

**DEPARTMENT OF HOUSING AND
URBAN DEVELOPMENT****24 CFR Parts 206 and 234**

[Docket No. FR-3655-F-02]

RIN 2502-AG23

**Office of the Assistant Secretary for
Housing-Federal Housing
Commissioner; Mortgage Insurance on
Condominium Units in Non-FHA
Approved Projects**

AGENCY: Office of the Assistant
Secretary for Housing-Federal Housing
Commissioner, (HUD).

ACTION: Final rule.

SUMMARY: This rule adds provisions to the regulations governing Federal Housing Administration (FHA) mortgage insurance on condominium units to permit insurance of mortgages on individual units in condominium projects that have not received FHA approval in advance. These "spot loans" will be approved under less stringent requirements than the existing requirements for mortgage insurance for condominiums, but mortgages on these units are required to satisfy standards that assure that the risk involved for FHA is reasonable. The final rule does make one change from the proposed rule in response to public comment—to increase, for small projects, the percentage of units that may be approved for FHA mortgage insurance.

EFFECTIVE DATE: June 28, 1996.

FOR FURTHER INFORMATION CONTACT: Richard Manuel, Director, Single Family Development Division, Office of Insured Single Family Housing, Department of Housing and Urban Development, 451 Seventh Street, SW, Washington, D.C. 20410. He may be reached at (202) 708-2700 (not a toll-free number). For hearing- and speech-impaired persons, this number may be accessed via text telephone by dialing the Federal Information Relay Service at 1-800-877-9339.

SUPPLEMENTARY INFORMATION:**Paperwork Reduction Act Statement**

The information collection requirements contained in § 234.26(i) of this rule were reviewed and approved by the Office of Management and Budget under the Paperwork Reduction Act of 1995 (42 U.S.C. 3501-3520) and assigned OMB approval number 2502-0513. An agency may not conduct or sponsor, and a person is not required to respond to, a collection of information unless the collection displays a valid control number.

I. Response to Public Comments

On June 23, 1995, HUD published a proposed rule to revise the regulations concerning eligibility of mortgages for insurance under the Home Equity Conversion Mortgage Insurance program (24 CFR part 206) or under the Condominium Ownership Mortgage Insurance program (24 CFR part 234). During the comment period, which ended August 22, 1995, HUD received 7 public comments from lending institutions and individuals. Three of the public comments favored the rule, while the remaining comments focused on difficulties with the rule. The only change being made in the rule as a result of consideration of these public comments is to increase the percentage of units on which "spot loans" are permitted from 10 percent to 20 percent of the units in a project of 30 or fewer units.

General comments

Several commenters stated that the rule would permit elderly homeowners to take advantage of the Home Equity Conversion Mortgage program more easily, since they would not have to make public to other unit owners in the condominium that they were seeking additional income from this source. Similarly, homeowners would be able to use the refinancing program that permits cash out to the buyer in a project not currently eligible for FHA mortgage insurance. The availability of this additional cash to condominium owners will increase their ability to keep up with growing costs for such basic needs as increasing condominium association fees, health care costs, or other essential services.

One commenter praised the reduction in paperwork, noting that the Federal National Mortgage Association ("Fannie Mae") and the Federal Home Loan Mortgage Corporation ("Freddie Mac") streamlined their project approval processes in the past decade, with each one using a procedure very similar to the one proposed in this rule for one class of mortgage (Fannie Mae Type A condominium and Freddie Mac Class III condominium).

A commenter also praised this effort as contributing towards stabilizing the condominium resale market.

Specific Comments**Ten Percent Limit on Participation in a Project**

1. *Comment:* There is no way now to track how many units in a particular project have received the benefit of FHA mortgage insurance. Even though project approval requests could be

added to HUD's existing CHUMS system at the time of project approval, spot loans would be difficult to track. This problem is complicated by the multitude of direct endorsement lenders.

Response: Since the Department currently is without the technical or staffing capability to track the exact number of FHA-insured mortgages in a condominium project, mortgagees will be responsible for assuring that the condominium project meets all the streamlined approval requirements. These streamlined requirements are similar to Fannie Mae's requirements for approving "Type A condominiums," found in Part VIII, Chapter 2, § 201 of its *Selling Guide*. To the extent that the Department has information that can assist in ensuring compliance with the new FHA requirements, it will provide mortgagees with that information.

The rule requires lenders to monitor all of the requirements, including the limit on FHA spot loans in a project of no more than ten percent of the units and certifying to this effect. The Department recognizes that there is some potential for exceeding the prescribed limit, either accidentally or intentionally. The local HUD offices or the Regional Processing Centers will be conducting random reviews of these mortgage loans. Mortgage lenders demonstrating a pattern of abuse will be subject to sanctions.

