



May 10, 2010

The Honorable David H. Stevens
Commissioner
Federal Housing Administration
United States Department of Housing and Urban Development
451 7th Street, SW
Washington, DC 20410

**Re: CAI Comments and Recommendations for Revisions to HUD
Mortgagee Letter
2009-46B: Condominium Approval Process**

Dear Commissioner Stevens:

On behalf of Community Associations Institute (CAI), an organization representing more than 30,000 individual members, 60 local chapters, and the interests of the one in five homeowners living in a community association, I am pleased to submit comments for your consideration regarding revisions to HUD Mortgagee Letter 2009-46B addressing the Condominium Approval Process.

CAI has been pleased to work with FHA staff regarding the implementation of the new condominium project approval process and appreciates the diligence of agency staff to educate industry partners and address unintended consequences. As stated in my December 1, 2009 letter CAI's members are a critical link in the FHA approval process. CAI's membership represents three major groups critical to the functioning of a condominium association: volunteer board members, professional community managers and management companies, and business partners. Each of these groups may be called upon to certify criteria to meet the requirements found in ML 2009-46B.

CAI's comments are divided into four sections. The first section addresses specific revisions to ML 2009-46B; CAI is seeking to ensure that residents of condominiums have access to FHA insured mortgages. The second section provides CAI's recommendations on certain revisions to ML 2009-46B where FHA staff has requested review and comment. The third section contains technical revisions CAI is recommending to ensure greater clarity of ML 2009-46B. Finally, the fourth section addresses general concerns regarding the operation of community associations and the development of standards and criteria for project approval by FHA.

225 Reinekers Lane
Suite 300
Alexandria, VA 22314

888.CAI.4321 TOLL-FREE
703.548.8600 MAIN
703.684.1581 FAX

www.caionline.org

A M E R I C A ' S A D V O C A T E F O R R E S P O N S I B L E C O M M U N I T I E S

I. Provisions of ML 2009-46B that Unnecessarily Restrict Condominium Association Management and Resident Access to FHA Programs

- A. 15 Percent Delinquency:** No more than 15 percent of the total units can be in arrears (more than 30 days past due) in paying their condominium association assessments.

CAI Comments: In prior correspondence, CAI stated its belief that the 15 percent delinquency criterion is arbitrary and is not an accurate or full reflection of an association's fiscal health. Rather, CAI believes the 15 percent delinquency criterion has the affect of denying all residents of a condominium access to FHA-insured mortgages if the condominium is unable to meet this standard. The potential negative impact of the 15 percent delinquency rule is substantial and could force homeowners and condominium associations into bankruptcy if financing for the sale of units is denied to the entire project based on this one variable.

The 15 percent delinquency rule fails to take into account the budget and reserves of a condominium association for bad debt and arrearages. As CAI stated in prior correspondence, condominium associations are increasingly budgeting for such shortfalls and, despite delinquencies, may still be able to meet budget obligations to maintain common elements. If an association maintains an allowance for delinquent assessments and the delinquencies do not exceed any budgeted bad debt allowance, the delinquencies should have no impact on the funding of continued operations and routine maintenance.

Associations have a range of tools to manage cash flow and raise additional needed funds during a fiscal year. An association may borrow against a reserve fund to meet unexpected financial obligations such as mechanical failures or unplanned utility cost spikes. An association may also vote to increase assessments to meet budgeted fiscal obligations. The overall financial health of an association can be judged better by looking beyond delinquencies to the underlying budget. A reasonable budget that funds maintenance and repair of common elements and provides an allotment for delinquent assessments provides a more accurate picture of the association's financial health. Such data also allow for a more effective evaluation of the association's ability to maintain the association's common elements, thereby protecting the value of units.

CAI Recommendation: Community associations should have no more than 15 percent of the total units more than 90 days past due. If a condominium association exceeds this threshold then an examination of the association's budget should be made to determine amounts allocated for bad debt. If the current assessment delinquencies do not exceed 15 percent more than the amount the association has budgeted for bad debt, the association should be deemed to have met the requirements under this section.

- B. Owner Occupancy Requirements:** At least 50 percent of units in an association must be owner occupied to maintain FHA approval. Vacant or tenant occupied-real estate owned properties are excluded from the owner occupancy calculation.

