

FEATURE ARTICLE

By the time you read this, the Condominium Project Approval and Processing guidelines (the “guidelines”) will be a year old. Issued by the Federal Housing Administration (“FHA”) on June 30, 2011 as part of Mortgagee Letter 2011-22, the guidelines were intended to provide a single source of information and consolidate, update and clarify the FHA’s policies and procedures for condominium project approval.

However, the uproar voiced from association boards, community managers, attorneys and lenders when the guidelines were released was considerable; confusion and serious concerns with certain requirements were raised almost immediately after release of the guidelines. Yet many of these concerns have yet to be adequately addressed, and the FHA continues to promise further explanation by way of a new Mortgagee Letter in the near future.

So what have we learned in a year? Have the guidelines affected condominiums seeking approval for FHA-insured mortgages for better? Or have the stricter guidelines merely complicated the process instead of simplified it as they were intended? And when will we finally get clarification as to the concerns raised almost a year ago after the release of the guidelines?

What Is FHA Mortgage Insurance?

In order to understand the guidelines, it is important to understand what FHA mortgage insurance is (and is not). The FHA does not make or guarantee mortgage loans; rather, the FHA insures mortgage loans and FHA mortgage insurance protects lenders against losses on a mortgage if the borrower defaults ¹. FHA-insured loans play a critical role in the housing and mortgage markets because they are easier to obtain than conventional mortgages and typically require a significantly lower down payment ². While FHA approval for a condominium is not legally mandated, an association that is FHA approved provides potential home buyers with an additional financing option that, at least



ONE YEAR LATER: REVISITING FHA’S CONDOMINIUM PROJECT APPROVAL AND PROCESSING GUIDELINES

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in theory, makes the association more marketable ³.

Traditionally, FHA-insured mortgages played only a small role in the condominium market, accounting for approximately five percent of all condominium mortgages in 2007. However, from 2008 to 2010 the number of FHA-insured mortgages skyrocketed to between 30 and 40 percent of all mortgages ⁴. And in 2011 alone, FHA insured its highest dollar volume ever – \$236 billion, including 770,000 new purchase loans, 585,000 for families who became homeowners for the first time ⁵.

In response to this dramatic increase in FHA-insured loans, the FHA took a closer look at its condominium approval process and began implementing a new protocol in 2009, which did away with traditional spot approvals, limited project approvals to two years and tightened lending criteria. However, even with this belt-

tightening, the FHA estimates that losses on loans insured through the first quarter of fiscal year 2009 are expected to reach \$26 billion ⁶, which was one of several reasons for the adoption of the new guidelines.

Examining the Condominium Project Approval and Processing Guidelines

In some areas, the guidelines do provide greater clarity and flexibility, allowing each Home Ownership Centers (HOC) greater flexibility in approving project applications that do not meet certain requirements. Unfortunately, many of the new provisions also create troubling issues for associations seeking project approval. A few of the most problematic areas include:

Certification of Compliance

One entirely new requirement in the guidelines, and the most problematic, concerns a certification that must be executed by an association representative that confirms compliance with all state and local laws and FHA requirements. The signatory will also have to attest that he or she knows of no "circumstances or conditions that might have an adverse effect on the project or cause a mortgage secured by a unit in the project to become delinquent." Included among these potential adverse conditions are construction defects or "substantial disputes or dissatisfaction among unit owners about the operation of the project [or the association], and disputes concerning unit owners' rights, privileges, and obligations." Moreover, these attestations are subject to a "continuing obligation" on the part of the signatory and potential criminal penalties including up to \$1 million in fines and 30 years in prison.

Needless to say, the penalties are significant enough to cause serious trepidation even if anyone was considering signing such a vague and undefined certification. Specifically, it would be near impossible for anyone to know or predict what adverse circumstances might affect an association's financial stability or what constitutes a substantial dispute among unit owners. And among other issues, the continuing obligation provision could theoretically subject board members or managers to penalties even though they no longer serve on the board, live in the community or work with the association.

