Impact

A regulatory impact analysis must accompany every economically significant federal rule or regulation. The Office of Policy Development and Research performs this analysis for all U.S. Department of Housing and Urban Development rules. An impact analysis is a forecast of the annual benefits and costs accruing to all parties, including the taxpayers, from a given regulation. Modeling these benefits and costs involves use of past research findings, application of economic principles, empirical investigation, and professional judgment.

Project Approval for Single-Family Condominiums

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The purpose of the Project Approval for Single-Family Condominiums final regulation[1] is to reduce regulatory barriers and provide equal access to Federal Housing Administration (FHA)-insured loans for borrowers for the purchase of condominiums. This regulation is potentially beneficial to lower-income households in high-density areas, as condominiums can be an affordable form of property there. Since 2001, approximately 84 percent of borrowers insured by FHA have been first-time homebuyers. Despite the advantages of condominiums, however, FHA's share of condominium loans declined to 2.1 percent of all FHA-insured loans in 2018 from a high of 8.4 percent in 2001. In comparison, the condominium share of all Fannie Mae loans is just under 10 percent and has been since 2014. FHA's condominium share is at a post-2000 low, while Fannie Mae's condominium share of its portfolio is just a few tenths of a percent off of its post-2000 high. Currently, FHA must approve condominium projects to allow borrowers to use an FHA-insured loan to finance the purchase of a condominium unit in that project. The terms of this approval

[1] "FR-5715-P-01 Project Approval for Single-Family Condominiums,"24 CFR 203. *Federal Register* 81 September 28, 2016. https://www.regulations.gov/docket?D=HUD-2016-0108.

will be described later. Only one-fourth of all condominium projects that have been approved for FHA-insured loans retain that approval, which requires reapplication every 2 years. The decline in FHA-approved condominium projects tracks the decline of FHA-insured condominium loans. This regulation, which simplifies the FHA condominium project approval process, may address the discrepancy in the level of scrutiny given to FHA-insured condominium lending versus other types of property.

This regulation was encouraged by the Housing and Economic Recovery Act (HERA) of 2008 through an amendment to the National Housing Act, which provided authority for the U.S. Department of Housing and Urban Development (HUD) to insure condominium units under the single-family program. The regulation establishes more regulations concerning four aspects of the Direct Endorsement Lender Review and Approval Process (DELRAP) for single-family condominiums. First, the regulation establishes parameters regarding which kind of condominium projects are eligible for approval for single-family unit mortgage insurance through FHA. Second, the regulation changes the frequency with which approved condominium projects need to be reapproved, from 2 years to 3 years. Third, the regulation changes the minimum required experience standards for condominium DELRAP mortgagees to permit supervision by experienced personnel and establishes quality control levels. Finally, by providing that only completed condominium projects or phases may be approved, this regulation reduces regulatory burden by eliminating the need to perform an environmental review before the completion of the project.[2]

Project Approvals

Under the new regulatory regime, as mentioned earlier, a condominium project must be certified by FHA before FHA will insure any loans to purchase a unit within that project. Requirements for approval of a project include characteristics of a project's tenants, including the owner-occupancy rate and the shares of commercial and residential tenants, and quality of management. If a condominium project is not already certified, then it goes through one of two distinct approval processes: HUD Review and Approval Process (HRAP) and DELRAP. The major difference between the two processes is the reviewer. For HRAP, project approval applications, annexations, and recertification submissions are reviewed and processed by FHA staff. For DELRAP, these tasks are reviewed and processed by the staff of a qualified Direct Endorsement (DE) lender. Under the FHA DE program, these approved lenders may originate, underwrite, and close FHA-insured mortgage loans without FHA's prior review or approval, except in some circumstances.

Requiring project approval, regardless of the requirements themselves, will constitute paperwork costs. The regulation formally introduces more rigorous criteria for approval. An approval package must be prepared and reviewed, and approximately every fifth one is submitted to quality control. The annual number of applications per year will accurately reflect the potential burden when multiplied by a cost per application. FHA estimated an incremental annual paperwork burden of 48,000 hours. The median hourly wage of "Property, Real Estate, and Community Association Managers" in 2017 was $28.21 (Bureau of Labor Statistics, 2018). The opportunity cost of labor

[2] A full version of the Regulatory Impact Analysis can be viewed at https://www.regulations.gov/document?D=HUD-2016-0108-0093.

to employers is greater than the wage paid to the employee and includes taxes, employee benefits, management, equipment, and rental. A "loaded" wage reflecting the full cost could be as high as $56. The total cost of additional paperwork would be approximately $2.7 million annually ($56 x 48,000).

