

Memorandum

March 15, 2016

This is the original memo from GAC re:
RR105c. See page 4 for updated email
from current GAC Chair, Peter Davis

TO: Kalama Kim, Chair
Standard Forms Committee

FROM: Lawrence Carnicelli, Chair
Government Affairs Committee

RE: **Review of RR105C Interpretation of Second Home Occupancy
Definition**

It was brought to our attention that there has been an increase in the misapplication and reduction in owner occupancy percentages on condominiums within the RR105C. The result of this reduces conventional and government financing on condominiums and the types of loans available to buyers.

We are informed that the wording of one question may be resulting in confusion, causing a large number of inaccurate responses. The question at issue relates to how many units in a subject complex are regarded as "second homes". The specific wording is:

"What approximate percentage of Condominium Apartments are second homes?"

In practice, however, a large number of on-site property managers are using different standards. There are extreme cases in which the managers will only recognize a unit as a "second home" if the annual property tax bill is mailed to the unit's address. Others refuse to recognize any units that are being vacation rented, even when the owners actually occupy the unit extensively during the year. There are still others that simply eliminate the "second home" category altogether, taking the position that any unit not occupied by the owner full time is an "investment property". In short, there is confusion and inconsistency in the management community as to how to correctly respond to this question.

The issue with these procedures is that they have all but eliminated second home owners who were lumped into owner occupied percentages to determine owner occupancy of the condo complex.

FannieMae's definition of a second home occupancy is as follows:

1. Must be occupied by the borrower for some portion of the year
2. Is restricted to one-unit dwelling
3. Must be suitable for year-round occupancy
4. The borrower must have exclusive control over the property

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5. Must not be rental property or a timeshare arrangement (If the lender identifies rental income from the property, the loan is eligible for delivery as a second home as long as the income is not used for qualifying purposes, and all other requirements for second homes are met—including the occupancy requirement above).
 6. Cannot be subject to any agreements that give a management firm control over the occupancy of the property. (Comment – many off-island owners do this, working with a management firm to set up times for owner/family to use during the year)

Based on this, we believe the definition of a second home is vague at best but “must be occupied by the borrower for some portion of the year”. Since most second home owners are normally going to have their mail delivered to their primary, not second home residence, management companies are eliminating the second home category which decreases the owner occupancy and eliminates conventional financing for most of these projects.

The elimination of the second home occupancy category (which were counted along with owner occupied units in the past) on RR105Cs appears to be a voluntary decision on the part of the management companies in Hawaii.

RR105C's were developed to report accurate numbers and follow the three types of occupancy identified by Fannie, Freddie and Government underwriting guidelines (1) Owner Occupied, (2) Second home and (3) Investment property.

Relying on site manager observations or mail delivery to the address is contrary to conventional and government underwriting guidelines since neither is considered in these guidelines.

Recommendations

1. Our committee believes that it would be beneficial to revise the wording of two of the questions on the form, providing a clearer standard for those responding. Our suggested revised language would change two of the three occupancy questions, and result in the following:

“What approximate percentage of Condominium Apartments are primary residences?”

Excluding the above, what approximate percentage of Condominium Apartments are used by owners and/or their family members for 15 days or more during the year?

What approximate percentage of Condominium Apartments are investor properties, leased to long term tenants?”

These changes should hopefully result in a greater consistency in the responses being provided, as well as having those responses conform to the underwriting needs of the lending community.

From: peterdavis55@aol.com
Date: August 3, 2016 at 10:53:04 PM HST
To: roy@sakamotoproperties.com
Subject: RR105C Form

Updated email re: RR105c
from current GAC Chair,
Peter Davis

Aloha Roy

Thanks for taking the time to meet with Lawrence and me earlier today. As we expressed at the time, the HAR-GAC is very interested in having our suggestions re: changing the language on the RR105C form be seriously considered by the HAR Standard Forms Committee at their next meeting. We sent an earlier memo on this subject on March 15th, although our suggested changes have changed slightly since then.

By way of background, the GAC was asked to look at this by several lenders, citing consistent problems arising from those responding to the form taking an inappropriate view of what is or isn't a "second home". The consequences of these misguided responses often resulted in entire complexes not qualifying for financing.

The GAC formed a Working Committee who interviewed a cross section of lenders including national banks, local portfolio lending banks, and individual mortgage brokers. All those contacted agreed that the current wording of the form has resulted in serious problems.

Interestingly, there was also a total consistency in the lenders' underwriting practices. Virtually all lenders classify properties used by an owner (or their family members) for 14+ days during the year as a "second home", not an "investment property".

This 14 days+ rule is probably adopted from the IRS rules for classifying properties as "second homes" vs. "investment properties". (See IRS Publication 936, using the 14 days+ standard, even if properties are otherwise rented during the year.)

The lending community was clear that they would like the occupancy questions reformatted, giving better direction and encouraging responses that are consistent with their underwriting rules. With that object in mind, we've suggested rewording the questions re: occupancy as follows:

1. What approximate percentage of Condominium Apartments are primary residences?
2. What approximate percentage of Condominium Apartments are used by owners or their family members for more than 14 days per year?
3. What approximate percentage of Condominium Apartments are investor properties? (Not used by the owners for more than 14 days per year.)

We reviewed these suggested changes with the lenders who were kind enough to work with us on this, and they were enthusiastic about the prospect of them being adopted.

Hopefully this would result in a much greater percentage of appropriate responses. Even as to those who still "got it wrong", the changes would put the lenders (and those trying to sell) in a position to challenge the inappropriate responses.

Thanks again for meeting with us, and for carrying our message forward to your committee.

Peter Davis, Chair
HAR-GAC