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CONDOMINIUMS SHOULD ENSURE THEY MEET FANNIE MAE AND FREDDIE MAC REQUIREMENTS FOR MORTGAGE LOANS

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With approximately 90% of mortgages written in the country today being backed by Fannie Mae (Federal National Mortgage Association) or Freddie Mac (Federal Home Loan Mortgage Corporation), Boards of Directors and managers should be aware of what is required of owners associations in order to ensure that current owners and potential buyers are able to obtain needed financing. As a result of the mortgage crisis beginning in late 2007, Fannie Mae and Freddie Mac began requiring much more for mortgage loans involving condominium units.

While this list is not intended to be in any way exhaustive, and some of these requirements depend on the size of the condominium project as well as whether the condominium project is “established” or “new,” Fannie Mae/Freddie Mac require that the lender who is handling the loan application for the condominium purchaser verify and warrant to Fannie Mae or Freddie Mac that:

1. The association has an “adequate” budget (generally, the budget must be consistent with the nature of the project and appropriate assessments must be established to manage the project).

2. The association budget allocates at least 10% of revenues to reserve funds.

3. The association has cash on hand sufficient to cover all the deductibles under its insurance policies.

4. An appraiser has reviewed assessments, property rights, amenities, and condition of the property, and has reported upon how they compare with other similarly situated condominium projects in the area that compete for the same purchasers as well as comparable sales of similar condominiums in the area.

5. No one investor can own more than 10% of the total units in the project.

6. No more than 15% of the total assessment payments can be delinquent or nor more than 15% of the total units can be 30 days or more past due.

7. At least 51% of the units in the project must be owner-occupied (but note that this rule only applies if the buyer is purchasing the unit for investment purposes; if he or she is purchasing the unit for use as a primary or secondary residence, then this restriction does not apply).

Given the fall-out from the economic downturn in Michigan, the 15% delinquency rate threshold mandated by Fannie Mae and Freddie Mac may be difficult for many communities.

The 51% owner-occupancy requirement can have implications for those condominiums that have a high number of rental units. Any person seeking to purchase a unit in such a condominium solely for investment (i.e., rental) purposes will likely not be able to obtain mortgage financing for the transaction.

On the plus side for Associations, with respect to casualty insurance, Freddie Mac and Fannie Mae now require that *borrower* obtain a “walls-in” coverage policy (HO-6 Insurance) unless the project provides evidence that the master policy provides the same coverage. The HO-6 insurance must be for at least 20% of the condominium unit’s appraised value.

For all projects with twenty or more units, Freddie Mac and Fannie Mae also now emphasize that they will enforce their requirements adopted in 2001 and 2002 concerning an association’s “fidelity insurance” (“employee dishonesty” is the term we see here in Michigan). Fannie and Freddie require such insurance, and it must meet the following:

1. The policy must name the association as the insured.

2. The association must pay the premium expense.

3. The amount of the coverage must meet certain minimums. The policy must be sufficient to cover the maximum amount of the association’s cash assets (operating accounts plus reserves). These minimums can be reduced if the association (<u>and</u> its property manager) can document that any one or more of the following “financial controls” are in place:

- There must be separate accounts for the reserves and the operating funds and the bank or credit union must send monthly statements directly to the association.

- Separate records and accounts are maintained for each association managed by a given management company and the management company cannot draw checks against the reserves.

- Two or more directors must sign any checks drafted against the reserve fund account(s).

Associations which can document that they satisfy any of these three “financial control” practices are allowed to reduce their employee dishonesty insurance coverage to a figure that represents three months’ assessment revenue for all units.

Your community should review its financial procedures and records to verify that it meets these loan requirements. The cost of employee dishonesty insurance is relatively inexpensive, and eligibility for loans underwritten by Fannie or Freddie will help stabilize property values in your community.

Lastly, it is worth noting that many conventional lenders follow the Fannie Mae and Freddie Mac lending requirements even for mortgages that are originated “in house” as conventional loans and not directly through Fannie or Freddie. This is because many lenders sell the vast majority of their residential mortgage loans to Fannie and Freddie shortly after the loan is closed. Lenders must comply with the Fannie and Freddie requirements in order to be able to sell the loans to these governmental entities on the secondary market.

A comprehensive review to determine whether your condominium project meets the loan requirements discussed above (or any other Fannie/Freddie loan requirements) may require the assistance of a qualified legal professional.

If you have questions regarding such a review or are interested in obtaining further information on this topic, please contact attorney Lee S. Schofield or one of our other experienced community association lawyers.

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