



BULLETIN

No. B-89-6

September 22, 1989

TO: Chief Executive Officers of all State Banks
and Examining Personnel

SUBJECT: Pinecrest Decision

Purpose

This memo is to inform you of the recent holding in State of Tennessee vs. Robert G. Heath, et al.

Facts

This case involved Pinecrest Townhomes, a condominium time-share development, in Sevier County, Tennessee. The project was developed by Robert Heath. He secured loans from various Tennessee Financial Institutions. The two banks primarily involved in this case were: First National Bank of Gatlinburg, and Tennessee State Bank.

The deeds of trust securing these loans contained no protection for nondefaulting purchasers. The Tennessee Time-Share Act (T.C.A. Section 66-32-101 et seq.) requires that such agreements provide protection for nondefaulting purchasers. First National Bank of Gatlinburg had already held a foreclosure sale, and Tennessee State Bank was preparing to hold such a sale.

Issues

1) Were the Tennessee Time-Share Act (T.C.A. Section 66-32-101 et seq.), the Horizontal Property Act (T.C.A. Section 66-27-101 et seq.), and the Consumer Protection Act (T.C.A. Section 47-18-101 et seq.), violated by these agreements?

2) If the Acts were violated, should First National's foreclosure sale be set aside?

3) And, if the Acts were violated, what would be the appropriate remedy for such violations?

Invalid loans fall into three (3) classes:

1. Those which met all requirements except for approval by the State Director of Local Finance;
2. Those which were issued for a valid purpose, but which did not comply with all procedures required for borrowing, such as valid, enabling resolutions or other procedural defects; and
3. Those which were for an invalid purpose.

The new law sought to remove the harsh penalty, that the loan is totally void, from classes 1 and 2 above. Instead, the city or county would be permitted, but not required, to ratify the loan by completing the procedure correctly. The new legislation does not address loans which are for an invalid purpose.

The new law attempted to encourage lenders to supervise municipal borrowing and require the correct procedures, by providing that the lender would forfeit any interest during the period of time that the loan was invalid. Any interest received could be recaptured by suing the lender in a Circuit or Chancery Court, or by an administrative hearing brought by the Comptroller's office. Under prior law, the Comptroller had no authority to initiate this action.

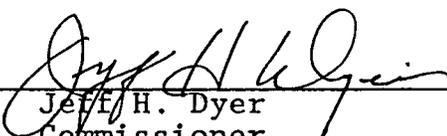
WARNING: The State Attorney General in an advisory opinion to the Commissioner has advised that while the General Assembly attempted to ameliorate the harshness of the prior law by enacting a "curing provision", the legislation apparently failed to achieve the desired result because of drafting problems. The Department's interpretation of the new law, read with the Attorney General's opinion, is that:

Loans made prior to the effective date of the 1988 Act, July 1, 1988, which were illegal when made, may not be "cured" under the provisions of the new law. However, loans made after July 1, 1988, which have some statutory defect (e.g. failure to receive prior approval from the State Director of Local Finance), may be cured by subsequent adherence to the law, subject to the interest forfeiture provisions.

State banks are directed to include the advice contained in this Bulletin into their loan and/or investment policies. It is further the policy of this Department that any loan to a governmental entity, which falls under the approval authority of the Director of Local Finance, shall have prior written approval of the Director, evidence of which shall be retained in the bank's files. Loans, not so documented, will be subject to adverse classification by state examiners. Bulletin No. B-87-5 further required a legal

opinion from either a city or county attorney or independent counsel that the requirements of state law relative to such loans to local governments had been met before the loan could be closed. This requirement is herewith eliminated.

Questions about these matters should be addressed to Mr. H. Wayne Williams, State Director of Local Finance, at 615/741-4272.



Jeff H. Dyer
Commissioner