

COMMON FOUNDATIONS

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MANAGING AN ASSOCIATION?

FannieMae Has Some New Guidelines That You Should Be Aware Of

In the last two years, FannieMae has amended its guidelines for selling and serving mortgages on condominiums, cooperatives, and planned unit developments three times. Why should we, as service providers to and managers of community associations, care?

Today, 70 percent of all mortgages are sold on the secondary market. FannieMae and its sister government-

sponsored enterprise (GSE), Freddie Mac, control roughly 90 percent of that. In short, if there are to be buyers of condominiums and coops, they need to be able to satisfy FannieMae requirements. And without the ability to buy and sell units freely, we can readily imagine the impact on this type of housing; in fact, we are seeing it already to a limited degree.

History of FannieMae

How did this come to be? Fannie Mae was created in the '30s as part of the New Deal to purchase Federal Housing Administration (FHA) loans. Banks had stopped lending for housing (sound familiar?), and this was a way to bring low-cost money back into the market. FannieMae became a private company in 1968. Capital was raised to buy mortgages and resell them as mortgage-backed securities.

This has traditionally been referred to as the secondary market. It exists to ensure a ready supply of mortgage capital to the market. Although some banks, and small savings and loans in particular, still retain some mortgages in their own portfolio, most mortgages are sold to the secondary market.

Further, most originators would like to keep that option open, that is, to sell the mortgages in the future, even if

they don't do it now. That is why FannieMae's underwriting guidelines have become the de facto standard throughout the mortgage industry.

FannieMae was originally established as the Federal National Mortgage Association. Freddie Mac (or the Federal Home Loan Mortgage Corporation) was created in 1970 because FannieMae was perceived to have a monopoly on the secondary market. Collectively, these and a few other agencies are referred to as GSEs.

New Guidelines for Community Associations

The new guidelines issued by FannieMae include:

- Announcement 07-18: Lender Delegation of Project Review Processes and Related Changes, November 15, 2007
- Announcement 08-01: Amends Guides "Selling" and "Servicing," January 31, 2008
- Announcement 08-34: Amends Guides "Selling," December 16, 2008

These guides are primarily directed at mortgage lenders. However, there are several important issues that managers

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Florida: A Special Case

Florida, as everyone knows, has a large community association market and, unfortunately now, a large percentage of troubled real estate. With the issuance of the December 2008 Announcement, FannieMae has issued special regulations for underwriting in Florida. In particular, all new or newly converted condominium projects will require a Project Eligibility Review Service (PERS) by Fannie Mae. Consult with your lender for any additional requirements.

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should understand to ensure the smooth and easy transfer of property from sellers to buyers. Furthermore, they are a direct outgrowth of the current financial situation across the country.

The first requirement is that associations maintain an "adequate budget." Adequacy is not defined, except for some of the following conditions:

- Capital reserves must represent at least 10 percent of the budget. As a provider of reserve studies, we know that this may often not be enough, but it does establish a *threshold* for reserve funding that all associations should be cognizant of. The CAI *Complete Guide to Reserve Funding* (GAP Report 24) defines threshold funding as the method of establishing reserves wherein the "minimum reserve cash balance... is set at a predetermined dollar amount."
- The insurance deductible must be funded in the budget. Although there is no stated requirement for this to appear as a line item in the budget, the deductible may be considered another component of the threshold in establishing reserves.
- The requirement for insurance coverage has changed. Formerly, associations had to maintain "all-in coverage," meaning that the policy covered

losses both in common areas and in individually owned units. This has now changed. It is possible for unit owners to obtain what is known as HO-6 coverage, which covers elements from the "walls in." When that is the case, the association need only maintain coverage on the common elements. This can reduce premiums for the association but requires consistent enforcement in the bylaws and regulations.

Additional requirements relate to general ownership of other units. For example:

- The loan-to-value ratio varies with type of ownership, with owner-occupants viewed more favorably than investors.
- More than half the units (51 percent) must be owned by owner-occupants or as second residences.
- No more than 15 percent of the units can be delinquent.
- No more than 20 percent of the total square footage can be for commercial purposes.
- Individual units must be separately metered or have a plan for the ready adoption of same.
- If it is a new project, the number of units that must be under contract has increased from 51 percent to 70 percent. In addition, new condominiums are subject to FannieMae's Project Eligibility Review Service (PERS).

There are other guidelines and regulations as well. You should always consult with your attorney to review your role in the underwriting process. And if there is one or more lenders you work with, make sure that they are up-to-date on the latest requirements. As your reserve study provider, we will be sure to include in our study those requirements that are specific to the obligations of the association under the new guidelines.

Criterion Engineers is an international engineering firm located in 38 states and 2 Canadian provinces. Our 65 office locations are all owned and operated by licensed, Professional Engineers who are dedicated to their community association market. We combine the resources of international engineering leaders with the services and knowledge of a local firm.

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