HYATT & STUBBLEFIELD, P.C.

The Client Letter

Volume XXII • Fall Edition 2009

This newsletter addresses current issues and developments in the law relating to development of planned communities. It is published periodically for distribution to clients and friends of Hyatt & Stubblefield, P.C., Attorneys and Counselors. The information presented is not intended as specific legal advice to any person. Principles of law expressed in this newsletter are subject to change from time to time.

Hold It: The Importance of Holding Meetings

This article and the article on page 3 regarding taking minutes are the first in a series on how developers can stay smart, organized, and on top of their corporate responsibilities during the period of developer control and avoid some pitfalls and hazards common in today's tough economic climate.

Because of today's adverse economic conditions, developers often remain in control of communities much longer than originally anticipated and have become more regularly involved in the day-to-day operation and business of condominium and homeowners' associations. In fact, a developer's responsibility for observing corporate formalities, executing its fiduciary duties, and making sure that every '*i*' is dotted and '*t*' is crossed begins the very day an association is incorporated. The individuals appointed by the developer to the association's board of directors during the developer control period are now increasingly accountable for holding association meetings, ensuring corporate compliance, and documenting proper approvals of actions, tasks that may at first seem trivial, but can have far-reaching consequences if not done properly or done at all.

An association's board of directors is required, above all, to hold meetings – both an annual meeting of the association's members as well as regular meetings of the board of directors. The community's governing documents and applicable state nonprofit corporation code may impose specific requirements for these meetings, including timing, notice requirements, and agenda items. At the annual meeting of the members, owners may or may not be entitled to elect directors, but a minimum, the nonprofit corporation code generally requires that the directors report to the members on the association's activities and financial condition. Although there may be little to report, a written record should be established to show that the required meetings were held each year.

The association's board of directors is also generally required to meet with some regularity. Directors should recognize, however, that regardless of whether board meetings are required to be held on a regular basis, the directors must ensure that all actions taken by or on behalf of the association have been properly authorized by the board. The best way to ensure proper authorization is to hold a board meeting and adopt resolutions authorizing the actions. Decisions generally should not be made on an ad hoc basis, with later attempts to ratify those decisions. It is very difficult to recall after the fact every action that should be authorized by the board and documented.

The absolute importance of holding meetings cannot be overemphasized, especially in these current troubled times for developers. Neglecting to hold meetings or observe what may be perceived as mere formalities has recently become a widespread problem plaguing many communities and their developers, particularly as control of an association is transferred to the owners. The more missteps that occurred or responsibilities overlooked throughout the period of developer control, the more the owners, likely suffering financially themselves, will be emboldened to question, criticize, and even challenge a developer's and individual directors' authority and decisions, both past and present. If a director cannot show that his or her actions were properly authorized, it is difficult to defend a claim for breach of fiduciary duty, which can lead to individual liability for the director.

In this Issue…

Do Your Condominium Association Operations Meet Current Mortgagee Standards?

Heightened lending standards in the U.S. has meant not only that borrowers have to meet stricter credit standards, but condominium association operations have come under heightened scrutiny as well. The standard is being set by Fannie Mae and Freddie Mac, who both issued new underwriting guidelines this year.

The Federal National Mortgage Association ("Fannie Mae") and the Federal Home Loan Mortgage Corporation ("Freddie Mac") remain the largest purchasers of home mortgages on the secondary mortgage market, despite the financial crisis faced by these organizations over the past year.

If a borrower, the mortgage product, and the home securing the mortgage do not meet Fannie Mae or Freddie Mac's standards, the mortgage is deemed non-conforming. It is extremely difficult, if not impossible, for mortgage lenders to sell non-conforming mortgages on the secondary mortgage market. Banks have traditionally been loath to hold on to mortgages because it reduces the credit they have to make new loans, and therefore, it can be difficult and more costly to obtain a non-conforming loan. If the home that is to be collateral for the loan is the problem causing the loan to be non-conforming, the buyer may choose to look for a home elsewhere.

The Fair Housing Administration ("FHA") also issued new underwriting standards this year that must be met for FHA-back loans. FHA is the largest insurer of mortgages in the world. This mortgage insurance helps low- and moderate-income families purchase homes by allowing the borrower to finance more than 80% of the purchase price and some of the closing costs.

