HYATT & STUBBLEFIELD, P.C.

The Client Letter

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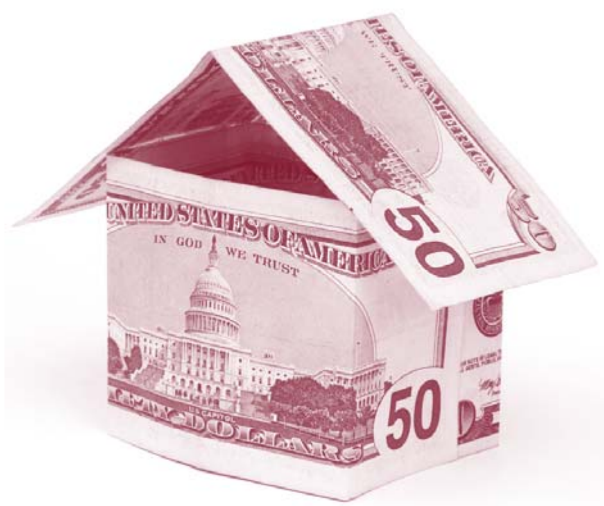
This newsletter addresses current issues and developments in the law relating to development of planned communities. It is published periodically for distribution to clients and friends of Hyatt & Stubblefield, P.C., Attorneys and Counselors. The information presented is not intended as specific legal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

The Secondary Mortgage Market: What is it and How Does it Impact Mortgages on Units in Your Community?

The news today is full of stories about the mortgage crisis and the difficulty that many homebuyers are having in getting mortgages. Some recent changes have occurred in the secondary mortgage market that may impact the types of mortgage products that may be available to buyers in your community, whether initial purchases or resales. Most of these changes affect condominiums only, but a few apply to planned communities with single family homes. In addition, industry reports indicate that, irrespective of the latest legal changes, banks that have lost billions because of bad debts are now reverting to strict lending standards that have not been seen in 20 years or more.



First, let's discuss the entities other than banks involved and their involvement with home mortgages. The bulk of the changes discussed in this article have been made by the Federal National Mortgage Association ("**Fannie Mae**") and the Federal Home Loan Mortgage Corporation ("**Freddie Mac**"). The names Fannie Mae and Freddie Mac are often mentioned, but not many people actually understand the role these organizations play in the marketplace. Fannie Mae was created by Congress in 1938 at a time when millions of Americans could not buy homes, or risked losing their homes, due to the lack of a consistent supply of mortgage funds. Fannie Mae was established to expand the flow of mortgage funds across the country and to provide liquidity to the mortgage market.

In 1968, Fannie Mae was converted to a private, shareholder-owed corporation with a public mission, funded solely with private capital raised from investors on Wall Street and around the world. Fannie Mae buys mortgages from banks and mortgage companies on the secondary mortgage market, pools the mortgages, and sells them as mortgage-backed securities to investors on the open market. This secondary mortgage market helps replenish the supply of money available for mortgages and ensures continued availability of money for new home purchases. In 1970, to provide competition in the secondary mortgage market, Congress chartered Freddie Mac as a private corporation to compete with Fannie Mae in the same business.

Fannie Mae and Freddie Mac, as the two largest purchasers of home mortgages on the secondary mortgage market, impose requirements that must be met before

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mortgages will be eligible for purchase by Fannie Mae or Freddie Mac. If a project or borrower does not meet Fannie Mae or Freddie Mac's requirements, then the lender may decide to not offer the loan, charge a higher rate of interest, require a larger down payment, or impose other requirements.

Two additional entities that often come up in a discussion of unit mortgages are the Federal Housing Administration ("**FHA**") and the Department of Veterans Affairs ("**VA**"). The VA guarantees loans, provides mortgage insurance, and makes direct loans to qualified veterans. FHA operates under the U.S. Department of Housing and Urban Development and is the largest insurer of mortgages in the world. FHA mortgage insurance encourages lenders to extend affordable mortgage credit to buyers who do not meet conventional loan underwriting requirements and helps low- and moderate-income families purchase homes by keeping the initial costs down. For example, FHA mortgage insurance allows borrowers to finance up to 97% of the home loan and some of the closing costs. FHA sets limits on the maximum amount of the loan, which limits vary by region across the county. As of February 18, 2008, the standard single home limit was $200,160, and the limit for a single home in a "high cost area" was $362,790.

