REES BROOME, PC

COMMUNITY ASSOCIATIONS NEWSLETTER

Resales, Lender Questionnaires, and the "Ineligible Projects" List

September 2024

By: Winta Mengisteab

As community associations continue to adapt to new resale requirements, lengthy lender questionnaires, and the dreaded "blacklist" of projects deemed ineligible for financing, we strive to find ways to support our clients. This article aims to provide an overview of the requirements and provide suggestions for how managers and boards can try to serve their members' interests.

Resale disclosure/certificate requirements are dictated by statute in D.C., Maryland, and Virginia. In D.C., the relevant statute is Section 42-1904.11 of the D.C. Condominium Act. Referred to as a "certificate", Section 42-1904.11(a) provides a list of nine (9) "statements" that must be included in the resale package along with the condominium instruments, all of which are due within ten (10) days of receipt of a written request from a unit owner or purchaser. The "statements" focus on disclosures related to the financial condition of the association and the state of the common elements and the unit in question. For example, the resale certificate must include a statement of any approved capital expenditures that are not reflected in the current operating budget, as well as the status and amount of any reserves and any portion of such reserves earmarked for any specified project. Section 42-1904.119(a) also requires the typical disclosures regarding the status of any pending suits or judgments that the association is party to, the insurance coverage maintained by the association, and any covenant violations against the unit.

In Virginia, many of you already went through the painstaking process of revising your resale certificates to conform to the Resale Disclosure Act, which became effective July 1, 2023. The Resale Disclosure Act consolidated all resale requirements into one statute and replaced all the prior resale disclosure provisions in the Virginia Condominium Act and the Virginia Property Owners' Association Act. The Resale Disclosure Act requires associations to provide a "resale certificate" in a prescribed form and order that includes a list of thirty (30) items/disclosures. As with the D.C. statute, the VA resale certificate contains information/materials related to the association's financial health and the property condition, but many of its disclosures are related to applicable use restrictions, such as whether there are parking or vehicle restrictions, or existing restrictions on the installation of solar energy collection devices. The association must deliver the resale certificate within fourteen (14) days after a written request by a seller or seller's agent. The Resale Disclosure Act also caps the fees that may be charged for the resale certificates, which fee is established and published by the Common Interest Community Board.

1900 Gallows Road • Suite 700 • Tysons Corner, Virginia 22182 • (703) 790-1911 • Fax: (703) 848-2530
7101 Wisconsin Avenue • Suite 1201• Bethesda, Maryland 20814 • (301) 222-0152 • Fax: (240) 802-2109
1602 Village Market Blvd SE Suite 385 Leesburg, Virginia 20175 • (703) 790-1911 • Fax: (703) 848-2530
www.reesbroome.com

For Maryland condominiums, the resale contract requirements are found in Section 11-135 of the Maryland Condominium Act. The association's obligation to furnish a resale certificate can be found in subsection (c) of the statute, but Section 11-135(a) is where you will find the specific contents for the resale package for condominiums that contain seven or more units. In addition to providing a copy of the condominium instruments, the certificate essentially includes fifteen (15) statements. The disclosures are very similar to the D.C. disclosures and concentrate on the financial health of the association and property conditions. Section 11-135 also includes the form of the certificate that should be used (in subsection (g)(1)) and a maximum fee that can be imposed for resale certificates.

Similarly, the Maryland Homeowners Association Act also requires associations to provide the seller with the information and documents necessary to comply with the resale disclosure provisions of Section 11B-106; however, it is much less burdensome than the condominium counterpart. The Section 11B-106 resale materials focus on notifying the prospective owner of the existence of the association, assessment obligations, and existing lot violations. Associations must respond to written requests for resale info within twenty (20) days and are subject to maximum fees that can be charged.

We have included links above to direct you to the referenced statute for further review of the resale requirements in your jurisdiction, but please contact our office if you have any questions or need assistance reviewing your resale packages for compliance.

Unlike resale packages, lender questionnaires are not a statutory mandate, but they are a necessary part of the resale process and an association's failure to cooperate will prevent sale transactions that rely on financing. And, because a vast number (between 60-70%) of home mortgage loans are insured or guaranteed by a federal agency (i.e. the Office of Housing within the Department of Housing and Urban Development, also known as FHA) or a government sponsored enterprise (i.e. Fannie Mae/FNMA and Freddie Mac/FHLMC), associations should be aware of the eligibility requirements imposed by these organizations and do their best to remain in compliance. For a summary of the eligibility requirements, you can refer to Fannie Mae's Lender Questionnaire, but we will address some of the concerns about which we most often get calls/emails and which can also land an association on the growing roster of buildings that are ineligible for financing.

