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Description New federal guidelines require that at least half the units in a condo be sold before potential buyers can get federal loan support.

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Abstract

Because of new Fannie Mae restrictions, at least half the units in a condo be sold before potential buyers can get federal loan support. But to get a loan from the bank to buy a condo, buyers need federal support, which they won't give because apartments aren't selling. And so it goes. Welcome to the crazy world of condos.

Article Text

Shopping for a condominium apartment in New York City today can be a bit like stepping into Joseph Heller's novel Catch-22. Only now, the catch isn't about the maddening difficulty of establishing the sanity of World War II flight crews. It is about the maddening difficulty of securing a mortgage loan.

Simply put, new federal guidelines require that at least half of a condominium's apartments must be sold before the federal government will back a loan. But without the government's backing, people can't get the mortgages from commercial banks to buy the apartments.

That, as Catch-22's John Joseph Yossarian observed, is some catch.

As far as a many people in the New York real estate world are concerned, it's just about the worst catch there could possibly be. Thanks to the recent financial meltdown and the near-collapse of Fannie Mae and Freddie Mac, even highly qualified buyers are having a hard time securing financing in buildings that are less than half sold.

First, the Bad News

Earlier this year, in response to the financial crisis, Fannie Mae announced it was tightening its "pre-sale requirements" for condo mortgage loans. It would now buy up loans only if at least 70 percent of the apartments in a condo are sold. By submitting a small pile of paperwork about the building's physical condition, financial health, insurance, and other information, a developer can get the number

reduced to 50 percent, a process known as “project eligibility review service.” Many still find that figure onerous.

And others rules were tightened. No entity, other than the developer, can own more than 10 percent of the units in the property. The building has to carry a fidelity bond equal to 25 percent of the annual budget, and it must keep a reserve fund equal to 10 percent of the annual operating budget. “We start with the premise that Fannie Mae’s guidelines are ridiculous,” says attorney Douglas P. Heller, a partner in Herrick Feinstein. “Nobody can meet them.”

“The rules are impossible,” agrees Melissa Cohn, president of Manhattan Mortgage Company. “We’re looking for as many [loan] sources as we can find. We go to smaller portfolio lenders. There are not that many of them and they keep changing their rules, too.” She declined to name any of the smaller portfolio lenders she goes to for loans.

“It’s very frustrating,” adds Roberta Axelrod, director of condo sales, marketing, and conversions for Time Equities, a selling and managing agent for co-op and condo converters in New York. Axelrod, a 28-year veteran of the company works as project manager for developers. She can remember only one time when the mortgage situation was more dire.

“It’s not as bad now as it was in the late 1980s,” she says. “In the ’80s, we had difficulty finding qualified buyers. Today, we have a situation where we have willing and qualified purchasers, but a lack of financing.”

Ellen Bitton, president of Park Avenue Mortgage Group, disagrees. “I think this is much worse than the late ’80s and early ’90s. Back then, you didn’t have issues with Fannie Mae approval because nobody cared about it. This go-round, Fannie Mae has become more relevant because there is more interest in fixed-rate mortgages. But now there are not enough players out there. The truth is that four years ago, credit was too loose and there were too many players, too many lenders. Now it’s gone 180 degrees. It’s too tight.”

People shopping for condo loans aren’t the only ones caught in the squeeze. “There are a lot of people affected by this,” says Axelrod of Time Equities, “including prospective buyers, existing owners, developers, and lending institutions. Not only are apartment buyers’ end loans affected, but so are the conversion loans taken out by developers. Owners are also having difficulty refinancing.”

One developer, Jenifer Steig of the Cheshire Group, is now trying to sell 45 refurbished condo apartments in Devonshire House, an elegant 1928 Greenwich Village building designed by Emery Roth, who also designed the San Remo and a number of New York’s other Art Deco gems.

“Condo mortgage loans are not as available as they were 18 months ago,” Steig says. “All of a sudden things have gotten close to drying up. I’ve got to get 50 percent sold to open up the playing field for major banks to come in.”

The reason, she says, is that “everyone’s reacting to Fannie Mae right now. The commercial banks won’t lend unless they’ve got project approval from Fannie Mae. We just don’t know what’s coming next. It’s chaos out there right now.”

Blame the meltdown.

“Everything that’s happening is a direct result of the meltdown,” says Pat Niland, president of First Funding, a commercial mortgage brokerage. “The additional requirements and greater difficulty in getting financing are the result of several things. People are playing by the rules now, and they’re tightening the rules. Credit requirements are tighter. There are fewer lenders out there, and the environment is perceived as riskier. Loan officers are afraid of losing their jobs, and they want to ask every single question that can possibly be asked.”

The Good News Is...

That’s the bad news. The good news is that it’s still possible to get a condo mortgage loan without going to a major commercial lender. And relief might be on the way from Washington, D.C.