Not only must the home itself meet certain criteria, but the condominium association managing the project in which the home is located must also meet certain standards. The following is an outline of some of standards that must be met.

Association Budget. The lender must review the association's budget to determine that it is adequate and includes allocations for line items pertinent to the type of condominium. The budget must provide adequate funding for insurance deductible amounts that may be incurred during the year.

Reserve Fund. At least 10% of the association's annual budget must be set aside to fund replacement reserves for capital expenditures and deferred maintenance. In addition, in a mixed-use condominium containing residential and non-residential units, operating reserves of at least three months of operating expenses are required.

Delinquencies. No more than 15% of the total units in the project may be 30 days or more past due in assessments. This is particularly a problem in today's economy where many homeowners are facing financial problems and/or foreclosure. An association with a high delinquency rate may be able to mitigate the problem by showing that it is actively pursuing delinquent homeowners.

Investor Ownership. No single entity, individual, or investor group may own more than 10% of the total units in the project. In the case of a project containing fewer than 10 units, no single owner may own more than one unit. While the developer is not counted for this purpose during the initial marketing period, FHA does count any units owned by the developer if the developer is renting unsold units.

Reserve Study. FHA requires that a reserve study be performed every 12 months to assure that adequate funds are available for funding capital expenditures and maintenance.

Marketing. If the developer intends to market five or more units within a 12-month period with FHA mortgage insurance, an Affirmative Housing Marketing Plan or Voluntary Affirmative Marketing Agreement must be in place.

Buyer Incentives. Freddie Mac will consider a project to be ineligible if the builder, developer, or property seller is offering contributions that may affect the value of the unit being used as collateral for the loan. Examples of prohibited contributions include payments of principal, interest, taxes, insurance or association assessments on behalf of the buyer, rentbacks or leasebacks, and other contributions from the seller not disclosed on the HUD-1 Settlement Statement.

Insurance. Fannie Mae requires that the association insure all of the general and limited common elements in the project, including fixtures, building service equipment, and common personal property and supplies belonging to the association. The association is also required to insure fixtures, equipment, and other personal property inside the units if these items are included in the purchase price or otherwise financed by a mortgage Fannie Mae purchases or securitizes, whether or not the property is part of the common elements. The insurance must cover 100% of the insurable replacement cost of the project improvements as well as the individual condominium units. The maximum permitted deductible amount for policies covering the project improvements in general must be no greater than 5% of the face value of the policy. The maximum deductible related to the individual unit should be no greater than 5% of the replacement cost of the unit.

Fidelity Bond. Fannie Mae requires that an association for a condominium project containing 20 or more units have blanket fidelity insurance coverage for anyone who either handles or is responsible for funds the association holds or administers. The association must the named insured, and the premiums should be paid as a common expense by the association. A management agent that handles funds for the association should be covered by its own fidelity insurance policy. The fidelity insurance policy must cover the maximum funds that are in the custody of the association or its management agent at any time. A lesser amount of coverage may be acceptable if certain financial controls specified by Fannie Mae are met.

Pre-Sale Requirements for New Projects. This is probably the most controversial requirement and applies to condominium projects where fewer than 90% of the total units have been conveyed to purchasers, the project is not fully built, or the developer is still in control of the association. Freddie Mac has the most stringent requirement, requiring that at least 70% of the total number of units in the project have been conveyed or are under contract to purchasers other than the developer or a successor developer who occupy or will occupy their units as primary residences or second homes. Fannie Mae and FHA's requirements are not as stringent. Fannie Mae requires that at least 51% of the total units in the project, and FHA requires that at least 50% of the total units in the project, be conveyed or under contract to purchasers who occupy or will occupy their units as primary residences or second homes. However, FHA does not permit a second home to be counted if the home is used primarily for recreational purposes and enjoyment. In phased project, the phase containing the unit serving as collateral for the mortgage must meet the pre-sale requirement as well as all phases combined.

