Fannie Mae

Project Insurance Requirements FAQs

These FAQs are intended to help sellers and servicers understand and implement the property, flood, and liability insurance requirements for projects, and related requirements for individual units in condo, coop and planned unit development (PUD) projects, including HO-6 coverage. For complete details regarding our requirements, please see *Selling Guide* Part B7, Insurance, *Servicing Guide* Part B, Escrow, Taxes, Assessments, and Insurance, and related announcements.

Q1. Why does Fannie Mae no longer permit master/blanket insurance policies that provide coverage for multiple unaffiliated projects in a single policy?

Effective with *Selling Guide* Announcement SEL-2013-08, and *Servicing Guide* Announcement SVC-2013-22, Fannie Mae discontinued the permissibility of insurance policies that cover multiple unaffiliated projects. The complexity of these policies can make it difficult to understand the terms of coverage and create operational risk for homeowners' associations (HOAs) and/or sellers and servicers. Except as described in the following paragraph, unaffiliated projects may not share a single master property insurance policy, but each must maintain its own policy that meets Fannie Mae requirements, as detailed in *Selling Guide* section B7-3-04, Property Insurance Coverage for Units in Project Developments and underscored in *Servicing Guide* Announcement SVC-2016-11.

Some project insurance programs that cover multiple unaffiliated projects now provide a dedicated policy limit for each individual covered project. Such a policy structure could provide equivalent coverage to our *Selling Guide* requirements for the policy limit. The policy limit dedicated to the subject project needs to be sufficient to cover the full insurable replacement cost of the project improvements including the units. When reviewing the insurance programs that cover multiple unaffiliated projects, the servicer must obtain the insurance policy as well as all of the necessary schedules, endorsements, statement of values, or other associated documents to adequately evaluate the insurance coverage. The HOA must be protected in the same manner as if it maintained its own individual policy and the coverage of the individual insured project cannot be affected by any actions or omissions of unaffiliated projects covered by the same policy. Additionally, all other *Selling Guide* requirements for project insurance would need to be met for such a policy to be permissible; including, but not limited to:

- insurance companies underwriting the master or blanket insurance coverage must meet Fannie Mae's insurance ratings requirements,
- the policy clearly states that each condominium, residential, or substantially residential project is a named insured, or is evidenced to be covered as an insured,
- at a minimum must protect against perils that are normally covered by the standard extended coverage endorsement, or customarily covered for similar types of projects,
- if co-insurance is included, it must be waived as stated in Selling Guide section B7-3-04,
- maximum deductible requirements must be met,
- building ordinance or law, steam boiler and machinery/equipment breakdown coverage is included, if applicable,
- the right of subrogation against unit owners must be waived, the insurance cannot be prejudiced by any acts or omissions of unit owners not under the control of the HOA, and the insurance must be primary,
- special other insurances must be included if required (i.e. earthquake insurance for Puerto Rico and some Guam buildings), and

© 2017 Fannie Mae. Trademarks of Fannie Mae.

- the policy must require the insurer to notify in writing the HOA (or insurance trustee) at least 10 days before it cancels or substantially changes a condo project's coverage.

The lender must document their conclusions on [Form 1071] to communicate that equivalent coverage to our *Selling Guide* requirements has been accepted, and maintain a copy in the loan file. As a reminder, proper insurance is a continuing obligation and is a life of loan representation and warranty by lenders, subject to the flexibilities noted in *Servicing Guide* Announcement SVC-2016-11 which offers servicer-level insurance alternatives to positively tracking project insurance.

Q2. What is Fannie Mae's definition of an "affiliated" project?

Affiliated projects include those that are under the same master association or share the use of common facilities that are either owned individually or as part of a master association or development. Multiple condo or PUD projects that do not have one of these characteristics, even if they are managed by the same management company, are not considered to be affiliated projects.

Separate projects under development by the same or affiliated developers shall be considered affiliated during the period of time when control of all units has not yet transferred from the developer to the individual owners or related association/corporation of a PUD, condo, or co-op project. This affiliated status of the subject project ends when control over the last unit in that project is transferred by the developer to an individual owner or related association/corporation of the project.