DELRAP Approval Authority

Allowing DE lenders to participate in the approval process of condominium projects represents a relative benefit for the condominium industry. The DELRAP approval process provides flexibility, and although it can be costlier than HRAP, DELRAP allows condominium projects and lenders to move forward more quickly than if only FHA were able to approve projects. During a tight market, DELRAP can ease the bottlenecks on FHA approval of projects and bring additional condominiums on the market for FHA-insured borrowers.

Other potential impacts are possible within this broad positive impact. HUD had the discretion to set the requirements for DELRAP lenders. Applying more stringent requirements would result in benefits, costs, and transfers. First, more stringent restrictions on which lenders may submit approvals will reduce the number of faulty applications, therefore reducing the risk and losses borne by FHA and indirectly to the U.S. Treasury. On the other hand, more stringent regulations would also reduce the number of DE lenders[3], who provide an important supplement to HRAP. Transfers could occur from those lenders that do not meet the standards to those that do, or perhaps to non-FHA lenders.

It is not clear at this stage whether changes to DELRAP authority or approval requirements will have a larger effect on the number of approved condominium projects. What is clear is that, since 2009, the number of approved condominium projects has been declining. As of April 2, 2018, more than 41,000 condominium projects had ever been approved at any time. Currently, however, only 9,888 remain approved, and 33,710 have let their approval lapse. Of the condominium projects that lapsed, about one-half were only approved for one 2-year cycle; most of these did not seek reapproval, and a very small fraction were rejected or withdrew their applications. It seems unlikely that DELRAP will turn the tide of declining condominium project approvals; according to the Office of Policy Development and Research's (PD&R's) review of condominium project data, not a single condominium project that was initially submitted by a lender has ever renewed its approval. Several projects initially submitted by a condominium association have been renewed by lenders.

Although the use of DELRAP authority may increase efficiency, the restriction of this authority to a small subset of lenders raised concerns about market power. PD&R explored measures of market power to gauge whether there is any risk of an adverse anticompetitive effect from the rule. Knowing the proportion of DELRAP approvals relative to total approvals provides an indicator as to whether borrowers have alternatives to DELRAP lenders. Submitting and non-submitting lenders make 37 and 63 percent of FHA condominium loans, while making 33 and 67 percent of all FHA loans, respectively. Submitting lenders do not have an outsized share of FHA condominium loans

[3] Some lenders may not feel it is worth it to participate with more stringent regulations and may drop out.

relative to their position in the overall FHA market. FHA borrowers interested in condominiums have a good chance of selecting a DELRAP lender but could easily avoid one if there were any adverse impacts of the rule.

Project Requirements

Condominiums are distinguished from single-family properties by the condominium owner's interest in a common area.[4] The common area adds an element of downside risk that is not present to the same extent for single-family homes. Other condominium units within the same project could be a source of negative spatial or fiscal externalities. For example, a condominium association may be financially responsible for the maintenance of an elevator, a playground, landscaping, or a pool. Failure to maintain the common area or unexpectedly raising fees would have an adverse impact on the value of a condominium unit. A decline in a home's market value can increase the likelihood of loss mitigation or foreclosure, which impose costs on both FHA and the lender. Codifying standards for condominium projects reduces the uncertainty surrounding negative externalities that may arise, by ensuring the financial soundness and viability of condominium projects.

There is precedent for imposing requirements on projects (NAR, 2017). Government-sponsored enterprises, or GSEs, such as Fannie Mae and Freddie Mac, impose restrictions on the characteristics of projects; in fact, they appear in some occasions to be stricter than FHA. For example, both Fannie Mae and Freddie Mac have stricter limits concerning when manufactured housing units can be treated as condominiums.

The regulation does not explicitly alter most of the condominium project requirements, but it does provide a range of limits. Generally, the ranges contain the current requirements, except for limited instances of FHA-insured loan concentration. The regulation sets ranges for minimum owner occupancy, maximum commercial space, and FHA-insured loan concentration. By releasing notices, HUD will be able to vary the standards for eligibility within the range to remain flexible and responsive to the market. If HUD decides to vary the upper and lower limits of the range itself, the regulation provides a procedure that includes notice and an opportunity for public comment.