The Department relies primarily on this limitation on the number of loans in a project to minimize risk of loss. As an additional safeguard, however, risk of loss also is minimized by the other requirements added to § 234.26, which collectively should ensure the viability of the project.

2. *Comment:* HUD need not limit this type of approval to 10 percent of the units. Alternative suggestions were to eliminate the limit entirely (Fannie Mae and Freddie Mac do not so limit their exposure); to add a requirement for the lender to insure that the project's budget is adequate, such as to fund replacement of common elements; or to increase the percentage to 20 percent of the units if the project has fewer than 30 units and/or has been in existence for more than five years. For example, in a project of fewer than 10 units, even one unit would exceed the 10 percent limit.

Response: The reason for this restriction is to limit the Department's risk of loss under this program. Furthermore, it assures that the spot loan process does not become a means of circumventing the requirements and protection of HUD's condominium approval process. Since the Department recognizes that small condominium

projects might not be able to participate in the spot loan program, we are accepting the recommendation to permit up to 20% of the units in a project of 30 or fewer units to have FHA-insured mortgages.

Concern About Default Rate

1. *Comment:* Units insured under spot loans pose a greater risk of default than those approved as part of a project approval. Many of the criteria relied upon in approving condominium developments for FHA insurance under the Section 234(c) program would not be used in the case of spot loans.

Response: The Department expects mortgage lenders to apply sound underwriting practices in processing spot loans. In most cases, spot loan projects should have the same maintenance level, reserves for replacement level, plan for maintenance, and insurance coverage as comparable developments approved under the Section 234(c) program. Lenders also should look at the length of time the homeowners association has operated successfully. All pertinent information regarding the viability of the development should be reviewed. Lenders may wish to create checksheets to facilitate this review. Presently, the Department believes that it is unnecessary to require all spot loan appraisals to be done on the Fannie Mae Form 1073, as one commenter suggested.

2. *Comment:* One method for limiting FHA's risk would be to limit spot loan mortgage insurance to reverse mortgage loans.

Response: The impetus for the spot loan program was to provide home mortgage insurance for those seeking to purchase condominium units in developments where there is little likelihood that the development would make the requisite changes in its legal documents (usually to benefit one association member) to obtain FHA approval. However, the Department wants spot loans to be available in forward loans as well as reverse loans. Reducing the risk of loss is addressed by limiting the Department's involvement in the development.

Downpayment

Comment: Given the additional risk involved in approving mortgage insurance without the full approval process, the downpayment should be proportionately increased, for example to 20 or 30 percent.

Response: The Department believes that increased downpayment requirements would thwart the spot loan program and, particularly, those

constituents the Department has traditionally served—middle- and moderate-income families who normally could not obtain loans in other mortgage insurance markets. Few of FHA traditional constituents could afford to meet a 20 percent downpayment requirement. As previously noted, the Department has determined that spot loans pose a "reasonable risk," which the rule controls largely by limiting the Department's involvement in each development.

Enforcement of lender responsibilities

Comment: If a lender approves a mortgage for FHA insurance under the spot loan provisions and the project does not satisfy the eligibility requirements stated in the regulation, there should be a penalty. Cancellation of the mortgage insurance or loss of the lender's direct endorsement authority might be appropriate.

Response: The Department agrees that enforcement mechanisms governing mortgagee activity apply to this program, as to other FHA mortgage insurance activity. The Department will monitor activity under the spot loan program.

Miscellaneous

1. *Comment:* Current provisions for FHA-approved projects with respect to the 51% owner-occupancy requirement should be loosened—permitting HUD field offices to approve a lower percentage if appropriate.

Response: This provision is not new. It follows current practice for non-spot loans. The Department does not believe it appropriate to change this requirement at this time.

2. *Comment:* The criterion (§ 234.26(i)(1)(iii)) limiting the number of units *owned by a single entity* in a project for which a spot loan approval is sought should be changed to the number of units *controlled by a single entity*. This would prevent insuring mortgages in projects where family members and wholly owned businesses or partnerships own more than 10 percent of the units in a project.

Response: The Department believes that "ownership" is a reasonable standard to use and that is easy to understand. "Control" is harder to identify and enforce. The Department declines to change this provision.

Findings and Certifications

Impact on the Environment

A Finding of No Significant Impact with respect to the environment was made in accordance with HUD regulations at 24 CFR part 50 that

implement section 102(2)(C) of the National Environmental Policy Act of 1969, 42 U.S.C. 4332, in connection with the proposed rule on this subject. The Finding of No Significant Impact is available for public inspection and copying during regular business hours (7:30 a.m. to 5:30 p.m.) in the Office of the Rules Docket Clerk, room 10276, 451 Seventh Street, SW, Washington, DC 20410-0500.