Projects that do not meet the definition above are considered unaffiliated projects.

Q3. Can projects under development be covered by the developer's insurance policies covering the project?

Yes. If the projects are under development, then they may be covered by the developer's insurance policies if the policies provide equivalent coverage to the requirements in the *Selling Guide*. When control is transferred to the individual owners or related association/corporation of the PUD, condo, or co-op project, each project must obtain its own insurance policies in accordance with Fannie Mae's requirements.

Q4. If the seller is unable to obtain any schedules, endorsements, or a declarations page associated with an insurance policy, how can the seller determine if the policy provides coverage that meets Fannie Mae's project insurance requirements?

If the seller is unable to obtain the necessary documentation, it cannot make the determination as to whether the master/blanket insurance policy meets Fannie Mae guidelines. Without that determination, the associated mortgage loan would not be eligible for sale to Fannie Mae.

Q5. If a master/blanket policy that met Fannie Mae's guidelines at time of delivery is subsequently changed and no longer meets Fannie Mae's guidelines, must the servicer repurchase mortgage loans in that project?

Annually and at the time of policy renewal, the servicer must ensure that master/blanket policies continue to meet Fannie Mae guidelines. If at any time, the servicer becomes aware the policy is no longer compliant with Fannie Mae guidelines, the servicer must make reasonable efforts to resolve the compliance issues. If the issues cannot be resolved, the servicer must contact its Fannie Mae Servicing Consultant or Portfolio Manager or Fannie Mae's Single-Family Servicing Support Center at 1-800-2FANNIE (232-6642). Some servicers may choose to use alternatives to verifying project master/blanket

© 2017 Fannie Mae. Trademarks of Fannie Mae.

policies annually over the life of the mortgage as described in the Servicing Guide B-2-03, Property Insurance Requirements for Mortgage Loans Secured by a Unit in a PUD, Condo, or Co-op. Servicers should refer to that guidance before discontinuing the annual tracking of project insurance. The use of an alternative to verify master/blanket insurance coverage does not extend to annual verification of the HO-6 coverage, if separate coverage is required.

Q6. If a commercial general liability policy contains "Separation of Insureds" language, does that meet Fannie Mae's requirement regarding "Severability of Interest"?

These terms are basically equivalent. The requirement is that the policy terms confirm that each insured party on the master liability policy is treated as if it is covered by its own liability insurance policy. This provision protects the insured party facing a loss due to a negligent act from being denied a claim brought against the liable party merely because both are insured under the same policy. Fannie Mae requires "Severability of Interest" or "Separation of Insureds" or equivalent coverage to be included in the body of the policy or in a specific endorsement.

Q7. Does the master property insurance policy or a related endorsement have to state "100%" replacement cost?

No, but the amount of coverage described in the terms of the policy and/or endorsements must equal 100% of the insurable replacement cost of the project improvements.

Q8. If a project master policy states coverage is provided at replacement cost, or a replacement cost endorsement is included in the policy, is this adequate verification that the policy limit maintained is adequate?

No, "Replacement Cost" coverage does not guarantee that the policy limit covers the full insurable replacement cost of the project improvements, including the units, as required by the *Selling Guide*. This coverage indicates that the building materials will be replaced with like kind and quality materials, but only up to the policy limit. The lender is still responsible for confirming the dollar amount of the policy limit is adequate.

Please note, if a master policy does not include a co-insurance provision (or the co-insurance provision has been waived as described in the *Selling Guide*), the lender can assume the policy limit is adequate.

Q9. Why does Fannie Mae require master property insurance policies to include a Building Ordinance or Law Endorsement?

Fannie Mae requires the Building Ordinance or Law Endorsement if the enforcement of any law or ordinance results in increased costs for repairs or reconstruction or additional demolition and removal costs for both damaged and undamaged portions of a covered building. Without this endorsement, the HOA would not have coverage to pay for these additional expenses in the event of a loss.

Q10. If a master property insurance policy contains a Mechanical Breakdown Endorsement, does that meet Fannie Mae's requirement regarding the Steam Boiler and Machinery Coverage Endorsement?

