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CHAPTER 5. CLOSINGS

5-1. CLOSING REQUIREMENTS.

- a. Commitment Requirements. Except for condominiums of 11 or less units, all condominiums (including those processed for insurance upon completion under simplified procedures) have a project commitment and there must be a closing to satisfy the commitment requirements. In projects with 11 or less units the Grantor/Sponsor will have to show evidence that the requirements in the application (FHA Form 3280), Mortgagee's Application for Blanket Commitment, as well as the commitment (FHA Form 3275-A) Blanket Commitment for Insurance of Individual Condominium Mortgages have been met and the Regulatory Agreement (FHA Form 3278) has been properly recorded.
- b. Procedure. The condominium project mortgage insurance program is procedurally comparable to the investor-sponsor cooperative (Section 215) program and the procedures of the latter, as outlined in Reference (6) of the Foreword are applicable generally to the condominium program under Section 234(d). Certain model forms are used in both programs, and other model forms relate to the condominium program only. In the absence of specific instructions in this Condominium Handbook, the Field Office Director should be guided by the instructions relating to Section 213 Investor-Sponsor projects Reference (7) of the Foreword. If any questions arise on this subject they should be submitted to the Office of Underwriting Standards.
- c. Forms. The following forms containing check lists of required closing instruments are contained in the Appendix of this Handbook:
  - (1) Initial Endorsement Insurance of Advances, FHA Form 3257;
  - (2) Final Endorsement Insurance of Advances FHA Form 3257-G;
  - (3) Insurance Upon Completion (Simplified Processing), FHA Form 3257-H.

- d. Standard Case Requirements. In standard Insurance Upon Completion cases under the Commitment to Insure Upon Completion, FHA Form 3284, a title policy is required, and the check list, FHA Form 3257-H, is not adequate. The Standard Commitment to Insure Upon Completion, FHA Form 3284, is used only when the Developer/Grantor requests a dual commitment, condominium/rental, and no check list has been prepared. Until one has been prepared, a check list can be made up by relating the commitment form to the Insurance of Advances (FHA Form 3257-G) check list and underscoring appropriate items.

5-2. CONDOMINIUM ORGANIZATIONAL DOCUMENTS.

- a. Approval. For the purpose of protecting the public against premature solicitation, all condominiums, prior to solicitation for memberships, must obtain the Field Office Director's approval of the organizational documents, including the Enabling Declaration, By-Laws, Regulatory Agreement, (FHA Form 3254-A) and Subscription and Purchase Agreement plus required exhibits.
- b. Language. No Language will be permitted in the Enabling Declaration or the By-Laws that would permit the grantor to retain ownership of community facilities or language that would restrict the resale rights of an owner of a unit.
- c. The FHA Model Forms hereinafter described are largely self-explanatory and are applicable to the condominium regime under Section 234. It is not of course possible to prepare these documents in precise form for use in every jurisdiction. Under the Act and the Regulations HUD-FHA does not determine that the Enabling Declaration and the Exhibits attached thereto are legally acceptable and binding in the jurisdiction where the family unit is located nor does HUD-FHA pass upon title at the time of insurance endorsement requirements, all of which are matters which must be determined by the parties to the mortgage transaction.
- d. Model Form Changes. The FHA model forms should be followed with only such changes as may be required to conform to the facts pertaining to individual project or to requirements of local law.

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- \* e. Any Change of Substance from the FHA model forms that requires the advice and assistance of Headquarters staff should be submitted to the Office of Underwriting Standards. Washington \*

review will be given only after submission of specific questions together with a set of documents and a plan of condominium development to show the context in which the questions arose and the Field Office Director's findings and recommendations.

- f. In Order to Expedite the examination of the organizational papers, the parties should be required to submit not only typed copies thereof, but also marked-up drafts on the FHA model forms with changes therein shown by deletions or interlineations. Also, a brief statement of the reason for each change, and citation of state law, if relevant, should accompany these drafts.

