



**Statement of Community Associations Institute
to
House Financial Services Committee
Subcommittee on Insurance, Housing and Community Opportunity**

**“Legislative Proposals to Determine the Future Role of FHA, RHS and
GNMA in the Single- and Multi-Family Mortgage Markets, Part 2”**

September 8, 2011

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Dear Chairman Biggert and Esteemed Members of the Subcommittee:

On behalf of Community Associations Institute (CAI)¹, we submit these comments for the record as part of the hearing on Legislative Proposals to Determine the Future Role of FHA, RHS and GNMA in the Single- and Multi-Family Mortgage Markets. CAI would like to make the subcommittee members aware of growing concerns among our members regarding the Federal Housing Administration's (FHA) stewardship of the Condominium Insurance Program. For the past two years, FHA has mandated standards for this program without public notice or input. This has resulted in the adoption of guidelines which are excluding qualified buyers from access to FHA financing and needlessly excluding entire condominium associations from access to FHA and non-FHA mortgages. We bring these issues to your attention and encourage you to take appropriate action, including directing the agency to revisit its guidance in light of the issues we are raising.

While FHA continues to play a critical role in the recovery process, the methods by which FHA has chosen to develop and implement guidance for the condominium program continues to create unnecessary obstacles for qualified condominium buyers. FHA has developed a set of requirements for the condominium insurance program without prior notice or input by key stakeholders. This has resulted in underwriting criteria for condominium associations that do not comport with common association business operations, state law or common sense. This approach also conflicts with the guidance provided by HUD general counsel to FHA. In a memorandum to FHA, counsel noted that a more public approach to policy making benefits both the consumer and the agency. Specifically, former HUD General Counsel Diaz wrote:

*"... Revised guidelines for legal documentation, while not rising to the level of a substantive rule that must be published in the Federal Register ... Housing should consider the advisability of using a Federal Register notice that solicits public comment before a final policy on condominium and PUD legal documents is adopted. As in the present situation, whenever an agency is considering a course of action or policy that involves divergent interests and classes of persons or when the issues are complex, interrelated, and represent a number of concessions and compromises, an administrative record can be very useful in sorting out the equities and buffering the agency's eventual decisions against legal and political challenge."*²

CAI has previously voiced to FHA staff its concerns with the individual association underwriting criteria. While FHA has attempted to provide greater flexibility on

¹ CAI is a national membership organization with more than 30,000 members and 59 chapters representing the interests of residents, managers and businesses engaged in community association housing in the United States. Community associations, which consist of condominium, homeowners associations, planned communities and cooperatives account for over one in five homes in the United States and account for close to \$80 billion in annual economic activity.

² HUD OGC Legal Opinion CIS-0091, p. 9-10 (emphasis added).

delinquencies, rental restrictions and affordable housing, the lack of stakeholder input has resulted in guidance that creates new problems for qualified condominium associations. Had FHA followed a more transparent process, it would have allowed such matters to be resolved prior to issuance of the mortgagee letter, allowing for more effective implementation.

FHA currently accounts for up to 30 percent of all condominium mortgages and, in some cases, lenders are underwriting to FHA criteria for non-FHA backed loans. CAI is not advocating for a full notice and comment regulatory process; however, as noted in the OGC memorandum, notice of the draft guidance and a period of public input would not only benefit consumers, but would also protect the agency from political and legal challenges. CAI members are disappointed that FHA continues to produce sweeping changes with no stakeholder input. As a result, the new guidance contains many provisions which will further inhibit the participation of qualified condominium associations and buyers in the FHA mortgage insurance program.

Beyond our ongoing concerns with the process of developing the new mortgage criteria, CAI has flagged areas of the guidelines that have been the source of questions, concern or confusion by our members. We hope that by bringing these issues to the subcommittee's attention, it will encourage members to direct FHA to clarify the intent of the new guidance to ensure condominium boards and management companies can work with FHA to qualify their communities for the mortgage insurance program.

Specifically, these issues include:

- 1) A requirement that the person certifying the association approval with FHA, under federal criminal penalty, has no knowledge of circumstances that may cause a borrower to become delinquent in their mortgage at an unspecified future date.
- 2) Continued reliance on a 15 percent of units, 30-day delinquency threshold for condominium assessments, which does not comport with association practices and conflicts with existing state laws.
- 3) The imposition, without notice or comment, of a costly mandate that condominium management companies obtain fidelity bonding even if covered by an association-obtained policy as mandated by state law.
- 4) A prohibition against any condominium association that has deed restrictions that impose a contractual obligation on a buyer, without an apparent understanding that all deed restrictions impose a contractual obligation on a buyer and are the legal basis for a condominium association.
- 5) The arbitrary imposition of criteria, such as disqualification from the FHA program for associations with loans or special assessments, which are not addressed by the FHA guidance.

