



## FHA Releases Condo Update—CAI Areas of Concern Addressed

The Federal Housing Administration released a long-awaited revision of its condominium project approval guidelines on September 13<sup>th</sup>. The revisions to FHA condominium guidelines are contained in Mortgagee Letter 2012-18 and expire on August 31, 2014. FHA states it is making temporary adjustments to its condominium standards in response to market conditions.

CAI has the new guidelines, Mortgagee Letter 2012-18, under review. FHA appears to have been responsive to several key CAI concerns including delinquency rates, fidelity insurance coverage, the condominium project certification statement, and limitations on commercial space.

Preliminary staff analysis show FHA policy changes in the following areas—

- » **Delinquencies**—No more than 15 percent of units may be more than 60 days delinquent. The 15 percent limitation includes all units in the project and FHA will not consider any exceptions to this standard. Previously, the guidelines used 30 day delinquency as a threshold. The change to 60 days is very beneficial to community associations.
- » **Employee Dishonesty Insurance**—All new and established condominium projects with more than 20 units shall obtain and maintain employee dishonesty insurance coverage. The association's policy must—
  - o cover all officers, directors and employees of the association
  - o all other persons handling or responsible for funds administered by the association
  - o the coverage amount must be no less than three months assessments on all units plus reserve funds unless State law mandates a maximum dollar amount of required coverage.
  - o If the condominium engages the services of a management company—
    - the company must have obtained its own fidelity coverage that meets FHA association coverage requirements; or
    - the association's policy names the management company as an insured; or
    - the association's policy includes an endorsement stating that management company employees subject to the direction and control of the association are covered by the policy

This is a substantial change to the previous requirements that required management companies to obtain separate fidelity insurance for each condominium.

- » **Project Certification (Appendix A)**—FHA will require that the individual submitting a condominium project for approval certify that—
  - To the best of their knowledge, the information in the approval request is accurate
  - They have reviewed the project application and upon the advice given by an attorney it meets all State and local laws
  - They have reviewed the application and it meets all current FHA condominium approval requirements, and
  - They have no knowledge of circumstances or conditions that may have an adverse impact on the condominium project (construction defects, substantial operational issues, or litigation, mediation, or arbitration issues)

Previous guidelines required much more onerous project certification attestation that had put the individual submitting the project approval for the condominium at risk for legal liability.

- » **Commercial Space Limitations**—FHA will consider condominium projects with commercial space of between 25 and 35 percent for projects through the HRAP process only. FHA will consider, on a case-by-case basis, exceptions for mixed-use condominiums with commercial space of up to 50 percent, but requires substantial documentation for consideration. All exception requests must be submitted for review through the Philadelphia Homeownership Center.

CAI will publish additional information and guidance following a complete analysis of the guidelines.



# U.S. DEPARTMENT OF HOUSING AND URBAN DEVELOPMENT

WASHINGTON, DC 20410-8000

ASSISTANT SECRETARY FOR HOUSING-  
FEDERAL HOUSING COMMISSIONER

**Date: September 13, 2012**

**Mortgagee Letter: 2012-18**

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**To** All Approved Mortgagees  
All FHA Roster Appraisers

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**Subject** Temporary Approval Provisions for the Federal Housing Administration  
(FHA) Condominium Project Approval Process

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**Purpose** This Mortgagee Letter (ML) puts in place temporary condominium project approval guideline changes to some of the current FHA condominium approval policy provisions. These changes replace, for the period specified by this ML, certain approval requirements specifically identified in this ML that were established in ML 11-22 and the attached Condominium Project Approval and Processing Guide (Guide). It was determined that certain policy adjustments were needed to address current housing market conditions.

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**Effective Date** This ML is effective for all condominium project approvals, recertifications, annexations or reconsiderations submitted for review as of the date of this directive unless otherwise specified in a particular information block. This approval process will apply until August 31, 2014, unless further extended by FHA.

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**Changes** The policy changes made in this ML are underlined. Further, the entire referenced section of the guidance previously issued in ML 11-22 and the attached Guide has been replaced or revised as stated in each information block.