5-3. FHA MODEL FORMS APPLICABLE TO THE PROJECT MORTGAGOR. Model Forms applicable to the project mortgagor under Section 234(d) are as follows:

- a. Certificate of Incorporation, FHA Form 3236-A. This form is appropriate for use by a developer/grantor in insurance of advances cases.
- b. Mortgagor's Certificate, FHA Form 3212-A. This form is appropriate for use in insurance of advances cases.
- c. Mortgagee's Certificate, FHA Form 3220. This form is appropriate for use in insurance of advances cases.
- d. Regulatory Agreement, FHA Form 3254-B. This is a form developed solely for the project mortgagor under the Section 234 program and will be used in all cases involving construction or rehabilitation under Section 234(d). This form is not to be confused with the Regulatory Agreement, FHA Form 3278, which is recorded with the Enabling Declaration to regulate the home mortgage phase.
- e. Regulatory Agreement, FHA Form 3278. The Regulatory Agreement will constitute Exhibit "C" to the Enabling Declaration. (FHA Form 3276-A) In view of legislative requirements and the Regulations, a Regulatory Agreement is necessary but an effort has been made to keep the limitations, therein, to a workable

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- (5-3) minimum. The Regulatory Agreement is a recorded document which is effective while the Secretary is the holder or insurer of any mortgage covering a family unit, is the owner of a family unit, or is obligated to insure a mortgage covering a

family unit.

- f. Subscription and Purchase Agreement, FHA Form 3279. This form is required to be used in the solicitation for condominium purchasers where the purchaser seeks an insured mortgage under Section 234, or 235. This form must be used, also, for purchasers who are obtaining conventional financing or paying cash for the unit. This document incorporates informational material which should be carefully reviewed by the Field Office in each condominium undertaking. Sums received on account of the purchase of all the family units (HUD-FHA, conventional or cash) must be deposited in an escrow account under an escrow agreement which has been approved by the Field Office Director.

- (1) A schedule of estimated monthly assessments is required to be attached as an exhibit. This requirement sometimes makes it necessary for the grantor to prepare the schedule long before initial occupancy and, in many cases, before precise expense and income estimates can be made.
- (2) It is on the basis of the initial schedule of monthly assessments that condominium purchasers are solicited. Their decision may be influenced by the fact that HUD has approved the adequacy of the monthly dollar amounts shown on the schedule. It is therefore essential that expenses not be underestimated.

- g. Model Form of Management Agreement For Condominiums FHA Form 3281.

- (1) In a condominium undertaking, it is essential that the common facilities be maintained and operated in a sound and business-like manner. This is especially true where these facilities include commercial areas, parking areas, swimming pools, etc. It is clear that under normal circumstances the proper and most efficient method for such operation is through the retention of an experienced management agent.

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- (2) The condominium may include family units which are unencumbered by mortgage liens or which are financed conventionally. It is also possible that more than one mortgagee may be involved in the undertaking. In view of the foregoing it is proper that the management and control of the condominium should vest in and remain with

the members of the Association of Owners through its board of directors, subject to the approval of HUD-FHA, so long as HO-FHA has any interest in the undertaking. The model form of Management Agreement, FHA Form 3281, has been drafted with the foregoing in mind. The Field Office Director must be satisfied that the management agent selected is competent to provide skilled and effective management. The termination date of the initial Management Agreement in Section 234 cases should be not later than two years from the effective date of the Agreement. In housing for low and moderate income families under Section 235(i) continuity of good management is especially important and the Field Office Director may in his discretion approve initial management contracts for a period up to three years. During the period of this initial contract, the Association of Owners will have an opportunity to observe the management of the project and to formulate an opinion as to whether the contract should be continued or the management changed.

- (3) It is to be noted that the model form restricts the management to the common areas and the restricted common areas. It does not include the management of the family units.

5-4. GUIDELINES FOR CONDOMINIUM MANAGEMENT.

- a. Requirements. As indicated above there is no absolute requirement that a condominium association be managed by a professional management firm, but there is a requirement that any substitute plan be approved by HUD-FHA.
- b. A Condominium Association is made up of a number of individual mortgagors that are directly responsible to their mortgagees. The association in itself is not a mortgagor and is not responsible for monthly debt service payments. Its primary responsibility is to collect the monthly assessment, fund the reserves, maintain the common property in good condition and

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- (5-4) govern the use of the community facilities (if any). Some condominiums have extensive community facilities or contain many assisted mortgages and professional management should be required. Many condominiums, however, have minimal community facilities and the common areas of the properties are limited to such things as party walls, parking area, roofs and common green area. Also, in some small towns where condominiums are

beginning to appear, there may not be a professional management firm capable of performing the function.

- c. Most State Statutes establish the Board of a condominium as a Board of Managers, but they do not prohibit the Board from contracting for the various kinds of services needed. On the other hand the HUD-FHA Regulatory Agreement, FHA Form 3278, which is effective while any single mortgage is insured, or as long as HUD-FHA has an Interest In the property, specifically requires that the HUD-FHA must approve the form of management. If a professional management firm is required the FHA Model Form of Management Agreement for Condominium, PHA Form 3281, must be used.
- d. A Determination at a Professional Management Organization will not be Required does not, however, reduce the need for the substitute plan to be professionally put together so as to assure the condominium owners of skilled and effective management.
- e. The Model Form of Management Agreement. Because of the individual work schedules of the members of the Board they may not find it possible to do more than to meet on policy matters. The Model Form of Management Agreement, FHA Form 3281, was designed to require a management firm to provide a comprehensive package of services to a Board for a budgetable fee. The contractual arrangement between the Board and the management firm provides for legal remedy if the contract is breached. Competition between management agents also gives the Board and owners some assurance that the job will be done in a professional manner.
- f. In Resolving not to use a Professional Management Firm a Board should be able to justify to the owners it represents that it can do the job as efficiently at no more cost or at less cost.

