REQUEST FOR INPUT: SHORT TERM RENTAL UNITS IN CONDOMINIUM, COOPERATIVE, AND PLANNED UNIT DEVELOPMENT PROJECTS

MAY 6, 2021

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Introduction

The Federal Housing Finance Agency (FHFA) is seeking input on aspects of the project eligibility requirements that Fannie Mae and Freddie Mac (the Enterprises) impose on mortgage loan sellers (sellers). Specifically, this Request for Input (RFI) focuses on the Enterprises' eligibility requirements covering condominium (condo), cooperative (co-op), and planned unit development (PUD) projects that (i) have short-term rental units (30 days or less), (ii) that operate as commercial enterprises with services and amenities similar in function to hotels and motels (i.e., vacation or recreational lodging), and/or (iii) may otherwise be considered transient housing (collectively, "Short-Term Projects").

The Enterprises use project eligibility requirements to manage the credit risks associated with the mortgages they acquire and to ensure compliance with their statutory charters. Pursuant to these requirements, sellers are required to conduct accurate project eligibility assessments and to determine that the loans they deliver to the Enterprises are secured by properties that are residential in nature and comply with all other applicable Enterprise requirements.

When short-term rentals are organized in condo, co-op, and PUD projects in such a way that the dominant function of the project is to facilitate vacation rentals, the overall project takes on the characteristics of a hotel or resort type entity, commonly referred to as a "condotel." In addition to raising concerns related to charter compliance, such projects present risks that the Enterprises' policies are not designed to manage, particularly the aggregate impact of many different types of risks across a single project. Further, many sellers do not have the expertise to complete the underwriting required to manage risks that are commonly addressed through commercial insurance underwriting and appraisal practices.

In 2020, each Enterprise updated its policies addressing the purchase of Short-Term Projects. While the Enterprises recently updated and clarified longstanding policies, industry feedback indicates confusion remains about how sellers should best determine whether projects comply with existing requirements.

While the Enterprises' policies for Short-Term Projects are generally similar, there are some differences between how they determine project eligibility. FHFA is seeking input on how these issues may impact eligible loan deliveries that comply with the Enterprises' charters. FHFA also seeks to identify issues related to these differences and to understand whether these differences might contribute to industry confusion or processing inefficiencies.

FHFA will consider the public input received in response to this RFI in determining whether actions may be appropriate to align Enterprise policies, to minimize adverse selection risk to the Enterprises, and/or to provide greater clarity to market participants. In particular, the requested input will help FHFA determine whether changes to Enterprise policies are necessary to ensure more accurate and consistent project eligibility assessments by sellers.

Background

Each Enterprise provides requirements for sellers to identify eligible projects and dwelling units, including condos, co-ops, and PUDs. Under the selling requirements, it is the seller's responsibility to assess project eligibility. A seller that delivers an ineligible mortgage loan to an Enterprise is generally obligated to repurchase the ineligible loan. These requirements help manage the Enterprises' charter compliance, credit, and collateral risks. They also ensure that Enterprise capital will not be diverted from the residential mortgages to which they are limited by their charters to mortgage loans secured by units in commercial properties that are beyond the scope of the Enterprises' investment authority.

There are several attributes of short-term rentals that can increase liability risk such that the standard unit owner's insurance policy may be inadequate, resulting in losses that are uninsured, underinsured, or improperly insured. Condotels and other transient or resort type projects located in areas with higher exposure to natural disasters increase exposure to inadequate hazard insurance, flood insurance, special assessments, and concentration risk. These factors can lead to increased default risk due to loss of rental income both at the project and unit levels. Recent industry feedback indicates confusion or divergent views regarding how sellers should determine whether a project meets the Enterprises' eligibility requirements. Specifically, feedback suggests that existing Enterprise requirements pertaining to projects considered transient in nature or that operate as commercial enterprises are not clearly defined. Although the Enterprises do not classify as "eligible" commercial resort-type projects or transient housing, Enterprise selling requirements provide specific characteristics that sellers must consider in determining project eligibility. [1] For example, a project is ineligible if the homeowners association is financially or legally involved in the rental of units or is operating the project as a commercial enterprise (e.g., receiving income or paying expenses for hotel or transient housing services offered to renters). Projects that hold a license to operate as a hotel or motel, even if the units are individually owned, are also ineligible.

Compared to typical residential projects, homeowners association fees and assessments may be higher in these types of ineligible projects because the association's monthly fees often support hotel or resort like amenities and services, increased liability insurance expenses, and other costs such as registration and cleaning staff that can be related to operating a project that hosts large numbers of transient guests.

