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Federal Housing Finance Agency

Office of Housing and Regulatory Policy

400 7th Street, SW, 9th Floor

Washington, DC 20219

RE: Request for Input: Short-Term Rental Units in Condominium, Cooperative and Planned Unit Development Projects (May 6, 2021)

The Community Home Lenders Association (CHLA) submits these comments on FHFA’s Request for Input (RFI) referenced above.

CHLA applauds FHFA for seeking public input on the eligibility requirements of Fannie Mae and Freddie Mac (the Enterprises) for condominium (condo), cooperative (co-op) and planned unit development (PUD) projects that have short-term rental units, provide services and amenities similar to those of hotels and motels, and/or may otherwise be considered transient housing.

This RFI is timely, given the emergence of services like Airbnb and VRBO that enable owner-occupants of primary residences and second homes to make their dwellings available for short-term rentals, to an unprecedented degree. These services also have helped drive increased investor purchases of single-family homes for use as vacation or other short-term rentals, with notable impacts on many housing markets throughout the nation. Furthermore, the increased use of primary residences and second homes as short-term rentals blurs the longstanding distinction between owner-occupied properties and investment properties. This could impact credit risk exposure to the extent that mortgages on second homes begin to perform more like investor-owned properties, thus effectively increasing investor concentration in a loan portfolio.

Accordingly, we recognize the Enterprises need to monitor and manage the impact of these ongoing changes on the credit risks they face in their single-family guarantee businesses. These changes may create particular challenges to their credit risk management of purchases of mortgages on condominium units, which generally pose higher risks than mortgages on other types of single-family housing. However, the use of other types of single-family properties as short-term rentals could also present credit risk management issues for the Enterprises.

CHLA offers this summary of our views and recommendations:

* **FHFA and the Enterprises should accommodate the enhanced ability of unit owners to offer their properties for short-term rentals, in a manner consistent with Enterprise charters and safe and sound business practices.** As discussed in our response to question 1, we believe changes to the Enterprises’ eligibility standards earlier this year discourage unit owners from making their units available for short-term rental. **We urge FHFA and the Enterprises to engage with stakeholders in a long-term collaborative effort to determine how to best accommodate the long-term market changes being driven by the increased use of single-family homes as short-term rentals. CHLA and our members would like to work with you in such an effort.**
* **The Enterprises should provide clear, precise definitions and guidance to both sellers and condo/co-op associations.** We believe this must include bright line guidance with safe harbors to minimize the potential for reclassifying projects as ineligible simply due to confusion among lenders and associations about eligibility requirements. Confusion over changes to the Enterprises’ requirements earlier this year underscores the need for this approach.
* **Enterprise policies should minimize the potential for disruption of condo markets.** We are concerned that changes to Enterprise eligibility policies implemented earlier this year could affect the willingness of lenders to originate loans in many projects, especially resort communities. Any changes to policies should be made with advance notice and provide a transition period sufficient to enable lenders and project associations to fully comply.
* **FHFA’s inquiry should be expanded to include all types of single-family housing.** All types of single-family houses are made available for short-term rentals, and many of the questions and concerns underlying this RFI apply to them as well. Moreover, owners of other types of single-family dwellings do not face the restrictions placed on owners of condos, co-ops and PUDs in offering their homes for short-term rental. While short term rentals of units in condos, co-ops and PUDs might present challenges specific to those types of dwellings, we see no reason for the far more restrictive treatment of these units in the Enterprises’ requirements.

Our answers to the questions in the RFI are below. In some cases we provide one answer for more than one question.

1. *What revisions, if any, would you recommend to Enterprise requirements to better enable sellers to make accurate and consistent project eligibility determinations?*

We recommend the Enterprises reverse changes to their guidelines earlier this year that effectively expanded the definition of condotels to include projects previously not considered to be condotels. The Enterprises characterized these changes as clarifications to existing requirements, but in fact they made substantive changes to their requirements that discouraged offering units for vacation and other short-term rentals.

Prior to these changes, the Enterprises provided clear and understandable guidance in determining when a project functions or operates as a condotel (e.g., it is licensed as a hotel, owners are required to make their units available for rent, owners are required to share profits from the rental of their units with the HOA). Unfortunately, these distinctions were muddled by the creation of additional guidelines that in some cases were not clearly defined or explained, creating confusion about whether certain projects are still in compliance with eligibility requirements.

A prime example is Fannie Mae’s new requirement that a project “primarily transient in nature” is ineligible.[[1]](#footnote-1) This term is not defined in Fannie’s Selling Guide, but an accompanying FAQ defined it as when “the predominant use of the units is short-term rentals of less than 30 days.”[[2]](#footnote-2) Yet “predominant use” was not clearly defined.

