



Real Estate Law Alert

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Greater Burden On Lenders Writing Condominium Loans

The aftershocks of the subprime mortgage crisis continue to rumble through the mortgage lending industry. It should come as no surprise that many lenders have reacted by requiring higher credit scores and larger down-payments from borrowers. Another recent development is that Fannie Mae and Freddie Mac, have shifted costs and risks to originating lenders and brokers in the case of mortgage loans on condominiums, cooperatives and planned-unit development projects (PUDs). Private mortgage insurers have also gotten into the act by strictly limiting the condominium loans that they will underwrite. The end result is that fewer condominium borrowers will qualify for loans and mortgage insurance, and the cost involved in originating those loans will increase.

Formerly, Fannie Mae and Freddie Mac performed in-house reviews of condominium, cooperative, and PUD projects (collectively referred to herein as a “development” or “developments”) to confirm that the developments were properly created, structured, and managed. As a result of this process, mortgage originators had a list of approved developments for which they knew Fannie Mae, Freddie Mac and others would purchase loans. In early 2008, however, Fannie Mae began to phase out this process by amending Part XII of its Selling Guide, as more specifically detailed in Fannie Mae Announcements 07-18 and

08-01. (Developments that had already been approved continue to be published by Fannie Mae as “Accepted Condos, Co-ops, and PUDs” and can be found by searching www.efanniemae.com.) Freddie Mac has made similar changes in its approval process, the specifics of which can be found in Chapter 42 of the Freddie Mac Single-Family Seller/ Servicer Guide, available at <http://www.freddiemac.com/sell/guide/>.

The effect of the new Fannie Mae review process is to shift the due diligence burden for these developments to originating lenders. To sell condominium loans for developments not previously approved by Fannie Mae, the originating lenders and brokers must provide Fannie Mae with extensive representations and warranties, including representations and warranties regarding the legal formation and current state of the development — information that Fannie Mae previously gathered for itself.

Fannie Mae has set out three basic forms for its new lender review process: the Limited Review Process, the Expedited Review Process, and the Lender Full Review Process. Each has different criteria and applies in different circumstances. The Limited Review Process appears to be the least burdensome for lenders and is designed to enable lenders to deliver individual loans secured by project units based on loan-level characteristics with-

out a full project review. The Limited Review Process is intended to be used only on a “spot loan” basis and may not be used to deliver multiple mortgages within the same project. The Expedited Review Process is a web-based tool used to provide lender-specific project acceptance for attached and detached, new and established, two-to four-unit condominium projects. The most labor-intensive review is the Lender Full Review, which is used for new and established condominium, cooperative, and PUD developments.

Although the specific qualifications for each review process differ, lenders must make certain representations and warranties to Fannie Mae based on their underwriting review and on a qualified attorney’s review of the legal documentation. This review includes, without limitation, confirmation that (i) the condominium project complies with applicable state laws and regulations governing condominiums; (ii) use of the residential units is limited to private residences and/or home professions, and there is a comprehensive set of occupancy regulations and restrictions; (iii) there exists an explicit turnover procedure as between the developer and Board of Directors of the association; (iv) there exist provisions related to casualty loss and/or eminent domain which adequately protect the lender’s investment; (v) any right of first refusal in the project documents will not adversely impact the mortgagee; (vi) certain material and adverse amendments to the project documents are not effective unless agreed to by a majority of mortgagees; and (vii) the project documents provide that the mortgagee and/or guarantor of the mortgage receives specified timely written notices.

As reported by Kenneth Harney in *The Washington Post* on April 20, 2008,

and adding to the new restrictions imposed by Fannie Mae and Freddie Mac, private mortgage insurers have also changed their condominium loan underwriting policies. For instance, as of May 1, 2008, AIG United Guaranty, a private-mortgage insurer, no longer writes coverage on condos in hundreds of ZIP Codes that AIG has designated “declining” markets. This ban is irrespective of the potential borrowers’ credit scores, assets or other financial guarantees. AIG also now requires that buyers make a down payment of at least 10 percent, in stark contrast to AIG’s and similar firms’ past practice of insuring loans for buyers who put next to nothing down. AIG has also announced that it will reject applications, regardless of credit-worthiness, in condominium projects where more than 30 percent of the owners are investors rather than owner-occupants. Although AIG is certainly not the only private mortgage insurer willing to write coverage on condominiums, its underwriting restrictions should not be viewed as an anomaly in light of current market trends but, rather, as the shape of things to come in the industry.

The subprime mortgage crisis continues to impact the mortgage lending industry, in this case causing major changes in the manner in which lenders and ancillary providers, such as private mortgage insurers, view and account for the risk inherent with condominium and similar project lending. In the end, consumers will find it more difficult to finance condominium purchases, and the cost involved will increase as lenders attempt to pass the expense of this additional review through to borrowers. Originating lenders are urged to review the new Fannie Mae and Freddie Mac policies thoroughly and develop internal checklists to facilitate and standardize their internal review of condominium loans.