CAI does not disagree with FHA that substantive underwriting criteria focused on assessments, delinquencies and even fidelity insurance are a sound basis for establishing underwriting guidelines. However, FHA's continued practice of developing

standards without transparency or public input has and continues to result in the establishment of standards that bear no relation to the operation of the market or state law and have created problems that could have been resolved with minimal due diligence by FHA and public input. When confronted with this, FHA has expressed a preference to continue to issue guidance and address any substantive issues once that guidance has been applied to the market. This has caused widespread confusion and inconsistent application of FHA's criteria. As a result, a survey of CAI members found that only half of condominium associations would be able to meet the FHA criteria. Additionally, more than 45 percent of condominium associations nationally reported that the lack of FHA financing has prevented owners from selling their units to qualified buyers. Even FHA reports that of the approximately 12,000 condominium associations that are eligible for recertification under the new guidelines, only about 1,000 have completed the process. It is clear from this data that FHA's process and subsequent guidance are having a negative impact on the housing market.

A more detailed discussion on each of these points can be found in the attached CAI letter to Acting Commissioner Galante.



July 25, 2011

Ms. Carol Galante, Commissioner
Federal Housing Administration
U.S. Department of Housing and Urban Development
451 7th Street, S.W.
Washington, DC 20410

**RE: CAI Comments and Recommendations Based on HUD Mortgagee Letter
2011-22: Condominium Approval Process**

Dear Ms. Galante :

On behalf of Community Associations Institute (CAI), representing more than 30,000 individual members, 60 local chapters and the interests of the 1 in 5 homeowners living in community associations, please find below the comments and concerns expressed to us by our members relating to the HUD Mortgagee Letter 2011-22 (ML 2011-22 or the Guide) addressing the Condominium Approval Process. Developed without stakeholder input, the new mortgagee letter introduces new and serious challenges which will exclude financially sound condominium associations from the FHA program. This letter highlights our concerns on both the process by which the ML 2011-22 was developed and the requirements it imposes on the market.

CAI acknowledges the critical role FHA has played in the condominium marketplace since the advent of the housing crisis. Since 2008, FHA's share of condominium mortgages has expanded from single digits to more than one-third of all condominium mortgages. Without FHA financing to fill the gaps left in the market, the condominium market would be in far worse condition. However, the housing crisis is far from resolved and provisions found in ML 2011-22 will, in our opinion, further hinder the recovery by adding more uncertainty and confusion to the FHA approval process.

Concerns on the Development Process for Criteria Found in ML-2011-22

While FHA continues to play a critical role in the recovery process, the methods by which FHA has chosen to develop and implement guidance for the condominium program continues to create unnecessary obstacles for qualified condominium buyers. As it did with Mortgagee Letters 2009-46A and 2009-46B, FHA has developed a set of requirements for the condominium insurance program without prior notice or input

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by key stakeholders. As noted by CAI in previous communications, this approach conflicts with the guidance provided by HUD general counsel¹. In that memorandum, counsel noted that a more public approach to policy making benefits both the consumer and the agency. Specifically, former HUD General Counsel Diaz wrote:

Federal Register Notice. Revised guidelines for legal documentation, while not rising to the level of a substantive rule that must be published in the Federal Register, still would affect the interests of many groups (attorneys, homeowners, planners, developers) who would not receive direct notice of changes through regular handbook distribution. Publication of revised guidelines in a policy notice in the Federal Register should result in a more widespread and rapid dissemination of revised FHA policy. A single one-time notice could be used, but Housing should consider the advisability of using a Federal Register notice that solicits public comment before a final policy on condominium and PUD legal documents is adopted. As in the present situation, whenever an agency is considering a course of action or policy that involves divergent interests and classes of persons or when the issues are complex, interrelated, and represent a numbers [sic] of concessions and compromises, an administrative record can be very useful in sorting out the equities and buffering the agency's eventual decisions against legal and political challenge.

