Loosening FHA Restrictions on Condominium Financing Makes Sense

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Many have complained that the Federal Housing Administration (FHA) places tight restrictions on the conditions under which condominium (condo) units are eligible for FHA loans, which makes it difficult for homebuyers to obtain financing for these units.[1] To qualify for financing under current FHA rules, established condo projects must be at least 50 percent occupied by homeowners, people who occupy the unit as a primary or secondary residence. The FHA has addressed this rule twice in recent months with a mortgagee letter and a proposed rule. In this brief, we first review FHA actions and present data that suggest that the FHA can loosen the restrictions and increase FHA financing availability for condo buyers.

FHA Actions

In July 2016, Congress passed legislation decreasing the minimum level of owner-occupied units for existing condos to 35 percent for the building to be eligible for FHA financing, unless the FHA released rules by late October to the contrary. On October 26, the FHA released Mortgagee Letter 2016-15, effective immediately.[2] Under this mortgagee letter, the 50 percent owner-occupant minimum was retained, but projects meeting the following three requirements could have the owner-occupancy threshold lowered to 35 percent:

- The project has a reserve account for capital expenditures and deferred maintenance that represents at least 20 percent of the budget
- No more than 10 percent of the units are more than 60 days past due

- The condo has three years of acceptable financial documents

It is unclear what percent of established condos qualify for the 35 percent threshold. The owner-occupancy threshold for new projects (those less than 12 months old or undergoing gut rehab conversions) is 30 percent.

The FHA rules for established condos are stricter on this dimension than those imposed by Fannie Mae and Freddie Mac. These enterprises do not have a minimum owner occupancy requirement for owner occupants in established condos; they will not make investor loans on established condos unless the condo is at least 50 percent owner-occupied.

Meanwhile, on September 28, 2016, the FHA proposed for 60 days of comment a rule that would give the FHA more flexibility in formulating its condo rules (Golding 2016). Comments are due by November 28, 2016. Here are two of the proposed rule's elements:

- The FHA is proposing to establish a permissible range for the minimum owner-occupancy threshold of 25 to 75 percent, giving the FHA the discretion to set its minimum threshold within that range with the ability to change it as market conditions warrant. In the preamble to the proposal, the FHA states that "having too few owner-occupants can detract from the viability of a project; requiring too many can harm the marketability of a project." If the rule is adopted as proposed, the FHA could change the owner-occupied floor indicated in the October mortgagee letter.
- Under certain circumstances, the FHA is proposing to insure mortgages on individual condo units in developments that are not currently approved for FHA insurance of the entire development. These single-unit approvals are limited to a maximum of 20 percent of the units in the property, a limit that may be reduced to zero via subsequent notice. This allows mortgages on some units in condo projects that do not meet the minimum owner-occupancy rule to be insured by the FHA.

Items in the proposed rule beyond the scope of our analysis include (1) allowing condo projects to recertify their eligibility every three years (replacing the current two-year requirement) and implementing a streamlined recertification process, (2) allowing a more lenient definition of completion, (3) allowing the FHA to modify the limitation that requires that the commercial space within an approved condo not exceed 50 percent of the floor area, giving the FHA the flexibility to set a range between 25 and 60 percent, and (4) codifying requirements for Direct Endorsement lenders to be approved for underwriting condos.

Can the FHA afford to be more flexible in insuring condominiums without increasing risk to the insurance fund? The data suggest that more flexibility should be considered. Condos have lower default rates than single-family purchases. And condo purchasers are more heavily weighted toward first-time homebuyers and women than the purchase population at large.

The Data

Condo loans are an important tool for first-time homebuyers. Table 1 shows that first-time homebuyers make up a larger percentage of borrowers of condo loans than of noncondo loans. (Noncondo loans include single-family defined as one- to four-family homes, for previously occupied and not previously occupied houses). From 2000 through April 2016, condo loans constituted about 5.8 percent of all FHA purchase loans.[3] During that period, first-time homebuyers made up 83.7 percent of condo buyers, compared with only 78.9 percent of noncondo purchasers.