CAI Comments: Determining owner occupancy percentages with accuracy can be challenging and problematic. A unit may be under lease, contract for sale, located in a state that may use a trust to hold title or under some other arrangement that would

frustrate providing owner occupancy percentages with complete accuracy. As noted in ML 2009-46B, inaccurate representations may confer severe criminal penalties under 18 U.S.C. 1014 and the chain of liability on such certifications could extend to association board volunteers or community managers.

CAI Recommendations: FHA should provide guidelines to lenders, builders/developers and associations to clarify what constitutes an acceptable data source for current and accurate owner occupancy information. In establishing such guidelines, FHA should consider the practical issues involved in gathering owner-occupancy data in condominium associations. CAI recommends FHA consider a two-tier approach to satisfy the requirements under this section.

Tier One: When submitting a condominium for approval under HRAP or DELRAP, a lender should disclose if a search of the public record has been conducted to determine the owner-occupancy rate or document the due diligence undertaken to determine owner occupancy ratios in a given association.

Tier Two: An association may provide an owner-occupancy percentage for approval under HRAP or DEPRAP using the means described below, qualifying that the information used to determine owner-occupancy percentages is accurate to the best of the association's knowledge or is based on information currently available to the association. CAI recommends the following as a means of meeting this requirement:

- 1) The association demonstrates it has conducted a survey of unit owners within 12 months preceding the approval process and a majority of units have responded, providing data to verify a 50 percent owner occupancy rate. Where all owners do not respond, the association may, if there is at least a 50 percent response ratio, extrapolate the data received across all units; or
- 2) The association can demonstrate it has an enforceable rental restriction which on its face provides for at least 50 percent owner occupancy; or
- 3) The association can demonstrate that more than 50 percent of assessment billings are mailed to addresses in the zip code where the association is located.

C. Commercial Floor Area: No more than 25 percent of the property's total floor area in a project can be used for commercial purposes.

CAI Comments: Mixed-use developments are becoming more prevalent and the demand for such developments is likely to increase given consumer preferences and government incentives for the construction of sustainable mixed use developments. To reduce suburban sprawl, some states and local governments have begun to incentivize redevelopment in urban centers. Much of the redevelopment activity includes mixed-use development. Restrictions on the commercial component of a project absent a process to apply for a waiver makes it appear the restrictions are arbitrary and not based on empirical data generated from FHA insurance claims payments. Further, without

opportunity to apply for a waiver to the 25 percent commercial space cap, all residents in mixed-use developments above the 25 percent threshold will be denied access to FHA-insured mortgages. Similar to the impact of the 15 percent delinquency rule, the 25 percent commercial space cap has the potential to increase homeowner and association bankruptcies by denying all residents of the community access to FHA-insured mortgages. This policy runs counter to the growing governmental desire to limit residential development outside urban centers and encourages less efficient use of resources (sewer treatment plants, water supply facilities, etc.) by promoting horizontal development in suburban or exurban settings rather than the more typical vertical development found in the urban centers.

CAI Recommendation: Projects with more than 25 percent of the project's floor area used for commercial purposes should be eligible for approval by FHA. Approval should be granted where the applicant provides reasonable evidence that, after consideration is given to projected reserves and the association budget, residential common areas can be properly maintained with assessments levied against residential owners, and common areas that benefit residential and commercial unit owners can be properly maintained with assessments levied against commercial and residential unit owners. Projects done as a sub-condominium should be viewed separately and should be considered 100% residential.

- D. Budget Requirements for Insurance Coverage and Deductibles:** Associations are required to demonstrate adequate funding for insurance coverage and deductibles in budget.

CAI Comments: There are many types of insurance an association may be required to carry (i.e. hazard insurance, fidelity insurance, flood insurance, directors and officers insurance). In certain areas of the country, in addition to these lines of coverage, an association may be required to purchase insurance coverage for risks associated with windstorm, earthquake, mold or terrorism. Deductibles for each line of coverage vary, with deductibles for catastrophic lines being very high. If FHA's intent is to require associations to hold reserve funds equal to the total amount of deductibles from all lines of coverage the association purchases, the agency is imposing a significant and unnecessary burden.

Additionally, Section 528 of the Internal Revenue Code limits the federal tax liability of homeowners associations that meet certain tests. Associations that fail to meet the requirements of this section or that choose not to seek exemptions provided by Section 528 may face a significantly increased federal tax liability by holding additional reserves for the purpose of meeting this requirement.