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- (5-4) g. Members of the Board of Directors, whose primary responsibility is to make policy, are not permitted to receive compensation for their services.
  - h. In the Absence of Voluntary Effort, the Board must seek the different services set forth in the Management Agreement from several sources and budget for them accordingly. To protect the owners there may be a need for a number of signed contracts or employment agreements rather than only one.

- i. The Field Office Director must make a determination as to the soundness of any self management plan where a management firm is not used. The usual guide lines for such a determination is how closely the substitute plan conforms to the model form as it should be applied to the property involved (taking into consideration its complexity or simplicity).
- j. When a Substitute Plan (by Resolution of the Board) is Submitted to the Field Office it should be accompanied by copies of any agreements necessary to carry it out, together with a copy of HUD Budget Form HM-93240 which contains a comparison of the cost of the plan versus the cost of management by a professional firm.
- k. If an Individual is Hired to Perform Some Function that is in the Management Agreement FHA Form 3281, i.e., bookkeeping, grounds maintenance, etc., the agreement between that individual and the Board must contain his basic responsibilities, terms of employment vacations, etc.
- l. If People are Directly Hired by the Condominium Association, the Budget, Form M-93240, must reflect adequate workmen's compensation insurance and assurances must be given that social security and other employee benefits are being properly handled. The Board may find it more economical to obtain grounds and pool service from a professional organization. If such is the case the Board should supply evidence of that fact in its submission of the plan for owner management.
- m. The Plan for Owner Management must be attached to each submission of the Budget, HUD Form HM-93240, to HUD-FHA (with any modifications noted) as long as the plan is in operation.

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- n. If the Form of Management Requested by the Board is Unsatisfactory to the Owners, they can petition for a special meeting under their By-Laws (FHA Form 3277, Article III, Section 4). Under the same provision they could, if necessary, remove and replace the existing Board.
  - o. If the Association of Co-Owners or an Individual Unit Owner Violates the Regulatory Agreement, Item 9(b) of the Regulatory Agreement (FHA Form 3278) sets forth the remedies available to the HUD-FHA.
  - p. One of the Primary Responsibilities imposed an any form of

management is that those responsible understand the basic legal documents that make the condominium functionable, i.e., the Declaration, the By-Laws, the Regulatory Agreement and the Management Agreement (if any). The basic principals of the Uniform System of Accounts for Cooperative Housing Corporations, Reference (8) and (9) of the Foreword should also be understood for the purpose of budgeting and bookkeeping.

5-5. REVIEW OF DOCUMENTS.

- a. Most State Statutes are broad and contain permissive, rather than mandatory, provisions. Such permissive provisions permit conventionally financed condominiums to do things that are not permitted in our documents which contain statutory provisions required by the National Housing Act and provisions for protection of the consumers. Those responsible for document review should obtain a copy of the State statute and be aware of its contents.
- b. If the Language used in the FHA Model Forms and the State Statute are Inconsistent, they can be made consistent by including them in a "Definition" section, i.e., Board of Directors shall mean Board of Governors or Apartment shall mean Family Unit, etc.
- c. The Condominium Enabling Declaration (Master Deed)(FHA Form 3276 or 3276-A) establishes the condominium regime and is one of the most important documents to be reviewed. After it has been recorded and titles have been conveyed to the individual units it normally requires agreement of 100% of the owners to change it.

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- (5-5) d. As a General Rule in reviewing condominium documents the following must be kept in mind:
- (1) The Grantor of the property establishes the condominium regime by making certain declarations. He is in control of the association and acts as the Board of Directors from the time the Declaration is recorded until the first election of a Board of Directors from among the owners. The Declaration should contain no language that would permit the Grantor to lock the condominium into long term agreements or self serving covenants before the consumer Board is in control. A case in point would be where a professional management requirement is written into the declaration which strips the Board of Directors of most

of its powers.

