FannieMae

October 31, 2013

BY E-MAIL: freyermuthr@missouri.edu

Joint Editorial Board for Uniform Real Property Acts
c/o R. Wilson Freyermuth, Executive Director
University of Missouri School of Law
215 Hulston Hall
Columbia, MO 65211

Re: Comments in Response to Proposed Changes to the Uniform Common Interest Ownership Act

Dear Mr. Freyermuth:

Fannie Mae is pleased to submit these comments in response to the open invitation from the Joint Editorial Board for Uniform Real Property Acts (the "Board") regarding the proposed changes to the six-month limited priority lien for homeowner association ("HOA") fees under the Uniform Common Interest Ownership Act ("UCIOA" or the "Act").

**Executive Summary**

Chartered by Congress in 1938, Fannie Mae is a government sponsored enterprise whose mission is to support liquidity and stability in the secondary mortgage market, and increase the supply of affordable housing. Fannie Mae shares the Board's goals of keeping HOA communities financially stable and sustainable. Setting out clear rules helps to enable both HOAs and lenders confidently assess their risks. We commend the past work of the Board that has created greater uniformity and clarity with respect to HOA liens.

Fannie Mae supports maintaining the existing maximum six-month limited priority lien for HOA assessments rather than the options proposed by the Board. The current rule is clear, simple and provides discrete and measureable risk exposure for mortgage lending on residential units located within common interest communities, including condominiums and planned unit developments (collectively referred to as "HOA communities"). The current six-month structure sufficiently balances the rights and needs of lenders (including mortgage servicers and secondary market investors), HOAs and borrowers.

**The Proposal**

In its proposal, the Board explains that the goal of the proposed alternatives is to keep HOA communities financially stable and sound. The Board further indicates that these proposals are intended to address current real estate market conditions, including higher than usual delinquency and foreclosure rates, delays in the completion of foreclosures, slower real estate

appreciation, as well as a decline in value in some areas. These market conditions have taken a toll on many HOAs in the form of unpaid assessments.

The Board has proposed the following alternatives to address its concerns:

- **National Lien Priority Extension**
  The National Lien Extension option would extend the number of months of HOA assessments that can be included in the HOA priority lien to a clearly defined time period greater than six months.

- **Regional Lien Priority Extension**
  The Regional Lien Extension option would extend the number of months of assessments that can be included in the HOA priority lien based on locally determined timelines around foreclosures. For example, in some jurisdictions the six month priority lien may be acceptable while in other jurisdictions the period might extend to nine or more months.

- **Foreclosure Delay Driven Extensions**
  The Foreclosure Delay Extension options would keep the existing priority lien rules but would allow HOAs to require lenders to pay for assessments during foreclosure delays, or allow HOAs to extend their priority lien position during foreclosure delays.

- **Assessment Super Priority**
  The Assessment Priority option would treat HOA assessments similar to real estate taxes and, as such, they would have an unlimited super priority over the first mortgage debt secured by the property.

Fannie Mae does not support any of these options because each would substantially increase financial, operational, and legal risks and create uncertainty for residential lending in HOA communities. Fannie Mae believes that HOAs already possess an adequate remedy for combating unpaid assessments, namely the ability to foreclose their liens on units or to impose other restrictions on unit owners under current law.

**General Considerations for the Board**

Before commenting on specific options, we would first like to address some over-arching issues raised by the proposal.

***Potential for Tighter Underwriting Requirements or Higher Pricing.*** First, Fannie Mae is concerned that any change to the priority lien rule that shifts greater financial responsibility to lenders may create significant unintended consequences in the form of limits on the availability of credit to borrowers in HOA communities. For example, lenders and investors may constrict underwriting requirements for homes in HOA communities if they are at greater financial risk. Cooperatives provide a good example of this kind of reaction. Fannie Mae's underwriting requirements for loans secured by ownership interests in cooperative share

communities ("co-ops") are more restrictive than those for condo and PUD projects.[1] One key reason for these additional restrictions is uncertainty as to the financial exposure for the pro rata share of a blanket mortgage as well as to regular and special assessments levied by co-op corporation boards. Co-op assessments may enjoy an unlimited priority lien position over the liens secured by borrowers' ownership interests.

