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HOA COMMUNICATOR

THE LATEST FORECLOSURE FALLOUT: New Federal Financing Regulations Impact Associations

The Federal Housing Administration (FHA) has always had a big impact on Associations. In December 2009, the FHA imposed new rules for financing on condominiums that will further increase their influence on condominium communities. November's CAI Rocky Mountain Chapter Fall Conference included a presentation on these rule changes and many questions were raised about what the government is doing and what Associations should do with respect to these regulations. As the presenters accurately pointed out, the answers are not clear.

According to numbers from the Department of Housing and Urban Development (HUD), there are 588 FHA-approved condominium projects in the Denver area. Once these approvals expire, each community will need to be recertified to maintain eligibility for FHA financing. Without this recertification, new purchasers would not be able to use FHA-insured mortgages to buy a unit in your community. In this article, part of an ongoing series, we will discuss the economic environment, the new FHA rules, and issues to consider in determining whether it is worthwhile for your condominium community to remain eligible for FHA insured mortgages.

For communities of single family homes, there may be no immediate consequences, but it is important to remember that policy changes can often cause unintended and unforeseen results, and that the government often carries over regulations to similar markets.

BACKGROUND ON THE HOUSING MARKET

Let us start with an examination of the condominium market and how the changes in Federal insurance requirements will affect condominium Associations. It is important to have a general understanding of current home financing practices in order to appreciate the impact of regulation in this area. The following description of the market is based on research of those involved in the real

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EDUCATION IS KEY TO GOOD MANAGEMENT AND GOVERNANCE

Our Firm's philosophy that preventive law is king is based on the proven fact that better educated clients are less likely to get into legal trouble. Our workshops are dedicated to presenting our clients with classes that provide a valuable legal educational experience that translate into practical applications for HOA Management Companies, Boards and Members. The cornerstone and success of our training programs is our commitment to continually improve and update both our teaching materials and our presentations to maximize the benefit to those who attend the classes. We do this by staying on top of all of the changes, case law and nuances that are always evolving in the area of HOA law.

For those of you who have attended our classes, you know that our classes are FREE of cost and that we provide information that is

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estate industry: from lenders, to purchasers, to managers, and overall tracking of the markets.

The Federal Government has long viewed the health of the U.S. housing market as vital to the country's overall economy.

Consider the current incentives offered by the government to homebuyers and owners: the ability to deduct mortgage interest, an $8,000 credit for first time homebuyers, and other credits available to buyers who have owned a home for over five years. These programs serve as a means of economic stimulus for the government to promote home ownership. To this end, the Government has also set up agencies and hybrid entities like the FHA, Fannie Mae and Freddie Mac to make it easier for many Americans to purchase a home.

The FHA was established in 1934, in the midst of the Great Depression, to stabilize the mortgage market and facilitate the construction of desperately needed affordable housing. When considering the current economic climate, these goals seem just as important today as they did 75 years ago. In order to meet these objectives, the FHA insures loans for individual homebuyers, as well as large, lower-rent, multifamily communities.

Although the FHA does not actually issue loans, they provide insurance protection to lenders against losses if the borrower defaults on an FHA-insured loan. For individual homebuyers, requirements to qualify for such loans are less stringent and down payments are much smaller because, even

if the borrower defaults, lenders know that the Federal Government guarantees their payment. Borrowers simply make a small monthly payment to the FHA (included with the mortgage payments) to pay for this insurance. According to a recent article in the Wall Street Journal, in some cities the FHA is guaranteeing as many as half of all home purchases.

Like the FHA, Fannie Mae and Freddie Mac were set up by the Federal Government to play a large role in strengthening the housing and mortgage markets. Both are hybrid entities, existing as both private and public entities. Both operate as private corporations, governed by a board of directors and accountable to stockholders, but are government created and regulated to a much greater extent than purely private companies.

The purpose for the government's creation of these entities was to ensure that money would be consistently available to the institutions that provide loans to homebuyers. To accomplish this goal, Fannie and Freddie buy mortgages from lenders and bundle them in securities, which are then traded on the secondary mortgage market. Ideally, this practice ensures that the original lenders get their capital back and can offer more loans, and Fannie and Freddie profit from the interest earned over the course of the mortgages they buy or the profit from the sale of these mortgage securities to other companies.

