

Update on FHA Condo Policies

Overview

FHA released its updated condominium policy on Nov. 6, which will become effective on Dec. 7. [Mortgagee Letter 2009-46B](#) provides permanent baseline guidance for condominium project eligibility. However, to address current market conditions, FHA has issued [Mortgagee Letter 2009-46A](#), which describes several temporary waivers that will be in effect from Dec. 7, 2009 through Dec. 31, 2010.

These exceptions include a temporary decrease in the pre-sale requirement to 30 percent (from 50 percent) and an increase to 50 percent (from 30 percent) in the allowable concentration of condo units financed with FHA-insured mortgages. The FHA concentration may be increased to 100 percent for existing projects that meet certain additional requirements. New construction and conversions are not eligible for this higher exception. The higher temporary cap on the concentration of FHA loans resulted after NAHB Chairman Joe Robson met with FHA Commissioner David Stevens and urged Stevens to consider a much higher cap.

At the end of the waiver period, FHA's condo requirements will revert back to those contained in ML 2009-46B, which outlines the criteria that condo projects must meet to receive FHA's approval and describes the condominium project approval process. Importantly, the new policy does not apply to site condos which are exempt from the condo approval process, effective June 12, 2009.

Key provisions of the new condo policy are described below.

Concentration Limits

The policy places a limit of 30 percent on the concentration of units that can be financed using FHA insured loans. The concentration level will be based on case numbers assigned on units in a project; FHA will not issue new case numbers once the 30 percent concentration level has been reached in a development. The 30 percent concentration ratio will apply to projects with four or more units. Projects consisting of three or fewer units cannot have more than one unit encumbered with FHA insurance.

FHA is allowing temporary waivers to this policy that will increase the allowable concentration to 50 percent until December 31, 2010. FHA will allow exceptions to

the 50 percent concentration level, up to 100 percent if the project meets all the basic condo standards and the items below:

- Project is 100 percent complete and construction has been completed for at least one year;
- 100 percent of the units have been sold and no entity owns more than 10 percent of the units in the project (for projects with fewer than 10 units, a single entity may own no more than 1 unit);
- The project's budget provides for the funding of replacement reserves for capital expenditures and deferred maintenance in an account that is at least 10 percent of the budget;
- Control of the Homeowners Association has transferred to the owner; and
- The owner-occupancy ratio is at least 50 percent.

New construction and conversions are not eligible for this higher exception.

"Spot Loan" Approval Process

Policy that has been in place since 1996 that has allowed lenders to approve FHA loans for condo units located in non-approved projects on a case-by-case basis is being eliminated for FHA case number assignments after January 31, 2010. After this date, lenders will be required to review and approve the project in which a unit is located. It is quite likely that lenders would be reluctant to do this in return for making a single loan in a project. **Thus, this policy could make it very difficult for potential purchasers of condo units located in older, non-approved projects to obtain FHA-insured financing.**

Pre-Sale Requirements

FHA's permanent policy calls for at least 50 percent of the units to be sold before the first FHA-insured loan is endorsed. Through the end of 2010, FHA will reduce the pre-sale requirement to 30 percent as long as the lender or the developer meets certain requirements to verify that the sales have occurred.

Owner-Occupancy Requirements

At least 50 percent of the units in a project must be owner-occupied or sold to owners who intend to occupy the units. Vacant or tenant-occupied real estate owned, including units owned by banks, are not to be included in the owner-occupancy calculation. For proposed, under construction or projects still in their initial marketing phase, FHA will

allow a minimum owner occupancy amount equal to 50 percent of the number of presold units.

Investor Ownership

HUD will not allow more than 10 percent of the units to be owned by one investor. This limitation also applies to builders / developers who have rented vacant or unsold units.

This policy will be problematic for members who have adopted the practice of leasing units in their projects to help keep these projects afloat until home buying activity picks up in their area.

Transfer of control

HUD will require the project developer to transfer control to the homeowners association no later than the latest of the following:

- 120 days after the date by which 75 percent of the units have been conveyed to the unit purchasers;
- Three years after completion of the project as evidenced by the first conveyance to a unit purchaser; or,
- The time frame established under state or local condominium laws if specific provisions regarding transfer of control exist.

These provisions may present a problem for projects where the time frame for completion of the project exceeds three years.

Project Approval Processing Options

For projects not located in Florida, lenders will have two project approval options. Lenders will be able to continue to submit projects directly to one of the four Homeownership Centers or, alternatively, lenders who have been granted permission by HUD may review and approve condominium projects internally. The second option is only available to Direct Endorsement lenders who have knowledge and expertise in the condo project review and approval processes.

Projects Located in Florida

Projects located in Florida must be submitted to the Atlanta Homeownership Center for review and approval and may not be approved by lenders.

Ineligible Projects

The following types of condominium projects are not eligible for approval:

- Condominium hotels;
- Timeshares;
- Houseboat projects;
- Projects with more than one dwelling per condo unit; and
- Projects not deemed to be primarily residential.

Recertification of Project Approvals

Project approvals will expire two years from the date of placement on the approved project list. Recertification will be necessary to determine if the project complies with HUD's owner-occupancy requirement and that no conditions exist which would present an unacceptable risk to FHA. During the recertification process, particular attention will be given to pending special assessments, pending legal action against the association or its officers and directors, and the adequacy of insurance coverage.

HUD will be phasing in the recertification process:

- Projects that received approval prior to October 1, 2008 will require recertification on or before December 7, 2010.
- Projects that received approval between October 1, 2008 and December 7, 2009 will be subject to the recertification process outlined above.

Developer Certification

For new projects HUD will require the developer to certify, under penalty of law, that the project complies with the applicable FHA requirements outlined in these Mortgage Letters and that the condo documents meet all HUD, state and federal requirements.

Structural Warranty Requirements

HUD will not require a 10-year warranty for projects where the local jurisdiction issues a building permit and certificates of occupancy. This is consistent with guidance issued in [Mortgage Letter 2001-27](#), which addresses warranty requirements for single family homes. If the jurisdiction does not issue building permits or conduct three inspections during the course of construction, the builder must either obtain an Early Start letter from an FHA-approved lender or provide a HUD-approved 10-year warranty.

Temporary or conditional certificates of occupancy are acceptable if the following conditions are met:

- All common areas and amenities for the project must be completed;
- The temporary or conditional certificate of occupancy that was issued must clearly indicate that the unit is habitable and eligible for occupancy; and,
- The jurisdiction that issues the temporary or conditional certificate of occupancy maintains a standard protocol for issuing permanent certificates of occupancy.