May 6, 2011

Mr. Robert C. Ryan
Acting Assistant Secretary for Housing - Federal Housing Commissioner
US Department of Housing and Urban Development
Washington, DC 20410

Dear Mr. Ryan:

We are writing on behalf of the 1.1 million members of the National Association of REALTORS® (NAR), the more than 160,000 members of the National Association of Home Builders (NAHB), the more than 30,000 individual members and 60 local chapters of the Community Associations Institute (CAI), and the 18,000 members of the Institute for Real Estate Management (IREM) to provide recommended enhancements to the condominium mortgage approval process. We understand that the Federal Housing Administration (FHA) is currently drafting revised condominium requirements for release later this year. This coalition recommends changes to FHA's condominium rules that will provide greater liquidity to this sector of the real estate market without causing additional risk to the Mutual Mortgage Insurance Fund (MMIF). We support enhancements to the rules and limits relating to 1) owner-occupancy, 2) FHA concentration, 3) investor ownership, 4) pre-sale, 5) delinquent HOA assessments, and 6) commercial space.

FHA-Insured Loans are Performing Well

FHA has taken several important steps over the last 18 months aimed to strengthen the performance of the MMIF and rebuild the capital reserve 2.00 percent ratio. In October 2010, FHA implemented a new credit score policy that requires a 10 percent down payment if the borrower's credit score is below 580. Borrowers with a credit score below 500 are no longer eligible for FHA-insured mortgages. FHA has also made significant changes to the appraisal process and enhanced requirements for the FHA Streamline Refinance program.

On November 16, 2010, FHA released its annual report on the MMIF. While the report found that the capital reserve ratio declined slightly from 0.53 percent to 0.50 percent, the MMIF remains actuarially sound. According to the Base-Case Scenario, the Capital Reserve Account will be at 1.99 percent in 2014 and surpass 2.00 percent in 2015. According to recent testimony by Secretary Donovan, the capital ratio would have increased from 0.42 percent in FY 2009 to 0.79 percent in FY 2010 were it not for the HECM program.[1] Insurance claims declined significantly, and the economic value of FHA's single-family insurance program grew by more than $1 billion, from $3.6 billion in

[1] Written Testimony of Shaun Donovan, Secretary of Housing and Urban Development. Hearing Before US Senate Appropriations Committee, Subcommittee on Transportation, Housing and Urban Development. April 7, 2011.

2009 to $4.7 billion in 2010. According to the audit, actuary reports show the MMIF remaining self-sufficient even in the worst case scenarios. FHA reported that it held more than 4.5 percent of total insurance-in-force in reserves; $33.3 billion to cover losses over the next 30 years.

FHA's purchase activity appears to be performing as well as it has in any period since Neighborhood Watch was established in 1999.[2] For the quarter ending on December 31, 2009, the Seriously Delinquent and Claims Rate was 5.05 percent, which is the lowest rate for any quarter over the last two years. For December 2010, the MMIF had a claim rate of 2.83 percent. For loans originated in 2010, FHA had only 6,728 seriously delinquent. This is a 71 percent decline from a year ago when the agency had 23,717 seriously delinquent loans.[3] FHA's early default and claim rate has fallen to 2.91 percent and is now lower than any time in the last three years. This is also lower than the early default and claim rate for 2001 when it was 2.94 percent (long before the housing crisis). Condominium loans are performing even more strongly than other purchase loans. According to the most recent data, condominium purchases had a delinquent/claims rate of 1.14 percent, which is less than half of the overall claims rate. In his testimony, Secretary Donovan said "FY 2010 is the highest quality FHA book-of-business on record, and FY 2011 may prove to be even better."[4]

Enhancements to FHA Condominium Rules

Given the strong performance of FHA-insured condominium loans, we commend FHA's review of its condominium program requirements. As the review progresses, we encourage FHA to provide opportunity for public review and comment prior to any comprehensive revisions to its condominium policy being finalized. Public review and comment on FHA's updated condominium program requirements will allow homeowners and FHA's industry partners to understand proposed policy changes and offer comments prior to the changes impacting the market. This will provide opportunity for FHA to contemplate the comments it receives and make any necessary policy adjustments. Identifying problems or unintended consequences prior to finalizing policy will minimize unnecessary disruptions in the nation's recovering housing market. To begin the process of public dialogue, we offer the following recommendations for consideration.