Each of these organizations imposes requirements for a project's legal documents to protect the rights of mortgagees. For projects that are still in the planning stages, we can discuss compliance with the latest requirements before those documents are recorded. The legal documents for existing projects likely complied with the requirements in effect at the time the documents were recorded. There is no requirement that a project revise its legal documents in order to comply with any new or changed requirements, so this article will not address the current legal document requirements. However, many of the former requirements have been eliminated, so the legal documents for an existing project may contain more protections for mortgagees than are required. If you are planning other amendments to your legal documents, you may want to consider updating your mortgagee protection provisions to get rid of any requirements that are no longer applicable. We are happy to consult with you on this matter. This article will instead discuss several operational requirements which apply regardless of whether the project is an existing or new project.

Reserve Funds (Fannie Mae, Freddie Mac, VA). Every condominium project and master planned community that contains a condominium project must have a reserve fund. At least 10% of the association's total annual budget must be put into the reserve fund. The VA takes this requirement one step further for condominium projects and requires that an "adequate" reserve fund be established to ensure periodic maintenance, repair, and replacement of the condominium common elements. This requires additional scrutiny of the budget, and a 10% annual contribution may not be sufficient for some projects.

Delinquencies (Fannie Mae, Freddie Mac). Not more than 15% of the units in a condominium project or in a master planned community that contains a condominium project may be more than one month delinquent in the payment of association assessments.

Private Street Maintenance (Fannie Mae). If a project (any kind of project – planned community or condominium), or a specific phase within a project, is located on a privately owned street, a written agreement or covenant for the maintenance of the street must be in place, unless state law imposes specific standards for maintaining private streets. For a planned unit development, this requirement will be met if the private street is conveyed to the homeowners association as common area and the covenants for the project (declaration of covenants, conditions and restrictions; community charter; or similar document) require that the homeowners association maintain the common area. Likewise, in a condominium project, the requirement will be met if the street is made a part of the condominium common elements and the declaration of condominium or similar document requires the condominium association to maintain the common elements. However, if the street is owned by a third-party private entity, a written agreement or covenant must be in place which addresses the rights of the parties, responsibility for maintenance and the costs of such maintenance, and default remedies in the event the party responsible for providing the maintenance fails to properly maintain the street.

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.

Utility Metering (Fannie Mae). For established condominium projects, Fannie Mae requires that the individual condominium units must be separately metered or sub-metered or that there be a plan in place that can be readily adopted for separate metering or sub-metering of the units.

Investor Ownership (Fannie Mae, Freddie Mac, FHA). Except for the project developer, no single entity (the same individual, investor group, partnership, or corporation) may own more than 10% of the total number of units in a condominium project.

Ownership of Amenities & Facilities (Fannie Mae, Freddie Mac). Fannie Mae requires that all of the facilities "related to the [condominium] project" be owned by either the unit owners or the condominium association. The developer may not retain any ownership interest in any of these facilities. In addition, the amenities and facilities for a condominium project (including parking and recreational facilities) may not be subject to a lease between the unit owners or the condominium association and any other party.

Freddie Mac requires that the developer not retain any ownership interest in a condominium project or a master planned community containing a condominium once control of the project has been turned over to the homeowners. In addition, Freddie Mac requires that the unit owners be the sole owners of and be the sole users of the common areas, including, but not limited to, all buildings, roads, parking and amenities. "Amenities" for purposes of this requirement means a portion or type of common area that enhance project attractiveness and owner enjoyment, even though the feature is not essential to the project's use. Examples given by Freddie Mac include swimming pools, spas, gardens, beach access, golf courses, and ski areas.

Non-Incidental Business Operations (Fannie Mae, Freddie Mac). Fannie Mae does not permit a condominium association to own or operate non-incidental business operations, such as a restaurant, spa, or health club. In addition for a condominium project or a master planned community containing a condominium project, Freddie Mac does not permit the association to receive more than 20% of its income from sources other than dues and assessments.

Mixed-Use Condominiums (Fannie Mae, Freddie Mac). No more than 20% of the total square footage of the condominium project can be used for nonresidential purposes. In addition, Freddie Mac requires that any commercial space within a condominium project must be compatible with the overall residential nature of the project.

Contiguous Land (Freddie Mac). A condominium project must be located on one contiguous parcel of land, although a public street may run through the project.

Presale Requirements (Fannie Mae, Freddie Mac, FHA). For condominium projects, at least 51% of the total number of units in the project, and at least 51% of the total units within any specific phase, must have been conveyed (or be under contract to be sold) to purchasers who occupy or intend to occupy the units as their principal or primary residence or as a second home.

Leasing Limitations (Fannie Mae, Freddie Mac, FHA). For condominium projects, at least 51% of the total number of units in the project must be owned (or be under contract to be sold) by owners who occupy or intend to occupy the units as their principal or primary residence or as a second home. There are several exceptions to this requirement, so an individual purchaser may be able to work around this requirement. In addition, buyers who are purchasing the property as an investment and intend to rent the property may not qualify for a conventional condominium mortgage in the first place. However, you should be aware that, if a condominium project is predominantly owned by investors who rent their units, it may be more difficult for a buyer who intends to occupy the home to obtain a conventional condominium mortgage.