Yes, the Steam Boiler and Machinery Coverage Endorsement is also referred to as a Mechanical Breakdown Endorsement. It is required for projects that have central heating or cooling. The amount of

© 2017 Fannie Mae. Trademarks of Fannie Mae.

coverage per accident must be equal to the lesser of $2 million or the insurable value of the building(s) housing the boiler or machinery.

Q11. Fannie Mae announced changes to flood insurance coverage requirements on September 24, 2013 (effective for applications dated on or after February 1, 2014), stating there must be a master flood insurance policy in effect for attached condos covering all of the common elements and property (including machinery and equipment that are part of the building) as well as the individual units in the building in an amount that is at least the lower of the following:

- **80% of the replacement cost, or**
- **The maximum insurance available from the National Flood Insurance Program (NFIP) per unit (which is currently $250,000).**

Does this mean that Fannie Mae has lowered flood insurance coverage requirements from 100% to 80% of the replacement cost of the insurable value of the improvements?

No. The policy is specific to the requirements for the master flood insurance policy only. The unit allocation from the master policy still must meet the 1- to 4-unit coverage requirements listed in Selling Guide section B7-3-07, Flood Insurance Coverage Requirements, Coverage for First Mortgages.

The borrower must maintain a supplemental policy to close any gap in coverage if the attached condo project's master policy meets the minimum project-level requirements above but does not meet the unit-coverage requirements.

Q12. Does Fannie Mae require the standard mortgagee clause to be included on Residential Condominium Building Association Policy (RCBAP) flood insurance policies issued by the National Flood Insurance Program (NFIP)?

Fannie Mae requires the standard mortgagee clause, naming either Fannie Mae or the appropriate servicer, except where prohibited or otherwise instructed by government or federal policies or regulations. NFIP policies that do not include the standard mortgagee clause are acceptable to Fannie Mae. The standard mortgagee clause is required on all private flood insurance policies.

Q13. If a condo master/blanket insurance policy provides for "all-in" coverage, is an HO-6 policy for the individual condo unit necessary?

Fannie Mae does not require an HO-6 insurance policy for the condo unit when the master/blanket policy provides for "all-in" coverage. However, if the unit includes improvements or betterments that are not covered under the standard master policy coverages (i.e., Elements superior to the quality provided by the builder or elements added by the unit owner), the borrower must obtain an HO-6 policy that provides coverage for 100% of the insurable replacement cost of all interior improvements and betterments. Fannie Mae always recommends lenders closely collaborate with the insurance agent to help determine appropriate coverages.

Q14. What is meant by the term "improvements and betterments?"

The details included in the definition of "improvements and betterments" may vary by insurance carrier, but generally refer to permanent changes, alterations, or upgrades made to an individual unit. Further details and guidance should be available from the insurance agent to confirm that the HOA's master

© 2017 Fannie Mae. Trademarks of Fannie Mae.

policy, combined with the unit owner's HO-6 policy, provides sufficient coverage to restore an individual unit to its condition prior to a loss claim event.

Q15. Can Fannie Mae provide more guidance on the requirement "to restore the unit to its condition prior to a loss claim?" How should a seller/servicer determine this?

A seller/servicer should use the best known/available information to determine whether the insurance coverage provided at the loan's origination was a reasonable representation of the condition of a property at the time the mortgage loan was delivered to Fannie Mae. Examples to determine the reasonableness of coverage include, but are not limited to:

- an appraisal,
- a replacement cost estimate performed by a third party,
- the original or updated condo unit specifications, or
- an interior Broker's Price Opinion.

It is a servicer's responsibility to ensure that the borrower maintains at least the required amount of coverage throughout the life of the loan. The borrower may, of course, increase the amount of coverage.

Q16. Fannie Mae's guidelines prior to 2012 stated that if a condo master/blanket insurance policy provided only "bare-walls" coverage, an HO-6 insurance policy had to be obtained in an amount no less than 20% of the condo unit's appraised value. Under the current guidelines, how much HO-6 insurance coverage as a percentage of the unit's appraised value is required?