This standard can be very difficult to meet in today's market, where sales are often few and far between, and represents a significant increase over previous pre-sale requirements. It has also been controversial because it favors resale homes over new condominiums. This past summer, Representatives Barney Frank (D-Massachusetts and Chairman of the House Financial Services Committee) and Anthony Weiner (D-New York) called on Fannie Mae and Freddie Mac to "make appropriate adjustments" to their underwriting requirements for new condominiums. Fannie Mae and Freddie Mac assert that the new standards are not as taxing as some claim because developers may qualify for exemptions to the new policies in certain instances by going through a project approval process.

The Fannie Mae, Freddie Mac, and FHA standards do not apply to all condominium mortgage loans. Each organization has a loan limit in order to qualify for programs or benefits from organization insured or backed loans. Fannie Mae's and Freddie Mac's standard loan limit for 2009 is $417,000. FHA's standard loan limit is $271,000. Each organization has higher caps for designed high cost areas. Fannie Mae's loan limit for high cost areas ranges from $625,500 to $938,250. The loan limit for designated high cost areas for Freddie Mac is $625,500 and for FHA is $729,750.

While there may be nothing that can be done with regard to pre-sale requirements, developers can comply with other mortgagee requirements, such as obtaining appropriate insurance and proper assessment funding, to ensure that sales of new condominiums are not hampered. If you would like more information about these or other mortgagee requirements, please let us know.

Hey, Wait a Minute: The Importance of Taking Good Minutes

Due to the fact that developers today often remain in control of communities much longer than originally anticipated, developers or their appointees to the association's board of directors, are now increasingly responsible for holding association meetings, ensuring corporate compliance, and documenting proper approvals of actions. This includes recording minutes for membership meetings and board meetings, no easy task for people who may not necessarily have any experience taking minutes. In fact, although an association's minutes may seem like a small thing, they are perhaps the most significant component in assuring that an association's board of directors gets the full benefit of a court's presumption that the directors acted in the best interests of the association and the association's members, the homeowners.

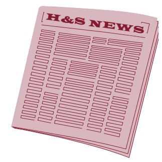
A member of the association's board of directors owes the association and its members his or her fiduciary duty, which is comprised of the duty of care, the duty of loyalty, and the duty to act in good faith. The duty of care requires the directors to exercise the level of care that a person in a similar situation would have exercised under the same or similar circumstances, and the duty of loyalty prohibits self-dealing. In reviewing the actions of an association's board of directors, courts have adopted a standard of judicial review referred to as the "business judgment rule," which grants the directors a presumption that the board acted independently with due care, in good faith, and in the honest belief that its actions were in the best interests of the corporation's members. This presumption requires the existence of an established record supporting the actions taken by the

(Continued on page 4)

(Continued from page 3)
association's directors, a record evidenced primarily by and in the minutes of meetings.

Developers should, therefore, be fully apprised of the critical importance of recording minutes in a clear, detailed, and comprehensive manner. Simply noting all motions and resolutions is inadequate. Rather, background information relevant to the directors' decisions should always be included and attached as exhibits to the minutes when applicable. Materials presented to the board influencing or supporting its decisions should also be attached as exhibits or at least thoroughly referenced and copies of the materials retained for easy future reference. Although minutes are generally a record of all actions and proceedings rather than a record of discussions transcribed verbatim, they should still be sufficiently detailed to provide a thorough explanation of all that transpired during the meeting. However, the recorder's personal opinions, interpretations, or comments, and any descriptive or judgmental phrases, should not be included. Finally, the association's minutes should be prepared, reviewed, and approved in an expeditious manner, rather than being filled out at a later time in a cursory way.

Ultimately, unless the developer's appointees to the association's board of directors get into the habit of taking comprehensive, even exhaustive, minutes, supplemented and validated by background information and materials as exhibits or references that the board considered prior to making a decision, the developer could risk litigation and a finding that the individuals breached their fiduciary duty to the association and the owners.



Inside News

- Check out the blog on our website at hspclegal.com for articles and helpful information.
- Wayne Hyatt and Jo Anne Stubblefield have been named to *The International Who's Who of Real Estate Lawyers 2009*.

We would be pleased to send **The Client Letter** to friends and business associates who you feel would benefit from receiving it. Just send our office a note with their names and addresses or give us a call at 404-659-6600.

HYATT & STUBBLEFIELD, P.C.
Peachtree Center South Tower
225 Peachtree St., N.E., Suite 1200
Atlanta, Georgia 30303