TABLE 1

Condo and Noncondo FHA Purchases, 2000–16

Year	Total purchases	Noncondo purchases	Condo purchases	% Noncondo purchases	% Condo purchases	% First-time homebuyer (noncondo purchase)	% First-time homebuyer (condo purchase)
2000	801,907	734,840	67,067	91.6	8.4	81.3	82.6
2001	795,574	731,114	64,460	91.9	8.1	78.8	82.3
2002	777,904	714,604	63,300	91.9	8.1	79.2	82.4
2003	653,055	602,055	51,000	92.2	7.8	78.4	82.3
2004	480,137	446,663	33,474	93.0	7.0	77.8	81.4
2005	317,136	296,612	20,524	93.5	6.5	79.2	84.4
2006	289,168	272,693	16,475	94.3	5.7	78.9	85.8
2007	281,603	267,673	13,930	95.1	4.9	79.4	86.4
2008	787,239	740,946	46,293	94.1	5.9	77.2	85.0
2009	1,016,799	946,125	70,674	93.0	7.0	79.7	87.0
2010	980,681	920,366	60,315	93.8	6.2	76.8	85.0
2011	741,361	708,150	33,211	95.5	4.5	76.0	81.8
2012	725,039	701,388	23,651	96.7	3.3	77.9	82.8
2013	667,892	647,750	20,142	97.0	3.0	79.1	83.0
2014	589,071	573,256	15,815	97.3	2.7	81.6	84.9
2015	798,714	777,572	21,142	97.4	2.6	81.5	84.8
2016	186,124	181,104	5,020	97.3	2.7	82.0	85.0
All	**10,889,404**	**10,262,911**	**626,493**	**94.2**	**5.8**	**78.9**	**83.7**

Source: Authors' calculations based on Federal Housing Administration data; 2016 data through April.

Table 2 shows the characteristics of condo and noncondo FHA purchase loans and borrowers. The most interesting differences are as follows:

- **Condo borrowers have higher FICO scores than noncondo borrowers.** In recent years, the difference has been 10 and 15 points. For 2015, the average FICO score for a condo purchaser was 694 and was 681 for a noncondo purchaser.
- **Condo loans have higher balances than noncondo loans.** That is, for 2015, the average condo purchase loan was $206,200; it was $188,400 for noncondo loans. This pattern has been consistent since 2003. While many of us tend to think condos are less-expensive first purchases, they tend to be located in higher-cost urban areas.

- **Condo loan borrowers have slightly higher monthly income than noncondo borrowers,** and the gap has increased in recent years. In 2006, noncondo borrowers had an average monthly income of $1,052 while condo borrowers averaged $1,224. In 2016, the average monthly income is $1,397 for noncondo borrowers and $1,693 for condo borrowers.
- **Condo borrowers are more likely to be female.** In 2015, 46 percent of condo borrowers were female versus 35 percent for noncondo borrowers.

In addition, we find that the loan-to-value ratios of FHA purchase condo loans are similar to noncondo loans. The share of minority borrowers is also similar. The interest rates paid by condo buyers in every year are the same or slightly lower than for noncondo buyers. This likely reflects condo buyers' higher FICO scores.

TABLE 2A

Loan Characteristics of Noncondo and Condo FHA Purchasers

Year	LTV		FICO Score		Interest Rate (%)		Loan Amount ($)	
	Noncondo purchase	Condo purchase	Noncondo purchase	Condo purchase	Noncondo purchase	Condo purchase	Noncondo purchase	Condo purchase
2000	96.23	96.03	N/A	N/A	8.21	8.10	104,904	97,860
2001	96.35	96.19	N/A	N/A	7.38	7.32	110,896	105,809
2002	96.38	96.28	718	N/A	6.84	6.69	116,608	114,678
2003	96.35	96.32	649	669	5.98	5.81	122,207	123,587
2004	96.16	96.22	642	668	5.92	5.68	123,092	128,462
2005	96.02	95.82	642	669	5.82	5.64	122,048	133,319
2006	95.85	95.81	643	669	6.37	6.19	127,768	142,639
2007	95.82	95.76	633	658	6.48	6.28	136,197	151,042
2008	95.93	95.65	662	687	6.27	6.16	166,774	172,896
2009	95.45	95.10	691	710	5.34	5.27	170,877	179,714
2010	95.30	94.82	697	714	4.94	4.88	173,170	190,112
2011	95.32	94.67	698	715	4.54	4.48	168,382	186,784
2012	95.46	95.07	695	710	3.79	3.73	170,606	186,223
2013	95.36	94.83	690	704	3.80	3.72	178,215	185,890
2014	95.24	94.88	680	692	4.22	4.13	176,645	190,895
2015	95.29	95.08	681	694	4.01	3.92	188,459	206,230
2016	95.25	94.91	681	694	4.02	3.94	193,636	218,699
All	**95.73**	**95.62**	**681**	**698**	**5.52**	**5.85**	**151,943**	**149,142**

TABLE 2B

Loan Characteristics of Noncondo and Condo FHA Purchasers (continued)

