

**DEPARTMENT OF HOUSING AND URBAN DEVELOPMENT****24 CFR Parts 203, 206, and 234**

[Docket No. FR-5715-F-02]

RIN 2502-AJ30

**Project Approval for Single-Family Condominiums****AGENCY:** Office of the Assistant Secretary for Housing-Federal Housing Commissioner, HUD.**ACTION:** Final rule.

**SUMMARY:** This final rule implements HUD's authority under the single-family mortgage insurance provisions of the National Housing Act to insure one-family units in a multifamily project, including a project in which the dwelling units are attached, or are manufactured housing units, semi-detached, or detached, and an undivided interest in the common areas and facilities which serve the project. The rule provides for requirements for lenders to obtain approval under the Direct Endorsement Lender Review and Approval Process (DELRAP) authority for condominiums, and for standards that projects must meet to be approved for mortgage insurance on individual units. The rule provides for flexibility with respect to the concentration of Federal Housing Administration (FHA)-insured units, owner-occupied units, and the amount that can be set aside for commercial and non-residential space. This will enable HUD to vary these standards, within parameters, to meet market needs. This final rule follows a proposed rule published in the **Federal Register** on September 28, 2016.

**DATES:** The effective date of this rule and the related handbook is October 15, 2019.

**FOR FURTHER INFORMATION CONTACT:** Elissa Saunders, Director, Office of Single Family Program Development, Office of Housing, Department of Housing and Urban Development, 451 7th Street SW, Washington, DC 20410-8000; telephone number 202-708-2121 (this is not a toll-free number). Hearing- and speech-impaired persons may access this number through TTY by calling the Federal Relay Service at 800-877-8339 (this is a toll-free number).

**SUPPLEMENTARY INFORMATION:****I. Background**

Section 2117 of the Housing and Economic Recovery Act of 2008 (Pub. L. 110-289) (HERA) amended the definition of "mortgage" in section 201(a) of the National Housing Act (12 U.S.C. 1707(a)) to provide authority for

HUD to insure individual condominium units under the single-family program under section 203 of the National Housing Act (12 U.S.C. 1709). At the same time, HERA amended HUD's prior authority for condominium units, section 234 of the National Housing Act (12 U.S.C. 1715y), to require a blanket mortgage for the project. Due to this change and other restrictive requirements under section 234, the single-family mortgage insurance program under section 203 became the primary vehicle for FHA mortgage insurance for units in condominium projects.

Section 2132 of HERA also provided for implementation of section 2117 by notice. Accordingly, HUD issued mortgagee letters implementing the program (2009-46a, 2009-46b, and 2011-03). These were then consolidated into the Condominium Project Approval and Processing Guide (the Guide), the current operational guideline for the program.

The Housing Opportunities Through Modernization Act of 2016 (Pub. L. 114-201) (HOTMA) became law on July 29, 2016. Title III of HOTMA established by statute certain requirements. Among these was a requirement that HUD issue a regulation within 90 days from enactment (*i.e.*, by October 27, 2016), requiring that any requests for exceptions to the limitation on commercial space be processed under either the DELRAP or HUD review and approval process (HRAP), and that in determining whether to grant the exception, factors related to the economy of the local area of the project, or to the project itself, be considered. The statute also required HUD, by regulation or less formal means, including a mortgagee letter, to establish an owner-occupancy requirement, also in the same time frame. If HUD failed to do so, the statute provided that the minimum owner-occupancy percentage for a project would be 35 percent of all family units, including those not covered by an FHA-insured mortgage. On October 26, 2016, HUD issued the required mortgagee letter, establishing the general owner-occupancy percentage for an existing project at 50 percent, unless certain specific indicators were met indicating lower risk, and allowing for review by HUD under HRAP, in which case the requirement could be as low as 35 percent.

Title III of HOTMA also provided for changes to HUD's treatment of private transfer fees (these are in effect based on statutory authority and are not part of this rulemaking).

**II. The Proposed Rule**

HUD issued the proposed rule on September 28, 2016 (81 FR 66565), both to codify the program, and, based on experience, to offer greater flexibilities and efficiencies that would increase participation in the program and make it more responsive to changes in the marketplace.

**A. DELRAP**

The rule proposed that participants in DELRAP must: Be a Direct Endorsement (DE) lender under 24 CFR 203.3: Have a one-year experience requirement for all staff participating in DELRAP approvals; have originated no fewer than 10 FHA condominium loans; and have an acceptable quality control plan. There is also a process for first obtaining conditional DELRAP authority before obtaining unconditional authority based on performance, and periodic performance monitoring. As proposed, HUD can take action based on non-performance, legal or rules violations, including any action listed in § 203.3(d), or termination of DELRAP authority. The proposed rule also established a process for reinstatement.

**B. Definitions**

The rule proposed new definitions for a number of terms, including Condominium Association (or Association), Condominium Project, Condominium Unit, Infrastructure, Single-Unit Approval (SUA), and Site Condominium. The definition of Condominium Association makes clear that the homeowners who manage the financial and common areas of the condominium project are the Condominium Association as meant by this rule, regardless of the name used. The proposed definition of Condominium Project and Condominium Unit are based on 12 U.S.C. 1707(a), which is also the usual usage of that term in the industry. The proposed definition of Infrastructure, which is related to the requirement in § 203.43b(d)(4) of this rule, that the project or legal phase be complete and ready for occupancy, includes utilities, common elements, and amenities, such as parking lots, swimming pools, golf courses, playgrounds and similar items called for in the project or legal phase. The proposed definition of Single-Unit Approval is approval of one unit, in accordance with § 203.43b(i) of this rule, in an unapproved project. The proposed definition of Site Condominium is a single-family detached dwelling (without any shared garages or attached buildings), including the site and air space, which is

encumbered by a declaration of condominium covenants or condominium form of ownership. Finally, this rule adopts the definition of Rental for Transient or Hotel Purposes in section 513(e) of the National Housing Act (12 U.S.C. 1731b(e)).

#### C. Eligibility for Approval

Section 203.43b(c), as proposed, would require approval by HUD (HRAP) or by a mortgagee (DELRAP). Otherwise, the project would have to meet the additional requirements for a Site Condominium or for Single-Unit Approval. To be approvable, the project would have to meet the eligibility requirements of § 203.43b(d) of this rule. These include: Being primarily residential in nature; consisting entirely of dwelling units that are one-family units; being in full compliance with applicable laws and local approval requirements with respect to the condominium plat and development plans; and being complete and ready for occupancy, and not subject to further rehabilitation, construction, phasing, or annexation (if the construction consists of legal phases, this requirement and the requirements of § 203.43b(e) of this rule applies to each phase). In addition, the rule proposed that HUD may establish further requirements for eligibility through notices under § 203.43b(d)(6), such as insurance requirements, financial condition, nature of title, the existence of any pending legal action or physical property condition (§ 203.43b(d)(6)(i) through (vi)), and such other matters as may affect the viability or marketability of the project or its units (proposed § 203.43b(d)(6)(xi)).

#### D. Flexibility

The rule proposed to grant flexibility in three key areas, to allow HUD to respond quickly to changes in market conditions. The three areas are the amount of commercial/non-residential space; the maximum percentage of FHA-insured units; and the minimum percentage of owner-occupied units (§ 203.43b(d)(6)(vii), (viii), and (ix)). Within each range, HUD may from time to time issue a notice establishing a particular percentage or percentages. As proposed, the ranges are: For commercial space, between 25 and 60 percent of the total floor area; for units with FHA-insured mortgages, between 25 and 75 percent of the total number of units in the project; and for owner-occupied units, likewise between 25 and 75 percent of the total units. Changes in the upper and lower limits

of the ranges would be published for 30 days of public comment (§ 203.43b(f)).

#### E. Legal Phasing

As proposed, legal phasing only would be permitted as long as the phase is fully built out and the dwelling units have a certificate of occupancy (CO). Both vertical buildings and detached or semi-detached developments would be required to be contiguous (§ 203.43b(e)).

#### F. Reserve Requirements

Generally, the proposed reserve requirement would be at least 10 percent of the monthly unit assessments. A lower amount could be deemed acceptable by HUD based on a reserve study completed not more than 24 months before a request for a lower reserve amount is received (§ 203.43b(d)(6)(x)).

#### G. Exceptions

The rule provided in proposed § 203.43b(f) (§ 203.43b(g) of this final rule) that the Secretary may discretionarily grant an exception to the requirements found in § 203.43b(d)(6), provided that the statutory conditions for exceptions to the commercial space requirements enacted under HOTMA and codified under 12 U.S.C. 1709(y)(2) are met. These are that the request and disposition of the request for the exception may be made at the option of the requester under the DELRAP or HRAP process; and that in determining whether to allow the exception, factors relating to the economy for the locality in which the project is located or specific to the project, including the total number of family units in the project, shall be considered.

#### H. Recertification

The rule proposed to extend the recertification period for an approved project from 2 to 3 years, and allow recertification by updating previously submitted information, rather than resubmission of all information. There would be a window of 6 months before to 6 months after the expiration of approval to submit a request for recertification.

#### I. Single-Unit Approval

The rule proposed in § 203.43b(h) (§ 203.43b(i) of this final rule) to allow approvals on individual units that are not in approved projects and not in projects that have been subject to adverse determination for significant issues that affect the viability of the project. The project must be complete and ready for occupancy under § 203.43b(d)(4), must not be a manufactured home, and must have at

least five dwelling units. The upper limit on single-unit approvals as proposed would be in a range from 0 to 20 percent of the total number of units in the project, the exact percentage to be established by HUD through notice.

#### J. Site Condominium

The rule proposed at § 203.43b(i) (§ 203.43(j) of this final rule) that for Site Condominiums, insurance and maintenance costs must be the responsibility of the unit owner, and that any common assessment collected must be restricted for use solely for amenities outside the footprint of the individual site.

#### K. Rehabilitation Loans

The rule proposed to revise 24 CFR 203.50 to permit FHA insurance under the 203(k) program for loans to rehabilitate the interior space or install firewalls in the attic of a condominium unit. Such FHA mortgage insurance would not cover any exteriors or areas that are the responsibility of the Association. The loan limits would be those stated in § 203.50(f), and for condominiums that are not manufactured homes, townhouses, or Site Condominiums, 100 percent of the after-improvement value of the condominium unit.

#### L. Part 234

As provided in the proposed rule, part 234 now will apply in cases where the project has a blanket mortgage insured by HUD. This part 203 applies to the more usual condominium configuration, that is, a one family unit and undivided interest in the common areas and facilities.

### III. This Final Rule

After further consideration, including careful consideration of public comments, HUD has made some changes in this final rule.

#### A. DELRAP Qualifications

HUD received multiple comments concerning the proposal to only allow staff meeting the experience requirement to use DELRAP authority to approve Condominium Projects. Commenters indicated that the proposed credential requirements impose a barrier for smaller lenders to fully participate in the DELRAP program. Given the comments received, where HUD had proposed that all staff involved in DELRAP activities had to meet the experience requirements, the final rule revises proposed § 203.8(b)(1)(iv) to allow participation by staff supervised by personnel that meet the experience requirements in

response to public comments. Also, the proposed rule provided that, to be granted unconditional DELRAP authority, a lender would have to complete at least five DELRAP reviews. HUD recognized that such a requirement may not always be necessary; therefore, this final rule, in § 203.8(b)(3), gives HUD the flexibility to reduce this number where appropriate, for example, in the case of a DELRAP lender with significant experience under the current program. This will ease potential burdens on lenders who wish to participate and who have qualified supervisor personnel.

#### B. Definitions

The definitions in § 203.43b(a) of “Condominium Project” and “Condominium Unit” have been reworded and reorganized. Substantively, the definition of “Infrastructure” is removed and a definition of “Common Elements” is added. In addition to typical items, the definition includes a catch-all, “other areas described in the condominium declaration.”

The definition of “Site Condominium” is revised to address the problems with air space that the public comments identified, and to allow for different Site Condominium arrangements existing in the marketplace that can potentially be approved. The inclusion of air space in the proposed rule was identified in public comments to potentially create conflicts with laws of certain states.

#### C. Suspension of FHA Case Numbers

HUD currently monitors FHA insurance concentration for projects that are, or have been, FHA approved. With the introduction of the Single-Unit Approval process, HUD recognizes the need to enhance the insurance concentration tracking mechanism to determine compliance with the concertation ranges allowed. A commenter also noted the importance of having a reliable tracking system in place and available to the public to track percentages of single-unit approvals. In the context of the maximum percentage of units with FHA-insured mortgages under § 203.43b(d)(6)(viii), and in the context of single-unit approvals under § 203.43b(i)(2), this final rule adds a statement that “HUD may suspend the issuance of new FHA case numbers for a mortgage on a property located in any project where the number of FHA-insured mortgages exceeds the maximum.” The maximum percentages that apply will be established by notice. This additional provision to the final

rule will allow FHA to build a robust process to proactively manage FHA insurance concentration while recognizing the need for lenders to operationalize the impact of such a requirement early in the loan lifecycle so as not to affect the origination process.

#### D. Secondary Residences

The proposed rule provided that units occupied as a principal or secondary residence as defined under § 203.18(f)(2) would count towards the required minimum percentage of owner-occupied units. As commenters indicated, the definition established under § 203.18(f)(2), which establishes the definition for the purpose of permitting FHA financing on a secondary residence which requires analysis of the lack of affordable rental housing is too restrictive and out of scope in the context in which HUD or the DELRAP lender is looking at the owner-occupancy level of the project to determine whether the *project* is approved. Thus, solely to calculate owner-occupancy percentage, this final rule provides that any unit that is occupied by the owner as his or her place of abode for any portion of the calendar year other than as a principal residence and that is not rented for a majority of the calendar year shall count towards the total number of owner-occupied units. While such a definition for the purpose of calculating owner occupancy for condominium project approval is more expansive, the definition in § 203.18(f)(2) will continue to be used when determining eligibility of mortgage secured by a borrower’s secondary residence.

#### E. Reserve Study

The proposed rule in § 203.43b(d)(6)(xi) stated that for an approvable project to have less than 10 percent of the monthly unit assessments in a reserve account, the lesser amount would have to be based on a reserve study completed within 24 months of the request for the lower amount. The final rule, in § 203.43b(d)(6)(x), enlarges this time to 36 months, or, in the case of HRAP, such greater amount of time as the Secretary determines. This change conforms with HOTMA’s requirement that HUD streamlines the recertification process for approved properties by considering lengthening the time between certifications, *see* 12 U.S.C. 1709(y)(1).

#### F. Eligibility for Approval: Financial Condition

The final rule states that the financial condition component of the further

approval requirements in § 203.43b(d)(6)(v) includes the allowable percentage of units in a project owned by a single owner. This comports with current practice in the marketplace and was recognized as a key policy consideration to prevent a financial shock that may occur in the event of an economic failure by a single owner with a large share of units in a complex.

#### G. Percentage Ranges

This final rule, following the proposed rule, sets a range within which HUD may make specific determinations on minimum owner-occupancy percentage, maximum FHA-insured mortgage percentage for project approval, maximum FHA-insured mortgage percentage for Single-Unit Approval, and maximum percentage of floor area taken by commercial or nonresidential space. There is an ability to grant case-by case exceptions to any of these ranges under § 203.43b(g). Additionally, if HUD determines to adjust the upper or lower limits of these ranges, the rule provides for a public comment process under § 203.43b(f). HUD may establish multiple limits within a range for owner-occupancy and commercial space for differently situated projects. For example, the owner occupancy limit may be established differently for newly constructed projects, in which a number of units likely would not yet have transferred to first owners, and for existing projects, which are more likely fully sold.

This final rule makes some minor changes to the proposed rule regarding the percentage ranges of owner-occupants and commercial/nonresidential space. In the case of the maximum allowed percentage of units with FHA-insured mortgages for project approval, this final rule makes no change.

##### 1. Owner Occupancy

The possible range for the minimum level of required owner-occupancy for project approval is narrowed slightly; the floor is set at 30 percent in this final rule. This is in part because under current HUD practice, the minimum owner occupancy percentage for new construction is 30 percent of the total units, and the lower end of the range must be set to accommodate newly constructed projects. In part, it provides FHA with additional room to calibrate this requirement to a level below that identified in HOTMA (35 percent) as the default, if necessary, in response to housing market changes. A 30 percent owner occupancy percentage is the

lowest limit compatible with risk to the Mutual Mortgage Insurance Fund (MMIF).

The upper limit of 75 percent remains unchanged from the proposed rule. This upper limit flexibility is necessary to manage risk. Unlike Fannie Mae and Freddie Mac (which require 50 percent owner occupancy for certain types of projects<sup>1</sup>), HUD cannot require larger down payments or higher credit scores, but must manage risk to the MMIF in other ways. Depending on future market conditions, flexibility to require 75 percent owner occupancy is needed if it is determined that a lower owner-occupancy rate is contributing to loan delinquency.

If HUD determines to change the owner-occupancy threshold within these limits, it will examine a variety of market factors. These will generally include:

- FHA portfolio analysis of default and claim rates of loans with similar attributes across different bands of owner occupancy percentages. The bands would be, for example, 10 percent bands of owner occupancy percentages.

- Analysis of FHA condominium loans across geographical areas segmented by average owner occupancy ratios (e.g., average owner occupancy ratios in metropolitan areas versus rural areas).

- Analysis of trends of financial stability of condo projects in relation to owner occupancy (e.g., relationship of default and claim rates when compared with factors that determine financial stability and owner occupancy percentages).

HUD may consider other relevant factors as well.

## 2. Maximum Commercial/ Nonresidential Space

This final rule reduces the maximum commercial space percentage upper limit to 55 percent of the total floor area. While there was substantial support for a 50 percent limit on nonresidential commercial space, a number of public comments supported a maximum limit for commercial space above 50 percent. There are many potential benefits of mixed-use development, and recent real

estate trends studies support continued demand for these types of projects.<sup>2</sup> The 55 percent ceiling would give HUD future room to grant an exception under HRAP where HUD's review shows that a specific case warrants it (or, under DELRAP review in the case where the exception is at the request of an eligible party and the requester asks for DELRAP review under 12 U.S.C. 1709(y)(2)(A)), while still maintaining the overall residential character of the project.

The lower limit of the range for the maximum allowable commercial space remains at the proposed 25 percent. This percentage aligns with the historical maximum commercial space allowed in a condominium project across the industry. However, mixed-use development is an upward trend in the marketplace.<sup>3</sup> Fannie Mae recently increased the maximum percentage of commercial space in a condominium to 35 percent from 25 percent,<sup>4</sup> consistent with this upward trend. This is also consistent with the *Emerging Trends in Real Estate*<sup>®</sup> report, which states that there is a trend toward mixed-use development with a mixture of residential, with retail and other commercial uses.<sup>5</sup> HUD believes that 25 percent of commercial/nonresidential space of the projects total floor area sets the historical lowest maximum for a mixed-use project that has been used for the program to be successful. The maximum percent of commercial/nonresidential space will be established within this range considering current and projected real estate market trends.

The data which HUD will consider when changing the specific percentage of commercial space allowed for project

<sup>2</sup> *Real Trends: The Future of Real Estate in the United States* by Urban Economics Lab and MIT's Center for Real Estate (October 2017). The study is available at <https://mitcre.mit.edu/wp-content/uploads/2017/10/REAL-TRENDS-MIT.pdf> (visited 3/18/2019).

<sup>3</sup> Id. at 19 ("Around the globe, 'live, work, play' has become a fashionable mantra for urbanism and real estate development. This trend has spurred the rescue and redevelopment of historical neighborhoods. It also has yielded new and denser mixed-use developments . . . . The resurgent prominence of quality urbanism in the United States is here to stay and will keep on energizing a segment of the industry.").

<sup>4</sup> Fannie Mae Selling Guide B4-2.1-03: Ineligible Projects (6/5/2018). This is available at <https://www.fanniemae.com/content/guide/selling/b4/2.1/03.html>.

<sup>5</sup> *PWC and Urban Land Institute, Emerging Trends in Real Estate®: United States and Canada 2019* at 83 ("There also is a trend toward redeveloping urban malls by intensifying sites with mixed-use properties that combine retail with high-density residential, restaurants, community services, green space, and experiential attractions. . . ."), available at <https://www.pwc.com/us/en/industries/asset-wealth-management/real-estate/emerging-trends-in-real-estate.html> (visited 3/18/2019).

approval, within the permitted range, will generally include:

- FHA portfolio analysis of default and claim rates of loans with similar attributes across different bands of commercial/nonresidential space percentages (e.g., default and claim rates for purchase transactions at commercial/nonresidential percentages in appropriate percentage bands that HUD will select).

- Analysis of FHA condominium loans across geographical areas segmented by average commercial/nonresidential space percentages (e.g., average commercial/nonresidential space percentages in metropolitan areas versus rural areas).

- Analysis of trends of financial stability of condo projects in relation to commercial/nonresidential space percentages (e.g., relationship of default and claim rates when compared with the percentage of the residential portion of the project financial stability and the commercial/nonresidential space percentage).

HUD may consider other relevant factors as well.

## 3. Maximum FHA-Insured Concentration for Project Approval

The final rule makes no change to the 25-to-75 percent range proposed for the maximum FHA insurance concentration requirement. The upper limit of 75 percent is the maximum risk exposure to the MMIF that HUD is willing to accept. At the same time, the range must be wide enough to accommodate qualified borrowers in multiple markets where access to affordable housing and financing may be difficult.

In changing the maximum amount of units with FHA mortgage insurance for project approval within the allowable range, data points will generally include:

- Analysis of FHA market share of condominium loans versus market share of non-condo loans.

- Analysis of FHA market share of condominium loans versus market share of non-FHA condo loans.

