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Federal Housing Administration condo rules to change

June 30, 2011 - Owners Developers & Managers

The Federal Housing Administration (FHA) told industry stakeholders to expect a detailed update to existing condominium underwriting regulations which would be released by the end of June 2011. According to the FHA, the new guidance would provide greater detail, clarity and more flexibility for condominium associations to qualify for FHA financing. Since FHA began the process of revising condominium underwriting criteria more than two years ago, Community Associations Institute (CAI) has been critical of both the criteria adopted by FHA and the process used to develop new guidance. At the time of this printing, the guidelines had not yet been released, but if FHA representations on the forthcoming guidance were accurate, the evolved requirements would show movement toward policy recommendations made by CAI and our industry allies.

On June 13th, a CAI delegation led by CAI president Steven Brumfield met with Bob Ryan, acting commissioner of FHA. The purpose of the meeting was to discuss issues raised by CAI and our industry allies including the Institute of Real Estate Management (IREM), the National Association of Home Builders (NAHB) and the National Association of REALTORS (NAR) that were communicated to FHA via letter dated May 6th, 2011 in support of enhancements to the rules and limits relating to 1) owner-occupancy, 2) FHA concentration, 3) investor ownership, 4) pre-sale, 5) delinquent HOA assessments, and 6) commercial space.

While the entire May 2011 letter can be found at www.caimortgagematters.org, abbreviated recommendations from that letter include:

Owner-Occupancy

Requirement

FHA currently requires an owner-occupancy rate of 50%. It was recommended that FHA eliminate the occupancy ratio for FHA mortgages for all condominium developments. Eliminating this requirement will allow more buyers to purchase units in condominium developments and help stabilize these developments and the community.

FHA Concentration

Requirement

FHA was encouraged to amend or, at least, temporarily suspend the FHA concentration requirement. Condominiums are often the only option for first-time home buyers or borrowers with good credit but small down payments. The concentration limit impacts first-time and less affluent home buyers the most because these families' best (and sometimes only) option is a FHA mortgage.

Pre-Sale Requirement

It was recommended that the FHA pre-sale requirement be reduced or eliminated. Many condominium projects remain largely vacant because of the existing real estate crisis. This requirement minimizes consumer choice for borrowers interested in using FHA to purchase a condominium unit.

Investor Ownership

FHA currently prohibits any one investor from owning more than 10 percent of units in a project, including developers or builders that subsequently rent vacant and unsold units. FHA should consider increasing the percent of units that may be owned by any one investor. Allowing an investor to own more than 10% of units in a project, particularly if the investor is the builder or developer, means that units are less likely to remain unoccupied.

Delinquent Association

Assessments

FHA requires that no more than 15% of units in a project can be in arrears (defined as more than 30 days past due) of their condominium association assessments. Rules should be amended to allow no more than 15% of total units to be delinquent more than 90 days.

Commercial Space

Mixed-use developments are becoming increasingly prevalent across the country. FHA's current requirement prohibiting more than 25% of a property's floor area to be used for commercial space runs counter to growing government policy developing urban centers to reduce sprawl and encourage more efficient use of resources. Condominium projects with up to 45% of commercial space should be eligible for FHA approval.

In response to these concerns, FHA noted that the new guidelines will greatly expand on the current 21-page guidance and indicated that the guidance would be comprehensive and written in easy-to-understand language, as well as provide greater flexibility in allowing community associations to qualify for FHA financing even if they do not meet all of the current requirements, although it did not provide further details.

FHA has also indicated that the guidance would be followed by a more formal process of establishing more permanent regulations governing the condominium program. This is an important move by FHA as developing formal regulations requires FHA to seek input from stakeholders like CAI, something it has not done in developing the current or soon-to-be-released guidance. Since 2009, CAI has called for greater transparency and more public input in the development of new FHA underwriting rules.

Since the housing crisis, FHA has become an important source of financing for many condominium buyers. In 2010, FHA-insured mortgages accounted for more than one-third of all condominium purchases. Many potential buyers seek out FHA-approved properties as a sign of sound governance in a troubled market. Many other lenders are also informally adopting FHA standards as a benchmark for condominium lending, so the impact of FHA requirements will continue to expand. CAI will post an analysis of the new regulations to our Mortgage Matters www.caimortgagematters.org shortly after they are released.

As part of our ongoing Mortgage Matters program, CAI is working to protect homeowners in community associations and to ensure access to fair and affordable mortgage products for all current and potential community association residents. You can follow our work and share your thoughts at www.caimortgagematters.org. CAI will continue to monitor and participate in shaping the development of the FHA's condominium underwriting guidelines to ensure that the perspective of community associations is heard. If you have any questions about the FHA's underwriting criteria and how it could affect your community, e-mail government@caionline.org with FHA Mortgage Insurance Requirements in the subject line.

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