In the event that risks associated with lending in HOA communities increase because of changes in the priority lien provisions, Fannie Mae would consider pricing changes to compensate for additional expenses resulting from a foreclosure; such price increases would likely be passed to borrowers in HOA communities. Fannie Mae would also need to consider whether to treat loans secured by units in HOA communities more like co-op loans and re-evaluate applicable underwriting guidelines, and eligibility standards to address these additional risks. Lenders may make similar underwriting changes.[2] Such changes could create obstacles for borrowers seeking financing for units in these communities. A more restrictive lending environment could weaken purchase demand, diminish property values, and/or pose challenges for existing unit owners seeking to refinance their existing mortgages or sell their properties.

***Disincentive for HOAs to Pursue Remedies.*** Another potential unintended consequence relates to the willingness of HOAs to use the tools already at their disposal to mitigate losses. Shifting the bulk of the financial risk to lenders or investors may inadvertently create a perverse incentive that encourages HOAs to delay exercising their remedy to foreclose on unpaid assessments, increase the potential for litigation, and/or cause lenders or investors to increase pricing or restrict eligibility parameters.

***Any Changes Must Be Prospective.*** While Fannie Mae does not support any of the proposed alternatives, if any changes are adopted, it will be critically important for them to apply prospectively to future loan originations.

***Changes Should Be Based on "Normal" Market Conditions.*** Without question, we have witnessed between 2008 and the present an extraordinary deviation from normal conditions for the residential real estate market. We have seen:

- exceptionally high delinquency and foreclosure rates, as well as steep declines in real estate values;

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[1] For example, for co-ops, Fannie Mae does not permit investor loans, secondary financing, deed restrictions, or leasehold estates. Further, Fannie Mae requires a more thorough review of the financial position of the cooperative corporation, imposes limits on the pro rata share of the blanket mortgage, and requires the appraised value of the ownership interest (unit) to be reduced by the pro rata share of the blanket mortgage assigned to the stock or shares which effectively lowers the eligible loan-to-value ratio permitted on many transactions. In addition, FHA requires that applications for loans to be secured by co-op interests be submitted to FHA for underwriting and approval.

[2] Recent history provides many examples where lenders have overlaid additional underwriting requirements to reduce risk. Some of these include specific restrictions that mortgage insurance companies and lenders have placed on mortgages secured by units in condominium projects such as loan-to-value ratio restrictions and market-level restrictions.

- lengthy delays in the foreclosure process, particularly in states requiring judicial foreclosure, as courts have been stressed not only by the volume of foreclosure cases, but also by related documentation issues; and
- foreclosure delays as a result of numerous state laws that have added to and/or altered existing procedures and requirements that apply to mortgage delinquencies, loss mitigation, foreclosure mediation, and the foreclosure process.

Changes to HOA priority lien provisions should not be adopted in a reactionary manner based on these atypical market conditions. Rather, any changes should be adopted based upon normal market conditions. For this reason, we urge the Board to defer action until we see a return to more typical market conditions, likely in the next few years.

**Fannie Mae Comments on the Board's Proposal**

The following comments relate to the specific options the Board has proposed.

***National and Regional Lien Priority Extension.*** Both the National and Regional Lien Priority Extension options would expose lenders and investors to increased financial burdens. Moreover, this financial burden may be further compounded if local jurisdictions rush to implement more aggressive priority lien allowances due to political pressure from constituents without regard to potential consequences. For both the National and Regional Lien Priority Extension options, lenders and investors may choose to adjust pricing, underwriting parameters and/or other requirements to offset associated risks. Fannie Mae recognizes that the Board proposed the Regional Lien Priority Extension option in an attempt to provide more flexibility to localities based upon the average length of time it takes to complete foreclosure actions. However, Fannie Mae and its largest lender customers conduct business nationally, and our experience has shown that adjusting policy or practice based on localized circumstances introduces operational challenges and risks.