- (2) Many condominiums are small enough and their common areas so minimal that professional management is not necessary. We do not have an absolute requirement for professional management of condominium as is the case for cooperatives. A cooperative corporation is an owner and a mortgagor. A condominium association is neither. The powers given to the condominium association by the Declaration and By-Laws are fundamentally for "use control" and maintenance of the undivided interest all of the owners have in the common areas. These powers normally include management which may, if desired, be delegated to a professional manager. If the Board wants or if HM-FHA requires professional management it must be contracted for by use of the Model Form of Management agreement for Condominiums, FHA Form 3281.

The Field Office Director has the authority to require professional management in cases where a substantial percentage of owners are assisted under Section 235 or in any case where the need is apparent.

- (3) The Declaration must contain a provision which imposes the HUD-FHA Regulatory Agreement on the condominium regime. Most documents copied from conventional formats will not contain such a requirement.

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- (5-5) (4) Restrictive covenants in the Declaration should be reviewed with the knowledge that when the property is sold and converted to a condominium regime generally 100% of the owners will have to agree to any change. If the developer purchased a single unit for his own use he could prevent any change in this instrument. Architectural and esthetic control by covenants running with the land (common elements) could be useful. There are other covenants which could be useful to control the common areas and which would give a basis on which legal enforcement can be used. Covenants may also be put in the Declaration that affect the individual's use of the unit, i.e., the unit will not be used for any immoral purpose. There should be no objection to such a covenant. Covenants that unduly restrict an owner's rights or affect the marketability of the unit must not be permitted.

- (5) The policy of HUD-FHA is to not permit any language in the Declaration that would restrict the resale rights of the owner. While the right of first refusal is permitted in some State statutes, it is not permitted in a HUD-FHA approved condominium.
- (6) By-Laws are used to establish a basis for governing the condominium. Use restrictions and rules for conduct should be embodied in this document. By-Laws are more flexible than the Declaration and can be amended by a majority of owners if it is found that certain rules are no longer desirable. Owners are also given the right in the FHA model form of By-Laws (FHA Form 3277) to petition for changes in the government of the condominium.
- (7) As noted above, there is no objection to sections of our documents being expanded for the purpose of clarification. The insurance provisions of the Declaration are an example. The Declaration, however, should not be used to lock in any particular insurance Trustee, (a Trustee may be used where a mortgagee fears that the insurance might be dropped), or types of insurance other than the basic hazard policies. Vandalism, malicious mischief, etc., should be discretionary with the Board. The provisions for insurance that are made in the Declaration should be backed by an acceptable dollar amount of cost in the Budget, Form HM 93240 (this form is required as

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an exhibit to the Application, FHA Form 3201). The Budget should be reviewed to determine, among other things, that the regulatory requirement for a replacement and general operating reserve has been met.

- (8) The Declaration contains a description of the unit, the restricted use areas, and recreational common areas. It also indicates whether or not the streets are owned by the condominium owners. It is important to know where the horizontal planes run. If, for instance, the horizontal plane runs across the finished surface of the roof; repair and replacement of the roof will be the responsibility of the individual owner. If it runs under the roof, repair and maintenance will be the responsibility of the condominium association and would fall within the purview of the replacement reserve. Routine maintenance and repair would also be included in the Budget (HUD

5-6. FISCAL MANAGEMENT OF CONDOMINIUMS.

- a. Accounting System. To facilitate the successful operation of the condominium, it is required that the procedures outlined in the Uniform System of Accounts for Cooperative Housing Corporations References (9) and (10) of the Foreword be followed as closely as possible. Certain of the account titles listed therein are obviously not applicable to the condominium program, and, therefore, should be disregarded in establishing an account system for the condominium. The system is, however, otherwise appropriate. The Budget, Form HM-93240, must be submitted prior to the beginning of the sales program and annually thereafter.
- b. Monthly Reports and Budget Preparation. For accounting, purposes, the association will make use of the Monthly Report of Cooperative Projects, Form HM-93211, and the Model Form of Operating Budget and Schedule of Carrying Charges, Form HM-93240, copies of which should be furnished to the Field Office at its request. While certain of the accounts listed on these forms are not applicable to condominiums and should be disregarded, the use of the forms will enable the Board of Directors of the Association Owners to ascertain monthly trends in the fiscal affairs of the association and to prepare a realistic budget for the ensuing fiscal year. References (8) and (9) of the Foreword may be consulted for more detailed information concerning the preparation of budgets.

