



Six Things to Know About Fannie Mae's and Freddie Mac's New Mortgage Requirements

On June 24, 2021, the Champlain South Tower in Surfside, Florida collapsed. In response, the Federal National Mortgage Association (Fannie Mae) and Federal Home Loan Mortgage Corporation (Freddie Mac) promulgated new temporary requirements for issuing mortgages on units in condominiums and cooperatives with five or more attached units.ⁱ Under the new requirements, Fannie and Freddie must vet condominiums and cooperatives for their “overall safety, soundness, structural integrity, [and] habitability[.]”ⁱⁱ

Fannie's and Freddie's new temporary requirements may portend permanent structural, financial, and maintenance thresholds for mortgage lending. Condominium associations, cooperative corporations, and property managers should interpret the new requirements as a bright signal to ready sufficient documentation for establishing their condominium's or cooperative's overall safety, soundness, structural integrity, and habitability. Failure to act may result in failed financings and diminished property values.

This article explains:

- Why Fannie's and Freddie's requirements are important.
- What information is necessary to satisfy those new requirements.
- Where you can find that information.
- Who has a right to receive that information.
- Who has an obligation to provide that information.
- What liability there may be in providing or failing to provide that information.
- What can be done if the information does not exist.

Why are Fannie's and Freddie's new lending requirements important?

Fannie and Freddie are mortgage-industry behemoths. They hold half of all residential mortgagesⁱⁱⁱ and, therefore, directly determine eligibility for half of all residential mortgages.

They also indirectly set the eligibility standard for mortgages issued by other lenders. Those other lenders cannot offer competitive rates for their clients or earn reasonable profits for themselves unless the mortgages they issue become part of a mortgage securitization pool.

But the largest pools in town—by a galactically wide margin—are the pools that Fannie and Freddie maintain. Those pools account for 95% of all mortgage-backed securities.^{iv} It should be unsurprising, therefore, that most private lenders issue mortgages with the intent to later sell those mortgages to Fannie or Freddie.^v

Because Fannie and Freddie only purchase mortgages that meet their requirements, private mortgage lenders adapt their mortgage lending requirements to meet or exceed Fannie's and Freddie's lending bar. In short, Fannie's and Freddie's lending requirements directly or indirectly set the standard for nearly all residential mortgages.

What new information or documents do Fannie and Freddie require?

First, it is important to remember that Fannie's and Freddie's new requirements only apply to units in condominiums and cooperatives with five or more attached units. The requirements do not apply to units in smaller condominiums or cooperatives, to units in planned community associations,^{vi} or to interests in unincorporated real property (e.g., single-family residences).

For most, however, Fannie's and Freddie's new requirements are resounding. Condominiums house one-third of Hawai'i's population^{vii} and, together with cooperatives, account for two out of three of our fastest growing housing segments.^{viii}

Second, it is important to remember that the new requirements are traceable to the Champlain South Tower collapse. Fannie's and Freddie's new requirements manifest what is, in effect, their new philosophy of "scrutinizing before securitizing."

Fannie and Freddie require information on all deficiencies that affect a subject unit's or building's "overall safety, soundness, structural integrity, or habitability[.]"^{ix} They also require certain information relating to a condominium association's or cooperative corporation's special assessments and reserve (on the theory that either or both may manifest an overall safety, soundness, structural integrity, or habitability deficiency or indicate an inability to correct such a deficiency).

Overall Safety, Soundness, Structural Integrity, and Habitability

To satisfy both Fannie and Freddie, you must describe all significant deferred maintenance and critical repairs, including but not limited to repairs that require the building's full or partial evacuation for seven days or for an indeterminate period; repairs that present life safety hazards; and violations of any federal, state, or local law, or ordinance relating to zoning, subdivision and use, building, housing accessibility, health matter, or fire safety.^x

Special Assessments

Both Fannie and Freddie require information on all current special assessments. Neither Fannie nor Freddie will issue a mortgage: (1) if the borrower would be unable to satisfy their mortgage obligations while repaying the amounts assessed against the

subject unit; or (2) if the special assessments negatively impact (a) the building's overall safety, soundness, structural integrity, or habitability or (b) the condominium association's or cooperative corporation's financial viability or marketability.

Note: In addition to all current special assessments, Fannie requires information relating to all *planned* special assessments. It is unclear, however, what constitutes a planned special assessment. We interpret *planned special assessment* to mean all special assessments that a reasonably prudent person in the seller's position would expect their association or corporation to levy.

Reserve

Fannie no longer accepts working capital fund reports or reserve studies. All units that receive a Fannie mortgage must be part of a condominium association or cooperative corporation that budgets at least 10% of its assessment income to its reserve.

