FHFA DIRECTS FANNIE MAE AND FREDDIE MAC TO UPDATE PROPERTY INSURANCE REQUIREMENTS

PLUS: FLOOD INSURANCE DURING NFIP LAPSE

Recently, Government Sponsored Enterprises Freddie Mac and Fannie Mae issued updates to the Seller/Servicer Guides at the direction of the Federal Housing Finance Agency (FHFA). These updates specify Seller/Servicer responsibilities to ensure that mortgaged real estate property is covered by adequate insurance in order to promote sustainable homeownership. These updates include the following:

Mortgages Sold to Freddie Mac

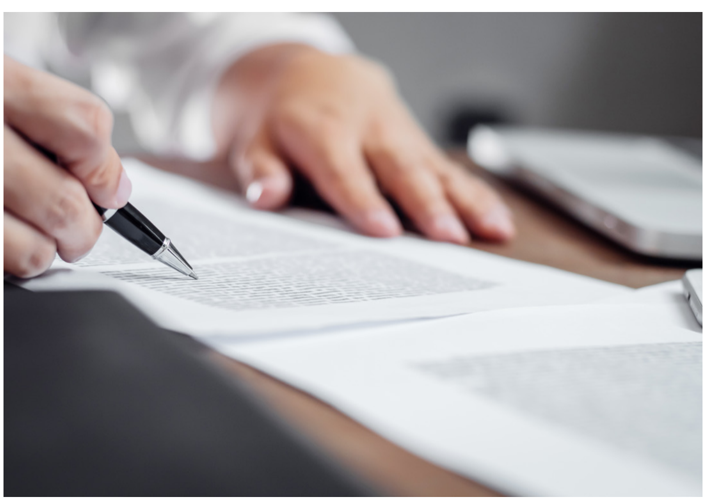
- Insurance claims must be settled on a replacement cost basis, and insurance policies that provide for claims to be settled at actual cash value or that limit, depreciate, reduce or otherwise settle losses for less than a replacement cost basis are not eligible for acceptance;
- **Sellers/Servicers must verify the replacement cost value of the mortgaged real estate property as of the current insurance policy effective date and must provide examples of acceptable replacement cost verification sources;**
- Policy limits for master condominium and cooperative projects (associations) must be at least equal to 100% of the replacement cost value of the project's improvements, including Common Elements and residential structures (units), as of the current insurance policy effective date;
- Flood insurance requirements for condominium projects (associations) must reflect the maximum coverage amount available from the National Flood Insurance Program per unit, consistent with Planned Unit Development (PUD) and Cooperative Project requirements;
- Two acceptable options for condo unit coverage are provided, depending on governing legal condo documents:
    1. Condo association insures the building and structures in the condo project as well as fixtures, machinery, equipment, and supplies maintained for the service of the condo project which may or may not include interior of the condos. Should the condo association policy not cover the interior of the units, homeowners must maintain an HO-6 unit owner policy with coverage to repair the condo unit to at least its condition prior to a loss claim.
    2. Condominium unit owners insure their condo units individually, with the homeowners association covering the common elements through a master homeowners association policy.
- A master or blanket insurance policy that combines insurance coverage for multiple unaffiliated condo projects or associations is allowed provided that each

covered association has a dedicated policy limit and a specific deductible that does not exceed 5% of the building coverage. Also, the policy must clearly state that each association is a named insured, and the policy limits must cover the full replacement cost required for the common elements and if required, the condo units.

Mortgages Sold to Fannie Mae

For one-to-four-unit properties and master property insurance policies for project developments:

- Clarifying that actual cash value coverage on insurance policies is unacceptable and emphasizing policies that limit, depreciate, reduce or otherwise settle losses at anything other than a replacement cost basis are also not acceptable.
- The lender and servicer are responsible for verifying that the coverage meets Fannie Mae's requirements as of the current insurance policy effective date:
    1. 100% of the replacement cost value of the improvements; or
    2. The unpaid principal balance of the loan, provided that the coverage equals no less than 80% of the replacement cost value of the improvements.
- **The lender or servicer must verify the coverage amount is not less than the minimum required as described above, and the replacement cost value verification source can be the property insurer, an independent insurance risk specialist, or other professional with appropriate resources to make such determination.**



