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Community Associations Newsletter

FHA Modifies Existing Regulations for Condominium Certification Once Again

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Effective August 29, 2011, the Federal Housing Administration (FHA) will once again have new standards for insuring mortgage loans involving condominium units. While the provisions that were implemented in November 2009 remain generally the same, there are new, additional changes that will take effect starting at the end of August which managers and Boards need to be aware of. These changes can be found in FHA's Mortgagee Letter 2011-22.

What Hasn't Changed:

The following eligibility standards are still in place under Mortgagee Letter 2011-22:

- 51% of the units must be owner-occupied or sold to owners who intend to occupy the units (i.e., not purchased for investment purposes).
- No more than 25% of the property's total floor area can be used for commercial purposes.
- No more than 15% of total units in the condominium can be 30 days or more past due on the payment of assessments.

- The budget must include allocations/line items to ensure sufficient funds are available to maintain and preserve all amenities and features, provide for the funding of reserves in an account representing at least 10% of the budget, and provide adequate insurance. If the Association does not meet these 3 criteria, the mortgagee may request a reserve study which must be no more than 12 months old.
- The Association must maintain fidelity coverage equal to the amount currently held in reserves plus $\frac{1}{4}$ of the total annual assessment for the year.
- No more than 1 investor can own more than 10% of the units in the project.

New Requirements:

- Financial statements submitted with the application cannot be more than 90 days old. Actual income and expenses statements and the copy of the current budget must be provided. A balance sheet must also be provided.
- FHA will consider a project with up to 35% commercial space on a case-by-case basis.

- FHA has clarified what restrictions are permissible with respect to leasing. Standard leasing restrictions (such as leases must be in writing, must be for a term not less than 6 months, lease caps, etc.) are permissible.
- FHA will consider a project with 20% of the units delinquent under certain circumstances and with supporting documentation provided.
- Foreclosed units (by mortgagees) are included in the delinquency ratio calculation.
- If there is a current special assessment, the application must include a signed and dated explanation of the assessment answering specific questions posed by FHA about the special assessment.
- If there is pending litigation, the application must include a signed and dated explanation of the litigation answering specific FHA questions about the litigation. It is not currently clear whether this obligation includes reporting of routine collections litigation.
- The condominium must be covered by hazard insurance (“master” or “blanket”) equal to 100% of the replacement cost. If the master policy does not include interior unit coverage, including replacement of interior improvements and betterment coverage, the unit owner must have a “walls in” policy (“HO-6”).
- If the Association engages the services of a management company, the management company must maintain fidelity coverage with the Association listed as a named obligee. Furthermore, such coverage must be in an amount not less than the estimated maximum funds in the custody of the management agent. Management’s certificate of insurance evidencing this coverage must be provided.
- The Association must have flood insurance coverage equal to the replacement cost of the project less land or up to the National Flood Insurance Program standard limit if located in a Special Flood Hazard Area /100-year flood plain.
- The applicant is required to make 3 certifications regarding the project:
 - 1) The project meets all state and local condominium laws and FHA approval requirements;
 - 2) To the best of the submitter’s knowledge, the information and statements contained in the application are true and correct; and
 - 3) *The submitter has no knowledge of circumstances of conditions that might have an adverse affect on the project or cause a mortgage secured by a unit in the project to become delinquent, such as defects in construction, substantial disputes or dissatisfaction among unit owners about the operation of the*

project of the association, etc. The submitter must continually notify HUD of any material information that was submitted is no longer true or correct.

This third certification is new and very onerous. Not only does the applicant have to certify the validity of the information being submitted, he or she also must certify that there are no owner “disputes or dissatisfaction” about the operation or management of the Association.

In our industry, owner disputes can be very common. FHA has not clarified what it considers to be an owner dispute, so Associations should err on the side of inclusiveness in the FHA application and continuing reporting requirements.

The continuing reporting requirement of material changes within the Association since the last FHA submission is also a very significant new requirement. Associations must now notify FHA of a special assessment, litigation, increase in delinquencies, discovery of a major defect in the building, etc. that occur since the last submission to FHA as they occur. The Association cannot wait to identify these material changes when the project is getting re-certified in 2 years.

As such, it is imperative that Associations keep whoever is preparing the submission (management, legal counsel, a third party vendor, etc.) abreast of any material changes in the status of the condominium that may occur throughout the certification term.

The penalties for failing to do so are high. If one knowingly or willfully making a false, fictitious, or fraudulent statement in connection with the FHA application, the submitter can be fined a penalty of \$1,000,000 and face imprisonment of up to 30 years.

With such severe penalties, we will all need to be extra careful in making sure that the information submitted to FHA is complete and accurate and that the continuing reporting obligations are satisfied.

Obviously, these new requirements raise a lot of issues that did not exist before. At the forefront, FHA has not clarified whether FHA will remove the Association’s certification if the Association has a material change (such as the delinquency ratio increasing over 15% or the owner-occupancy ratio dipping below 51%) since the last submission under the new reporting requirements.

Furthermore, management companies must insure that they have the requisite fidelity coverage.

We will continue to monitor FHA’s actions and report any additional changes to our clients and industry professionals. It would not surprise us if these regulations continue be re-worked to address some of the issues raised in this memo.

In the mean time, if your association is contemplating changes to the Association documents to address these new requirements, please contact your association counsel for legal guidance when you first start discussing solutions to address these new regulations.