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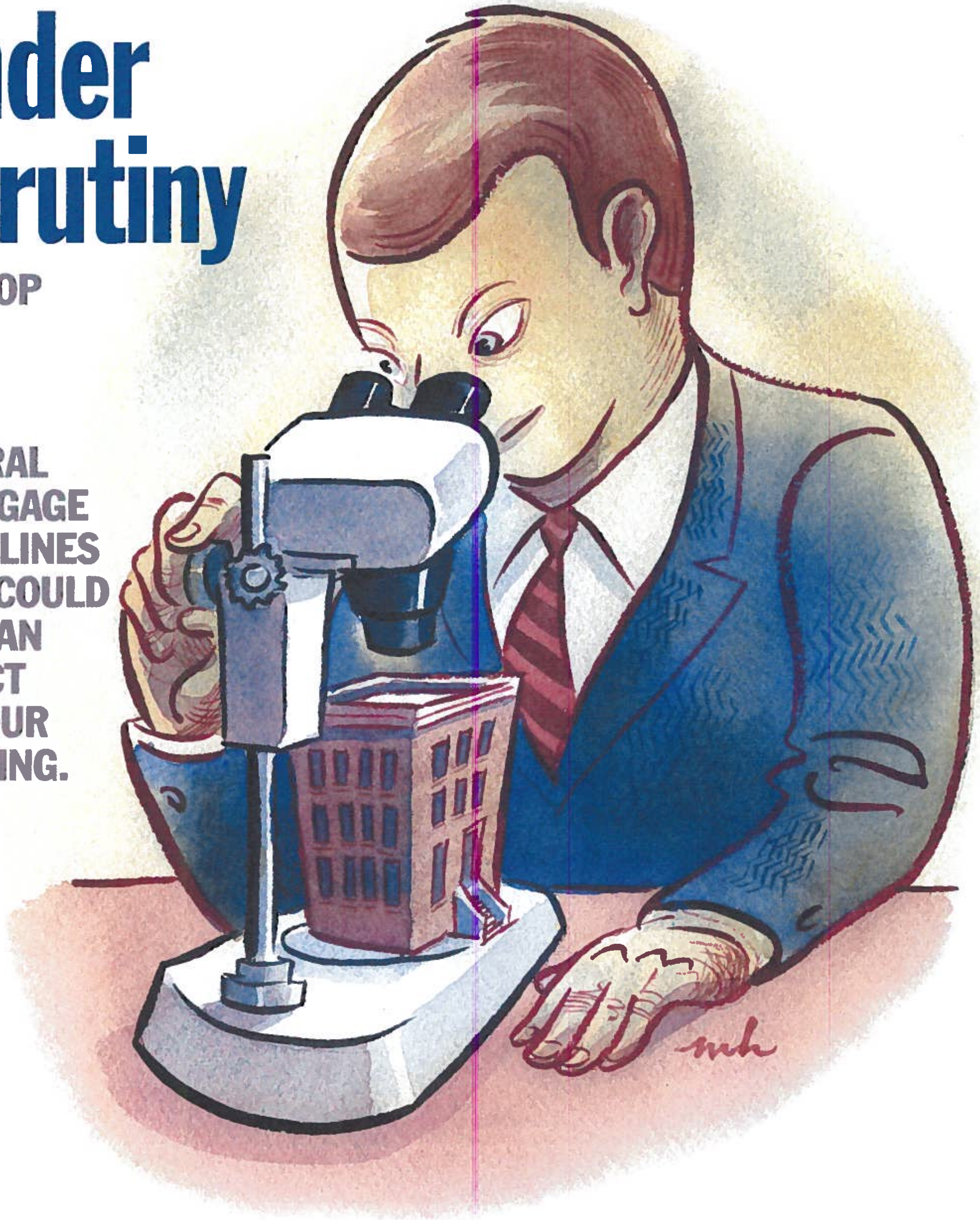
Under Scrutiny

THE TOP 5 FEDERAL MORTGAGE GUIDELINES THAT COULD HAVE AN IMPACT ON YOUR BUILDING.



NOT LONG AGO, when CPA Chris Griebel was at an annual condo board meeting in an upscale Manhattan neighborhood, he saw first-hand how the ripples of the financial crisis were trickling down. Although the building was on solid financial footing, the sponsor still owned a significant portion of the units and, because high non-resident ownership is considered a black mark to lenders, owners couldn't get refinancing when their apartment loans came due. "It affects the building as a whole because it affects the people who live there," explains Griebel, senior manager with Czarnowski & Beer. "In Manhattan, it's all about resale and marketability."

The top 5 federal mortgage guidelines that could have an impact on your building.

Under Scrutiny

IF YOU WANT A NEW LOAN, BE WARNED: THE REQUIREMENTS ARE GETTING TIGHTER.

By Jennifer V. Hughes

It all comes down to this: since two government loan agencies – the Federal National Mortgage Association (popularly known as Fannie Mae) and the Federal Home Loan Mortgage Corporation (commonly called Freddie Mac) – end up carrying most of the home mortgage loans, other lenders end up adhering to rules set up by the two entities. Those guidelines, known as *The Selling Guide,* have been on the books for decades, Griebel says, but within the past few years, lenders have started to follow them more closely. And the guidelines themselves have become more rigorous, stating, for example, that the sponsor will hold no more than 10 percent of the units.

