The Catch-22 Impact of New Fannie Mae Condominium Lending Regulations

Posted by Richard Vetstein under Condominium, Fannie Mae, Mortgages (edit this)
1 Comment

Recent Fannie Mae (FNMA) condominium lending regulations are beginning to live up to the hype as having an onerous impact on condominium sales and project development. The changes, made in January, were part of an effort by mortgage giants Fannie Mae and Freddie Mac to limit risky lending in a segment of the housing market particularly hard hit by foreclosures in recent years.

Here is a brief overview of the Fannie Mae condo guideline changes:

- For new construction and newly converted condo developments, 70% of the units must be pre-sold (closed or under contract). This is being increased from 51%. **This is the real Catch-22. Fannie Mae won't approve condo mortgages unless 70% of the units are sold, but a developer cannot sell 70% of the units without buyers being able to obtain conventional Fannie Mae compliant mortgages. Reportedly, small banks who hold their own mortgages are the winners here.**
- No more than 15% of a condo project units can be more than 30 days delinquent on condo fees. This is an existing guideline that is now being applied to new condo projects. The calculation was also changed from being 15% of the total fee payments to 15% of total units.
- Fidelity insurance will be required for condos with 20 or more units, ensuring that homeowner association funds are protected. Presently, this requirement applies to new projects and is now being extended to include established condos.
- Borrowers must now obtain a condo unit owners insurance policy unless the master policy provides interior unit coverage; coverage may not be less than 20% of the assessed value. A condo-owners policy, known as an HO-6 policy, covers personal property, personal liability, and the physical unit from the studs and in. Many policies also include special assessment coverage or the option to include a special assessment coverage rider.
- No more than 10% of a project can be owned by a single entity. **Apparently, this was to keep the so-called "vulture buyers" from taking over project.**
- No more than 20% of a project can consist of non-residential space. **There goes most mixed commercial-residential use projects.**
- The homeowners association must have at least 10% of its budgeted income designated for replacement reserves and adequate funds budgeted for the insurance deductible. **Many older condo associations keep woefully inadequate reserves and operating budgets, so they are non-compliant.**

Fannie and Freddie have also boosted fees on mortgages for condos. Buyers without a minimum 25% down payment have to pay closing-cost fees equal to 0.75% of their loan, regardless of their credit score, under new rules that took effect in April. Fannie has said it will drop that fee in August for cooperative apartments and detached condos.

According to a Fannie Mae, the guidelines can be modified for condo projects on a case-by-case basis. Therefore, these guidelines may not apply to all condo projects.

What's the effect of the changes?

Certainly, the revised guidelines are negatively affecting buyers' ability to obtain conventional loans for either a new or established condo if the project does not conform. Most notably, the changes are dramatically affected new developments, especially in hard hit areas such as Florida and California. Through discussions with some fellow Massachusetts real estate professionals, the impact here is not as bad as some of the harder hit states, but it's proving to be a major thorn in many transactions.

All hope is now lost, however. Our knight in shining armor is none other than Rep. Barney Frank, who ironically spent the last year lambasting Fannie Mae for its questionable lending practices. He is now calling for Fannie Mae to relax these guidelines.