The Condominium Supply Situation Is Getting Worse

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The supply of new condominiums for sale has been low since the Great Recession. Our previous analysis indicated that the lack of condo construction was partly attributable to the crippling effects of condo defect litigation, which chilled condo development.[1] At the same time, restrictions placed on mortgage financing for condo purchases limited demand, discouraging new supply.

Recently, both the government-sponsored enterprises (GSEs) and the Federal Housing Administration (FHA) have begun to relax rules to make it easier to access financing. But the Champlain Towers disaster in Surfside, Florida, has led the GSEs to implement stricter temporary measures related to condo building conditions. We show this has coincided with a decrease in the share of GSE loans for condo purchases.

In this brief, we show that despite the relaxation in GSE condo financing rules, recent steps the GSEs have taken in the wake of the Champlain Towers collapse have been crippling on both the supply of new condos and GSE financing for the purchase of existing condos. In contrast, the FHA condo share of purchase loans, which is smaller than that of the GSEs, has stabilized in recent years. In response to these trends, we suggest other measures that would have a more modest impact on both the supply of new condos and the financing of existing condos.

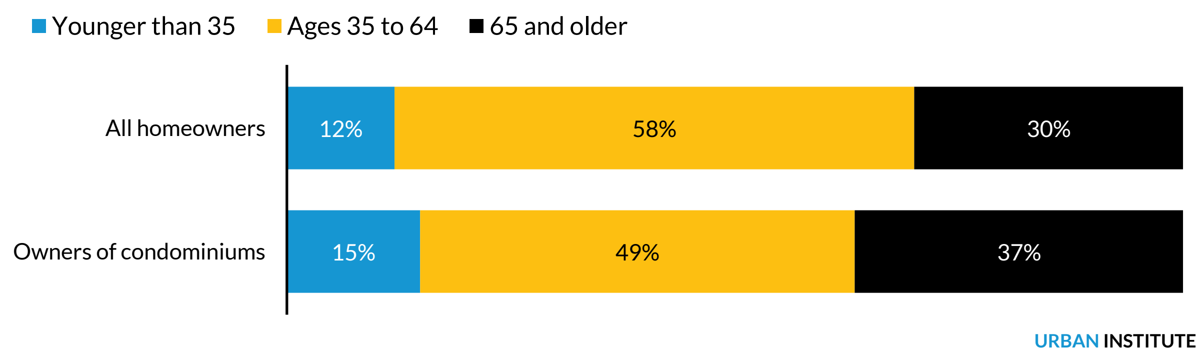
The outline of this brief is as follows. We first look at the importance of condos for the market. We then look at the historical factors that have held back supply. We discuss the lifting of the requirements that have historically restricted financing and then review the new requirements. Finally, we suggest some alterations to the temporary requirements that would protect insurers and guarantors but would eliminate some of the bottlenecks to credit access.

The Importance of the Condo Market

Condo owners are disproportionately younger than 35 and 65 and older. Figure 1 shows the age of condo owners versus all homeowners; households headed by those younger than 35 constitute 15 percent of condo owners and 12 percent of all homeowning households. Those 65 and older constitute 37 percent of condo owners and 30 percent of all homeowning households. These groups have lower median incomes than other homeowners. The median household income is $84,000 for homeowners younger than 35, $98,000 for those ages 35 to 64, and $56,230 for those 65 and older.[2]