CAI has previously voiced its concerns with the individual association underwriting criteria. It appears FHA has attempted to address some of these concerns in the release of ML 2011-22. Specifically, FHA has attempted to provide greater flexibility on delinquencies, rental restrictions and affordable housing. However, as the new guidance was developed without stakeholder input, the welcome attempt to address industry concerns has again resulted in guidance that creates new problems for qualified condominium associations. Had FHA followed a more transparent process, it would have allowed such matters to be resolved prior to issuance of the mortgagee letter, allowing for more effective implementation.

Once again, the implementation of sweeping changes by FHA through administrative order means that condominium associations are forced to scramble to comply with new program rules without prior notice. That this continues to be the standard operating procedure of FHA is unsettling and also needlessly inhibiting a full recovery in the condominium market. CAI is not advocating for a full notice and comment regulatory process; rather, as noted in the Office of General Counsel's memorandum, notice of the draft guidance and a period of public input would not only benefit consumers, but would protect the agency from political and legal challenges. CAI members are encouraged by the attempt of FHA to address shortcomings found in Mortgagee Letters 2009-46A & B; however, we are disappointed that FHA has chosen yet again to produce sweeping changes with no stakeholder input. As a result, the new guidance contains many provisions which will further inhibit the participation of qualified condominium associations in the FHA mortgage insurance program.

¹ HUD OGC Legal Opinion CIS-0091, p. 9-10 (emphasis added).

Substantive Concerns with FHA Program Criteria

Beyond our ongoing concerns with the process of developing the new mortgage criteria, CAI has flagged areas of the guidelines that have been the source of questions, concern or confusion by our members. We hope that in identifying these issues, it will allow FHA to clarify the intent of the new guidance to ensure condominium boards and management companies can work with FHA to qualify their communities for the mortgage insurance program.

Project Certification Requirement: Chapter 2 project eligibility requirements will mandate that the person submitting a project for approval attest, under criminal penalty, to three FHA imposed requirements. These requirements include that the condominium project complies with all state and local laws, the information contained in the submittal is true and correct, and requirement #3 which reads:

The submitter has no knowledge of circumstances or conditions that might have an adverse effect on the project or cause a mortgage secured by a unit in the project to become delinquent (including, but not limited to: defects in construction; substantial disputes or dissatisfaction among the unit owners about the operation of the project of the owner's association; and disputes concerning unit owner's rights, privileges and obligations). The submitter understands and agrees that the submitter is under a continuing obligation to inform HUD if any material information compiled for the review and acceptance of this project is no longer true and correct.

CAI Comments: CAI believes it is appropriate that a person or entity submitting a project approval attest to the association's compliance with current law and the truthfulness of the information submitted. However, this requirement also entails that the submitter agree to provide HUD with information on an ongoing basis that does not comport with the transactional nature of FHA approval and the varying entities who may submit a project on an association's behalf. This attestation also requires the submitter to make, under criminal penalty, guarantees as to the ability of a borrower to meet *future* mortgage obligations. As such, the requirements implemented in section three are too vague, too broad and impose punishments so severe that CAI believes that no association, attorney or project approval specialist will advise associations to sign such a statement. Our concerns on this provision center on the issue of future condition of the borrower and the ongoing reporting requirement imposed by it.

Association Boards Cannot Attest to Future Conditions: First, requirement #3 of the project certification imposes a condition that the submitter attests to current and future conditions of the property that may affect the borrower's ability to be current in their mortgage. Specifically, defects in construction; substantial disputes or dissatisfaction among the unit owners about the operation of the project of the owner's association; and disputes concerning unit owner's rights, privileges and obligations. This imposes a standard that is too vague, and too broad for any reasonable form of compliance. As drafted, this section not only requires the submitter to attest that they have no current knowledge of such conditions, but also requires them to attest that such current conditions will not have a future impact on the person holding an FHA mortgage. This is an impossible standard to meet.

Condominium associations are governed by residents elected by unit owners in periodic elections. CAI survey data demonstrates that condominium owners and residents of community associations have high satisfaction rates with the leadership provided by their elected boards, with 8 in 10 residents expressing approval of how their community is governed and more than 9 in 10 believing the board acts in the owners' best interests.² However, in any self-governed process, disputes are not uncommon. In fact, in any democratic process, debate and disagreement on policy are the lifeblood of a vibrant community in which members engage in defining their living arrangements from diverse viewpoints. As such disputes are not uncommon in a condominium association and are as much an indicia of a healthy community as a sign of distress. A vast majority of condominium association disputes are resolved without litigation; however, there exists no clear process by which a board member or project submitter can reasonably certify that such disputes will not have a future effect on a borrower.

