

## CHAPTER 1. INSURANCE OF INDIVIDUAL MORTGAGES

## 1-1. CHARACTERISTICS PERTAINING TO INDIVIDUAL UNIT MORTGAGES.

- a. General Eligibility for Insurance Under Section 234(c). To be eligible for mortgage insurance under Section 234(c) of the National Housing Act an individual unit estate must be an integral part of a condominium which was constructed or rehabilitated and insured as a project under Section 234(d) or as a project insured under any other Section of the Act, except a Section 213 Management type or Sales type cooperative.
- (1) Notwithstanding the above, if a condominium contains 11 or less individual units, one or all of the units are eligible for mortgage insurance, provided the condominium regime is compatible with HUD-FHA requirements and all the unit owners are willing to subject themselves to a regulatory agreement.
  - (2) A property containing 11 or less units, that was not previously a condominium, may be converted provided a condominium regime is established in accordance with HUD-FHA requirements.
  - (3) If a property comprising 12 or more units was not previously covered by project mortgage insurance, the individual units therein are not eligible for HUD-FHA-insured financing under Section 234(c) unless the property is rehabilitated under Section 234(d).
  - (4) Different underwriting instructions apply in all of the above cases.
- b. The Two Internal Phases of a Condominium (Project/Individual Unit). A single family unit on a single deed estate can normally be conveyed at any time because it is a complete and independent estate in real property. An individual unit estate in a condominium is not an estate in real property until the unit is coupled with an undivided interest in the common estate comprising the condominium. The estate would not be conveyable as a condominium estate without either the unit or the undivided interest. Until all the units comprising the condominium are constructed, there is no certainty as to the amount of undivided interest applicable to any of the units. The Model Form of Declaration (FHA Form 3276-A) does, however, provide for some variation between the "as built" horizontal and vertical planes and those recorded on the plat.

- (1-1) (1) Notwithstanding any presale requirements, the number of units the condominium is to contain must be known. In addition, the entire property must be dedicated to a condominium regime. All units must be constructed before HUD-FHA will insure the mortgage of any individual unit estate in the condominium.
- (2) Regardless of whether or not a condominium is, or has been, encumbered by a multifamily project mortgage, its characteristics are those of a project (i.e., each unit and its undivided interest is a part of a larger estate) and, except for the condominiums comprising 11 or less units, HUD-FHA is required, by the National Housing Act, to treat it as such.
- c. Unsubsidized vs Subsidized Unit Mortgage in a Condominium. The basic condominium documents set forth in this handbook and Reference (1) of the Foreword are not changed by the application of assistance payments under Section 235(i). A Section 234(c) commitment can be qualified so as to make it convertible to Section 235(i) if the unit and the family that is to own the unit are eligible for assistance payments. The basic documents are also applicable to project condominiums which are to be insured under Section 236 and all of the units are to be converted, at some later date, to Section 235(i) individual condominium mortgages. Also the basic documents are applicable to rehabilitation project mortgages to be insured under Section 235(j)(1) for future conversion to Section 235(j)(4) individual condominium mortgages.
- (1) In subsidized cases the eligibility of the unit, and the family that is to own the unit, is established and administered by the Office of the Director of Subsidized Housing Programs.
- (2) The basic programs are established and administered by the Office of the Director of Unsubsidized Insured-Housing Programs via the Condominium and Cooperative Housing Branch.

1-2. GENERAL REQUIREMENTS.

a. Type of Unit Ownership Required.

- (1) The mortgage must constitute a first lien covering a fee simple or leasehold interest in a one-family unit, together with an undivided interest in the common elements.
- (2) Leaseholds are contrary to the homeownership concept and will normally be permitted only in localities where the

use of leaseholds of this type is customary, and only in those cases where their use has received specific approval of the Director, Office of Unsubsidized, Insured Housing Programs. Leaseholds must be on the individual units only; blanket leaseholds or subleases will not be eligible for insurance.

- b. Number of Unit Mortgages that One Owner May Insure. One individual may be the mortgagor of not more than four one-family units covered by mortgages insured under Section 234 but he must reside in one of the units. (The HUD-FHA mortgage ratio on the unit which he occupies is more liberal than those which he owns on a non-occupant basis.)
- c. Real Estate Taxes. In order for the condominium plan to be acceptable, real estate taxes must be assessed and be lienable only against the individual units, together with their undivided interest in the common elements, and not against the multifamily structure. Unless this limitation is made, a tax lien could amount to more than the value of any particular unit in the structure. This could present a situation which would be unsatisfactory from the mortgaging standpoint. The mortgagee will be required to certify at time of endorsement that the family unit is assessed and subject to assessment for taxes pertaining only to that unit and its interest in the common areas.
- d. Ownership, Voting Rights and Assessments. State statutes and the configuration of a condominium or a group of separately constituted condominiums will dictate the most equitable method of establishing ownership of the common estate, voting rights and assessments. They may be based on:
  - (1) The value of the individual unit to the total value of all units, or