- Analysis of default and claim rates of loans with similar attributes across different bands of FHA concentration percentages.

- Analysis of FHA concentration percentages segmented by geographical areas.

- Analysis of performance of FHA condo to non-FHA condo loans.

HUD may consider other relevant factors as well.

## 4. Maximum FHA-Insured Concentration for Single-Unit Approval

This final rule implements the proposed rule's 0-to-20 percent range

<sup>1</sup> See Fannie Mae Selling Guide, B4-2.2-02: Full Review Process (6/5/2018) on investment properties' 50 percent requirement. This is available at <https://www.fanniemae.com/content/guide/selling/b4/2.2/02.html>. A similar requirement for investment property—that at least 50 percent of the total number of units in the condominium project must have been conveyed to purchasers who occupy their units as a primary residence or second home—is at chapter 5701.5(c)(2) in the Freddie Mac Single-Family Seller/Service guide. This is available at <http://www.freddiemac.com/singlefamily/pdf/guide.pdf> (visited 3/18/2019).

with the addition of an allowance for a de minimis number of units in projects with less than 10 units. Section 203.43b(h) has been reorganized in this final rule and redesignated as § 203.43b(i). The lower limit of 0 percent is set as a risk control measure if, for example, evidence shows that SUA loans show a significantly worse performance when compared to similar loans in approved projects. Most projects do not have a significant proportion of FHA-insured units. Under a 20 percent cap, 90 percent of current approved projects could have employed a single-unit loan approval. Under a much more restrictive 10 percent ceiling, 73 percent of current projects could have avoided the project-approval process through single-unit loans. Thus, the 20 percent limit would allow HUD great flexibility to allow single-unit loans in unapproved projects. This would enable smaller condominium projects, for whom applying for project approval might be too costly, to have similar access to FHA mortgage insurance as currently approved projects.

In setting or changing the maximum FHA concentration for single-unit approval, data points that HUD will consider will generally include:

- Analysis of SUA loan performance compared to the performance of loans made in approved condo projects.
- Analysis of SUA loans across geographical areas and further segmentation by average owner occupancy ratios and financial stability.

HUD may consider other factors as well.

#### H. Phasing, Contiguous/Adjoining Requirement

Proposed in § 203.43b(d)(6)(x)(B) was a requirement that in a detached or semi-detached development, all homes in a phase must be adjoining or contiguous. A number of public comments pointed out problems with this requirement, and this requirement is removed in this final rule. The requirements that all homes in a phase be separately sustainable, built out, and ready for occupancy remain. This material has been reorganized and is in § 203.43b(e) of this final rule.

#### I. Site Condominiums

This final rule revises the definition of Site Condominium in § 203.43b(a) to include projects consisting of single family detached dwellings that do not have shared garages or any other attached buildings, as well as single family detached or townhouse-style horizontally attached dwellings where the unit consist of both dwelling and

land. The rule also removes the requirement in proposed § 203.43b(i) that all common assessments collected would have to be used solely for amenities outside the footprint of the individual site; however, the requirement that insurance and maintenance costs of the individual units must be the sole responsibility of the unit owner remains (see § 203.43b(j) of this final rule). When combined with the revised definition of Site Condominium, the requirements under this rule better accommodates the Site Condominium arrangements that exist in the market. Because manufactured home condominiums are processed under the HUD review and approval process, the final rule definition clarifies that Site Condominiums do not include manufactured homes.

#### J. Rehabilitation Loans

This final rule removes the exclusion of condominiums, other than Site Condominiums, from the 100 percent of the after-improvement value of the unit loan amount restriction (24 CFR 203.50(f)(3)).

#### K. Home Equity Conversion Mortgages (HECMs)

This final rule makes technical and clarifying changes to part 206 to avoid potential confusion as to the insurability of HECM condominium loans.

#### IV. Public Comments and Responses

This proposed rule was published in the **Federal Register** on September 28, 2016 (81 FR 66565), and the public comment period closed on November 28, 2016. HUD received 91 comments by the close of the public comment period. Commenters included individuals, mortgage companies, banks, trade associations, realtors, and mortgage brokers. The following is a summary of the significant issues raised in the public comments.

In addition to the specific issues noted, some commenters expressed general support for the rule, citing the increased flexibility and opportunities for homeownership.

#### General

*Comment:* HUD's rules are too restrictive and should be loosened to allow projects to participate and buyers to have more access to affordable housing. Condominiums are currently the strongest and least risky part of FHA's portfolio, yet FHA has significantly reduced condo approvals since 2009, and provisions in this rule will further decrease the FHA's share of the market. Making FHA insurance for condominium mortgages more widely

available will help first-time homebuyers, including millennials, as well as seniors and low-to-moderate income buyers. Condominium mortgages perform better than other single-family mortgages, so increasing their availability will benefit the housing market and the FHA insurance fund.

*HUD Response:* HUD recognizes that mortgages secured by condominiums currently perform better than non-condominium secured mortgages, while noting that prior to FHA's approval process in 2009, the opposite was true. In order to achieve the appropriate balance between meeting the housing needs of the borrowers FHA's mortgage insurance programs were created to serve and to minimize the level of risk undertaken relative to the insurance, this rule provides additional flexibility and a basic framework for condominium project approval. HUD plans to issue additional guidance, with elements that can be changed as the market changes. HUD believes this approach will alleviate this concern and allow HUD to achieve the right balance as market conditions may change.

*Comment:* Many economic analyses are showing a shortage of multifamily housing in location-efficient areas and an oversupply of detached single-family houses. The closer we get to single-family and multifamily projects having the same approval requirements, the more efficient our housing market will be, the more we will get out of our developed land, the more we will conserve our pristine land, the more choices we can provide for people who may not necessarily want to use a car for every errand, and the more energy-efficient our cities will be. This proposed rule is a good first step, and it should be revised to go even further towards normalizing the lending rules.

*HUD Response:* HUD believes this rule strikes the correct balance between providing flexibility while protecting the Mutual Mortgage Insurance Fund and recognizing the difference in ownership of single-family dwellings that are maintained solely by the owners versus condominium ownership that includes maintenance by owners and associations.

*Comment:* Due to the significance of the changes, there should be a 12-month implementation period.

*HUD Response:* This final rule provides for a 60-day implementation timeframe that allows stakeholders to view additional guidance provided in HUD handbooks prior to implementation.

*Comment:* Commenter states that condominiums are currently the

strongest and least risky part of FHA's portfolio, yet FHA has significantly reduced condo approvals since 2009. This commenter urges FHA to ease restrictions on condominiums in many areas.

*Comment:* Many families want to purchase their own home and want to purchase condos; however, many lenders are not able to support the purchase because the condo project is not FHA approved. It would be nice to see if FHA could allow more condo projects to be allowed to participate in the FHA Home Loan program. It would open doors to those that are not able to qualify under conventional home loan terms.

*HUD Response:* This final rule provides the framework to establish flexibility, with increases and decreases, in applying the rule's standards through policy. It also includes the ability to obtain Single-Unit approval as an opportunity to provide access to FHA's programs in unapproved condominium projects.

#### *The Proposed Flexible Percentage Ranges for Owner Occupancy, Commercial/Nonresidential Space, and FHA Concentration*

*Comment:* HUD states that setting a range would allow FHA to vary the specific percentage, at will, that it believes to be responsive to market changes. The commenter does not understand the purpose of the ranges as it is the specific percentage that will have a more direct impact on condominium project eligibility for FHA insurance. While HUD proposes to offer the public the opportunity to comment if it considers changes to the upper and lower limits of the range, it would not offer the same opportunity when resetting the specific percentage within the range. The public should also receive notice and an opportunity to comment if HUD is considering a change in the specific percentage within the range as the specific percentage will have a greater impact on buyers and sellers than a change in the range. Further, the commenter requests confirmation that the case-by-case exceptions to specific limits allowed under the Guide and subsequent Mortgage Letters will remain in effect under the new regulations.

*HUD Response:* The purpose of the proposed rule was in part to give the public the opportunity to comment on the potential upper and lower limits of the ranges for owner occupancy, FHA concentration, and nonresidential/commercial space. Thus, the public has had a chance to comment on the range of possible choices. In order to correctly

allocate risk, HUD may potentially have to implement choices within these ranges quickly. HUD believes that the comment process adopted in the proposed rule balances the need for public involvement in the rulemaking with the need for market flexibility. As to any future change HUD might make to percentages within the ranges, this preamble identifies the factors that HUD will consider at section III.G of this preamble. As to the availability of case-by-case exceptions, such exceptions are permitted under § 203.43b(g) of this final rule (unchanged from § 203.43b(f) of the proposed rule). In the case of exceptions to the commercial/nonresidential space percentage, as required by statute (12 U.S.C. 1709(y)(2)), exceptions can be granted under either DELRAP or HRAP processing at the option of the requester, and in determining whether to allow such an exception, factors relating to the economy for the locality in which the project is located or specific to the project, including the total number of family units in the project, shall be considered.

*Comment:* A commenter cites the example of Mortgage Letter 2016–15, which will not have significant practical benefit for condominium associations. Opportunity for public comment could have prevented such an outcome, remedying limitations in this policy update.

*Comment:* A commenter generally approves of the flexibility but notes that too many changes that create a moving target will frustrate board members and community managers.

*HUD Response:* This final rule provides the framework to establish flexibility in applying the rule's standards through policy. HUD strongly believes that establishing the ranges in the regulation provides the flexibility it needs to effectively respond to market fluctuations while giving the public information about the limits of that flexibility. Enabling HUD to respond to market changes will benefit condominium communities.

#### *Standards for Flexible Ranges*

*Comment:* For the flexible ranges on commercial space percentage, FHA-insured percentage, and minimum level of owner-occupied units, HUD should broadly identify and provide more information on the factors it will consider and the criteria for recalculations when determining whether to increase or decrease the percentage limit. Knowing the factors HUD will consider when determining the percentage of allowable commercial space in a condominium project ahead

of time will enable compliance and can assist homebuilders in designing condominium projects that will meet the needs of both commerce and consumers in general keeping with HUD's expectations. Also, HUD should provide additional clarity on the frequency of adjustments and the amount of notice that will be given prior to a change in the range.

*HUD Response:* For changes to the applicable owner-occupancy percentage and commercial/nonresidential space percentage, factors that HUD will consider will include a portfolio analysis of default and claim rates of loans with similar attributes across different bands of owner-occupancy and commercial/nonresidential space percentages; analysis of condominium loans across geographical areas segmented by average owner occupancy ratios or average commercial/nonresidential space percentages; and an analysis of trends of financial stability of condominium projects in relation to each of the factors. For changes to the maximum FHA concentration, the analysis would also include analyses of FHA market share, analyses of default and claim rates by bands of percentages, analysis of FHA concentration percentages segmented by geographic area, and analysis of the performance of FHA condominium and single-family non-condominium loans. For single-unit approvals, data would include an analysis of single-unit approval loan performance versus loans in approved condominium projects, and analysis of single-unit approval loans across geographic areas and segmented by average owner occupancy ratios and financial stability. HUD may also consider additional data. These data points are also discussed in Section III of this preamble.

Where a statistically significant deviation occurs over an extended period of time (typically enough time to identify a trend, which is often, but not always, in the 6-month to 1-year range), FHA would then consider making a change after factoring in the effects of any change in providing credit to borrowers that FHA programs were designed to serve and the impact to the MMI Fund. FHA would also look at the level of deviation to determine the level of any change. One aspect of analysis would be to compare default rates of the relevant factors across similar tier bands and make decisions based on those results so as to avoid excessive risk to the MMIF as compared to the overall market.

*Owner Occupancy*

*Comment:* While having too few owner-occupants can detract from the viability of a project, requiring too many can harm its marketability. The ratio based on primary, secondary, or investment property is still too high. This will not make it easier to get FHA approval.

*Comment:* HUD should increase the minimum owner-occupancy ratio from 25 percent to 35 percent and should allow condominiums with fully funded reserves pursuant to a current reserve study to qualify for the exemption. HUD should include Real Estate Owned (REO) units and owner-occupied units in the ratio. This aligns with Fannie Mae and Freddie Mac and protects FHA's ability to play a countercyclical role in times of economic distress. Commenter supports the minimum acceptable level of owner occupancy at 35 percent.

*Comment:* Data indicate that condo borrowers tend to have higher FICO scores than non-condo borrowers, and that since 2010 the default rate on condos has been lower than for non-condo loans. These facts support FHA allowing a lower percentage of owner-occupants. This commenter supports Mortgagee Letter 2016-15 allowing 35 percent and suggests that HUD should monitor the use of this threshold for existing condos to determine if more general application might be possible.

*HUD Response:* HUD's final rule provides the framework to establish flexibility in applying owner occupancy standards through policy guidance as market forces may dictate, as well as address if such ratios vary based upon the construction status of the condominium. This final rule sets the lower range at which the minimum owner-occupancy percentage could be set at 30 percent. This is the current minimum occupancy requirement for new construction projects, and the lowest limit that HUD believes would protect the MMIF from undue risk. This standard does not seem to be having a negative effect on HUD's portfolio. Issuing a final rule with standards more restrictive than the ones currently in place, without strong justification supported by data, will create disturbance in the market, further impact development, and restrict access to affordable housing. Further, HUD must be able to set a standard that will accommodate recently completed and ready for occupancy projects, at which point a typical condominium project will not likely have sold all units to home buyers, or even a majority of its units.

*Comment:* The proposed rule of a sliding owner occupancy rate of 25 percent to 75 percent would create additional work for the homeowners' association (HOA) and would be more harmful for condominium developments struggling to increase homeownership rates. One of the unfortunate effects of the 2008 housing crisis is the "death spiral" many condominium developments continue to struggle with. As mortgage delinquencies rose, so too did HOA fee delinquencies and foreclosures purchased by investors. This happened at the same time HUD tightened the FHA condo requirements. As homebuyers discovered more condo developments could no longer qualify for FHA financing, more investors bought the units to rent. This helped the Condominium Association financials, but the result was that more developments could not qualify under the 50 percent owner occupancy rule. Associations and homebuyers are looking to HUD and the FHA for clear and consistent rules, and only a flat 25 percent owner occupancy rate will provide this surety. The proposed sliding homeownership scale is anything but clear and consistent. Voluntary Associations will be less incentivized to seek FHA approval as this will cause more work for them to determine which percentage applies to them and if they qualify or not. Even worse, FHA requiring stronger financials to get a lower owner occupancy rate requirement only further depresses developments in communities that are still struggling to recover. This commenter vehemently disagrees with HUD's statement that the "current standard of 50 percent has worked in the recent market." To the contrary, this standard has led to more condo units being sold to investors and pushing their developments farther from FHA qualification. The result is the reduced inventory for first-time homebuyers that has contributed to declining homeownership rates.

*HUD Response:* The proposed range is designed to not only address current market conditions, but also to give HUD flexibility to act quickly to revise the percentage minimum in the future if market data indicates that this is necessary. This final rule revises the lower end of the standard to 30 percent owner occupancy, the current standard for new construction. This gives HUD sufficient room to reduce the requirement if analysis of the data indicates that the current minimum is too high.

*Comment:* A proposed upper limit of 75 percent for a given project effectively

would prevent homebuilders from completing projects, especially in areas of the country with high concentrations of investment properties and second homes. This would chill employment in construction and lead to negative economic consequences and a lack of choice for the consumer. Therefore, HUD should set the permissible percentage range between 25 percent and 50 percent.

*Comment:* 75 percent would be too high an owner occupancy requirement, which would be an extreme outlier and would needlessly restrict the ability of owners to lease units, potentially forcing owners to sell units at discount prices while further jeopardizing consumer access to mortgage credit. HUD should reduce the maximum from 75 percent to no more than 51 percent. Many associations amended their condominium documents to meet the FHA 50 percent requirement; raising the percentage above 50 percent would put them out of compliance and affect financing options. Amending the condominium documents is difficult and expensive. This would impact projects that already spent considerable funds meeting the earlier guideline. Dropping the percentage to 35 percent will not make a big impact given the additional criteria, as few projects will be approved for that rate. Seventy-five percent is excessive and could create project delays impacting costs that would be passed on to consumers.

*HUD Response:* The proposal regarding the range was designed to allow HUD to react quickly if future market conditions should warrant it. FHA will then establish the maximum limit within this range. Any proposed future changes to the range will have advance notice.

Changes to the acceptable limit within the proposed ranges will be driven primarily by performance data for the Mutual Mortgage Insurance Fund. Such analysis may include:

- FHA portfolio analysis of default and claim rates of loans with similar attributes across different bands of owner occupancy percentages.
- Analysis of FHA condominium loans across geographical areas segmented by average owner occupancy ratios (e.g., average owner occupancy ratios in metropolitan areas versus rural areas).
- Analysis of trends of financial stability of condo projects in relation to owner occupancy (e.g., relationship of default and claim rates when compared with percent of financial reserves and owner occupancy percentages). None of the requirements for owner occupancy maximum will require condominium

association to update or rewrite their legal documents.

*Comment:* The restrictions placed on approval for condominium projects with below 50 percent owner-occupancy levels are onerous and too restrictive. Pursuant to a recent Community Associations Institute study,<sup>6</sup> FHA's current requirement on reserves for projects with greater than 50 percent owner-occupancy was one of the leading reasons condominium projects were unable to obtain FHA certification. This requirement hurts the potential viability of condominium properties. If a building cannot be certified by FHA, it is more difficult for sellers of condominium units to find eligible borrowers. Often the seller's only alternative is to turn the unit into a rental, thus further lowering the owner-occupancy ratio.

*HUD Response:* The range provided in § 203.43b(d)(6)(ix) as it relates to owner-occupancy in a condominium project refers to a minimum requirement that HUD may establish within that range through notice. Historically, HUD has been the mortgage insurance provider for many first-time homebuyers and establishing a minimum owner-occupancy percentage protects the investment of new homeowners. In addition, HUD has a fiduciary responsibility to balance policy that promotes homeownership while protecting the Mutual Mortgage Insurance Fund. With this in mind, HUD's final rule provides the framework to establish flexibility in applying this standard through policy guidance as market forces may dictate. This final rule sets the allowable minimum percentage at 30 percent of the units. There may be times when a reduction in the owner-occupancy percentage is an appropriate action based on current market conditions and other contributing factors. HUD will consider the comments and recommendations when drafting the specific policy guidance on condominiums.

#### Owner-Occupancy Minimum of 50 Percent

*Comment:* HUD has provided no measurable rationale for the 50 percent requirement. In fact, both Freddie Mac and Fannie Mae have no such requirement when the property is being purchased as a primary residence. All FHA borrowers are purchasing a primary residence; their purchase will only help to boost the association's

owner occupancy ratio. In this instance, an owner/occupancy requirement is counterproductive when a property meets all other certification requirements related to financial safety and soundness. FHA should remove the current owner-occupancy requirement and align with Fannie Mae and Freddie Mac policy by allowing lenders to review a condominium project in its entirety. Owner-occupancy levels, whether 100 percent or 0 percent, should be evaluated in conjunction with the project's reserves, delinquency rates, etc., to determine a condominium project's viability.

*HUD Response:* HUD disagrees with the recommendation. HUD insures mortgages for properties that are primarily owner-occupied and has a statutory fiduciary responsibility to balance policy that promotes homeownership while protecting the Mutual Mortgage Insurance Fund. Eliminating the owner-occupancy requirement in its entirety solely based on the strength of the borrower has proven to be an unsound and inoperable financial policy for FHA.

While Fannie Mae and Freddie Mac (Government Sponsored Enterprises or GSEs) do not impose owner occupancy restrictions for condominiums when the property being purchased is a primary residence, FHA serves a narrower band of borrowers that generally have credit profiles and equity positions below those that the GSEs permit. The final rule, however, provides the framework to establish flexibility in applying this standard through policy guidance as market forces may dictate.

*Comment:* The current 50 percent threshold has not been a significant barrier to approval, save for limited circumstances such as developer-controlled condos or condos located in vacation or resort areas. However, greater flexibility would be welcome in this area. Lowering the current threshold below 50 percent would have a detrimental effect on approvals. The proposed regulation does not specify conditions in which FHA would consider raising the occupancy threshold from 50 percent to a higher range. Setting the occupancy below 50 percent would be detrimental to the commenter's clients. This comment supports a flexible range in the 50 percent to 75 percent range. Allowing a 50 percent owner/renter ratio is a valid, and sound practice. If it is too difficult for people to rent their condominium when life changes (*i.e.*, death, divorce, job relocation, new baby, etc.), the property values become depressed, which is bad news for borrowers and FHA.

*HUD Response:* HUD's final rule provides the framework to establish flexibility in applying owner occupancy standards through policy guidance as market forces may dictate. To preserve flexibility and potentially accommodate recently completed projects, this final rule allows the possibility of a 30 percent owner-occupant minimum. HUD will consider the recommendations when updating future policy guidance.

#### Owner-Occupancy Minimum Below 50 Percent

*Comment:* 25 percent should be the owner occupancy percentage. Even lowering owner occupancy from 50 percent to 25 percent, there is still a Board of Directors of the owners that will be empowered with running the Association to the best of their ability. There is no risk to the FHA in making loans to borrowers in these condominium projects. The purchasers of these units, if they use FHA financing to purchase, will be owner occupants.

*Comment:* To stabilize the financial viability and increase purchase options for FHA borrowers, two comments support a minimum level of owner-occupancy range between 25 and 50 percent, while certain exceptions could be made for lower percentages, or for extending the range to 75 percent, as proposed by HUD based on criteria dictated in ML 2016-15.

*HUD Response:* The final rule establishes the owner occupancy range that provides the framework to establish flexibility in applying this standard through policy guidance as market forces may dictate. The comments and recommendations will be considered when updating and drafting the specific guidance for owner occupancy.