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- 5-7. PREVAILING WAGE REQUIREMENTS. Detailed instructions on the subject of prevailing wage requirements are set forth in Reference (10) of the Foreword and must be adhered to.
  - 5-8. COST CERTIFICATION REQUIREMENTS. One of the requirements for conversion to condominium ownership is the termination of the project mortgage insurance either by payment in full of the project mortgage or by voluntary termination of the insurance contract upon request of the mortgagee. Under the condominium statute, the project mortgage must not exceed 90% of the estimated replacement cost of the project subject to family unit limitations or an amount equal to the sum of the condominium unit mortgage amounts eligible for insurance under Section 234(c), whichever is the lesser. Although the project mortgage amount is further subject to reduction under cost certification (and cost records must be kept by the developer), the unit mortgages which replace

the project mortgage are not subject to cost certification under Section 227 and are eligible for mortgage amounts determined in accordance with Section 203 home mortgage criteria. By reason of this home mortgage criteria, the total eligible amount of the individual condominium unit mortgages always exceeds the eligible project mortgage amount. Therefore, in any condominium case where the units are all conveyed to individual purchasers, whether or not the condominium project mortgage is reduced by cost certification does not affect: the sales price to the individual condominium purchaser; the eligible condominium mortgage amounts under Section 234(c); the return to the project mortgagor, and the ultimate mortgage risk of HUD-FHA. On the other hand, where the project mortgagor-developer is unable to sell the units the reduction of the project mortgage by cost certification would result in a reduction of mortgage risk by HUD-FHA and would prevent the project mortgagor from realizing excess profits from the construction of a project destined to be operated as a rental project.

- a. Cost Certification - Insurance of Advances Cases (FHA Form 3283, Commitment). Under Section 234(c) condominium units are eligible for mortgage insurance if they are located in a multifamily project which is or has been covered by a project mortgage insured under any Section of the Act, except Sections 213(a)(1) and (2) (Cooperatives). Therefore, if the project mortgage covering a presold condominium project has been initially endorsed and the advances thereunder insured, and if the project is completed to the satisfaction of the Field Office, final endorsement of the mortgage instrument need not

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be made in order to proceed to final closing of the project file. The units are located in a project which is or has been covered by an insured mortgage and are therefore eligible for mortgage insurance under Section 234(c). Cost certification by the mortgagor-developer need not be filed if there is no final endorsement. Thus if the mortgagee and other interested parties voluntarily request HUD-FHA to terminate the insurance for the project mortgage, approve the recordation of the Enabling Declaration, thereby establishing the condominium and all other applicable requirements of FHA Form 3257-G are met the individual units can be insured.

- (1) The project commitment for this type of case should be amended by adding the following provision:

"In the event the project is completed to the

satisfaction of HUD-FHA and all requirements for conversion to condominium ownership have been met, the parties may request, in lieu of final endorsement the voluntary termination of insurance of the project mortgage, and if same is accomplished, the parties need not file a certification of costs with the Field Office."

(2) This does not eliminate the need for a developer to maintain records as he would have to furnish the required cost certification if the development failed to market and had to be insured as a rental project.

- b. Cost Certification-Insurance Upon Completion FHA Form 3284, Commitment, Standard Procedure). There is no initial endorsement in this type case. The project must therefore be endorsed upon completion and cost certification will be required. Short FHA Form 2205 may be used for this purpose.
- c. Cost Certification - Insurance Upon Completion (FHA Form 3284, Commitment, Simplified Procedure). Use cost certification statement that has been included in Reference (1) of the Foreword.

5-9. RETENTION OF PROJECT FILES. Where a project mortgage (whether insured under Section 234(d) or other Sections) is prepaid in full and the project converted to condominium the project plans file should not be sent to storage but should be retained in the local HUD office. The Data Appraiser should retain a data file on the project, including FHA Forms 180 for use in individual appraisals of units upon resale.

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5-10. REFERENCE TO SECTION 234(c) FOR PROCESSING INDIVIDUAL UNIT PHASE AND IN SIMPLIFIED PROCEDURES FOR INSURANCE UPON COMPLETION CASES. In those instances where the sponsor is able to complete construction of a condominium project composed of detached, semi-detached, row or walk-up apartment structures (where no unit extends over or under another unit) without the need for HUD-FHA insured construction advances on the project, he may request the use of simplified administrative procedures which includes a presale condition and a simple project mortgage computation. These simplified administrative procedures are outlined in Reference (1) of the Foreword and are not applicable to elevator construction.

- a. Even though the simplified administrative procedures may be

used in the project phase where units extend over or under other units (except for elevator construction) the multifamily underwriting instructions in Chapters 6, 7, 8, and 9 of this Handbook are required in lieu of the home mortgage underwriting procedures described in Chapter 10 of Reference (1) of the Foreword.

- b. Mortgage credit processing of all individual loans in a condominium will be in accordance with the procedures set forth in Reference (1) of the Foreword.