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  - (2) The living area of the individual unit to the total living areas of all-units, or
  - (3) Equally (1 over the total number of units), or
  - (4) A combination of the above. (see Chapter 5)
- e. The Master Deed. The Master Deed (Declaration) will set forth the ratio of each family unit to all units in the condominium. This ratio will be implemented under the By-laws and will remain static throughout the life of the condominium, unless changed by consent of 100% (or as required by State Statute) of the condominium owners and HUD-FHA. The ratio will represent the extent of ownership, the assessments and the

voting rights of the unit owner. This ratio is reflected in the Schedule of Units, (FHA Form 3280-A).

- f. Testing the Market. It is policy, to not permit solicitation prior to the issuance of the commitment and HUD-FHA approval of the condominium organizational documents. The purpose of this limitation is to avoid involvement of the consumer's down payments until such time as there has been a thorough study of the proposal by HUD-FHA and it appears reasonable that the project will in fact go forward and adequate consumer safeguards have been established.

(1) However, there is no intention to preclude interested parties from ascertaining the number of people in the area who would be interested in the development of a particular housing project, provided that individuals do not obligate themselves at that point to purchase units in the condominium when and if it is formed.

(2) A sponsor must not collect down payments at the time he is testing the market, although upon delivery of an information bulletin, acceptable to HUD-FHA, to the prospective purchaser he may collect a small amount (not exceeding \$200) to evidence sincerity, provided such sum is refundable in the event the undertaking does not materialize within a reasonable time.

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- (1-2) (3) If the undertaking does materialize, the amounts collected must be applied to the respective purchasers' down payments. In such instances, the sponsor must be admonished not to make any representations, oral or written, that there have been any HUD-FHA approvals in connection with the project and must be advised that all deposits are to be escrowed in such manner as to fully protect the depositors.

- g. Solicitation of Condominium Purchasers. Solicitation for condominium purchasers can be made before or during the course of construction assuming the parties have obtained blanket commitments for insurance and follow solicitation procedures approved by HUD-FHA.

(1) Commitments will be conditioned so as to restrict the conveyance of title until construction has been completed and until the required percentage of condominium purchasers has been obtained.

(2) Pending transfer of title pursuant to the condominium plan, the sponsor may permit occupancy by the condominium subscribers who, until the passage of title, will have

the status of rental tenants.

h. Downpayment Requirements.

- (1) A downpayment of not less than 3% of the total cost of acquisition is required where the mortgagor is the occupant and such cost is not in excess of \$25,000. If such cost is in excess of \$25,000, higher downpayments will result from the loan-to-value ratios set forth below.
- (2) Where the mortgagor is not the occupant of the unit, the maximum mortgage amount may not exceed 85% of the amount computed under owner-occupant limitations.

i. Eligible Mortgage Amounts and Term.

- (1) Amount Insurable: (not to be confused with per unit limits on projects)

(a) Occupant Mortgagor \$60,000.

(b) Non-Occupant Mortgagor \$51,000.

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(1-2) (2) Loan to Value Ratio:

- (a) Occupant Mortgagor - 97% of first \$25,000 of sum of HUD-FHA estimate of property value and closing costs (because of their inclusion in the mortgage, care should be taken that the mortgagee does not collect closing costs again from the purchaser), plus;

95% of over \$25,000. of sum of HUD-FHA estimate of property value, and closing costs.

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- (b) Non-Occupant Mortgagor - An individual who is an owner-occupant of one unit under a HUD-FHA insured mortgage may be the mortgagor of not to exceed three additional units. The mortgage on the non-occupant units is limited to 85% of the amount computed for an owner occupant. The percentage may be increased if an appropriate deposit is made in accord with the escrow commitment procedure.

- (3) The mortgage must have a maturity satisfactory to the Assistant Secretary for Housing-Federal Housing Commissioner but not less than 10, nor more than 30 years (35 years under certain circumstances) from the date of the beginning of amortization or three-fourths of the Assistant Secretary for Housing-Federal Housing

Commissioner's estimate of the remaining economic life \*  
of the building and improvements, whichever is lesser.

- j. Title Requirements. Title requirements are basically comparable to those which obtain in the Section 203 insurance program. Thus, it is the responsibility of the mortgagee at the time it files a claim under the mortgage insurance contract to present good marketable title to the property, free of liens. (This differs from the basic multifamily housing procedure where the title evidence is examined by the Assistant Secretary for Housing-Federal Housing Commissioner at the time of the original endorsement of the credit instrument and his endorsement for insurance is evidence of the acceptability of title.)