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**Project Types  
Section 1.5** The requirements of Section 1.5 of the Guide are replaced by the following updated policy guidance.

- Proposed construction is defined as a new development where no construction has been started.
- Under construction is defined as: (1) a new development in which

construction has been started but is not yet completed or in which units are completed but are less than 1 year old (existing < 12 months old); or (2) gut rehabilitation conversions. The definition of ‘under construction’ applies to legally phased developments.

- Existing project is defined as fully completed and is over one year old.

**Newly  
Converted  
Conversions  
Section 1.5.1**

The requirements of Section 1.5.1, Newly Converted Conversions, Converted, Non-Gut Rehabilitation Condominium Projects is replaced by the following updated policy guidance. **All requirements for Converted, Gut-Rehabilitation Condominium Projects, including the Eligibility and Processing Requirements in Section 1.5.1 remain unchanged.**

**1.5.1 Newly Converted Conversions**

Conversion to a condominium regime occurs in those projects which involve changing the title of the existing structure generally under one title, to property that is separated into units so that the title to most units can be held separately. **Newly converted means condominium project applications submitted for approval within two years from the date of conversion.** This definition is applicable to the rest of this ML and the/or Guide.

**Conversion occurs:** As of the date on which all the documents, specifically, the condominium declaration, necessary to create a condominium regime have been recorded in accordance with state and/or local laws. A notation must be made in FHA Connection (FHAC) if multiple documents exist that establish the condominium regime. **The provisions contained in Section 1.5.1 of the Guide only apply to Converted, Non-Gut Rehabilitation projects and Converted, Gut-Rehabilitation projects, for which condominium project applications for approval are submitted within two years from the date of conversion. Thereafter, the conversion will be considered as existing and subject to all applicable requirements for approval of an existing project.**

**Converted, Non-Gut Rehabilitation Condominium Projects**

Provided below are examples of non-gut rehabilitation work/repairs. These are examples only and there may be other non-gut rehabilitation work/repairs that is not defined but make the project eligible under this conversion type.

- Painting
- New Carpet
- Replacement of cabinets
- Replacement of fixtures
- Replacement of doors
- Replacement of windows

### Eligibility and Processing Requirements

<p>Converted, non-gut rehabilitation condominium project conversions may only be processed under the HRAP option.</p>
<p>Approval is considered only for conversions that have already taken place, not based on conversions or phases of conversions that are anticipated to occur in the future.</p>
<p>All rehabilitation work/repairs involved in a condominium conversion must have been completed as evidenced by an engineering or architectural inspection (dated within 12 months of work/repair completion).</p>
<p>A current (defined as no more than 24 months old) reserve study prepared by a qualified, independent professional company, accompanied by an engineer's report, or functional equivalent, must comment favorably on the structural integrity of the project and the remaining useful life of the major project components.</p>
<p>The following financial documents must be submitted for review.</p> <ul style="list-style-type: none"> <li>• Current Year Budget;</li> <li>• Current Balance Sheet less than 90 days old at time of submission for project approval;</li> <li>• Actual Income and Expense Statement for project; <b>and</b></li> <li>• Bank statements may also be requested.</li> </ul> <p>The review of the financial documents must determine that the budget and operating results are sufficient and:</p> <ul style="list-style-type: none"> <li>• Includes allocations /line items to ensure sufficient funds are available to maintain and preserve all amenities and features unique to the condominium project; <b>and</b></li> <li>• Provides for the funding of replacement reserves for capital expenditures and deferred maintenance in an account representing at least ten (10) percent of the budget; <b>and</b></li> <li>• Provides adequate funding for insurance coverage and deductibles; <b>and</b></li> <li>• Funds to cover the total cost of any items identified in the reserve study or engineer's report that need to be replaced within 5 years from the date of the study must be deposited in the HOA's reserve account.</li> </ul> <p>In cases where the budget documents do not meet the financial review standards, a reserve study will be requested to assess the financial stability of the project. The reserve study cannot be more than 24 months old. When reviewing the reserve study, consideration must be given to items that have been replaced after the time that the reserve study was completed.</p>
<p>The developer must provide a detailed description of the work proposed or already completed in order for the <u>individual</u> project units to be ready for</p>