Project Requirement: Minimum Ratio of Owner Occupants

This regulation establishes a range of minimum owner-occupancy of 30 to 75 percent, within which HUD sets a minimum. The current requirement is that at least 50 percent of the units must be owner-occupied or sold to owners who intend to occupy the units, or 35 percent in limited, low-risk situations with additional oversight. Establishing a minimum proportion of owner-occupants is partially motivated by homeowners being more likely to participate in maintaining common areas than a renter. Decisions of the condominium association board may not be favorable for FHA borrowers if owner-occupants do not constitute a majority. To clarify, this requirement sets bounds on a minimum percentage for approval; in other words, the minimum owner-occupancy percentage set by HUD for project approval will never exceed 75 percent. Condominium projects could still receive approval with owner-occupancy percentages as high as 100 percent.

[4] The physical structure of a building is not the defining characteristic of a condominium property.

Owner-occupied units constitute, on average, 54 percent of all condominium units. Although the average project will not be affected, it is possible that a proportion of condominium projects will be below the minimum.[5]

Although the current FHA standard of 50 percent owner-occupants is strict, it is aligned with informal industry practice, which is often stricter. Both city governments and conventional lenders insist on percentages as high as 70 percent owner-occupants, based on Fannie Mae and Freddie Mac guidelines. Fannie Mae imposes an owner-occupancy minimum that varies between 51 and 70 percent for non-owner-occupied properties, but will consider waivers (NAR, 2015). FHA makes the requirement easier to meet by expanding the definition of owner-occupancy to the extent permitted under the requirements established under the Housing Opportunity Through Modernization Act of 2016.

Project Requirement: Ratio of Commercial and Residential Units

The regulation provides for HUD to set a standard for the maximum commercial/nonresidential space within a range from 25 percent to 55 percent of the total floor area. Limiting nonresidential space reduces the risk of FHA-insured units bearing the consequence of an adverse economic shock on the commercial tenant(s). The existing limit imposed by FHA is a maximum of 25 percent with exceptions to 49 percent. The cost of setting a limit would be borne by projects/units that would not meet the eligibility criteria and on any business denied a lease for a project to be certified.

Currently, Fannie Mae requires eligible projects to devote no more than 30 percent of space to commercial purposes. HUD recognizes that there are many potential benefits of mixed-use development and has provided for a ceiling that may range from 25 to 55 percent.[6] Mixed-use developments have become very popular to develop recently, and it is possible that both businesses and residents are more likely to succeed in this type of community. It is too early for HUD to have evidence concerning the effects of ratio requirements on communities, however.

Project Requirement: FHA Concentration

HUD is allowed to set the maximum percentage of units with FHA-insured mortgages in a condominium project between 25 and 75 percent of the total units in the project. The existing limit imposed by FHA is 50 percent with exceptions to 100 percent. Limiting the FHA-insured loans of any project avoids the concentration of risk in one project. The cost of this risk management policy could be excluding a borrower from an FHA-insured loan. HUD, however, does not expect a ceiling in this range to be binding except for atypical condominium projects: during the last 15 years, the market share of FHA-insured condominiums has varied from 3 to 8 percent of the total (NAR, 2015). An internal actuarial review of FHA policy by HUD showed that the maximum FHA concentration requirements rarely bind.

[5] From the available statistics, HUD estimates that the proportion of those not meeting owner-occupancy requirement is very small. Using the standard error (1.3 percent) as an estimate of the standard deviation and assuming a normal distribution, it would be to safe to assume that only a small proportion of condominiums (approximately 2 percent) would face a binding constraint. Most that do would be close to meeting the limit.

[6] As in Mortgagee Letter: 2012-18, HUD could continue to offer exceptions to the requirement.

Length of Approval

HUD settled on 3 years as the lifetime of a condominium project's approval. A greater duration carries the benefit of reducing administrative costs, but carries the risk that approval information is out of date. The current practice is 2 years. This regulation reduces re-approval costs by approximately one-third.[7]

The impact of this regulation is the present value of all costs paid for re-approval. The cost-saving is the difference between the present value of reapproval costs under the two rules. The cost of a DELRAP approval has been estimated to be between $500 and $2,000 by private lenders, an average of $1,250. HUD uses this amount to estimate the present value of costs of re-approvals, including HRAP. Over 30 years, the present value of the reduced cost is approximately $4,000 ($3,000) at a discount rate of 3 percent (7 percent). Cost-savings at this level would occur only if approval is done regularly over a 30-year cycle.