CAI Recommendation: FHA should qualify the lines of coverage for which it will require associations to adequately fund potential deductible payments in a budget year. Further, FHA should consider flexibility for associations where holding such amounts in reserves will cause negative tax consequences or cause the association to impose special assessments to generate FHA-required increases in reserves for certain catastrophic lines where substantial deductibles are required. FHA should further consider allowing existing capital reserves held by associations for ultimate replacement of the

community's capital assets to serve a limited dual purpose, so that if, in the event of a catastrophe, an association must cover deductibles it can "borrow" from its capital reserve account and then restore that sum over a reasonably short period of years.

II. Discussion of Additional Revisions Contemplated to ML 2009-46B

- A. Signing of Certification Statements by Agents or Third Parties:** ML 2009-46B contains a lender certification and a developer/builder certification to be signed and included in a condominium project approval packet submitted under HRAP. FHA is considering a requirement that an officer, director or approved employee of a lender or developer/builder sign the statement in addition to the agent or third party preparing the submission. Additionally, FHA is considering a new certification to be signed if an association submits directly for project approval via HRAP.

CAI Comments: The lack of a separate certification for associations submitting for project approval via HRAP has caused confusion and uneven treatment of associations seeking project approval by FHA's homeownership centers. CAI believes that obstacles preventing established resident-controlled condominium associations from submitting via HRAP for project approval should be removed.

CAI Recommendations: FHA should include in its revisions to ML 2009-46B an Association Certification to Condominium Requirements to be signed by an officer, director, authorized employee or authorized agent of a condominium association. Such a certification will ensure associations can submit for project approval via HRAP for initial project approval and subsequent approvals every two years thereafter as required by ML 2009-46B.

If FHA creates an Association Certification to Condominium Requirements, CAI believes that a third party, acting as an authorized agent, should be allowed to sign the certification and submit an association's package for approval under HRAP. Many associations are operated almost entirely by volunteer board members. CAI believes volunteer association leaders will refuse to sign certifications for fear of potential criminal sanction if information in the package proves to be inaccurate. Allowing a sanctioned third party to sign a certification on behalf of an association will result in more communities having access to FHA-insured mortgages. Alternatively, given the fact that an association submitting an HRAP package is not motivated by the same economic benefits as lenders or builder/developers, the standard for an actionable false certification should be set so that the person certifying the application must have actual knowledge that the application was intentionally false and misleading with respect to one or more material facts.

- B. Financial Documentation and Association Budgets:** FHA is considering a revision to the Condominium Project Approval Matrix to require an association's financial statements be reviewed and submitted with a project review package. Currently, the matrix requires an association's proposed or actual budget be submitted.

CAI Comments: FHA is considering this revision to Appendix A, Item 3 to harmonize budget review requirements with HUD Handbook 4150.1, Chapter 11, Paragraph 8(A)(4), which required established communities, under the prior project approval process, to submit, "The project's annual income, expenses, and budget. The reserve funds for commonly owned replacements must be sufficient to meet current costs;".

CAI is, in general, supportive of such a revision. However, CAI does not support any requirement concerning the production of additional financial information that will impose significant or additional costs to associations.

CAI Recommendations: CAI recommends that an association's (1) balance sheet and statement of revenues and expenses or (2) a recent audit or review of financial condition completed in the prior 12 months satisfy any new requirements to document the fiscal condition of an association.

CAI is concerned that absent such a clarification, smaller associations would face increased costs related to the engagement of an auditor while larger associations may be required to produce a substantial volume of information for project approval. The production of documents other than a balance sheet and statement of revenues and expenses or a recent audit of financial condition will increase association costs and will inundate FHA staff with unnecessary information to determine the fiscal condition of an association.

III. Technical Comments to Achieve Greater Clarity of Intent

- A. Hazard Insurance:** Paragraph VI(A) of ML 2009-46B provides that associations shall maintain insurance coverage in an amount equal to 100 percent of current replacement costs and that a unit owner may not purchase gap coverage if an association's master policy does not meet this standard. CAI is not aware that such coverage is available and believes the reference to such coverage is unnecessary and potentially confusing. CAI recommends that Paragraph VI(A) be revised to state that an association shall, at all times, maintain coverage in an amount equal to 100 percent of current replacement costs through its master policy. Doing so will harmonize language describing this requirement with language describing FHA's requirement that an association maintain flood insurance equal to current replacement costs or the maximum amount authorized under the National Flood Insurance Act.
- B. HO-6 Policy Requirement:** Paragraph VI(A) of ML 2009-46B requires that where an association's master policy does not include interior unit coverage and coverage of interior improvements made to a unit by an owner that "...the borrower must obtain a "walls-in" coverage policy (HO-6 Policy)." To ensure better clarity, CAI recommends the language in this paragraph be redrafted to more accurately reflect FHA's intent that a borrower obtain a "walls-in" coverage policy (commonly referred to as a HO-6 policy) unless it is documented that the association's master policy provides the same interior unit coverage.

