CHAPTER 30: CONVERSION TO CONDOMINIUM OWNERSHIP

30-1. INTRODUCTION.

A. Condo conversions are driven by market demand and "highest and best" use. Though a lot of activity is not expected to be generated in this area, the Department may wish to consider proposals to convert under appropriate circumstances. Since conversions do sometimes occur, the following discussion is provided for the benefit of Loan Servicers/Asset Managers.

B. The purpose of this Chapter is threefold: (1) to provide basic reference material on the subject (2) to establish a limited scope of consideration for condo conversion projects and (3) to familiarize Loan Servicers with some of the issues that must be addressed.

30-2. GENERAL. In order to convert a rental project to condominium ownership, in periods of high interest rates, owners of unsubsidized projects with HUD-insured or HUD-held mortgages may wish to use the existing mortgage as a bridge loan rather than borrowing money up front in order to pay off the HUD mortgage in full. HUD may consider such a proposal, but in developing guidelines below, attention has been given to ensure that owners assume the appropriate share of the burden and risks.

30-3. EXAMPLE. An owner, either on its own or in conjunction with the residents, or a purchaser, through a TPA, wishes to convert a rental project to condominium ownership and use the existing mortgage as a bridge loan during the period of conversion.

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30-4. NOW A CONVERSION WORKS.

A. Condo conversions for projects with HUD-insured or HUD-held mortgages are accomplished through a partial release of security. It is important to note that this type of condo conversion leaves an existing project mortgage in place. It does not involve a refinancing or the creation of a new mortgage loan.

B. As each individual unit is sold and closed, a partial release of security will remove the unit from the blanket mortgage by having a portion of the sale proceeds pay off a portion of the existing mortgage. For specific instructions on how this is to be accomplished, refer to paragraph 30-6.

30-5. GENERAL PROVISIONS: ELIGIBILITY PROJECTS AND CONSENT REQUIREMENTS.

A. Because conversions under this Chapter do not entail a refinancing or prepayment, the Chapter only covers condominium conversions which are not governed by Section 234 of the National Housing Act and which are not subject to Part 234 of the Department's regulations.

B. The end result of the conversion, as the blanket mortgage is paid off, is that the project would cease to be under HUD's control, i.e., HUD would no longer have regulatory control over the project and its operations. For this reason the option to convert a rental project to condominium ownership is restricted to the unsubsidized portfolio subject to the restrictions in paragraph 30-5(F).

C. Definition of "unsubsidized" for purposes of this chapter: a project which does not (1) have a subsidized mortgage or a direct mortgage loan from HUD at a below market interest rate or (2) receive project-based housing assistance payments.

D. A proposal receiving consideration under this chapter may only involve an unsubsidized project with an existing mortgage insured under the National Housing Act not subject to the provisions of the Emergency Low-Income Housing Preservation Act of 1987 or the Low-Income Housing Preservation and Resident Homeownership Act of 1990.

E. Projects eligible for consideration must have HUD-insured or HUD-held mortgages.

F. Not all unsubsidized projects have the right to convert to condominiums. The following unsubsidized projects cannot be converted to condominium ownership:

1. Projects with mortgages insured under Section 207, pursuant to Section 223(f) of the National Housing Act where a commitment was issued after October 8, 1980, are subject to five or twenty year rental use restrictions, with certain exceptions. One of the exceptions permits conversion to condominiums if the conversion is sponsored by a tenants' association representing a majority of the households in the project. See Section 207.32a(e)(2) of Title 24 of the Code of Federal Regulations. Unless this requirement is met, the owner would not be able to convert the project during the restricted period.

2. Rental projects sold upon foreclosure under Section 203 of the Housing and Community Development Amendments of 1978 must be subject to an agreement requiring that the project be

used as rental/cooperative housing for twenty years or the remaining term of the mortgage, whichever is greater.

G. Field Staff are advised to examine, for each project for which an owner submits an application to convert, the mortgage, mortgage note and any agreements which may impose use restrictions on the project precluding conversion to condominium ownership.

H. For projects with HUD-held mortgages, HUD must approve proposed conversions; for projects with insured mortgages, joint mortgagee and HUD consent for the conversion is required.

I. Tenant notification requirements per 24 CFR Part 245 are not applicable here since the Chapter addresses only the unsubsidized portfolio.

J. Conversion of subsidized projects is covered by the Emergency Low Income Housing Preservation Act and the Low Income Housing Preservation and Resident Homeownership Act, as well as HOPE II.

K. Conversions must be in accordance with applicable State and local laws and regulations.

30-6. SPECIFIC TECHNICAL REQUIREMENTS AND THRESHOLDS.

A. Closing proceeds are to be applied to the existing project mortgage in a manner and in an amount sufficient to assure that the existing project mortgage is paid off in full once 60 percent of the

units have been spun off to condo ownership. A 60% pay off threshold, at which point HUD is no longer involved in the conversion, is established rather than a higher percentage in order to minimize the potential risk to the Department of ending up with a mixed-use project, i.e, partially rented and partially converted, if sales levels are not met.

B. The 60% threshold as per above is accomplished in two stages. HUD will approve the first stage of partial releases of security when 40% of the units are sold (i.e., sales contracts have been signed and individual mortgages are being processed with commitments pending). HUD will allow individual closings up to the 40% level. As stated previously, a portion of the closing proceeds on each unit goes to pay down the existing blanket mortgage.

C. HUD will approve the second stage of partial releases of security when 60% of the units have been sold. When the last of these units, has been released, the blanket mortgage will be paid off in full and the project will cease to be under HUD's control.

30-7. SUBMISSION AND REVIEW PROCEDURES. Some parts of the country have had more experience in the area of condominium conversions than others. Proposals to convert a project to condominium ownership are reviewed by the HUD field office. Loan Management staff will need to review the information listed below in order to make a determination regarding the merits of the proposal and whether HUD consents to the conversion.

A. Owners are to submit the following to the local HUD office for review: market survey, proposed sales price, marketing plats, and schedules estimating how the blanket mortgage is going to be paid. In addition Field Office staff will need to examine the project's controlling documents such as the mortgage, mortgage note and use restrictions if any.

B. If the conversion involves a TPA, the requirement for co-review by Field Counsel is incorporated here by reference. See Chapter 13 to this Handbook, entitled Change in Ownership: Transfer of Physical Assets, Section 3, Part VII, "Special Circumstance Determination: Condominium/Cooperative Conversions," page 13-17.

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