Ongoing Reporting Requirement Impractical for Submitter and HUD: Second, project certifications can be made by members of the condominium association board, attorneys, professional community association managers and businesses specializing in FHA project approvals. The standards imposed by FHA do not address that, in most cases, the project approval process is transactional in nature and does not lend itself to ongoing reporting by a homeowner volunteer or by a business or agent. An association may engage a management company, attorney or project approval company for project approvals on a transactional basis. The ongoing reporting requirement will radically change that relationship and require that any firm engaged in project approvals be hired not only for the approval itself, but for a 2-year period to meet monitoring requirements. This will needlessly increase the cost of obtaining FHA project approvals, which already can run as much as \$6,000 per association. Additionally, considering that FHA has to engage a contractor to assist in processing the volume of applications it received, and the volume of the applications remains low compared to the total number of condominium associations, it is unlikely that FHA or HUD has the resources to process such materials.

CAI Recommendations: CAI believes that, in its current form, section three of project certifications is unworkable and will have a negative impact on the market by discouraging qualified associations from submitting project approvals. This requirement will restrict credit to otherwise qualified borrowers, will result in lost sales and will have a negative impact on the market and on FHA's current condominium portfolio. CAI recommends this section be modified so the submitter provides FHA with any current knowledge on litigation and to attest to such factors that may impact the borrower at the time the package is sent to FHA. Such a section should read:

#3 At time of submission, submitter has no knowledge of any conditions that might have an adverse impact on the project or knows of any existing litigation filed against the association. Submitter has an obligation to notify FHA, after project submission but prior to project approval, if such conditions change.

² *What do Americans Say about their Community Associations?*, National research by Zogby International, 2009, Community Associations Institute.

Delinquency Criteria: Section 2.1.5 of ML 2011-22 revises allowable delinquency criteria for condominium associations participating in the FHA program. Specifically, FHA has retained the 30-day, 15-percent-of-units delinquency standard; has expanded delinquencies to now include bank-owned (REO) properties; and allows for limited expectations beyond the 15-percent threshold if certain conditions are met.

CAI Comments: The provisions under section 2.1.5 provide additional flexibility that follows some of the recommendations made by CAI to FHA. However, the inclusion of REO property and the continued use of the 30-day delinquency measure will offset any benefits of the proposed flexibility and will likely lead to fewer projects qualifying for FHA condominium mortgage insurance. Our concerns are focused on three areas: delinquency period, burden of determining ownership of REO properties and required disclosures to qualify for exemptions.

30-Day Requirement Unreasonable: First, the requirement that no more than 15 percent of the total units can be more than 30 days in arrears on association assessments is an arbitrary number and does not adequately measure the financial health of the community. Increasingly, condominium associations are budgeting for bad debt, so even though 15 percent of the units may be delinquent, the association may still be able to meet its budget obligations to maintain the association's common property. Therefore, if an association maintains an allowance for delinquent assessments and the delinquencies do not exceed any budgeted bad-debt allowance, the delinquencies should have no impact on funding continued operations and routine maintenance.

Additionally, a 30-day test for delinquencies fails to take into account time periods required under various state laws with respect to any notice and mandatory payment plans. The association must comply with these time periods as a precondition to its collection efforts.³ In many cases, the association begins the process of tracking and seeking collection at or beyond the 30-day delinquency date, therefore, making a delinquency determination at such an early date difficult. Thus, many associations will be unable to meet the 30-day delinquency window because of requirements of state law, not because of the financial condition of their community.

CAI Recommendation: Community associations should have no more than 15 percent of the total units more than 90 days past due. This change would be consistent with existing association practices and emerging state law requirements, and would be in line with the larger financial picture FHA will allow under ML 2011-22.

Assessment Burden of Bank Owned Properties: CAI agrees with FHA that the failure of REO properties to pay assessments can have a negative impact on the financial health of the condominium association. It is critical that such assessments be paid to protect current condominium owners as well as the value of loans in FHA's existing portfolio. However, the revised guidance places the burden of determining the ownership of such property and collection of such fees on the volunteer boards of condominium associations, who are in the least advantageous position to determine ownership and collection of past due assessments.

