

MERCERTRIGIANI

COMMON INTEREST COMMUNITY LEASING RESTRICTIONS

Secondary Mortgage Market Considerations

Secondary mortgage market lending agencies generally disfavor communities with high rental ratios, as a large percentage of tenant-occupied units may indicate increased financial risk, reduced owner engagement and greater potential for delinquencies or property neglect. However, secondary mortgage market lending may also disfavor overly burdensome leasing restrictions, particularly those that significantly limit an owner's ability to lease their unit because such restrictions can negatively affect the marketability and liquidity of the property. Accordingly, common interest community associations should strive to adopt leasing policies that maintain community stability while preserving reasonable flexibility for owners and maintaining eligibility for secondary mortgage financing.

For condominium projects seeking financing through the secondary mortgage market, certain occupancy considerations are commonly applied. Generally, at least 50 percent of the units must be owner-occupied or sold to owners intending to occupy the units. While Fannie Mae and Freddie Mac do not impose direct rental caps on condominium projects, owner-occupancy ratios may affect the availability of investor financing within a project. These ratios typically apply only to loans made to investors purchasing units for rental purposes and do not apply to purchasers acquiring units as their primary or secondary residence.

STATUTORY AUTHORITY

National Housing Act, Section 203(b) – Establishes authority for the Federal Housing Administration to administer a condominium approval process that determines whether a condominium project is eligible for FHA-insured financing. The process evaluates various aspects of the condominium project, including financial stability, governance, insurance coverage, owner-occupancy levels, and the content of the condominium instruments. Only condominium projects that satisfy FHA requirements may be approved for participation in FHA mortgage insurance programs, which allows qualified purchasers within those projects to obtain FHA-backed loans.

The U.S. Department of Housing and Urban Development (HUD) – HUD provides detailed condominium approval guidelines through Mortgagee Letters 2009-46A and 2009-46B. These mortgagee letters outline the policies, procedures, and underwriting standards used to evaluate condominium projects for FHA eligibility. The guidance addresses key factors such as owner-occupancy requirements, leasing limitations, financial reserves, insurance coverage, and project management standards. These letters were issued to clarify FHA condominium approval policies and to promote consistency in how lenders and HUD review condominium projects for FHA financing eligibility.

The Housing and Economic Recovery Act of 2008 (HERA) – HERA was enacted in response to the national housing and financial crisis and significantly impacted federal housing finance programs. Among other reforms, HERA expanded FHA authority and introduced measures intended to stabilize the housing market and increase access to mortgage credit. The legislation influenced FHA condominium approval policies and encouraged greater flexibility in financing options for condominium purchasers while maintaining oversight of lending standards to protect both borrowers and the federal mortgage insurance program.

FEDERAL HOUSING ADMINISTRATION

The Federal Housing Administration (“FHA”) establishes underwriting guidelines applicable to both proposed and existing condominium projects to determine eligibility for FHA financing. These guidelines include a variety of requirements, including limitations on the percentage of units within a condominium project that may be leased. For a purchaser of a condominium unit to qualify for FHA financing, the condominium project itself must first obtain FHA approval. The amount financed must fall within the applicable FHA loan limits for the jurisdiction in which the condominium project is located.

Section 203(b)(3) further provides that condominium instruments may not contain restrictions on the conveyance of units that would limit an owner’s ability to transfer the unit. This includes provisions that restrict leasing in a manner that would result in a conveyance being voidable by a third party or that require the consent of a third party before a unit may be conveyed or leased. Such restrictions may disqualify a condominium project from FHA approval and consequently, limit the availability of FHA financing for potential purchasers.

The Federal Housing Administration has clarified types of leasing restrictions in condominium instruments considered acceptable:

- Restrict number or percentage of units rented
- Create hardship clause for rental caps
- Require copy of lease
- Require written lease
- Request names of tenants
- Require lease conform to condominium instrument requirements