Deed-Based Transfer Fees

The new guidelines also disallow approval of projects where certain deed-based transfer fees or restrictions may affect the ability of a buyer to freely transfer the property. Although not specifically addressed in the new guidelines, the FHA had

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informally announced that any condominium association with a deed-based transfer fee, including a working capital or capital contribution fee, would be disqualified from access to FHA-insured mortgages ⁷.

The inclusion of this prohibition, especially as it pertains to working capital and capital contribution fees, is perplexing, especially considering that this issue was addressed recently by the Federal Housing Finance Agency (FHFA). Specifically, FHFA found that such transfer fees add value to the properties where collected and have been an important source of funds for communities for over 40 years ⁸. Why FHA would unilaterally decide to take action contrary to other federal agencies and, more importantly, to effectively deny approval to close to half of all condominium associations in the country is confounding. The FHA has since backed off its original stance on this issue, but no official pronouncement has been made to clarify this issue.

Insurance and Fidelity Bonds

The guidelines call for the association to be covered by hazard, liability, flood and other insurance at levels as required by state or local law. In addition, the guidelines inexplicably require both the association *and* its management company obtain separate fidelity bonds to cover board members and employees. The uproar over this last requirement was immediate, and the FHA relented and advised that it will allow associations to obtain a fidelity bond that both names and covers the management company rather than require a separate fidelity bond.

And these are just a few of the many problematic issues with the new Guidelines.

Yet, the guidelines *do* provide greater clarity and flexibility in some areas. The new rules allow HOCs to grant exemptions for associations that do not meet certain delinquency requirements (so long as there are no more than 20 percent of units in arrears). Also, HOCs can authorize

exemptions for associations that contain up to 35 percent commercial-space or exceed the requirement for investor-owned units. Further, the guidelines allow for certain flexibility in associations with affordable housing and with rental restrictions (although certain problematic restrictions are still applicable).

Overall, the effect of all of these new requirements on the FHA approval process is just beginning to be felt across the country. Many associations that received FHA approval or that were recertified under the previous guidelines have now had their certifications expire with little hope of recertification. The FHA indicated that out of the approximately 25,000 condominium projects nationwide that expired between December 2010 and September 2011, only 2,100 – approximately eight percent – have been approved or recertified ⁹.

CAI continues its attempts to negotiate changes in the new guidelines, specifically those requirements dealing with transfer fees, the assessment delinquency criteria, and the certification of compliance. In addition, many members of Congress have expressed their concerns with the guidelines and called on the FHA to reconsider these new policies ¹⁰. Again, FHA officials have announced that they intend to issue a new mortgage letter “shortly”, which, we hope, will address some of these concerns.

So by the time you are reading this article, the guidelines may have changed yet again. But until then, the current state of FHA condominium project approvals remains in flux, leaving everyone – association boards, community managers, lenders and attorneys – in a continued state of confusion.

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FOOTNOTES

- 1 CAI Mortgage Matters, “CAI FAQ – FHA Condominium Guidelines,” at <http://www.caionline.org/govt/news/Political%20HeadsUp%20Public%20Document%20Library/FHA%20FAQ%202011-22.pdf>
- 2 Id.
- 3 Id.
- 4 Id.
- 5 Carol Galante, Acting Assistant Secretary for Housing, “Report to Congress” (November 21, 2011), at http://portal.hud.gov/hudportal/documents/huddoc?id=fhacomcnov2111_final.pdf
- 6 Id.
- 7 CAI Mortgage Matters, “CAI Cautions FHA on Transfer Fees, Calls for Waiver” (October 14, 2011), at <http://www.caionline.org/govt/MortgageMatters/blog/Lists/Posts/Post.aspx?ID=26>
- 8 Id.
- 9 Kenneth R. Harney, “FHA Rules for Condo Purchases are Causing Major Headaches for Buyers and Sellers,” The Washington Post, published October 21, 2011.
- 10 CAI Mortgage Matters, “Key Congressmen Express Concern with FHA Criteria, Process” (November 8, 2011), at <http://www.caionline.org/govt/news/Political%20HeadsUp%20Public%20Document%20Library/Key%20Congressmen%20Express%20Concern%20with%20FHA%20Criteria.pdf>