Condominium Document Drafting and Negotiation in Affordable Housing Transactions
May 24, 2019
Why are condominiums important in affordable housing?

• Definition
• Uses
• Entities and Terminology
What is a condominium?

• Real property, portions of which is designated for separate ownership and the remainder which is commonly owned solely by those owners.

• Key feature is that unit owners share an undivided ownership interest in commonly owned property.
How are condominiums used?

• Mixed use commercial residential with separate commercial owner
• Excluding nonresidential construction costs from 50% test
• NMTC/LIHTC
• 4%/9% Projects
• Maximizing credit delivery (e.g. placement in service on a floor by floor basis)
Why are condominiums useful?

• Condominiums provide flexibility in allocating:
  • Ownership
  • Maintenance Obligations
  • Cost sharing
Key Documents

- Condominium Formation Documents
  - Declaration
  - Bylaws
  - Rules and Regulations
  - Map/Plat
Key Terms & Parties

• Association
  • Articles of Incorporation/Organization (if applicable)
  • By-Laws
• Key Parties
  • Sponsor/Declarant
  • Equity Investor/Syndicator
  • Unit Owners
  • Mortgagees
Lifecycle of the Condominium Drafting Process

- Review of Floor Plans: Who owns what?
- Drafting Considerations (Declaration)
  - Ownership of Units
  - Allocation of Common Interests/Responsibility for Common Elements and Limited Common Elements
  - Agency/Investor/Lenders’ right to approve: amendments, structural repairs, borrowing by the Board of Managers
  - Anticipated transfer/sale of condo units to third parties
- Drafting Considerations (Bylaws)
  - Control of Board of Managers
  - Major decisions vs Affordable Unit Owner’s right to act unilaterally
  - Insurance Provisions
  - Prohibited uses
  - Insurance
ABA FORUM ON AFFORDABLE HOUSING AND COMMUNITY DEVELOPMENT
WASHINGTON, D.C.

Kathleen M. Furey, Esq.
Holland & Knight LLP
31 W 52nd St.
New York, NY 10019

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I. MORTGAGE CONSIDERATIONS IN LOAN TRANSACTION

A. Lender’s Counsel’s Considerations When Drafting Loan Documents When There Is A Condominium Structure

1. The condominium structure will affect both a construction loan and a permanent loan.

2. Drafting will differ if the condominium exists at the time of closing or if the condominium will be created post closing.

3. Lender’s are concerned about the condominium structure because (i) it affects the appraised value of the property, (ii) if it is a construction loan, the construction lender will want to know that the condominium is properly formed so that the permanent lender will not have any issues and close the permanent loan, and (iii) if the lender forecloses, it will take ownership subject to the condominium regime so the lender needs to know it is properly formed.
I. MORTGAGE CONSIDERATIONS IN LOAN TRANSACTION

B. Loan Documents Should address the Condominium Structure as follows:

1. Representations and Warranties

   a. If the condominium exists at the time of the loan closing, the borrower should represent and warrant that the condominium documents are in full force and effect. The condominium documents typically include the declaration, the by-laws and the rules and regulations.

2. Covenants

   a. If the condominium exists at closing, the borrower should covenant and agree (i) to keep the condominium documents in full force and effect during the term of the loan and (ii) provide lender with any notices related to the condominium documents, from the condominium board or from any governmental authority.

   b. If the condominium is to be formed post-closing, the borrower should covenant and agree to enter into the condominium documents within a date certain but provide drafts of such document to lender for its review and approval prior to finalizing such documents.
I. MORTGAGE CONSIDERATIONS IN LOAN TRANSACTION