The annualized cost reduction is $200 during a 30-year time horizon. The annualized cost reduction is higher for shorter time horizons but spread over fewer years. For example, over 5 years, the annualized cost savings is approximately $300. The annualized cost reduction does not vary significantly with the discount rate (3 or 7 percent). The average number of approvals during the past 2 years is approximately 5,000.[8] In addition to those 5,000 first-time approvals, 1,600 projects have been re-approved in each of the past 2 years. The reduced frequency of approval would lead to a cost reduction of approximately $1 million per year over 30 years or $1.5 million per year over 5 years.

Reduced frequency of re-approval may result in more mortgages being issued in condominiums that no longer conform to HUD's minimum standards, thereby increasing the risk of losses borne by FHA. More mortgages could be insured in a project that, otherwise, would have been ineligible. HUD determined that the addition of 1 year would not be a significant risk.

There may also be significant cost savings from HUD's clarification of recertification rules; an applicant may choose to merely update previously submitted information instead of resubmitting all information. The exact amount of savings will depend on how HUD implements this procedure.

Single-Unit Approval

At HUD's discretion, single-unit approval (permitting a loan in a condominium project without a rigorous approval of the project) will be permitted. Before HERA, the similar but less stringent "spot approval" process was allowed and was the norm. Condominium loans made through "spot approval" were riskier than FHA-insured loans for the purchase of other types of property. Because of the demonstrated risk, a post-HERA mortgagee letter banned the endorsement of spot

[7] The provision will not reduce the cost of an individual re-approval, instead it will reduce the aggregate cost of all re-approvals. For one property, the answer is slightly more complex and involves discounting over the lifespan of a mortgage. The reduction will be slightly less than one-third for an individual condominium, a reduction of 32 percent (31 percent) with a discount rate of 3 percent (7 percent) over 30 years.

[8] FHA only records the most recent 2-year reapproval in its data. One can reasonably assume that the number of reapprovals in the past 5 years averaged at least 5,000.

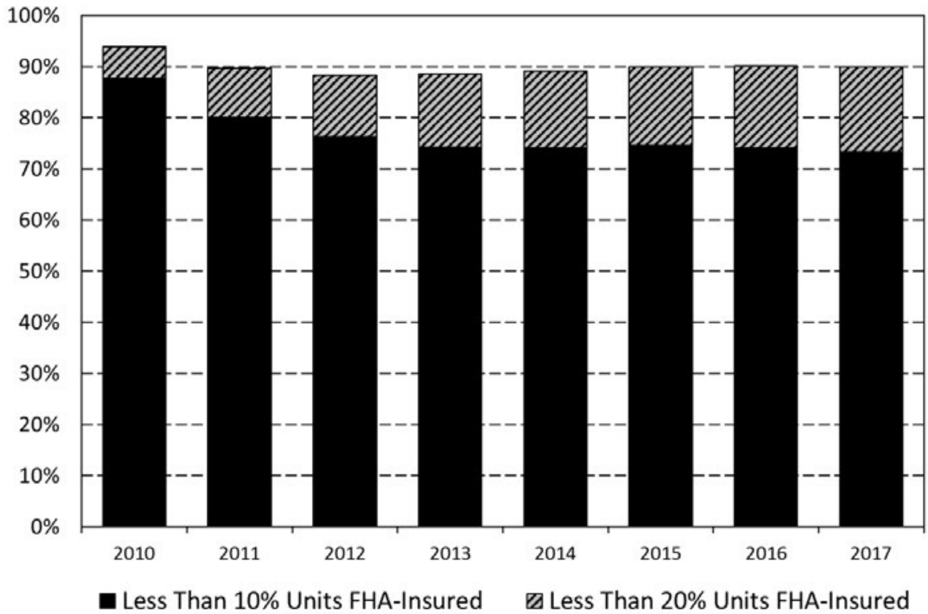
loans in 2009. The action was successful. After ceasing spot loan approval, FHA-insured condo loans became less risky than non-condo loans. Regardless of the risk reduction, the banning of spot approval was perceived as overly restrictive (Harney, 2014). This regulation reintroduces the possibility of single-unit approval in unapproved projects, but only if the condominium project meets a set of eligibility requirements, which were not in place for the earlier spot loans. Thus, the new regulation is less restrictive when compared with current practice but more restrictive when compared with the condominium approval process before 2009. The new regulation is a compromise between the competing objectives of risk-reduction and expanding homeownership.

