

Fannie Tightens Its Conditions for Backing Condo Mortgages

By Nick Timiraos

The Wall Street Journal - March 18, 2009

Just as a flood of new condominiums are scheduled to hit the housing market this year, Fannie Mae has added restrictions making it more difficult for developers to sell their units.

The government-backed mortgage-finance company stopped guaranteeing mortgages in condo buildings where fewer than 70% of the units have been sold, up from 51%. In addition, the company won't back loans for sales in buildings where 15% of current owners are delinquent on association fees or where more than 10% of units are owned by a single-entity.

The new policy became effective March 1, and most lenders have started to implement Fannie's guidelines. Freddie Mac, Fannie's chief rival, hasn't yet followed Fannie's lead.

Fannie says the new rules protect borrowers from buying units in buildings that have a high risk of failure while also preventing the companies -- and taxpayers, given that Fannie and Freddie are operating under government conservatorship -- from throwing good money into troubled developments. Developers can petition Fannie for an exemption from the rule, and so far more than 50 exceptions have been made.

Still, condo developers say the rules may hasten the failure of countless buildings across the country and seem to be at odds with federal efforts designed to speed along a housing-market recovery. "These buildings are just in purgatory. This new requirement is the straw that's going to break the back of a lot of projects," says Norman Radow, an Atlanta real-estate investor who works with lenders to rescue distressed condo complexes. "It's a weight being tied to a drowning industry."

Moreover, Fannie and Freddie are both set to increase fees on condo buyers next month. Buyers without at least a 25% down payment will have to pay closing-cost fees equal to 0.75% of their loan, regardless of the borrower's credit score. The companies say these fees are necessary to protect against higher default rates.

The changes come as cities brace for a new flood of condo supply. Reis Inc., a New York-based real-estate firm, estimates that 93,000 new condo units will be completed this year, a 28% increase in new inventory from last year. More than 12,000 units will be completed in New York and northern New Jersey by year's end. Chicago will add 5,500 units, Seattle has 3,000 units coming online, and Los Angeles is readying 2,600 units, according to estimates provided by Reis.

The U.S. finished 2008 with a supply of condos large enough to absorb 14 months of demand, the highest level since the National Association of Realtors began its count in 1999. With more inventory coming online, that figure is bound to grow.

In New York, the average monthly inventory for condos reached 5,400 in February, the highest level since appraisal firm Miller Samuel Inc. began the tally in 1999. "What's happening in Manhattan is happening in Seattle, in Chicago, in Boston," says Jonathan Miller, chief executive of Miller Samuel. "These weren't speculative bubbles. Any housing market where you restrict the flow of sales by limiting transactions, that will depress prices."

The new rules have left developers in limbo. Some are turning their buildings into rental apartments -- at least in the near term -- on the expectation that they won't be able to sell the units anytime soon. Others are selling units in auctions, often at prices discounted steeply enough to entice cash buyers.

Some developers are seeking creative ways to finance units. Asset-management firm New Oak Capital, based in New York, has begun working with developers to offer seller-financing by recycling existing capital from investors and lenders to fund loans that can be sold to investors or lenders once secondary markets recover.

In extreme cases, developers also are beginning to use Chapter 11 bankruptcy protection to restructure and use their remaining capital to provide seller financing. "It's not that there's not demand for the condo; you just can't get the financing," says Craig Rankin, a bankruptcy lawyer representing the principals of West Millennium Group, which has 12 condo projects in Southern California including the Brockman, an 80-unit condo conversion of a historic building in downtown Los Angeles.

Some are turning to their construction lenders to provide seller financing. Projects with multiple buildings are "re-phasing" their development plans to treat each structure as its own condo. Others are offering rent-to-own purchase plans.

The current climate is a marked turnaround from just a few years ago, when buyers stood in line for hours at sales offices to put down deposits on units that wouldn't be completed for years. One big question facing developers: How many of those buyers who signed contracts will close. Some may walk because the price of their unit has fallen beyond the value of their deposit, while others mightn't be able to qualify for a mortgage.

"Is anyone even going to get a mortgage in a mostly vacant building?" says Chip Serkland, 37 years old, who plunked down \$22,000 as a deposit for a \$435,000 condo unit at Rollin Street Flats in downtown Seattle two years ago. The building's opening has been delayed because the developer hasn't presold enough units. Mr. Serkland doesn't know if he is still able to get a mortgage even though he and his wife were prequalified by the building's preferred lender.

A representative for the developer, Vulcan Inc., said it was considering how to proceed in light of the new guidelines. Other buyers say Vulcan has encouraged them to purchase units in a different Vulcan development that is closer to being 70% sold.

"The irony in all of this is that the lenders, by ratcheting underwriting guidelines to some of the most conservative benchmarks I've ever seen, are effectively damaging the collateral that they're trying to protect," says Mr. Miller, the New York appraiser.