

**Qualifying and Applying for FHA Certification:
The Newest Changes to the FHA Certification Process and Requirements Affecting
Condominium Associations**

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In 2011, the FHA published a comprehensive Condominium Project Approval and Processing Guide. The purpose of this publication was, in part, to educate condominium associations regarding the requirements for FHA certification, as well as the application process. Since that time, the FHA has repeatedly revised both the application process and the certification qualifications. Some of these changes have imposed greater burdens on condominium associations seeking FHA certification, while others have made FHA certification easier to obtain. The most recent changes to the certification requirements were announced in U.S. Department of Housing and Urban Development (“HUD”) Mortgage Letter 2016-15.

Owner Occupancy

Pursuant to HUD Mortgage Letter 2016-15, the owner occupancy requirement for FHA certification is still 50%. However, the FHA may now grant an exemption to this requirement if all of the following conditions are met:

- 1) An exemption is expressly requested at the time the association submits its application for FHA certification or re-certification;
- 2) The application must be submitted directly to the FHA rather than a lender qualified to grant FHA certification;
- 3) The association has an owner occupancy percentage of at least 35%;
- 4) At least 20% of the association’s budgeted income must be allocated to reserves and documentation confirming this allocation must be provided;
- 5) No more than 10% of the units are in arrears in paying assessments by more than 60 days; and
- 6) The association submits to the FHA financial records for the most recent three years, and these records evidence (to the FHA’s satisfaction) the association’s long term financial stability.

Perhaps of better news is the confirmation that the term “owner occupied” now applies to principal (also referred to as primary) **and** secondary owner residences, as well as units that have been sold to purchasers who intend to occupy them as primary or secondary residences but have not yet moved in.

A unit qualifies as a principal or primary residence if the owner(s) occupy or plan to occupy the unit for the majority of the calendar year (i.e., 183 or more days). If the owner(s) occupy or plan to occupy the unit for a period of less than 183 days and if the owner(s) also have a qualifying principal or primary residence but no other residences, the unit qualifies as a secondary residence – unless it is classified as a “vacation home”.

Vacation homes do not qualify as owner occupied residences.

Unfortunately, the FHA does not provide a clear delineation between what is deemed a secondary residence and what is deemed a vacation home. However, it appears from HUD documents that a condominium unit must be used primarily because of seasonal employment, employment relocation or other circumstances not related to any recreational use to qualify as a secondary residence. If the residence is used primarily for recreational purposes, it is a vacation home.

As evidence that an association complies with the FHA’s owner occupancy requirement, an association must now submit with its application package a letter attesting to the number and percentage of owner occupied units within the project. This letter must be on Association letterhead and hand-signed by a member of the association’s Board of Directors.

The fact that an association seeking re-certification is now required to submit a completed and signed FHA worksheet that addresses, among other things, the current number of owner occupied units does not exempt the association from having to provide this letter.

What are the Other Key Requirements for FHA Certification?

In addition to the owner occupancy requirement discussed above, an association must meet a number of other requirements to qualify for FHA certification, including the following:

- 1) Reserves must be 100% funded or at least 10% of the annual budget must be allocated to reserves.
- 2) No more than 15% of the owners may be delinquent in paying their assessments by more than 60 days. (As stated above, this percentage drops to 10% for an association seeking an exemption from the owner occupancy requirement.)
- 3) The only kinds of rental restrictions that may be contained in the governing documents are as follows:
 - a) A requirement that all leases must be in writing and subject to the governing documents;
 - b) A requirement that owners provide the association with a copy of the sublease or rental agreement;
 - c) A requirement that owners provide the association with the name(s) of all tenants including the tenants’ family members who will occupy the unit;
 - d) A prohibition on leasing for an initial term of less than 30 days;
 - e) A maximum allowable lease term (e.g. six months, twelve months, etc.); and
 - f) A restriction on the maximum number of rental units within the project, provided this percentage does not exceed 50%.

- 4) No more than 35% of the project can be used for commercial, industrial or other non-residential purposes (exceptions may be granted to this requirement).
- 5) No more than 50% of the units may be investor owned by one or more investor owners. In other words, no more than 50% of the units can be non-owner occupied.
- 6) "Master or blanket" property insurance must be obtained in an amount equal to 100% of current replacement cost of the condominium exclusive of land, foundation, excavation and other items normally excluded from coverage. (If the HOA does not maintain 100% coverage, the unit owner may not obtain "gap" coverage to meet this requirement.). (There are exceptions to this requirement.)
- 7) A project with more than 20 units is required to obtain and maintain fidelity insurance for all officers, directors, and employees of the association and all other persons handling or responsible for funds administered by the association. This coverage must be no less than a sum equal to three months aggregate assessments on all units plus reserve funds unless State law mandates a maximum dollar amount of required coverage.
- 8) For projects with more than 20 units, the management company must have a fidelity bond/insurance in an amount no less than the sum equal to 3 months aggregate assessments on all units within the project plus reserve funds (unless State law requires a maximum amount of coverage). Alternatively, the association's fidelity bond or insurance policy must specifically name the management company as an agent or insured, or the association's fidelity bond or insurance policy must include a "Covered Employee" endorsement that states that a person employed by an employment contractor (i.e., management company) performing services subject to direction and control by the association is covered under the policy.
- 9) If the project is all or partially located within a FEMA special hazard flood zone, the association must maintain flood insurance.

It is important to know that notwithstanding an association's compliance with the requirements identified above, the FHA may still reject the association's application based on a planned or pending special assessment, deferred common area maintenance, construction defects that have not yet been corrected, pending or threatened litigation and other factors that it deems have or could have an adverse effect on the project.

Pending Changes to the FHA Certification Process and Requirements

The Housing Opportunity through Modernization Act ("Act") was signed into federal law earlier this year. The Act is designed to facilitate FHA certification and recertification by, among other things, proposing a longer certification period. FHA certification currently expires after two years. This means that associations wishing to maintain certification must reapply to the FHA certification every two years.

The Act also proposes simplifying the application process for previously certified associations so they do not have to resubmit documents that have not changed since the last time they were submitted. Since the Act only provides general direction to HUD however, we will have to wait for HUD to comply with the Act to know specifically how (or if) the Act will achieve its objective.