***Foreclosure Delay Driven Extensions.***
*Unintended Consequences and Increased Litigation Potential.* Fannie Mae has considerable concerns that these options will result in (1) uncertainty about maximum potential lien amounts, and, in turn, an inability for lenders and investors to estimate their exposure and to price for that risk, and (2) substantial and costly litigation between HOAs and lenders or investors over what constitutes a delay in foreclosure, what is a reasonable amount of assessments for lenders to pay or have added to an extended priority lien during delays, and who is at fault for foreclosure delays. The inability to estimate potential exposure and price for expected risks likely would lead to higher pricing and more restrictive underwriting terms for loans secured by properties in HOA communities. Increased litigation between HOAs and lenders would be costly to all parties and in particular may burden HOAs with legal expenses and no certain outcome. Further, investor guidelines, including our own, often restrict mortgage lending in HOAs engaged in lawsuits. In other words, given the potential for lawsuits, mortgage financing to residents in HOA communities may be significantly curtailed. The combined impact of legal expenses for HOAs and more limited financing options for units in HOA communities may affect the financial stability of these communities. Any

outcome resulting in financial instability for HOAs is certainly not in anyone's best interest. Fannie Mae believes that this consequence is in direct conflict with the Board's stated goals.

*Adequate Existing Remedy.* Fannie Mae believes that it is important to reaffirm that HOAs do not have to suffer the delay in foreclosure proceedings before they can recover unpaid assessments. HOAs already possess a viable remedy in the form of foreclosure of the association's lien for unpaid assessments. No change in the Act is required to effectuate this remedy. Indeed, expanding the priority period to match delays in mortgage foreclosure proceedings would create a disincentive for HOAs to pursue their own existing legal remedies.

*Delays Outside of Control of Lenders.* Additionally, the Board has expressed its concern that lenders have deliberately delayed foreclosures, and that during such delays, HOAs (and other unit owners) have borne the burden of preserving the mortgage collateral. Fannie Mae respectfully disagrees with the Board on this issue. Delays in foreclosure are real and have had a significant impact not only on HOAs but also on the entire residential real estate industry. These delays have been caused by many factors, including systemic capacity constraints in local judicial systems, an increase in efforts to evaluate borrowers for foreclosure alternatives, mortgage servicer operations, borrower conduct, and legal and regulatory requirements. Delays in foreclosures are harmful and expensive to lenders, and in many cases, delays have resulted in declines in resale value and increased losses for lenders.

***Assessment Super Priority.*** Fannie Mae believes this option would place an undefined and potentially unlimited financial burden on lenders and investors for unpaid assessments. As a result, if HOA liens were to enjoy a priority equal to real estate taxes, Fannie Mae would likely be forced to require that HOA assessments be escrowed by the mortgage servicer to ensure assessments are paid timely in order to reduce our overall exposure. The Board should understand the widespread industry costs and challenges that would be involved in implementing such a change, which would include but not be limited to: (1) requiring that HOAs maintain proper records to identify unit mortgagees/loan servicers, and notify all servicers in advance of any changes to assessments; (2) establishing ACH or other electronic fee processing systems between servicers and HOAs to support remittance activities; and (3) requiring servicers to change systems and staffing levels to support proper escrow accounting and recordkeeping for remitting HOA assessments. Unlike escrows for taxes and insurance, the sheer number of HOAs across the country as compared to the number of taxing jurisdictions and property insurers, adds further complexity. The burden of complying with a requirement to escrow for HOA assessments would jointly fall on loan servicers and HOAs.

The following comment relates to issues Fannie Mae has identified but the Board did not specifically discuss.

**Other Fannie Mae Comments**

***Request for Clarifications to Existing Provisions.*** As we have indicated through our prior comments, Fannie Mae believes that certainty and clarity help the mortgage industry operate

efficiently, without unnecessary litigation, cost or delay. Because state laws and practices vary, Fannie Mae supports revising the Act to clarify the treatment of the following issues:

1) Whether special assessments, including any equity or capital contribution, imposed by HOAs prior to the lender taking title are included in the limited priority lien, and thus the responsibility of the foreclosing lender;
2) Whether a lender taking title through foreclosure is obligated to pay any assessments, special or regular, before any applicable foreclosure redemption period has expired; and
3) Whether HOAs may seek to enforce the six-month limited priority lien through successive foreclosure actions or otherwise, and thus collect more than once for the limited priority lien amount from a lender.

**Conclusion**

Fannie Mae continues to support HOA communities. However, extending HOA lien priority or the other proposed changes have the potential to increase losses to Fannie Mae and place undue risk on lenders, investors and borrowers. For these reasons, Fannie Mae supports maintaining the existing maximum six-month limited priority lien for association communities.

Fannie Mae very much appreciates the opportunity to provide these comments and would be happy to engage in a further dialogue with the Board regarding this important issue

Sincerely,

John S. Forlines
Senior Vice President
Chief Credit Officer for Single Family