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January 25, 2011

HRSA Guidance Provides Increased Flexibility for Community Health Center Financings

Authors: Neil S. Faden | Tara Herman | Peter F. Olberg

Guidance Expressly Endorses Use of Certain HRSA Grants in Connection with New Markets Tax Credits or Historic Tax Credits.

Community health centers face significant challenges in expanding their facilities to handle the expected increase in patient demands resulting from the Affordable Care Act ("ACA") at the same time that federal and state governments continue to examine ways to make the Medicaid reimbursement program more cost-effective. Community health centers are a mainstay of the primary care delivery system in the U.S. and have a decades-long track record. ACA only increases their importance and the likelihood that federal and state government will continue to strongly support well-managed community health centers. Yet creative and informed financing techniques remain necessary to afford access to the capital markets for these critical components of the patient safety net.

The Health Resources and Services Administration ("HRSA"), a division of the U.S. Department of Health and Human Services, has issued guidance that may help health centers design capital financing transactions that combine federal incentive programs. The guidance clarifies the extent to which community health centers may supplement their HRSA capital grant awards with additional project financing involving the federal New Market Tax Credit ("NMTC") and/or Historic Tax Credit ("HTC") program. The new guidance confirms HRSA's position that Capital Development ("CD"), Facility

Investment Program ("FIP") and Capital Improvement Program ("CIP") awards may not be directly leveraged through an NMTC or HTC structure, but for the first time expressly endorses the use of HRSA grant funds to repay bridge financing obtained through or in conjunction with an NMTC or HTC structure.

Under the FIP and CIP programs, almost $1.4 billion in federal grant funds have been awarded to support construction and renovation of community health centers. Many community health centers sought to use these grants in conjunction with other sources of favorable project financing, including financing using NMTC and HTC. However, prior FIP policy statements left open the question of to what extent HRSA would endorse the joint use by health centers of financing under these separate federal programs even if the health center qualified under each.

NMTC transactions frequently involve using a leverage loan to enhance the NMTC credits. An optimal structure for health center financings would have been to use HRSA grant proceeds as the source of the leverage loan. However, HRSA's technical assistance materials issued for the FIP program stated that although applicants could partially finance an FIP project with NMTC funds, "FIP funds may NOT be invested into the NMTC program to finance the FIP project. This is considered an unallowable use of FIP funds." This restriction meant that FIP grant proceeds could not be used as a leverage source; the grant proceeds had to go to the project directly. Grant recipients remained uncertain as to whether grant proceeds could be used to repay bridge financing incurred in connection with the NMTC program. Grant recipients also did not know if this restriction applied to CIP and CD grants as well, or to HTC transactions.

On Thursday, January 20, 2011, HRSA issued guidance providing clarification on many of these issues and expressly endorsing certain uses of HRSA CD, FIP and CIP grant proceeds in NMTC or HTC financings. In the guidance, HRSA states that, consistent with previous FIP guidelines, HRSA capital grant funds "may not be directly invested in NMTC and/or HTC project financing." However, "grantees may use separate bridge financing to allow project grant funds to be drawn as project expenses are incurred."

Thus, HRSA grant proceeds – whether CD, FIP or CIP – still may not be used as a leverage source in NMTC financing. They must be received directly by the project grantee. However, the new HRSA statement makes clear that HRSA grant proceeds can be used to repay other bridge financing for construction. This guidance provides greater options for structuring transactions that make use of NMTC and HTC arrangements. For example, the project could receive conventional construction financing and use HRSA grant proceeds to repay such financing. During the construction period, the Qualified Low Income Community Investment ("QLICI") representing the NMTC financing would be junior in priority to the construction loan, but upon repayment of the construction loan the QLICI would succeed to the first lien position. HRSA grant proceeds could also potentially repay a bridge loan that was used as a leverage source in the transaction, so long as the grant recipient actually incurred project costs first and was reimbursed by HRSA with grant proceeds for such costs. Under the requirements of the NMTC program, the grant proceeds could not be used directly to repay the QLICI, which needs to remain outstanding throughout the seven-year NMTC compliance period. However, the health center may be able to structure financial arrangements that are permissible under both the HRSA and NMTC program requirements to enable affiliates to utilize reimbursement funds to acquire all or a portion of the leverage loan made through the NMTC structure.

A number of questions remain to be resolved in connection with particular health center NMTC financings where HRSA grant funds are used. For instance, it will be necessary to determine how a construction or bridge lender will underwrite the HRSA grant, and whether the lender can obtain a security interest in the grant or the proceeds of the grant to secure the health center's obligations. The Community Development Entity ("CDE") making the QLICI will need to consider the implications of the notice of federal interest that HRSA requires the health center to record, and the implications of the notice should a default occur under the QLICI and the CDE seeks to exercise remedies. Federal and state licensing and reimbursement program requirements add further complexity to the CDE's underwriting analysis.

Grantees should also be aware that they still need prior written approval from HRSA prior to using grant proceeds with an NMTC or HTC financing. Requests should be submitted to the appropriate HRSA Grants Management Specialist for the applicable grant and should include the following information:

- Detailed description of the financing for the previously approved capital project, including the proposed NMTC and/or HTC arrangement and other associated financing resources, such as bridge financing.
- Description of the benefits of the proposed NMTC and/or HTC financing for the previously approved capital project (e.g., comparison of NMTC loan rates and associated cost savings compared to other loans or bond rates available to the grantee).
- Description of the financial risks associated with the proposed NMTC and/or HTC financing and corresponding mitigation strategies to protect the grantee's and HRSA's interest in the associated property.
- Assurance that the capital grant project approved by HRSA will be completed as proposed, in accordance with Federal Interest requirements and the approved timeline.
- Letter of commitment from the Community Development Entity (the entity providing the NMTC or HTC credits).
- Proposed schedule of cash draws (dates and amounts) from the appropriate FIP/CIP Payment Management System (PMS) subaccount.

Notwithstanding the complexities involved in marrying HRSA capital grants with NMTC or HTC program requirements, the need for creative financing for health centers' capital projects makes the HRSA policy statement a welcome announcement. Health centers together with advisors who have experience in the realms of health center regulation, federal and state reimbursement law, capital financing and the NMTC and HTC programs should be able to make use of the new HRSA guidance to make needed capital investments in their facilities.

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