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Community Associations Newsletter

Confused About Lender Questionnaires Regarding Deferred Maintenance? You're Not Alone

By Leslie S. Brown, Esquire

“Does the project include deferred maintenance that is severe enough to affect the safety, soundness, structural integrity, or habitability of the improvements?”

“Is the HOA and/or management company aware of any conditions or project-wide deferred maintenance within the project that may negatively impact the safety, structural soundness, habitability, or functional use of the project?”

“Has any local regulatory, authority, or inspection agency provided any notices to the HOA to make repairs due to unsafe conditions?”

“Do the improvements need substantial repairs and rehabilitation, including any major components?”

Do these questions look familiar?

In the wake of the June 2021 Champlain Towers South Condominium collapse in Surfside, Florida, Fannie Mae issued new temporary project requirements that took effect

on January 1, 2022 pertaining to building safety. Freddie Mac followed suit with similar temporary project requirements effective February 28, 2022.

Fannie Mae and Freddie Mac are government-sponsored enterprises (GSEs). They are supported by the federal government but are run privately under the oversight of the Federal Housing Finance Agency (FHFA). They do not issue residential real estate loans. Rather, they guarantee to purchase a specific type and number of residential real estate loans and then sell them as “mortgage-backed securities” to investors in the secondary market. This structure is in place to make home ownership more accessible nationwide. Lenders rely on GSEs to purchase or guarantee their mortgages because it gives more liquidity for lenders, which then allows them to underwrite or fund more mortgages, thus allowing for more homeownership.

But, in order for GSEs to purchase loans and re-sell them, lenders, and the loans and the

projects they secure, have to meet certain criteria. Due to Fannie Mae and Freddie Mac's new project requirements issued in response to the tragic Surfside collapse, mortgages on units in condominium and co-op buildings with 5 or more units are not eligible for purchase by Fannie Mae and Freddie Mac if there is significant "deferred maintenance" or where the association has "received a directive from a regulatory authority or inspection agency to make repairs due to unsafe conditions." The projects remain ineligible until the required repairs have been made and documented. The GSEs define "significant deferred maintenance" as the "postponement of normal maintenance", but it does not mean isolated damage like a water leak or small in-unit fire.

What these new requirements mean is that it will be more difficult for homeowners to obtain lending for units in buildings where there are significant critical repair needs.

How does a lender know if there is deferred maintenance or other safety issues?

Lenders learn of the state of the building through questionnaires that they issue. Typically, the association's management company fills out these questionnaires.

These new lender questions regarding deferred maintenance and unsafe conditions have thrown managers for a loop. The main concern is whether the manager is even in a position to make representations about "deferred maintenance" and the structural soundness of buildings. Most managers will answer with a resounding "no." They do not want to be put in a position to have to represent to a lender the physical state of the premises.

They rather leave those conclusions to professional engineers.

However, if the manager refuses to answer lender questions about the physical state of the premises, then the lender may not issue the loan to the prospective purchaser, causing even more complications for the association and the management company. Fannie Mae and Freddie Mac have stated they will not back loans in condominiums and co-ops if the lender is uncertain or unable to confirm the safety, soundness, integrity, and habitability of the building, which can essentially cut off financing for prospective purchasers and make units difficult to sell.

So, what's a manager to do?

While there seems to be an industry-wide consensus that management is not in a position to make representations about deferred maintenance and structural soundness of buildings, managers can refer the lender to the association's latest reserve study and any engineering reports that may address structural issues. In that regard, associations need to make sure that they are complying with their jurisdiction's reserve study and funding requirements. Please refer to our office's ***July 2021 Newsletter outlining the reserve requirements for our local jurisdictions.***

Managers can also direct the lender to recent meeting minutes that may discuss outstanding maintenance or construction projects that may have significant impact on safety, soundness, structural integrity, or habitability of the community.

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Managers can also direct the lender to the association's financials. GSEs generally require that at least 10% of the association's budget be allocated towards reserves, which is evidence that the association is taking measures to fund major capital projects down the road.

Of course, if there is any official citation from a state or local body, those should be disclosed. The GSEs will not grant waivers if the association does not pass local regulatory inspections or certifications. You may see this issue come up with elevator inspections, for example. The manager can provide the lender a list of recent inspections, with the dates, purpose, etc. and then making the related documentation available upon request. The manager can also refer the lender to state and local regulatory bodies.

The key is to provide the lender with information and documentation so that it can make its own decision regarding deferred maintenance and structural soundness. Fannie Mae has expressed willingness for the seller to be a source of information, but, in practice, it's more likely that management will be the one to provide the documentation.

If the association is found to have significant deferred maintenance or other structural soundness issues, it can become a real problem for the association. The GSEs will list the association in a private database called "Condo Manager", that is only accessible by lenders. It tracks buildings that are ineligible for mortgage backing from the GSEs. According to FHFA, Fannie Mae and Freddie Mac own 62% of conforming loans. So, ending up on a "no loan" list is a major concern.

Boards need to move quickly to address critical issues.

The Community Associations Institute (CAI), the trade organization representing the interests of the community association industry, is tackling these concerns. On February 17, 2022, CAI sent a letter to FHFA requesting that the implementation of the new requirements be suspended by at least 1 year to reduce uncertainty, allow for associations and managers to produce documentation materials more efficiently, and to account for local and state government enactment of appropriate condominium and cooperative project safety and financial solvency standards. CAI reports that its members shared that creditworthy borrowers have been denied credit to purchase homes and refinance mortgages in condominium and cooperative projects with no safety, soundness, structural integrity, or habitability concerns because of the temporary guidelines.

If your community needs assistance in responding to a lender questionnaire, please reach out to one of our community association attorneys.

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