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HUD Announces Changes to the Condominium Approval Process for FHA-Insured Mortgages

The U.S. Department of Housing and Urban Development (HUD) announced changes to the condominium approval process for Federal Housing Administration (FHA)-insured mortgages in their release of Mortgagee Letter 2009-19. These changes are effective for all case numbers assigned after October 1, 2009, with the exceptions that (i) Condominium Project approval is not required for Site Condominiums (single family detached dwellings, not including manufactured housing), and (ii) Site Condominium requirements are effective immediately. Furthermore, the "Spot Loan" Approval Process has been eliminated.

Under the FHA's new approval process, the lending institution will determine whether the individual units in a condominium project are eligible for FHA mortgage insurance. There are two approval processing options that the lender can use: (i) the HUD Review and Approval Process (HRAP), or (ii) the Direct Endorsement Lender Review and Approval Process (DELRAP). Under either approval processing option, the lender is required to review project documentation, retain and maintain all documents used in the review for three years from the date of project approval, and certify compliance with Section 203(b) of the National Housing Act and 24 CFR 203 of HUD's regulations.

The first step of the lender's review process is to determine whether the condominium project qualifies for FHA mortgage insurance. The eligibility requirements are the same under both HRAP and DELRAP. The condominium project can be in any stage of construction – proposed, under construction, existing, or conversion. However, the condominium project must consist of two units or more, must be used for primarily residential

purposes, and must be composed of units owned by a single owner, as opposed to a timeshare or similar shared use. Additionally, at least 50% of the units must be sold and owner-occupied (or sold to owners who intend to occupy the units), and no more than 10% of the units can be owned by one investor. In order for units within a condominium project to qualify for FHA mortgage insurance, the condominium project must comply with all laws and regulations, including the requirement that an Affirmative Fair Housing Marketing Plan be in place for new construction and conversions if more than five units will be marketed by the developer within the next 12 months with FHA mortgage insurance. Furthermore, transfer of control of the condominium association must pass to the owners of units not later than the first to occur of (i) 120 days after 75% of units have been conveyed to purchasers, or, (ii) as quoted directly from HUD's letter, "one year after completion of the project evidenced by the first conveyance to a unit purchaser." This language appears to be unclear, perhaps ignoring phase projects. We think that clarification from HUD will be necessary. This latter requirement may force turnover of the association prior to expiration of the time periods permitted under the Ohio Condominium Act.

A significant difference between the two approval processing options is the environmental review requirement. Under HRAP, an environmental review is required unless the condominium project has progressed beyond the stage where HUD has any influence over the remaining uncompleted construction. In contrast, a lender who opts to use DELRAP is not required to do an environmental review. However, under DELRAP, if the lender is aware of an existing environmental condition, the lender

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must avoid or mitigate certain conditions listed in Mortgagee Letter 2009-19 before completing its review process. Another important distinction is that DELRAP cannot be used to review Manufactured Housing Condominium Projects, which are now eligible for FHA mortgage insurance.

Upon completion of its review of the condominium project, using either HRAP or DELRAP, the lender must certify on company letterhead, signed by an authorized representative, that (i) the condominium project is eligible for FHA mortgage insurance and complies with all FHA requirements, (ii) the documents comply with all HUD regulations and state and local condominium laws, and (iii) that pre-sale and owner occupancy ratios have been met. The lender's certification

of a condominium project will expire two years from the date that the condominium project is placed on HUD's list of approved condominiums.

Notably, the newly promulgated project eligibility requirements require that a reserve study must be performed to assure that adequate funds are available for the funding of capital expenditures and maintenance. This study may not be more than 12 months old. Additionally, FHA no longer requires an attorney's certification. However, lenders may obtain such a certification as part of their due diligence.

In order to facilitate the approval process, Condominium developers should be prepared to provide their lenders with documentation that the condominium project meets all of the above criteria.

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