Project Management and Maintenance (Freddie Mac). Freddie Mac requires that the project must be demonstrably well managed and in good financial and physical condition. Any contract for professional management of the project must also be for a reasonable term and include equitable provisions for termination.

If you have any questions about the mortgagee requirements or would like to discuss how the mortgagee requirements apply to your community specifically, please give us a call and we will be happy to discuss it with you.

FCC Adopts New Rules Regarding Use of Exclusive Contracts for Cable Providers

Many cable and satellite television providers have been requiring that developers, community associations, and condominium associations sign exclusive contracts before they are willing to make the investment to install equipment and run cabling to the building or to the new subdivision. The video service providers are looking for a guarantee on the return of their investment by requiring that everyone in the community subscribe to the particular service offered by the service provider. These contracts sometimes try to prohibit residents in the community from using any other service provider during the term of the contract, which can last for many years.

On October 31, 2007, the Federal Communications Commission ("**FCC**") adopted a report and order banning the use of exclusivity clauses in contracts for the provision of video services to multiple dwelling units ("**MDUs**"), which includes apartment buildings, condominium buildings, and cooperatives. In addition, the definition of "MDU" has been extended for purposes of the new rule to include other types of centrally managed real estate developments, such as gated communities, mobile home parks, and other developments where residents share some common spaces requiring central management (such as a community with common area governed by a homeowners association). The new rule went into effect on February 6, 2008. It prohibits the enforcement of existing contracts and the execution of new contracts that grant a multichannel video programming distributor ("**MVPD**") the exclusive right to provide any video programming service (alone or in combination with other services provided to the MDU).

The FCC found that nearly 30% of all Americans live in MDUs and that this number is growing. FCC Chairman Kevin Martin said that the FCC was urged to act by consumer groups as basic cable rates increased by 93% since 1996 when cable companies were largely deregulated. According to Commissioner Jonathan Adelstein, basic cable rates were 17% lower where cable competition is present. The FCC found that any benefits to consumers by agreements that grant exclusive rights to particular cable operators are outweighed by the harm to competition and broadband deployment. The FCC's authority to regulate cable operators is derived from Section 628 of the Communications Act of 1934, 47 U.S.C. § 548 (the "**Act**"). The purpose of Section 628 is to promote the public interest, convenience, and necessity by increasing competition and diversity in the multichannel video programming market and to spur the development of communications technologies.

Exclusivity clauses in contracts protect cable operators or local exchange carriers ("**LECs**") and other wire-based MVPDs that bring satellite broadcast programming to their subscribers. FCC rules already in place protect satellite-based video service providers, but wire-based providers previously did not receive the same protection. Exclusivity clauses typically are a complete bar to entry into MDUs by fiber-deploying cable operators, such as Verizon, AT&T, and Qwest. Exclusive contracts did not prevent residents from installing satellite dishes, but they did prevent new wire-based competition. The FCC found that LECs and other wire-based providers have begun entering the video service business on a large scale, particularly where bundled service packages are offered, such as one providing voice, video, and broadband Internet service. However, incumbent cable operators are still by far the dominant force in the MVPD business with a market share recently measured at 67%.

Only MVPDs covered by Section 628(b) of the Act are covered by the new rule, and the rule does not reach Direct Broadcast Satellite ("**DBS**") or private cable operators ("**PCOs**") because an adequate record has not been established for the FCC to determine whether such a prohibition is warranted. PCOs (also known as Satellite Master Antenna Television providers) are video distribution facilities that use closed transmission paths without using any public right-of-way. PCOs acquire video programming and distribute it via terrestrial wiring in urban and suburban MDUs and commercial multiple tenant units, such as hotels and office buildings. They are small compared to the major incumbent cable operators and LECs.

The new rule does not require that any new entrant be given access to a MDU. A MDU owner still retains any rights it may have under state law to deny a particular provider the right to provide service to its property. For example, if a condominium association owns the wiring within a condominium building or the condominium unit owners own such wiring as tenants-in-common, the rule does not grant any new cable operator the right to use the privately-owned wiring, and the condominium association can continue to enter into contracts for the exclusive use of such wiring. However, any exclusivity clause in an existing contract between the condominium association (or the condominium developer) and the existing cable provider that prohibits the condominium association and/or individual unit owners from obtaining services from other cable service providers is unenforceable.