It is not always clear to a condominium association who is the owner of a foreclosed property. This problem is so pervasive as to be the subject of numerous exposés in the press, including a

³ General Assembly of North Carolina Session 2011, Session Law 2011-362.

recent segment on 60 Minutes.⁴ CAI members report that, in many cases, lenders delay filing the paperwork or recording deeds on foreclosed property specifically to avoid paying assessments. This problem was pervasive enough in California that CAI worked with the state legislature to pass a law⁵ requiring the party taking title in foreclosure to record and notify the association within a specific time period for the purposes of collecting assessments. Other states have worked to provide for a priority assessment lien. Such liens give the association up to 6 months of past due assessments, prior to satisfying the underlying mortgage, in the event of foreclosure. Despite these efforts, a survey of CAI members indicates that nearly 8 out of 10 REO properties do not pay required condominium assessments. That same survey also indicates that payment of assessments is a legal obligation of owners of property in a community association. Those who are not paying assessments are breaching their legal obligations to the association and undermining the value and marketability of all properties in the development. The FHA Condominium Mortgage Insurance Program provides a tangible benefit to lenders by insuring the mortgage against default by an FHA-qualified borrower. In exchange for receiving this guarantee, it would make sense that FHA would want to ensure that lenders participating in the program are not subsequently undermining the soundness of FHA-backed mortgages by not paying assessments on properties they own. This approach would work to resolve a problem that has confounded state legislators and volunteer condominium board members for some time. Such an approach would also ensure that borrowers are not undermining the FHA programs they are relying on for their mortgage products.

CAI Recommendation: FHA should not include bank-owned properties in the determination of association assessments. Rather, FHA should require that approved mortgagees disclose to FHA any condominium properties currently owned and provide FHA with proof that assessments are being paid on said units. This action alone will significantly reduce delinquencies caused by FHA-approved mortgagees that have a material impact on the performance of FHA's condominium-related book of business. Additionally, CAI has received multiple reports from condominium associations that HUD itself routinely fails to pay assessments on HUD-owned properties. CAI strongly urges FHA to catalog properties for which a claim has been paid to ensure the Agency is actually working to resolve the problem of REO-related delinquencies rather than exacerbating the problem.

Requests for Exceptions: ML 2011-22 has introduced some flexibility in regard to assessment delinquencies; some of these recommendations mirror suggestions made by CAI in communications with FHA in December 2009. The added flexibility takes into account that the current measure of delinquencies may be excluding otherwise qualified associations by looking at their finances at a specific point in time rather than looking at the associations' broader financial picture. CAI applauds FHA for taking these steps, and we hope these additional comments can assist in ensuring that the flexibility can be conducted in a manner that comports with condominium association operations.

Specifically, Section 2.1.5 allows for up to 20 percent of units to be no more than 30 days in arrears, provided the following six conditions are met:

⁴ *The Next Housing Shock*, 60 Minutes, April 1, 2011.

⁵ Senate Bill 1511 (2008) enrolled as California Civil Code Section 2924b.

1. The homeowners' association (HOA) provides a report for the past 6 months that reflects the history of unpaid assessments.
2. The HOA current reserve fund balance and current operating results (documented HOA Balance Sheet and Income/Expense financial statements dated less than 90 days at the time of submission) evidences excess available funds in the amount of the outstanding arrearage.
3. A review of the HOA financial statements and verification of the reserve account balance reveals that the HOA has sufficiently accounted for bad debt and arrearages.
4. A current reserve study that is no greater than 24 months old supports the sufficiency of the current HOA assessments to meet the project component replacement needs.
5. The HOA provides evidence of actions to collect the unpaid arrearages, including legal action, execution of payment plans, or other similar efforts.
6. The exception terminates with the expiration of the current condominium project approval.

CAI believes that this approach would provide FHA with a more detailed and accurate picture of the financial health of the association over a period of time rather than at the point of application and that the required disclosures, with the exceptions discussed below, will provide a more fair opportunity for associations who do not meet the arbitrary 15-percent, 30-day-delinquency window or those who cannot meet it due to conflicting state laws. CAI's concerns with the new delinquency guidance follows:

The second provision of the required reports for the assessment exception reads:

The HOA current reserve fund balance and current operating results (documented HOA Balance Sheet and Income/Expense financial statements dated less than 90 days at the time of submission) evidences excess available funds in the amount of the outstanding arrearage.