- C. Liability Insurance:** Paragraph VI(A) of ML 2009-46B requires that associations purchase and maintain a “comprehensive general liability” insurance policy. To more accurately reflect terminology used in the community association and insurance industries, CAI recommends the term “comprehensive general liability” be replaced with “commercial general liability,” which more accurately reflects current legal terminology.

IV. Issues Relating to the Development of Standards and Underwriting Criteria for Condominium Project Approval

A. Training and Education Concerning Resident Controlled Common Interest

Communities: For over 30 years, CAI and its members have developed standards for management, operation, governance and volunteer leadership in common interest communities. The education and certifications available to CAI members results in efficient and sound management of common interest communities, improved compliance with federal and state law, and fair application of covenants, conditions and restrictions by community volunteers serving as leaders in their community. When FHA staff contemplates changes to its programs that will affect the residents of common interest communities, we encourage them to avail themselves of this expertise as is done with other industry partners.

CAI is the only national organization that represents the residents of common interest communities. As representatives of residents of common interest communities, the concerns expressed are sometimes different than those of other industry partners, whose priorities are more related to the business of building, selling and financing homes.

CAI has been pleased to work with FHA staff in recent months regarding the implementation of ML 2009-46b and to provide comments and suggested revisions to these standards to help FHA achieve important public policy goals while avoiding unintended consequences. CAI believes such continued collaboration can improve the mortgage underwriting process for FHA, resulting in sustainable homeownership opportunities for families and more stable, healthy associations.

CAI is pleased to offer access to its education materials, professional certification curricula, and professional industry expertise to FHA staff to assist in industry training/educational events FHA may undertake related to the implementation of ML 2009-46B. Additionally, CAI is pleased to make available this expertise and experience to ensure a strong partnership with FHA in the future.

B. Creating Uniform Goals on Issues Related to Community Association

Underwriting: As the only national organization representing the interests of homeowners living in community associations, CAI has a long history of working with state and federal agencies to build consensus-based policy solutions that serve to strengthen communities. CAI’s work has extended to an active role in the creation and development of the Uniform Condominium Act, the Uniform Common Interest Ownership Act and similar statutes across the country.

ML 2009-46B clearly states that FHA no longer has reciprocity on approvals granted by VA, Fannie Mae or Freddie Mac. Through the years, in response to Congressional

urging, we have also worked to bring uniformity to the underwriting criteria used by FHA, VA, Freddie Mac, and Fannie Mae. Specifically, CAI convened successful task forces during past housing downturns and worked with the key organizations, such as FHA, to address uniformity issues. Indeed, some of this work resulted in Appendix 24 to HUD Handbook 4150.1.

CAI renews its call for increased coordination between federal government agencies and the housing-related government sponsored enterprises concerning revisions to underwriting requirements for condominiums. In the current market, 9 of every 10 mortgages is either guaranteed by an agency of the federal government or purchased or otherwise supported by Fannie Mae, Freddie Mac or the Federal Home Loan Bank System. The market impact of changes to underwriting standards by federal agencies are therefore magnified, affecting virtually the entire market. CAI believes that federal agencies should, to the maximum extent allowable under law, review and coordinate changes to underwriting policies rather than making such economically significant revisions in an ad hoc manner. The absence of uniform underwriting criteria and reciprocity creates inefficiencies, increases demands on staff time required for HRAP project approvals and unnecessarily increases the cost of housing. CAI stands ready to work with all interested parties to achieve strong underwriting protections while promoting access to sustainable mortgage credit for condominiums—the most affordable housing choice.

C. Implementation of Major Revisions to FHA Programs through Mortgagee Letter Absent Rulemaking: CAI is concerned that FHA undertook such a significant revision to its programs outside of the normal regulatory process. This is especially the case given the historic market share FHA now has as it fulfills its mission as a counter-cyclical influence in the mortgage markets.

