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5/29/14

Members of the Housing Strategy Committee,

Last month in the discussion regarding low-income homeownership, it was mentioned that low-income condominiums could be a viable ownership option for lower income households.

I'd like to share some insight and provide some recommendations for the City of Madison from my 7 years of experience serving on the board of a moderately sized low-income condo association, Whispering Woods Condominium Association. We are a 54-unit complex located on the east side just south of the intersection of Stoughton and Pflaum Roads. I believe our property was originally developed in the late 1960s as low-income multifamily rental housing. The condo developer purchased the property out of sheriff's sale and continued to run it as a multifamily rental community for around a decade before converting the it into condominiums in 2005. At that time, three bedroom units were marketed for \$129,900. We became an independent of the developer in late 2006.

Over the years, I have steadfastly stated this is a wonderful community to live in. My children have built-in friends to play with. This summer a group of children has started to ply their business skills with a lemonade stand. The Association promotes social events like barbeques and block parties. My wife and I have developed close friendships with our neighbors. We walk each other's dogs and provide the occasional babysitting service. On top of all that, there have been numerous times when a neighbor has helped another out in a pinch.

That said the Association has been met with a fair share of challenges.

From the outset, the annual budget has been an issue. When the units were purchased, the developer set dues at \$75 per month. Within months of taking control, the Association could not pay its bills, raided the initial reserve fund, and then began to randomly increase dues and apply special assessments. When I joined the Board in late 2007, I forced the budget issue and convinced the rest of the board and management that a large dues increase would stabilize the budget and allow for capital planning. Over the past five years, we have had relatively stable dues levels. Today, we operate with a budget around \$100,000 and have reestablished a reserve fund. Out of the budget, we fund management fees, lawn care, snow removal, utilities (sewer and common area electrical), repairs and maintenance, capital improvements. Our reserve allocation is set at a level of 10% of our annual budget as required by secondary market financing providers. By my estimates, using published industry expense figures, if the property was run as a multifamily rental community, rental cash flow would support operations at twice what we budget. This would give us sufficient room to make needed repairs and improvements that would, in turn, help increase our property values. However, this level of funding would raise dues to over \$300 per month. With our members, there are not too many households that could absorb such a large increase. So, for as stable as our dues have been, our board must deal with constant tough decisions regarding maintenance and improvements projects and we have to promote volunteer labor on some projects to help reduce expenses.

To put this in perspective, our property is around 50 years old. It requires a great deal of maintenance. In our budget, we dedicate around \$30,000 annually for this. Recent projects have included heat seal patching of the parking lot, replacing old timber walls with concrete, removing dead trees, and new

landscaping improvements. In addition, we have spent a great deal of money undoing shoddy work from the past half century. This includes repairing rotten structural supports because building foundations were ended below the soil grade. We had to upgrade our gutter system because the condo developer installed a system that was too small to handle the runoff from a commercial size roof. Just this year, we had our entire maintenance budget blown by a water main that broke in the second week of January. If you have ever had to call a plumber on a Friday night, you can understand how this repair cost us over \$20,000. Instead of being in a position to move forward, we had to revise long-term plans and institute an assessment of \$25 per month for the remainder of the year so as not to raid the barely established reserve fund.

Of everything, working with the secondary mortgage market has been one of the hardest pieces to deal with. When most of our owners purchased our units, there was no association approval process in the secondary market. Now, Fannie, Freddie, the FHA, the VA, and the private market all have their own individual rules. My association spent 18 months trying to move the needle to get everything in shape for FHA approval. It was the most likely source of funding for potential buyers of our units and other secondary market participants would recognize the approval for their own approval process. We worked hard to get our past due dues level under the 15% maximum allowed. For our association, this means that 8 units can be past due. At the time, we had 6-7 owners going through foreclosure. However, this was also during the robo-signing era when banks essentially froze their foreclosure processes and lengthened the time it took to correct our receivables levels. We cut every expense we could in order to somehow allocate 10% of our working cash towards a reserve fund. We wrote a rental policy to appease requirements. We hired a FHA approval specialist to get the process to flow smoothly.

And, it turns out that our developer inadvertently wrote a poison pill into our condo declaration. The document states that our association will be owner-occupied unless approval is provided by the Board. Our rental policy was designed to provide this approval. However, the FHA requirement is that it must be a free and clear provision. (Oddly, they also will not approve condo associations that are less than 50% owner occupied.) So, we were denied on this small technicality. And, because the provision was written in the declaration we are required to get approval by both $\frac{3}{4}$ of owners and $\frac{3}{4}$ of mortgage holders. This is a hurdle that would take years to overcome.

Somehow, buyers could still qualify for spot approval, but we would not have automatic approval. Now, the FHA has announced that they are removing the spot approval option. To me, this is the final frustration. I have an association of unit owners who saw their units, likely their single largest asset, drop in value by 50% at the trough of the market. They watched as 20-25% of their neighbors lost their units through foreclosure. For three years, our association did not have a single market rate sale. And, most of our owners are likely still underwater on their mortgages. Instead of turning tail and running however, my association members have put sweat equity into building their community. I have personally spent countless nights trying to figure out how to make everything work. And now, as the housing market begins to recover, the primary financing option we have to sell our units is being pulled out from under us. I'm not sure how to go back to my members and say "Sorry. You did everything right, but you are stuck with an asset you cannot sell."