The extension of the temporary guidance in Mortgagee Letter (ML) 2009-46 A, *Temporary Guidance for Condominium Policy*, on January 5, 2011, was an appropriate first step in relaxing several permanent condominium requirements pursuant to ML 2009-46 B, *Condominium Approval Process for Single Family Housing* (November 6, 2009). We are pleased that FHA extended the ML 2009-46A waivers through June 30, 2011. We believe, however, that these exemptions should be made permanent, at a minimum. FHA should also consider additional changes to ML 2009-46B discussed below which we believe could have a dramatically positive impact on condominium markets across the country.

Owner-Occupancy Requirement

FHA currently requires an owner-occupancy rate of 50 percent. We recommend that FHA eliminate the occupancy ratio for FHA mortgages for all condominium developments. While we applaud FHA for temporarily not including bank-owned REO properties for the purposes of calculating

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[2] Neighborhood Watch Early Warning System is FHA's system for monitoring lenders and FHA programs and is designed to aid lenders and the public in self-policing the industry by providing access to FHA loan data, including delinquency and claim rates. https://entp.hud.gov/sfnw/public/

[3] Source: Neighborhood Watch Data.

[4] Written Testimony of Shaun Donovan, Secretary of US Department of Housing and Urban Development. Hearing Before US Senate Appropriations Committee, Subcommittee on Transportation, Housing and Urban Development. April 7, 2011.

occupancy ratios, eliminating this requirement will allow more buyers to purchase units in condominium developments and help stabilize these developments and the community (vacant and REO may no longer be excluded in the owner-occupancy calculation on June 30, 2011, unless that policy is extended). Fannie Mae and Freddie Mac, the government sponsored enterprises (GSEs), do not have an occupancy ratio requirement for condominium projects if the borrower is going to occupy the unit after purchase.

FHA Concentration Requirement
We recommend amending or, at least, temporarily suspending the FHA concentration requirement. We applaud FHA for temporarily increasing the concentration requirement to no more than 50 percent of the total units in a project and, in certain circumstances, to 100 percent for some projects at least one year old that meet the additional requirements listed in ML 2009-46 A**.** FHA should consider expanding the concentration requirement to 100 percent for new construction projects as well. Condominiums are often the only option for first-time home buyers or borrowers with good credit but small downpayments. Many of these buyers rely on FHA because downpayment requirements are significantly lower than for conventional mortgages. An unintended consequence that we are already experiencing in the field is that the concentration limit impacts first-time and less affluent home buyers the most because these families' best (and sometimes only) option is a FHA mortgage. Increasing the concentration limit, or temporarily suspending it, will result in a greater number of owner-occupied units because more borrowers will be able to use FHA in more condominium projects. This, in turn, should further reduce losses related to FHA-insured mortgages for condominium units.

Pre-Sale Requirement
We recommend reducing or eliminating the FHA pre-sale requirement. ML 2009-46 A requires that at least 30 percent of the total condominium units be sold prior to FHA's endorsement of any mortgage on a unit (the pre-sale requirement is scheduled to revert to 50 percent on June 30, 2011). Many condominium projects remain largely vacant because of the existing real estate crisis. This requirement minimizes consumer choice for borrowers interested in using FHA to purchase a condominium unit. Reducing or eliminating this requirement grants greater choice for the borrower but also helps reduce the number of vacant units in the market which, in turn, will promote price stability and reduce loss to the insurance fund.