When FHA changed its condominium policy in late 2009, some suspected that the new restrictions would ultimately harm the condominium industry. Some claimed that the removal of the "spot" loan process and additional restrictions on FHA condominium project approval made the financing of condominium mortgages more difficult, especially for FHA's traditional consumer base—low-income homebuyers, first-time homebuyers, and people of color. Without spot approval, condominium projects needed to attain FHA approval if sellers wanted to sell to FHA-qualified buyers. The additional restrictions on condominium projects and the 2-year recertification process were claimed to have resulted in fewer condominium projects being FHA-approved.

The regulation allows single-unit approvals but only under certain circumstances. Single-unit approvals are limited to 0–20 percent of the units within one project; they are not allowed for manufactured home projects, or if HUD is aware of any circumstances that would adversely affect the viability of the condominium. Given that the FHA-insured percentage of condominiums rarely rises beyond 10 percent, it is not likely that the cap will be restrictive. Most projects do not have a significant proportion of FHA-insured units. Under a 20-percent cap, 90 percent of currently approved projects could have employed a single-unit loan approval. Under a much more restrictive 10-percent ceiling, 73 percent of current projects could have avoided the project-approval process through single-unit loans. Exhibit 1 illustrates the concentration of projects with less than 10 percent and less than 20 percent FHA-forward loan occupancy since FY 2010.

Exhibit 1

FHA Insurance Concentration Among FHA Approved Condominium Projects



FHA = Federal Housing Administration.
Source: HUD Office of Risk Management and Regulatory Affairs

The reintroduction of a single-unit approval process should create two volume effects. One is a pure expansionary effect: because barriers to entry are reduced, units in more projects will be eligible for FHA insurance. The other is a substitution effect: projects that would have otherwise sought full approval from FHA may opt for the less burdensome process of single-unit approval.

From an informal review of market data, HUD has been unable to identify any obvious and quantifiable market effects of the regulation. The regulation may lead to a gentle increase in condominium construction, sales, and prices by giving FHA a greater stabilizing role in the condominium market. Although FHA loans represent only a fraction of the entire market, they have had a major impact on stabilizing the housing and mortgage market (Quercia and Park, 2013). Increasing FHA's flexibility in the condominium market and ability to respond to adverse economic shocks could lead to an observable change in condominium activity.

The question of whether the regulatory change will reverse the negative trend in the condominium share of FHA insurance endorsements is key. A fall (or rise) in the FHA share of condominiums could indicate that the regulatory action has a restrictive (or expansive) effect on the market. The FHA share of condominium loans has declined since 2009. It is not obvious, however, that the decline in FHA condominium activity is the direct result of FHA's regulatory actions in 2009, rather than a continuation of a longer-term trend in FHA's share of condominiums.

Analyzing only the FHA-specific condominium share misses some important trends. In general, FHA's share of the market increases (or decreases) with mortgage credit rationing (or accessibility).

A downward trend of FHA-insured condominium loans could mean nothing more than that alternative sources of condominium loans are becoming more affordable.

The 2009 limitation has not appeared to harm the U.S. condominium market. In the years directly succeeding the implementation of restrictions on spot loans, there is no obvious change in the evolution of the condominium share of existing sales. The condominium share of existing home sales has remained roughly the same from 2000 to 2017, varying between 11 and 12 percent of total sales.[9] Any potential market impacts of restricting supply may have been mitigated by the existence of condominium associations that already meet the FHA project requirements.

Finally, and perhaps most importantly, the new single-unit approval process is more restrictive than the previous spot approval process. Even if banning the spot loans had had a detrimental impact on condominium lending, the expansion as a result of the new regulation would be lesser than the contraction from banning spot approval.