Despite all of this, I still believe the concept of low-income condominiums is a cost effective way to promote responsible homeownership. The cost of property maintenance is normalized and spread out over time instead of coming in irregularly spaced large expenditures. It provides stability to families, neighborhoods, and communities. This feeds into achievement in our schools and can help reduce demand on social services.

However, if the City of Madison would like to promote low-income condominiums as a viable housing option, I believe it also needs to provide structural support to address areas where the private market has either failed or been inconsistent over the years. Starting at approval of converted rental units, the City should ensure the property meets current code levels and does not have any structural deficiencies. In addition, it should be required that the utility infrastructure can properly handle the needs of both the association as a whole and unit owners on individual meters. The City should not allow sophisticated multifamily operators transfer the maintenance of older properties with fundamental issues onto the backs of low-income families with little experience in managing large property complexes. To further support associations in this, either the City or a designated private organization should provide support for technical budget and property management assistance. In addition, low cost reserve analysis could help low-income associations a long way towards properly budgeting and capital planning. Both of these would help support associations looking to qualify for secondary market approval. Where a gap remains, the City could assist low-income families with down payment assistance grants to help qualify for secondary market financing that comes with fewer restrictions. Finally, the City could also look at micro-TIF grants, or a similar type of program, to provide small levels of financial assistance to associations looking to make capital improvements that can increase property values and improve curb appeal out to the surrounding community.

Thank you for your time.

Condos are becoming FHA no-lending zones

By KENNETH R. HARNEY

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or young first-time buyers, people with modest down-payment cash or seniors who want to tap their equity using a reverse mortgage, it's a growing problem: They cannot use Federal Housing Administration financing in condominiums.

It's not that these buyers and unit owners can't qualify on credit and income grounds for a loan personally — they often can. Instead, it's because the entire condominium development is ineligible. As the result of policy changes at the federal level and decisions by condominium boards of directors, thousands of communities have essentially become prohibited lending zones for the FHA in the last several years.

The agency has banned so-called spot loans and will insure mortgages only on units in condo projects that have passed a certification process that examines budgets, reserves, insurance coverage, percentage of renters in the development, and delinquencies on payment of condo fees.

The procedures weed out fiscally weak, poorly managed developments and reduce taxpayer exposure to future losses, the FHA says. Condominium boards, on the other hand, contend that some of the evaluation criteria are too strict and that the certification process is bureaucratic and costs them money they'd prefer not to spend.

Since toughening its financing rules and requiring certification of entire projects four years ago, the number of condo developments approved for FHA financing has plunged by more than half. As of mid-month, it stood at just 10,020 communities, according to an FHA spokesman. Industry sources estimate that the total number of condo projects nationwide is around 144,000.

FHA financing is important because of the special niches it fills. Among the three major federal lending intermediaries — Fannie Mae and Freddie Mac are the other two — the FHA is the most flexible on credit issues. It is also lenient on debt ratios and allows down payments as small as 3.5%.

As a result, the FHA has been the go-to mortgage option for moderate-income buyers for decades and has been a key resource for African American and Latino buyers, many of whom have made their first purchase in a condominium development.

The FHA also plays an outsized role in the reverse-mortgage market for seniors 62 and older. Its insured reverse-mortgage product accounts for more than 90% of all borrowing in that field, enabling seniors to extract cash from their home equity to support their retirement expenses.

But with the sharp decline in FHA-approved condominium projects, many buyers and unit owners are finding themselves financially frozen out. Equally troubling, unit owners who want to sell find the pool of potential buyers reduced — along with the market value of their property — because FHA mortgages are banned.

Seth Task of Berkshire Hathaway HomeServices Professional Realty in Solon, Ohio, says a condo unit client his firm represented recently was forced to sell for \$10,000 below what she had been offered by a buyer who was pre-qualified for an FHA loan — a loss solely attributable to the condominium's noncertified status.

Situations like this are becoming more frequent, housing industry experts say, and the lack of FHA financing eligibility for entry-level-priced condo units is partially responsible for the decline in first-time buyer participation in the real estate market.

But now a movement is underway to reverse this shrinkage. At this month's spring legislative conference of the National Assn. of Realtors in Washington, California brokers and agents unveiled a campaign to persuade condo boards to re-think their objections to FHA certification — for their unit owners' sakes.

The primary focus, said Mike DeLeon, president of the Orange County Assn. of Realtors, which debuted an educational video at the conference, is to show reluctant condo boards of directors "the positive benefits" of certifying with the FHA. The video stresses "keeping condo unit values at their highest" by widening the pool of potential buyers; helping unit owners tap their equities for retirement; and the relatively low risk of default presented by today's FHA buyers.

Is there a broader message here for condo boards nationwide? Maybe not so much for those in the high-priced market segments that the FHA rarely serves — but even their owners are cut out of FHA's dominant reverse-mortgage program.

For most other condo developments, however, the message is this: Give some thought to the issue. FHA certification has its complications and costs, but it could be more than worth the effort for your current residents and future buyers.

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