<p>sale.</p> <p><u>At least 50 percent of the total units in the project must have been conveyed or be under a bona fide contract for purchase to owner-occupant principal residence purchasers.</u> The developer may provide the following evidence to meet this requirement: copies of sales agreements and loan commitments evidencing that a mortgagee is willing to make the loan; or evidence that units have closed and are occupied; or information that lists all of the units already sold, under contract, or closed (e.g., a spreadsheet, chart, or listing used for the company’s own tracking purposes) that is accompanied by a signed certification from the developer (Appendix B of the Guide). The developer is certifying to the accuracy of the submitted documentation that meets the pre-sale and/or owner-occupancy requirements.</p>
<p><u>A developer may own up to 50 percent of the total units at the time of project approval.</u></p>
<p>The project developer must provide a comprehensive sale and marketing strategy that includes efforts to affirmatively market the units and a transition strategy for any unit(s) currently rented with the exception of those rentals required by state or local law, including rent controlled units.</p>

**Non-Residential/Commercial Space Section 2.1.3**

This section has only been updated to provide additional options for Non-Residential/Commercial space. No more than 25 percent of the property’s floor area in a project or a unit can be used for non-residential/commercial purposes. The non-residential/commercial portion of the project must be of a nature that is homogenous with residential use, which is free of adverse conditions to the occupants of the individual condominium units. A project can be approved with non-residential/commercial space less than or equal to 25 percent under the HRAP or DELRAP options.

**Exception Requests: Percentage >25% but ≤ 35%**

Exception requests will only be considered on a case-by-case basis by the jurisdictional HOC. FHA reserves the right to reject any exception request received. Based on the HOC review, additional information and/or documentation may be required. Granting an exception does not change the requirement that the project’s use remains primarily residential, homogenous with residential use and is free of adverse conditions to the occupants of the individual condominium units.

Provided in the table below are the requirements for submitting a request for consideration of an exception.

Processed only under the HRAP option.	<b>No exception requests may be processed under the DELRAP option.</b>
Must be submitted as part of the	<b>No exception requests may be</b>

approval, re-approval or recertification process under the HRAP process.	<b>processed under the DELRAP option.</b>
Proposed, under construction (including existing projects less than one year old, existing < 12 months old) and newly converted projects are not eligible.	<b>Project must be complete for at least one year.</b>
Exceptions will only be considered under the requirements defined in Exception Requests for Mixed-Use Developments Unable to Satisfy 25 and/or 35 Percent Space Requirements section below.	
Control of the HOA has been transferred to the unit owners.	

**Exception Requests for Mixed-Use Developments Unable to Satisfy the 25 and/or 35 Percent Space Requirements**

Exception requests will only be considered on a case-by-case basis. All requests must be submitted to the Philadelphia HOC. FHA reserves the right to reject any exception request received. Based on the HOC review, additional information and/or documentation may be required. Granting an exception does not change the requirement that the project's use remains primarily residential, homogenous with residential use and is free of adverse conditions to the occupants of the individual condominium units.

Mixed-use developments are defined as developments with a combination of any of the following: commercial, residential, retail, office or parking space.

Provided in the table below are the requirements for submitting a request for consideration of an exception.

Submission package must include the following documentation:

- Complete condominium submission package per the requirements of the Guide (reference ML 11-22).
- Cover letter requesting consideration of an exception request that includes good cause reason(s) for requesting the exception; overall description of the project identifying all uses in the development by building and floor area; and the commercial space percentage.
- Explanation of how the commercial space percentage was determined – provide calculations. Marketing analysis – must include neighborhood analysis.
- Photographs of the project (front and back) and surrounding neighborhood (left, right, across the street, street scene).