Exhibit 2

Existing Home Sales (2000–2017)

Year	Total Sales (Count)	Total Change from Previous Year (%)	Condo/CoOp Sales (Count)	Condo/CoOp Change from Previous Year (%)	Condo/CoOp Percent of Existing Sales (%)
2000	5,152,000		571,000		11.1
2001	5,296,000	+3	601,000	+5	11.3
2002	5,631,000	+6	657,000	+9	11.7
2003	6,183,000	+10	732,000	+11	11.8
2004	6,784,000	+10	820,000	+12	12.1
2005	7,072,000	+4	896,000	+9	12.7
2006	6,480,000	-8	801,000	-11	12.4
2007	5,652,000	-13	713,000	-11	12.6
2008	4,913,000	-13	563,000	-21	11.5
2009	5,156,000	+5	590,000	+5	11.4
2010	4,190,000	-19	480,000	-19	11.5
2011	4,260,000	+2	477,000	-1	11.2
2012	4,660,000	+9	528,000	+11	11.3
2013	5,090,000	+9	603,000	+14	11.8
2014	4,940,000	-3	591,000	-2	12.0
2015	5,250,000	6	608,000	+3	11.6
2016	5,450,000	+4	619,000	+2	11.4
2017	5,510,000	+1	614,000	-1	11.1

Sources: National Association of Realtors and U.S. Statistical Abstract 2012

[9] Examining a proportion helps to control for factors affecting the entire condominium market (market-wide changes in demand or supply).

Exhibit 3

Trends in Condominium Loans, 2000-2018

Year	Number of FHA Condo Loans	Share of All FHA Loans (%)	Comparison: Fannie Mae Condo Share, by Acquisition Year (%)	Comparison: Fannie Mae Condo Share, by Origination Year (%)
2001	67,900	8.4	6.7	6.6
2002	68,600	8.0	6.7	6.7
2003	51,200	7.8	6.6	6.7
2004	41,300	7.0	7.0	7.0
2005	22,300	6.3	7.2	7.2
2006	17,900	5.7	8.4	8.6
2007	13,900	5.0	9.0	9.0
2008	33,800	5.3	9.7	9.7
2009	65,800	6.6	7.2	7.3
2010	72,900	6.6	7.5	7.4
2011	37,900	4.9	7.8	8.0
2012	24,300	3.3	8.1	8.1
2013	21,500	3.1	9.1	9.1
2014	16,100	2.7	9.6	9.6
2015	19,700	2.6	9.7	9.8
2016	22,700	2.6	9.5	9.5
2017	21,400	2.4	9.7	9.7
2018	16,200	2.1	9.4	9.3

FHA = Federal Housing Administration
Sources: Federal Housing Administration and Fannie Mae Loan Performance Data

A concern is whether the single-loan approval process would raise the risk to FHA of loss mitigation and paying insurance claims to lenders. Intuition into the possible effect on risk can be gained by examining the performance of spot loans (allowed before FY 2010).[10] All types of forward mortgages in the 2006 and 2007 portfolio performed poorly, but condominium loans, which occurred under spot approvals, were among the worst performing subsets. FHA may have permitted loans for projects that were inherently risky (Harney, 2014) because FHA lacked the capacity to carefully examine every loan and its associated condominium project. HUD, and subsequently the taxpayer, bears most of the costs when an FHA-insured loan moves into foreclosure.

Despite the potential of increased risk from allowing single-unit approvals, we believe that other provisions of the regulation will diminish the risk. Formalizing the HRAP and DELRAP, by setting

[10] Before FY 2010, spot loans were the exclusive channel for FHA insurance. All endorsements after FY 2010 are HRAP and DELRAP project approval loans.

standards for condominium projects and lenders, should reduce financial risk by subjecting projects to a full-fledged review by experienced lenders. The claim experience of HRAP and DELRAP condominium project approval loans (as distinguished from the earlier spot-approval loans) yields claim rates slightly more favorable than other FHA single-family forward mortgages.

Environmental Review and Completed Projects

Only completed projects are eligible for HRAP or DELRAP under the regulation. Legally phased projects may be approved, but all units must be built out, and the phases must be separately sustainable. HUD and DE lenders save costs because Environmental Review of completed projects is not required. Other regulatory provisions are in place to guard against environmental damage that may otherwise result from not completing an environmental review.