FIGURE 1

Share of Homeowners, by Age and Structure Type

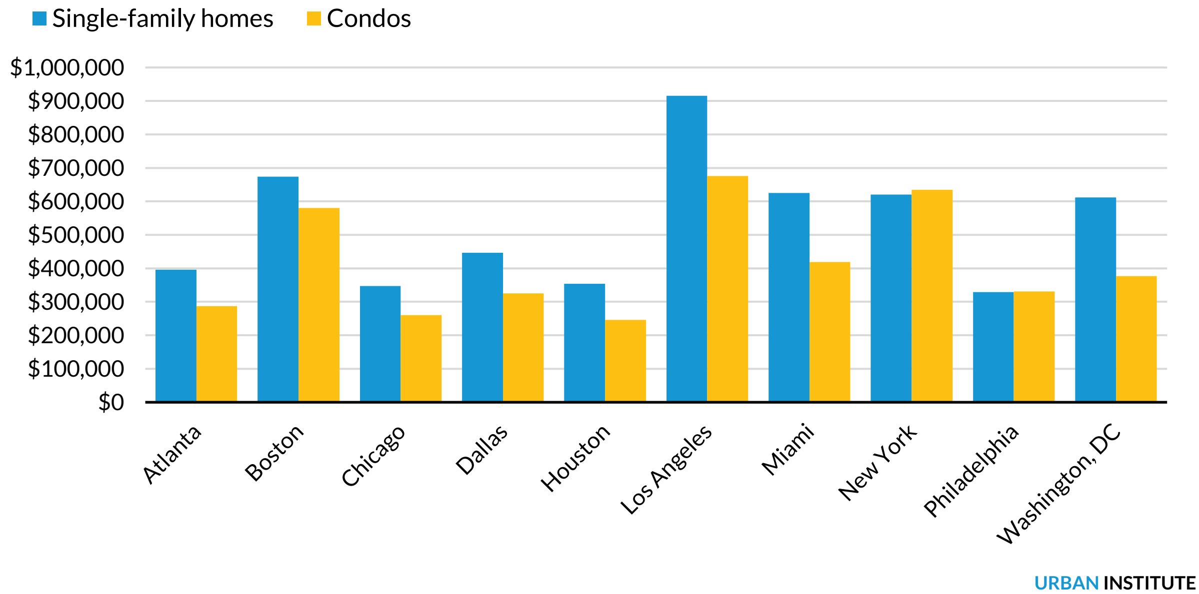


Source: 2021 American Housing Survey.

This difference in median income makes sense, as condos are more affordable. They are the first step on the homeownership ladder for many younger buyers, and they are the ticket to downsizing for older buyers. Figure 2 shows the prices of condos versus single-family homes in metropolitan statistical areas (MSAs) with a fair number of condos. Of the 10 MSAs we looked at, condos were cheaper in 8 of them (Atlanta, Boston, Chicago, Dallas, Houston, Los Angeles, Miami, and Washington, DC). In Atlanta, median prices are $285,996 for a condo and $395,977 for a single-family home. In Boston, the median condo price is $582,134, and the median price of a single-family home is $675,768. In New York and Philadelphia, condos and single-family homes are very similar in price. In Philadelphia, median prices are $329,399 for a condo and $328,684 for a single-family home. In no markets were condos considerably more expensive than single-family homes.

FIGURE 2

Median Prices for Condos and Single-Family Homes, by Metropolitan Statistical Area



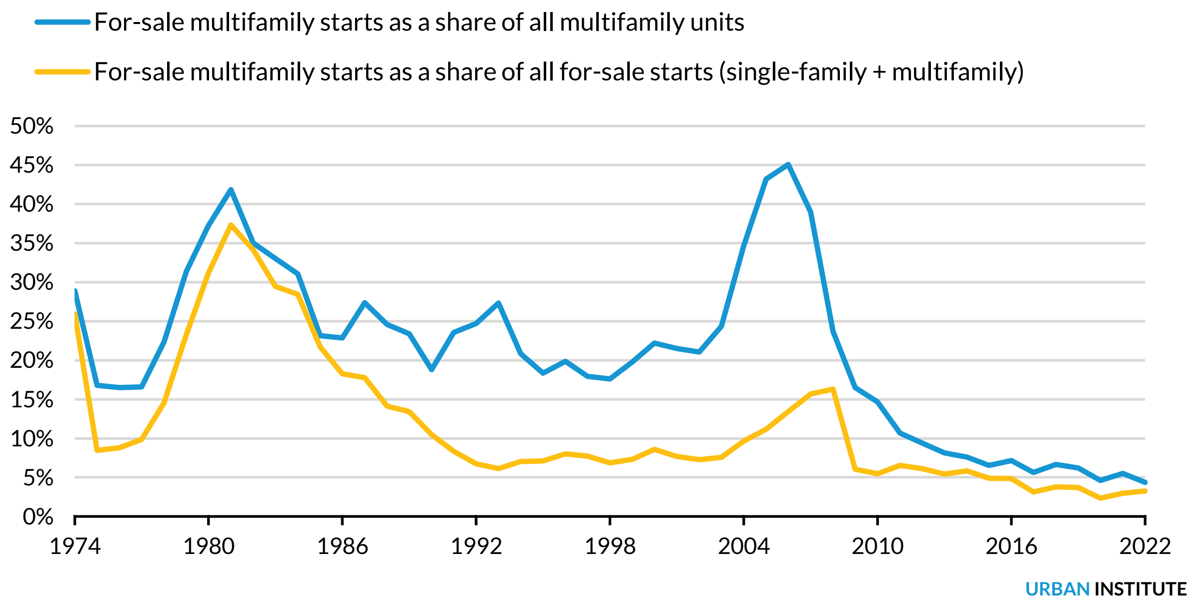
Source: Urban Institute calculations of Black Knight data.

