



Fannie Mae's New Rules

Q&A with Chris Griebel, CPA, Czarnowski & Beer

By Tom Soter

What to do with a budget surplus may not be on the top of your list of things to do for 2011, but believe it or not, some co-ops and condos have cut costs and have actually come in under budget. One accountancy firm is suggesting that such frugal boards can kill two birds with one bullet: reallocating the extra funds to capital reserve fund – and satisfying recent Fannie Mae/Freddie Mac requirements. Chris Griebel, a CPA at Czarnowski & Beer, sat down with Habitat's Tom Soter to explain their recommendations.

Tell me what you are suggesting your clients do with surpluses – if they have any, of course.

To give a little history: Fannie Mae and Freddie Mac devised what they called “sales guidelines” that lenders are required to follow. And, under that, condominium budgets were required to allocate at least ten percent of the annual budget to a reserve contribution. Fannie and Freddie could deny mortgages for any association that did not have [10 percent allocated for the reserves] in their annual budget.

How widespread is the problem?

I don't know if it's affecting New York in great numbers. It applies to condominiums, and will have the most impact on new construction. Still, at least one condominium handled by our firm had a problem selling units because their budget didn't “conform.” Czarnowski & Beer is making recommendations and we're looking at budgets currently [to see] if there are surpluses. As we approach December 2010, we're asking that they earmark those surpluses and try to transfer those into a designated reserve fund, and of course we can give unit-owners as a step-up in basis as a result of that because essentially it's a capital assessment.

What do you mean a “step-up in basis”?

Well, if the unit-owners are assessed a capital assessment, a step-up in basis actually increases the cost basis in their units. So, let's say someone bought a condo for \$500,000, and here they have a capital assessment of \$1,000 per unit. Now they've got a tax basis of \$501,000 in the unit. So, when they sell their unit, theoretically, they'll have less

taxes due, assuming that the sale of the unit is subject to tax.

Do buildings have surpluses?

Yes. We're just reviewing our policy right now, recommending that any surpluses that anybody has, whether it's a condo or a co-op, towards the tail end of 2010, to really take a look at the budget, determine if in fact they have a genuine surplus. Obviously, with fuel costs down this year and utility costs down from '09 into '10, some of the budgets may have overshot those targets, so what we're finding is that there could be some legitimate surpluses that actually could be reallocated and then earmarked as a capital assessment. Then, the board could make a resolution that, say, the capital assessment is, or the budget surplus is x amount. They can actually resolve or make a resolution in the minutes that they want to reallocate or reclassify some of the December maintenance or common charges in the form of a special assessment.

Is this strictly because of what Fannie Mae and Freddie Mac are doing?

No, not really. We're looking at it as prudent financial and fiscal responsibility. Because I think what's happening is now a lot of people are taking a look at the reserve funds and, you know, the AICPA [American Institute of Certified Public Accountants] wanted these common interest realty associations, co-ops, condos, to do a study of future major repairs and replacements. Nobody does that because of costs and other concerns. So, I think now people are just starting to wake up, in light of the current economy, [and] a lot of these co-ops in particular are just going to the banks to fund their improvements and what we're finding is some boards are making an intensive effort to try to see where they can save money and then reallocate the money towards capital accounts and not have to go to the banks to borrow.

So the money stays in-house, pretty much.

That's correct. Yeah, if they have the surpluses, and they have the ability to sweep the money into the reserve account, and then they legitimately spend the money on capital improvements, they have completed the loop and essentially they can get a step-up in basis. It's a win-win situation.

Do you require or suggest that they do ten percent?

Obviously, if they're a condominium in particular, I think that the ten percent would

conform with the new rules of Fannie Mae and Freddie Mac.

Attorney Stuart Saft, a partner at Dewey & LeBoeuf, has told me that those rules don't affect co-ops.

They don't apply to co-ops, condominiums exclusively. The Florida real estate market was probably the hardest hit with these condominiums and no one was able to sell any units in Florida, and what they did was as a part of the process, they said "Listen, if you want us to be able to provide the money in loans, and to back the loans if it's FHA, they want to make sure that these budgets have a ten percent surplus line item allocated in their reserve fund."

And having the reserve fund makes them more attractive?

Well, actually, if they have the line item for the reserve fund, and they meet the certain other "minimum" standards now they comply, and Fannie Mae and Freddie Mac will buy the mortgages. So, if you're an underwriter, if you're a broker or a bank, depending on which entity you're dealing with, Freddie Mac or Fannie Mae, there's only one way you could actually get them to buy the mortgage, basically, was to make sure that your unit-owner and prospective buyer qualified. They would have to provide the financials, the budget for the condominium, and the budget would have to have this ten percent reserve requirement or line item in it.

How big is this going to be in New York?

We're actually in the process of reaching out to one of the bankers here, in an effort to determine just how much of a push Fannie Mae and Freddie Mac will make [to enforce this rule], because apparently they're offering exemptions, if you don't have this ten percent line item in your budget, you can probably still get prospective purchasers to sign for mortgages, and, in fact, then, units can be sold. But we're not sure what type of impact it's going to have on the New York market until we talk to Fannie Mae and Freddie Mac, particularly in our metro area. An established condominium can get a waiver of the ten percent requirement if it's performing capital repairs on an ongoing basis and Fannie Mae can see that they're responsibly dealing with it. If they can see due diligence, they'll get the waiver. They are more worried about new construction condominiums that have no track record. ■

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