Investor Report: HUD's Condo Rules

by Kenneth R. Harney

HUD just changed its condominium rules again, and there's both good news and sobering news for investors and developers tucked away in the revisions.

On the one hand, HUD relaxed its previously controversial requirement that at least fifty percent of the units in a project be sold before FHA could insure loans for new buyers on individual units.

Under the amended rule, FHA financing will be available in projects where at least 30 percent of the existing units have been sold.

That change is important, say developers and investors, because many newly-constructed projects have had trouble pre-selling units in the current tough real estate market.

A large number of new developments and conversion projects would have been knocked out of eligibility for FHA financing on their remaining units under the 50 percent presale rule.

HUD also relaxed its controversial policy that no more than 30 percent of the units in a condo project could be financed with FHA-insured mortgages. The new standard maximum will be 50 percent.

Under certain circumstances, however, HUD said it would be willing to consider situations where the percentage of FHA financing on individual units is even higher, provided the project has been completed for at least a year, and the condo association's operating budget provides significant reserves for capital improvements and deferred maintenance.

In its revised regulations, HUD stuck with a number of previously announced requirements that have drawn criticism from investors and developers, including that fifty percent of the units be owner-occupied. However, HUD says it will no count vacant or tenant-occupied bank-owned REO (R-E-O) as non-owner occupied units in the computation.

HUD will continue to require that no more than ten percent of the total units in a condo project be owned by a single investor - and that the 10 percent limit will include unsold units that developers are renting out.

That policy has sparked renewed controversy within the building and investment communities. Phil Sutcliffe, a condo financing consultant based outside Philadelphia, says that including unsold units rented out by developers or project investors will threaten the viability of many condo communities.

"In these market conditions," Sutcliffe told Realty Times, developers "routinely rent unsold inventory to generate cash flow so they can keep paying their construction loans," If HUD prevents them from selling units to buyers using FHA financing, builders may simply "hand the keys back to banks and walk away," he warned.

One footnote to all this: HUD labeled its latest condominium changes "temporary." They take effect December 7 and can only be counted on by investors and developers through December of 2010.

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