By contrast, Freddie continues to allow adequate capital funds and satisfactory reserve studies to substitute for a condominium association's or cooperative corporation's failure to dedicate 10% of its assessment income to its reserve.

Where do I get the documents and information to satisfy Fannie's and Freddie's Requirements?

Fannie and Freddie recommend a review of a condominium association's or cooperative corporation's meeting minutes. To obtain the information required by Fannie's and Freddie's new requirements, scour the past six months of an association's or corporation's meeting minutes for mentions of:

- maintenance or construction projects that may significantly impact the unit's or the building's safety, soundness, structural integrity, or habitability;
- special assessments; and
- the condominium association's or cooperative corporation's budget.

Other acceptable sources of documentation include inspection, engineering, or other certificate reports completed within the past five years.

Meeting Minutes

Meeting minutes should be available to most unit owners. Hawai'i law requires condominium associations and cooperative boards to meet at least once per year^{xi} and to make their minutes available to each unit owner.^{xii}

Special Assessments and Budgets

To satisfy both Fannie’s and Freddie’s requirements, you must report all existing or planned special assessments and provide sufficient documentary evidence to establish that those special assessments do not negatively affect the condominium association’s or cooperative corporation’s financial viability or marketability.^{xiii}

Hawai‘i law helps condominium owners obtain those documents. Under existing law, condominium associations must adopt a budget before levying any assessment.^{xiv} That budget must set forth the association’s:

- estimated revenues and operating expenses;
- actual replacement reserve;
- the replacement reserve that the association estimates is necessary to maintain the association’s property based on the estimated life and the estimated capital expenditure or major maintenance required for each part of the property; and
- the income the association estimates it must collect to fund that estimated replacement reserve.^{xv}

And the condominium board must distribute those budgets to the association’s unit owners each year.^{xvi} In other words, condominium owners already have the right to documents that can help them establish their association’s financial viability and satisfy Fannie and Freddie.

Like condominium associations, which must keep and maintain budgetary documents, cooperative corporations must maintain certain books, records, and accounts. Hawai‘i law requires cooperative corporations to keep and maintain “accurate and complete books and records of account”^{xvii} that detail the corporation’s assets, liabilities, receipts, disbursements, gains, and losses[.]”^{xviii} Hawai‘i also requires cooperative corporations to keep and maintain their meeting minutes, insurance policies, contracts, invoices, and any document regarding a delinquency to the corporation of 90 or more days.^{xix} Unit owners have a right to receive all of these documents,^{xx} any or all of which they may use to satisfy Fannie’s and Freddie’s new requirements.

What liability may there be in providing this new information?

Some directors may fret that furnishing documents or providing information relating to the deficiencies in their building’s “overall safety, soundness, structural integrity, or habitability” may expose themselves or their association or corporation to potential liability.

For instance, a director may worry that the reports they supply are inaccurate or incomplete. But state law protects condominium and cooperative directors who reasonably rely on their association's or cooperative's information, opinion, report, or statement.^{xxi} To the extent that a director reasonably relies on such information in describing their building's "overall safety, soundness, structural integrity, or habitability[.]" they should not fear liability.

Condominium directors who do not accept remuneration for their duties are particularly well insulated from liability. Not only are they immune to liability for conduct arising from their reasonable reliance on their association's information and documents, but they are immune to liability for information and documents that they *independently* prepare or generate, absent their gross negligence.^{xxii}

What liability may there be in *not* providing this new information?

In most instances, the danger is in not providing information that Fannie and Freddie require. State law gives unit owners the right to receive most, if not all, of that information. For instance, as noted above, state law requires condominium associations to produce and adopt assessments for common expenses, which their boards must annually distribute to their association's unit owners.^{xxiii} A board's failure to distribute any such assessment may trigger a unit owner's statutory right of action against the board.^{xxiv}

Also, remember that state law requires condominium associations to "keep financial and other records sufficiently detailed to enable [them] to comply with requests for information and disclosures related to [the] resale of [their] units."^{xxv} That ostensibly broad duty includes the express statutory obligation to furnish a full statement of unpaid assessments against each unit owner to each unit owner and potential purchaser that properly requests it.^{xxvi} Failing to comply with that statute, or refusing to provide documents in response to reasonable requests relating to a unit's sale, may expose a director, their board, or their building to liability.

Furthermore, and more generally, condominium and cooperative directors must perform their duties with the care that an ordinary prudent person in their position would exercise, and they must perform their duties in a manner that they reasonably believe is in their association's or corporation's best interest.^{xxvii} A director who does not provide information to satisfy a national lender's requirements for purchasing a mortgage may compromise their fiduciary duty and create an unnecessary legal vulnerability.

