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HUD Rules for Community Associations Seeking FHA Approval or Recertification for Condominium Communities

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I. Introduction

Beginning in 2009, Condominium projects are now required to have U.S. Department of Housing and Urban Development (“HUD”) and Federal Housing Administration (“FHA”) approval before FHA-insured mortgages can fund on their units. However, because HUD/FHA are frequently changing their rules and regulations for such approval, community associations have been forced to keep up with the changing rules or risk decertification. This article addresses the most recent changes to the rules.

II. Background of Approval/Recertification Process

FHA is a subdivision of HUD and provides mortgage insurance on loans made by FHA-approved lenders. In 2009, HUD published a series of new guidelines that dramatically changed the FHA approval process for condominiums, including that, among other things: (1) each condominium project as a whole must now obtain FHA approval before any individual unit in the project will be eligible for FHA financing; (2) condominium project approval now expires every two years; and (3) projects must determine whether the property improvements are located in a 100-year flood plain.

III. Benefits of Approval/Recertification

FHA loans are extremely popular because qualified buyers can own a home for as little as 3.5 percent down,

where conventional lenders typically require a 20 percent down payment. Thus, FHA condo approval dramatically increases the pool of potential buyers. Another benefit to FHA loans are that the loans are transferrable, so that they can be assumed (including the interest rate) by a new buyer. With interest rates at an all-time low, this can be a very valuable asset to an HOA community.

In addition, since FHA-approved units have a larger pool of prospective buyers, competition and demand are increased, resulting in higher purchase prices and an increase in market value. There is an argument that maintaining property values is one of an association’s duties to the owners. If FHA approval/recertification increases property values, this is a benefit.

¹This article should not be construed as legal advice. For specific questions or more information, please consult the HUD/FHA website(s) or contact The Perry Law Firm, at (949) 379-3141.

²Prior to this change, it was possible to obtain an FHA loan on an individual unit even if the condominium project was not on the list of FHA-approved condominiums. However, this “spot loan” approval process was completely eliminated by the new guidelines.

³In the past, once a condominium project received FHA approval, the approval was more or less indefinite and had no fixed expiration date.

⁴If so, flood insurance is required, per Mortgagee Letter 2009-37. To demonstrate and document that the property is not located in a 100-year flood plain and not subject to flood insurance requirements, the petitioner must submit specific documents showing same.

⁵The condo approval process and thus the contents of the new Guide are governed by the provisions of the National Housing Act and 24 CFR Part 203.



IV. Recent Changes to Rules and Impacts on Associations

Since these changes in 2009, HUD/FHA have issued several additional guidelines and rules that impact community associations, including the FHA's Condominium Project Approval and Processing Guide (issued June 30, 2011), and the most recent revision of the project approval guidelines on September 13, 2012, contained in Mortgagee Letter 2012-18. Some of the key changes are highlighted below.

- **Fee Delinquency Rule Increased**

FHA is now allowing up to 15% of a project's units to be 60-days delinquent on condo fees, an increase from the 30-day delinquency allowance under the prior rule.

- **Expanded Investor Purchasing Allowed**

Under the new rules, investors can purchase more units in a project - up to 50% of the project units (up from the previous 10%). However, the developer must convey at least 50% of the units to individual owners or be under contract as owner-occupied.

- **More Commercial Space Allowed**

Projects can now have more space devoted to non-residential commercial uses than before. Previously, only 25% of project space could be used for commercial purpose. With the recent rule changes, 50% of the project can be commercial, although certain authority for approval is reserved for the local FHA office.

- **Fidelity Insurance Coverage Required**

Of particular importance for community managers and management companies, if a community is managed by a professional management company, the company must now either be named in the association's policies as an additional insured, or obtain its own fidelity coverage meeting the FHA association coverage requirements.

V. Best Practices for Associations Considering Approval or Recertification

The process for HUD approval or recertification is not quick or easy. It is recommended that associations consult an attorney or other professional with experience in submitting all of the documents required. Associations should keep on top of their initial approval date and recertification date, and begin compiling all documents at least 6-months prior to the deadline for recertification. Remember that the documents will include all govern-

ing documents and recorded documents, including all CC&Rs, Amendments, Notices of Annexation, etcetera, for each phase of the project. Thus, the process is time-consuming and the documents can be voluminous. Keep in mind also that the process is very different from other special financing processes, such as VA-assisted financing.

VI. Manager Q & A

1. *How can I check the status of my community association and where we are on the approval list?*

Community managers and other interested individuals can check the HUD website to verify whether your condominium is FHA approved, and if so, when the current approval is set to expire: <https://entp.hud.gov/idapp/html/condlook.cfm>.

2. *What are some of the documents we will need to submit to HUD for this process?*

Among other things, HUD will require that you submit: the condominium project's recorded plat map(s); the governing documents (CC&Rs, Bylaws, and Articles of Incorporation); recorded site plans for the project; proposed or actual budget; a current management agreement; an applicable FEMA flood map; an analysis of any outstanding or pending litigation.

3. *How can I get more information on the most recent changes to HUD requirements and rules?*

You can refer to the September 2012 rules in Mortgagee Letter 2012-18: <http://portal.hud.gov/hudportal/documents/huddoc?id=12-18ml.pdf>

4. *What is the maximum percentage of units at a project that can have FHA-backed loans?*

Currently HUD still only allows a maximum of 50% of units to have FHA loans.

5. *How long does it take to go through this process?*

In our experience, it has taken between 60-90 days to complete the approval/recertification process once the application has been submitted.

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