3. **Default Provisions**
   a. For an existing condominium, it should be a default if the borrower defaults under any of the obligations set forth in the condominium documents that remain uncured.
   b. For a condominium that is to be formed post-closing, it should be a default if the borrower does not (i) timely provide to lender the draft condominium documents, (ii) timely obtain approval of the condominium documents once submitted to the approving governmental authority.
4. Casualty and Condemnation
   a. Lenders need to control the insurance/condemnation proceeds received when there is either a casualty, condemnation or eminent domain.
   b. Lenders need the right to decide if the insurance/condemnation proceeds are used to either (i) rebuild the building or (ii) be used to repay the loan. The lender will not want the proceeds to go directly to the borrower or the condominium board.
   c. In several transactions, particularly with housing agencies or bond issuers, they will require that the Condominium Declaration provide that an Insurance trustee be appointed to oversee the disbursement of the insurance/condemnation proceeds at the direction of the agency/issuer or its servicer.
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C. Types of Condominiums

1. Condominiums that are created non-sale purposes, allow for dividing part of the building for separate uses (i.e., Residential, Retail, Community Facilities, Parking), which allow different units to be created at the same asset to have different treatment for separate financing, real estate tax or low income housing tax credit purposes

2. Condominiums with for-sale units require specific language in the loan documents that relate to how the sale proceeds are governed and applies to repay the loan
   a. Typically found in new construction
   b. Require the borrower to provide (i) a sales price schedule, (ii) a selling and marketing schedule, and (iii) a construction benchmarks schedule ensuring that the condominium is created in time to sell the units. Units cannot be marketed until the condominium documents are accepted by the approving governmental agency
   c. It will be a default if the condominium documents are not timely filed and if the units are not sold with sufficient sales proceeds to repay the loan.
C. Types of Condos (continued)

d. As part of the formation of the condominium, the lender will require the following in the event of a foreclosure:

i. Conditional Resignation of Board of Manager

ii. Conditional Assignment of Declarant Rights under the Condominium Declaration

iii. Conditional Resignation of Management Agreement

iv. Evidence of acceptance of the condo document by applicable governmental agency

v. Title Endorsement (if available) stating that the formation of condominium does not affect the lender’s first lien on the collateral

vi. Prior to the sale of the units in some states (i.e. New York), lender will need to subordinate to the Condominium Declaration so the lien of the mortgage cannot foreclose out the Condominium Declaration
The Borrower represents, warrants, agrees and covenants as follows:

i. It has submitted or will submit to the New York State Department of Law a Declaration of ______________ Condominium (the “Declaration”) and has requested a “No Action” letter for the conversion of the Improvements to be located at ____________________________ to a condominium regime (as approved by Bank) that will contain two (2) condominium units, one of which shall be a commercial unit containing approximately ____________, ft. (the “Commercial Unit”) and the other shall be the Improvements containing ______________ rental apartments for seniors (the “Residential Unit”) and it will satisfy, in a timely manner, all of the requirements of the Condominium Act, ______________ Law of ______________ and any other applicable law, restriction or ordinance necessary to create such valid residential condominium regime (the “Condominium Approval”);

ii. It will comply with all of the provisions of the applicable condominium laws and/or statutes of the State of ______________ and/or any subdivision thereof, including, without limitation, the City of ______________, and of the Condominium Documents; and

iii. It will duly perform, or cause to be performed, all obligations of the developer or sponsor under Condominium Documents, and do or cause to be done all things necessary to operate and maintain the portion of the Property to be located at ____________________________ as the Residential Unit and Commercial Unit and will comply with the statutes, rules and regulations, including securities regulations, of every governmental agency and authority having jurisdiction over such portion of the Property, the Commercial Unit and/or the Residential Unit and will furnish such evidence of compliance therewith as Lender may reasonably request.
Subordination to Condominium Declaration

At the request of the Borrower, provided that no default or Event of Default shall exist under this Agreement, the Mortgage or any other Loan Documents, the Lender shall subordinate the lien of the Mortgage to the Declaration upon the receipt by the Lender of all of the following documents, all of which shall be satisfactory in form and substance to the Lender and Lender’s counsel:

i. The Condominium Documents;

ii. A copy of the letter from the [______________ State Department of Law] certified by the Borrower that it is true and complete stating that the Condominium Documents have been accepted and satisfy all applicable requirements of Government Authorities, including, but not limited to, those of the Condominium Act; and

iii. [a copy of the “No Action” letter from the Department of Law accepting the offering plan for such condominium, for filing and accepting an amendment to such offering plan declaring it effective.]
Release of the Commercial Unit.

