CAI FAQ

FHA Condominium Guidelines

On Friday, November 6, 2009, the Federal Housing Administration (FHA) issued two documents related to FHA mortgage insurance requirements for condominium associations. These two documents: HUD Mortgagee Letter 2009-46A and Mortgagee Letter 2009-46B provide an overview of the FHA proposed transitional criteria and successor criteria for condominium association requirements for FHA mortgage insurance. For a full summary of the new requirements, please click here.

What is FHA Mortgage Insurance?

FHA mortgage insurance is a policy that protects lenders against some or most of the losses on a mortgage if the borrower defaults on the mortgage. FHA insurance is typically required on mortgages where there is less than a 20 percent down payment. The insurance is funded by a fee on the overall mortgage amount and a small annual levy on the loan amount.

FHA insurance is important, as it provides a mechanism to recover losses associated with default and ensures a continuing flow of money into the mortgage markets.

Why Should My Association Care about the FHA Requirements?

This is an issue of interest for condominium associations as FHA insured mortgages are playing an increasingly important role as a financing mechanism for those seeking to purchase condominium units. While traditionally, FHA-insured mortgages played a small role in the housing markets (approximately 5 percent in 2007), that number has increased to roughly 20 percent of mortgage originations in 2008.

As lenders continue to reexamine and tighten lending criteria, qualifying for FHA mortgage insurance provides potential buyers with an additional financing option and, thus, makes units in your condominium association marketable to a larger pool of potential buyers.

How Does the FHA Approval Process Work?

Typically a lender processes the paperwork associated with meeting FHA requirements. For new developments, developers may also work with FHA to have their project pre-qualified for FHA financing.

In processing the paperwork to qualify for FHA approval, lenders will seek information required by the FHA from a condominium association. Condominium associations may also be able to work directly with the FHA to qualify for financing.

Once a project qualifies for FHA mortgage insurance, FHA may insure mortgages for buyers in a condominium up to a certain percentage of units.

What FHA Criteria Apply to Condominium Associations?

The FHA mortgagee letters outline criteria that lenders or FHA will examine to determine whether a condominium association qualifies for mortgages insured by FHA. For existing condominium associations, these criteria include:

> **Eligible Projects -** Eligible projects are declared condominium projects that exist in full compliance with appropriate state law. Condominium hotels, timeshares, houseboat projects, multi-dwelling unit condominiums and projects not deemed to be residential are not eligible for FHA insurance under the regulations.
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> **Eligibility Requirements -** All condominium project approvals must meet the following requirements:

- Projects must consist of two or more units.
- Projects must be covered by hazard and liability insurance and flood and fidelity insurance where applicable.
- Right of first refusal is permitted, provided it does not violate the Fair Housing Act regulations found in 24 CFR Part 100.
- No more than 25 percent of the total floor area can be used for commercial purposes. The commercial portion must also be of a "nature that is homogenous with residential use."
- No more than 10 percent of the units may be owned by one investor. This limitation also applies to developers/builders that subsequently rent out vacant and unsold units. For projects with 10 or fewer units, no single entity can own more than one unit.
- Delinquent Homeowners Association Dues [Assessments]: No more than 15 percent of the total units can be in arrears (more than 30 days past due) of their condominium association fee payments.
- At least 30 percent of the total units must be sold prior to endorsement of a mortgage in on any unit. After December 31, 2010, the pre-sale requirement will increase to 50 percent. *(See Presale section below)*

- At least 50 percent of the units of a project must be owner-occupied or sold to owners who intend to occupy the units. For proposed, under construction or projects in their initial marketing phase, FHA will allow a minimum owner occupancy amount equal to 50 percent of the number of presold units. *(Through December 31, 2010, or otherwise provided by FHA, bank-owned properties, vacant, or tenant-occupied real estate-owned properties are excluded from this calculation.)*

Budget Review - Mortgagees must review all homeowner's association budgets (actual budgets for existing projects and projected budgets for new projects) for all project approvals.

- The review must determine that the budget is adequate and:
- Includes allocations/line items to ensure sufficient funding for upkeep of amenities and features unique to the project.
- Provides for the funding of replacement reserves for capital expenditures and deferred maintenance amounting to at least 10 percent of the budget.
- Provides adequate funding for insurance coverage and deductibles (as required under the insurance requirements section).
- If the documents do not meet these standards, the mortgagee may request a reserve study to assess the stability of the project. The reserve study cannot be more than 12 months old. In reviewing the reserve study, consideration must be given to items that have been replaced after the time that the reserve study was completed.