#### Owner-Occupancy Requirement in Strong Rental Housing Market Areas

*Comment:* HUD should eliminate ownership restrictions and occupancy requirements in an area in which rental housing is in strong demand. It makes no sense to penalize property owners who have tremendous value in their properties (as determined by strong rents and low vacancies) by not letting them sell them or finance them. In such areas, a rental property is worth a lot because there are so many prospective tenants and the rules for owner-occupancy do not work. Such properties may not be able to be sold because their value is too high to allow third parties to obtain financing.

*Comment:* To reduce barriers to obtaining a reverse mortgage, make the owner-occupant requirement extremely low or non-existent (commenter states

<sup>6</sup>Community Associations Institute, "Survey: Federal Housing Administration (FHA) Condominium Project Approval," November 2016.



they are in an area where rentals are highly desired, and it will be impossible to meet HUD's owner-occupancy requirement for the building).

*HUD Response:* HUD disagrees with the recommendation to eliminate owner-occupancy requirements. HUD insures mortgages for properties that are primarily owner-occupied and has a fiduciary responsibility to balance policy that promotes homeownership while protecting the Mutual Mortgage Insurance Fund. Eliminating the owner-occupancy requirement in its entirety solely based on the strength of the rental market in an area has been proven to be an unsound financial policy in the marketplace with respect to both forward and reverse mortgages. The final rule, however, provides the framework to establish flexibility in applying this standard through policy guidance as market forces may dictate.

#### HOTMA and Owner Occupancy

*Comment:* HUD should decrease allowable owner-occupancy limits from 50 percent to 35 percent without need for additional documentation as directed by Congress under the Housing Opportunities Through Modernization Act (HOTMA).

*HUD Response:* HOTMA directed HUD to "issue guidance regarding the percentage of units that must be occupied by the owners" by October 27, 2016, or the 35 percent requirement to which the comment refers would have become effective. HUD issued Mortgagee Letter 2016-15 prior to the statutory deadline. That mortgagee letter is outside the scope of this rulemaking, which provides for a percentage of owner occupancy as low as 30 percent.

However, HUD will consider this comment as well as then-current market conditions in future adjustments to the percentage within the range of 30 percent to 75 percent allowed by this final rule.

#### Secondary Residences

*Comment:* In prior years, HUD allowed secondary residences to count as owner occupied. With issuance of ML 2009-46B and 2011-22, HUD allowed a second home to count as owner occupied only if it was a secondary residence with an FHA loan under 24 CFR 203.18(f)(2). A commenter states that 24 CFR 203.18(f)(2)(iii) relates only to the maximum FHA loan amount (24 CFR 203.18 "Maximum Mortgage Amounts") for a "second FHA loan" in the sole event that an owner with an existing FHA loan faces "undue hardship" and needs to obtain a second FHA loan on another unit in certain circumstances.

*Comment:* HUD's reference to the definitions of principal and secondary homes in 24 CFR 203.18(f)(1) and (2) carries an implication that the secondary residence must have an FHA loan on it in order to be counted in the owner-occupancy ratio. It does not mean that a unit with a conventional second loan (or even a unit that is mortgage free), either of which are secondary residences, should not be counted as owner occupied. In the recent past, HUD again reversed its decision and now allows secondary residences to count as owner occupied (as does Fannie Mae). Because of its reference to 24 CFR 203.18(f)(2), it is unclear as to what the Proposed Rule's intent is. Please state unequivocally and unambiguously that secondary residences count as owner-occupied, and/or that all residences which are not investor-owned or vacation homes count as owner-occupied, and/or also please state separately the definitions cited in §§ 203.18(f) (1) and (2) and omit (f)(2)(iii).

*Comment:* 24 CFR 203.18(f)(2)(iii) relates only to the maximum FHA loan amount (24 CFR 203.18 "Maximum Mortgage Amounts") for a "second FHA loan" in the sole event that an owner with an existing FHA loan faces "undue hardship" and needs to obtain a second FHA loan on another unit in certain circumstances.

HUD should establish a revised owner-occupancy calculation based on the number of the minimum allowable investment units rather than based on a subdivision of classifications for owner-occupied units, investor units, vacation homes, etc. This revised grouping would make it easier for lenders to distinguish and track the number of primary, secondary, and investor held units. Currently, lenders face significant challenges in distinguishing secondary residences from vacation homes and investor-owned units, and struggle to accurately validate and monitor these units in approved projects. By classifying units as (1) primary residences; (2) secondary residences; or (3) investor units, in line with GSE industry standards and removing the need to distinguish vacation homes from secondary residences, which most associations are not equipped to track, lenders will be able to more accurately track owner-occupancy levels and FHA will be able to better manage default risk in approved projects.

*HUD Response:* HUD recognizes the concern with the reference to Secondary Residences, which term is unique to FHA insured mortgages. FHA had previously addressed this issue in Mortgagee Letter 2015-17 (ML 15-17),

whereby FHA indicated it would consider a property as owner occupied provided it was not "Investor Owned" for the purpose of calculating owner occupancy ratios for Condominium Project approval. However, in accordance with the Housing Opportunity Through Modernization Act (HOTMA), which was signed into law on July 29, 2016, the National Housing Act was amended to require HUD to use properties which were either principal residences or Secondary Residences "as such terms are defined by" HUD (or sold to owners who intend to meet such occupancy requirements) to establish HUD's owner occupancy requirements. As required by HOTMA, Mortgagee Letter 2016-15 replaced the requirements in ML 15-17 with the current percentage standard. Currently, HUD's definition of "Secondary Residence" is found in 24 CFR 203.18(f), and, as noted in the comments, has three elements: It is (1) part-time abode where the mortgagor typically spends less than a majority of the calendar year; (2) not a vacation home; and (3) the Commissioner has determined it eligible for insurance to avoid undue hardship to the mortgagor. These standards, particularly (3), are addressed to eligibility for mortgage insurance in accordance with Section 203(g) of the National Housing Act. This rule relates to the approval of the project to participate in the mortgage insurance program; specifically, the issue of Secondary Residences comes up with respect to the owner-occupancy percentage. In the context of project approval, as comments noted, (3) does not make sense; it is an assessment that will be made if the mortgage on the unit is submitted for insurance after the project is approved to participate. Additionally, HUD recognizes the exclusion of vacation homes, while necessary for the definition found in 24 CFR 203.18(f)(2) to conform with the requirement in section 203(g)(1) of the National Housing Act, 12 U.S.C. 1709(g)(1), is not necessary to calculate owner occupancy rates of condominium projects for project approval purposes. For this reason, this rule states that for project approval, any unit in which the owner resides as his or her place of abode for any portion of a calendar year other than as a principal residence, and that is not rented for a majority of the calendar year, counts towards the owner-occupied percentage. Individual mortgages on units in approved projects would still have to meet HUD's rules, regulations, and underwriting requirements, as applicable, to obtain insurance on their mortgages.

### Percentage Ranges for Commercial/Nonresidential Space

Commenters Stated That HUD Should Not Impose a Limit on the Percentage of Commercial/Nonresidential Space

*Comment:* The economically optimal mix of residential and commercial will differ both by the project and by the community. Any such restriction on uses can only reduce the economic value of projects; it can never enhance it. For the purposes of underwriting, any limit on the mix of uses in a mixed-use project is counterproductive and should be eliminated from the proposed rule. Second, from a public health perspective, there is a need for more mixed-use projects in our towns, cities, and suburbs. Mixed-use developments greatly enhance the walkability of neighborhoods, which in turn promotes health and well-being through more frequent social interactions, more walking, and reduced crime. It should not be the role of HUD to place limits on mixed-use projects via rulemaking.

*Comment:* Mixed-use commercial/residential spaces are the cornerstone of traditional small-town America. Preserving the 'residential characteristics' of a condominium is done at the expense of creating a walkable neighborhood. People should be able to apply for help to build or renovate residences even if those residences are part of a building that is more than 50 percent commercial. Rather than protecting the "residential character" of condominium projects, the focus should be on underwriting standards that are more directly related to creditworthiness of the individual. Federal regulations must support mixed-use rental housing for affordability and walkability.

*Comment:* Commercial space would not harm the project's financial viability. Many of the nation's most successful and in-demand mixed-use neighborhoods are comprised of such projects. Increased HUD flexibility regarding the amount of commercial space in multi-family buildings would help to grow and expand mixed-use development efforts, specifically in areas targeted for redevelopment. Furthermore, HUD should review its criteria for all its programs so that they better reflect growing demand for walkable, mixed-use communities; conform to the overall goals for mixed-use, sustainable communities outlined in the Administration's Sustainable Communities Initiative; and bolster rather than stymie local government efforts to preserve and grow the stock of affordable housing in neighborhoods that include mixed-use buildings.

*HUD Response:* HUD agrees that mixed-use developments that combine commercial enterprises with residential housing are increasing in popularity.<sup>7</sup> HUD notes that Fannie Mae recently increased its allowable commercial space percentage to 35 percent.<sup>8</sup> With a strong demand for residential units in mixed-use projects within and outside urban settings, the percent of commercial/nonresidential space becomes less concerning if there is no other negative impact on the residential character and financial stability of the project.

This final rule provides a sufficient range to allow adjustments that may be necessary for the foreseeable future. HUD disagrees with the suggestion that HUD should not impose any upper limit on the percentage of commercial/nonresidential space an acceptable project may have. HUD insures mortgages for properties that are primarily residential in nature and has a fiduciary responsibility to balance policy that promotes homeownership while protecting the Mutual Mortgage Insurance Fund.

### Alternative Suggestions as to the Amount of Commercial Space That Should Be Approvable

*Comment:* Commenters support the expansion of allowable commercial space to the proposed range of 25 percent to 60 percent. This range, when combined with a look at local economic factors, would allow more associations to qualify for FHA approval without necessarily increasing risk. More and more jurisdictions are fostering walkable, transit-oriented communities that offer a blend of commercial and residential space. This change would align FHA with emerging market preferences. A commenter notes an example of a mixed-use development that is highly vibrant and desirable, but would not be approved by FHA because the commercial space exceeds 30 percent.

*Comment:* The maximum standard for commercial space should be set and maintained at 60 percent of the total floor area in § 203.43b(d)(6)(vii). Many highly successful mixed-use neighborhoods are comprised of a similar commercial space to residential space ratio, and there is a real demand

nationwide for development of such projects. If financing were made more readily available, it would have nothing but a positive impact on communities across the nation. This commenter stated disagreement with HUD's assessment of potential negative impacts on the residential character of mixed-use developments with greater than 50 percent of total area designated for commercial space.

*Comment:* The rule should maintain the current commercial/nonresidential space requirements, which are consistent with National Association of Builders policy that calls for the allowable percentage of nonresidential space up to 45 percent. Setting a limit too high could impact the residential character of a project and expose FHA-insured units to risk should a commercial tenant leave the project. Mortgagee Letter 2012-18 provides flexibility and HUD should maintain these requirements.

*Comment:* The commercial space requirement should be set between 25-50 percent, with specific guidelines to allow exceptions for projects with up to 60 percent commercial space. Special consideration is needed when a project seeks to use more than 50 percent of a property's total floor area for commercial space due to the potential impacts of this expanded presence on the characteristics of a residential project.

*Comment:* Mixed-use neighborhoods are preferred, and 56 percent of millennials and 46 percent of baby boomers prefer to live in areas with a mix of retail and housing options (Regional Plan Associations, "The Unintended Consequences of Housing Finance," February 2016). Mixed-use neighborhoods have held up their value better in the years following the Great Recession compared to solely residential neighborhoods. Given FHA's mission to promote safe and affordable housing, the current policy limiting commercial space hinders efforts to build neighborhoods that have a mix of residential housing and businesses with access to public transit that HUD has championed. FHA should allow up to 45 percent commercial space without documentation. Greater levels of commercial space should be evaluated holistically along with the strength of the project, but should not be capped at a specific percentage.

*Comment:* To expand the pool of eligible projects, HUD should set the minimum range for commercial/nonresidential space without requiring an exception from the current 25 percent to 35 percent. Projects with commercial space of more than 35 percent but less

<sup>7</sup> *Real Trends: The Future of Real Estate in the United States* by Urban Economics Lab and MIT's Center for Real Estate (October 2017), at 19. The study is available at <https://mitcre.mit.edu/wp-content/uploads/2017/10/REAL-TRENDS-MIT.pdf>.

<sup>8</sup> Fannie Mae Selling Guide B4-2.1-03: Ineligible Projects (6/5/2018), available at <https://www.fanniemae.com/content/guide/selling/b4/2.1/03.html>.

than 50 percent may request exemptions pursuant to FHA criteria subject to proposed §§ 203.43(f)(1) and (2).

*Comment:* Increasing the percentage of permissible commercial/nonresidential space prior to triggering an exception request builds on FHA's experience with the exception structure currently enforced in the Guide that permits the jurisdictional Homeownership Centers (HOCs) to consider and approve exemptions for projects with commercial space that exceeds 25 percent but is less than 35 percent of total floor area. Protecting a project's residential use and character is not exclusive of consumers who view access to a broad array of services within a project as a fundamental component of the project's residential use and character. Many consumers place a high value on immediate access to services. For these consumers, commercial space is a meaningful component of enhancing the residential experience and a motivation to purchase.

*Comment:* An upper limit of 50 percent should be set for the range regarding commercial space. A higher percentage threatens the residential nature of a project and too closely ties the residential viability to the project's commercial success. HUD should continue to use the standard of 25 percent while exercising the ability to increase that threshold for certain markets or projects as proposed in the regulation.

*Comment:* It is possible for a project with commercial space exceeding 50 percent of total floor area to be successful in certain housing markets. Any exceptions granted above the 50 percent limitation must appropriately mitigate potential exposure to business cycle risk. At this time, it may not be appropriate for FHA to approve condominiums in the upper limit of the proposed 60 percent commercial space range—the agency lacks data and experience concerning the sustainability of such projects. This is not the case for projects with 35 percent or less commercial space.

*Comment:* Older business/residential buildings help entrepreneurs live upstairs from their businesses. HUD should lift the minimizing constraints of space versus funding. HUD should consider doing a survey on said remodeling of old tenements/downstairs businesses. All old buildings need new life for sustainable development.

*Comment:* Research shows that consumers increasingly place a price premium on housing that is near (walking distance of less than .25 miles) of services, including retail, healthcare,

and transportation. This research has also shown a correlation between a homeowner's access to transportation, employers, and household economic growth. Condominium projects with commercial components not only meet consumer demand for access to services, but also may improve access to jobs leading to greater financial stability for households and the community at-large.<sup>9</sup>

*HUD Response:* This final rule narrows the upper end of the potential allowable commercial space percentage to 55 percent of the total floor area. This percentage acknowledges the future potential of mixed-use developments while avoiding risk to the MMIF. The range gives HUD flexibility to adjust the standards through policy changes as the market conditions dictate.

HUD believes in allowing the development of pedestrian oriented communities that offer the convenience of commercial and residential space in the same project, so long as the residential character is not negatively impacted. Multiple commenters seem to agree with HUD's assessment, noting that although they also agree with the expanded range of allowable commercial/non-residential space, special consideration is warranted when a project seeks to use more than 50 percent of a property's total floor area for commercial/non-residential use. HUD will consider the recommendations submitted through the comments when drafting specific policy guidance on this subject.

*Comment:* The HOTMA provision allowing lenders to make exceptions to the commercial space requirement based on "factors relating to the economy for the locality in which such project is located" should be immediately implemented (the deadline was October 28, 2016).

*HUD Response:* This provision was proposed on September 28, 2016 (81 FR 66565) and is made final by this rule (§ 203.43b(g)(2)).

*Comment:* Most of the newer condominium projects that have been built in the past 5 years in one area include street level commercial space. To disqualify the ability of a purchaser to purchase a condominium in this building using FHA financing due to current commercial space vacancy

(assuming this is a temporary short-term vacancy) does not make sense. HUD should set this minimum occupancy rate of commercial space at 25 percent.

*HUD Response:* The rule establishes the range for commercial space, but does not impose a restriction on commercial space vacancy. As to the percentage, please see the prior response.

*Comment:* HUD should clarify that this requirement is not a minimum, but an allowable maximum for the addition of commercial space as well as the frequency with which FHA will reexamine the commercial space requirement, how much notice will be provided to lenders when a change is made, and what criteria will be used to determine recalculations. Finally, FHA should further define the items that may contribute to commercial space to ensure that lenders understand what features will fall into this category to aid in the completion of accurate commercial space calculations.

*HUD Response:* The range provided in § 203.43b(d)(6)(vii) as it relates to the commercial/non-residential space in a condominium project refers to an allowable maximum, not a minimum requirement. Regarding the commenter's request for additional information on guidelines, procedures, and items that contribute to commercial space, HUD expects to issue future guidance on such issues. Section III of this preamble discusses data that HUD will consider when determining a change in the percentage of commercial/nonresidential floor area.

#### Single-Unit Approval and Reserve Requirements

*Comment:* Single-unit approvals offer millennials an opportunity to own homes, and the elderly to stay independent, especially if the reserve requirement could be set lower than that of Fannie Mae, perhaps 10 percent of the overall budget instead of 10 percent per annum. If the project is budgeting properly, it always has the appropriate amount to cover its expenses already on hand and it doesn't make sense to put in an additional 10 percent each year.

*Comment:* HUD should consider an exemption from the reserve requirement for single-unit loans where a project has been well-managed for decades, while approaching the capital funding issue via special assessments. HUD could use appraisers to speak to the historical values of units within the complex. If one could determine that the price variance is too high to meet a certain standard, then the exemption is not granted.

<sup>9</sup> Richardson, Nela, Urban Institute/Core Logic: *Demand, Data, and Demographics Symposium, Integrated Services and Inclusionary Housing for Changing Demographics: Can we build our way out of this?* (Washington DC, November 2, 2016). Data deck available for download at: <http://www.urban.org/events/data-demand-and-demographics-symposium-housing-finance-2> (accessed 3/18/2019).

*HUD Response:* This rule does not impose a minimum reserve requirement for single-unit approval, but establishes a framework for single-unit approval that utilizes the eligibility requirements in 24 CFR 203.43b(d) as a baseline, which includes requirements for reserves; or a subset of these requirements. HUD will consider these comments when addressing single-unit approvals in future notices.

#### *FHA Concentration Percentage*

*Comment:* HUD, through FHA has a responsibility as a steward of the program to mitigate risk. Without further clarification as to existing risk or the rationale for potentially reducing or expanding the concentration limits, it is difficult to provide substantive comment. However, HUD is a critical source of funding for buyers in condominiums, and HUD should not lower the concentration threshold from its current 50 percent level without adequate data to support such a contraction in the program. Existing levels should be preserved with greater flexibility for increased concentration where appropriate. If HUD determines that changes are warranted, HUD should provide additional information about the factors that will be considered.

*Comment:* 25 percent FHA insured would be too low. HUD should not be overly concerned about FHA concentration in projects that are well-managed and meet all FHA approval criteria. Some limitation is prudent risk management. HUD should retain a 50 percent minimum FHA concentration limit.

HUD should maintain its current guidelines to allow for 50 percent of the total number of units in a project with some leniency to allow for potential cancellations. In many circumstances, HUD has already allowed for up to 75 percent FHA financed units in established projects based on individual project conditions and the associated risks of this flexibility are monitored and mitigated through the recertification process. The maximum percentage should be raised to 75 percent. The flexibility provided under current guidelines along with the sufficient risk mitigation provided through the recertification process remains the most effective approach to this calculation for both lenders and FHA.

*HUD Response:* This final rule implements the FHA concentration range that provides the framework to establish flexibility in applying this standard through policy guidance as market forces may dictate. HUD will evaluate these recommendations when updating policy guidance and will

consider pertinent data to support any future changes to the concentration limit.

*Comment:* A commenter recommends that HUD allow an FHA concentration up to 100 percent, especially for new construction. In most metropolitan areas, the cost of a condominium is significantly less than a traditional single-family home. FHA is often the only financing available for many buyers, especially first-time or middle-income homebuyers who have limited resources for a down-payment. Research shows that the time needed to save for an FHA related down payment is significantly higher for a single-family home compared to a condominium. Purchasing a condominium will allow many FHA borrowers faster access to homeownership, helping to build their wealth and stabilize their living situation sooner rather than later. A high concentration of FHA borrowers means a high concentration of owner-occupants, which helps the financial soundness of the condominium project. FHA does not limit the amount of financing available within a neighborhood of single-family structures, nor should FHA limit financing within a condominium project. Generally, FHA condominium buyers have a stronger financial footing than non-condominium buyers. FHA condominium buyers tend to have higher FICO scores than the non-condominium buyers and higher monthly incomes. In 2016, the average monthly income for a condominium buyer was \$1,693, versus \$1,397 for non-condominium buyers.<sup>10</sup> These are creditworthy borrowers who deserve to live in buildings and communities that meet their needs.

*HUD Response:* HUD disagrees with the recommendation to increase the maximum allowable FHA concentration percentage to 100 percent. HUD has a fiduciary responsibility to balance policy guidance with risk to the Mutual Mortgage Insurance Fund. Allowing for a higher FHA concentration percentage without careful consideration for additional requirements or justification may increase the Government's risk.

#### *Single-Unit Approval*

##### Single-Unit Approval Generally

*Comment:* Single-unit approvals should be allowed in buildings that do not meet current requirements, for

example, if the owner-occupant percentage is too low, single-unit approvals could provide a way for the development to build up to the required percentage.

With only 9,866 condominium projects currently on FHA's approved list (of 150,000 nationwide), access to condominium units with FHA-insured mortgages is limited. Allowing single-unit approvals could greatly improve access and "change the trajectory of the FHA condominium approval trend line" to the benefit of condominium associations and consumers.