i. Provided that no Default or Event of Default exists under this Agreement, the Mortgage or any other Loan Documents, and upon Borrower’s compliance with Sections [] and [] above, upon a request of the Borrower received not less than five (5) days prior to the release contemplated by this Section, the Bank shall release from the lien of the Mortgage the Commercial Unit.

ii. The Title Policy insuring the lien of the Mortgage shall have been endorsed to provide affirmative insurance to the effect that notwithstanding the release of the Commercial Unit, the Mortgage encumbers all of the interests in a condominium duly created under the Condominium Act and Condominium Documents, the lien of the Mortgage shall remain a valid lien against the Property, the Residential Unit and common areas appurtenant thereto, subject to the Condominium Documents.
Investor Considerations and Sample Language
Control

• Does Housing Unit Owner control the Association and Board decision making?
  • Is non-residential unit owned by an affiliate of General Partner?
  • Balancing concerns of minority owner with investor interest in control

• Why is control important?
  • Assuring necessary maintenance and repair is completed
  • Cost containment
  • Ability to repair/reconstruct
Consent

• Investor approval rights, are they in the Condominium Documents, or in the Partnership Agreement, or both?

• Condominium Document Approval:
  • Amendments to the governing documents
  • Increase or decrease in number of units
  • Borrowing by the Association
  • Use of insurance proceeds
  • Termination of the Condominium
  • Foreclosure of liens for assessments
  • Notice & right to cure
Samples

• Define Investor/Limited Partner
  • “Limited Partner” means Fund Name LLC, or any other fund designated by ABC Bank, National Association as a limited partner, and their respective successors or assigns, only during such time that such entity or its successors or assigns is a partner of the entity that owns Unit 1, and when Fund Name LLC or such other fund so designated by ABC Bank, National Association, or their successors or assigns, is not a limited partner in the entity that owns Unit 1, references to Partner shall be of no force or effect.
• **13.1 Approvals Required.** In addition to any other approvals required by Oregon law, this Declaration or the Bylaws, the prior written approval of the Limited Partner and all of the holders of Mortgages of units in the Condominium must be obtained for the following:
  - Abandonment or termination of the Condominium regime.
  - Any change in the pro rata interest or obligations of any individual unit for (a) purposes of levying assessments or charges or allocating distributions of hazard insurance proceeds or condemnation awards, or (b) determining the pro rata share of ownership of each unit in the Common Elements.
  - Abandonment, partition, subdivision, encumbrance, sale or transfer of the Common Elements. The granting of easements for public utilities or for other public purposes consistent with the intended use of the Common Elements by the Condominium project shall not be deemed a transfer within the meaning of this clause.
  - Use of hazard insurance proceeds for losses to any Condominium property, whether to units or to Common Elements, for other than the repair, replacement or reconstruction of such improvements, except as provided by statute in cases of substantial loss to the units and/or Common Elements of the Condominium project.
  - Any amendment of this Declaration, the Articles of Incorporation, the Bylaws or the Plat.

• **13.2 Notice to First Mortgagees and Limited Partner.** Any first Mortgagee, upon request, and the Limited Partner will be entitled to written notification from the Association of any default in the performance by the owner of the mortgaged unit of any obligation under this Declaration, the rules and regulations or the Bylaws that is not cured within 60 days.

• **13.3 Amendment of this Article.** This article may not be amended without the prior written consent of the Limited Partner and all holders of Mortgages on units in the Condominium.
• **Section 26.4  Investor Notice.** The Investor shall be entitled to receive: (1) the same notices as an Eligible Mortgagee hereunder; (2) the budgets as proposed, ratified and/or supplement under Section 16.3 or Section 16.4 hereof; (3) any notice provided to an Owner under Section 21.3 hereof; and (4) any notices required to be delivered to the Investor.

  Notices to the Investor shall be given at the following address, or such other address as the Investor may specify in written notice to the Board or the Owners:

  [insert investor address]
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Questions & Answers