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- (1-2) (1) At the time of closing the individual mortgage loan, the mortgagee will be required to certify that the mortgagor has good marketable title to the family unit subject only to the mortgage which is a valid first lien on same.
- (2) Likewise, it is the responsibility of the parties to the mortgage transaction to determine that condominium ownership as provided in the submitted documents is valid in the particular jurisdiction.
- k. Maximum Charges, Fees or Discounts. The requirements in this connection parallel the Section 203 program rather than the multifamily insurance programs.

The mortgagee shall not collect from the mortgagor charges in excess of:

- (1) The amount of the application fee charged by the Assistant Secretary-FHA Commissioner.
- (2) Recording fees and recording taxes or other charges incident to recordation.
- (3) Credit Report expense.
- (4) Expense for title examination and title insurance, if any.
- (5) Initial service charge: A charge to compensate the mortgagee for expenses incurred in originating and closing the loan; the charge is not to exceed \$20 or one percent of the original principal amount of the mortgage, whichever is the greater.
- (6) Such other reasonable and customary charges and fees as authorized by the Assistant Secretary-FHA Commissioner.

1. Section 235 as it applies to One or More Individual Units,. Reference (2) of the Foreword sets forth the basic policy and procedural instructions for Section 235.

- (1) For example, the instructions in the Handbook on such matters as eligible mortgagees, maximum mortgage amounts, mortgage interest rate, HIP, mortgage term, sales price

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limitations, income and assistance limitations, reservation of funds, processing of assistance payments, etc., are the same for condominium owners as for other eligible home owners under Section 235.

- (2) The construction, or substantial rehabilitation, of the one family unit in a condominium project, must have been completed within two years prior to applying for assistance payment; and, the family unit must have had no previous occupant other than the mortgagor.
- (3) A condominium wherein individual units are insured under Section 235(i) is organized in the same manner as other HUD-FHA approved condominiums.

- 1-3. OPTIONAL HOUSING EXTRAS FOR CONDOMINIUM UNIT PURCHASERS. The Field Office Director may permit a developer to offer optional housing extras to unsubsidized condominium home buyers. A proposal by a developer to offer optional extra equipment (e.g. dishwashers, garbage disposals, etc.) to condominium unit buyers is acceptable, just as in the case of a single family subdivision home purchaser.

Condominium developments differ from single family subdivisions, however, in that the initial values which are assigned to the various units determine the undivided interest each unit owner has in the project's common area. The unit value also establishes the voting rights and assessment liabilities. These values are recorded in the project Master Deed, and any arrangement requiring the constant changing of these established values, to take into account optional items, would obviously be unworkable. Therefore, a proposal to offer optional items must be such that the initial ratio of unit value to total value is not disturbed.

- a. Instructions. Field Offices will permit a developer to make optional items available to the purchaser subject only to the following instructions:
  - (1) The initial processing of the project should reflect all the amenities typical purchasers would require in the value of the units.

- (2) Once calculated, the ratios established for determining the undivided interest in the common areas, voting rights and share of common expenses are not to be changed.

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- (1-3) (3) Optional items should be developed on the standard Application and Commitment - Schedule of Alternates (FHA Form 2439), reflecting those additional amenities which may be desired by purchasers. The optional equipment must be confined to the purchaser's unit boundaries. Options added to one unit must have no effect on the ownership of the other units, nor should they cause any additional housing costs to the other owners.
- (4) When a buyer selects optional items the mortgage credit processor will add the predetermined values at firm commitment processing from FHA Form 2439. Hence, the additional value derived from the options would increase the mortgage allowable on the unit, but would not change the undivided interest previously established.
- (5) It will be necessary for the mortgage credit processor to change the unit replacement cost and unit value on the condominium Analysis and Appraisal (FHA Form 180), reflecting the amount of the options for the particular unit when the sales price is recorded.
- b. Ratio of Unit Value to Total Value. The allocation of undivided interest in the common areas and the voting rights is established in accordance with the ratio of unit value to total value without consideration of any alternates. The inclusion or exclusion of alternates for any unit will not change the ratio of unit value to total value which has been assigned to that unit. The initial ratio of unit value to total value is made part of the Master Deed and will not change during the life of the condominium project.
- c. Limitations. The cost of the options must not exceed 7% of unit value. Major changes in units during the construction period (and after the proportionate values have been established and made a part of the Master Deed), would create large discrepancies between the actual value of the unit and that which is assigned to the unit in the Master Deed and used for voting purposes, etc. Notwithstanding the fact that an owner will change the value of his unit after closing by the addition of amenities, where these changes are made at the inception of the condominium, it may be more difficult for an individual to understand why his dollars and votes do not coincide. Therefore, large optional changes are not to be encouraged,

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and in no case will such options exceed the maximum limitation of 7% of unit value. Where the optional changes would increase the mortgage beyond the limit established for the program under which the unit is to be insured, cash must be paid for the items.