The FCC is seeking comment on whether it should address exclusivity clauses entered into by DBS providers, PCOs, and other MVPDs not covered by Section 628 of the Act. The FCC is also seeking comment on whether it should prohibit exclusive marketing and bulk billing arrangements. A typical bulk billing arrangement is where there is a contract between a condominium association, homeowners association, or apartment building owner and a cable or satellite provider. The association or apartment owner is obligated to pay the service provider a fixed fee per unit in the MDU, regardless of whether the resident uses the service. If the resident desires to use another service, the resident has to continue to pay the association or apartment owner the fixed fee under the bulk billing arrangement as well as a subscription fee to the new service provider chosen by the resident. The FCC will conclude this rulemaking and issue an order on the matter by early August.

Who Holds the Developer Rights?

Developers often create special purpose entities to develop and construct a community. The development entity may be an affiliate or subsidiary of the development company, or it may be a joint venture or similar entity owned by the developer and its partners on a particular project. Developers also often have separate home building companies that are separate from the overall project developer but still affiliated with the development company. It is important in situations where multiple entities are involved to keep the names straight since different entities may hold different rights in the community.

One of the problems that may occur when the proper party name is not used is illustrated in *Gulf Bay Land Investments, Inc. v. Trecker*, 955 So. 2d 1157 (Fla. Dist. Ct. App., 2nd Dist., 2007). In this case, Westinghouse Communities of Naples, Inc. ("**WCN**") was the original developer of the Pelican Bay Planned Unit Development, and it held architectural control rights over all of Pelican Bay pursuant to the 1990 protective covenants filed by WCN. The defendant development entities (collectively, "**Gulf Bay**") purchased land in Pelican Bay from WCN for the purpose of building the Waterpark Place neighborhood to be comprised of four luxury high-rise residential condominiums. Gulf Bay constructed two of condominiums, and the plaintiffs in the case were owners or residents of these two condominiums. They later decided to scrap the plans for the two remaining condominiums in favor of constructing one larger building with twin towers. To achieve their goal, Gulf Bay amended the Waterpark Place development plans, and commenced construction. Two years after construction had begun, the plaintiffs filed suit seeking a permanent injunction barring the construction of the new building.

The revised development plans clearly violated the setback requirements contained in the 1990 Pelican Bay protective covenants. At issue in the case was whether Gulf Bay properly obtained a waiver of the setback requirements from WCN or its successor. The court determined that it did not. The waiver letter was sent by the Administrator of Design Review of WCI Watermark Communities Inc. ("**WCI**"). No where in the letter does it indicate that WCI was a successor of WCN, and Gulf Bay was unable to provide evidence at trial that WCI had acquired any of WCN's developer rights, particularly its rights of architectural control. Therefore, the court found the setback waiver letter to be invalid, and a permanent injunction barring construction of the building was granted.

It can be very easy to confuse entity names, particularly when names may be very similar, but it is important to keep the names straight. It is also best to create letterhead for a special purpose development entity and use it when sending correspondence on behalf of the developer. If you have a branded logo or operating name, it is acceptable to include that logo or common operating name on the letterhead, but make sure that the correct legal name of the developer is clearly identified on the letter. The same holds true if a different entity is the manager or operator of the developer. For example, the general partner or manager of ABC, LLC, the developer, may be XYZ Corp. While employees of XYZ may be sending out the correspondence, it is important to remember that they are doing so on behalf of ABC, and it should be clear that the letter is either coming from ABC or from the manager for ABC.

Also, when development rights are transferred to a successor, it is important to document this transfer. Some covenants may require that the transfer of rights be recorded in the county land records before a successor may be recognized, so it is important not only to prepare the internal corporate paperwork to document the transfer but also to check the community governing documents for other requirements that may exist.

Inside News

- Jo Anne Stubblefield was the faculty chair for a two-day continuing education seminar entitled "Drafting Documents for Residential and Mixed-Use Condominiums and Planned Communities" sponsored by the American Law Institute-American Bar Association in New Orleans in February.

- Wayne Hyatt served as chair and faculty member a course sponsored by the American Law Institute-American Bar Association entitled "Conservation and Preservation Easements and Community Stewardship Entities" in San Diego in March.

- David Herrigel and Jan Bozeman presented a program entitled "Community Governance and Documentation for Age-Restricted Communities" at the Building for Boomers and Beyond: 50+ Housing Symposium sponsored by the National Association of Home Builders in New Orleans on May 19-21, 2008.

- Congratulations to Ashley Smith, who graduated from Georgia State University on May 10, 2008. Ashley earned a Bachelor of Arts in Speech Communications.

- Hyatt and Stubblefield participated in the Atlanta Legal Aid Society 2007 Run for Justice in the fall. Pictured at the left are participants: (front row left to right) Jan Bozeman, Ryan Smith, and Rebecca Glatzer; (back row left to right) Ashley Smith, Thad Woody, David Herrigel, and Kristi Smith.

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