Insurance Requirements- Condominium projects must be covered by hazard, flood, liability, and other insurance as required by state or local laws, or acceptable to FHA under the following criteria:

<u>Hazard Insurance</u>: The Condo Association is required to maintain a master or blanket property insurance equal to 100 percent of current replacement costs exclusive of land, foundation, excavation, or other normal exclusions. If the association does not maintain 100 percent coverage, unit owner gap coverage does not satisfy meeting this requirement.

- <u>HO-6 Coverage:</u> In cases in which the master policy does not include interior unit coverage, the borrower must obtain a "walls in" coverage policy (H0-6).

- Liability Insurance: The association is required to maintain comprehensive general liability insurance covering all common elements, commercial space owned and leased by the owner's association, and public ways of the condominium project.
- Fidelity Bond/Fidelity Insurance: New or established projects with more than 20 units are required to carry fidelity bonds/insurance for all officers, directors, and employees of the association, and all other persons handling or responsible for funds administered by the association in an amount equal to three months aggregate assessments on all units plus reserve funds.
- Flood Insurance: Insurance coverage equal to the replacement cost of the project less land costs or up to the National Flood Insurance Program standard of $250,000 per unit, whichever is less. If insuring a residential building, the maximum building coverage is $250,000 times the number of units in the building. The association, not the borrower, is responsible for maintaining adequate flood insurance under the NFIP when the building is located in a Special Flood Hazard Area.
- Determining Need for Flood Insurance: If the property is located in a 100-year flood plain, flood insurance is required. If the project is not located in a 100-year flood plain, it is not subject to the flood insurance requirement if documentation is provided (documentation that includes either a final Letter of Map Amendment or a final Letter of Map Revision).

If My Condominium Association Is Already FHA approved, Do We Need to Take Any Additional Action?

Projects that received FHA approval prior to October 1, 2008, will be required to recertify on or before December 7, 2009.

Projects approved between October 1, 2008, and December 7, 2009, will follow the recertification requirements defined below:

Recertification: Condominium projects will expire within two years from the date of placement on the list of approved condominiums. Further participation in the program after this two-year period has expired will require recertification to determine that the project is still in compliance with the HUD's Owner-Occupancy requirement and that no conditions currently exist which would present an unacceptable risk to FHA. Items that must be given consideration are:

- Pending special assessments
- Pending legal action against the condominium association or its officers or directors
- Adequate hazard, liability insurance, and when applicable, flood insurance coverage

For Qualified Associations, How Many Units Will FHA Provide Financing For?

Concentration Limits (Temporary) - During the transition period of December 7, 2009, to December 31, 2010, FHA will increase its temporary concentration limits (the percentage of units that it will insure in a project) to 50 percent.

FHA will also consider increasing concentrations up to 100 percent if a condominium project meets additional criteria that include:

- The project is 100 percent complete and construction has been completed for at least one year.
- 100 percent of the units have been sold and no entity owns more than 10 percent of the units in the project.
- The projects budget provides for the funding of replacement reserves for capital expenditures and deferred maintenance in an account representing at least 10 percent for the budget.
- Control of the association has been transferred to the owners.
- The owner-occupancy ratio is at least 50 percent. *(Bank-owned properties, vacant, or tenant-occupied real estate-owned properties are excluded from this calculation.)*

Concentration Limits (Successor) – Beginning on January 1, 2011, or earlier by FHA action, FHA concentrations will revert to the following:

- In projects of 3 or fewer units, FHA will insure no more than 1 unit.
- In projects consisting of 4 or more units, FHA will have no more than 30 percent of the total units encumbered with FHA insurance.
- Calculating the level of FHA concentration in a project declared with legal phases will follow the same methodology as the owner-occupancy requirements.

CAI will keep you updated in the coming weeks as additional information becomes available. Updates will be posted to the "Heads-Up" page on CAI's Web site. CAI members with questions should call Andrew Fortin, Vice President of Government and Public Affairs, at 703-548-8600, or by e-mail at g&pa@caionline.org, with the subject line "FHA Condo Regs."