Reserves and Underfunded Repairs. While reserve funding requirements for FHA, FNMA, and FHLMC continue to be 10% of the association's annual budget, which has become the industry standard, lenders are also tasked with reviewing projects for any existing repairs that are underfunded. As such, associations should allocate funds and implement funding plans for all pending repairs as soon as they are known to the board.

Deferred Maintenance or Critical Repairs. Deferred maintenance issues are by far the leading cause of associations being placed on the "ineligible list". Deferred maintenance can be minor, or it can be significant. Routine repairs are not considered to be critical and will not cause ineligibility. However, the overlapping guidance provides that projects in need of critical repairs

are ineligible until such repairs are completed. Critical repairs are repairs or replacements that significantly impact the safety, soundness, structural integrity, or habitability of the project's building, or the financial viability or marketability of the project. Critical repairs include conditions such as: material deficiencies, which if left uncorrected, have the potential to result in or contribute to critical element or system failure within one year; any mold, water intrusions or potentially damaging leaks to the project's building; advanced physical deterioration; any project that failed to pass state, county, or other jurisdictional mandatory inspections or certifications specific to structural safety, soundness, and habitability; or any unfunded repairs costing more than $10,000 per unit that should be undertaken within the next 12 months but does not include repairs made by the unit owner or repairs funded through a special assessment.

However, if damage or deferred maintenance is isolated to a few units and does not affect the overall safety, soundness, structural integrity, or habitability of the project, or if the deferred maintenance can be described as preventative or part of normal capital replacements (for example, focused on keeping the project fully functioning and serviceable) and accomplished within the project's normal operating budget or through special assessments that are within guidelines, then you can keep your association from being “blacklisted”. As such, we recommend that managers and boards work with their engineers and contractors to accurately describe pending or recommended repairs in any inspection report and in responses to lender questionnaires.

Condominium Building Insurance. Striking the right balance between premiums and deductibles while protecting the building against insurable risks continues to be a challenge for condominium associations. All three, FHA, FNMA, and FHLMC, require a condominium’s master policy to include 100% of the replacement cost value of the project's improvements, including common elements and residential structures, with inflation guard coverage (if available). Also, the master policy deductible for fire, water (not caused by flooding) or wind damage to the insured improvements may not exceed 5% of the limit maintained for building coverage (with some additional caps imposed by HUD in the FHA context). Therefore, boards will have to be mindful of these limits when setting their deductibles, especially for water claims, which tend to be high and include per unit deductibles, which can exceed the 5% threshold. Managers and boards should also work with their insurance brokers and underwriters to write policies that comply with these guidelines.

Delinquencies. Per FHA, FNMA, and FHLMC guidelines, no more than 15% of the total number of units in a condominium can be 60 or more days delinquent in the payment of common expenses, including special assessments. In addition to pursuing delinquent balances promptly, associations should audit and “clean up” their accounts on an annual basis. We recommend that boards reclassify “bad” debt where possible, such as debts associated with foreclosed properties, debt discharged in bankruptcies, debt belonging to deceased owners with no estates, time-barred debt, etc.

Litigation. While all three require associations to disclose the status of any litigation or pending litigation that they are party to, properties in associations may still be eligible for financing if the

litigation involves non-monetary lawsuits, collection efforts and foreclosure actions, litigation for which the association's insurance carrier has agreed to provide defense, or litigation that involves anticipated damages and legal expenses that are not expected to exceed 10% of the association's reserves. However, an association will likely be blacklisted if the litigation relates to the safety, structural soundness, habitability, or functional use of the project (not an individual unit/lot). Our firm often prepares a litigation statement for our clients to use in their resales and in response to lender questionnaires to factor in these considerations and make the necessary distinctions where possible.

Finally, in case you missed it, managers and boards are now also able to search FNMA and FHLMC's "ineligible list" online (links are embedded) to confirm their association's status. We encourage you to check your association's status and contact our office if you need assistance to submit an appeal.

Feel free to contact our office if you have any questions.

1900 Gallows Road • Suite 700 • Tysons Corner, Virginia 22182 • (703) 790-1911 • Fax: (703) 848-2530
7101 Wisconsin Avenue • Suite 1201• Bethesda, Maryland 20814 • (301) 222-0152 • Fax: (240) 802-2109
1602 Village Market Blvd SE Suite 385 Leesburg, Virginia 20175 • (703) 790-1911 • Fax: (703) 848-2530
www.reesbroome.com