Condo Construction Has Been Limited

Very few condos are being built. There are two ways we can measure condo construction. We can look at it as a share of total multifamily construction (for-sale multifamily starts as a share of all multifamily starts). We can also look at it as a share of all for-sale construction (for-sale multifamily starts as a share of all single-family plus multifamily starts). But no matter which measure we use, the picture is the same: for-sale multifamily starts have fallen to a new low (figure 3). The latest data for full-year 2022 show that for-sale multifamily starts are 4.4 percent of all multifamily starts versus an average of 21.0 percent since 1974 and an average of 7.4 percent since 2010. Similarly, for-sale multifamily starts are 3.2 percent of all for-sale single-family and multifamily starts; this compares with an average of 11.7 percent since 1974 and an average of 4.4 percent since 2010.

FIGURE 3

For-Sale Multifamily Starts, 1974–2022



Source: Urban Institute calculations using US Census Bureau and US Department of Housing and Urban Development data.

Indeed, we showed in our blog post about 18 months ago that condo construction was very low because of condo defect litigation and financing issues.[3] We showed that defect litigation can substantially increase insurance costs and the riskiness of a condo project. For example, in New York State, construction defects are covered for one year after the warranty date. Plumbing, electrical, heating, cooling, and ventilation systems are covered for two years, and material defects are covered for six years. Thus, the condo association has an interest in raising defect claims promptly. While litigation is under way, it is difficult to sell or finance new units in the building.

Thus, the builder not only pays higher insurance costs, but because of the higher risk associated with condo development, the builder pays a higher rate to finance the condo construction than they would on a rental unit.

Financing Constraints Were a Factor but Have Been Relaxed

Financing constraints were also an issue, curtailing new production. Successful condo development requires that the sponsor be able to sell the units quickly. This requires the potential buyers of the units to obtain financing, as few owner-occupants, particularly in affordable buildings, will be able to purchase with cash.

Financing restrictions used to include provisions that a potential condo buyer cannot get an FHA loan or a GSE loan unless (1) at least 50 percent of the condos are owner occupied and (2) no more than 15 percent of the units in the complex have association dues that are more than 30 days behind.

The rules have been amended to be less restrictive. The FHA now requires at least 35 percent of the units be owner occupied. The GSEs have no restrictions on owner-occupants. The GSEs restrict financing of investment units in projects where investors own at least 50 percent of the units in the project. And this can be circumvented in “established” condo projects with a 25 percent minimum down payment (30 percent in Florida). In addition, the rule regarding delinquent homeowners’ association (HOA) dues has been relaxed; both the FHA and GSEs allow no more than 15 percent of the units to be more than 60 days behind.

The FHA used to require that no more than 10 percent of the units in a complex secure FHA loans, but this restriction has been increased to 50 percent.

Finally, neither the FHA nor the GSEs would finance projects in which the HOA was named in a lawsuit. This has been relaxed to allow for financing as long as the litigation does not involve structural soundness, habitability, or functional use of the property. The HOA must provide documentation to show it has sufficient liability insurance to cover any potential claim. A summary of the financing changes is provided in table 1.

TABLE 1

Relaxation of Old Financing Rules

Topic	Old rule	New rule
A potential condo buyer cannot get an FHA or GSE loans unless	At least 50 percent of the units are owner occupied.	FHA: At least 35 percent of the units are owner occupied. GSEs: No restrictions on owner-occupants. The GSEs restrict financing of investment units in projects where investors own at least 50 percent of the units in the project. This can be circumvented in “established” condo projects with a 25 percent minimum down payment (30 percent in Florida).
A potential condo buyer cannot get an FHA or GSE loan unless	No more than 15 percent of the units in the HOA are more than 30 days behind.	No more than 15 percent of the units in the HOA are more than 60 days behind.
FHA restriction	No more than 10 percent of the units in a complex secure FHA loans.	No more than 50 percent of the units in a complex secure FHA loans.
Litigation restrictions	The HOA is not named in any lawsuits.	Litigation must not involve structural soundness, habitability, or functional use of the property. The HOA must provide documentation showing it has sufficient liability insurance to cover any potential claim.

Note: FHA = Federal Housing Administration; GSE = government-sponsored enterprise; HOA = homeowners’ association.

One would think that this relaxation on the financing side would have encouraged condo production. But in the wake of the Champlain Towers collapse, the GSEs added some temporary guidance in early 2022.

