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Housing Administration Creates

Confusion for Condominium Certifications

With the recent changes to Virginia resale disclosure law now requiring condominium associations to disclose whether the condominium is approved by secondary mortgage market agencies, such as the Federal Housing Administration (FHA), the Department of Veterans Affairs, etc., now is a good time to revisit the ever-changing landscape of FHA condominium certifications.

Several years ago, FHA removed the "spot loan" approval process and adopted the current process for issuing FHA-insured loans to buyers and refinancers of condominium units. In order for an owner to utilize FHA financing, the entire condominium in which the unit is located must now be certified with the agency.

Since the removal of the spot loan process, it seems like every several months or so, FHA issues a new mortgagee letter changing, and often complicating, how it intends to approve condominiums to be qualified for agency financing under its new regime.

Not only do continued changes to FHA's requirements cause confusion within our industry as to what is required for a condominium community to be eligible for FHA financing, there are now new, further concerns being addressed in our industry regarding specific leasing restrictions typically found in condominium instruments.

The most recent of these mortgagee letters was issued Sept. 13, 2012. This mortgagee letter actually eased some of the standards that condominium associations once found to be burdensome to obtain FHA certification. The specific areas, which were addressed and modified in the mortgagee letter, are as follows:

Commercial Space

Under the previous rules, no more than 25 percent of the total floor area in the condominium could be used for commercial purposes, although FHA would consider a project with up to 35 percent commercial space on a case-by-case basis. Under the new standards adopted in September 2012, FHA will consider a project between 35 percent and 50 percent commercial space if the applicant provides additional information regarding how the commercial space is calculated, a description of the use of the space on a floor-by-floor basis, a marketing and neighborhood analysis and other criteria identified in the mortgagee letter.

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Investor Ownership

Previously, no more than one investor could own more than 10 percent of the units in the condominium. Now, a single entity may own up to 50 percent of the units in a condominium so long as at least 50 percent of the units are still owner occupied.

Delinquencies

Under the previous rules, no more than 15 percent of the total units in the condominium could be 30 days or more past due in the payment of assessments. FHA would consider a project with up to 20 percent delinquent units under certain circumstances and with supporting documentation provided. The new rule is that no more 15 percent of the total units in the condominium can be 60 days or more past due in the payment of assessments. There is no more 20 percent exception. However, FHA has clarified that the delinquency ratio it is evaluating pertains to principal assessments only; not charges, late fees, costs, etc.

Fidelity Coverage

Under the previous rules, the association was required to maintain fidelity coverage equal to the amount currently held in reserves plus one-fourth of the total annual assessment for the year. Furthermore, the management agent had to be listed as a covered entity. FHA required that the management agent be listed on the certificate of insurance. This requirement is still in effect, but the management agent can be listed as a covered employee via an endorsement.

Legal Liability

Under the previous rules, the applicant was required to make three very stringent certifications regarding the application package and the health of the condominium. These certifications have been eased in light of industry pushback.

Leasing Restrictions

Up until recently, FHA had been rejecting applications for condominium certification where the condominium's recorded instruments stated that typical leasing restrictions prohibiting hotel and transient use do not apply in the case where a lender takes possession of the unit via the foreclosure process. FHA had found that not subjecting bank-owned units to typical leasing restrictions prohibiting transient and hotel use of units is a violation of Section 513 of the National Housing Act, which prohibits the use of the insurance programs for transient or hotel purposes and also prohibits leases for less than 30 days.

However, on July 19, 2013, FHA issued Information Bulletin 13-42 stating that FHA would accept projects whose recorded documents contained language stating that certain bank-owned units are not subject to standard restrictions on hotel and transient use so long as the association makes a certification, signed on letterhead, that no units are currently rented more than 30 days nor provide hotel-type services.

FHA's change in position should alleviate recent problems condominiums were experiencing in getting agency approval.