*Comment:* Most developments fail to keep their FHA approval because it is not in their budget and most do not have the knowledge and expertise to keep the project approved. By eliminating this process, developers would be able to serve more borrowers that are looking to use FHA financing to accomplish their goal of homeownership.

*HUD Response:* Single-unit approvals, in the appropriate circumstances, can be beneficial, and are retained in this final rule as an opportunity to provide access to FHA's programs in this or similar situations. The rule establishes requirements to mitigate risk to the Mutual Mortgage Insurance Fund, while providing that these can be varied in the future as needed.

*Comment:* Because of the reluctance of condominium associations to become HUD-approved, single-unit approval is imperative. HUD should reconsider requiring any complex that shows up on HUD's approval list to go through project approval. That will require many of these associations to be approached a second time when many of them had a bad first experience.

*HUD Response:* HUD has a fiduciary responsibility to the Mutual Mortgage Insurance Fund that generally precludes allowing single-unit loans on any project, although the rule provides a framework for HUD to vary single-unit approval requirements as needed to meet market needs.

*Comment:* To make single-unit approval as successful as it could be, HUD should do away with "loophole letters," because the property manager can refuse to provide one and kill the loans that would otherwise happen.

*HUD Response:* The comment seems to be referring to a questionnaire that is sent to the Association. HUD appreciates that obtaining information from Condominium Associations can complicate the mortgage process, but recognizes that such information may not be obtainable through other methods. While this rule does not mandate that any specific questionnaire

<sup>10</sup> Urban Institute, "Loosening FHA Restrictions on Condominium Financing Makes Sense," November 2016, available at <https://www.urban.org/sites/default/files/publication/85936/loosening-fha-restrictions-on-condominium-financing-makes-sense.pdf>.

be completed by a Condominium Association, this rule provides the framework to establish flexibility in applying the proposed standards through future policy guidance as market forces may dictate.

*Comment:* The current approval process has incentivized condominium boards to undertake an examination of the Association finances, state of insurance policies, collections, and other factors that are needed to obtain approval. This has been beneficial to communities who have undertaken this process. Providing an approval process with a lower approval threshold will short circuit the larger project approval process as boards will forego the time and effort of project approval knowing there is a lower barrier for approval elsewhere. This would be unfair to the communities which have undertaken project approval and provide a dueling set of standards.

*HUD Response:* Providing for a limited number of single-unit approvals, based on standards appropriate to mitigate against excessive risk, should not affect the fairness of the overall project approval process. Limiting the number of such approvals in projects provides incentive for Associations to continue to pursue the project approval process in projects that typically have a larger percentage of FHA financing. The increased flexibility to meet market needs and enlarged approval period provided by this rule is expected to increase the number of eligible mortgages in Condominium projects.

The lower end of the range, including a 0 percent maximum, is available if overly negative effects occur. However, smaller condominium projects may simply not have the financial ability or expertise to apply for project approval, and a limited number of Single-Unit Approvals would give them a path forward to provide FHA mortgage-insured housing units. Project approvals will have benefits, including a degree of certainty that units will be eligible for mortgage insurance; therefore HUD believes those projects with the ability to do so will continue to seek project approval.

*Comment:* The previous spot loan program led to concerns of abuse. This program should have diligent monitoring and adequate system enhancements to prevent abuses. Without further guidance and clarity regarding lender obligations, the criteria that will be used for unit approval verification, and the processes that will be in place to monitor and track these unit approvals, this program may result in unintended risk to the Mutual Mortgage Insurance Fund, and to

borrowers seeking sustainable homeownership. FHA should implement a limited review process for single-unit approvals and a screen within FHA Connection to collect data for FHA on spot approvals to help FHA monitor and manage these risks. Based on the current proposal, a condominium identification number would not be available for a single unit, and without effective monitoring systems, both FHA and participating lenders will have significant difficulties determining approved unit percentages in an ineligible building. There should be a way for the public to track percentages of single-unit approvals. HUD should clarify the tracking mechanism to be used to determine compliance with the 0–20 percent range allowed.

*HUD Response:* HUD agrees that a reliable tracking mechanism is needed to determine compliance with the range allowed. As a result, HUD has added a provision that “HUD may suspend the issuance of new FHA case numbers for a mortgage on a property located in any project where the number of FHA-insured mortgages exceeds the maximum,” which will allow FHA to proactively manage the concentration range. The maximum percentages that apply will be established by notice. Also, the 0 percent possibility provides a safety valve. This final rule provides specific criteria for single-unit approval that HUD believes will adequately protect the Mutual Mortgage Insurance Fund, while providing needed flexibility for HUD to make changes in the future as needed.

*Comment:* Single-unit approval should not undermine the project approval process and should be limited. While the FHA and industry have struggled with encouraging boards to undertake project approval, the importance and benefits of approval have become more widely understood over the past few years. Adopting a shortcut will undermine the process unless more clearly delineated limitations are adopted. If the criteria for single-unit approvals is extremely loose, HUD will lose control of the process and lenders will turn to single-unit approval as the industry standard.

A comment proposed that single-unit approval would be acceptable if:

- (1) The association had held FHA approval which has been expired for fewer than 3 years.
- (2) The FHA approval was not withdrawn or rejected for failure to meet FHA criteria.
- (3) Other criteria FHA deems appropriate.

Another comment stated that there should be some leeway and suggests

that the following common issues should be considered to determine what is required for single-unit approval:

- Construction Defect Litigation or repairs in response to defect litigation are still in process.
- Owner Occupancy is between 35 percent–50 percent.
- Leasing Restrictions that include: Seasoning Clauses, Tenant-Screening, short-term Rentals.
- Co-Insurance is used without 100 percent replacement cost, but replacement cost can be validated using Marshall-Swift or other acceptable means.
- Bylaws are not signed.
- Status with the Secretary of State is not current.
- Condominium Documents were not created and or filed properly at the time of development.
- Transfer fees are in place.

*HUD Response:* HUD has considered these suggestions and believes that the limitations stated in this final rule are appropriate. Single units, to be approved for mortgage insurance, must not be either in a project that is already approved, or a project that has been determined to have significant issues that affect the viability of the project. The unit must meet the general standards for approval stated in the rule, or some subset of these standards, or less stringent standards, determined by HUD. The unit must be in a completed project that has at least 5 dwelling units. HUD plans to issue further guidance under the framework provided in this rule.

*Comment:* HUD should define and clarify the documentation requirements for approvals under the exception for less stringent standards.

*HUD Response:* The less stringent standards will be determined based on experience and conditions at the time.

*Comment:* HUD should allow public comment on the specific criteria and processes FHA will use to manage single-unit approvals prior to implementation. The actual standards and process that FHA adopts are critical to the success of single-unit approvals. If a single-unit approval system is to be successful, all market participants (including lenders, condominium association boards, community managers, community management companies, and other professionals who support the community association housing model) must have the opportunity to review and comment on the procedures and standards to be used.

*Comment:* HUD should consider adopting Freddie Mac and Fannie Mae’s guidelines when it comes to

condominiums, that is, limited review and full review for “spot approvals” for condos not listed on the Fannie Mae PERS list. Freddie takes the reciprocal of Fannie Mae’s PERS approval. Review should be similar to the Fannie Mae Condo Project Manager (CPM) review (reviewing the budget, delinquencies, litigation, etc.) for the single unit only. HUD would benefit from the same level of review as the agencies and set the same protocol for certain type that would need HRAP or DELRAP approval as Fannie does with PERS. Having FHA, Fannie and Freddie all on the same page when it comes to condominium reviews will give more flexibility to certain credit type borrowers, along with product options.

If there is no guidance, some lenders may approve anything without any type of review and consider the unit acceptable as long as it is not on HUD’s approved list. Perhaps HUD could have a list of staff trained in condominiums within each lender, or only allow DELRAP-approved lenders to issue Single-Unit Approvals.

*HUD Response:* HUD has considered these suggestions and believes that the limitations stated in this final rule are appropriate. Single units must be in projects that meet eligibility criteria and cannot have any significant issues affecting viability. HUD plans to issue further guidance under the framework provided in this rule. HUD has received a number of comments on criteria for Single-Unit Approval via this rulemaking, which it will consider when issuing guidance going forward.

#### *Single-Unit Approval and FHA Concentration*

*Comment:* Is there any relationship between the number of Single-Unit Approvals and the percentage of FHA-insured loans currently in the project?

*HUD Response:* Generally, the projects in which SUAs will occur must meet the eligibility requirements of § 203.43b(d) and (i), which place a limit on the percentage of FHA-insured loans. This rule provides that HUD may vary the specific limit, giving HUD the flexibility to respond to market needs; the total FHA insurance concentration will include all FHA-insured mortgage loans in the project, whether counted for SUAs or the overall limit.

*Comment:* The FHA concentration range proposed for the SUA process is the only factor that raises the possibility of severely restricting the program on a broad basis or targeting a sub-set of projects for disqualification from the underlying program. FHA now has greatly improved risk management due to improvements in data collection and

the Qualified Mortgage standards (of the Dodd-Frank Wall Street Reform and Consumer Protection Act). Currently, condominiums outperform most other categories in FHA’s book of business and have a lower foreclosure rate, which would allow HUD to expand access to credit while protecting the insurance fund. A minimum FHA concentration range of 0 percent is contrary to this policy goal, and could lead to a practical withdrawal of FHA from the condominium market, which would be destabilizing and contrary to FHA’s countercyclical role in any future crisis to the detriment of American homeowners and communities. The lower end of the range should be 10 percent.

*HUD Response:* HUD recognized the need to establish a limited Single-Unit Approval process in its proposed rule and maintains that process through this final rule. HUD also recognizes that the performance of mortgages secured by condominiums had performed worse than other single-family mortgages for a time period prior to the elimination of FHA’s Spot Approval process and have shown to be prone to more volatility than other mortgages. Establishing a range that includes 0 percent provides FHA with the necessary flexibility to respond to market movements that may put the FHA Mutual Mortgage Insurance Fund at risk.

#### *Single-Unit Approval With Home Equity Conversion Mortgages (HECMs)*

*Comment:* Seniors face difficulty in obtaining HECM loans due to the inability or unwillingness of condominium associations to have the projects approved by FHA due to the difficulty, time, and expense of the project approval process, without a single-unit option. In some cases, HECM loans are the only way seniors can stay in their home in retirement, or need the cash flow. A single-loan approval process would make it relatively simple for individual units to be approved. HUD should allow Single-Unit Approval for a reverse mortgage in any condominium complex that meets the new Single-Unit Approval criteria.

Eligibility for a HECM loan should be based on individual creditworthiness rather than the condominium association. The current requirement for whole-project approval is a form of discrimination because a detached homeowner who isn’t credit worthy can more easily get a HECM loan than a highly qualified senior owning a condominium. “Overly aggressive” HUD requirements prevent highly qualified borrowers from qualifying for loans, and HUD should go back to spot

approvals based on appraiser input of marketing data. “The local appraiser’s input would properly evaluate the short and long-term viability of the project.”

When HUD ended spot approvals, HECM loans became inaccessible to many seniors. HUD should clearly include HECM loans within the Single-Unit Approval process. The policy that HECM loans are not eligible has to do with consistency with the prior policy of terminating spot loan approvals. The program currently prevents highly qualified borrowers from qualifying for loans and fulfilling the objective of the HECM program. It is a form of discrimination.

*HUD Response:* While HUD does not agree that either a lack of single-unit loan approvals for HECMs or a general requirement for project approval are forms of discrimination, the availability of Single-Unit Approvals under this final rule should make HECM loans in condominium projects more widely available while recognizing the difference in ownership of single-family dwellings that are maintained solely by the owners versus condominium ownership that includes maintenance by owners and associations.

HECM mortgages may include condominium loans (see the definition of “mortgage” in 24 CFR 206.3) and are eligible for mortgage insurance if the project is acceptable to the Commissioner (24 CFR 206.51). For HECMs, as for forward mortgages, a condominium loan is approvable for insurance if it satisfies eligibility requirements and is: (1) Located in a project that is acceptable to the Commissioner as described in § 203.43b(d) of this rule, (2) for a single condominium unit located in a project that is acceptable to Commissioner as described in § 203.43b(i) of this rule, or (3) for a site condominium project that is acceptable to Commissioner as described in § 203.43b(j) of this rule. The requirements of § 203.43b of this rule establish the standards for a project that is acceptable to the Commissioner.

*Comment:* Condominium associations often are not interested in becoming HUD-approved, and therefore they could not obtain a reverse mortgage. This is a common situation (one commenter stated that only 6–8 percent of condominium projects are HUD-approved), resulting in an underserved market.

Some commenters stated that seniors were being discriminated against, and that seniors in condominiums unfairly lack the same opportunities provided to those who live in single-family homes, even if the condominium owners are more creditworthy. These commenters

sought the ability to obtain reverse mortgages, which would allow seniors to live near relatives but keep their independence, and stated that there should be an easier way than getting the entire project approved. This rule would “re-open doors in a fiscally responsible manner for many people that have been closed for too long.”

A senior with a tax lien against a mortgage-free condominium unit would likely not be able to pay the taxes past due without a HECM loan. Some housing markets have become so expensive that even small condos are out of reach of many seniors if they are not able to use a reverse mortgage. Many seniors already in a condo need to access their equity for everyday living, medical and other expenses and long-term care. When some large banks left the reverse mortgage industry, the market lost their dedicated in-house condominium departments, which worked solely on getting condominium projects approved. More and more condominium associations do not want to go through the time and expense of getting approved. Single-unit loans should come back so that older Americans can enjoy staying in their home in retirement.

*HUD Response:* The Single-Unit Approval process under this rule is expected to make units more easily available, including for HECM loans.

*Comment:* HUD should allow a certain percentage of Single-Unit Approvals for reverse mortgages in any complex, or, in the alternative, HUD should consider wiping the project approval database for any complex without a status change in 2 years.

*HUD Response:* HUD does not believe allowing a certain percentage of Single-Unit Approvals solely for HECM loans in all projects would be consistent with its fiduciary duty to the Mutual Mortgage Insurance Fund. HUD believes that making the determination of how many units would be Single-Unit Approvals based on specific factors, experience, and with flexibility to change in response to future market conditions is the correct approach. For the same reason, HUD would not agree to wipe the approval database at any periodic intervals.

*Comment:* The ability to apply for a HECM loan based on individual viability rather than blanket rules applicable to a whole complex is much more democratic and would logically help the economy and give more people cash flow. Allowing single-unit loans will also help the values of these condominium projects.

*HUD Response:* HUD has a fiduciary responsibility to the Mutual Mortgage

Insurance Fund that generally precludes allowing single-unit loans without considering the project. The rule provides a framework for HUD to provide some Single-Unit Approvals and to vary requirements as needed to meet market needs.

#### *Direct Endorsement Lender Review and Approval (DELRAP)*

Commenters Questioned the Proposed Staff Experience Requirement for DELRAP Approval

*Comment:* It is often standard practice for a lender to employ junior underwriters with respect to condominium projects who may not have at least one year of experience, but who work under the direct supervision of a very experienced senior underwriter. Procedures are already in place to oversee this current system through FHA’s quality control reviews. Accordingly, HUD should instead utilize the current guideline requirements with respect to this issue, which call for the lender to employ staff that have knowledge and expertise in reviewing condominium projects. Supervision by a senior underwriter and internal quality controls allow for underwriters with less than a year experience to work on a project while protecting consumers and the FHA.

Because each lender is responsible for the outcome of each reviewer’s actions, it is best left to each lender to determine if/when a reviewer is ready to make these important decisions. HUD should make no changes to current guidance.

*Comment:* HUD should consider if the proposed credentialing process constitutes a barrier to entry, depressing the number of lenders eligible to process DELRAP approvals. DELRAP serves the useful purpose of increasing administrative capacity when there are bottlenecks. Such administrative capacity constraints may occur when the market is very active or when new regulatory standards are introduced. The reduction of DELRAP approvals could have negative implications for FHA’s countercyclical role in the housing finance system. FHA played a critical countercyclical role in the recent financial crisis, making mortgage credit available to households, including condominium households, and accounting for 26 and 22 percent of condominium unit market originations in 2009 and 2010, respectively. Direct Endorsement lenders should be provided unconditional approval, with the understanding that qualified personnel will process condominium approvals, unless or until FHA quality control reviews identify a pattern or

practice of DELRAP approval violations. Providing a list of material deficiencies found would help lenders prevent returning from unconditional DELRAP authority to a conditional status, or worse, a termination or other action.

If a Direct Endorsement lender has pattern of negative DELRAP outcomes, it would be appropriate for the Department to impose the proposed additional requirements to retain DELRAP authority at that time. This has the benefit of clearly communicating FHA expectations, which will improve the quality of DELRAP approvals and retain the efficiency of the DELRAP approval process for FHA in periods of economic stability and distress. HUD should review initial DELRAP approvals and engage in continued quality assurance reviews. Greater Direct Endorsement lender participation resulting from fewer barriers to entry in the project approval process, buttressed by the potential of penalty for non-compliance, benefits both condominium households and FHA.

*HUD Response:* This final rule revises § 203.8(b)(1)(iv) to clarify that staff members that participate in the approval of a Condominium Projects using DELRAP authority must have at least one year of experience in underwriting mortgages on condominiums and/or condominium project approval or be supervised by staff that meet such experience requirement. Also, in appropriate circumstances, such as where a lender has significant experience through the existing program, this final rule provides flexibility for HUD to reduce the requirement of completion of five DELRAP reviews to obtain unconditional DELRAP authority.

#### Other DELRAP Issues

*Comment:* There is no specific skill or indication of appropriate experience that could prove competency in condominium project approval. Skills such as understanding condominium financials and governing documents, understanding a reserve study, knowing what a major component is and whether a condo project is in sound financial condition do not translate to other fields. The most important skills would include HOA accounting principles, community management, and great attention to detail. The use of project consultants by DELRAP lenders would be beneficial in that the DELRAP reviewer would get a thorough review and the client would benefit from quick approval. Mistaken DELRAP approvals that are later withdrawn do not benefit anyone and add to the negative opinion of the process.

*HUD Response:* HUD understands the skills required to review condominium project applications for FHA approval may be varied. Therefore, this rule provides the minimum requirements for FHA approved mortgagees to become DELRAP approved, but neither prohibits nor requires the use of project consultants.

#### DELRAP Submission Process

*Comment:* Relating to conditional DELRAP approval, HUD should clarify how a lender with conditional DELRAP authority should submit its recommended condominium project approvals, denials, and recertification's to FHA for its review. An email contact will be appreciated to speed up the procedure during conditional DELRAP. It would be most efficient, and provide consistency for lenders and for FHA, if a centralized submission source and process is established for these purposes for consistency. There should be clarification of whether the material must be submitted through FHA Connection, a homeownership center, or some other avenue.

*HUD Response:* The specific submission requirements for conditional DELRAP authority will be detailed in Handbook guidance that will be issued following this final rule.

#### DELRAP vs. HRAP

*Comment:* Can there be flexibility where either HUD or a DELRAP lender approves condominiums? Can the lender choose?

*HUD Response:* The final rule establishes the process for condominium project approval by either a DELRAP approved mortgagee or HUD. With limited exceptions (For example, use of reserve studies over 36 months old, which requires HRAP under § 203.43b(d)(6)(x) or other exceptions that may be contained in guidance) either method may be utilized.

#### Mortgagee Letter (ML) 2016–15

*Comment:* HUD should not have issued ML 2016–15 in the middle of rulemaking on integrally related topics as mandated by federal legislation without further opportunity for interested parties to comment.

*HUD Response:* HOTMA required HUD to issue guidance within 90 days of the date of enactment to establish the required owner occupancy percentage for FHA approved projects. The 90-day deadline made it inevitable that this guidance would be issued during the overall rulemaking process. HOTMA allowed HUD to act by Mortgagee Letter.

*Comment:* While supporting a 35 percent owner-occupancy threshold as

stated in ML 16–15, requiring a 20 percent reserve for capital expenditures and deferred maintenance will make this 50 percent owner-occupancy threshold unusable and mostly non-existent for the majority of the condominium projects. Also, the fact that HRAP is required for approval below 50 percent “confuses and undercuts” the emphasis on DELRAP authority as outlined in the rule. Also, the Mortgagee Letter has a limitation on arrears on association fee payments and requires 3 years of acceptable financial documents. As part of its proposed rulemaking, HUD should allow comments on the Mortgagee Letter.

*Comment:* Owner-occupancy of 25 percent is far from generally accepted practice and could jeopardize the equilibrium between owner occupants and non-owner occupants. However, there are markets that could benefit from a flexible standard as proposed, and commenter supports a fair regulatory process that would permit a condominium to receive approval with an owner-occupancy ratio of less than 50 percent. While HUD has, as directed by HOTMA, lowered the owner-occupant rate to 35 percent, few condominiums will satisfy the conditions to actually be approved for that rate. HUD should adopt procedures and standards that would result in condominiums actually receiving such an exemption. In particular, the requirement for a 20 percent reserve rate is excessive and unnecessary. Providing an incentive to over-fund reserves could be destabilizing, and may have significant unintended tax consequences, particularly for associations using IRS form 1120. Any association that has fully funded reserves pursuant to a current reserve study should be considered as having satisfied the reserve requirement.