<ul style="list-style-type: none"> <li>• <u>Spreadsheet that provides non-residential/commercial leasing space information (owners name, applicable lease terms, including lessee's name, lease term, business operation, monthly rental and current vacancies).</u></li> </ul>
<p><u>The commercial space must not have a negative impact on the residential character of the project in which the unit is located and consist of no more than 50 percent commercial space unless specifically approved by the Commissioner or her/his designee.</u></p>
<p><u>Consideration is limited to mixed-use condominium development projects.</u></p>
<p><u>Requests must be reviewed under the HRAP method. Requests to exceed the current non-residential/commercial space requirements <b>may not</b> be reviewed by the DELRAP method.</u></p>

### Live/Work Projects

Live/Work projects are traditional condominium projects with legal documents that require or allow for non-residential use within the residential condominium unit. Live/work projects usually look and feel like traditional condominium projects and must meet the below requirements.

- Live/Work project approvals require approval under the HRAP option; **and**
- The condominium declaration must require that the work (non-residential) space per unit cannot exceed 25 percent of the unit's total floor area; **and**
- The non-residential work space may not exceed 25 percent of the project's total floor area; **and**
- The non-residential use must be subordinate to the unit's residential use and character.

### Investor Ownership Section 2.1.4

The requirements of Section 2.1.4, Investor Ownership are replaced by the following updated policy guidance.

A unit that is occupied as a principal residence is not considered as an investment property. When calculating the investor owned percentage, this unit will not be included in the calculation.

For all existing or non-gut rehabilitation projects, any investor/entity (single or multiple owner entities) may own up to 50 percent of the total units at the time of project approval if at least 50 percent of the total units in the project have been conveyed or are under a bona fide contract for purchase to owner-occupant principal residence purchasers.

Unoccupied and unsold units owned by a builder/developer are not considered as investor owned and subject to the requirements unless the unit



is currently rented or has previously been occupied.

Eligible non-profit and/or eligible governmental housing programs are subject to the same investor and owner-occupied percentage requirements stated above. An eligible governmental or non-profit program means a program designed to assist the purchase of low-or-moderate-income housing including rental housing that is operated pursuant to a program established by Federal law, operated by a State or local government, or operated by an \*eligible non-profit organization as defined by the Department’s current guidelines. (Refer to 24 CFR 203.41 for additional information.)

**Delinquent Homeowners Association (HOA) Dues Section 2.1.5**

The requirements of Section 2.1.5 of the Guide are replaced by the following updated policy guidance.

This requirement must be reviewed as part of the analysis for project approval and must also be verified as part of the loan level requirements. No more than 15 percent of the total units can be in arrears (more than 60 days past due) on their condominium association fee payments (does not include late fees or other administrative expenses). The 15 percent includes all units (occupied, investor, bank owned and vacant).

There will be no exception requests granted.

**Insurance Requirements Section 2.1.9**

This section has only been updated to provide additional options for Fidelity Bond/Fidelity Insurance requirements for management companies. All other requirements of Section 2.1.9 remain unchanged.

**Fidelity Bond/Fidelity Insurance – may also be known as “Employee Dishonesty” or “Crime Policy” (required submission for project approval)**

For all new and established projects with more than 20 units, the **homeowners association** is required to obtain and maintain this insurance:

- The homeowners association must maintain this insurance for all officers, directors, and employees of the association and all other persons handling or responsible for funds administered by the association;
- The coverage must be no less than a sum equal to three months aggregate assessments on all units plus reserve funds unless State law mandates a maximum dollar amount of required coverage.

If the homeowners association engages the services of a management company, one of the following requirements must be met evidencing that

Fidelity Bond/Fidelity Insurance – may also be known as “Employee Dishonesty” or “Crime Policy” is in place for the management company’s officers, employees and agents handling or responsible for funds of, or administered on behalf of, the owners association.