The amount of coverage necessary under an HO-6 insurance policy is determined as a result of collaboration between the insurer and the borrower. Fannie Mae no longer requires that the amount of HO-6 coverage equal a specific percentage of the condo unit's appraised value.

Q17. Why does Fannie Mae require the coverage under the HO-6 insurance requirements to be "determined by the insurer?" Can it be determined by some other entity or method?

Yes, it can be determined by another entity or method. When an HO-6 policy is required, the seller/servicer must ensure that the policy provides coverage in an amount that is determined from the best known/available information to the seller/servicer, including existing information from the borrower in collaboration with the insurer and the condo association.

Q18. If a seller/servicer does not maintain an escrow account for a particular mortgage loan and HO-6 insurance is required, is the seller/servicer required to escrow for HO-6 insurance?

No, if a seller/servicer does not already maintain an escrow account for a particular mortgage loan for which an HO-6 insurance policy is required, then establishing an escrow account for the HO-6 insurance is not required. However, if the seller/servicer does maintain an escrow account for that particular mortgage loan, then it must also escrow for HO-6 insurance premiums.

Q19. The Fannie Mae *Selling Guide* states that for condo master property insurance policies the maximum deductible amount must be no greater than 5% of the face amount of the policy. Occasionally, a project may have a master property insurance policy with a deductible that exceeds the 5% maximum, due to a higher per-unit deductible for named perils specific to a geographic area (e.g., ice damming). In such

© 2017 Fannie Mae. Trademarks of Fannie Mae.

cases, is it possible for a lender to accept this higher deductible on the master policy, if an HO-6 (owner's) policy is in place that covers the unit owner's possible deductible assessment above the 5% maximum?

Yes, if the deductible of the project's master policy exceeds the 5% maximum due to a per-unit deductible for named perils specific to a geographic area (where such coverage is common and customary), Fannie Mae will allow the per-unit amount of deductible over 5% to be covered under a borrower's HO-6 policy. The lender is responsible for ensuring that the HO-6 coverage (1) includes the peril(s) required, (2) will cover master policy deductible assessments levied on the unit owner by the HOA for the peril, and (3) has a sufficient limit to cover the per-unit amount over the permissible 5% limit. An HO-6 policy meeting these conditions is required to cover the per-unit deductible amount in excess of 5% even if the master policy provides coverage for the interior of the units.

Example:

- Master policy limit: $4,000,000
- Project number of units: 20
- Master policy deductible: $50,000
- Master policy separate per unit deductible for ice dam coverage: $25,000

The general deductible of $50,000 is 1.25% ($50,000/$4,000,000), so it meets the Fannie Mae requirement for a maximum of a 5% deductible. However, the ice dam deductible equates to 12.50% deductible (($25,000 x 20 units)/$4,000,000), so the policy is not compliant for delivery of a loan to Fannie Mae. The maximum per-unit deductible to meet the 5% maximum benchmark is $10,000 (($4,000,000/20) x.05). Accordingly, the unit owner must purchase an HO-6 policy that would cover the $15,000 per-unit overage in the deductible required ($25,000 – $10,000 = $15,000, should an ice dam peril affect the unit).

Q20. If a co-op master policy does not cover the interior of the units, is an HO-6 policy, in conjunction with the "bare walls" master policy, an acceptable alternative to meet the requirements?

The *Selling Guide* requires that co-op policies cover the entire project, including the individual units. If the project's master policy does not cover the unit interiors, the following criteria must be met:

- The project's legal documents must require all shareholders to maintain an HO-6 policy, and
- The lender has confirmed that the subject unit shareholder maintains an HO-6 policy that is adequate to restore the unit to the condition prior to a loss claim event.

Q21. If the insurable value of the common elements (e.g., entrance signage, lamp posts, etc.) is minimal – for example, the potential policy limit is less than or very near the cost of the standard deductible – is coverage mandatory?

If the lender determines that the insurable value of the common elements is de minimis, or close in value to any insurance deductible that would be obtainable, thereby negating a reasonable value of the insurance, the lender may document in the loan file a conclusion to proceed without insurance coverage on these common elements.

© 2017 Fannie Mae. Trademarks of Fannie Mae.