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[1] Freddie Mac Guide Sections https://guide.freddiemac.com/app/guide/find/5701.3 and https://guide.freddiemac.com/app/guide/find/5705.3 and Fannie Mae Guide Sections

https://selling-guide.fanniemae.com/1032993971 provide details on determining a condotel or similar type of transient housing.

Condominium projects that include short-term rentals may be eligible if the seller fully analyzes all the characteristics of the project and related information and determines that the project is not a condominium hotel or transient housing. However, delivery of ineligible loans to the Enterprises exposes the seller to repurchase risk. The Enterprises report incidents of sellers instructing appraisers to remove descriptive language from appraisals that may indicate a property is part of a transient project. It is important that sellers and the Enterprises properly and consistently assess project eligibility, particularly in projects with short-term rental units, so that ineligible loans can be identified by sellers prior to delivery or can be identified by the Enterprises post-delivery as a breach of the seller's representations and warranties and put back to the seller for repurchase.

Projects that function as commercial enterprises have certain characteristics that add complexity to typical residential project analysis and underwriting. Current Enterprise requirements are broad in some respects to account for seller discretion in a wide variety of scenarios. FHFA seeks to understand whether providing sellers with more clearly aligned policies and processes would address industry confusion regarding charter compliance and whether any such changes would result in an unnecessary tightening of selling requirements in determining project eligibility.

Questions and Public Input Instructions

FHFA considers the following questions important to inform its understanding of the impacts of any misalignment of Enterprise policies and whether such misalignment contributes to industry confusion about project eligibility as described in this RFI. FHFA encourages stakeholders to provide meaningful and detailed responses to the RFI and to make those responses public whenever possible, to inform broader public discourse on these issues. FHFA will consider all information that is provided in response to the RFI, along with supporting data, analysis, and outreach.

FHFA invites interested parties to provide written input on the questions listed below within 60 days of the publication of this document, no later than July 5, 2021. Please submit input electronically using the response form at FHFA.gov. Please submit all other responses to the Federal Housing Finance Agency, Office of Housing and Regulatory Policy, 400 7th Street SW, 9th floor, Washington, D.C., 20219. Generally, all input received will be made public and posted (without changes) to FHFA's website. However, if you prefer that FHFA consider any portion of your response exempt from disclosure, please put that portion in a separate attachment and clearly mark it "confidential commercial information." The procedures for identifying "confidential commercial information" can be found in FHFA regulations at 12 CFR 1202.8, available on FHFA's website.

Questions	
Question 1:	• What revisions, if any, would you recommend to Enterprise requirements to better enable sellers to make accurate and consistent project eligibility determinations?
Question 2:	• Should the Enterprises define short-term rentals and transient use? If so, how should the definition(s) separate projects operating as commercial enterprises from projects in which units are predominantly owned by primary or second home homeowners/investors who use the property themselves but may also rent it on a short-term basis? To what extent, if at all, might such definitions result in a tightening of project eligibility?
Question 3:	• Are there differences in the risks associated with lending in a project that is primarily characterized by short-term and vacation rentals compared to a project that has a large number of units owned by investors or second home owners that are used for residential purposes but may be rented on a seasonal short-term basis? Please describe in as much detail as appropriate.
Question 4:	• Is there any data or evidence you could share regarding the performance of mortgage loans in projects that have short term/transient rentals compared to mortgage loans secured by primary residences, second homes, and investment properties with long-term leases?
Question 5:	• How should a project that is comprised solely or largely of second home units and investment properties be evaluated? What additional documentation should be reviewed to determine risk?
Question 6:	• How, if at all, would providing mortgage financing for units in projects with short-term/transient rentals, consistent with Enterprise charters and guidance, impact access to credit, including for low- and moderate-income and first-time homebuyers? Please provide any relevant data or analysis to support your position.
Question 7:	• How, if at all, should appraisal requirements be modified or bolstered to address some of the unique complexities presented by the transient use and income generating activities in condos, co-ops, and PUDs?
Question 8	• How, if at all, should appraisal requirements be enhanced to better enforce existing appraiser independence requirements for analysis, conclusions, and reporting (which may include comments that identify a project characteristic that could affect the seller's or Enterprise's determination of project eligibility)?
Question 9:	• How should sellers prevent and detect occupancy fraud on mortgages for project units that are used for vacation or short-term rentals (e.g., borrower claiming primary or second home occupancy when the intended use is for short-term rental)?

Question 10:	• How, if at all, are neighborhood property values impacted as short-term rental properties expand nearby?
Question 11:	• Do you have any additional feedback on the issues and questions raised by this RFI?