



Issue Update

The U.S. Department of Housing and Urban Development announced a revision of its condominium project approval rules and guidelines.

- » A final regulation on condominium project approval will be published in the *Federal Register* on August 15th. A pre-publication version of the rule may be viewed [here](#). The rule becomes effective October 14, 2019.
- » FHA has released revisions to HUD Handbook 4000.1, incorporating policy authorized under the rule. *It is important to note the implementing policy (i.e., the actual approval standards) is in the Handbook, not the final rule.* The HUD Handbook revisions may be accessed [here](#). [NOTE: this is a large file]

Structure of HUD Condominium Rule

The final condominium rule is intended to offer HUD and FHA broad authority to administer the condominium approval program in a flexible fashion. Accordingly, the rule establishes risk tolerances for several criteria, authorizing FHA to select specific standards within the tolerances via mortgagee letter or updates to the HUD Handbook. A general description of FHA authority under the final condominium rule follows.

Three Year Approvals

FHA approvals are extended to a term of 3-years. Consistent with this approval term, FHA will permit exceptions to the general 10 percent of budget annual reserve requirement if a reserve study that has been completed within the prior 36 months justifies a lower reserve contribution amount.

Basic FHA Property Eligibility and Financial Standards Retained

The rule retains FHA's long-standing property eligibility and financial standards, including—

- » no hotel services or transient housing purpose
- » projects must consist solely of one family units
- » project or phase must be complete and ready for occupation
- » project or phase in compliance with local recordation requirements
- » project in compliance with applicable Federal, state, and local law, including fair housing and disability access statutes

- » project meets minimum project insurance requirements including flood, hazard, and fidelity coverage
- » demonstrate financial and operational stability (budget review, 10 percent reserve requirement, pending legal action, pending or planned special assessments, etc.)

Approval Criteria Subject to Tolerance Ranges

Certain approval criteria may be established by FHA within established tolerances incorporated in the final rule. Actual standards are to be set by FHA through mortgagee letter and/or revisions to the HUD Handbook.

The final rule establishes the following tolerances for FHA when adopting final standards—

- » Commercial Space—between 25 percent and 55 percent of the total floor area may be used for commercial purposes provided the commercial space does not jeopardize the financial stability or residential nature of the project
- » FHA-Insured Loan Concentration—between 25 percent and 75 percent of units in a condominium project may have an FHA-insured mortgage
- » Owner Occupancy—between 30 percent and 75 percent of units must be owner occupied. Second homes (owner resides in unit a portion of the year but may not lease unit a majority of the year) are included in the owner occupancy calculation.

Single-Unit Approvals

The final rule reintroduces a version of the previously terminated “spot-loan” approval process, renamed “single-unit” approvals. The final rule authorizes FHA to insure up to 20 percent of unit mortgages in a condominium, provided—

- » the project meets all FHA property eligibility standards
- » the project has not received an adverse determination for FHA approval
- » the unit is not a manufactured home
- » the unit is in a project with at least 5 units

As with other criteria subject to a tolerance, FHA will adopt specific single-unit limits and approval procedures for use by mortgage lenders.

General Regulatory Flexibility

The final rule provides FHA authority, on a case-by-case basis, to make exceptions to non-statutory approval criteria. Such criteria include most financial stability criteria and FHA risk management criteria (i.e., FHA concentration, commercial space). Statutory criteria such as prohibitions on hotel or transient housing purposes may not be waived.

Reverse Mortgages

The rule clarifies that reverse mortgages are eligible for insurance through the single unit approval process. The rule requires lenders to comply with property inspection and condition standards.

Rehabilitation Loans

The rule clarifies that condominium unit mortgages are eligible for FHA's 203(k) rehabilitation loan program. The rule notes that rehabilitation does not include work on common elements, is confined to work within a unit, and complies with the general 203(k) program requirements.

Site Condominiums

The rule clarifies the circumstances under which a mortgage for a unit in a site condominium are eligible for FHA-insurance.

Implementation of Condominium Rule through HUD Handbook

Concurrent with the release of the final condominium project approval rule, FHA announced an update to *HUD Handbook 4000.1, FHA Single Family Housing Policy Handbook*, the definitive administrative guide for all FHA mortgage insurance programs.