CAI believes the intent of this statement is to allow FHA to gauge the impact of delinquencies on operations *and* reserve accounts, two critical measures of an association's current and future fiscal health. As FHA is aware, the operating account and the reserve account each have distinct functions. As drafted, CAI members have expressed concern that FHA is conflating these two accounts in a manner that may cause unit owners to believe that such funds can be freely transferred from reserves to operations. While such transfers are possible, such "borrowing" from reserves has tax consequences and may trigger reporting or notice requirements by the board. This may also lead to special assessments or other problems in out-years if reserve funds can be transferred to operations. As each account has a dedicated and critical function in assuring an association's fiscal health, examination of these accounts should treat them according to their function.

CAI Recommendation: CAI recommends that this provision for exception to the 15-percent, 30-day-delinquency requirement be applied in a manner that examines the funding levels in the operating account and reserve account separately to ensure adequate funding is available for current operations as well as future obligations.

Fidelity Bonding of Management Companies: Section 2.1.9 of the Guide requires fidelity coverage for the theft of a community association's funds. That Section imposes two different

requirements: coverage for a theft committed by a board member of an association must be covered by fidelity insurance, and coverage for a theft committed by a management company hired by an association must be covered by a fidelity bond. Fidelity insurance and a fidelity bond are not synonymous.

A fidelity bond is a 3-party contract in which a bonding company guarantees to reimburse a party for any losses it suffers caused by the dishonest acts of another party. Each person that is bonded is named and has been scrutinized by a bond company for “character, capacity and credit.” Unlike a fidelity bond, fidelity insurance is a policy of insurance. It is a 2-party contract just like any other policy of insurance involving the insurer and the insured. As the Guide shows, fidelity insurance is known as employee dishonesty insurance or crime insurance.

The need to protect an association from an unreimbursed loss of funds resulting from a dishonest act of a management company has been addressed by the community association industry. Fidelity bonds are not used in the community association industry to protect an association’s funds. The protection is afforded by an association’s employee dishonesty policy that extends coverage to a management company. The primary reason fidelity bonds are not used in the community association industry is the impracticality of naming and the cost of investigating each person within a management company that has access to association funds. Since bonds specifically identify the persons that are bonded, bonds do not automatically cover new employees.

Even if fidelity bonds were available for management companies, the specific coverage required by the Guide will be practically unattainable. The specific coverage issues created by the Guide are:

- The minimum amount of coverage required by the Guide fails to recognize the constant change in the amount of funds under the control of a management company. For example, an association that imposes assessments on an annual basis will have an ever-declining balance as a year progresses. Bonds are not variable; the premium, if a bond could be obtained, is based on the maximum potential loss. Such a premium would be based on an amount that will exist for less than 30 days.
- The Guide requires a management company to obtain a separate bond, in the minimum amount, for each of its association clients. A management company will not be able to afford the premiums. Bonds are not like an insurance policy that can name additional insureds on a single policy, thereby, reducing costs. Few associations will be able to afford the pass through of the cost of a bond.
- The Guide also requires a management company’s bond to cover the total funds in the custody of the owner’s association. That requires a management company’s bond to cover funds that are not in the management company’s custody or control. Bonds require the bonded person(s) to have custody and control of the covered money and securities.

Most associations do not allow a management company to have access to its reserve funds. Access is restricted to members of the association board. The Guide requires all management company bonds to be in a sum that includes reserve funds, regardless of whether the company has access to those funds.

The only way to achieve FHA's goal of avoiding an unreimbursed loss caused by a management agent's theft of association funds is to add the management company as an insured under the association's employee dishonesty policy. A management company can be included in the definition of an employee, just as members of a board of directors are considered employees for that coverage. Alternatively, a management company can be covered by a designated agent endorsement, ISO Form.

Insuring an association's funds from theft by a management company with an employee dishonesty insurance policy meets the entire fidelity requirements of the Guide and has the following advantages for an association:

- The Guide requires an association to obtain and maintain the insurance so all claims are controlled by an association as the first party insured. An association, as the insured, files a claim with the insurer and covered claims are paid directly to the association. (The bond requirement obligates an association to require the management company obtain the bond.)
- The minimum coverage's required by the Guide are insured by a single policy that covers acts of theft committed by both members of a board and management agents. The issue of custody or control created by the bond requirement is eliminated.
- Since the minimum coverage required by the Guide for board members and a management company is the same, there is little or no added cost to extend coverage to the dishonest acts of a management company. The amount of coverage, not the number of persons with access to an association's funds, establishes the premium.
- Reserve funds are covered, regardless of whether access is restricted to board members or if access is given to a management company.

