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Insurance Changes Could Lead to Association Members' Inability to Sell Their Units

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Fannie Mae and Freddie Mac are large, government-backed companies that play a crucial role in the mortgage market. In late 2008, following the global financial crisis, the federal government took over operations at both companies, and these government-sponsored enterprises (GSEs) now guarantee most of the mortgages in the United States. It is critical to understand how the policies of these massive entities affect the ability of community associations to ensure homeowners in their communities continue to have ready access to mortgage loans.

Mortgage loans guaranteed by the GSEs are known as conventional loans. According to the National Association of Home Builders, 71.9% of home loans in 2022 were conventional loans.[1] To qualify for a conventional mortgage loan, the loan must conform to certain criteria and underwriting guidelines, some of which are set by the federal government, and some by Fannie Mae and Freddie Mac themselves.

GSEs do not directly loan money to consumers; rather, they purchase, sell, and guarantee mortgages to provide stability and affordability in the overall housing market. Loan guarantees from Fannie Mae and Freddie Mac, therefore reduce risk for lenders who make loans and investors who purchase them, while simultaneously providing liquidity in the mortgage market. This in turn makes loans more affordable and contributes to the wide availability of the 30-year fixed-rate loans that we think of as standard. Loans that are not eligible for Fannie Mae or Freddie Mac guarantees are typically more expensive and more difficult to qualify for.

When an individual applies for a conventional loan to buy property within a community association (a homeowners association, condominium owners association, or housing co-op), the lender assesses the association's compliance with conventional loan regulations as part of the application and underwriting process. If a community association is not in compliance with conventional loan regulations, lenders may be forced to reject applications for conventional loans in that community, resulting in significantly reduced availability of

mortgage loans for buyers. This can severely affect property values and the ability of owners within an association to sell their property.

One of the requirements that a community association must meet in order for properties within the association to qualify for conventional loans is compliance with certain insurance standards. In December 2022, Fannie Mae adjusted their minimum insurance requirements for master policies. Under these new requirements, the maximum deductible percentage for any master policy is 5%. Anything above this percentage, including deductibles for wind and hail, may put an association on "unavailable" status for conventional loans. What might this mean for your association?

Fannie Mae, in particular, updated the following regulations regarding insurance policies covering the common elements and residential structures within associations:

B7-3-03, Master Property Insurance Requirements for Project Developments (12/14/2022)[2]

Deductible Type	Maximum Deductible
Per occurrence	**The maximum allowable deductible for all required property insurance perils is 5% of the master property insurance coverage amount.**

Deductible Type	Maximum Deductible
Per occurrence, multiple deductibles	When a master property insurance policy includes multiple deductibles, such as a separate deductible that applies to windstorms, or a separate deductible that applies to a specific property element such as the roof, the total amount for such deductibles applicable to a single occurrence must be no greater than 5% of the insurance coverage amount.
Per occurrence, per unit	Fannie Mae will allow a per unit master property insurance policy deductible when the sum of the applicable per unit deductibles is greater than 5% of the coverage amount, and all of the following requirements are met. 1. The master property insurance policy has a per unit deductible for named perils specific to a geographic area where such coverage is common and customary; and 2. The borrower's individual property insurance policy includes a. coverage for the applicable peril(s); b. coverage for master property insurance policy deductible assessments levied on the unit owner by the HOA or co-op corporation for the applicable peril(s); and c. loss assessment coverage in an amount sufficient to cover assessments in excess of 5% of the master property insurance policy coverage amount, divided by the number of units.

Note: A deductible buy-back insurance policy purchased by the community association may be used to meet Fannie Mae's master property insurance policy deductible requirements, provided the policy meets all other property insurance requirements in

Chapter B7-3, Property and Flood Insurance, including insurer rating requirements.[2]

These regulations adopted by Fannie Mae have already significantly impacted associations that are unable to obtain a 5% wind-and-hail deductible. Buyers are turned down for conventional loans, which then requires the seller to find a buyer who can pay cash or obtain other means of financing. This significantly limits the seller's ability to sell their property, and can negatively affect property values as a result.

Occasionally, Fannie Mae may assign an "unavailable" status to a condo or co-op project in its internal database, Condo Project Manager (CPM), if it obtains information indicating that a project does not meet its criteria. Loans secured by units in projects with an "unavailable" status are not eligible for sale to Fannie Mae. The number of projects in CPM that are assigned an "unavailable" status is not overly large; – as of June 2023, they make up only 1.2% of the total projects in the system, – but this number could increase as insurers become more risk-averse, so it is imperative that associations be informed of the risks of falling into this category, and how to avoid them. Needing critical repairs or having significant deferred maintenance are just some characteristics that would make a project ineligible under Fannie Mae guidelines, aside from insurance. Most projects that are

currently listed as unavailable have other eligibility issues as well, such as active or pending significant litigation, hotel- or resort-type characteristics with transient occupancy, or too much commercial space.

Freddie Mac has a similar 5% maximum deductible requirement, but If the deductible exceeds the 5% maximum due to a per unit deductible for named perils specific to a geographic area, the Mortgage is eligible for sale to Freddie Mac if the Borrower's unit is covered by an owner's HO-6 policy. The Borrower's owner's policy must include the same perils as the condominium association's master policy, cover master policy assessments levied on the unit owner and carry a sufficient coverage amount to cover the per unit amount over the permissible 5% limit.[3] While this seems like a sufficient alternative to Fannie Mae, the limits of HO6 may not permit the owner to obtain insurance sufficient to meet Freddie Mac requirements.

Colorado has been affected more than most states with these new insurance guidelines, as wind and hail claims continue to drive the minimum deductible offered by insurers to 5% or more. Your association must be prepared for similar circumstances, so please contact our office to discuss what positive changes you need to make to protect your association.

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[3] https://guide.freddiemac.com/app/guide/section/4703.2

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