The Handbook updates reflect FHA's exercise of the authority granted by the rule and refine the agency's condominium policy by setting exact approval criteria, including specific approval requirements for criteria subject to a tolerance.

For all intents and purposes, the HUD Handbook is the controlling authority for FHA condominium project approval. The prior FHA Condominium Project Approval and Processing Guide has been superseded and incorporated, with substantive revision, in HUD Handbook 4000.1. A general description of major authorities under the revised HUD Handbook follows.

Single-Unit Approvals

The following criteria apply to single-unit approvals—

- » borrower's loan application must receive an Accept rating from the TOTAL Mortgage Scorecard system or have a maximum loan-to-value ratio of 90 percent
- » condominium project is NOT FHA approved or been previously denied full FHA project approval
- » condominium project has more than 5 units
- » condominium project meets all FHA property standards
- » no more than 10 percent of mortgages in the condominium may be insured by FHA
- » the condominium must have at least a 50 percent owner occupancy rate
- » control of the condominium association must have transferred to the owners
- » the condominium meets FHA financial stability requirements and have not experienced a financial distress event within the previous 3-years
- » no more than 15 percent of association assessments may be delinquent
- » no single individual or entity may own more than 10 percent of units in the condominium. In projects with fewer than 20 units, no individual or entity may own more than one unit
- » project complies with FHA borrower, flood, hazard, and fidelity insurance requirements
- » commercial space does not exceed 35 percent of the project's total floor area

Full Condominium Project Approval Standards

The following criteria apply generally to all condominiums, including those projects submitting (or submitted by an FHA-approved lender) for full project approval—

- » FHA Insurance Concentration—no more than 50 percent of unit mortgages may be insured by FHA at time of approval or when a mortgage is presented to FHA for endorsement
- » Owner Occupancy Standard—at least 35 percent of units in the condominium project must meet FHA's definition of owner occupied. *This includes second homes that are occupied by the owner for any portion of a calendar year and not leased for a majority of a calendar year.*
- » Assessment Delinquencies—no more than 15 percent of total units may be more than 60 days delinquent on common expense assessments
- » Individual Owner Concentration—no individual or entity may own or control more than 10 percent of units in the condominium project. For projects with fewer than 20 units, no individual or entity may own or control more than one unit.
- » Insurance Requirements—

- Mortgagee must verify the borrower has obtained so-called “Walls-In (HO-6) coverage
- Project has in force a master or blanket hazard policy for at least 100 percent of the insurable replacement cost of the condominium project, including individual units. Policies must meet minimum coinsurance and pooling requirements and the project must be a named insured (provisions made for affiliated condominium projects)
- Project has in force a flood insurance policy purchased through the National Flood Insurance Program or has secured a LOMA, LOMR, or NFIP elevation certificate indicating the project or building is not in a Special Flood Hazard Area or complies with 100-year floodplain construction requirements
- Project has obtained fidelity or theft of funds coverage
- » Commercial Space—
 - Commercial space may not exceed 35 percent of the project’s total floor area
 - A project’s commercial space may range up to a maximum of 49 percent of the project’s total floor area provided HUD determines the commercial space does not interfere with the residential character of the project and local economic considerations justify higher commercial space in the project
 - To be considered for an exception to the general 35 percent commercial space cap, a project must present an opinion from a certified residential appraiser attesting to market acceptance of higher commercial space projects in the project’s specific market and present a current market study conducted by an independent third party assessing the project’s viability under local economic conditions.
- » Various Operational and Legal Requirements—
 - Management Contract
 - Voidable without penalty under 90-day termination clause
 - Contracts transferring to association from developer must be voidable without penalty subject to a 90-day termination clause
 - Litigation—
 - project must not be subject to pending litigation in which the project sponsor is a named party and that relates to the safety, structural soundness, habitability, or functional use of the project
 - project must not be subject to pending litigation not covered by insurance or litigation that will exceed insurance coverage amounts
 - Legal Restrictions on Conveyance

- Project must comply with 24 CFR 203.41(c) and (d)
- An exception applies if a legal restriction on conveyance is imposed by specified affordable housing requirements
- Excepted Transfer Fee Covenants under 12 CFR 1228 are exempted from legal restrictions on conveyance requirements

Contact: Dawn M. Bauman, CAE
SVP, Government Affairs
Dbautman@caionline.org | (888) 224-4321