The GSEs' Temporary Guidance after the Champlain Towers Collapse

The temporary guidance has provisions intended to protect against another Champlain Towers disaster. These provisions include the following:

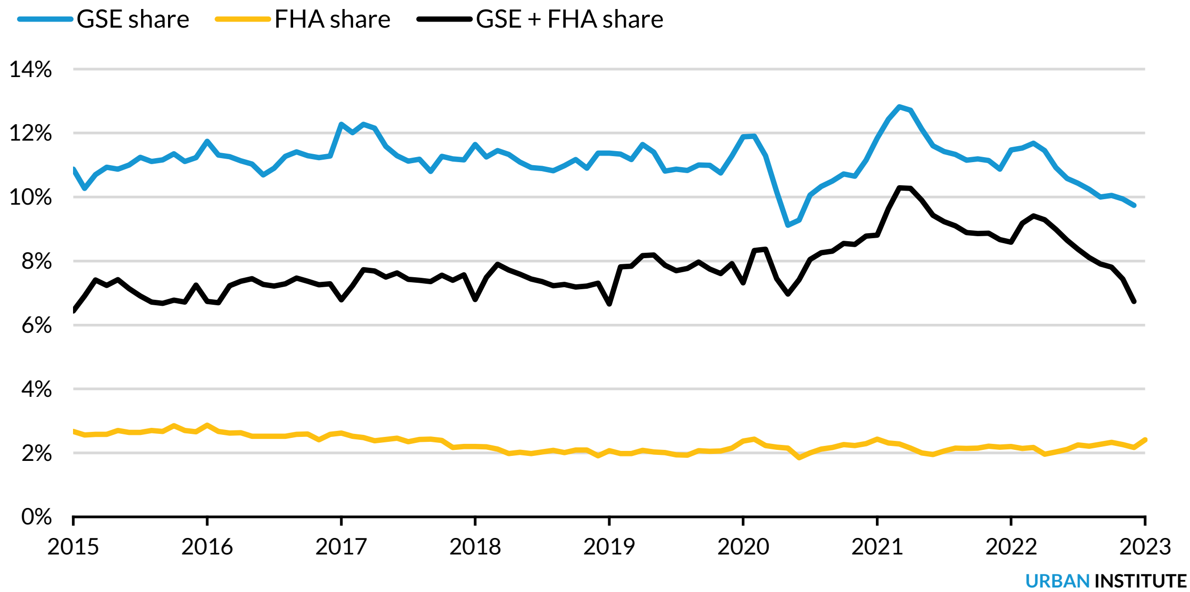
- Ten percent of the HOA's annual income must be placed into a reserve account to cover deferred maintenance.
- The HOA is required to answer a questionnaire and addendum regarding the safety, soundness, and structural integrity, special assessments, and upcoming special assessments of the buildings.[4] Copies of recent inspection reports and HOA minutes are required to substantiate the replies. The addendum is particularly burdensome. If the HOA management company fails to provide this information, the project is ineligible for financing. But giving the information exposes the board members to liability if the responses turn out to be inaccurate.
- HOAs that have critical repairs in the process of being completed are ineligible for financing until all repairs are completed and documented by a final inspection report.
- Freddie Mac does not allow for financing in any project where more than 5 percent of the unit holders are behind in their special assessment. Lenders are required to repurchase loans in projects with special assessments if the lender cannot document that special assessment arrears are less than 5 percent. Fannie Mae had not adopted this requirement, but there are fears that it will.
- The GSEs do not provide a list of eligible or ineligible projects.

How Big a Problem Is This, and What Has the Impact Been on Financing?

The net result is that despite the relaxing of financing rules, the temporary measures have had a crippling effect. Figure 4 shows that the condo and co-op share of GSE primary-residence purchase loans has dropped to 9.7 percent. Meanwhile, FHA condo financing has stayed roughly static as a share of total FHA financing (in the 2 to 2.5 percent range). Finally, we look at total GSE plus FHA condo financing, which has clearly dropped coincident with the implementation of the temporary measures in early 2022.

FIGURE 4

Condo Share of Purchase Loans, by Channel



Source: Urban Institute calculations of eMBS data.