- The management company has secured their own Fidelity Bond/Fidelity Insurance in an amount no less than the sum equal to 3 months aggregate assessments on all units plus reserve funds unless State law requires a maximum amount of coverage; **or**
- The homeowners association’s Fidelity Bond/Fidelity Insurance policy specifically names the management company as an agent or insured; or
- The homeowners association’s Fidelity Bond/Fidelity Insurance policy includes a “Covered Employee” endorsement that states that a person employed by an employment contractor (Management Company) performing services subject to direction and control by the homeowners association is covered under the policy.

**Project  
Certification  
Section 2.4**

The requirements of Section 2.4 of the Guide are replaced by the following updated policy guidance.

The Project Certification (Appendix “A”) document provided in ML 2011-22 has been revised. The revised document defining the new certification requirements is attached and replaces the prior certification language. Use of the new Project Certification document is optional until 30 days from the date of this directive at which time use of the new document becomes mandatory.

The Project Certification is a required document when submitting condominium approval, recertification or annexation packages for review under the Direct Endorsement Lender Review and Approval Process (DELRAP) or HUD Review and Approval Process (HRAP) options. A new Project Certification is required on reconsideration actions if the submitter of the reconsideration package is not the original package submitter.

The Project Certification document must be submitted on letterhead and must be executed (signed and dated – signature stamps or electronic signatures are not permitted) by the person (homeowner’s association or their representative, management company or their representative, project consultant, builder, developer, attorney or lender) submitting the condominium approval package. Authorized representative is defined as the management company, project consultant or attorney.

The certification states that the undersigned hereby certifies that:

1. To the best of my knowledge and belief, the information and

- statements contained in the condominium project application are true and correct; and
2. I have reviewed the condominium project application and in reliance upon advice given by my attorney, it meets all State, and local condominium laws; and
  3. I have reviewed the condominium project application and it meets all current Federal Housing Administration (FHA) condominium approval requirements; and
  4. I have no knowledge of circumstances or conditions that might have an adverse effect on the project (including but not limited to defects in construction; substantial operations issues; or litigation, mediation or arbitration issues).

**Note:** FHA will not require an attorney’s certification. However, mortgagees, builders/developers, homeowners’ associations, management companies, or project consultants may obtain this as part of their own due diligence process. This document does not replace other required condominium certifications that are required to be executed (Appendices A and B).

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**Pre-Sale  
Requirements  
Section 3.4**

The requirements of Section 3.4 of the Guide are replaced by the following updated policy guidance. At least 30 percent of the total units must be sold prior to endorsement of a mortgage on any unit. This pre-sale requirement is not applicable to existing projects or non-gut rehabilitation conversions, which require a 50 percent owner-occupancy percentage. The pre-sale percentage must be documented as follows:

- Copies of sales agreements and evidence (loan commitment) that a mortgagee is willing to make the loan\*, **or**
- Evidence that units have closed and are occupied; **or**
- Information from a developer/builder that lists all of the units already sold, under contract, or closed (e.g. a spreadsheet, chart, or listing used for the company’s own tracking purposes) that is accompanied by a signed certification from the developer.

**Note:** A secondary residence can only be considered to be “owner-occupied” if it meets all of the requirements of 24 CFR 203.18(f)(2). Additionally, a unit sold to an owner who intends to occupy the unit may only be considered “owner-occupied” if it was a valid presale.

A unit that is occupied as a principal residence is not considered as an investment property.

Unoccupied and unsold units owned by a builder/developer are not considered as investor owned and subject to the requirements unless the unit is currently rented or has previously been occupied.

The chart below provides the requirements for pre-sale, owner-occupancy and investor percentages for proposed, under construction (including existing < 12 months old) or gut-rehabilitation conversions. Regardless of the status of transfer of control and/or if there has been a change in ownership/sponsorship, the below requirements are applicable,

Pre-Sale Percentage	Owner-Occupancy Percentage	Investor Percentage
30 percent	30 percent	No more than 30 percent
>30 – 35 percent	>30 – 35 percent	No more than 30 percent
>35 – 40 percent	>35 – 40 percent	No more than 35 percent
>40 – 45 percent	>40 – 45 percent	No more than 40 percent
>45 – 50 percent	>45 – 50 percent	No more than 45 percent
50 percent	50 percent	50 percent

**Owner-Occupancy Requirements Section 3.5**

The requirements of Section 3.5 of the Guide are replaced by the following updated policy guidance.

