

Why Many Florida Condominiums Don't Qualify for FHA Financing

Let's start with some background on FHA-insured mortgage financing. The Federal Housing Administration (FHA) is an agency of the US Department of Housing and Urban Development (HUD), a Cabinet-level department of the Federal government. In order to help make mortgage funding available to a broader range of buyers, the FHA insures independent lenders against buyer/borrower default. The FHA does not make mortgage loans, it *insures* them. Buyers/borrowers pay mortgage insurance premiums to the FHA; the lender receives the insurance payout from the FHA if the buyer/borrower defaults.

Why might buyers want to use FHA financing? FHA qualifying standards for borrowers are more lenient than most lenders' conventional loan programs (those that are not FHA-insured). These standards help buyers with **lower credit scores** and **lower down payments** qualify for mortgage financing. Lenders are more willing to make loans using these broader qualifying standards because they are protected by FHA insurance. Look for an article on mortgage insurance (both FHA and conventional) in the near future.

Since the FHA is insuring the lender against borrower default risk, they set the underwriting standards for loans that are eligible for FHA-insured financing. These standards include condition, appraised value, habitability and resident safety, intended occupancy, and buyers' financial ability to repay the loan. The buyer, the property, and transaction details must all meet FHA standards in order to be eligible for FHA-insured financing. This risk management keeps defaults and mortgage insurance payouts as low as possible.

There are many more details involved with FHA financing. Speak with a licensed Mortgage Loan Originator for further information on available mortgage financing programs.

This general overview focuses on Florida resale condominium units purchased from an individual owner, not newly constructed ones purchased from the developer. Readers might also be interested in "*Seven Questions All Florida Condo Buyers Should Ask*". Send an email to request a PDF copy.



When considering making a mortgage loan (either conventional or FHA-insured) for an individual condominium unit, all lenders use a Condo Questionnaire to evaluate the condo Association's financial, legal, and operational condition. Either the Association's Board of Directors or their current Management Company may complete the Condo Questionnaire. The answers tell lenders' underwriting departments how well an Association meets qualifying standards for a mortgage on an individual condo unit. The condo building or development and its owners Association must meet specific qualifying standards *along with* the buyer/borrower. This is part of all lenders' risk management for condo mortgage loans. With FHA-insured financing, buyer/borrower qualifying tends to be more lenient, while standards for condo properties and Associations are more strict than most lenders' conventional (non-FHA) condo mortgage standards. Some qualifying standards are shared by both FHA and conventional mortgage programs for Florida condominiums.

In late 2019, HUD (through the FHA) announced that it will now accept applications for *individual* condo unit financing approvals (Single Unit Approvals) in buildings (projects, as they call them) that do not have overall project approval. Previously, the entire condominium property had to receive approval in order for individual condo units to be eligible for FHA-insured mortgage financing. Many lenders and real estate agents have been calling this a long-awaited breakthrough in qualifying standards considered too strict for some time. That may be true in other parts of the US, though not much will really change for Florida condo FHA approvals.

(In May 2020, there were almost **25,000** condominium projects (buildings and developments) in Florida according to the Division of Condominiums, Timeshares, and Mobile Homes of the Florida Department of Business and Professional Regulation. At the same time, there were only around **200** condo projects approved for FHA-insured financing in the entire State of Florida, according to HUD. Less than 1% of all Florida condominium properties are FHA-approved.)

Before we get into why most Florida condo buildings and Associations don't qualify, it's important to note that only **Primary Residence** occupancy is eligible for FHA-insured financing. Second homes and vacation properties are NOT eligible. This by itself eliminates FHA-insured financing as an option for many buyers' intended use of a Florida condominium!

Florida condos are very different from those in other parts of the US. The main reasons for this are included in the way they were legally established through the Declaration of Condominium (one of the essential Governing Documents or "condo docs") which was drafted during the property's initial planning stages. The 3 main Governing Documents (*Declaration of Condominium*, *Articles of Incorporation*, and *ByLaws* for corporate function) are recorded with the County Clerk where the condominium property is located. This provides public notice of the condominium's existence and its rules.

Combined, the Governing Documents are the specific rules and regulations under which condominium buildings and Associations function and operate. They include legal and financial information related to Association governance and individual unit ownership. Buyers of individual units within the condominium property agree to abide by the rules laid out in the Governing Documents.