Federalism Impact

The General Counsel, as the Designated Official under section 6(a) of Executive Order 12612, Federalism, has determined that the policies contained in this rule do not have significant impact on States or their political subdivisions since the provisions of the proposed rule affect private purchasers and sellers of condominium units.

Impact on the Family

The General Counsel, as the Designated Official under Executive Order 12606, The Family, has determined that this rule does not have potential for significant impact on family formation, maintenance, and general well-being. Therefore, the rule is not subject to review under the Order. The rule merely broadens the coverage of condominium units for which mortgage insurance can be obtained.

Impact on Small Entities

The Secretary, in accordance with the Regulatory Flexibility Act (5 U.S.C. 605(b)), has reviewed this rule before publication and by approving it certifies that this rule will not have a significant impact on a substantial number of small entities, because it makes available additional financing options for purchasers and sellers of condominium units.

Catalog

The Catalog of Federal Domestic Assistance number for the program affected by this proposed rule is 14.133.

List of Subjects

24 CFR Part 206

Aged, Condominiums, Loan programs—housing and community development, Mortgage insurance, Reporting and recordkeeping requirements.

24 CFR Part 234

Condominiums, Mortgage insurance, Reporting and recordkeeping requirements.

Accordingly, for the reasons stated in the preamble, parts 206 and 234 of title 24 of the Code of Federal Regulations are amended as follows:

PART 206—HOME EQUITY CONVERSION MORTGAGE INSURANCE

1. The authority citation continues to read as follows:

Authority: 12 U.S.C. 1715b, 1715z-20; 42 U.S.C. 3535(d).

2. Section 206.51 is revised to read as follows:

§ 206.51 Eligibility of mortgages involving a dwelling unit in a condominium.

If the mortgage involves a dwelling unit in a condominium, the project in which the unit is located shall have been committed to a plan of condominium ownership by deed, or other recorded instrument, that is acceptable to the Secretary, except as provided in § 234.26(i) of this chapter.

PART 234—CONDOMINIUM OWNERSHIP MORTGAGE INSURANCE

3. The authority citation for part 234 continues to read as follows:

Authority: 12 U.S.C. 1715b and 1715y; 42 U.S.C. 3535(d). Section 234.520(a)(2)(ii) is also issued under 12 U.S.C. 1701(a).

4. In § 234.26, a new paragraph (i) would be added, to read as follows:

§ 234.26 Project requirements.

* * * * *

(i) Notwithstanding the requirements of paragraphs (a) through (h) of this section, a loan on a single unit in an

unapproved condominium project ("spot loan") may qualify for mortgage insurance under this part.

(1) The project must meet the following criteria:

(i) All units, common elements, and facilities—including those that are part of any master association—must have been completed, and the project cannot be subject to additional phasing or annexation. The project must provide for undivided ownership of common areas by unit owners;

(ii) Control of the owners' association must have been turned over to the unit purchasers, and the unit purchasers must have been in control for at least one year;

(iii) At least 90% of the total units in the project must have been conveyed to the unit purchasers, and at least 51% of the total units in the project must have been conveyed to purchasers who are occupying the units as their principal residences or second homes. No single entity (the same individual, investor group, partnership, or corporation) may own more than 10% of the total units in the project;

(iv) The units in the project must be owned in fee simple or be an eligible leasehold interest, as described in § 234.65, and the unit owners must have sole ownership interest in, and right to the use of, the project's facilities, common elements, and limited common elements including parking, recreational facilities, etc.;

(v) The project must be covered by hazard, flood, and liability insurance acceptable to the Commissioner;

(vi) For projects with more than 30 units, no more than 10% of the total units in the project may be encumbered by FHA-insured mortgages. (If more than 10% of the units in the project are encumbered by FHA-insured mortgages, the condominium project must be approved under paragraphs (a) through (h) of this section.) For smaller projects, no more than 20% of the total units in the project may be encumbered by FHA-insured mortgages; and

(vii) The assumability provisions of § 234.66 must be satisfied.

(2) Lenders must perform an underwriting analysis and certify that a project satisfies the eligibility criteria for a "spot loan" in a condominium project that has not been approved by FHA. Lenders may use information from the appraiser, the owners' association, the management company, the real estate broker, and the project developer, but the lender must ensure the accuracy of the information obtained from these sources.

(Approved by the Office of Management and Budget under control number 2502-0513)

Dated: May 22, 1996.

Nicolas P. Retsinas,
*Assistant Secretary for Housing-Federal
Housing Commissioner.*

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