Last summer, in response to the squeeze on mortgage loans, Axelrod joined forces with Mary Ann Rothman, executive director of the Council of New York Cooperatives & Condominiums (CNYC), and attorney Stuart Saft, a partner in Dewey LeBoeuf and a board director at mortgage lender NCB. The trio sat down in New York with representatives from Fannie Mae, including its senior risk manager, Patrick Connolly.

“We discussed the situation, how the new Fannie Mae requirements were hurting the housing market in New York,” says Saft, who also sits on CNYC’s board. “The rules might make sense in Miami or Las Vegas, but the situation in New York is very different.”

“The council was very concerned,” adds CNYC’s Rothman. “Lenders who are relatively new to New York were over-interpreting the Fannie Mae guidelines and refusing to make loans. For example, when buildings convert to condos or co-ops – and even with new construction --- very often it takes years before all the units are sold. Some lenders are not aware of such nuances.”

The problem is that Fannie Mae’s new guidelines were written to apply equally across the country, using a sort of a one-size-fits-all mindset. In other parts of the country, most condo sales are in new buildings. In New York, condos are both new

construction and conversions. The non-eviction clause in conversion plans, a fact of life unique to New York, was making it virtually impossible for developers of condo conversions to meet the Fannie Mae pre-sale requirements.

“Many buildings are caught in this Catch-22,” says Axelrod. “Fannie Mae may have acted in good faith to try to make what they think are prudent loans, but my feeling is that their guidelines were changed with an eye to the situation in a place like Florida, where there are a lot of foreclosures.”

Axelrod, who sits on 10 co-op and condo boards as a sponsor representative, adds: “I don’t see defaults and foreclosures and dangerous loans in my buildings.”

“The broader problem,” says Saft, “is that they’re changing the rules but we can’t just change co-op proprietary leases and condo bylaws. It takes an overwhelming vote of shareholders or unit-owners to accomplish that.”

When the meeting with Fannie Mae broke up, the New York contingent felt confident they’d gotten their message across and relief would be forthcoming. But they are dealing with the federal government, so they know that patience will be required.

“They’re preparing a special program for New York,” Saft says. “Fannie Mae will approve projects on a project-by-project basis if developers contact Fannie Mae to discuss their project. They told us they would have draft requirements out sometime in the late fall.”

“It was a very positive meeting,” says Axelrod. “I left with the impression that something’s going to change.”

And So It Goes

With interest rates and prices still low, there has been some recent movement in the city’s condo market. It’s not uncommon today for people to pay cash for an apartment in New York City. Another option is jumbo loans, which are usually made to buyers of pricier apartments. They are not backed by the Federal Housing Administration, and since they are seen as having higher risk for the lender, they tend to require larger down payments and carry higher interest rates. Their appeal is, understandably, somewhat limited.

Savvy developers are finding there are ways to make sales without resorting to jumbo loans or adhering to Fannie Mae’s stiff pre-sale requirements. Several have been turning to so-called portfolio lenders, local and regional banks that keep the loans on their books rather than trying to sell them off.

“The regional banks – portfolio lenders that don’t adhere to Fannie Mae and Freddie

Mac requirements – have stepped up in a way that’s transforming the mortgage landscape,” says June White Richardson, vice president of GuardHill Financial, a mortgage banking and brokerage firm. “Having access to different avenues of lending is the key to being successful in this landscape now.”

And some buyers have been turning to mortgage bankers like Rolan Shnayder, who heads the New York office of Home Owners Mortgage. With 13 offices on the east coast, the company lends \$1 billion a year in residential mortgages for co-ops, condos, and one- to four-family dwellings, including jumbo loans.

“When the condo guidelines got strict with Fannie Mae, I realized I had a niche product,” says Shnayder. “We’re currently the preferred lender in 70 condo buildings in the New York metro area, including the Georgica, Manhattan House and One Brooklyn Bridge. We have no pre-sale requirements. If the buyer can demonstrate that they have the assets to make the down payment and the income to pay the mortgage, why not make the loan?”

He calls the approach “make-sense underwriting.” And he insists that the risks are not as great as some people, in these jittery times, fear. “Where’s our risk? What’s the worst-case scenario if the sponsor goes under? Not much. You’ve got a beautiful building that’s fully occupied. Someone else will take the sponsor’s place.”

The problem, as Shnayder sees it, is not that there’s no money out there. It is that there has been a failure to communicate. “It’s been good for us, but Fannie Mae needs to do a better job of communicating. For example, they didn’t tell building managers and boards about the new requirement that the building’s reserve fund has to equal 10 percent of the annual budget. Obviously it’s hurting the market. The perception is that there are no loans available. But people who want to buy can find a way.”

And some people who want to buy are finding that, despite the obstacles, the time is right. “People are seeing we’re near the bottom in terms of price and interest rates will probably go up,” says Cohn of Manhattan Mortgage. “Activity has picked up.”

“I believe the condo market is getting better,” adds Richardson of GuardHill Financial. “And I don’t believe lending is going to be as dependent on the major commercial banks in the future. There’s going to be a shift to smaller regional lenders who are more nimble and more flexible.”

