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Client Alert

FHA REVISES MORTGAGE INSURANCE CRITERIA FOR CONDOMINIUM ASSOCIATIONS

The Federal Housing Administration (FHA) has recently issued new requirements for the approval of condominium projects and the issuance of insurance on mortgages on individual condominium units (Mortgage Letter 2009-46 A & Mortgage Letter 2009-46 B).

FHA mortgage insurance acts as a guarantee that lenders will be repaid on certain high risk loans. If such insurance is not available because of an Association's inability to satisfy the FHA's requirements, the potential pool of buyers may shrink and thus reduce unit values. Associations should take note of these new requirements to ensure that mortgages issued on units within their communities qualify for FHA insurance.

A condominium project may be approved either by obtaining direct review and approval from the U.S. Department of Housing and Urban Development (HRAP) or by having a lender complete the Direct Endorsement Lender Review and Approval Process (DELRAP). Typically, the lender will obtain the necessary information from an Association to complete the approval process.

For an existing condominium project to be approved, it must satisfy the following requirements:

1. The Condominium consists of two or more units.

2. The Condominium is covered by hazard and liability insurance and, when applicable, flood and fidelity insurance.

3. A right of first refusal is permitted, provided it is not discriminatory pursuant to the Fair Housing Act regulations, 24 CFR part 100.

4. No more than 25% of the total floor area in a project can be used for commercial purposes which are not adverse to residential use.

5. No more than 10% of the units may be owned by one investor. If ten or fewer units, no single entity may own more than one unit.

6. No more than 15% of the total units can be in arrears (more than 30 days past due) of their condominium association fee payments.

7. At least 50% of the total units must be sold prior to endorsement of a mortgage on any unit. (This is important for new construction).

8. At least 50% of the units of a project must be owner-occupied or sold to owners who intent to occupy the units.

9. Legal Phasing is permitted for condominium processing.

10. FHA will not issue insurance on a unit where more than 30% of the units are already encumbered with FHA insurance. This restriction has been temporarily increased to 50% until December 31, 2010. Further, the FHA may permit up to 100% if the project has been 100% complete for at least one year; no more than 10% is owned by one entity; the budget provides for the funding of replacement reserves in an account representing at least 10% of the budget; control of the association has been handed over to unit owners; and the owner-occupancy ration is at least 50%.

11. The Association Budget must be adequate and:

    a. Include allocations/line items to ensure sufficient funds are available to maintain and preserve all amenities and features unique to the condominium project;

    b. Provides for funding of replacement reserves for capital expenditures and deferred maintenance in an account representing at least 10% of the budget; and

    c. Provides adequate funding for <u>insurance coverage</u> and deductibles, including:

        i. Hazard Insurance – the association shall maintain “master or blanket” property insurance equal to 100% of the current replacement cost of the condominium, exclusive of land, foundation, excavation and other items normally excluded from coverage. A unit owner may not obtain “gap” coverage to meet this requirement.

        ii. HO-6 Coverage – where the association master or blanket policy does not include interior coverage, the borrower must obtain a “walls-in” HO-6 policy.

        iii. The association must maintain comprehensive general liability insurance covering all common elements, commercial space owned and leased by the owner’s of the association, and public ways of the condominium project.

        iv. Fidelity Bond/Insurance – must be maintained by the association in projects with 20 or more units. The bond/insurance must cover all officers, directors, employees and all other persons handling or responsible for funds administered by the association. The coverage must be in an amount no less than a sum equal to three months aggregate assessments on all units plus reserve funds.

v. Flood insurance where the property is located in a 100 year flood plain. Coverage shall equal 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. See Mortgage Letter 2009-37.

d. Where the budget does not satisfy these requirements, a reserve study may be utilized to assess the financial stability of the project. The study may not be more than 12 months old. In addition, mortgagees may rely upon Fannie Mae Form 1073a, Analysis of Annual Income and Expenses – Operating Budget.

Should an association fail to meet these requirements; potential purchasers will be unable to obtain FHA insurance on mortgages. Such inability may result in lower unit values and an inability to sell units in a timely fashion. Hill Wallack can assist your association in complying with the new FHA mortgage insurance criteria.

For more information, contact one of the attorneys who work in this area: Ronald L. Perl, Esq., Terry A. Kessler, Esq., or Brian J. McIntyre, Esq.

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