*Comment:* HUD followed the letter of HOTMA by allowing the owner occupancy requirements to be as low as 35 percent, but it did not meet the spirit of the law when it added the conditions that many have said are onerous and unlikely to be met by many condominium projects. Congress called for a lower limit to increase the number of condominiums that qualify for FHA approval, thereby increasing the number of units available to home buyers and renters. As mentioned above, condominium units are a particularly important homeownership option for first-time and low- to moderate-income home buyers, *i.e.*, HUD's target consumers. However, the addition of tighter eligibility requirements when the owner occupancy rate is below 50 percent essentially eliminates the

potential of a significant increase in Condominium Associations able to qualify for approval. HUD should remove the onerous conditions for the 35 percent owner occupancy rate established in ML 2016–15, including prohibiting the DELRAP option, requiring replacement reserves for capital expenditures and deferred maintenance of 20 percent of the condominium budget, and not more than 10 percent of total units more than 60 days past due. Per the intention of HOTMA, the owner occupancy rate for all HUD-approved condominiums should be 35 percent. The comment also requests confirmation that HUD will maintain its current owner-occupancy requirement of 30 percent for existing projects less than 12 months old.

*HUD Response:* HOTMA mandated certain requirements that HUD must use to determine owner occupancy but did not mandate the actual owner occupancy percentage that HUD could issue through guidance, leaving HUD with discretion. HUD acted based on its experience and in accordance with its fiduciary duty to the Mutual Mortgage Insurance Fund. The final rule provides the framework to establish flexibility in applying this standard through policy guidance as market forces may dictate. HUD notes that HOTMA requires HUD to base such owner occupancy percentage on units occupied by the owners as a principal residence or a secondary residence or sold to owners who intend to meet such occupancy requirements, which would preclude a blanket inclusion of REO units, or any vacant unit not sold to an owner who intends to occupy the unit as a place of abode for at least a portion of the calendar year and does not rent the unit for a majority of the calendar year.

HUD will consider these comments when issuing such policy guidance. Such guidance will address the specific owner occupancy ratios necessary as well as address if such ratios vary based upon the construction status of the condominium.

#### Reserve Requirement

*Comment:* A 10 percent reserve requirement is excessive, and HUD should consider lowering this amount. If an association has insurance in place for hazards with 100 percent replacement cost, then ostensibly the building would be covered for any major hazards or emergencies. Further, as outlined below, if the association gathers and holds 10 percent of its annual assessment income each year, requiring a reserve account to be funded with at least 10 percent of the monthly assessments could have the effect and



probability of increasing sums held in the reserve account, and thus also increasing the amount of fidelity insurance required under the Guide.

*Comment:* Most people buying condominium units are not looking into reserves before buying. The greater risks of collateral declining in value are pending legal action due to faulty construction; lack of a track record for a new project; and a high percentage of rentals.

*HUD Response:* This rule establishes a reserve requirement of 10 percent of the monthly unit assessments, but provides for a lower reserve amount, based on a reserve study completed within 36 months, or such greater amount of time as determined by the Secretary under the HRAP review process.

#### *Required Recertification Timeframe*

A number of commenters supported extending the time for recertification.

*Comment:* Condominium approvals should be extended from 2 to 3 years, making it easier to submit and get condominium approvals and allowing for more flexible guidelines. Many condominium associations prohibit rentals and without FHA financing opportunities, it makes them more difficult to sell, and thus creates plummeting values. This often creates a scenario where condominium owners stop making mortgage and association payments and creates hardships on the association to where the repairs and other amenities are compromised.

*Comment:* Extending the provision to a 3-year period would reduce costs to associations in obtaining FHA approvals.

*Comment:* A project may experience a number of financial or legal changes during the 3-year period. Special assessments are frequently imposed. If HUD extends the approval period, it is strongly recommended that HUD provide examples of what constitutes "fails to comply with any requirement for approval."

*Comment:* The change to 3 years will decrease submission burdens on lenders and review burdens on HUD. HUD should further memorialize the lenders' obligation to report known changes in circumstance through explicit language in the final rule. This language should mirror current guidelines that require lenders to report any known litigation, budget deficiencies, changes to association documents that may not align with eligibility requirements, and excessive homeowners' association delinquencies that place the property in financial distress as soon as they are made known to a lender throughout the

3-year approval period. A clear provision of lender reporting requirements and reporting processes will contribute to decreased risks for both lenders and HUD.

*Comment:* This change will result in an increased number of projects approved and available for FHA lending with only a marginal increase in the potential for significant change since the project's approval. It will also potentially improve the customer experience as well as decrease costs to the condominium industry by reducing the need for re-approvals.

*Comment:* Two commenters state that the time between renewal of FHA condominium approval should be 5 years, not the current 2 years or the proposed 3 years. One commenter states that HUD and the FHA need to take into consideration how the small volunteer HOA's will implement the final rule. While a large HOA managed by a professional company can easily meet the short renewal period because that is what they are paid to do, every requirement acts as a disincentive for the small HOAs. Renewing the approval every 3 years as proposed will have little or no positive impact. The unintended consequence of the current rule has been to limit housing inventory and hurt first-time homebuyers. One commenter states that the process is daunting, the average cost of obtaining the appropriate documents and legal opinions related to the certification process can range between \$1,500 and \$3,000. A 5-year approval period, rather than the proposed 3 years, would be ideal for reducing the burden to the condominium associations and entice many more buildings to apply for FHA approval, while still maintaining safety and soundness.

*HUD Response:* HUD agrees with the comments supporting a 3-year timeframe, and this final rule retains the approach provided in § 203.43b(g)(3) of the proposed rule (§ 203.43b(h)(3) of this final rule) where projects may be approved for a period of 3 years from the date of placement on the list of approved condominiums. As noted by the commenters, the benefits of increasing the project approval period by 1 year far exceed the potential risks of changes to the project's requirements for approval while limiting the period beyond 3 years, which would run too great a risk of detrimental changes to the project. This final determination was based on FHA-insured condominium performance, consideration of risk to the Mutual Mortgage Insurance Fund, positive impact in the industry, and increase in affordable housing opportunities.

As to the comments regarding failure to comply with requirements for approval and a lenders obligation to report any changes, this rule establishes the framework for approval requirements and establishes the recertification timeframes, but does not specify the format for recertification requests. HUD plans to issue additional guidance regarding the recertification process as well as lenders responsibilities to monitor requirement on a "loan level."

#### *Objections To Extending the Recertification Timeframe*

*Comment:* Three years is too long for an approval or recertification. HOA's change their budgets every year and they don't always keep the reserves at 10 percent. Litigation and delinquencies can also be a cause for concern. Fannie Mae approvals expire every 6 months. Commenter suggests staying with the 2-year requirement.

*Comment:* The exiting 2-year recertification provides a minimal stop-gap to discover projects that are not in compliance. Fannie Mae effectively requires a lender to perform a full review of a project every 6 months for compliance. HOA financials show that it is not untypical to see issues such as the minimum requirement for reserve funds not being enforced; reserves have not been transferred on a regular monthly basis from the operating account to the reserve account; reserve funds have been used for purposes other than allowed; special assessments; et al. This presents a significant risk to the FHA insuring program if a unit is foreclosed and becomes a HUD REO, and the HOA financial condition poses a risk.

*HUD Response:* HUD has decided to retain the approach proposed in § 203.43b(g)(3) in the final rule where projects may be approved for a period of 3 years from the date of placement on the list of approved condominiums (see § 203.43b(h)(3) of this final rule). This determination was based considering the public comments received, FHA-insured condominium performance, risk to the Mutual Mortgage Insurance Fund, positive impact in the industry, and increase in affordable housing opportunities. However, HUD will take the specific comments and recommendations regarding managing project renewals under consideration when drafting future policy guidance.

*Comment:* Does a condo project have to meet the eligibility requirements only at the time of approval, or does it have to meet them continuously going forward?

*HUD Response:* The final rule establishes the eligibility requirements that must be met at time of approval and then continuously going forward. HUD will provide clarity regarding a mortgagee's responsibility to monitor approval requirements beyond the time of approval in future policy guidance.

*Comment:* One commenter stated that there are both positives and negatives. Negatives: With a 3-year process, more eligibility issues may develop. Staying in compliance is more likely with a 2-year recertification. Also, the cost would be more likely to stay in budget. With a 2-year process, Board Members and Community Managers are more likely to be familiar with the process and maintain certification. A 3-year recertification will require additional education of new board members. Positives: Potential cost savings, although it will be minimal; more projects would be FHA certified at a single time.

*HUD Response:* HUD recognizes the positive and negative factors stated by the commenter and believes that the reduced burden associated with a 3-year recertification process outweigh the effects related to Board Members' knowledge of the process.

*Comment:* Commenter seeks additional public input on the recertification process and for HUD to ensure that recertification burdens are eased through simplified procedures and the use of technology that facilitates providing FHA information required for recertification.

*HUD Response:* HUD will take this comment under consideration for future policy guidance and technology developments.

#### Legal Phasing

Commenters expressed concerns about the potential financial impact on projects by requiring that phases for detached and semi-detached developments must consist of groups of adjoining or contiguous homes.

*Comment:* Fannie Mae will sometimes allow non-contiguous developments (e.g., two parcels separated by a school) if there are not common recreational facilities located on one parcel for which the unit owners would be required to travel to the other parcel having the facilities.

*Comment:* HUD has not offered sufficient justification to limit project approval based on phase location. This policy would deny consumers access to FHA-insured mortgages. It is appropriate that builder determine which phases will be declared and constructed based solely on the builder's assessment of market demand

and sales. However, the Department proposes to deny approval for phases that are not contiguous to previously completed phases. This will not provide significant consumer or taxpayer protections. If such decisions are to be regulated, it should be by state and local governments. Proposed

§ 203.43b(d)(6)(x) (§ 203.43b(e) of this final rule) should be removed.

*Comment:* There is a potential financial impact on projects by the requirement that phases must, for detached and semi-detached developments, consist of "groups of adjoining or contiguous homes." HUD should be aware that buildings are often built out of order for marketing purposes, so to require they be built in contiguous order would eliminate FHA financing opportunities for many purchasers, especially in geographic markets that do not allow for legal phasing. Also, does this requirement mean that legal phases must be contiguous in their order of construction and approval? The phases should be approved even if the units are completed out of contiguous order. HUD should remove the requirement for contiguous units or buildings for lateral (non-vertical) developments.

*Comment:* The FHA should limit the need for contiguous criteria to only vertical buildings, as requirements for builders to construct buildings in a specific order may limit the ability of a builder to make their projects available to borrowers in a timely manner. This would limit supply and consumer choice.

*HUD Response:* HUD agrees with the comments and has revised this final rule to allow non-contiguous development for detached or semi-detached buildings. If the project is complete to the extent that all units in the completed legal phase are ready for occupancy, the viability of the detached or semi-detached project is not determined by the contiguous development of the buildings.

#### Legal Phasing, Under-Construction Projects, and Other Related Matters

*Comment:* The language regarding approval of legal phases is ambiguous. Whether an entire condominium project can be approved when only the initial phase is fully complete or whether the entire condominium project must be fully complete should be clarified. If the initial legal phase is complete and approved, does each subsequent legal phase need to be submitted separately for approval? The current practice is that the approval for the initial phase would be amended with the recorded documents for the subsequent phases.

Will this practice continue under the new regulations? If not, condominium developers have indicated that a process requiring separate approval of each completed legal phase would cause them to abandon the FHA market.

*HUD Response:* HUD has clarified in this rule that individual legal phases may be approved independently without the need for the entire condominium project to be fully complete. The establishment of the ability to independently approve phases ensures the ability to perform such approval on separate phases by multiple DELRAP mortgagees or by HRAP without the need to amend a current approval performed by another reviewer. Conversely, the rule does not prohibit such approval on separate phases by the same DELRAP mortgagee or by HRAP where the existing information on separate phases could be used in the approval process of the subsequent phases.

*Comment:* Requiring a legal phase to be completed will require a separate budget for the initial phase, and a cumulative budget for each subsequent phase, which is a practice required in California for phased developments. Under this practice, the regular monthly assessments for the first and initial phase(s) can (will) be substantially higher than that of the subsequent phase unit owners. This can affect the loan/payment qualifications for the initial buyers. If this rule is adopted, there should be allowed a provision for the developer to provide bonding to subsidize the initial phases of development in order to provide a maximum assessment to the initial phase(s) unit owners (e.g., a maximum assessment guarantee). This is also practiced in California and serves to minimize the initial phase(s) buyers needing to qualify for a mortgage based on the higher monthly assessments.

*HUD Response:* This final rule provides the framework to establish flexibility in applying the rule's standards through policy (including standards for financial condition). Based on HUD's experience, the concern with monthly assessments in new developments, including those that are built in legal phases, is that they are usually subsidized by the developer as an incentive to the buyers. Additionally, any potential considerations regarding underwriting of borrowers is outside the scope of this rule. HUD, however, will consider these recommendations when updating future guidance.

*Comment:* The word "project" should be removed and only the term "phase" should be used to provide the greatest level of transparency/clarity possible.

*HUD Response:* To clarify proposed § 203.43b, proposed paragraph (d)(6)(x) is moved to a new top-level paragraph (e) in this final rule, and slightly reworded to more properly state the relationship between projects and phases, and other paragraphs are redesignated accordingly.

*Comment:* Clarification is needed regarding what “sufficient numbers” (of units in phases to be separately sustainable) means. Under current guidance, phases are appropriately permitted in segments as small as a single building. Increasing the number of units to be included within a legal phase may be detrimental to economic viability of the planned development and may not be in alignment with local building restrictions. If a legal phase is mandated to require a greater number of units, and as further stated in proposed § 203.43b(d)(6)(x)(B), the units must be built and have a certificate of occupancy, the developer will endure a significant financial hardship by carrying inventory for units that cannot be financed, or it will lead to fewer opportunities for purchasers who would benefit from FHA financing. HUD should provide more clarity on sufficient numbers of units that allows for several units that matches local ordinance or that aligns with the developer’s marketing plan.

*Comment:* The current phasing guidelines should remain as they are, specifically for new construction projects to ensure optionality and choice for the FHA borrower.

*HUD Response:* This final rule retains the proposed ability to provide project approval on phases without the need for approval of the entire proposed or under construction project (this provision is § 203.43b(e) of this final rule). A completed phase is built out, ready for occupancy, and independently sustainable. The statement that there must be “sufficient numbers” has been removed in this final rule because that quantity may vary in individual cases. The comments and recommendations will be considered when updating and drafting the specific guidance and procedures for determining independent sustainability in future guidance.

*Comment:* There is a need for additional clarity on what criteria would make a legal phase eligible due to varying state law definitions of what constitutes a phase, whether one legal phase or all phases must be complete prior to approval, and what constitutes a sufficient number of units to be considered separately sustainable.

*Comment:* It is unclear as to how amenities would be treated. For example, it is common in construction

projects to delay construction of an amenity (such as a clubhouse) until a certain number of phases have already been completed. There is a concern that the provision, as currently drafted, would require that all such amenities be completed before project approval could be obtained, impacting standard building practices and increasing costs for builders and consumers. Furthermore, commenter notes that tying project approvals to completion of a legal phase could be burdensome and problematic from a state law perspective. There is a patchwork of state laws concerning how to properly effect legal phasing, with varying levels of difficulty depending on the state in question. This would mean that it would be a lengthier and more expensive process to obtain project approval in some states rather than others, which would negatively impact consumers in those states.

*HUD Response:* Under § 203.43b(e) of this final rule, a complete legal phase is one that is available for occupancy (whatever that requires under local law in terms of amenities and other elements) and self-sustaining. This regulation would not alter the existing effect of State processes on consumers.

“Infrastructure” and Phasing

*Comment:* The word “infrastructure” as it relates to legal phase approval is somewhat vague. Although a legal phase may not include the building of a common amenity, that legal phase typically has an undivided interest in common amenities that may be proposed in other legal phases. Are these amenities in other phases thus considered infrastructure? Commenter states that HUD should define the term “infrastructure.”

*HUD Response:* HUD agrees with this comment. HUD has simplified the requirements specific to phasing and has removed the term “infrastructure”. HUD has maintained the requirement for each phase to be ready for occupancy and separately sustainable.

*Comment:* If this rule for requirement of project or phase completion is adopted, a provision should be added to the effect that the completion of the infrastructure can be bonded for completion, and/or to maintain the current guidelines as follows:

- a. A condominium plat or similar development plan and any phases delineated therein have been reviewed and approved by the local jurisdiction and, if applicable, recorded in the land records; and,
- b. The construction of the project’s infrastructure (streets, storm water management, water and sewage systems, utilities), and facilities (e.g., parking lots,

community building, swimming pools, golf course, playground, etc.) and buildings containing the condominium units has proceeded to a point that precludes any major changes.

*Comment:* In-lieu-of an Environmental Review, infrastructure completion can be evidenced by:

- a. Photos of the project and site to evidence completion status of infrastructure (streets, utility stubs to building pads, building foundations, buildings completed and under construction); and/or,
- b. City final inspection records; or,
- c. Letter (letterhead) from city stating completion or percentage of completion, or stating that the construction of the project’s infrastructure (streets, storm water management, water and sewage system, and utilities) and facilities has proceeded to a point that precludes any major changes; or,
- d. Completion bond release.

*HUD Response:* HUD has removed the definition of “Infrastructure” and replaced it with the definition of “Common Elements”. As a result of this change, bonding for completion of infrastructure is not addressed in this rule. HUD will consider this comment when updating and drafting the specific guidance and procedures that will govern the analysis of determining a phase’s ability to be separately sustainable.

*New Construction*

Allow New Construction and Proposed Construction, in Addition to Legal Phasing

*Comment:* HUD is proposing to remove the requirement of HUD staff conducting Environmental Reviews for new projects which do not provide evidence that the infrastructure is completed to a point where HUD would have no influence. The requirement that the project or legal phase be complete prior to submitting for approval will impose a hardship not only on the builder, but moreover, on the buyer seeking to obtain an FHA loan, because this requirement means that a phase must be completed to obtain HUD approval. However, prior HUD approval is required before the lender can obtain a case number, and a case number is required before the lender can request an FHA appraisal. Lenders typically prefer to have a cushion of 60–75 days for the process to complete an appraisal and other underwriting functions, all of which are required to be completed prior to closing the loan. In the case of this proposed rule, although the unit would be completed and ready for occupancy, the buyer would be forced to wait significant time after the phase is completed, then after it is HUD approved (30-day review for HRAP),

only then could the lender order the case number and then order the appraisal, and then complete all required underwriting. This also increases the builder's carrying cost (interest) on the construction loan, and this will have an impact on housing affordability.

*Comment:* The current HUD process of approving under construction, phased projects places the responsibility on the lender to determine completion, and it should be noted that the FHA lender must include evidence of completion in the Insuring Binder (Certificate of Occupancy or equivalent). Based on this alone, the FHA Insuring Program would not be at risk.

*HUD Response:* This final rule maintains the requirement that a project or phase be complete and ready for occupancy as a condition for approval. HUD recognizes this may impact a small segment of the market and possibly delay the time period from completion to sale, but has weighed this impact against the overall reduced burden for compliance contained in this rule as well as the balance required to ensure appropriate risk controls to protect the Mutual Mortgage Insurance Fund. HUD constantly monitors its requirements to ensure the right balance is achieved between serving the market FHA mortgages are designed to service and protecting the MMIF. HUD will take these comments under advisement in this manner.

*Comment:* It is not clear what the definition of "complete" is. Often amenities such as recreation centers aren't begun until a certain number of units are presold. Requiring adjustments to this practice in effect will not just impact condominium approval, but will require a re-evaluation of standardized and generally accepted building process timelines across the country.

*HUD Response:* A project or phase must be complete and ready for occupancy as demonstrated by the certificate of occupancy, or its equivalent, and includes completion of all the common elements of the project, and not subject to further rehabilitation, construction, phasing, or annexation, except in cases where the project is seeking approval for a legal phase. If a phase, it must be self-sustaining.

*Comment:* HUD's practice of allowing FHA loans on units in a completed building in a legal phase containing multiple buildings (two or more) does conflict with Fannie's Mae's requirement that all buildings in a legal phase must be completed (although Fannie Mae does offer a process to allow construction phasing via PERS Application). FHA should continue to

allow FHA closings on such buildings when other buildings in the phase have not yet been completed. Moreover, some governmental authorities do not allow or otherwise recognize legal phasing.

*Comment:* Although Fannie Mae requires a phase to be completed, this does not hamper the appraisal process. A lender can order a conventional appraisal regardless of whether the project is seeking Fannie Mae approval or otherwise.

*HUD Response:* This final rule makes legal phasing consistent with Fannie Mae's policy regarding completion of legal phases, even though Fannie Mae has other underwriting requirements that reduces their risk of exposure, such as lower loan to value (LTV) parameters for condominium loans. However, this rule does not make changes to HUD's use of the status at the time of appraisal in determining the construction status of a property.

*Comment:* The requirement that the project (or initial legal phase) be fully completed and the condominium legal documents be fully recorded for the condominium to receive FHA approval will create a hardship not only on the builder but more importantly on the consumer. For the builder waiting for the full completion of construction and the recording of the legal documents will push back the processing, underwriting, and approval of the FHA loan request by at least a month or more. In addition, without FHA approval during the early marketing and sales cycle of an under-construction condominium, the builder will not be able to advertise the availability of FHA insured loans. This will increase the builder's carrying cost on their construction loan by delaying closings that could result in added cost to the consumer. Also, under the current process the responsibility is on the lender to determine completion by requiring that the lender include evidence of completion in the Insuring Binder (CO or equivalent) and thus the FHA insurance fund would not be put at risk. This proposed rule will have an extremely negative effect on the consumer by delaying access to the FHA insurance program and to the builders by delaying closing on many FHA buyers. HUD should continue its current approval processing requirements for new construction condominiums by allowing the submission of a project (or initial legal phase) while construction is still on-going and before the condominium legal documents have been recorded.

