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Condo lending: Drilling down beyond the buyer

March 10, 2010 - Appraisal & Consulting

I had the opportunity recently to visit Florida to get out of the icy New England weather. As widely reported, Florida's weather has been chilly also, somewhat of a metaphor for its real estate market. The residential market in Florida is still frozen, but showing some signs of thawing. Perhaps spring is around the corner in all respects.

I like Florida because it is a great testing ground for all that is good and bad in residential real estate. It is a boom and bust economy, and with a fair amount of available land, and many loosely knit developers not sharing information with one another, it can be overbuilt quickly. It is among the four or five poster children for distressed real estate, including California, Arizona, Nevada, and Michigan.

I both visited with some of my broker friends there and even attended some condominium open houses, typical for rainy day entertainment. My broker friends told me that there had definitely been more sales this year, predominantly in the lower cost end. Prices in their area of Naples/Bonita have dropped about 25% to 30% in general, and the condominiums at the lower end are beginning to trade as people can find very good deals, perhaps at the bottom of the market. The Case-Schiller Home Price Indices also show modest signs of improvement, at least in the pace of sales. In some cases, there is also a bottoming trend in pricing, and some areas even a potential upward movement.

On a few of the open houses that I attended Sunday, the representative brokers at the condo made the usual pitch, but also focused on some new information. They talked a lot about condominium associations, and their management, but more importantly, their financial shape. I hadn't heard much about that in the past from the brokers who typically speak more to the views and renovated kitchens. I decided to drill down a little deeper on this issue and discovered one additional impediment to the revival of the residential market: that is, the ability for the buyer to borrow money on condominiums, with less than perfect associations.

Mortgage lenders of course verify all of the usual buyer information including income, credit history, etc., but they are now assessing the financial viability of the condominium association. In my view, this is entirely appropriate, and while it may be stressful for the buyer, the lender is doing some important homework.

Fannie Mae, Freddie Mac and FHA account for about 90% of all loans in the $450,000 and below market and thus set the bar for due diligence. As an example, FHA now reviews many factors in determining whether or not the building and its association is "approvable." They will check the number of unit owners who are late paying their assessments, the amount of cash reserves that the association maintains, and the ratio of leased to owner-occupied units. Similarly, Fannie Mae guidelines will reject a condo building if more than 15% of the owners are delinquent in paying their monthly assessments or where the association has not put aside at least 10% towards reserves and improvements. Sometimes these agencies will even reject the building if there is any retail involved, such as residential units stacked over street scope retail. This is clearly because they believe the weakness in retail could hurt the residential.

This review will constrain condominium lending more in 2010 than in 2009, although there are also many banks anxious to lend, in theory. It will be frustrating, but the lenders end up protecting the buyers as well as their own institutions. Try to think of them as part of your team.

Dan Calano, CRE, is managing partner and principal at Prospectus, LLC, Cambridge, Mass.