

## **Financing Vacation Condominiums Becomes More Difficult – Endangers Recovery**

*Editorial Comments Regarding Lender Confusion Over Fannie Mae Guidelines*

*by Joseph H. Guerry, SRA, June 25, 2009*

In the midst of comprehensive Federal efforts to stimulate the economy, forestall foreclosures and facilitate the recovery of the real estate market, many owners of second home vacation condominium properties have suffered a lack of available mortgage financing. The vast majority of residential mortgage loans are made following guidelines established by Fannie Mae. The primary issue seems to be related to two factors; confusion regarding the difference between a traditional condominium and a condominium hotel, and confusion over the difference between a second home vacation property and an investment property.

### **Condominium Hotels**

While the vast majority of condominium properties qualify for Fannie Mae financing, Condominium Hotel properties are not eligible. The following description of a Condominium Hotel (aka Condotel) can be found in the Fannie Mae 06-12 Amendment to the Selling Guide released on July 20, 2006.

Selling Guide Part XII: Project Standards; Chapter 1. General Project Eligibility; Section 102. Ineligible Projects.

Revised definition of Condominium or Cooperative Hotels – Any project that is managed and operated as a hotel, resort, motel, inn, or lodge and, therefore, is not a residential project, even though the units are owned individually.

Fannie Mae considers projects with any of the following characteristics to be non-residential hotel-type projects and therefore, ineligible projects:

1. projects with units that do not contain full-sized kitchen appliances;
2. projects with units that are marketed for sale based on the availability of short term rental rates;
3. projects that are marketed as hotels including, but not limited to, projects with units that are available to be rented on a daily basis or projects with names that include the words “hotel,” “resort,” “motel,” “inn,” or “lodge”;
4. projects with a significant level of hotel-type services such as, but not limited to, the availability of a registration service to support short-term rentals, daily unit cleaning services, food and beverage services, and central or integrated telephone service;
5. projects with units subject to timeshare or segmented ownership;
6. projects with mandatory rental pooling agreements that require the unit owners to either rent their units or to give a management firm control over the occupancy of the units;
7. projects that restrict the owner’s ability to occupy the unit; or
8. projects with non-incidental business operations owned or operated by the owners’ association such as, but not limited to, a restaurant.

Unfortunately, some lenders are refusing to lend when only a couple of items on the list may apply to a specific property. The confusion occurs in markets with existing condominium developments where the typical owner utilizes the unit as a second home vacation property. The following table identifies the difference between a typical Condotel property and a second home vacation condominium based upon the numbered items above:

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Item	Condotel	Second Home Condominium
1	No kitchen	Full kitchen
2	Income is a driving factor for buyers because personal use is limited.	While rental income does supplement the cost of ownership, it is well below that which would be sought by investors motivated to purchase solely by return on investment. Personal use is typically the primary factor that influences purchase decisions. The key area of confusion here is that item 2 uses the term “short term rental” without any reference to a time frame, while item 3 implies that daily rental is the key.
3	The terms hotel or inn are typically included in the project name. Daily rentals are common.	The terms hotel or inn are not part of the project name. Many of these properties are located within resort communities. The key difference is these properties are NOT offered for daily rental. The problem is that item 3 includes the phrase “ <i>rented on a daily basis or projects with names.....</i> ” (emphasis added). The word “or” is followed by a list of names that includes “resort”. As written, the guide implies that daily rentals and project names are mutually exclusive (either applies). Unfortunately, the term “resort” is commonly used to describe large scale planned unit communities that include legally separate single family homes, condominium projects, and commercial hotels. The fact that an individual condominium project is located within a community that is referred to as a resort does not render the individual project as ineligible.
4	Some or all hotel type services are typically available. Daily rentals with daily maid service are REQUIRED. Phone service through a centralized system is REQUIRED.	While independent rental agencies typically offer a “check in” location where tenants pickup keys, they are never located on the site of the condominium project. Maid service is generally limited to cleaning of the unit between tenants, which is typically once per week. While some rental agencies utilize technology to “transfer” calls to a property after the call is received by the rental company, individual property owners are not tied to a centralized phone system.
5	Timeshares may be included in the same project.	Although timeshares may be located within the same resort community, timeshares are NOT included in the subject condominium project.
6	The key characteristic is that owners are REQUIRED to rent, and they are REQUIRED to utilize the entity that operates the “front desk” to manage rentals. Rental pooling is required in order to insure that all units of equal appeal receive similar rental levels.	Owners are NOT required to rent. Furthermore, if an owner chooses to offer their property for rental, they are allowed to self manage or select any rental agency they choose. Rental pooling is not required by the condominium covenants and restrictions.
7	Owner occupancy is limited to a specific number of days per year.	Owner occupancy is not limited in any way.
8	Non-incident business operations are common.	There are no business operations.

The key areas of confusion appear to evolve around the phrase “short term rental rates” included in item #2, and the reference to the word “resort” in item #3. If the eight item list of characteristics is considered in it’s entirety, it is clear that a condominium hotel is virtually indiscernible from a traditional hotel. Unfortunately, lenders have often cited individual issues such as weekly rentals, occasional maid service, or location within a resort community as criteria that render a condominium project ineligible. In many cases this ineligibility has only been cited

recently despite the fact that these same projects have previously been considered eligible for many years.

This problem seems to have become more prevalent as a result of increased attention to underwriting guidelines resulting from the real estate and banking crisis. At this stage, the recovery of the real estate market for this type of property is threatened. Sales of individual condominium units have fallen through due to a lack of available financing. It is clear that Fannie Mae will need to clarify the guidelines in order to address those areas where confusion arises in order to avoid further damage to an ailing market.

## **Investment Property**

Fannie Mae guidelines have traditionally allowed lending on a second home vacation property as long as the owner occupies the property periodically during the year, and as long as any rental income is not relied upon for approval of the loan. The rental income that is generated by second home vacation properties is well below the income that would be sought by an investor motivated solely by return on investment. While the income may serve as a subsidy to the cost of ownership, the return on investment is clearly motivated by other factors such as personal use. Unfortunately, many lenders are now refusing to lend if the property is offered for rent at any time. Fannie Mae needs to clarify the definition of an investment property versus a second home that is occasionally rented.

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