Project Status	Requirement
Existing (projects fully completed and over one year old or non-gut rehab conversions)	At least 50 percent of the units of a project must be owner-occupied or sold to owners who intend to occupy the units.
Proposed, Under Construction (including existing < 12 months old) or Gut Rehab Conversions	<u>FHA will allow a minimum owner-occupancy percentage equal to 30 percent of the declared units. Legally phased projects must meet 30 percent presale and 30 percent owner occupancy requirements. (See chart referred to in Pre-Sale Requirements, section 3-4).</u>

The owner-occupancy percentage must be documented as follows:

- Copies of sales agreements and evidence (loan commitment) that a mortgagee is willing to make the loan\*, **or**

- Evidence that units have closed and are occupied; **or**
- Information from a developer/builder that lists all of the units already sold, under contract, or closed (e.g. a spreadsheet, chart, or listing used for the company’s own tracking purposes) that is accompanied by a signed certification from the developer.

**Note:** A secondary residence can only be considered to be “owner-occupied” if it meets all of the requirements of 24 CFR 203.18(f)(2). Additionally, a unit sold to an owner who intends to occupy the unit may only be considered “owner-occupied” if it was a valid presale.

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**FHA Retains the Right to Terminate**

FHA reserves the right to modify, suspend or terminate the guidance contained in this document if analysis of condominium mortgage performance indicates that the insurance fund is at risk.

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**Information Collection Requirements**

Paperwork reduction information collection requirements contained in this document are pending submission to the Office of Management and Budget (OMB) under the Paperwork Reduction Act of 1995 (44 U.S.C. 3501-3520) and are pending an OMB control number. In accordance with the Paperwork Reduction Act, HUD may not conduct or sponsor, and a person is not required to respond to, a collection of information unless the collection displays a currently valid OMB control number.

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**Questions**

Please address any questions about the topics in this Mortgagee Letter to the FHA Resource Center at 1-800-CALL-FHA (800-225-5342) or visit HUD’s website at [www.hud.gov/lenders](http://www.hud.gov/lenders). Persons with hearing or speech impairments may reach this number via TTY by calling the Federal Information Relay Service at 1-800-877-8339.

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**Signature**

Carol J. Galante  
Acting Assistant Secretary for Housing-Federal Housing Commissioner

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Attachment

**ATTACHMENT  
PROJECT CERTIFICATION (APPENDIX "A")\***

**PROJECT ID NUMBER (IF ASSIGNED):** \_\_\_\_\_

**PROJECT NAME:** \_\_\_\_\_

**PROJECT ADDRESS (include city/state/zip):** \_\_\_\_\_

The undersigned hereby certifies that:

1. To the best of my knowledge and belief, the information and statements contained in the condominium project application are true and correct; **and**
2. I have reviewed the condominium project application and in reliance upon advice given by my attorney, it meets all State, and local condominium laws; **and**
3. I have reviewed the condominium project application and it meets all current Federal Housing Administration (FHA) condominium approval requirements; **and**
4. I have no knowledge of circumstances or conditions that might have an adverse effect on the project (including but not limited to defects in construction; substantial operational issues; or litigation, mediation or arbitration issues).

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<b>Submitter Name and Title (Print and Sign)</b>	<b>Date</b>
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**Company/Organization Name**

**\*Certification must be submitted on letterhead, signed and dated.**

Title 18 U.S.C. 1014, provides in part that whoever knowingly and willfully makes or uses a document containing any false, fictitious, or fraudulent statement or entry, in any matter in the jurisdiction of any department or agency of the United States, shall be fined not more than \$1,000,000 or imprisoned for not more than 30 years or both. In addition, violation of this or others may result in debarment and civil liability for damages suffered by the Department.