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FHA, Fannie Mae and Freddie Mac: Condominium Lending Requirements Why Should We Care?

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As of December 2009, FHA, Fannie Mae and Freddie Mac yet again revised its funding requirements for condominium properties. While these funding requirements are directed at the condominium purchaser and may not directly impact the association, indirectly, these revised guidelines place new burdens on condominium sales and the ability of purchasers to obtain funding. Consequently, these requirements potentially impact the marketability of every condominium com-munity and cannot be ignored.

The funding requirements are detailed and varied depending upon the size and type of project, and whether it is a new development or existing community. We highlight some of the most significant provisions below.

FHA

FHA provides mortgage insurance that protects lenders from losses when homeowners default on their mortgages. When a condominium development qualifies for FHA mortgage insurance loans, it provides potential purchasers with more financing options making the development available to a larger pool of potential purchasers. This, in turn, increases competition and increased marketability of units in your community.

In order for lenders to loan on a development it must meet the following FHA requirements:

- No more than 10% of the units are owned by a single investor;
- No more than 15% of the units are more than 30 days delinquent in assessment payments;
- At least 50% of the units are owner-occupied;
- Budget has been reviewed by FHA and determined to be “adequate” for 1) funding for general common area maintenance; 2) setting aside at least 10% of the operating budget to fund reserves; and 3) funding for required insurance coverage and deductibles.

Insurance requirements include:

- 100% property damage current replacement cost coverage.
- Comprehensive General Liability insurance.
- Individual borrower must obtain “walls in” unit coverage. In cases where the association’s master policy does not include interior unit coverage, including replacement of betterments and improvements, the borrower must obtain individual unit coverage.

- Projects with more than 20 units must carry a minimum level of fidelity insurance for all officers, directors and employees.

Fannie Mae

This Federal agency makes funds available to purchase FHA insured loans from mortgage originators, allowing mortgage lenders to sell mortgages to replenish available cash to make loans.

For a loan to be Fannie Mae eligible (and thus increase the marketability of the property), the condominium project must contain the following:

- No more than 20% of the project is commercial
- At least 51% of the property is owner-occupied.
- At least 10% of the operating budget is set aside to fund reserves and insurance deductibles.

Freddie Mac

This Federally chartered corporation was established to purchase mortgages in the secondary market. Condominium projects eligible under Freddie Mac guidelines must have:

- No more than 15% of the units are delinquent 30 days or more.
- At least 51% of the units are owner occupied (either as primary residence or second home).
- At least 10% of the operating budget is set aside to fund reserves.
- Interior Unit insurance: like the FHA requirement, Freddie Mac requires that buyers obtain ”walls-in” interior unit insurance coverage insuring 20% of the unit’s appraised value unless the association master policy provides same coverage.

These new Federal standards also contain severe criminal penalties to anyone who knowingly and willfully makes or uses a document containing any false, fictitious or fraudulent information to the FHA. For many association’s already having difficulty gathering information about owner-occupancy and delinquency status, the fear of criminal liability for providing information required for FHA financing is a concern.

Another concern presented by these new federal guidelines is the 15%, 30-day delinquency requirement. For many associations, a 30-day delinquency status is not necessarily indicative of the association’s ability to maintain the value of the units. And in smaller communities, a few owners late in their assessments can put the association beyond the 15% threshold, and greatly impact funding for the community.

On the positive side, the FHA's focus on insurance coverage for the individual unit interior will bring greater awareness of the need for individual owners to insure their unit interiors and personal contents (aka HO-6 coverage). There is a significant degree of uncertainty among associations and their unit owners as to what portion of a unit, if any, is insured in the event of a loss. Association directors will have to examine the insurance coverage in place in light of the CC&Rs insurance requirements in order to communicate this required information to lenders and potential purchasers. Through this process, associations should be better able to disclose to their owners, in clear, understandable terms, what portions of the unit interiors are covered under the association's master policy, what items of the unit interior are not covered, and what additional interior unit coverage is recommended. And while the Federal lending guidelines do not require existing unit owners to purchase interior unit coverage, with clarified insurance coverage disclosure, each owner will be in a better position to evaluate their own individual needs and to advise potential purchasers about insurance coverage provided by the association.