At the same time, the FAQ said that projects can allow condo owners “to offer short-term rentals on a seasonal basis” if the owners “reside in the units during a significant portion of the year.”[[3]](#footnote-3) But this raised additional questions about how Fannie defines “seasonal basis” and “significant portion of the year.” Moreover, the FAQ also said Fannie may be willing to consider classifying a project as eligible if “the majority of the units [are] rented on a short-term basis by the individual owners and there are no other characteristics of a condotel.”[[4]](#footnote-4) This not only seems inconsistent with the earlier cited language, it also does not make clear whether these units must be owner-occupied or also can be investment properties.

Fannie Mae also cited the location of a condo project in a “resort area” as a red flag for lenders to consider in assessing whether the project is a condotel or other type of transient housing.[[5]](#footnote-5) This raises additional questions and concerns. Once again the key criterion — resort area — was not defined. While some communities exist primarily as resorts, many other places offer resort facilities and amenities, including a number of major cities and metropolitan areas (e.g., Los Angeles, Miami, Denver, Las Vegas) that are resort destinations themselves. We take it for granted that Fannie did not intend to apply this red flag so broadly, but lenders need greater clarity on what Fannie considers to be a resort area posing potentially higher risks.

The Enterprises’ changes raised other concerns as well. Many localities require vacation rentals to obtain licenses or otherwise register with local governments in order to be legally rented. Complying with this requirement with regard to condo units may require the project manager or association to obtain the license/registration. This arguably might be preferable, as a matter of managing the project, to having individual unit owners obtain licenses or registration. But this clearly would make the project ineligible under Freddie Mac’s new requirements, which specifically forbid projects or associations from obtaining licensing for short-term rentals of units,[[6]](#footnote-6) and probably under Fannie Mae’s standards as well. Likewise, both Enterprises’ new standards cast doubt on whether and how the use of third party short-term rental management services by condo unit owners are allowable.

We are concerned that the Enterprises’ new requirements will result in the reclassification of currently eligible condo projects as ineligible. We also believe that confusion and uncertainty about these requirements could lead some lenders to reduce or cease originations in many condo projects, out of fear the Enterprises may subsequently determine the projects are ineligible. Lenders may become especially reluctant to originate loans for units in condo projects in resort communities, as well as in cities and metropolitan areas that offer resort facilities or are themselves resort destinations, where units might be more likely to be offered as short-term rentals by owner-occupants and investors.

Either way, this could disrupt condominium markets by significantly reducing the availability of affordable mortgage credit for units in many projects across the nation. This in turn would drive down the value and marketability of condo units in affected projects, imposing potentially significant losses on owners. These losses will impact all owners in an affected project, full-time residents as well as second home and investor owners. To the extent that condominiums provide a primary source of affordable housing in many communities, these losses could fall particularly heavily on low- and moderate-income owner-occupants who do not offer their homes for short-term rentals.

Accordingly, we believe the Enterprises should reverse these changes. Any future changes to eligibility requirements should provide clear, precise definitions and guidance to both sellers and condo/co-op associations. This should include bright line guidance with a safe harbor. This will both maximize the ability of lenders and project associations to fully comply with Enterprise eligibility requirements and minimize the possibility that a project is reclassified as ineligible because the lender and/or association misunderstands these requirements.

Moreover, with these changes to Enterprise eligibility requirements, condo, co-op and PUD unit owners face restrictions to their ability to offer their homes for short-term rental that do not exist for owners of other types of single-family dwellings. Other types of second homes have to be occupied only two weeks per year, and there is no limit on owners’ ability to offer their investment properties, second homes and primary residences for short-term rentals. We see no reason for such significant differences in treatment. This is a principal reason why we recommend FHFA expand its inquiry to include all types of single-family housing.

1. *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?*

As a general rule, we believe the Enterprises should provide clear, precise definitions and guidance, including bright line standards with safe harbors to minimize the potential for reclassifying projects as ineligible simply due to confusion among lenders and associations about eligibility requirements. Confusion over changes to the Enterprises’ requirements earlier this year underscores the need for this approach.

At the same time, any changes to definitions that could reclassify currently eligible projects as ineligible or substantively reduce the ability or willingness of the Enterprises to provide financing to condo, co-op and PUD units should first be provided to stakeholders for review and comment. We do not recommend this lightly and recognize the need for the Enterprises to make ongoing changes to their underwriting guidelines to manage their businesses safely and soundly. However, changes that could result in a significant reduction in Enterprise support of a particular market segment, with attendant market and economic effects, should be treated differently.

In conversations with the Enterprises on this issue, they have stated their policy changes are in part driven by the need to comply with their charters. FHFA’s RFI also makes reference to charter compliance as a principal consideration. Yet it is not clear why enabling owners of condo, co-op and PUD units to offer their units for short-term rental creates charter compliance concerns, while no such concerns to our knowledge have been raised about the Enterprises allowing owners of other types of single-family dwellings almost complete freedom to offer their homes for short-term rental. Accordingly, FHFA should clearly define the charter limits of the Enterprises as part of addressing these questions.