Not requiring Environmental Review by DE lenders of under-construction projects will reduce the cost to the private sector of participating in the approval process. Between 1,000 and 5,000 condominium projects seek initial approval each year. Since 2010, more than 90 percent of first-time condominium project approvals have been for projects that were completed at least 1 year prior. None of these condominiums would experience a policy change because of the environmental review. The remaining 10 percent, however, might have initiated an environmental site assessment, or at the very least, considered starting the FHA approval process while still under construction. This affected minority amounts to between 100 and 500 projects every year, or an average of about 300 on an annual basis since 2010. HUD's Office of Environment and Energy estimated a range of costs for environmental assessments. For disaster relief, Phase I environmental assessments, which are necessary in the case of site contamination, cost about $7,000; however, Part 50 Environmental Reviews, a less thorough environmental assessment conducted by HUD, require only 3 estimated hours of work at an hourly cost of $83,[11] or $250 per review. Avoided reviews numbering 300 at $7,000 each would save $2.1 million; 300 avoided reviews at $250 per review saves only $75,000.

Summary of the Rule's Economic Impacts

Monitoring current trends in the housing and mortgage market, evaluating past FHA policy actions, and readjusting policy is essential to achieve the balance between the cost of assuming additional risk against the private loss to excluded borrowers. Completely eliminating spot-loans for condominiums in 2009 was justified by the risk that they posed for FHA. The regulation represents a slight readjustment in favor of borrowers by easing some of the burdensome aspects of the condominium approval process. Caution is maintained, however, and the regulation includes some safeguards against increased risk to FHA from insuring condominium loans.

Many provisions of the regulation (single-unit approval, flexible standards, a longer interval for condominium approvals, and exceptions for environmental review) will reduce the compliance costs of condominium lending. By reducing costs of participating in the FHA loan process, HUD's

[11] Loaded wage is double the median wage $41.73 (https://www.bls.gov/oes/current/oes172081.htm) of an environmental engineer.

condominium rule is expected to have a gentle and positive impact on FHA's condominium loan volume and share with a maximum impact ranging from 20,000 to 60,000 loans. Expansionary market impacts such as greater construction and sales are possible. There are elements of the rule and of the housing market, however, that will limit any expansionary impacts stemming from the rule. First, the quantified impacts of the rule are small relative to the housing market. The order of magnitude of the net savings from the rule ($900,000) is negligible when compared to the dollar volume of real estate market transactions. Second, the unmeasured expansionary impacts due to single-unit approval will be limited by risk-management features of the rule. Single-unit approval does not represent a reversal to spot approval, and HUD does not anticipate FHA-insured condominium lending to return to former levels. Third, any expansion of FHA into the condominium market will be partially offset by a contraction of its single-family business as borrowers attracted to FHA-insured condominium loans substitute away from FHA-insured single-family mortgage loans.

Another benefit of this rule is to ensure project viability. The newly introduced requirements are more flexible, less prescriptive, and more reflective of the current market. A further benefit will be realized by granting competent lenders a role in condominium project approval, thus reducing any administrative delays associated with a peak load of applications. DELRAP will also benefit buyers, sellers, and mortgage lenders who would like to use or offer FHA loans in instances where a condominium association does not pursue FHA approval.

Many of the economic impacts of the regulation are transfers: from lenders in riskier projects to FHA, from lenders not eligible to lenders eligible to participate, and from unapproved projects to approved projects. Projects that meet the eligibility requirements may gain relative to those that do not. Lenders who meet the DELRAP eligibility criteria may gain relative to those that do not.

FHA must ensure that it does not overextend itself with excessive financial risk in pursuing its mission to provide opportunities for homeownership. FHA is therefore obliged to execute a delicate balance of assisting borrowers without jeopardizing the solvency of its programs. In the case of condominium mortgages, risk management for FHA requires that the condominium units be within buildings that are financially sustainable. The flexibility introduced by the regulation is advantageous only as long as FHA adjusts the standards to changing market conditions.

Monitoring current trends in the housing and mortgage market, evaluating past FHA policy actions, and readjusting policy is essential to achieve the balance between the cost of assuming additional risk against the private loss to excluded borrowers. Completely eliminating spot-loans for condominiums in 2009 was justified by the risk that they posed for FHA. FHA's declining share of condominium loans, however, could indicate that the policy response overcorrected in favor of risk management and against access to condominium loans. The proposed rule represents a slight readjustment in favor of borrowers by easing some of the burdensome aspects of the condominium approval process. Caution is maintained, however, and the proposed regulation includes some safeguards against increased risk to FHA from insuring condominium loans.

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