Alternative Policy Options Could Provide Similar Protection but with a Lower Market Cost

The temporary measures are a well-intentioned effort for the GSEs to protect themselves against another Champlain Towers disaster. But the temporary guidance may actually discourage self-discovery of structural problems. Owners of buildings may be reluctant to undergo voluntary inspections, as another question asks whether there are any deficiencies related to the safety, soundness, structural integrity, or habitability of the project's buildings. Moreover, if repairs are in progress, the temporary guidance does not allow financing until the repairs are completed. This seems like a harsh way to deal with buildings that are addressing their issues. Perhaps the GSEs could consider an interest rate surcharge on new financings until the repairs are complete, in lieu of a blanket financing denial. At a minimum, it seems that if the GSEs have just approved one property in a building, redoing the process for another within a short period is unnecessary. The GSEs should maintain a list of properties that have been approved and do not need the documentation.

We propose alternative options that may also provide the same protection to the GSEs. More frequent inspections would be one way to achieve this. Currently, buildings in Broward County (home to Ft. Lauderdale) and Dade County (home to Miami) require an inspection after 40 years. Other Florida counties have no inspection requirements. The Florida Grand Jury recommended that condominium towers have an initial recertification inspection by an engineer between 10 and 15 years after their construction and every 10 years thereafter. Champlain Towers South, built in 1981, collapsed on June

24, 2021, as its 40-year recertification was due. The grand jury further recommended that the architects and engineers who find severe structural damage during an inspection to report it to local officials within 24 hours and not just to the condo board.[5] If the GSEs required inspections and relied upon these inspections in its financing decisions, it would put pressure on state lawmakers to legislate it. There should be some easy ways to find information for new condo buyers as to when a building passed its last inspection and when the next inspection is due; this could be maintained by localities.

In addition, the addendum requires an authorized representative of the HOA to make forward-looking statements. One question reads, Are there any planned special assessments that unit owner/cooperative shareholders will be required to pay? What will be the amount? Terms? Purpose? If a special assessment is being contemplated but not agreed upon, these questions could be difficult to answer without liability risk. Forward-looking statements should clear ("planned" means "agreed upon") and should include qualifiers (e.g., "to the best or my knowledge") or should be eliminated.

Conclusion

In short, the temporary guidance has had a chilling effect on mortgage financing and adds to the headwinds facing condo construction. And the market friction introduced by these policies undermines previous steps the GSEs have taken to address the lack of housing. In addition, these rules and their impact on the condo market come at a time when condo demand is likely strong, reflecting both the sizeable group of millennial and Generation Z renters seeking homeownership as well as baby boomer owners looking to downsize.

In the aftermath of the collapse in Surfside, those bearing the risks on condo mortgages need to be confident of the structural soundness of the buildings where these units are located. Although the purpose of the GSE rules are clearly well intentioned, the same goals can be achieved using other tools, where the result would likely be less detrimental.

Notes

1 Michael Neal and Laurie Goodman, "The Housing Market Needs More Condos. Why Are So Few Being Built?" *Urban Wire* (blog), Urban Institute, January 31, 2022, https://www.urban.org/urban-wire/housing-market-needs-more-condos-why-are-so-few-being-built.

2 Urban Institute calculations from 2021 American Community Survey data.

3 Neal and Goodman, "The Housing Market Needs More Condos."

4 The questionnaire and addendum for Fannie Mae are available at Fannie Mae (2016). Freddie Mac's is similar.

5 See Associated Press, "Florida Condos Need More Frequent Inspections, Waterproofing, Panel Says," NBC News, December 15, 2021, https://www.nbcnews.com/news/us-news/florida-condos-need-frequent-inspections-waterproofing-panel-says-rcna8959.

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Laurie Goodman is an Institute fellow and founder of the Housing Finance Policy Center at the Urban Institute. The center provides policymakers with data-driven analyses of housing finance policy issues that they can depend on for relevance, accuracy, and independence. Before joining Urban, Goodman spent 30 years as an analyst and research department manager at several Wall Street firms. From 2008 to 2013, she was a senior managing director at Amherst Securities Group LP, a boutique broker-dealer specializing in securitized products, where her strategy effort became known for its analysis of housing policy issues. From 1993 to 2008, Goodman was head of global fixed income research and manager of US securitized products research at UBS and predecessor firms, which were ranked first by *Institutional Investor* for 11 straight years. Before that, she held research and portfolio management positions at several Wall Street firms. She began her career as a senior economist at the Federal Reserve Bank of New York. Goodman was inducted into the Fixed Income Analysts Hall of Fame in 2009. Goodman serves on the board of directors of MFA Financial, Arch Capital Group Ltd., and Home Point Capital Inc. and is a consultant to the Amherst Group. She has published more than 200 journal articles and has coauthored and coedited five books. Goodman has a BA in mathematics from the University of Pennsylvania and an AM and PhD in economics from Stanford University.

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