*Comment:* The requirement for completed phases would represent a dramatic change in building plans for

new construction projects. In many instances, this proposal would significantly impact current industry practices in place for the installation of building amenities and the timing of project eligibility and approval. By requiring "completion," borrowers, lenders, and builders would experience sizeable impacts due to delays in approvals and closings due to the feasibility of construction. This will ultimately make it more difficult for an FHA borrower to obtain a unit in a new construction project. HUD should allow lenders to continue with the current practice of approving proposed or under construction projects, despite the possible need for additional environmental reviews, and maintain its current guidelines. Should HUD remain concerned regarding risk management issues, HUD should require a bond or letter of credit from the builder to assure completion.

*HUD Response:* HUD recognizes that the completion requirement may impact a small segment of the market and possibly delay the time period from completion to sale, but has weighed this impact against the reduced burden for compliance of projects overall contained in this rule as well as the balance required to ensure appropriate risk controls to protect the Mutual Mortgage Insurance Fund (MMIF). HUD constantly monitors its requirements to ensure the right balance is achieved between serving the market FHA mortgages are designed to service and protecting the MMIF. HUD will take these comments under advisement in this manner.

*Comment:* As soon as the Certificate of Occupancy is approved by the local government agency, the lender should be able to start the FHA permanent financing for potential purchasers. This proposed rule will affect the mortgage industry since: Mortgage Applications are worked with potential purchasers 60 days before the Certificate of Occupancy is given by the state government (on walk-ups, this will delay the process and clients who otherwise could move to their new homes); an interim financing loan for the construction of walk-ups project (multiple low rise) is based on a peak (maximum loan disbursement before repayment starts), and if there is no repayment on the mortgage the builder cannot continue the construction and cannot sell the units.

*HUD Response:* HUD recognizes that the completion requirement may impact a small segment of the market including "walk-up" projects and possibly delay the time period from completion to sale; however, HUD has weighed this impact

against the reduced burden for compliance of project overall contained in this rule as well as the balance required to ensure appropriate risk controls to protect the Mutual Mortgage Insurance Fund.

*Comment:* A commenter states that they are unable to understand how the elimination of the environmental review only for HRAP applications compensates for the total prohibition of project approvals, HRAP and DELRAP, on proposed and under construction projects. If an environmental review is not required for an approval by a Direct Endorsement Lender, why is it necessary for a HUD review and approval? If HUD believes the environmental review is a burden on its staff, it seems it could be eliminated or used in more restricted circumstances. Not having FHA approval until completion may cause builders and developers to abandon the market. The advantages of allowing proposed and under construction projects to be approved, and the ability for developers to pre-sell units to FHA borrowers, prior to being fully complete far outweigh any disadvantages of environmental reviews that HUD may perceive. HUD should withdraw the proposed prohibition and keep the current requirements for proposed and under construction projects.

*Comment:* Condo approvals are too restrictive, resulting in decreasing condo approvals. Provisions in the proposed rule will further decrease FHA's share of the condo market. Specifically, the proposed changes to proposed and under construction approvals and Site Condominiums could result in developers leaving the FHA market to the detriment of FHA borrowers.

*HUD Response:* This final rule continues to allow for approval of completed legal phases, but does not permit approval of phases that are proposed or under construction. HUD constantly monitors its requirements to ensure the right balance is achieved between serving the market FHA mortgages are designed to service and protecting the Mutual Mortgage Insurance Fund. HUD will take these comments under advisement in this manner and will continue to assess the impact of this requirement as well as any impacts related to new construction projects in relation to environmental requirements in 24 CFR part 50. However, HUD believes that this rule will increase participation in the program due to the added flexibility it provides to address future market changes.

*Comment:* A commenter states that the requirement for completion often results in a senior waiting months to close on a HECM unit until the landscaping can be completed, weather permitting. In the meantime, seniors often have a greater expense as they have to continue renting until they can move into their new home or live with friends or relatives causing significant stress. The current regulations discriminate against seniors based on where they live. This is a problem with condominiums, Site Condominiums, and new single-family homes in cold weather states. If the landscaping is the *only* issue, then there needs to be an exception. This issue needs to be resolved quickly.

*HUD Response:* Substantive changes to the HECM program, as well as local law regarding real estate closings, are beyond the scope of this rulemaking. Single-Unit approvals and project approvals require that the unit be in a project that is complete under § 203.43b(d)(4), that is, complete and ready for occupancy. If local standards do not require that landscaping be completed in order for the project to be occupied, the project, or single units in the project, may be eligible if meeting the requirements of this rule.

*Comment:* There are concerns about the rule permitting only legal phasing and requiring each phase to be separately sustainable due to implications for new construction and FHA borrowers seeking units, resulting in substantial closing delays. Without pre-approvals that are currently issued for "under-construction" or proposed construction projects, a lender would not be able to order a case number until a project is approved, subsequently delaying the processing of a loan application and resulting in significant closing delays of up to 60 days. This will ultimately limit the choices for low-to-moderate income borrowers, leaving them at a disadvantage if they are seeking new construction units.

*Comment:* The requirement that all infrastructures be complete prior to approval of the phase/project is a significant departure from previous practice that may limit the usage of the program. Presently, approvals may be made in the framing stage of building and this new requirement could be an unnecessary and burdensome requirement. Without the ability to secure approval prior to completion, builders will be unable to market during construction and gain the necessary mortgage approvals until the final inspection for the phase/project has been completed and certified. This places an additional requirement upon

builders and borrowers not present in the FHA program today as well as other agencies' programs.

*Comment:* Requiring all buildings in a phase to be completed will delay closings. The requirement for completed phases will cause a delay of 30–45 days for HUD approval, with an additional 15–30 days for processing and underwriting of the loan, creating negative consequences for consumers and increasing the builder's expenses in carrying interest on the construction loan, reflected in higher home prices. This change will not provide any benefits to the FHA insurance fund and will only negatively impact consumers and homebuilders.

*HUD Response:* This final rule maintains the requirement that a project, or phase, be complete and ready for occupancy as a condition for approval. HUD recognizes this may impact a small segment of the market and possibly delay the time period from completion to sale but has weighed this impact against the reduced burden for compliance of project overall contained in this rule as well as the balance required to ensure appropriate risk controls to protect the Mutual Mortgage Insurance Fund (MMIF). HUD constantly monitors its requirements to ensure the right balance is achieved between serving the market FHA mortgages are designed to service and protecting the MMIF. HUD will take these comments under advisement in this manner.

*Comment:* These provisions, if enacted, will unnecessarily delay a consumer's ability to close on and take possession of their condominium. Under the proposed regulations, a lender would not be able to order a case number or an appraisal until the project or legal phase is completed and the condominium documents have been recorded. The rule could delay closing by several months. It would also result in the builder having to hold onto inventory longer than anticipated, which would increase the costs to the builder and ultimately to the consumer. Equally troubling is the fact that homebuilders often rely upon a certain amount of presold condominiums in order to qualify for financing to construct the condominiums. The inability to obtain approval for the project or phase prior to construction and recordation of the condominium documents could, in fact, chill construction of new condominium projects altogether.

*Comment:* The ability to approve condominium projects prior to completion benefits both home buyers and home builders. The approval of a

proposed or under construction condominium project allows a mortgage application to be processed while the condominium unit is being constructed and decreases the time required to close the loan after a unit is completed. Prohibiting the approval of proposed and under construction projects means that a lender will not be able to order an appraisal and begin processing a mortgage loan application until the first phase of the condominium is completed. This is because a lender cannot request a case number and order an appraisal for a mortgage loan application until a condominium project has received a Project ID Number, which is not assigned until a project has been approved. This revision to the current process will result in significant delays, 60 days or longer, in the purchase and settlement of condominium units whose buyers are seeking FHA-insured financing. Developers may not be willing to offer FHA-insured mortgage loans to buyers prior to approval of a project since they cannot begin processing the mortgage application and the condominium may ultimately not be approved for months, if at all. The result will likely mean fewer condominium projects submitted for FHA-approval and home buyers interested in purchasing units in new condominium projects will not have FHA insurance as a financing option. Builders will not be incented to seek FHA approval for new construction condominiums if they can have their under-construction projects approved for conventional financing using Fannie Mae or Freddie Mac programs. FHA-insured loans will be at a significant disadvantage to the Fannie Mae and Freddie Mac conventional financing programs. This could prove a disadvantage to homebuyers who may need the advantages of FHA-insured financing, which include a higher debt-to-income ratio, smaller down payment, and less-than-perfect credit requirements.

*Comment:* The policy of approving only completed projects or phases will restrict access to FHA-insured mortgages for consumers seeking to purchase new construction condominium units. Further, FHA may be inappropriately influencing the market-based decisions of its private enterprise partners. Consumers benefit from this earlier review and approval as lenders are able to process loans, allowing consumers to close in a timely manner. This advance submission and approval process protects the Fund and taxpayers as a mortgage may not be endorsed until the fully recorded legal

documents have been provided to FHA and acknowledged in relevant systems as having been received. The proposed rule will disrupt this process and introduce inefficiencies and delays for consumers. The proposed policy change will place consumers seeking to obtain FHA-insured mortgage credit at a market disadvantage, lead such consumers to more expensive mortgage loans and will delay closings for an undefined policy benefit. The potential for delayed closings will also alter builder business decisions, which may have unintended consequences for consumers. It is well established there is a lack of affordably priced housing available to lower and moderate-income households. It seems counter to federal and state policymaker efforts to increase the supply of affordable homes to limit consumer access to FHA-insured mortgages and alter the business economics of the builder industry. HUD should remove § 203.43b(d)(4).

*Comment:* The proposed rule may impose an unduly high burden on new construction with the requirement that the project phase be “complete and ready for occupancy, including completion of the infrastructure of the project or legal phase, and not subject to further rehabilitation, construction, phasing, or annexation, except to the extent that approval is sought for legal phasing in compliance with the requirements of proposed (d)(6)(x) of this section” (§ 203.43b(e) in this final rule). New construction projects do not always fully incorporate the common elements of a project until there are sufficient residents within the project to sustain those features. Necessitating the absolute completion of all common elements would substantially limit the ability for purchasers to obtain FHA financing until the project is well established. Commenter believes that the current requirement that common elements be “substantially complete” is sufficient and should be maintained.

*HUD Response:* This final rule continues to allow for approval of completed legal phases but does not permit approval of phases that are proposed construction or under construction. HUD recognizes this may impact a small segment of the market and possibly delay the time period from completion to sale, but has weighed this impact against the reduced burden for compliance of a project overall contained in this rule as well as the balance required to ensure appropriate risk controls to protect the Mutual Mortgage Insurance Fund. HUD continues to assess the impact of this requirement as well as any impacts related to new construction projects in

relation to environmental requirements, 24 CFR part 50.

#### *Site Condominiums*

*Comment:* Site Condominiums should not be placed into the proposed approval process. HUD should maintain the definition and approval process currently in place.

*HUD Response:* This final rule maintains and expands the definition of “Site Condominium.” This final rule is more inclusive of additional configurations of Site Condominiums that exist in the market. Site Condominiums must meet the definition in § 203.43b(a)(7) and the basic requirements of § 203.43b(d)(1)–(5). Insurance and maintenance costs must be the responsibility of the owner as provided in § 203.43b(j).

*Comment:* HUD’s current definition of a Site Condominium should include the provisions relating to insurance, maintenance, and common assessments.

*Comment:* Insurance and maintenance costs must be the sole responsibility of the owner with respect to Site Condominiums, and any common assessments collected must be restricted to use solely for amenities outside of the footprint of the individual site. Site Condominiums generally do not have master insurance policies associated with the condominium itself; therefore, this would be consistent with industry and market practice.

*HUD Response:* HUD believes that the revised definition of Site Condominium in 24 CFR 203.43b(a) combined with the separate regulatory requirements for unit owners in 203.43b(j) provides the correct balance in addressing Site Condominiums based upon the market’s reaction of treatment of such properties as a potential substitute for other detached dwellings.

*Comment:* Certain provisions of the definition should be clarified: (1) The word “site” is interpreted variously. The comment recommends the inclusion of the word “land.” (2) Many condo plans limit ownership interests in land and air space by creating three-dimensional envelopes or modules. These envelopes or modules may be created in relation to sea level. The unit owner’s interest remains within the envelope or module, and is, thus, limited. The areas outside of the envelope or module is considered common area. HUD’s current definition suggests unlimited ownership of air space and land and does not consider the typical legal construction of such areas.

*Comment:* Various HOC reviewers and mortgagees interpret HUD’s Site Condominium language to mean

“ownership of air space and land that generally limits some other use.” Obviously, this interpretation differs from the literal language. We recommend that HUD clarify by adding words such as “unlimited” or “at least X above sea level” or some other language that makes clear what HUD intends when envelopes or modules limit ownership.

*Comment:* HUD’s failure to provide comprehensive guidance on Site Condominiums results in an uneven playing field among mortgagees.

*Comment:* Under prior 2009 HUD guidance, a detached condo unit was simply defined as a completely freestanding structure. In 2011, HUD then defined a Site Condominium and required certain characteristics (e.g., insurance, maintenance) including the unit must include the ground (to the center of the earth) and the air space (to infinity), without restrictions. HUD further recognized the insurance issue with the ground restriction and issued an Insurance Waiver. Some states such as California allow the unit site ownership to extend below the ground surface and/or the air space above the structure to be limited, such as 50 ft. below and/or 50 ft. above the structure. The areas beyond these limits are common area and/or association property. The requirement that there can be no restriction or limit on the ground beneath and the air space above a structure serves no purpose and this would not jeopardize the FHA insuring program.

HUD partially recognized this matter in its issuance of the Insurance Waiver, which allowed the unit owner to be responsible for insurance if there was a limit on the ground beneath the structure or if it is common area. However, the Insurance Waiver does not take into equal consideration the air space above the structure. This may have been an oversight in drafting the Insurance Waiver. If the current definition of a Site Condominium will remain intact, we would propose that the Insurance Waiver be revised and codified to the extent of allowing the air space above a unit to likewise be deemed as common area.

*Comment:* HUD’s requirements are too strict; HUD should mirror Fannie Mae’s guidelines. Fannie Mae does not require that detached condos must

include the air space above and the ground beneath the structure. Likewise, the Department of Veteran’s Affairs (VA) does not place such restrictions or otherwise define Site Condos for eligibility. Both attached and detached condos require VA approval. The waiver was issued to expand project eligibility for those projects where the legal governing documents required that obtaining and maintaining the insurance was the responsibility of the unit owner.

*HUD Response:* This final rule revises the Site Condominium definition under § 203.43b(a)(7) to remove the consideration of the type of air or land ownership for detached units as well as to address land ownership requirements for townhouse style projects. HUD believes this change will substantially reduce or eliminate the need for such Insurance Waivers and provides the correct balance in addressing Site Condominiums based upon the market’s reaction of treatment of such properties as a potential substitute for other non-condominium ownership style dwellings.

#### Air Space Common Area and Site

*Comment:* Section 1.8.1 of the Guide, because of the inclusion of air space, which may not be a common area, in the definition of Site Condominium, conflicts with California law with the result that in California, Site Condominiums are not exempt from full project review, unlike Site Condominiums generally. This will increase costs and time to obtain approval and could cause developers to stop offering FHA financing. Under California law and that of some other states, there is an “air space common area” requirement for detached Site Condominiums that include a residence, yard, and other improvements that are wholly owned, maintained, and insured by the buyer. The vertical and horizontal boundaries will have no bearing on a detached condominium’s value, nor do they have an impact on the use of the condominium by its owner. Lower vertical boundaries are typically placed well below the earth’s surface, and upper vertical boundaries are placed at elevations above the unit that could be of no possible use or benefit to the unit owner. The three-dimensional separate interest is not created to limit use of any area; it is

simply created to comply with California law. A condominium unit that fails to identify its vertical limits, as HUD appears to require for a Site Condominium, may be a violation of the California Subdivision Map Act.

HUD has previously allowed detached condominiums with this air space common area to qualify as exempt from full condominium project approval under the Guide. HUD’s change of interpretation of section 1.8.1 of the Guide is troubling, as California detached condominiums look and function like a traditional single-family detached residential project where the homeowner wholly owns, maintains, and insures his or her residence as well as all other improvements within the footprint of the detached condominium unit. Neither Fannie Mae nor VA have such an air space requirement. The air space common area, and boundaries placed below the earth’s surface, require no maintenance and do not impair the project’s ability to function like a single-family detached project. It is not clear how including air space and indefinite lower boundaries as a common area would create a risk for the insurance fund. The fact that master insurance policies associated with the Site Condominiums generally do not exist supports removal of the “site and air space” component.

Commenters suggested removing “site and air space” from the definition of “Site Condominium” in § 203.43b(a)(7), and other revisions. HUD will be better served because fewer single-family detached projects will have to be submitted for full project approval. Homeowners will be better served by allowing the individual homeowners to obtain insurance on their single-family homes instead of an association policy required under full HUD-FHA approvals. The mention of “air space” is not typical in the industry and any risk should already be addressed by FHA’s requirement that all state and local ordinances be followed.

One commenter suggests adding to the end of the proposed definitions of “Condominium Unit” and “Site Condominium” the following: “(as defined under any applicable local laws or statutes governing the creation of common area or limited common area)”. Another comment suggests revising the definition as indicated:

“Site Condominium means a single family detached dwelling (which does not have a shared garage or any other attached building, including such improvements as archways or breezeways), which is encumbered by a declaration of condominium covenants or condominium form of ownership, and which consists of the entire structure as well as the site and air space and no part of the dwelling or structure, or any other improvement considered to be a part of the condominium unit is not considered to be a common area or limited common area (as defined under any applicable local law or statutes governing the creation of common area or limited common area).”

Another comment suggests:

Site Condominium means a single family detached dwelling (which does not have a shared garage or any other attached building, including such improvements as archways, or breezeways), which is encumbered by a declaration of condominium covenants or condominium form of ownership, and which consists of the entire structure and no part of the dwelling or structure, or any other improvement considered to be a part of the condominium unit is considered to be a common area or limited common area (as defined under any applicable local laws or statutes governing the creation of common area or limited common area). Such Site Condominium may have upper and lower vertical boundaries to the extent required to comply with applicable State law provided that all structural improvements of the Site Condominium are contained within such upper and lower vertical boundaries.

*HUD Response:* HUD agrees with the commenters and has revised the Site Condominium Definition under § 203.43b(a)(7) to include its easily determined physical attributes and land ownership attributes without the consideration of air space. These revisions allow more configurations of Site Condominiums to be eligible. In addition, § 203.43b(j) of this final rule (§ 203.43b(i) of the proposed rule) has been revised to require only that insurance and maintenance costs of the individual units must be the sole responsibility of the unit owner for Site Condominiums, without stipulating any additional requirements for use of assessments. Hence the rule avoids potential conflicts with local law and is clearer for the public. Accordingly, future guidance will reflect this new policy.

#### Site Condominiums—Appraisal Reporting

*Comment:* HUD should direct lenders to accept the 1004/70 URAR Appraisal Form for Condominiums. While the Legal Description indicates these properties as being Condominiums, most are marketed as, perceived as, utilized as, Single Family Homes, with front, side and back yards, no shared walls, and often no shared maintenance

other than “common areas,” *i.e.*, parks, trails, bike paths, etc. The Properties are being Listed/Marketed as Single-Family Homes and more often indicated as having defined Lot Sizes. This recent phenomenon is a result of developers looking for ways around county platting requirements that slow the development/building process. This hybrid property has all the attributes of a Planned Unit Development or single-family home, yet as it is legally a condominium and lenders are requiring the appraisal report be developed on Form 1073/465. Form 1073/465 encompasses the attributes of developments where the owners have shared ownership responsibilities that include site maintenance, exterior structural maintenance, and shared structural liabilities, none of which apply to the single-family Condominium or Site Condominium. Until the lending community, and more specifically Fannie Mae/Freddie Mac, address this new Property Type, the only current form that can accurately address the attributes of the Site Condominium is the 1004/70 URAR. Furthermore, the use of the Condominium Form 1073/465 could be misleading to the reader expecting a property that adheres to the more traditional condominium regime.

One commenter stated that he uses the following language in appraisal reports: “An Extraordinary Assumption is made that the use of the 1073/465 Form will not be misleading. In developing this report and the Opinion of Value, this Appraiser has utilized a Hypothetical Condition that the Subject is Single Family Residential to best represent the Markets Perception of the Subject”. As these properties become more prevalent, there is a need for a clear directive to the Lending/Appraisal community. Until the GSEs can address the issue of this hybrid property type by developing a new form that encompasses the unique character of these properties, HUD should direct lenders to accept the 1004/70 URAR as

the standard appraisal form for these entities.

*HUD Response:* The practices associated with appraisal of Site Condominiums are outside the scope of this rule; however, HUD will take this comment under consideration for future policy guidance.

#### Free Assumability and Private Transfer Fees

*Comment:* 24 CFR 203.41 currently prohibits mortgage insurance if a mortgaged property is subject to an affordability covenant that survives foreclosure or certain foreclosure alternatives. The nation is experiencing a growing housing affordability crisis, particularly in housing markets where condominium projects may play a productive role in meeting this need. The affordability crisis is leading many jurisdictions to require an affordability component in new condominium projects and multi-family rental housing developments, reserving units for sale or rent at affordable prices. FHA should work with local governments and developers to approve all units in such condominium projects. Fannie Mae and Freddie Mac are currently supporting access to affordable homeownership by accepting delivery of loans subject to an affordability covenant that survives foreclosure. FHA should join this effort and amend § 203.41 to permit FHA insurance for mortgages secured by a condominium unit subject to a covenant designating the unit as an affordable housing unit where the covenant survives foreclosure.