Griebel notes that each lender has to make sure that the building meets the specifications in *The Selling Guide* at the same time that it scrutinizes the buyer's individual finances. The rules apply to both condos and co-ops, but Griebel says they have hit condos harder. In part, that's because nationwide there are fewer co-ops, so banks keep a closer eye on condos. It's also because co-ops are often pickier about their buyers, since residents have

to meet the bank's specifications – and the board's.

"Banks have to listen to the big man here – and it's Fannie or Freddie – and what these guys are saying is, 'You're on your own if you don't meet our specifications,'" says Griebel, who estimates that as many as 90 percent of loans wind up under the auspices of Fannie or Freddie.

Attorney Pierre E. Debbas, a partner in the firm Romer Debbas, says the belt-tightening started about two years ago. "What they're trying to do is to make up for their lax lending regulations over the real estate boom by being over-diligent, and they're looking for reasons not to lend," he says, noting that the issues are particularly thorny for new developments. One rule, for instance, stipulates that 70 percent of the units have to be in contract before Fannie Mae will write a mortgage. "You can't have 70 percent all-cash buyers, so how do you get there? You have to have lenders who are willing to take a risk."

The Top Five

The top five Fannie Mae requirements that could have an impact on your building are:

1 Reserve fund requirements. One standard that frequently trips up condo and co-op loan-seekers requires that a building set aside 10 percent of revenue for a reserve fund. If the building does not have this, it should set it up immediately. CPA Richard Montanye, a partner at the firm Marin & Montanye, says lacking that reserve line item causes the most problems for condo and co-op buyers. "We have boards that have been setting aside money for years in reserves but didn't have a specific line item to do so," he says. "Now they're making it a line item in order to make it conform to the Fannie Mae regulations." The Manhattan condo mentioned earlier, for instance, is contemplating instituting a flip tax in order to reach that figure. Debbas says that some co-ops or condos face problems even though they have as much as 30 percent of annual charges in reserve but no line item.

So, why does it matter if the building has 10 percent set aside for reserves when it comes to an individual's home loan? Montanye says the rationale is this: if there is no reserve and there is a big capital expense, the building would have to raise maintenance, affecting the unit-owner's personal finances and thus potentially jeopardizing the loan. "I'm seeing it in pockets," the CPA notes, meaning that the problem is not in every building or even in every case. "I recently spoke to a board at a building that had nine refinances or sales in the past year, and seven went through fine and two had problems."

Montanye says he also sees issues at new buildings, where residents wonder why they have to set aside for reserves when everything is brand new. But Montanye says the individual loan-seeker does matter. "What's happening is that when the individual buyer has borderline credit to begin with, it appears the lender is going further to make sure there is nothing in the closet that will hurt them," he says.

2 Sponsor ownership restrictions. The sponsor can own no more than 10 percent of the units. The theory is: more sponsor ownership (as opposed to resident ownership) can destabilize the building. Indeed, lenders

look unfavorably upon high non-resident ownership.

3 Arrears restrictions. No more than 15 percent of the units can be more than 30 days in arrears for maintenance and common charges. The financial crisis has caused people to have a tough time financially and has made it less likely that they will be able to keep up with monthly maintenance or common charges. At the same time, the financial crisis has led lenders to look more strictly at rules that require that no more than 15 percent of the units be more than 30 days in arrears. "It does become a snowball effect," says Montanye, whose firm assists more than 200 condos and co-ops in the city.

4 Insurance premiums. The budget must include a provision for all insurance deductibles. Debbas says that one of the first signs of the impact he noticed was how lenders insisted buildings carry more insurance. In one case, he says the co-op board had a $1 million policy but the lender wanted $1.25 million. (The board upped its policy.) "The increase in the premium was like $120 a year, but the building said no at first, thinking, 'Why? We don't get it.' Once three or four refinance loans got rejected, that got them to do it," Debbas says.

5 Management cancellations. If there is a professional management company in place, any cancellation clause for the contract must be 90 days or less. Griebel says some firms prefer longer-term contracts but buildings need to convince them the shorter term is necessary in order to be attractive to lenders.

In the final analysis, if you haven't paid close attention to the new federal rules, it's time you did. If you start heeding them only when board members themselves run into trouble, you may find yourself in the position of the parachutist who realized, too late, that he had left his chute behind and that he had jumped to a conclusion. ■

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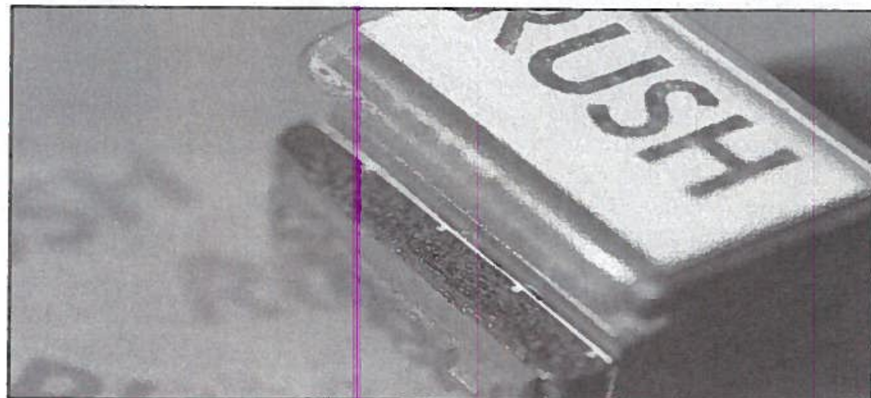

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