1. *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*.
2. *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?*
3. *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?*
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?*
5. *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?*

CHLA members active in serving this market segment report that, in their experience, the performance of loans on condo units owned as a second home or investment property generally perform better than loans on condos used as a primary residence. It is believed that income from short-term/vacation rentals, which can be substantial, is a principal reason. We note that these lenders provide financing only to projects eligible under the Enterprises’ standards. Further, these lenders finance only some, not all units in each project.

We recommend FHFA, as part of its inquiry into this issue, work with the Enterprises to obtain and make publicly available comprehensive performance data that would shed light on these questions. This comprehensive dataset should include performance data on Enterprise loans.

1. *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?*

As noted in our answer to questions 3-7 above, CHLA members active in this market segment find loans on condo units owned as a second home or investment property generally perform better than loans on condos used as a primary residence. This underscores the need for FHFA to obtain and analyze more comprehensive data to determine the level of risk in projects with relatively larger numbers of second home and investment units.

1. *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.*

Generally speaking, condos, co-ops and PUDs provide relatively lower cost housing, so providing financing of projects with short-term/transient rentals should generally increase access to credit to these groups of borrowers. As discussed, in our answer to question 1, reducing Enterprise financing of these projects would have an adverse impact on access to credit to these and other borrowers, as well as harm current unit owners in affected projects. We are concerned that recent changes to Enterprise eligibility requirements could result in reduced Enterprise support of this market segment.

1. *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?*
2. *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)?*

We are unaware of any significant concerns with either the quality of appraisals on condos, co-ops and PUDs or the independence of appraisers serving this market segment.

1. *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)?*

We are not sure what risks are posed by “occupancy fraud” as defined in the question. As noted above, CHLA members who serve the condo/co-op/PUD market segment find that loans on units used as investment properties and second homes generally perform better than loans on units used as primary residences, at least in part because of income earned from short-term/vacation rentals.

Preventing and detecting such “fraud” would appear to require sellers and servicers to closely monitor borrower use of their units throughout the life of the loan. This would be intrusive on borrowers and place unreasonable limits on their use of their properties, particularly in the absence of compelling policy and/or risk management rationales. The ambiguities in the Enterprises’ requirements introduced by their Guide changes earlier this year, discussed in our answer to question 1 above, also fail to give borrowers clear guidance and standards to follow, putting them at risk of being accused of fraud years after the origination of their loans. If FHFA pursues this issue, it should define and quantify the risks to the Enterprises posed by increased use of units as short-term rentals, and provide bright line standards with safe harbors for borrowers to follow.

Here again, the contrast in the treatment of other types of single-family dwellings under the Enterprises’ underwriting guidelines is notable. Second homes have to be occupied only two weeks per year, and there is no limit on owners’ ability to offer their investment properties, second homes and primary residences for short-term rentals. FHFA does not appear to be concerned about occupancy fraud in other types of single-family housing (nor should it be, in our view). But it raises the question of why occupancy fraud, as defined in the question, appears to be an issue in condos, co-ops and PUDs only.

1. *How, if at all, are neighborhood property values impacted as short-term rental properties expand nearby?*

Expansion of short-term rental properties can impact overall property values in a neighborhood based on a mix of factors. During the past couple of years, in many areas around the country (and particularly resort areas), single-family dwellings of all types are being converted from full-time residential use to short-term rental use. In many if not most cases, these conversions result from purchases of properties by investors. These purchases and conversions appear to be a major driving force in the substantial increases in the market values of homes and properties in many places throughout the nation.

Because this is happening across all single-family housing market segments, it is another reason why we recommend FHFA expand its inquiry on short-term rentals to include all types of housing.

1. *Do you have any additional feedback on the issues and questions raised by this RFI?*

FHFA’s inquiry includes considering to what extent the Enterprises should align their eligibility standards for condo/coop/PUD projects. While a certain degree of alignment may be desirable for risk management purposes (i.e., to reduce the potential for adverse selection), we believe FHFA should not mandate identical eligibility requirements. For lenders and projects, it is most important that each Enterprise’s guidelines be clear and precise and offer bright line guidance with a safe harbor. Allowing a degree of variation in requirements also better enables the Enterprises to respond to changes in the market and credit risk exposure in a timely manner.

We again thank FHFA for issuing this RFI and providing us with the opportunity to comment. Please let us know if you have questions or require additional information.

Sincerely,

COMMUNITY HOME LENDERS ASSOCIATION

1. Fannie Mae Selling Guide, Chapter B4-2.1-03. [↑](#footnote-ref-1)
2. Fannie Mae, Project Standards Requirements, Frequently Asked Questions, November 2020, pg. 4. [↑](#footnote-ref-2)
3. Ibid. [↑](#footnote-ref-3)
4. Ibid. [↑](#footnote-ref-4)
5. Fannie Mae Selling Guide, Chapter B4-2.1-03. [↑](#footnote-ref-5)
6. Freddie Mac Single-Family Seller/Servicer Guide, Chapter 5701.3. [↑](#footnote-ref-6)