Year	Monthly Income ($)		Female (%)		Minority (%)	
	Noncondo purchase	Condo purchase	Noncondo purchase	Condo purchase	Noncondo purchase	Condo purchase
2000	972.93	999.17	29	45	43	42
2001	964.03	1,011.90	30	46	42	42
2002	976.29	1,036.77	31	46	41	41
2003	957.08	1,033.99	33	47	39	40
2004	964.40	1,061.75	33	47	38	39
2005	961.16	1,104.66	34	47	33	34
2006	1,052.05	1,224.62	34	48	31	35
2007	1,133.87	1,309.08	34	47	34	41
2008	1,362.78	1,508.46	33	46	34	37
2009	1,323.03	1,506.52	34	46	33	35
2010	1,305.74	1,563.30	35	45	35	37
2011	1,312.43	1,584.68	36	45	35	38
2012	1,283.29	1,532.97	35	45	35	35
2013	1,347.10	1,531.41	35	46	36	37
2014	1,379.09	1,610.15	35	45	39	40
2015	1,366.97	1,613.79	35	46	39	41
2016	1,397.13	1,693.40	35	45	41	44
All	**1,195.73**	**1,285.94**	**34**	**46**	**37**	**39**

Source: Authors' calculations based on Federal Housing Administration data; 2016 data through April.
Notes: LTV = loan-to-value ratio. N/A = not available.

The FHA draws a distinction between new and existing condos. Table 3 shows that new condos constituted 15 percent of total FHA financings between 2000 and early 2016. The loan-to-value ratios of new and existing condo loans are similar, as are the FICO scores of their borrowers (table 4). The interest rates on new condos are a bit lower than for older condos, but the difference is small. The largest difference is that newer condos tend to have much higher loan amounts. For 2015, the loan balance of purchase financing was $285,000 for new condos versus $196,000 for existing condos. As a result, first-time homebuyers are a larger share of existing-condo (rather than new-condo) purchasers (85 percent versus 82 percent from 2000 to 2015).

Older condos tend to have more female borrowers (by about 3 percent), while new condos have more minority borrowers. The differences in the past few years are especially notable. In 2015, new condos were 55 percent minority, versus 39 percent for older condos. Not surprisingly, buyers of new condos have higher monthly incomes than buyers of existing condos. For example, in 2015, new-condo borrowers had an average monthly income of $2,100 versus $1,551 for old-condo borrowers.

TABLE 3

New Condos as a Percentage of Total FHA Financings, 2000–16

Year	*N*	Percentage
2000	67,067	14.5
2001	64,460	12.1
2002	63,300	14.2
2003	51,000	18.8
2004	33,474	18.9
2005	20,524	22.1
2006	16,475	19.9
2007	13,930	22.0
2008	46,293	16.4
2009	70,674	12.3
2010	60,315	12.8
2011	33,211	14.3
2012	23,651	14.0
2013	20,142	14.0
2014	15,815	12.5
2015	21,142	11.4
2016	5,020	14.3
All	**626,493**	**14.9**

Source: Authors' calculations based on Federal Housing Administration (FHA) data; 2016 data through April.

TABLE 4A

Loan Characteristics for New-Condo and Existing-Condo Purchasers

Year	LTV		FICO Score		Interest Rate (%)		Loan Amount ($)	
	New condo	Existing condo	New condo	Existing condo	New condo	Existing condo	New condo	Existing condo
2000	95.03	96.20	N/A	N/A	7.81	8.15	113,617	95,188
2001	95.46	96.29	N/A	N/A	7.25	7.32	120,097	103,838
2002	95.90	96.34	N/A	N/A	6.61	6.70	129,436	112,237
2003	96.29	96.33	685.33	665.75	5.85	5.80	133,257	121,352
2004	96.36	96.18	671.48	667.39	5.61	5.69	141,837	125,336
2005	95.37	95.94	673.69	668.18	5.53	5.66	142,875	130,614
2006	95.97	95.77	675.97	667.40	6.12	6.21	152,913	140,088
2007	95.07	95.95	670.91	654.01	6.17	6.31	157,545	149,208
2008	94.52	95.88	685.33	686.98	5.99	6.20	196,838	168,183
2009	94.53	95.18	706.15	711.02	5.14	5.28	225,768	173,233
2010	94.25	94.91	714.42	713.62	4.79	4.90	254,823	180,635
2011	93.92	94.79	715.95	714.89	4.32	4.50	264,177	173,883
2012	94.96	95.09	708.47	709.78	3.67	3.74	256,731	174,761
2013	94.72	94.85	703.16	704.25	3.63	3.74	257,058	174,270
2014	94.33	94.96	690.77	692.28	4.05	4.15	266,950	180,004
2015	94.60	95.14	692.20	694.06	3.81	3.93	285,223	196,053
2016	94.62	94.96	694.75	694.08	3.84	3.96	307,275	203,915
All	**95.17**	**95.70**	**695.71**	**698.64**	**5.76**	**5.86**	**179,028**	**143,910**

TABLE 4B

Loan Characteristics for New-Condo and Existing-Condo Purchasers (continued)