When it comes to a condominium meeting the standards for unit financing approval (FHA and conventional), the criteria are applied to the condo docs as they were initially drafted and amended over the years. It doesn't matter whether or not individual unit buyers intend to follow FHA standards after they own a condo unit. If what the Governing Documents either allow or don't allow isn't consistent with FHA standards, the entire Condominium Project Approval or the newer Single-Unit Approval will be denied.

All FHA standards have to be met through how the Governing Documents are written and what they allow or don't allow. Meeting only some, or even most, of the standards will result in a denial.

Here are a few of the standards that many Florida condominium Associations have difficulty meeting:

- **Sufficient common area insurance coverage** (types and limits – flood if in A or V zone)
- **Rental policy** (30 day minimum - no transient or short-term rentals)
- **Adequate financial reserves** (*minimum* 10% of annual budgeted income goes to reserve fund)
- **Transfer fees** (fees charged must be for actual transfer services, not buy-ins to the Association)

However, the number one standard by far that prevents most Florida condo Associations from receiving FHA-insured financing approval:

- **Purchase or leasing restrictions** (background check and Board approval of buyers and/or tenants)

The Governing Documents of most Florida condominiums state that the Board or Management Company must approve new buyers and/or rental tenants. Many Boards further require a background or credit check of potential buyers or tenants before approving an application for residency. These practices violate the FHA standard that a property "conveyance" (sale or lease) not be subject to the consent of a third party.

HUD looks at third-party approval before selling or renting as opening the door to a potential violation of the Federal Fair Housing Act (a different FHA) which prohibits discrimination based on race or color, religion, sex, national origin, familial status, or disability. Under FHA standards, the property owner must have the right to sell to any buyer or lease to any tenant. The unit owner may request a background check or credit check, though the Association and Board (third party) cannot require one under FHA-insured financing standards.

Remember that individual unit owners' intentions or actions aren't the issue here. If the Association's Governing Documents require buyers and tenants to be approved by the Board, that condominium development is not eligible for FHA-insured mortgage financing.

Anything in the condominium Governing Documents that doesn't comply with FHA standards will cause that condo property to be ineligible for FHA-insured mortgage financing.

Why do most condo Governing Documents include this provision for Board approval of buyers and tenants? A couple of reasons. First, the Florida Condominium Act (Florida Statutes Chapter 718) establishes a fiduciary duty on condo Board members to protect the interests of owners. This means that Board members are responsible for putting other owners' interests above their own. Approval of new residents could have been considered an extension of fiduciary responsibility and therefore was included in the Governing Documents.

Second, because many Florida condo units are used as seasonal residences by the owners, those drafting the original Governing Documents may have thought new resident approval was a way to protect the interests of owners not occupying the property for most of the year. Whatever the reasons for including Board approval of new buyers or tenants in the Governing Documents, it doesn't comply with FHA-insured financing standards.



What if a Florida condo Association thinks it may want to change its Governing Documents (and the way it functions) so individual units in it can be eligible for FHA-insured financing? It is VERY important that the Association understands all the reasons, benefits, drawbacks, and costs involved. It is strongly suggested that Boards consult their Association attorneys long before considering an amendment to Governing Documents.

Unless the existing condo docs include another procedure for amendment, the Florida Condominium Act outlines the steps necessary for condo Associations to amend their Governing Documents.

In practical terms, there are a few things to keep in mind before starting:

- Fully educate all owners/members about the intention and reasons for any proposed amendment.
- It is critical that the Association attorney is involved before even thinking about an owner vote.
- In order to pass an Association vote, at least 2/3 of unit owners must vote in favor of the amendment.
- The entire procedure must follow Florida Statutes guidance for amending Governing Documents. If it doesn't, the amendment could be challenged or overturned in the future.

Condo Boards and Associations should be VERY aware that amending their Governing Documents can significantly change the rights of, and continued use by, each unit owner in the condominium property.

While FHA-insured financing may make resales in a given Florida condominium building or community available to a wider range of potential buyers, it is important to first understand what existing provisions in the Governing Documents either allow or prevent eligibility. FHA-insured mortgage financing eligibility may or may not turn out to be a benefit to many Florida condominium properties. Detailed legal and resale market research needs to be performed before making a decision that will clearly affect all individual unit owners.

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