What if the information does not exist?

Some condominium associations or cooperative corporations may fail to generate or maintain adequate meeting minutes or account records. But the required documents can often be reconstructed or compiled from other reliable sources.

For instance, a condominium association or cooperative corporation might correctly determine its assets, liabilities, receipts, disbursements, gains, or losses by compiling contemporary business records (e.g., bank statements, vendor receipts, managing agent records,^{xxviii} or public accountant records^{xxix}), a unit owner's statement against their interest (e.g., an email in which a unit owner agrees that the condominium association or cooperative project properly assessed them for a debt to the association or corporation), a public record (e.g., a lien or developer's public report), or any other statement or record that is independently reliable and that speaks to a matter for which there is no other record that is as reliable.

For new condominiums, their developer's public report may be fruitful. Fannie Mae describes the review of a certification report as a "best practice,"^{xxx} and the reports are replete with information on the association's "overall safety, soundness, structural integrity, [and] habitability." For instance, a condominium developer's public report must include a declaration "that the project is in compliance with all county zoning and building ordinances and codes . . . and all other county permitting requirements applicable to the project[,]" as well as "[a]ny other facts, documents or information that would have a material impact on the use or value of a unit or any appurtenant limited common elements or amenities of the project available for an owner's use"^{xxxi} Many developer public reports must also contain

[a] statement by the developer, based upon a report prepared by a Hawai'i-licensed architect or engineer, describing the present condition of all structural components and mechanical and electrical installations material to the use and enjoyment of the units . . . [their expected useful life and a] list of any outstanding notices of uncured violations of building code or other county regulations, together with the estimated cost of curing [those] violations.^{xxxii}

The developer must amend their public report with new information "until such time as the developer has sold all units in the project"^{xxxiii} and every unit's first purchaser has a right to receive the developer's public report.^{xxxiv}

Absent any of this information, some lenders may accept a "not to my knowledge" statement, but condominium associations and cooperative corporations should consider collecting these reliable sources, if they are available, so that they may reconstruct their minutes, budgets, and special assessments documentation in good faith and with the care of a reasonably prudent person in a similar position. They should then, if in the bests interest of

their association or corporation, supply the information that is necessary to satisfy Fannie's and Freddie's new lending requirements.

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ⁱ Fannie Mae, Lender Letter (LL-2021-14) (Oct. 13, 2021), <https://singlefamily.fanniemae.com/media/29411/display>; Freddie Mac, Bulletin 2021-38: Temporary Condominium and Cooperative Project Requirements and Topic 5600 Reorganization, <https://my.sf.freddiemac.com/updates/guide/bulletin~2021-38> (Dec. 15, 2021); *see also* Fannie Mae Form 1076 at 6-8 (Dec. 2021), <https://singlefamily.fanniemae.com/media/15656/display> (incorporating new requirements into Fannie's and Freddie's joint condominium project questionnaire).

ⁱⁱ Fannie Mae: Lender Letter (LL-2021-14) (Oct. 13, 2021); Freddie Mac: Bulletin 2021-38 (Dec. 15, 2021).

ⁱⁱⁱ *Compare Total Mortgages Held by Fannie Mae*, FEDERAL RESERVE BANK OF ST. LOUIS (Mar. 10, 2022), <https://fred.stlouisfed.org/series/BOGZ1FL403065015Q> (reporting total asset value of Fannie Mae's mortgage holdings as \$3,899,025,000,000), *and Government-Sponsored Enterprises; Total Mortgages Held by Freddie Mac; Asset, Level*, FEDERAL RESERVE BANK OF ST. LOUIS (Mar. 10, 2022), <https://fred.stlouisfed.org/series/BOGZ1FL403065025Q> (reporting total asset value of Freddie Mac's mortgage holdings as \$2,789,825,000,000), *with Total Home and Multifamily Residential Mortgages*, FEDERAL RESERVE BANK OF ST. LOUIS (Mar. 17, 2022), <https://fred.stlouisfed.org/series/BOGZ1FL893065015Q> (Mar. 17, 2022), <https://fred.stlouisfed.org/series/BOGZ1FL893065015Q> (reporting total asset value of all residential mortgages as (\$14,413,740,000,000)).

^{iv} *See* HOUSING FINANCE POLICY CENTER, URBAN INSTITUTE, *Housing Finance at a Glance* 12 (Feb. 2022).

^v *See* Bruce Mizrach & Christopher J. Neely, *Fed Intervention in the To-Be-Announced Market for Mortgage-Backed Securities*, 19 ECONOMIC SYNOPSIS 1 (2020), <https://research.stlouisfed.org/publications/economic-synopses/2020/04/15/fed-intervention-in-the-to-be-announced-market-for-mortgage-backed-securities>.

