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FHA Loans May Spark Housing Recovery

The story is now familiar … subprime loans … bank bailouts … the Great Recession … foreclosures … and bankruptcies.

More than four years after the mortgage crisis began, the turmoil in housing continues. Many community associations, already under financial stress, are bracing for the next round of lender foreclosures in 2011.

Since 2008, an array of federal government initiatives have sought to stabilize the nation's largest mortgage lenders and stem the tide of home foreclosures.

FHA-Insured Loans

Central to the federal government response to the home mortgage crisis is the Federal Housing Administration (FHA), an agency of the United States Department of Housing and Urban Development (HUD).

Established by the National Housing Act in 1934 in the wake of the collapse of the housing market during the early years of the Great Depression, a primary mission of the FHA is to encourage private home loan lending by insuring mortgages. FHA insurance guarantees that lenders will be paid if the homeowner defaults on a mortgage debt. Since 1934, the FHA has insured more than 37 million mortgages.

In the early 1960s, the FHA began insuring loans for condominium units. The availability of FHA-insured loans led to the growth of condominium ownership, which has grown exponentially in the past 50 years.

With private lenders unable or unwilling to lend after the financial crisis and federal takeover of Fannie Mae and Freddie Mac in late 2008, the popularity of FHA-insured loans has increased significantly in the past few years.

More than 50 percent of first-time homebuyers now use FHA loans. FHA loans offer borrowers lower down payments, lower closing costs and easier credit qualifications than conventional loans. And, underwriting guidelines for FHA loans offer greater flexibility for evaluating borrowers based upon income, assets and credit scores. The FHA loan limit is $729,750 in the Washington metro area and $560,000 in the Baltimore metro area.

The availability of FHA loans may provide the much needed spark for a housing recovery.

FHA-Approved Condominiums

For many years, the FHA has required that a condominium project be "approved" in order for a borrower to obtain an FHA-insured loan on an individual condominium unit. Some condominiums obtained approval as part of the original development process. Once a condominium was on the FHA approved list, units remained eligible for FHA loans. Other condominiums were approved on a "spot-loan" basis for individual loans.

In accord with the federal Housing and Economic Recovery Act of 2008, the FHA reviewed its approval process for condominium projects and issued new eligibility standards in November 2009, designating expiration of most prior FHA approvals on Dec. 7, 2010. No new spot loans were allowed after Feb. 1, 2010.

Faced with the possibility that the sudden expiration of existing approvals could cause turmoil in the sale and refinancing of condominium units, the expiration of existing approvals was extended on a rolling basis through September 2011. The expiration date will depend on when the original approval was obtained.

For condominiums first approved prior to 1986, the approval expired Dec. 31, 2010.

The expiration dates for other condominiums are:

Initial Approval	Expiration Date
2006-September 2008	March 31, 2011
1986-1990	May 31, 2011
1991-1995	July 31, 2011
1996-2000	Aug. 31, 2011
2001-2005	Sept. 30, 2011

For approvals first obtained after Sept. 30, 2008, the approval expires two years from the approval date.

FHA Approval Standards

A condominium association can apply to the FHA directly to become an FHA-approved condominium. The current requirements to qualify for FHA loans include:

- No more than 15 percent of the units can be in arrears in payment of condominium assessments for more than 30 days.
- At least 50 percent of the condominium units must be owner occupied.
- No more than 10 percent of the units may be owned by one investor.
- At least 10 percent of the annual budget must be for funding replacement reserves for capital expenditures and deferred maintenance or there must be a reserve study within the past 12 months to assess the financial stability of the condominium.
- Fidelity insurance in an amount of at least three months' assessments plus reserves is required.
- No more than 25 percent of the unit floor area may be used for commercial purposes.
- No more than 50 percent of the units in a condominium may have FHA-insured loans.

The FHA will also consider the special assessment and litigation history of the condominium.

Although the standards require at least 50 percent of units to be owner occupied, FHA practice until recently was to deny approval if a condominium has a cap on the number of units allowed to be leased. In mid-March, the FHA issued new guidance to allow limits on the number of leased units and to allow a maximum length of leases.

The application for approval must be supported by various legal and financial documents, including recorded copies of the condominium declaration, bylaws, plats and articles of incorporation, if any; current budget and financial statement; proof of hazard, liability and fidelity insurance; management contract; and FEMA flood map. Certification regarding the number of units, ownership of units and delinquent assessments and other information is also required.

The FHA project approval is good for two years. However, loan-level certifications are also required when an owner or purchaser applies for an FHA loan.

Benefits of FHA Approval

A condominium that has FHA approval benefits by enabling owners to refinance to an FHA loan and by making condominium units available to more potential purchasers. Additionally, purchasers may find an FHA-approved condominium preferable since the condominium has met FHA standards for financial stability.

With conventional loans now requiring 20 percent down payment and tougher credit and income standards, FHA financing may be the only option for many purchasers and owners who want to refinance. Individual FHA-insured condominium loans are available only if the entire condominium is FHA-approved.

What's Ahead for 2011

Further clarification and refinement of the FHA condominium standards and application process are in the works. The revised guidance for obtaining FHA condominium approval is expected by June.

The "temporary" standards for owner-occupancy and the number of FHA-insured units allowed in a condominium are set to expire June 30. The temporary owner occupancy standard now in effect allows bank-owned units, which are vacant or tenant-occupied to be excluded from calculation of the 50 percent owner-occupancy percentage. The maximum number of FHA-insured units allowed in a condominium would be reduced from 50 percent to 30 percent.

Other recent FHA initiatives may further increase demand for FHA loans this year. As of September 2010, the FHA Short Refinance program allowed owners who are current on their mortgage to refinance an existing mortgage, which is more than the value of the property. The existing lender must agree to write-off at least 10 percent of the mortgage debt. The new FHA loan can be up to 97.5 percent of the property value and the new combined first and second mortgages can be up to 115 percent of the property value.

And, in October 2010, FHA began offering a new version of reverse mortgages–also known as Home Equity Conversion Mortgages (HECM)–with lower upfront fees and lower loan limits. A reverse mortgage allows a borrower age 62 and older to obtain funds with no repayment required until the borrower dies or leases or sells the property. At that time, if the balance due on the loan exceeds the value of the home, FHA insurance pays the difference.

To boost home values and accelerate resale of vacant properties in communities experiencing high foreclosure activity, the FHA, in January 2011, extended the temporary waiver of its "anti-flipping rule" to Dec. 31, 2011. The waiver permits buyers to continue to use FHA-insured financing to purchase a property, perform renovations and re-sell the property in less than 90 days.

The public debate on the future of Fannie Mae and Freddie Mac is also expected to heat-up this year. These entities, which purchase and securitize conventional home loans, have been under control of the Federal Housing Finance Agency (FHFA) since September 2008.

Also underway is implementation of the mortgage finance provisions of the Dodd-Frank Wall Street Reform Act enacted in July 2010. This includes adoption of new federal rules for Qualified Residential Mortgages (QRM) eligible for securitization. Unless a mortgage meets the requirements for a QRM, the lender must retain at least a 5 percent ownership stake in any loan which it sells.

The new statute designates FHA-insured loans as a QRM, underscoring the importance of FHA-insured loan standards.

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