

## **Getting Your Condominium Association Approved for FHA Insured Financing**

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It has become difficult for purchasers to obtain financing in the present state of the housing market and lending industry, which in turn has added to the anxiety a condominium unit owner may face when selling his/her unit. As a result, FHA insured mortgages are increasingly being considered as alternative financing compared to conventional mortgages. For an individual condominium unit to be eligible for FHA insured financing, the entire condominium building/project must be determined suitable by the Federal Housing Administration (“FHA”) for such financing. Within the condominium segment of the housing market, “FHA approval” has become a hot topic. The current conventional wisdom is that a condominium unit in an FHA approved condominium project will have a larger pool of potential purchasers than a non-FHA approved project.

First, it is important to understand what “FHA approval” means. The FHA does not lend or otherwise provide financing to purchasers directly; rather, the FHA insures or guarantees mortgage loans obtained through conventional banks and lending institutions. Such mortgages are commonly referred to as FHA insured mortgages or FHA insured financing. With regard to condominiums, “FHA approval” means that the FHA has determined that a given condominium project meets certain requirements so that individual units within that project are eligible for FHA insured financing.

In 2009, the FHA issued revised criteria with which condominium projects must comply to be eligible for FHA insured financing. Some changes have been implemented under these new guidelines. For example, “spot loans” are no longer available; meaning that condominium units cannot be eligible individually. Also, the existence of a right of first refusal in an association’s governing documents may be permitted, provided it does not constitute discriminatory conduct under the Federal Fair Housing Act. Currently, there are two methods for condominium projects to obtain FHA approval: (1) HUD Review and Approval Process (HRAP); and (2) Direct Endorsement Lender Review and Approval Process (DELRAP).

Under DELRAP, a qualified lending institution gathers and prepares the documentation to be submitted for FHA approval. The DELRAP process can only proceed after a prospective purchaser has applied for mortgage financing with a qualified lending institution. A qualified lending institution cannot submit an approval request through DELRAP without a corresponding mortgage application. In other words, the lender needs a borrower. A qualified lending institution may also elect to use the HRAP option.

Under HRAP, the condominium association may prepare and submit a request for FHA approval directly, regardless whether any given unit in the condominium project is listed for sale or whether there is a prospective buyer for any unit that is for sale. The association may seek the assistance of a knowledgeable attorney in gathering and preparing the documentation for submission to the FHA. Alternatively, a variety of companies have sprung up across the nation marketing to condominium associations and offering assistance in obtaining FHA approval. Through the HRAP approval process, the association submits its approval request to the appropriate FHA Homeownership Center (“HOC”) for review. The FHA indicates that the processing time for such requests is about 30 days from the receipt of the complete document package by the HOC. A condominium project approval expires two years after placed on the approved condominium list; thereupon, the condominium project will have to be recertified to continue to be included on the list.

There are a variety of requirements that the association must meet under the new approval process guidelines, provided it qualifies as an eligible project. These requirements include, but are not limited to, minimum number of units, insurance coverage, commercial space, investor ownership, delinquency ratios, owner-occupancy ratios, FHA concentration, and financial stability. In Illinois, an eligible project is a condominium project that has been declared and exists in full compliance with the Illinois Condominium Property Act, as well as any other applicable laws and regulations, and does not fall within one of the ineligible project categories enumerated by the FHA.

The financial stability of the association and adequate insurance coverage are primary concerns in determining approval eligibility. The association’s budget must provide for adequate funding for maintenance of amenities unique to the association, for replacement reserves for capital expenditures and deferred maintenance in an amount representing at least 10% of the budget, and for insurance coverage. No more than 15% of the total units can be more than 30 days delinquent in the payment of assessments. Pending special assessments and/or pending litigation against the association may also be reviewed by FHA in considering the association’s financial stability and specifically, for any adverse impact on the association’s financial stability.

Presently, FHA approval does not mean that 100% of the units in a condominium association can be financed by an FHA insured mortgage. The guidelines provide that in projects consisting of four or more units, no more than 30% of the total units can have an FHA insured mortgage on them. However, this ratio was temporarily increased to 50% of the total units effective through December 31, 2010. It will return to 30% January 1, 2011, unless otherwise extended.

Under the FHA requirements, an Illinois association must be in full compliance with the Illinois Condominium Property Act. One could assume that this applies to association’s declaration and bylaws. Although the FHA has not established any clear guidelines as to whether an association’s declaration and bylaws must be amended to conform to current law, it may be advisable for the association to do so in order maximize probability of approval. In addition,

older declaration and bylaws may need to be amended to include secondary mortgage market protection provisions, including but not limited to notice and approval rights to mortgagees.

Of course, one question that associations often ask in relation to the FHA approval process is, “how much will this cost?” With a variety of entities to assist in the approval process comes a variety of fees charged, ranging from the hundreds of dollars to the thousands of dollars. For example, a qualified lender may offer to process an approval request for a few hundred dollars, where an experienced and knowledgeable law office may charge over a thousand dollars. An association should investigate any third-party in order to properly evaluate that third-party’s services. In addition to any fees charged by a service provider, the total cost for the approval process will depend on what, if anything, the association must do to comply with the FHA requirements. For example, if more than 15% of the unit owners are delinquent in assessments, then the association will first have to institute collection actions to reduce the delinquency rate. If needed, amending the association’s declaration and bylaws may add additional expense, possibly in the range of several thousands of dollars.

Whether a condominium association should seek FHA approval is a question to be answered by each individual association. Although FHA approval may provide access to a larger pool of potential buyers, it may not have a significant positive impact on that unit’s fair market value. Specifically, the large inventory of unsold units, high number of foreclosures and other market forces all play a role in a unit’s fair market value that FHA approval will not counteract. Also, there is no guarantee that approval will be granted. Ultimately, the association must determine what value or benefit it will derive from expending resources to initiate the FHA approval process.