CAI recognizes that changes to FHA's statute contained in the Housing and Economic Recovery Act of 2008 required a new legal framework for FHA's condominium project approval process. However, FHA chose to enact major program changes through Mortgagee Letters rather than following the normal regulatory process. As a result, wholesale changes were made to FHA's condominium project approval process that became effective immediately, without flexibility, and without the opportunity for public comment. This process has caused unnecessary confusion in the application of the new standards by field staff and denied FHA the benefit of public discussion of its policy proposals.

CAI urges FHA to proceed to rulemaking in order to provide the appropriate legal basis for the policy it is implementing via Mortgagee Letters. Further, CAI urges FHA, upon completion of the rulemaking process, to update HUD Handbook 4150.1. At the present time, the only guidance and documents upon which associations and other industry partners can rely are answers to frequently asked questions posted on FHA's website. While this information has been useful to some, it is not an acceptable substitute for guidance provided in HUD Handbook 4150.1.

D. Retroactive Application of ML 2009-46B to Previously Approved Projects:

Many projects approved by FHA prior to the issuance of ML 2009-46A and 2009-46B were sold by the developers with the promise that FHA financing would be available. Purchasers applied for and were approved for FHA financing but could not proceed to settlement until the project met the 50% presale requirement. Meanwhile, these projects were listed as approved on the FHA website. However, when ML 2009-46A and 2009-46B were issued, the guidelines were not applied only to projects seeking approval after issuance of the letters, but also to approved projects that had not yet applied for case numbers. The decision by FHA to make the new condominium guidelines in ML 2009-46A and 2009-46B applicable to ALL projects and not just to projects approved after the December 7, 2009 implementation date, (by making the trigger for applying the new guidelines when case numbers are issued instead of when projects are submitted for approval) has created a situation where projects that were approved previously by FHA based on guidelines in effect at that time are now being deemed ineligible. This retroactive application of the guidelines in the Mortgagee Letters resulted in the withdrawal of FHA approval from previously approved projects although nothing about these projects had changed. FHA thus arbitrarily, unfairly and without explanation defeated the reasonable expectations of both the developers and the homebuyers that FHA financing would be available for the condominium units being purchased.

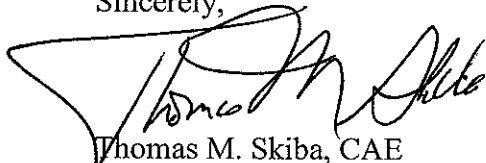
CAI urges FHA to modify ML 2009-46B to provide that any project approved before the issuance of the Mortgagee Letters on December 7, 2009 will not have its project approval withdrawn or be deemed ineligible merely because it does not comply with the guidelines in ML 2009-46A and 2009-46B—guidelines which did not exist when the projects were submitted for approval. Furthermore, CAI urges FHA to afford the developers of (and lenders to) these projects due process by at least advising them of the reasons for withdrawing FHA approval. Otherwise, it will be impossible to know if the FHA determination is even correct. To leave this situation unaddressed would be unfair to purchasers who expected to and would otherwise be homeowners today.

E. FHA Operational Capacity to Meet Requirements of ML 2009-46B: CAI notes that development and implementation of ML 2009-46B has been a significant undertaking for FHA staff. The effective date of the mortgagee letter was delayed on two occasions due to confusion over new requirements, and FHA staff hosted at least three separate industry conference calls each lasting approximately two hours. Further, due to the number of inquiries to FHA's homeownership centers, those with specific questions about provisions of ML 2009-46B are required to submit inquiries to a single e-mail address. Responses to inquiries are often not received within the timeframe set by FHA and are often vague.

CAI is concerned about the operational capacity of FHA to manage the increased workload, given that its role in the market has so significantly expanded. Specifically, CAI is concerned that FHA staff resources may soon be insufficient to manage the demands placed on the agency. CAI seeks assurances from FHA that sufficient technical and staff resources have been allocated so that FHA will be able to process all timely submitted packages under HRAP and DELRAP prior to the December 12, 2010 deadline for recertification. Further, CAI seeks assurances from FHA that technical and staff resources will be available to manage the bi-annual recertification process contained in ML 2009-46B.

Thank you for the opportunity to comment on FHA's proposed revisions to ML 2009-46B. CAI's members appreciate the diligent and demanding work being performed by FHA staff and look forward to a continuing and expanded partnership with the agency. I am available to discuss any of the policy recommendations contained in this letter, and I look forward to the courtesy of your reply.

Sincerely,



Thomas M. Skiba, CAE
Chief Executive Officer