Currently, Fannie and Freddie are under government conservatorship. Years of rising foreclosures and questionable policy decisions have left these entities desperate for funding. A few years ago, there were a variety of mortgage products available that did not require a buyer to put 20% down. Among these were stated-income loans, or "liar loans," where a borrower

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critical to your positions and your industry in particular. In addition to our CAI certified Fair Housing Workshop, HTS is offering additional educational opportunities related to Associations, Managements and Boards in 2010. One such class is a Homeowner Education Class, geared to educating homeowners on their rights and responsibilities of living within an HOA. The subject of another new class is Good Governance Practices for Boards. The focus of this workshop provides an excellent introduction for new board members to their legal responsibilities and obligations as board members.

We will continue to offer our Basic Fair Housing Workshop as well as an expanded Advanced Fair Housing Workshop. The advanced class will focus heavily on disability related issues, where class members will work together in responding to difficult scenarios that come up for Associations and their Management Companies. We are seeking feedback on how many would have an interest in this Advanced Fair Housing Workshop. ***Additionally we will welcome any suggestions for workshops topics that you would like us to see presented in a class. Please feel free to email your feedback to mike@htspc.com.***

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A Little New Year Humor To Make You Smile

During a recent password audit, it was found that a blonde was using the following password: MickeyMinniePlutoHueyLouieDeweyDonaldGoofySacramento

When asked why such a long password, she said

.... she was told that it had to be at least 8 characters long and include at least one capital.

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could receive mortgage approval by stating an income, providing minimal documentation and providing little to no money for a down payment. This led to a significant number of borrowers getting mortgages they never should have received and were unable to fulfill, which ultimately led to the recent outbreak of foreclosures.

The FHA's primary source of income is the insurance fees paid by borrowers on their FHA-insured loans. If a borrower defaults on a mortgage and the property goes into foreclosure, the consequences to the FHA are twofold. First, they are no longer receiving the monthly insurance payments from the borrower. Second, they are forced to pay off the lender for the balance of the mortgage. With this explosion of foreclosures across the country, the FHA program is running out of money. With so many of these FHA-insured mortgages in foreclosure, they are not receiving enough money to stay afloat. The financial strain that foreclosures have put on the FHA are, in our opinion, one of the main reasons the FHA is changing its regulations. The FHA has to shore up their books and try to minimize future foreclosures.

NEW REGULATIONS

In November 2009, HUD issued two new guidance letters regarding approval for FHA mortgages at condominium projects. These letters presented a number of new rules in relation to the

approval process for FHA-insured mortgages that took effect on December 7, 2009. The standards set forth in these letters show HUD's desire to get the FHA back on sound financial footing. Most of these new regulations serve to ensure that condominium communities receiving FHA mortgages are being properly governed and to better protect the FHA from losses if a condominium community suffers a significant depreciation in property values or a rise in foreclosures. Some of

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the more significant areas of impact in these guidance letters are outlined below. The intention of these new regulations is to limit the FHA's exposure by ensuring that the communities receiving FHA-insured loans are financially sound. They will also force better governance within Associations. HUD Mortgagee Letters 2009-46B and 2009-46A impose restrictions on financing for condominium units through Fannie and Freddie. These rules will have an impact upon individual homeowners attempting to sell or purchase in a community and on the operation of your Association. How can the Federal government dictate what happens within your Association? If your Association wants to maintain eligibility for FHA financing, they will comply with the new regulatory requirements.

It is important to keep in mind that such regulations can lead to other unintended consequences, such as new rules and programs. Obviously, it would be impossible to predict at this point what these unintended consequences will entail, and the final answer will be dependant upon the reaction to and consequences of these current rule changes.

Delinquent Association Dues

One of the regulations that has raised significant concerns addresses delinquent Association dues within a community. Guidance letter 2009-46B specifically states "no more than 15 percent of the total units can be in arrears (more than 30 days past due) of their condominium Association fee payments." This particular rule could have a large effect on smaller Associations. If your condominium community contains only 12 units and two of your owners are more than 30 days past due on their Association fees, your community is no longer eligible for FHA loans.

Even before these new regulations took effect, an effective collection policy was critical to Associations. Unfortunately, many Associations have policies that were appropriate five years ago but may not be nearly as effective in today's market. Associations need to be flexible with homeowners. If a homeowner is struggling, it may be in the Association's best interest to work out a payment arrangement. Nobody wants to be the creditor that pushes someone over the edge financially, especially a neighbor.

