



New FHA Regulations Require Condominium Associations to be Pre-approved

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New Federal Housing Administration (FHA) regulations took effect on February 1, 2010, which require condominium associations to become pre-approved before interested buyers can qualify for FHA mortgage insurance. Previously, buyers could obtain FHA mortgage insurance using a spot loan approval process specific to a particular unit.

The changes to the regulations are significant because a higher percentage of buyers generally qualify for FHA loans as opposed to conventional financing, and buyers who obtain FHA loans generally have lower down payments, closing costs and mortgage rates. As such, without FHA pre-approval, condominium associations will have a smaller pool of potential buyers.

To become pre-approved, a condominium association must meet the following eligibility requirements:

- **Residential requirement:** The association must be comprised of single-family residential housing units.
- **Minimum number of units:** The association must be comprised of two or more units.
- **Insurance coverage:** The association must have certain insurance policies, which are more fully described below.
- **Right of first refusal:** Any right of first refusal requirement cannot be discriminatory in nature or otherwise violate the Fair Housing Act.
- **Commercial space:** No more than 25% of the total floor area within the association can be used for commercial purposes and any such commercial purposes must be consistent with a residential use.
- **Investor ownership:** No more than 10% of the units within the association may be owned for investment purposes. If the association is comprised of ten or less units, then no single entity may own more than one unit. The investment ownership limitation also applies to developers or builders who subsequently rent vacant and unsold units.
- **Delinquent homeowner's association dues:** No more than 15% of the total units may be more than thirty days in arrears on association dues.
- **Pre-sale:** Before the FHA endorses any mortgage, at least 50% of the association's total units must be sold.
- **Owner-occupancy ratios:** At least 50% of the association's units must be sold to owners who intend to occupy the units.
- **Legal phasing:** Developers seeking to obtain FHA approval for a condominium project should submit all known phasing plans for initial project approval.
- **Financial stability:** The association must demonstrate that it is fiscally sound. The association's budget must provide for upkeep of its amenities, and at least 10% of the budget must provide for funding of replacement reserves and capital expenditures. The association must also obtain adequate insurance coverage. In the event the association cannot make this showing of financial stability, it may rely on a reserve study that is not more than twelve months old.

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- **Insurance requirements:** The association must also obtain certain insurance policies:
 - A blanket insurance policy of hazard insurance providing coverage equal to 100% of replacement costs exclusive of land, foundation, excavation, or other normal exclusions. In the event the master policy does not include interior unit coverage, the borrower must obtain a “walls-in” coverage policy.
 - A comprehensive general liability policy for all common elements and any commercial space owned by the association.
 - For associations with twenty units or more, the association must obtain fidelity bonds for all officers and directors in the amount of three months aggregate assessments on all units, plus reserve funds.
 - Flood insurance, if the land is located within a 100-year flood plain.

The FHA will insure no more than 30% of an association’s total units. If, however, an association has three units or less, then only one unit may be encumbered with FHA insurance. To maintain its FHA approval, condominium associations will need to re-apply every two years.

Sterns & Weinroth’s Community Association Group provides a customized and affordable approach to solving problems unique to condominiums, cooperatives and homeowners’ associations throughout New Jersey. Our attorneys work hand-in-hand with board members, community managers and other professionals, such as accountants and engineers, in order to assist and educate each association while fostering cooperation and communication. For more information concerning the new FHA regulations or other Community Association concerns, please contact Christina Vassiliou Harvey, Esq. at 609.989.5022 or charvey@sternslaw.com or Jonathan H. Katz, Esq. at 609.989.5036 or jkatz@sternslaw.com.