*HUD Response:* Such a consideration would encompass a review of such a requirement across all programs affected by 24 CFR 203.41 and not limited to only Condominium Projects, and therefore is beyond the scope of this rulemaking. However, current guidance addressing permissible restrictions on conveyance for condominiums remains in effect.

*Comment:* Section 301 of the Housing Opportunity Through Modernization Act of 2016 (HOTMA) mandates that with respect to mortgage insurance for



condominiums, HUD shall utilize the guidelines developed by the Federal Housing Finance Agency (FHFA) regarding private transfer fees. Two comments strongly support this provision which brings consistency and clarity regarding private fees across the industry. Therefore, HUD should confirm whether this provision is self-effectuating. If HUD believes that it needs to take action to effectuate this provision, HUD should do so swiftly, in order to avoid unnecessary confusion in the industry. Furthermore, HUD should consider applying these FHFA private transfer fee standards across all of HUD's programs, including, but not limited to, single-family mortgage insurance (for all FHA programs). This will provide one standard for the treatment of private transfer fees throughout the industry, reducing unnecessary complexity and confusion to the consumer's benefit. Lacking direction from HUD, the industry is subject to inconsistent application of guidelines between lenders which can negatively impact consumers due to unnecessarily limiting products and/or lender availability in certain communities.

*Comment:* The immediate adoption of FHFA's rule will provide consistent guidelines for the industry and will for expansion of eligible projects, so long as the private transfer fees are to the benefit of the borrower (*i.e.*, maintenance fees). The Mortgage Bankers Association believes that this change will create clearer and consistent guidelines across agencies, making it easier for lenders and FHA to serve the FHA borrower.

*Comment:* Private transfer fees that simply provide income to the developer or another entity are problematic. However, there are many private transfer fees that support the condominium facilities or provide tangible benefits to the homeowner. Acceptable of these "good" transfer fees, but rejection of the "bad" transfer fees is the standard employed by the FHFA. HOTMA requires HUD to adopt the "existing standards of the FHFA relating to encumbrances under private transfer fee covenants." The commenter agrees with HUD that this provision is immediately effective.

*Comment:* This rule should address transfer fees as it is a requirement by HOTMA. HUD should either revise 24 CFR 203.41 in this rulemaking, even if another 30-day comment period is immediately effective.

*HUD Response:* Section 301 of HOTMA on private transfer fees is self-implementing. HUD may consider

issuing a regulation on this subject in the future.

#### *Leasing of Units*

*Comment:* Limiting short-term leases may promote the residential use and character of a condominium project and the commenter recommends that HUD revise regulations at 24 CFR 203.41 to incorporate permissible leasing restrictions currently provided in section 1.8.9 of the Condominium Project Approval and Processing Guide.

*Comment:* HUD should reconsider its blanket objection to Association review of leases. Without prior notice or approval, a condominium board has no ability to enforce leasing restrictions to ensure the project continues to meet FHA owner occupancy requirements. Condominium boards have an ongoing interest in maintaining FHA approval criteria and FHA's general view that any condominium where the board has either direct or indirect approval authority of a lease is contrary to this interest. In taking this position, FHA is elevating one-unit owner's interest above the interests of all other owners. Allowing a well-defined and limited authority to act in a manner that preserves FHA approval benefits owners and consumers. HUD should revise regulations at 24 CFR 203.41 to provide a limited prior approval of leasing by a condominium association board to the extent exercise of such authority will retain the condominium's project compliance with FHA owner occupancy requirements.

*HUD Response:* HUD appreciates the recommendation and will take it under consideration for future policy guidance. Such a consideration should encompass a review of such a requirement across all programs affected by 24 CFR 203.41 and not limited to only Condominium Projects, and therefore is beyond the scope of this rulemaking.

#### *Right of First Refusal*

*Comment:* One of the main reasons for condo non-approval in Florida has been the insertion of language stating that the condo board has the right to reject potential tenants and purchasers. Since 2013, there has been a zero-tolerance policy for any right of first refusal (the commenter states that this is based on the Fair Housing Act). This has resulted in condos with good financials being denied approval. It is difficult to change a condo's governing documents. Fannie and Freddie do not have this issue. The condominium board could sign a certification that it does not utilize the objectionable provisions. In the instance of a spot approval, assuming that the

condo met usual financial and insurance guidelines a potential solution would be to waive any concern regarding the first refusal issue. This would help increase the supply of affordable housing.

*Comment:* Since 2013, the Atlanta HOC has taken the position that the condominium associations have to change their governing documents to remove the right of first refusal. Changing the bylaws for a condominium association of any size can only be accomplished once a year at the time association board elections are held. Doing so entails significant expense, including substantial legal fees and costs that are eventually borne by the individual unit owners through increased assessments to maintain the association budget. Also, while the legal structure of some condominium associations may vary, most require the affirmative vote of 100 percent of all owners to agree to modify the bylaws, which is impractical in a community of any size. Many Florida condominium association boards are willing to execute a formal and binding certification on an annual basis that the association does not and will not utilize any of the right of first refusal provisions in its charter. In this way, such associations would not be required to amend their charters if a resident desires FHA financing. Therefore, the final rule should clarify that boards of Florida condominium associations whose charters contain rights of first refusal may execute a formal and binding certification on an annual basis that the association does not and will not utilize any of the right of first refusal provisions, so that units can be approved for FHA-insured financing.

*Comment:* Approximately 75 percent of the condominiums in Florida have a right of first refusal, which is major obstacle to HECMs. There is less than a one percent chance of getting these lease restrictions changed. HUD should drop this leasing language as part of its SUA process.

*HUD Response:* HUD does not address rights of first refusal in this rulemaking; however, the existing guidance permitting the right of first refusal for condominium project approval will be continued in effect. HUD will address rights of first refusal generally in a future rulemaking, as this topic is outside the scope of this rulemaking.

#### *Approval by the State*

*Comment:* If a project meets the requirements of the relevant State oversight agency, that should be sufficient for approval. There could be a document covering single-unit loans

to determine the current operating status of the project.

*Comment:* HUD should insure loans in condominium projects approved by the Department of Business and Professional Regulation (DBPR) in each State of the U.S. In Florida, this could be accomplished by HUD officials working with officials at the Division of Condominiums, Time Shares and Mobile Homes which is a Division within the DBPR. After HUD/FHA is assured that the State requirements for condominium approval are sufficient, an identification number issued by the State could be used for loan processing. Compliance with Fair Housing laws will be the responsibility of all parties to the real estate transaction such as the Realtor, Lender, Condominium Association Board, etc.

*HUD Response:* HUD disagrees with the recommendation of insuring loans in condominium projects that are approved by the state agency responsible for regulating condominiums in every state. By HUD adopting national standards for condominium project approvals, industry members would benefit from clear, consistent, and enforceable standards that would reduce confusion and increase efficiency in the market. In addition, the condominium standards and processes that will be established through this rule are similar to the conventional market's processes, and HUD believes that such consistency will have the least impact on the industry.

#### *Lender Liability Post-Approval*

*Comment:* If a lender that obtains DELRAP approval under the new guidelines approves a condo are they later liable for loans approved by another lender? This example would assume that Lender A properly approves a condo project and that all documentation is in order. Lender B later underwrites an FHA loan in this project and their underwriting is faulty—the loan goes into default and causes a claim to the MMI fund. In this example, is lender A still liable? Clarity around this issue would be welcome as making lenders liable for underwriting errors beyond their control would cause many of them to rethink DELRAP approval.

*HUD Response:* Based on the commenter's example, Lender A would not be liable for Lender B's faulty underwriting of an FHA loan. A lender with DELRAP approval that approves a condominium in accordance with the new guidelines does not have loan-level liability for another lender's underwriting errors. Of course, each

case is different and would have to be assessed on its own merits.

#### *Condominium Associations Unwilling To Cooperate With Project Approval*

*Comment:* A commenter, a reverse mortgage loan originator, provides an example of a client living in an upscale condominium in town. The owner has a tax lien certificate against her mortgage free condominium unit for 2015 property taxes that are past due, and it is unlikely that she will be able pay the 2016 property taxes as well. The commenter and owner have both tried for months to get the condo association to help, but the process has stopped. The commenter states that it will be a shame that this senior will eventually have to vacate her residence and lose the lifestyle she is accustomed to because of those in power are not willing to help. There has to be a better way.

*Comment:* Many formerly FHA approved condominium projects have expired and associations do not or cannot get the projects re-approved. This limits the supply of housing to first-time buyers who require FHA loans to purchase a new condominium effectively locking them out of many homes and limiting their housing options. HUD is to be applauded for taking concrete steps to solve this problem. Further, we urge HUD to adopt Fannie Mae and Freddie Mac approval processes. This will create a more uniform and fair condominium approval process across the home mortgage spectrum. It will allow low- and moderate-income home buyers access to more financing options that currently exist.

*HUD Response:* HUD appreciates the comment. The final rule includes the ability to obtain Single-Unit approval in an unapproved condominium project as an opportunity to provide access to FHA's programs in this or similar situations.

#### *Insurance Requirements*

*Comment:* One commenter stated that there is no reason to continue the requirement for a fidelity bond of 3 months' aggregate assessments plus reserve funds, unless state law mandates required coverage. In today's practice, most condominium association dues are directly deposited electronically into an FDIC-insured bank account, and such accounts are insured up to \$250,000. Given this expedited and more secured cash flow based on more prevalent and modern electronic payment practices, in our view, there is no reason to continue the requirement.

*HUD Response:* Although fidelity insurance is not specifically addressed in this final rule, it would be covered under the general insurance requirements under § 203.43b(d)(6)(iii). HUD appreciates the comment but disagrees with commenter's overarching recommendation to eliminate the requirement for fidelity insurance (which insures against losses for fraud or dishonesty) based upon the prevalent use of direct deposit into an FDIC insured accounts, which are insured against loss due to bank failure. Accordingly, HUD has implemented the aforementioned section of the final rule as proposed.

*Comment:* We note that the Insurance Waiver is not included as part of the Proposed Rules. Will the Insurance Waiver currently in effect, and due to expire on January 5, 2017, be codified as part of the Proposed Rules and/or appear permanently as part of the Single-Family Housing Policy Handbook 4000.1?

*HUD Response:* This final rule does not provide for specific standards, but for a framework to establish HUD's specific requirements through policy. HUD will consider this comment when drafting further policy guidance.

#### *Exceptions Under Proposed § 203.43b(f) Generally*

*Comment:* HUD should clarify the process by which exceptions are requested and approved and provide additional guidance on the limits of the Secretary's exception authority, if not in the rule itself then in guidance. This will prevent situations where condominium associations surmise the project will not meet all approval standards and, therefore, decline to seek project approval, and limit instances where associations incur additional expenses to get into full compliance when they would have been eligible for an exception. Clear guidance will also ease processing burdens by limiting exception requests where HUD will not approve. Clear guidance will indicate that FHA is a reliable partner. Therefore, HUD should provide a standardized exception request process that clearly identifies the approval criteria for which an exception will be contemplated, and publish clear guidance concerning the exception process and provide examples and reasonable conditions that may result in approval of an exception request.

*HUD Response:* HUD appreciates the recommendations and will clarify exception process requirements in the policy handbook that will be issued as a result of this final rule. However, HUD believes the rule addresses the factors

that must be considered in determining whether to grant an exception while contemplating that such exceptions will be considered on a case by case basis which precludes the use of any one standard.

*Implementation Timeframe*

*Comment:* A 12-month implementation period will be needed given multiple significant industry compliance changes.

*HUD Response:* This final rule provides for a 60-day implementation timeframe that allows stakeholders to view additional guidance provided in

HUD handbooks prior to implementation.

**V. Findings and Certifications**

*Information Collection Requirements*

The information collection requirements contained in this rule have been submitted to the Office of Management and Budget (OMB) under the Paperwork Reduction Act of 1995 (44 U.S.C. 3501–3520). In accordance with the Paperwork Reduction Act, 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 currently valid OMB control number.

The information collection requirements of this rule revise a currently approved information collection (OMB Control No. 2502–0610). This information collection reorganizes and consolidates, in a less burdensome and more user-friendly format, the information currently required in form 96027, Condominium Project Approval Document/Checklist; form 96028, Condominium Project Annexation Checklist; 96017, Program Certification; form 96018, Loan Level certification; and form 96019, Pre-Sale certification.

The burden of the information collections is estimated as follows:

Current information collection (OMB approval No. 2502–0610)	New information collection	Burden hours (current)	Burden hours (new)	Net change
Package preparation .....	.....	2.00	1.00	– 1.00
Package review .....	.....	1.00	1.00	0.00
935.2c AFFH Plan .....	.....	6.00	3.00	– 3.00
92541 Builder’s Certification .....	.....	0.10	0.10	0.00
92544 Warranty of Completion of Construction. ....	.....	0.03	0.03	0.00
96029 Condominium Rider .....	.....	0.10	0.10	0.00
96017 Program Certification/Project Certification. ....	.....	0.10	0.00	– 0.10
Loan level certification .....	.....	0.30	0.00	– 0.30
Pre-sale certification .....	.....	1.00	0.00	– 1.00
96027 Condominium Project Approval Cover Document/Checklist. ....	.....	1.00	0.00	– 1.00
96028 Condominium Project Annexation Checklist. ....	.....	0.30	0.00	– 0.30
	Model FHA Condominium Loan Level/Single-1 Unit Approval Questionnaire. ....		.75	.75
	Model HRAP–DELRAP FHA Condominium Project Approval Questionnaire. ....		1	1
Total .....	.....	11.93	6.98	– 4.95
Total hours per annum .....	.....	90,660	22,000	– 68,660

In accordance with 5 CFR 1320.8(d)(1), HUD is soliciting comments from members of the public and affected agencies concerning this collection of information to: (1) Evaluate whether the proposed collection of information is necessary for the proper performance of the functions of the agency, including whether the information will have practical utility; (2) Evaluate the accuracy of the agency’s estimate of the burden of the proposed collection of information; (3) Enhance the quality, utility, and clarity of the information to be collected; and (4) Minimize the burden of the collection of information on those who are to respond, including through the use of appropriate automated collection techniques or other forms of information technology, e.g., permitting electronic submission of responses. Interested persons are invited to submit comments regarding the information collection

requirements in this rule. Comments must refer to the proposal by name and docket number (FR–5563) and must be sent to:

HUD Desk Officer, Office of Management and Budget, New Executive Office Building, Washington, DC 20503, Fax: (202) 395–6947; and  
 Reports Liaison Officer, Office of Public and Indian Housing, Department of Housing and Urban Development, Room, 451 7th Street SW, Washington, DC 20410.

Interested persons may submit comments regarding the information collection requirements electronically through the Federal eRulemaking Portal at <http://www.regulations.gov>. HUD strongly encourages commenters to submit comments electronically. Electronic submission of comments allows the commenter maximum time to prepare and submit a comment, ensures

timely receipt by HUD, and enables HUD to make them immediately available to the public. Comments submitted electronically through the <http://www.regulations.gov> website can be viewed by other commenters and interested members of the public. Commenters should follow the instructions provided on that site to submit comments electronically.

*Executive Order 13771*

Executive Order (E.O.) 13771, entitled “Reducing Regulation and Controlling Regulatory Costs,” was issued on January 30, 2017. This final rule is considered an E.O. 13771 deregulatory action. Details on the estimated cost savings and deregulatory effect of this proposed rule can be found below in the Summary of Regulatory Impact, Benefits, and Costs, and in the separate Regulatory Impact Analysis.

## Summary of Regulatory Impact, Benefits, and Costs

This rulemaking addresses a market failure that occurs when lenders ration credit instead of charging the appropriate risk premium; that is, when lenders consider denying a loan to be a superior business decision than raising prices. In the mortgage insurance market, such a market failure occurs when borrowers are willing to buy insurance at an actuarially fair price, but suppliers cannot sell at the cost of providing the insurance. One reason this occurs is lack of information. Adverse selection occurs because borrowers who are attracted to higher LTV loans are less able to withstand financial shocks. However, even with information about the household's resources, it is difficult for private insurers and lenders to predict the probability of default, which depends on trends in financial and real estate markets. This can cause a contraction of supply such that the equilibrium market response is an undersupply of credit and limitation of housing choices. In such periods, low-income households wishing to buy affordable homes, such as condominiums, would be the first to be excluded from the market.

FHA's role with respect to market failure due to an undersupply of credit is a countercyclical one. FHA serves to reduce market imperfections due to information asymmetry. When risk increases in the presence of information asymmetries, lenders ration credit (withdraw from the market) as opposed to adjusting interest rates. FHA provides a buffer in such circumstances; FHA's market share varies inversely with the ease of credit. Greater access to credit can be considered a benefit.

Mortgage insurance is required for high LTV loans. FHA provides mortgage insurance at average cost to qualified borrowers. FHA does not crowd out or replace the private sector, but instead fulfills unmet demand for mortgage insurance when private insurers withdraw from the market. Similarly, FHA's market share declines when there is less uncertainty in the real estate and mortgage markets.

Condominiums provide an affordable homeownership option for borrowers who may qualify for FHA mortgage insurance in high-cost or dense areas. Evidence suggests that there is an imbalance in FHA's treatment of condominiums in relation to single-family housing. Creating a level playing field is important in facilitating consumer choice, especially in the housing market where spending on housing represents a large proportion of

a household's budget. Any distortionary regulatory costs that do not serve a greater public purpose reduce social welfare.

The proportion of FHA-approved condominiums relative to the estimated size of the condominium market in the United States provides an indicator of the need for FHA guidance that simplifies the FHA condominium project approval process. In 2001, 8.4 percent of FHA loans were for condos, but the share has dropped since then, reaching its low of 2.1 percent of all FHA loans in the most recent complete year of 2018.

The rule addresses this market failure by deregulating some of the more burdensome aspects of the approval process to allow more condominium units to be purchased with FHA-insured mortgages. The rule will reduce the compliance costs of condominium lending. Analysis shows, however, that this will be a limited effect which will not result in an outsized market share for FHA. It is extremely unlikely that the maximum volume would exceed the historic peak of 73,000 loans in 2010, so that could be regarded as the potential upper limit. HUD would not expect the equilibrium share of condo loans to be greater than the market average given by FNMA's condo share of 10 percent, which would require an increase of 71,000 condo purchase loans. More likely, the rule is expected to have a moderate effect on volume with a maximum impact ranging from 20,000 to 60,000 loans.

The deregulatory changes to the program, while burden reducing, are not so great as to significantly change the nation's housing choices. The measurable expansionary impacts of the rule are small relative to the market, where annual combined cooperative and condominium sales are about 600,000 units and are counterbalanced to a degree by risk-management strategies (such as the requirement for review by HUD or qualified, experienced DELRAP lenders). Also, some FHA condominium borrowers will substitute from FHA single-family homes.

This rule will result in savings from increasing the periodicity of approval from 2 to 3 years equal to \$1.5 million annually. Reducing environmental reviews could save as much as \$2.1 million annually. Quantified cost reductions are therefore about \$3.6 million annually. The costs of requiring project approvals are an estimated paperwork burden cost of \$2.7 million annually. The overall quantified cost savings of this rule are therefore about \$900,000 annually. There is also a non-

monetized benefit of increased policy flexibility. By adjusting to market conditions, FHA will be able to strike the correct balance between providing affordable housing and risk management.

## Regulatory Planning and Review

OMB reviewed this rule under Executive Order 12866 (entitled "Regulatory Planning and Review"). This rule was determined to be a "significant regulatory action," as defined in 3(f) of the order (although not an economically significant regulatory action, as provided under section 3(f)(1) of the order). The docket file is available for public inspection between the hours of 8 a.m. and 5 p.m. weekdays in the Regulations Division, Office of General Counsel, Department of Housing and Urban Development, 451 7th Street SW, Room 10276, Washington, DC 20410-0500. Due to security measures at the HUD Headquarters building, an advance appointment to review the public comments must be scheduled by calling the Regulations Division at (202) 708-3055 (this is not a toll-free number). Individuals with speech or hearing impairments may access this number via TTY by calling the Federal Relay Service at (800) 877-8339. The Regulatory Impact Analysis (RIA) prepared for this rule is also available for public inspection in the Regulations Division and may be viewed online at [www.regulations.gov](http://www.regulations.gov), under the docket number above.

## Unfunded Mandates Reform Act

Title II of the Unfunded Mandates Reform Act of 1995 (2 U.S.C. 1531-1538) (UMRA) establishes requirements for Federal agencies to assess the effects of their regulatory actions on state, local, and tribal governments and the private sector. This rule does not impose any Federal mandate on any state, local, or tribal government or the private sector within the meaning of UMRA.

## Environmental Review

A Finding of No Significant Impact with respect to the environment has been made in accordance with HUD regulations at 24 CFR part 50, which implement section 102(2)(C) of the National Environmental Policy Act of 1969 (42 U.S.C. 4332(2)(C)). The Finding of No Significant Impact is available online at [www.regulations.gov](http://www.regulations.gov). The Finding of No Significant Impact is also available at for public inspection during regular business hours in the Regulations Division, Office of General Counsel, Department of Housing and Urban Development, 451 Seventh Street

SW, Room 10276, Washington, DC 20410–0500. Due to security measures at the HUD Headquarters building, please schedule an appointment to review the Finding by calling the Regulations Division at (202) 402–3055 (this is not a toll-free number). Individuals with speech or hearing impairments may access this number via TTY by calling the Federal Relay Service at (800) 877–8339.

#### *Regulatory Flexibility Act*

The Regulatory Flexibility Act (RFA) (5 U.S.C. 601 *et seq.*), generally requires an agency to conduct a regulatory flexibility analysis of any rule subject to notice and comment rulemaking requirements, unless the agency certifies that the rule will not have a significant economic impact on a substantial number of small entities.