Year	Monthly Income ($)		Female (%)		Minority (%)		First-Time Homebuyer (%)	
	New condo	Existing condo	New condo	Existing condo	New condo	Existing condo	New condo	Existing condo
2000	1,062.49	988.43	40	45	47	41	81	83
2001	1,080.24	1,002.48	41	46	43	42	80	83
2002	1,099.03	1,026.47	43	47	38	42	78	83
2003	1,052.25	1,029.77	45	48	40	40	78	83
2004	1,097.59	1,053.37	46	47	34	40	77	82
2005	1,127.55	1,098.18	47	48	33	34	82	85
2006	1,276.47	1,211.75	47	48	34	36	84	86
2007	1,321.60	1,305.54	49	46	42	41	84	87
2008	1,627.97	1,484.93	45	46	47	35	83	85
2009	1,772.59	1,469.07	43	46	45	33	84	87
2010	1,973.37	1,503.24	41	46	46	36	82	86
2011	2,064.62	1,504.68	41	46	43	37	77	83
2012	1,955.14	1,464.34	39	46	45	34	79	83
2013	1,973.12	1,459.30	42	47	46	35	80	83
2014	2,114.96	1,537.86	37	46	52	38	80	86
2015	2,100.89	1,551.04	39	47	55	39	81	85
2016	2,244.42	1,601.44	40	46	58	41	82	85
All	**1,444.10**	**1,258.25**	**43**	**46**	**43**	**38**	**80**	**84**

Source: Authors' calculations based on Federal Housing Administration data; 2016 data through April
Notes: LTV = loan-to-value ratio. N/A = not available.

Table 5 shows the percentage of loans that have experienced a serious delinquency (were ever 90 or more days delinquent). While condo loans have performed well compared with noncondo loans since 2010 with the current rules in effect,[4] loans on both new- and existing-condo purchases have usually had similar or slightly lower default rates than loans on noncondo purchases. (Occasionally, this does not apply; see 2008–09 for new-condo loans and 2006–07 for old-condo loans.) This is not surprising given the loan characteristics presented in tables 2 and 4. Condo borrowers look similar to other FHA borrowers (if anything, they are slightly stronger), and the default experience on condo purchase loans has been positive.

These data should convince the FHA that allowing a lower owner-occupied threshold for existing condos makes sense. We are pleased that the mortgagee letter allows financing with 35 percent owner-occupancy under certain circumstances. We would advise the FHA to monitor the use of the 35 percent threshold for existing condos to determine if more general application might be possible. We are also pleased that the proposed rule provides the FHA flexibility to change the owner-occupied floor and allows exceptions.

TABLE 5

Serious Delinquency Rates (90 or More Days) Based on Recent Status

Origination year	Noncondo purchase (%)	Refinance (%)	New-condo purchase (%)	Existing-condo purchase (%)	All (%)
2000	10.0	6.6	4.6	4.3	9.3
2001	10.4	5.1	4.2	4.9	8.5
2002	10.7	5.5	5.9	5.5	8.6
2003	14.2	7.7	9.9	8.9	10.7
2004	18.5	11.6	14.1	13.6	15.8
2005	24.4	17.4	21.2	22.8	22.2
2006	26.7	23.3	25.2	30.0	25.8
2007	29.5	26.1	25.6	34.5	28.3
2008	19.5	22.4	20.3	17.1	20.6
2009	8.9	15.3	9.5	7.4	11.8
2010	6.5	7.9	5.5	5.2	6.9
2011	4.2	4.9	3.4	2.9	4.4
2012	3.3	2.8	2.5	2.0	3.1
2013	2.9	2.2	2.1	2.0	2.6
2014	2.6	1.9	2.7	2.0	2.4
2015	0.9	0.9	0.5	0.7	0.9
2016	0.0	0.0	0.0	0.0	0.0
All	**9.7**	**9.2**	**9.5**	**8.0**	**9.5**

Source: Authors' calculations based on Federal Housing Administration data; 2016 data through April.

Notes

1. Kevin Mercadante, "Requirements to Get an FHA Loan for a Condo," Money under 30, July 17, 2015, http://www.moneyunder30.com/requirements-to-get-an-fha-loan-for-a-condo.
2. Federal Housing Commissioner, "Federal Housing Administration (FHA) Condominium Project Approval–Owner Occupancy Requirement," letter to Federal Housing Administration and Housing and Urban Development officials, October 26, 2016, http://portal.hud.gov/hudportal/documents/huddoc?id=16-15ml.pdf.
3. Condo loans constituted a higher percentage in the precrisis period (6–8 percent) than in the most recent years (2.5–3 percent).
4. For loans originated in 2010, noncondo purchase loans defaulted at 6.5 percent, while the default rate was 5.5 percent for new condos and 5.3 percent for existing condos.

Reference

Golding, Edward L. 2016. *Project Approval for Single-Family Condominiums.* Washington, DC: US Department of Housing and Urban Development, Federal Housing Administration. https://s3.amazonaws.com/public-inspection.federalregister.gov/2016-23258.pdf.

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