Owner Occupancy Ratios

Many communities within Colorado already have rules in place limiting rental options within a community. While there is nothing inherently wrong with condominium owners renting out their properties, there are many problems that can arises when a community has a large number of absentee owners renting out their properties. The biggest fear for Associations is that the owners will not take proper care of the property because they are rarely there. The tenants may be less inclined to maintain community standards because they don't own the property and are not actually members of the Association.

Based on HUD's new rule regarding owner occupancy ratios, this is a big concern for the FHA as well. The new rules from HUD require that "at least 50 percent of the units of a project must be owner occupied or sold to owners who intend to occupy the units." This new rule is meant to act as a stabilizing factor in maintaining a positive environment in condominium communities.

FHA Concentration

HUD has also decided to limit the concentration of FHA mortgages within a condominium

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community. The FHA will no longer consider any additional approvals once at least 50% of a project has

received FHA-insured funding. After December 31, 2010, this percentage will be reduced to 30%. Also in effect until December 31, 2010, is an exception allowing an increase up to 100% concentration if a project meets specific standards set forth in the HUD letters.

The reason for this new rule is to limit the FHA's exposure in any particular community. Concentration limits were imposed to protect the FHA from communities with declining home values due to insufficient upkeep, changing neighborhoods, financial crises, or any other event that could cause a decline. If a community's values decline significantly, FHA's exposure will be much less if they are insuring 30% of the condominiums in a community, as opposed to 100%.

BUDGET REVIEW

It is already a common practice among many Associations to conduct an annual reserve study. The Colorado legislature has already required Associations to have a policy on reserve studies and investment of reserves in place. HUD's new guidelines require that a mortgagee review the Association's budget to ensure that it is adequate and:

✔ Includes allocations/line items to ensure sufficient funds are available to maintain and preserve all amenities and features unique to the condominium project;

✔ Provides for the funding of replacement reserves for capital expenditures and deferred maintenance in an account representing at least 10% of the budget; and

✔ Provides adequate funding for insurance coverage and deductibles.

If these standards are not met, the mortgagee may request a reserve study, which must have been completed in the last 12 months.

Ideally, Associations should be doing an annual reserve study anyway. If Associations can better anticipate coming maintenance, they will be better positioned to deal with the regulations. Since it is budget season, it may be a good idea to examine your expenses. Associations should be scrutinizing all of their expenditures and consulting with vendors to make sure they are getting the appropriate value for their money. Associations will also need to fund their reserves. We understand that this is easier said then done in this market, however, saving now will protect the Association in the future. An earlier proposal of the loan requirements had minimum requirements for reserves that would have been a large issue for many Associations.

CONSEQUENCES

Should condominium Associations choose to ignore the HUD requirements, owners will have fewer potential buyers when they try to sell. With fewer potential buyers, the property will be harder to sell. If a property is harder to sell, it will be on the market longer. If a property stays on the market longer, the price may drop, causing current condominium owners to lose equity. Ignoring the FHA financing requirements will be a mistake for most Associations. The more marketable a unit is within an Association, the more all owners in the Association benefit.

So, what can Associations do to protect themselves and maintain FHA eligibility? Good governance will help ease the impact. In essence, these requirements are an attempt to reinforce good governance

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and to ensure that loans that are being issued will be repaid. For the majority of condominiums, it will be in their best interest to maintain eligibility for FHA financing. The new requirements will make the approval process more complicated, and you need be very careful when going through the recertification process. Penalties for misrepresenting compliance to a federal agency may result in a fine of up to $1,000,000.00 or imprisonment of up to 30 years.

One of the good things about laws and regulations is that change is constant. If these changes by the FHA further depress the condominium market, there may be relief in the future. We expect the government will have no choice but to closely monitor the impact of these new regulations and react to further changes in the housing market. These regulations will have an impact on condominium Associations, it is up to the boards, homeowners, and managers of the Association to make sure that it is a positive impact reinforcing good governance practices.

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- *"The ultimate measure of a man is not where he stands in moments of comfort, but where he stands at times of conflict and controversy"* -

Martin Luther King Jr.

Martin Luther King Holiday
January 18th, 2010