This rule establishes regulations for single-family mortgage insurance of condominium units pursuant to 12 U.S.C. 1707 and 1709. However, HUD has been providing mortgage insurance for this purpose pursuant to statute and the Condominium Approval and Processing Guide published in 2011.

The rule codifies requirements for DELRAP lenders, many of which are small entities. However, it is worth noting that many of these lenders are likely affiliated with much larger financial institutions, based on the names associated with the IDs. Of the few thousand unique originating mortgagee IDs in each year from 2001 to 2018, the median number of mortgages is always under 100. Additionally, for originating mortgages from 2012 through 2018, the median number of condo mortgages is exactly 1 in each year. While this data may seem to make a strong case for the prevalence of small entities, these entities likely have resources at their disposal that are not available to a typical small entity in other industries.

To be qualified for Direct Endorsement authority, a mortgagee must satisfy the following characteristics: Possess at least one year of experience in condo loans; have made at least 10 FHA approved condo loans; possess a quality control plan; and participating staff must possess or be supervised by those with prior experience. All of these requirements would be easier to meet by larger firms with greater capacity. Nonetheless, small firms that have at least occasional experience should be able to satisfy the requirements without undue burden. The ability to have staff supervised by those with experience in lieu of requiring all participating staff to have experience will substantially lessen the

impact to small firms. Additionally, approval as a DELRAP lender is not required in order to perform any of the functions of a DE Lender including the ability to originate mortgages under Single Unit Approval or on units in projects approved under HRAP or DELRAP authority of another lender.

Other elements of the rule lift regulatory burdens. First, allowing Single-Unit Approval enables small lenders business opportunities without the cost of seeking approval for an entire condominium project. HUD estimates that project approval will take approximately 3 hours at \$64/hour, for a total cost of about \$192 per project. Single-unit approval is estimated to take approximately 1.5 hours, also at \$64 per hour, for a total of about \$96 per unit.

Second, by providing that only completed projects may be approved, this rule eliminates the need for HUD to require an environmental review as a condition of approval. If the rule had allowed approvals of uncompleted new construction projects, in the case of DELRAP processing, lenders, including small lenders, would have been responsible for ensuring that environmental reviews were completed according to applicable State and local requirements. Thus, the rule eliminates a potential cost with respect to those condominium projects approved through DELRAP. Based on the costs to the government of an environmental review, HUD estimates the potential costs that would be saved per project reviewed as follows. The fixed cost for an environmental review, including travel per review, is approximately \$500. The average number of staff hours per review is 16 hours, and the labor cost per review is \$64 per hour, for a total labor cost of \$1,024 per review. The total labor and fixed costs that would be saved are \$1,524 per review.

Also, participation in condominium insurance, like HUD's other mortgage insurance programs, is purely voluntary.

Therefore, the undersigned certifies that this rule does not have a significant economic impact on a substantial number of small entities.

#### *Executive Order 13132, Federalism*

Executive Order 13132 (entitled "Federalism") prohibits, to the extent practicable and permitted by law, an agency from promulgating a regulation that has federalism implications and either imposes substantial direct compliance costs on state and local governments and is not required by statute or preempts state law, unless the relevant requirements of section 6 of the Executive Order are met. This rule does not have federalism implications and

does not impose substantial direct compliance costs on state and local governments or preempt state law within the meaning of the Executive Order.

#### *Catalog of Federal Domestic Assistance Number*

The Catalog of Federal Domestic Assistance number for 24 CFR parts 203 and 234 is 14.117.

#### **List of Subjects**

##### *24 CFR Part 203*

Hawaiian Natives, Home improvement, Indians-lands, Loan programs-housing and community development, Mortgage insurance, Reporting and recordkeeping requirements, Solar energy.

##### *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.

For the reasons stated in the foregoing preamble, HUD amends 24 CFR parts 203, 206, and 234 as follows:

#### **PART 203—SINGLE FAMILY MORTGAGE INSURANCE**

- 1. The authority citation for part 203 is revised to read as follows:

**Authority:** 12 U.S.C. 1707, 1709, 1710, 1715b, 1715z–16, 1715u, and 1715z–21; 15 U.S.C. 1639c; 42 U.S.C. 3535(d).

#### **Subpart A—Eligibility Requirements and Underwriting Procedures**

- 2. Add § 203.8 before the undesignated center heading "Miscellaneous Regulations" to read as follows:

#### **§ 203.8 Approval of mortgagees for Direct Endorsement Lender Review and Approval Process (DELRAP).**

(a) *General.* Each mortgagee that chooses to participate in the review and approval of Condominium Projects, as set forth in § 203.43b, must be granted authority to participate in the Direct Endorsement Lender Review and Approval Process (DELRAP).

(b) *DELRAP Authority—(1) Eligibility.* To be granted DELRAP authority, as described in § 203.43b, a mortgagee must be unconditionally approved for the Direct Endorsement program as provided in § 203.3 and meet the following requirements:

(i) Have staff with at least one year of experience in underwriting mortgages on condominiums and/or Condominium Project approval;

(ii) Have originated no fewer than 10 condominium loans in projects approved by the Commissioner;

(iii) Have an acceptable quality control plan that includes specific provisions related to DELRAP; and

(iv) Ensure that staff members that participate in the approval of a Condominium Project using DELRAP authority meet the above requirements in paragraph (b)(1)(i) of this section or are supervised by staff that meet such requirements.

(2) *Conditional DELRAP Authority.* Mortgagees will be granted conditional DELRAP authority upon provision of notice to the Commissioner of the intent to use DELRAP. Mortgagees with conditional DELRAP authority must submit all recommended Condominium Project approvals, denials, and recertifications to FHA for review. If FHA agrees with the mortgagee's recommendation, it will advise the mortgagee that it may proceed with the recommended decision on the Condominium Project.

(3) *Unconditional DELRAP Authority.* Mortgagees will be granted unconditional DELRAP authority after completing at least five (5) DELRAP reviews, or such lower number of DELRAP reviews as HUD may specify, to the satisfaction of HUD, and may then exercise DELRAP authority to approve projects in accordance with requirements of HUD.

(c) *Reviews.* HUD will monitor a mortgagee's performance in DELRAP on an ongoing basis.

(1) If the review shows that there are no material deficiencies, subsequent project approvals, denials, or recertifications may be selected for post-action review based on a percentage as determined by the Commissioner.

(2) If the review shows that there are material deficiencies in the mortgagee's DELRAP performance, the mortgagee may be returned to conditional DELRAP status.

(3) If additional reviews continue to show material deficiencies in the mortgagee's DELRAP performance, the mortgagee's authority to participate in DELRAP may be terminated or other action taken against the mortgagee or responsible staff reviewer.

(d) *Termination of DELRAP Authority.* (1) HUD may immediately terminate the mortgagee's authority to participate in DELRAP or take any action listed in 24 CFR 203.3(d) if:

(i) The mortgagee violates any of the requirements and procedures

established by the Secretary for mortgagees approved to participate in DELRAP, the Direct Endorsement program, or the Title II Single Family mortgage insurance program; or

(ii) HUD determines that other good cause exists.

(2) Such termination will be effective upon the date of receipt of HUD's notice advising of the termination.

(3) Notwithstanding any provisions of this section, the Commissioner reserves the right to take administrative action, including revocation of DELRAP authority, against any mortgagee and staff reviewer because of unacceptable performance. Any termination instituted under this section is distinct from withdrawal of mortgagee approval by the Mortgage Review Board under 24 CFR part 25.

(e) *Reinstatement.* A mortgagee whose DELRAP authority is terminated under this section may request reinstatement if the mortgagee's DELRAP authority has been terminated for at least 6 months. In addition to addressing the eligibility criteria specified in paragraph (b)(1) of this section, the application for reinstatement must be accompanied by a corrective action plan addressing the issues that led to the termination of the mortgagee's DELRAP authority, along with evidence that the mortgagee has implemented the corrective action plan. The Commissioner may grant conditional DELRAP authority if the mortgagee's application is complete and the Commissioner determines that the underlying causes for the termination have been satisfactorily remedied. The mortgagee will be required to complete successfully at least five DELRAP reviews in accordance with paragraph (b)(2) of this section in order to receive unconditional DELRAP authority as provided in paragraph (b)(3) of this section.

■ 3. In § 203.17, revise paragraph (a)(1) to read as follows:

**§ 203.17 Mortgage provisions.**

(a) \* \* \*

(1) The term "mortgage" as used in this part, except § 203.43c, shall have the meaning given in Section 201 of the National Housing Act, as amended (12 U.S.C. 1707).

\* \* \* \* \*

■ 4. Add § 203.43b to read as follows:

**§ 203.43b Eligibility of mortgages on single-family condominium units.**

(a) *Definitions.* As used in this part:

(1) *Condominium Association (Association)* means the organization, regardless of its formal legal name that consists of homeowners within a Condominium Project for the purpose of

managing the financial and common-area assets.

(2) *Condominium Project* means the project in which one-family dwelling units are attached, semi-detached, detached, or manufactured housing units, and in which owners hold an undivided interest in the Common Elements.

(3) *Condominium Unit* means real estate consisting of a one-family dwelling unit in a Condominium Project.

(4) *Common Elements* means the Condominium Project's common areas and facilities including: Underlying land and buildings, driveways, parking areas, elevators, outside hallways, recreation and landscaped areas, and other elements described in the condominium declaration.

(5) *Rental for Transient or Hotel Purposes* shall have the meaning given in section 513(e) of the National Housing Act (12 U.S.C. 1731b(e)).

(6) *Single-Unit Approval* means approval of one unit in an unapproved Condominium Project under paragraph (i) of this section.

(7) *Site Condominium* means:

(i) A Condominium Project that consists entirely of single-family detached dwellings that have no shared garages or any other attached buildings; or

(ii) A Condominium Project that:

(A) Consists of single family detached or horizontally attached (townhouse) dwellings where the unit consists of the dwelling and land; and

(B) Is encumbered by a declaration of condominium covenants or condominium form of ownership and does not contain any manufactured housing units.

(b) *Eligibility.* A mortgage secured by a Condominium Unit shall be eligible for insurance under section 203 of the National Housing Act if it meets the requirements of this subpart, except as modified by this section.

(c) *Approval required.* To be eligible for insurance under this section, a Condominium Unit must be located in a Condominium Project approved by HUD or a DELRAP mortgagee approved under § 203.8, or meet the additional requirements for approval as a Site Condominium or Single-Unit Approval.

(d) *Condominium Project Approval: Eligibility Requirements.* To be eligible for Condominium Project approval, the Condominium Project must:

(1) Be primarily residential in nature and not be intended for rental for Transient or Hotel Purposes;

(2) Consist of units that are solely one-family units;

(3) Be in full compliance with all applicable Federal, State, and local laws

with respect to zoning, Fair Housing, and accessibility for persons with disabilities, including, but not limited to, the Fair Housing Act, 42 U.S.C. 3601 *et seq.*, Section 504 of the Rehabilitation Act, 29 U.S.C. 794, and the Americans with Disabilities Act, 42 U.S.C. 12101 *et seq.*, where relevant;

(4) Be complete and ready for occupancy, including completion of all the common elements of the project, and not subject to further rehabilitation, construction, phasing, or annexation, except to the extent that approval is sought for legal phasing in compliance with the requirements of paragraph (e) of this section;

(5) Be reviewed and approved by the local jurisdiction with respect to the condominium plat or similar development plan and any phases; if applicable, the approved plat or development plan must have been recorded in the land records of the jurisdiction; and

(6) Meet such further approval requirements as provided by the Commissioner through notices with respect to:

(i) Nature of title to realty or leasehold interests;

(ii) Control over, and organization of, the Condominium Association;

(iii) Minimum insurance coverage for the Condominium Project;

(iv) Planned or actual special assessments;

(v) Financial condition of the Condominium Project, including, but not limited to, the allowable percentage of units owned by a single owner or group of related owners;

(vi) Existence of any pending legal action, or physical property condition;

(vii) Acceptable maximum percentages of commercial/non-residential space, which must be within a range between 25 and 55 percent of the total floor area (which range may be changed following the procedures in paragraph (f) of this section), with the specific maximum and minimum percentages within that range to be established by HUD through notice, provided that such commercial/non-residential space does not negatively impact the residential use of the project or create adverse conditions to the occupants of individual condominium units.

(viii) Acceptable maximum percentages of units with FHA-insured mortgages, which must be within a range between 25 and 75 percent of the total number of units in the project (which range may be changed following the procedures in paragraph (f) of this section), with the specific maximum percentage of units with FHA-insured

mortgages within that range to be established by HUD through notice. HUD may suspend the issuance of new FHA case numbers for a mortgage on a property located in any project where the number of FHA-insured mortgages exceeds the maximum insurance concentration established by HUD.

(ix) Acceptable minimum level of owner occupancy, which shall include units occupied as a principal or secondary residence or sold to an owner who intends to meet such occupancy requirements. Such acceptable minimum levels shall be within a range between 30 and 75 percent of the total number of units in the project (which range may be changed following the procedures in paragraph (f) of this section), with a specific minimum percentage to be established by HUD through notice. For the sole purpose of calculating the owner-occupancy percentage under this paragraph, any unit that is occupied by the owner as his or her place of abode for any portion of the calendar year other than as a principal residence and that is not rented for a majority of the calendar year shall count towards the total number of secondary residences.

(x) Reserve requirements, provided the reserve account is funded with at least 10 percent of the monthly unit assessments, unless a lower amount is deemed acceptable by HUD based on a reserve study completed not more than 36 months before a request for a lower amount is received, or such greater amount of time as determined by the Secretary under the HUD review and approval process.

(xi) Such other matters that may affect the viability or marketability of the project or its units.

(e) Phases of a project are approvable, provided that only legal phasing is used. Individual phases must be separately sustainable as required by HUD, so that the insurance fund is not put at undue risk. In determining whether to accept legal phasing, HUD will assess the potential risk to the insurance fund and other factors that HUD may publish in notices. Phases must meet HUD's requirements for approval in paragraph (d) of this section and must at a minimum be:

(1) In a vertical building, contiguous, with all units built out and having a certificate of occupancy; or

(2) In a detached or semi-detached development, where all homes in the phase are built out and have a certificate of occupancy;

(f) The Secretary will publish any generally applicable change in the upper and lower limits of the ranges of percentages in paragraphs (d)(6)(vii)

through (ix) of this section in a notice published for 30 days of public comment. After considering the comments, the Department will publish a final notice announcing the new overall upper and lower limits of the range of percentages being implemented, and the date on which the new standard becomes effective.

(g) The Secretary may grant an exception to any specifically prescribed requirements within paragraph (d)(6) of this section on a case-by-case basis in HUD's discretion, provided that:

(1) In the case of an exception to the approval requirements for the commercial/nonresidential space percentage that HUD establishes under paragraph (d)(6)(vii) of this section, any request for such an exception and the determination of the disposition of such request may be made, at the option of the requester, under the Direct Endorsement Lender Review and Approval process or under the HUD review and approval process through the applicable field office of the Department; and

(2) In determining whether to allow such an exception, factors relating to the economy for the locality in which the project is located or specific to the project, including the total number of family units in the project, shall be considered. A DELRAP lender, in determining whether to grant a requested exception, shall follow any procedures that HUD may establish.

(h) *Application for Condominium Project approval and Renewal of Approval.* (1) In order to become approved, an application for Condominium Project approval, in accordance with the requirements of the Commissioner, must be submitted to either HUD or a DELRAP mortgagee, if consistent with the mortgagee's DELRAP approval.

(2) The application will be reviewed and if all eligibility criteria have been met, the Condominium Project will be approved and placed on the list of HUD-approved Condominium Projects.

(3) Unless otherwise specified in writing by HUD, Condominium Projects are approved for a period of 3 years from the date of placement on the list of approved condominiums. HUD may rescind a Condominium Project's approval at any time if the project fails to comply with any requirement for approval.

(4) Eligible parties may request renewal of the approval of an approved Condominium Project by submitting a request for recertification no earlier than 6 months prior to expiration of the approval or no later than 6 months after expiration of the approval. HUD shall

specify the format for the recertification request, which shall allow the request to be supported by updating previously submitted information, rather than resubmission of all information.

However, if the request for recertification is not submitted within 6 months after the expiration of the Condominium Project's approval, a complete, new approval application is required.

(i) *Single-Unit Approval*—(1) *Single-Unit Approvals*. Mortgagees must ensure that the Condominium Unit is located in a Condominium Project that meets the eligibility requirements for approval as set forth in paragraph (d) of this section as modified by this paragraph, except that HUD may provide that Single-Unit Approvals may be approved by meeting a subset of these standards, or less stringent standards, as stated by notice. In addition, a unit may be eligible for Single-Unit Approval if it:

(i) Is not in a Condominium Project that is on the list of FHA-approved Condominium Projects; and

(ii) Is not in a project that has been identified by HUD as subject to adverse determination for significant issues that affect the viability of the project; and

(iii) Is in a project that is complete under paragraph (d)(4) of this section;

(iv) Is not a manufactured home; and

(v) Is in a project that has at least five (5) dwelling units.

(2) *Limit on Single-Unit Approvals*. HUD may suspend the issuance of new FHA case numbers for mortgages in Condominium Projects with Single-Unit Approvals where the number of FHA-insured mortgages exceeds the maximum insurance concentration established by HUD. Such acceptable maximum insurance concentration shall be within a range between 0 to 20 percent of units with FHA-insured mortgages for Condominium Projects with 10 or more units, with the exact percentage within that range to be determined by HUD through notice; or shall not exceed two FHA-insured mortgages for Condominium Projects with fewer than 10 units.

(j) *Site Condominium*. Site Condominiums must meet all of the requirements of paragraphs (d)(1) through (d)(5) of this section for approval, except that insurance and maintenance costs of the individual units must be the sole responsibility of the unit owner.

■ 5. In § 203.50, revise paragraphs (a)(1) and (f) to read as follows:

**§ 203.50 Eligibility of rehabilitation loans.**

\* \* \* \* \*

(a) \* \* \*

(1) The term *rehabilitation loan* means a loan, advance of credit, or purchase of an obligation representing a loan or advancement of credit, made for the purpose of financing:

(i) The rehabilitation of an existing one-to-four-unit structure which will be used primarily for residential purposes;

(ii) The rehabilitation of such a structure and refinancing of the outstanding indebtedness on such structure and the real property on which the structure is located;

(iii) The rehabilitation of such a structure and the purchase of the structure and the real property on which it is located; or

(iv) The rehabilitation of the interior space of a condominium unit, as defined in § 203.43b, excluding any areas that are the responsibility of the Association; and

\* \* \* \* \*

(f) The loan may not exceed an amount which, when added to any outstanding indebtedness of the borrower that is secured by the property, creates an outstanding indebtedness in excess of the lesser of:

(1)(i) The limits prescribed in § 203.18(a)(1) and (3) (in the case of a dwelling to be occupied as a principal residence, as defined in § 203.18(f)(1));

(ii) The limits prescribed in § 203.18(a)(1) and (4) (in the case of a dwelling to be occupied as a secondary residence, as defined in § 203.18(f)(2));

(iii) Eighty-five (85) percent of the limits prescribed in § 203.18(c), or such higher limit, not to exceed the limits set forth in § 203.18(a)(1) and (3), as the Secretary may prescribe (in the case of an eligible non-occupant mortgagor as defined in § 203.18(f)(3));

(iv) The limits prescribed in § 203.18a, based upon the sum of the estimated cost of rehabilitation and the Commissioner's estimate of the value of the property before rehabilitation;

(2) The limits prescribed in the authorities listed in this paragraph (f), based upon 110 percent of the Commissioner's estimate of the value of the property after rehabilitation; or

(3) For any Condominium Unit that is not a Site Condominium (as defined in § 203.43b), 100 percent of the after-improvement value of the Condominium Unit.

\* \* \* \* \*

**PART 206—HOME EQUITY CONVERSION MORTGAGE INSURANCE**

■ 6. The authority citation for part 206 continues to read as follows:

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

■ 7. Revise § 206.51 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 must be acceptable to the Commissioner as set forth in 24 CFR 203.43b.

■ 8. In § 206.131, revise paragraphs (c)(3) and (d) to read as follows:

**§ 206.131 Contract rights and obligations for mortgages on individual dwelling units in a condominium.**

\* \* \* \* \*

(c) \* \* \*

(3) To the condition of the property as of the date the assignment is filed for record. For units in projects with mortgages insured under 24 CFR part 234, § 234.275 of this chapter concerning the certification of condition applies.

(d) *Condition of the multifamily structure*. In projects with mortgages insured under 24 CFR part 234, the provisions of § 234.270(a) and (b) of this chapter concerning the condition of the multifamily structure in which the property is located shall be applicable to mortgages insured under this part which are assigned to the Commissioner.

**PART 234—CONDOMINIUM OWNERSHIP MORTGAGE INSURANCE**

■ 9. 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).

**Subpart A—Eligibility Requirements—Individually Owned Units**

■ 10. Add § 234.2 to read as follows:

**§ 234.2 Savings clause.**

HUD's regulations at § 203.43b of this chapter govern approval of real estate consisting of a one-family unit in a multifamily project, and an undivided interest in the common areas and facilities which serve the project, except where the project has a blanket mortgage insured under section 234(d) of the National Housing Act, 12 U.S.C. 1715y(d) (section 234(d)). Where the project has a blanket mortgage insured by HUD under section 234(d), this 24 CFR part 234 applies to the approval of a one-family unit in such project.

Dated: August 6, 2019.

**Brian D. Montgomery,**

*Assistant Secretary for Housing—Federal Housing Commissioner.*

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