- d. Notice to Purchasers. The Subscription and Purchase Agreement (FHA Form 3279) must clearly state which items included in the stated sales price of the unit are optional extras. It must further state that the inclusion of such items does not change the individual owner's proportionate relationship to the common areas.

1-4. PRE-SALE REQUIREMENT. It is normally required that before the first Section 234 individual mortgage in a condominium will be insured, evidence must be presented to the Field Office to the effect that appropriate agreements of sale have been executed by purchasers (contemplating HUD-FHA mortgage insurance or otherwise) whose purchases represent units having a value (based on the Assistant Secretary-FHA Commissioner's estimates) totalling at least 80% of the total value of all the family units in the condominium. If, in the discretion of the Field Office Director, circumstances are such as to dictate the need for a reduction in the presale requirement the following procedures will be used and a memorandum will be written to the file justifying the action.

- a. Insurance of Advances Cases (FHA Form 3283, Commitment). Insurance of Advances (see Reference (1) of the Foreword) cases have a dual commitment for insurance of either a project rental mortgage or individual unit mortgages. The 80% factor may be reduced to not less than 51% at the discretion of the HUD-FHA Field Office Director if the following conditions are met:

- (1) The sponsor shall obtain the written acquiescence of the outstanding subscribers to a closing and transfer of title with less than the normal 80% sale.
- (2) The sponsor shall be required to furnish to the Secretary an irrevocable proxy for voting purposes covering the difference between the actual percentage of sales and the normal 80% requirement.

- (1-4) (3) The sponsor shall execute an undertaking satisfactory in form and substance to the Field Office Director and the Area Counsel guaranteeing the performance of all ownership obligations pertaining to the unmarketed units. The sponsor shall be released from such obligations when approved sales for 80% of the units (in value) have been obtained.
- (4) All other normal commitment conditions must be met, including the payment in full of the project mortgage or the termination of the mortgage insurance thereon before the individual units will be eligible for HUD-FHA mortgage insurance.
- (5) The required percentage of the value of the units may consist of units being financed under Section 234(c), or it may consist partly of "Section 234(c)" units and partly of conventionally financed or "all cash" units.
- (a) One mortgagor is eligible to be the mortgagor of up to four unit mortgages insured under Section 234, provided one of these units is for his own use and occupancy.
- (b) In the Section 235 programs the mortgagor may not own more than one unit (which he must occupy).
- (c) For purposes of determining whether the required percentage has been achieved, "conventional" and "all cash" purchasers will likewise be limited for computation purposes to four units.
- (6) A "Schedule of Family Unit Sales" (FHA Form 3282) reflects the necessary information. Such schedule should be received by the Field Office in satisfactory form prior to insurance endorsement of the individual mortgage notes.
- (7) A copy of the "Schedule of Family Unit Sales", bearing clear and legible indications of which units are insured under Section 234(c), 235, conventional, cash, VA, etc., together with a copy of the completed "Request for Termination of Multifamily Mortgage Insurance, (FHA Form 311) should be forwarded to the Director, Office of Unsubsidized Insured Housing Programs, Attention: Cooperative and Condominium Housing Branch.

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- (1-4) b. Insurance Upon Completion (FHA Standard Form 3284). In Insurance Upon Completion cases (FHA Standard Form 3284) there

is a dual commitment for insurance of either a project rental mortgage or the individual unit mortgages as is the case for Insurance of Advances, If the construction is completed and the circumstances are such that, in the Field Office Director's opinion, the presale requirement should be lowered, it should be done in accordance with the instructions for Insurance of Advances, items (1) through (7).

- c. Insurance Upon Completion Cases, Simplified (Modified FHA Form 3284). In the Simplified Insurance Upon Completion cases, HUD-FHA is not committed to insure the development as a project rental if 80% of the value of units has not been sold (the simplified home mortgage processing does not contemplate a rental project). The construction of the project must also be completed (with 80% sales the indebtedness can normally be paid off prior to, or simultaneously with, spin off to individual ownership).
- (1) The construction must be completed primarily because by recording the Master Deed and conveying title an undivided interest would be created between the early buyers and the builder (this creates joint liability problems and problems of mechanic's liens attaching to the undivided interest).
  - (2) If the construction is completed and the indebtedness can be removed, the presale requirement could be lowered below 80% (but not until at least 51% of the value of the units have been sold to bona fide purchasers other than the developer and his immediate associates). This is true only if there is still evidence of a strong market (care should be taken to determine that the selling price is not substantially in excess of the HUD-FHA valuation).
  - (3) Before lowering a presale requirement, a visual inspection should be made to determine that the property is attractive and the units are conducive to long term occupancy (i.e., a garden type, without community facilities, may not be).
  - (4) If, within this framework, the decision is made (by the Field Office Director) to lower the-presale requirement, the instructions for Insurance of Advances cases items (1) through (7) are applicable.