For master property insurance coverage on condo project developments:

- Homeowners association legal documents determine whether the applicable requirements are those for individual property insurance and/or those for master property insurance policies.
- When a master property insurance policy is required by the legal documents, the lender/servicer must verify that the policy provides coverage for both the common elements and residential structures (units). Should the master policy not cover the residential structures (units), the borrower must maintain an individual unit owner policy that meets the requirements of Fannie Mae.
- Master property insurance policies must provide for claims to be settled on a replacement cost basis. Policies that provide for claims to be settled on an actual cash value basis are not acceptable.
- Master property insurance coverage should be written on a "Special" coverage form or equivalent with coverage to be included by a commercial "Broad" coverage form with the following required perils: fire, lightning, explosion, windstorm (including named storms), hail, smoke, aircraft or vehicles, riot or civil commotion, vandalism, sprinkler leakage, sinkhole collapse, volcanic action, falling objects, weight of snow, and water damage.
- Should any of the above perils be excluded or limited in the master property insurance coverage, the homeowners association must obtain an acceptable stand-alone property insurance policy which provides adequate coverage for the limited or excluded peril.
- The Selling Guide provides the ability for the lender/servicer to have a property insurance policy that covers multiple unaffiliated condo associations provided that a dedicated coverage amount be listed for each individual covered association and the coverage for each insured association be sufficient to cover the full replacement cost of the association as well as improvements including the common elements and residential structures.
    - The lender/servicer must review the insurance policy and any other associated documents needed to adequately evaluate the insurance coverage.

    - The association must be protected in the same manner as if it maintained a master property insurance policy.
    - Lender/servicer must document how they determined the applicable policy provided acceptable coverage as detailed above. A copy of the policy, along with lender's/servicer's documentation must be maintained in the loan file.
- The Servicing Guide requires that on an annual basis the master insurance coverage maintained for a condo association meet the requirements outlined in the Servicing Guide, which specifies that acceptable evidence of master insurance policies for a condo association can include either:
    - A copy of the current master policy and endorsements, and a certificate of insurance showing the individual unit securing the mortgage loan is covered under the policy;
    - A blanket insurance policy which covers every project in which the servicer services Fannie Mae mortgage loans, with the premium borne by the servicer as a corporate expense; or
    - An insurance policy maintained by the servicer which provides "wall-in" coverage as well as loss assessment coverage as needed in the event of an uninsured loss for all Fannie Mae condo mortgage loans serviced by the servicer.

Seller/Servicer Verification of Replacement Cost Value

As indicated above, the GSEs have made clear that the 100% replacement cost value used within the minimum coverage requirement must be verified by the lender/servicer. The GSEs indicate that this verification may be made by the property insurer, an independent insurance risk specialist, or other professional with appropriate resources to make such determination. Should the coverage amount not meet the minimum required coverage required by the GSE, lenders/servicers must obtain the minimum required coverage.

OSC is in the process of making needed changes within its operations to include a solicitation attempt in obtaining the replacement cost value from the insurance agent, should it not be readily available in the insurance policy documents. After such an attempt by OSC, should this value not be made readily available to OSC, lending clients' assistance to verify and/or provide a property's replacement cost value will be necessary in meeting the current Fannie and Freddie requirements. We stand ready to work with our clients in revising current procedures as required by June 1, 2024.

Requirements for Flood Insurance During a National Flood Insurance Program Lapse

The National Flood Insurance Program (NFIP) may lapse due to a shutdown of the federal government or if Congress does not renew the NFIP's authorization to issue new policies, increase coverage on existing policies, or issue renewal policies.

For the duration of such a lapse, a lender may sell to Fannie Mae where flood insurance is otherwise required without an active flood insurance policy provided the following requirements are met:

- Lenders/servicers must have a process in place to identify properties securing loans sold to Fannie Mae without proper evidence of active flood insurance on the conditions that the borrower must provide acceptable evidence of:
    1. a completed application for NFIP flood insurance and proof of the premium payment, or the final settlement statement reflecting payment of the initial premium, or
    2. the assignment of an existing NFIP flood insurance policy from the property seller to the purchaser.

Fannie also provides certain requirements related to a refinance of a mortgage loan where there is a current and/or an eminent lapse in the NFIP.