Condo Insights

#37 – Warrantable and Non-warrantable Condominiums

When seeking a mortgage to purchase a single-family home, the mortgage company is going to evaluate the buyer's credit worthiness and the property being purchased. When purchasing a condominium, lenders are going to analyze more than just the buyer's credit score and how much of a down payment is being offered. The financial and physical health of the entire condominium development will affect the risk level of the loan.

In the world of real estate financing, condominiums are categorized as either "warrantable" or "non-warrantable." These terms refer to specific activities occurring or permitted by the condominium association and the perceived related level of risk associated with financing a condominium project. Simply stated: a warrantable development meets the lending criteria and requirements established by Fannie Mae and Freddie Mac and is certified by the FHA.

The Federal Housing Administration ("FHA") is also known as the Office of Housing within the Department of Housing and Urban Development. The Federal National Mortgage Association (FNMA) is known by its moniker "Fannie Mae" and "Freddie Mac" is short for the Federal Home Loan Mortgage Corporation.

Some of these requirements and criteria to be considered "warrantable" include: the development must be 100% complete; commercial space must be less than 25% of the building's square footage; no single entity may own more than 10% of the units in the development; more than half of the condominium units are owner occupied; less than 15% of members are delinquent with their association fees; and that there are no lawsuits against the association.

A non-warrantable development does not meet the lending criteria and requirements established by Fannie Mae and Freddie Mac. Because non-warrantable condominiums do not meet one or more of the eligibility criteria set by conventional lenders, financing options are limited for a non-warrantable condominium. This classification doesn't necessarily mean that the condo is of low quality; it merely implies that the risk associated with financing the project is higher than a warrantable condominium project.

Common reasons for a condominium to be deemed unwarrantable include: unfinished or under-construction condominiums are generally considered unwarrantable until construction is completed; the condominium project may have a high percentage of commercial or non-residential space; characteristics of or hotel-type services; individual condominium units less than 400sf in size; if a significant number of condominium units are owned by investors rather than owner-occupants, lenders perceive a higher risk of default, as investors may not prioritize the maintenance and stability of the property. At the seashore, investor-owners tend to advertise short term rentals which certainly has an effect on classification.

In addition, lenders look at the financial health of the association to make sure the association has adequate reserves for repairs and maintenance as well as any planned capital improvements. Lenders will evaluate owner receivables as delinquent condo fees can be an indicator of financial instability. Lenders may view a condominium association as risky if it lacks adequate insurance coverage.

While an association may not be able to control its status as warrantable or non-warrantable, associations should have an independent accountant prepare annual financial statements. Associations should also confer with their insurance agent to ensure property insurance coverage accurately reflects reconstruction costs.

What exactly does this mean for a condo buyer? When a condo is labeled as non-warrantable, it means that it does not meet conventional guidelines and will not be financed by government-backed entities like Fannie Mae and Freddie Mac. Many lenders consider financing a mortgage for this type of property to be too risky which can make it harder to find financing options. A condo buyer will have to qualify for a bank's portfolio loan instead of a conventional loan. While portfolio lending practices vary from bank to bank, buyers can expect to face stringent underwriting criteria and may need to put down a large down payment to buy the condo.

Understanding the difference between warrantable and non-warrantable condos is crucial when it comes to securing financing for a purchase. Knowing the requirements of Fannie Mae and Freddie Mac, as well as the financial health of the condo association, can help buyers determine whether a condo is warrantable or not.

Non-warrantable condos may have more limited financing options, but they can still be a great investment. By performing due diligence and working with a knowledgeable real estate professional, buyers can navigate the complex world of condo financing and find the right home for their needs. Working with local lenders that are familiar with the local condominium market may secure some advantages for prospective buyers.

Understanding the key differences between these classifications is essential for making informed decisions in the real estate market. Buyers should carefully assess their needs, financial situation, and risk tolerance before committing to a condominium purchase, whether warrantable or non-warrantable.

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