^{vi} HRS Chapter 421J.

^{vii} Lila Mower, *State Must Address HOA Owners' Plight*, HONOLULU STAR ADVERTISER (Feb. 13, 2022), <https://www.staradvertiser.com/2022/02/13/editorial/island-voices/state-must-address-hoa-owners-plight/>.

^{viii} *Id.*

^{ix} Fannie Mae: Lender Letter (LL-2021-14) (Oct. 13, 2021); Freddie Mac: Bulletin 2021-38 (Dec. 15, 2021).

^x *Compare* Fannie Mae: Lender Letter (LL-2021-14) (Oct. 13, 2021) *with* Freddie Mac: Bulletin 2021-38 (Dec. 15, 2021).

^{xi} HRS § 514B-121 (as to condominium associations); HRS § 421-5 (as to cooperative boards).

^{xii} *See* HRS § 514B-122 (requiring condominium associations to adopt meeting minutes); HRS § 514B-154.5(a)(8) (requiring condominium association meeting minutes to be available to each unit owner); HRS § 421I-6 (requiring board minutes be available to unit owners).

^{xiii} Fannie Mae expressly requires lenders to document: "the reason for the special assessment; the total amount assessed and repayment terms; documentation to support no negative impact to the financial stability, viability, condition, and marketability of the project; and borrower qualification with any outstanding special assessment payment" to confirm that the association has the ability to fund any repairs and to determine if any special assessment relates to the unit's or

building’s “safety, soundness, structural integrity, or habitability[.]” Fannie Mae: Lender Letter (LL-2021-14) (Oct. 13, 2021). Similarly, Freddie Mac requires sellers to determine: the reason for each special assessment; the total amount assessed; and whether the amount budgeted to be collected has been collected. *See* Freddie Mac: Bulletin 2021-38 (Dec. 15, 2021). Like Fannie Mae, Freddie Mac collects information on special assessments to determine whether there is adequate cash flow to complete the special assessment’s underlying repair or improvement. *See id.*

^{xiv} *See* HRS § 514B-144(a).

^{xv} HRS § 514B-148.

^{xvi} HRS § 514B-144(a).

^{xvii} HRS § 414-470(a); *see also* HRS § 421I-11 (directing application of HRS Chapter 414 to cooperative corporations)).

^{xviii} HRS § 414-470(a).

^{xix} *See* HRS 421I-6.

^{xx} *See id.*

^{xxi} As to condominium directors, *see* HRS § 414D-149; *see also* HRS § 514B-106 (requiring condominium director to “exercise the degree of care and loyalty required of an officer or director of a corporation organized under chapter 414D”). As to cooperative directors, *see* HRS § 414-221(c); *see also* HRS § 421I-11 (incorporating HRS Chapter 414).

^{xxii} *See* HRS § 414D-149(f); *see also* HRS § 514B-106 (incorporating HRS Chapter 414D). Note: Unlike condominium director, a cooperative director that does not receive remuneration for performing their duties may still be liable for their acts or failures to act. *See generally* HRS Chapter 421I.

^{xxiii} *See* HRS § 514B-144(a).

^{xxiv} *See* HRS § 514B-148(g).

^{xxv} HRS § 514B-152.

^{xxvi} *See* HRS § 514B-144(f).

^{xxvii} For condominium directors, *see* HRS § 514B-106. For cooperative directors, *see* HRS § 414-221; *see also* HRS § 421I-11 (incorporating fiduciary duties under HRS Chapter 414).

^{xxviii} A condominium association’s managing agent must keep and disburse the association’s funds in strict compliance” with the condominium’s rules and HRS Chapter 467; *see also* HAR § 514B-149(e) (requiring brokers to maintain records for three years).

^{xxix} Condominium associations with 20 or more units must require an annual audit of its financial accounts and must commission a public accountant to conduct at least one unannounced verification of the association’s cash balance. HRS § 514B-150.

^{xxx} Fannie Mae, Lender Letter (LL-2021-14) (Oct. 13, 2021), <https://singlefamily.fanniemae.com/media/29411/display>; Freddie Mac, Bulletin 2021-38: Temporary Condominium and Cooperative Project Requirements and Topic 5600 Reorganization, <https://my.sf.freddiemac.com/updates/guide/bulletin~2021-38> (Dec. 15, 2021).

^{xxxi} HRS § 514B-83.

^{xxxii} HRS § 514B-84.

^{xxxiii} HRS § 514B-59; *accord* HRS § 514B-83.

^{xxxiv} HRS § 514B-82.