

NEW FANNIE MAE AND FREDDIE MAC REQUIREMENTS FOR CONDOMINIUM MORTGAGE LOANS

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The sharp decline in Michigan property values have made it more difficult for some condominium buyers to obtain mortgage loans. Also, many current co-owners are attempting to refinance existing mortgage loans, often to avoid an impending increase in their adjustable rate mortgages. As a result, Association Boards of Directors and property managers should be aware of what Associations must do in order to ensure that current co-owners and potential buyers are able to obtain mortgage financing. As you may be aware, private mortgage lenders usually sell the loans they make to free up cash for additional lending activity. Often, the purchaser of these loans is either Fannie Mae (Federal National Mortgage Association) or Freddie Mac (Federal Home Loan Mortgage Corporation). Most likely the result of the recent mortgage lending scandals and collapse of the real estate market, Fannie Mae and Freddie Mac are now requiring much more information for mortgage loans involving condominium units.

Fannie Mae now requires that the lender handling the loan application for the condominium purchaser verify and warrant to Fannie Mae that:

1. The association has an “adequate” budget.
2. The association budget allocates at least 10% of revenues to reserve funds.
3. The association has cash on hand sufficient to cover all the deductibles under its insurance policies.
4. No more than 15% of the co-owners are over one month delinquent in paying their assessments.

Given the current economic downturn, which has hit Michigan particularly hard, many co-owners are having difficulty paying the condominium assessments and/or are falling into foreclosure. Staying below the 15% delinquency rate mandated by Fannie Mae will, therefore, be difficult for many condominium associations.

It appears that Fannie Mae and Freddie Mac are also now enforcing their requirements adopted in 2001 and 2002 concerning an association’s “fidelity insurance” (“employee dishonesty” is the term we see here in Michigan). Fannie Mae and Freddie Mac require such insurance that meets the following criteria:

1. The policy must name the association as the insured.
2. The association must pay the premium expense.

3. The amount of the coverage must meet certain minimums. The policy must be sufficient to cover the maximum amount of the association's cash assets (operating accounts plus reserves). These minimums can be reduced if the association (and its property manager) can document that any one or more of the following "financial controls" are in place:

- There must be separate accounts for the reserves and the operating funds and the bank or credit union must send monthly statements directly to the association.
- Separate records and accounts are maintained for each association managed by a given management company and the management company alone cannot draw checks against the association's reserves.
- Two or more directors must sign any checks drafted against the association's reserve fund account(s).

Associations which can document that they satisfy any one of these three "financial control" practices are allowed to reduce their employee dishonesty insurance coverage to a figure that represents three months' assessment revenue for all units.

Each condominium association should review its financial procedures and records to verify that it meets these Fannie Mae and Freddie Mac loan requirements. The cost of employee dishonesty insurance is relatively inexpensive and eligibility for loans underwritten by Fannie Me or Freddie Mac may help slow the fall of property values in this declining market. The assistance of a qualified professional may be needed to determine whether a specific association meets these loan requirements.