The Guide also requires a management company to carry a policy, even if it would be covered by appropriate state law. In at least three states, Florida,⁶ Virginia⁷ and Maryland,⁸ an association may purchase fidelity insurance to cover acts by agents of the association. Under the provisions found in Section 2.1.9, a management company would be required to obtain duplicate coverage. This imposes a costly and unnecessary burden on businesses and homeowners.

FHA's requirements also stand in stark contrast to the treatment of fidelity insurance issued by Freddie Mac. While Freddie Mac requires fidelity insurance as a condition for mortgage issuance in a condominium, its guidance⁹ is a model of an appropriate and flexible approach more appropriate to the market place. It simply requires:

The condominium owners association must carry fidelity insurance covering losses resulting from dishonest or fraudulent acts committed by the association's directors, managers, trustees, employees or volunteers.

⁶ Florida Statute 718.111(11)(h).

⁷ Virginia Code Section 55-79.81(b).

⁸ Ann. Code of Maryland, Real Property Article, Title 11, Section 11-1141.1 Fidelity Insurance (a)(2)(ii).

⁹ See Appendix A: Freddie Mac Condominium Insurance Requirements.

CAI Recommendation: It is CAI's recommendation that Section 2.1.9 of the Guide be amended by deleting the second section that addresses a management company and amending the first section in the following manner:

For all new and established projects with more than 20 units or for any project that engages the services of a management company, the condominium association is required to obtain and maintain employee dishonesty or crime policy insurance that meets these requirements:

- *The condominium association must maintain this insurance for all officers, directors, employees of the association, and all other persons handling or responsible for funds administered by the association;*
- *If the condominium association engages a management company, it must also maintain this insurance coverage for the management company and its officers, employees and agents handling or responsible for funds of or administered on behalf of the condominium association; and*
- *The coverage must be in an amount not less than the estimated maximum funds, including reserve funds, in the custody of the condominium association or a management company, but in no event be less than a sum equal to 3 months aggregate assessments on all units plus reserve funds unless state law mandates a maximum dollar amount of required coverage.*

CAI believes that this approach would provide the coverage intended by FHA against theft of funds, but in a manner that is commercially practicable, reflects state insurance requirements and would mirror existing guidance imposed by Freddie Mac.

Deed Restrictions: Section 1.8.8 reiterates existing regulatory provisions under 24 CFR 203.41 that require FHA-insured property to be free of restrictions that prevent the borrower from freely transferring their property. It is noted in the Guide that deed restrictions which would "be the basis of contractual liability of the borrower" shall be excluded from FHA approvals.

CAI Comments: Section 1.8.8 references existing regulatory requirements on issues of free transferability. CAI reads this section as FHA incorporating these provisions by reference. However, FHA misstates existing regulations on deed restrictions and does so in a manner which would exclude all condominium associations from FHA's condominium insurance program. Specifically, the second bullet point in this section notes that deed restrictions which would "be the basis of contractual liability of the borrower" as grounds for rejection.

As FHA should be aware, this is a material misstatement of the provision found in 24 CFR 203.41(3)(ii) which actually reads:

(ii) Be the basis of contractual liability of the mortgagor for breach of an agreement not to convey, including rights of first refusal, pre-emptive rights or options related to mortgagor efforts to convey;

The clear intent of the regulations referenced by FHA is to exclude deed provisions that create a right of first refusal. As drafted by FHA, the guidance excludes any condominium association where the deed restrictions are the basis of contractual liability for the borrower. As all deed

restrictions impose contractual liability on a purchaser and in fact serve as the basis upon which the entire legal structure of condominiums is based, FHA's current language will serve to exclude all condominium projects from the FHA program on this basis. We do not believe that this outcome was the intent of this section, but rather to reiterate the regulatory restriction on rights of first refusal found in 24 CFR 203.41 (3)(ii).

CAI Recommendation: FHA should update the language in Section 1.8.8 to reflect the actual regulatory restrictions imposed under 24 CFR 203.41(3)(ii), as noted in our comments, that deed restrictions which impose a contractual right of first refusal are disallowed, not that any deed restriction which imposes a contractual obligation is disallowed.

Commercial Space: Mixed-use developments are becoming increasingly prevalent across the country. HUD has recognized this in the Sustainable Housing and Communities Program, which is focused on connecting jobs to housing to reduce transportation costs for families, improve housing affordability, save energy, and increase access to housing and employment opportunities.