Investor Ownership
FHA currently prohibits any one investor from owning more than 10 percent of units in a project, including developers or builders that subsequently rent vacant and unsold units. FHA should consider increasing the percent of units that may be owned by any one investor. Allowing an investor to own more than 10 percent of units in a project, particularly if the investor is the builder or developer, means that units are less likely to remain unoccupied. Vacant units often deter potential buyers from purchasing in a project whereas occupied units, even as investor-owned rental units, can be a sign of strength for a project. Increasing the investor ownership percentage to an appropriate level, that reflects the reality of many housing markets, can stabilize a community and, we think, actually reduce risk to FHA's insurance fund. For newly constructed projects, builders renting out units in the process of completing a development should be granted an exception to the investor ownership prohibition rule.

Delinquent Homeowners Association (HOA) Assessments
FHA requires that no more than 15 percent of units in a project can be in arrears (defined as more than 30 days past due) of their condominium association assessments. In today's market it is difficult to obtain financing for condominiums as many units remain vacant and some owners, due to economic circumstances beyond their control, may be unable to pay their assessments on time. Additionally, condominium associations and lenders with REO in the project must work together to facilitate payment of association assessments on those units. Finally, most condominium associations do not begin to contact delinquent unit owners until the delinquency is greater than 30 days.

Given these circumstances, associations are increasingly budgeting for assessment delinquencies and a 30-day delinquency rate on assessments is not necessarily reflective of an association's fiscal health. By accounting for assessment delinquencies in budgets, condominium associations may still be able to meet budget obligations to maintain common elements of the condominium project and fully fund reserve requirements. Further, associations have a range of tools available to maintain cash flow such as borrowing against reserves or voting to increase assessments to meet unexpected financial needs.

We recommend that FHA's condominium rules be amended to allow no more than 15 percent of total units to be delinquent more than 90 days. If this threshold is exceeded, FHA should require an examination of the association's budget to determine that the association has sufficient funds to maintain all common elements and fully fund required reserves. Condominium associations with 15 percent of total units more than 90 days delinquent that can show sufficient operating and reserve funds as well as an acceptable plan to resolve delinquencies should be considered compliant.

These proposed modifications to the assessment delinquency standard will allow more time for units, including vacant lender-owned and short sale units, to be sold to buyers who will reside there. Modifying the delinquency standard will also allow condominium associations to work more cooperatively with owners to resolve delinquencies, encouraging outcomes that benefit both the delinquent owner and all other owners in the condominium.

Commercial Space
Mixed-use developments are becoming increasingly prevalent across the country. HUD has recognized this in the Sustainable Housing and Communities program, which is focused on connecting jobs to housing to reduce transportation costs for families, improve housing affordability, save energy, and increase access to housing and employment opportunities. FHA's current requirement prohibiting more than 25 percent of a property's floor area to be used for commercial space runs counter to growing government policy developing urban centers to reduce sprawl and encourage more efficient use of resources such as sewer treatment plants and water supply facilities.

Condominium projects with up to 45 percent of commercial space should be eligible for FHA approval. The condominium developer or association should be able to provide reasonable evidence that common areas can be properly maintained and required reserves fully funded with assessments on residential and commercial units.

Conclusion

Amending the rules for condominium developments outlined in ML 2009-46 A and B will benefit all parties in the real estate transaction. Lenders will have the opportunity to move more REO properties off their books because more units could be eligible for buyers with FHA mortgages. Individuals and families purchasing units in these developments with FHA loans will have access to more flexible and affordable financing opportunities. Potential buyers with FHA mortgages will have a wider choice of condominium developments. Existing owners in these developments benefit as vacant units are purchased and occupied and the owner-occupied ratio increases. Improving the health of condominium developments will reduce risk to the insurance fund. Considering the strong performance of recent loans made under the revised underwriting criteria makes a compelling case that more relaxed rules are warranted not more restrictive ones. Enhancements to FHA's condominium rules will ensure the still fragile recovery stays on track and protect the long-term value of homeownership in the U.S.

Thank you for your time and consideration of this matter. If you have any questions or concerns, or if we may be of service to you, please do not hesitate to contact us.

Sincerely,

Community Associations Institute
President, Institute of Real Estate Management
National Association of Home Builders
National Association of REALTORS®