Should we determine it both legally possible and fiscally sound, we will refund that "excess" premium. In this regard, I would like to mention that this Department supports the recommendation that Congress amend Section 242 to eliminate mortgage insurance premiums on portions of loans also guaranteed by HEW under Title VI, and will include this suggestion as a part of our legislative amendment proposals.

Recommendation Number 2: The Secretaries of HEW and HUD should review their loan portfolio to determine the adequacy of the government's collateral position.

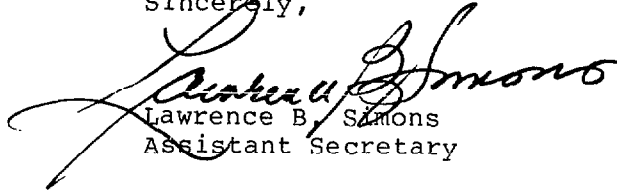
Reply: We will certainly cooperate with the Department of Health, Education and Welfare in reviewing the Section 242 loan portfolio and the adequacy of the government's collateral position. However, by law, the only collateral allowed under any of the multifamily mortgage insurance programs, including Section 242, are first mortgages in fee simple or on the interest of a lessee under a lease for not less than 99 years which is renewable, or a lease having a term of not less than 50 years to run from the date the mortgage is executed. Hence, this Department's security is the structure itself, any equipment covered by the insured mortgage and, where title is in fee simple, the land. It should be noted that our records reflect only two claims for insurance benefits arising out of the Section 242 program since its inception. Title to one of these hospitals was acquired by the Department through foreclosure, and it has subsequently been sold and, as the report notes, we are holding the mortgage on the other hospital, which is currently making principal and interest payments.

Recommendation Number 3: The Secretaries of HEW and HUD should provide regional staff additional guidance on the circumstances in which the various forms of collateral should be accepted.

Reply: As mentioned in the reply to Recommendation Number 2 above, we are limited by law as to the types of collateral which may be accepted in connection with the mortgage insurance transaction. Since HEW personnel perform much of the processing for this Department, it may be that some confusion exists on the part of their regional staffs as to HUD requirements, and we will discuss this issue with HEW Headquarters personnel to determine whether clarification is necessary. Prior to final endorsement of the mortgage for insurance, however, HUD area office personnel are responsible for reviewing the documents and assuring that our conditions have been complied with. To my knowledge, the case mentioned on page 39 of the draft report is unique and does not appear to comply with our statutory and regulatory requirements. I am having my staff look into this matter further to determine the nature and extent of the problem, and to determine what action is necessary to assure that it does not occur again.

I appreciate being given the opportunity to comment on the proposed report prior to its issuance in final form.

Sincerely,



Lawrence B. Simons
Assistant Secretary

(102510)

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