CAI commends FHA for allowing some flexibility in this requirement by allowing up to 35 percent of commercial space in some circumstances. This will provide additional flexibility and move the requirement to be more in line with HUD's goals of sustainable development. We encourage FHA to continue to review this requirement for greater flexibility.

CAI Recommendation: Condominium projects with up to 45 percent of commercial space should be eligible for FHA approval. The condominium developer or association should be able to provide reasonable evidence that common areas can be properly maintained and required reserves fully funded with assessments on residential and commercial units.

Special Assessments: Section 2.1.7 of the Guide requires the submitter of the project approval to provide information on special assessments. Where a special assessment has been approved and is pending, FHA will require the submitter to verify:

- What is the purpose of the assessment;
- What is the affect on marketability of any of the units;
- Have other special assessments been required;
- When is the assessment to be paid (i.e., required to be pre-paid or is it payable over a specified period of time);
- How will the assessment impact the overall financial stability of the project; and
- What is the impact the assessment will have on the future value and marketability of the property?

Condominium associations raise revenue through limited means: periodic common expense assessments; user and other fees; and special assessments. Members, acting through their elected boards and the association membership at large, approve funding mechanisms and allocate expenses according to the preferences of the unit owners. Special assessments are typically used when an association faces a large, non-budgeted expense and the owners vote to assess an additional amount to cover these costs.

CAI's concerns with this Section mirror those discussed in the project certification section. Specifically, with FHA's requirement that an association certify to FHA the future impact a special assessment will have on the value and marketability of the property. This is not an objective criterion, and thus cannot be provided by the submitter. Also, CAI questions the appropriateness and even legality of having the association conduct an appraisal of a project they are undertaking. As all data submitted for project approvals is subject to the project certification requirement, CAI believes that FHA should focus any certifications or attestations on current and verifiable data rather than on speculative assumptions on the future.

CAI Recommendation: FHA should eliminate or clarify the requirement that associations provide information on the future impact of any special assessment; as such a standard is conjecture. FHA may wish to seek information on the goal of the special assessment as it relates to the association and property values.

Leasing Restrictions: Section 1.8.9 addresses issues of leasing restrictions and incorporates the provisions found in the waiver to ML 2009-46B issued by FHA in March 2011. Allowing rental restrictions will assist condominium associations in meeting the owner occupancy requirements set by FHA. CAI also notes that the guidance finds that such restrictions improve "marketability of the whole community." However, the rental restriction language includes a provision that undermines the goals of FHA on financial soundness and the safety of the community. That provision reads:

The condominium association may not require that a prospective tenant be approved by the condominium association and/or its agent(s), including but not limited to meeting creditworthiness standards.

This provision causes concerns for CAI. The condominium association or the unit owner has an interest in assuring that any tenant be financially qualified to lease a unit. Current federal Fair Housing Laws provide additional protection against any unfair or discriminatory restrictions. The board of a condominium association is charged with ensuring members' satisfaction with their community and its financial well being. As such, unit owners and their boards are in the best position to determine what the needs of the community are, provided they comply with existing federal law. Failure of a tenant to pay rent can impact the unit owner and lead to delinquencies on assessments or mortgage payments. As such, allowing the unit owner or association to check the creditworthiness of a prospective tenant would work to further the goals of FHA in assuring the financial soundness of the community.

CAI Recommendation: CAI recommends that FHA allow for a limited right of the owner or the association to impose rental restriction standards on creditworthiness.

Conclusion: CAI commends FHA for working to address some of the concerns created by the existing FHA condominium approval process. In some cases these provisions will provide limited flexibility to qualified condominium associations. This is a welcome improvement, but falls short of what FHA could accomplish through a more transparent dialogue with stakeholders.

We hope that the issues we have raised in this letter can be addressed by FHA in a timely manner to ensure that associations can continue to have access to FHA insured mortgages. We appreciate

the dialogue we have had with the FHA program staff and look forward to continuing our dialogue on the condominium insurance program. CAI continues to encourage FHA to engage in a more transparent process in developing future guidance. Many of the issues raised in this letter could have been addressed prior to implementation which would have minimized problems with implementation. To this end, please do not hesitate to contact me or Andrew S. Fortin, Esq., CAI's vice president of government and public affairs, at (703) 970-9220, if we can provide any supplemental information or views on guidance or on any other topics related to community associations.

Sincerely,

A handwritten signature in black ink, appearing to read 'Tom Skiba', with a long horizontal flourish extending to the right.

Thomas M. Skiba, CAE
Chief Executive Officer