



INSIGHTS

Termination of Condominium Terminations?

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Condominiums, like humans, age. This is especially true for buildings along Florida's two coastlines exposed to the corrosive effects of salt water. The current Florida Condominium Act, F.S. Ch. 718, was adopted in 1976. Prior to that time, the statutory basis for condominium ownership was F.S. Ch. 711 enacted in 1963. The condominium form of ownership in Florida has, therefore, been in effect for more than 50 years. Some of these condominiums, like automobiles, may have reached a stage in which their repair costs exceed their value.

Until 2007, unless the condominium declaration provided otherwise, the only method of terminating a condominium was to secure agreement from all unit owners and all mortgagees,¹ an almost impossible task. However, in 2007, Sen. Steven Geller, whose constituency included older oceanfront condominiums in Hallandale Beach, spearheaded an amendment to §718.117 of the Condominium Act (termination statute) permitting termination of condominiums by 80 percent of the owners if more than 10 percent of the owners did not object.² This amendment applied to all condominiums in existence in recognition of Florida's aging condominium stock. For Senator Geller's constituency, it permitted owners in aged buildings experiencing extensive repair costs to unlock the value of their appreciated land by selling their property for redevelopment.

Coincidentally, 2007 was a watershed year in which the bull market in real estate reached its zenith. The next several years would see dramatic declines in real estate values. Beginning around 2003, however, investor sentiment for real estate, including condominiums, was unquenchable as a source of quick profit. Builders could sell out a to-be-built project in a single day or a week. Given the helium-based market conditions and the inability to provide enough ground-up construction due to the long lead time involved in development, conversions flourished as a source of ready product to fill the gap between supply and demand. The chart of conversion filings with the Division of Florida Condominiums, Timeshares and Mobile Homes on the following page is instructive to graphically illustrate the conversion phenomenon. Existing multi-family projects, never intended to be condominiums, were converted to condominium ownership at a dramatic rate to satiate investors' demands for a get-rich-quick opportunity.

In 2008, the music stopped, and the market came crashing down. Converters were left with substantial unsold inventories and units that were sold failed to close. Investors who had purchased units as a means of instant wealth abandoned their units and ceased paying their mortgages. Lenders, in the face of an illiquid market, held back on completing foreclosures. The net effect of the downturn was to starve condominium associations of operating income and necessary funds to maintain their projects.

In adversity, there are also opportunities. Investment groups, aware of a robust market in

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multi-family rentals buoyed in part by the loss of rentals through the conversion craze, acquired units in failed projects to terminate the condominiums and convert them back into rental housing. The effect of these reversions was to increase the stock of rental housing and prevent the loss of existing housing units which, in many cases, were in a state of continuing deterioration. Observers of the reversion phenomenon credit bulk purchasers with stemming the deterioration of Florida's housing stock and truncating what would otherwise have been a long recession in Florida real estate.³

The Dark Side of Terminations

A large amount of units in these reverted projects were, prior to reversion, held by investors or the original developer/converter. There were, however, a number of high-profile projects in which at least some of the units in the reverted or intended-to-be reverted projects were held by homesteaders. These people faced the unenviable prospect of losing their homes after the termination of the condominium and, to make matters worse, receiving in payment for their units less than the amount of their existing mortgage debt due to depressed property values. The net effect of the termination was to leave them without a place to live and with a substantial deficiency liability on their mortgage loan.

This unfortunate result in a few high-profile projects generated hysteria about the negative effects of terminations,⁴ generally not borne out by the facts. Interestingly, aside from one project in Pompano Beach, all of the negative publicity was confined to the Tampa Bay area.

The poster child for the evils attributable to the termination statute was the Madison Oaks Condominium located in the Tampa Bay area. A bulk purchaser's attempt to terminate this condominium received extensive press and television coverage. Existing homeowners, threatened with the loss of their homes, were vocal on how the termination statute left them defenseless to assaults from investors. There was a constant barrage of negative coverage on the evils of the termination statute. This publicity propelled the Florida Legislature to adopt changes to the termination statute.

The Madison Oaks case, however, was based on irrationality and not fact. The Madison Oaks declaration of condominium permitted termination of the condominium, not by 100 percent of the owners, but only by 80 percent. An investor group had acquired more than 80 percent of the units and was attempting to terminate the condominium. The declaration of condominium for Madison Oaks was recorded prior to the adoption of the termination statute. In the litigation brought by the owners to stop the termination, an issue before the court was whether the termination statute could be applied retroactively, as intended, to a prior recorded declaration. A few lower courts facing the same issue had held that the termination statute could not be applied to preexisting declarations because it would violate constitutional principles regarding impairment of contract.

The homeowners' counsel, however, contended that the termination statute could and should be applied retroactively. Their counsel wanted to take advantage of that portion of the termination statute that prevented a termination if owners holding more than 10 percent of the units voted against termination. Since the owners resisting termination held more than 10 percent of the units, they could block the termination. The declaration contained no such blocking mechanism.⁵

Although the judge preliminarily ruled that the termination statute could not be applied retroactively to the declaration, the case was eventually resolved without a final judicial determination of the applicability of the termination statute. But the Madison Oaks case, rather than illustrating the disadvantages of the termination statute as contended by the

owners, actually represents the benefits of the termination statute by permitting blockage of a prospective termination by owners holding in excess of 10 percent of the units.

The New Legislation

In response to the barrage of negative publicity, CS/CS/CS/HB 643 (termination reform bill), sponsored by Rep. Sprowls and Sen. Grant, and adopted as Ch. 2015-175, was enacted during the 2015 Florida legislative session. This bill makes a number of changes in the termination statute. Many of these changes attempt to iron out certain glitches in the 2007 legislation suggested by a subcommittee of the Condominium and Planned Development Committee of the Real Property, Probate and Trust Law Committee of The Florida Bar. Most changes applicable to a bulk owner and the restrictions involving conversions did not originate in such source, but were intended to inhibit the ability of a bulk owner to terminate a condominium. The legislation defines a “bulk owner” as an owner who, together with certain affiliates, holds at least 80 percent of the voting interests in a condominium.

- *Restrictions on Termination* — First, focusing on conversions, the termination reform bill imposes a lockout period of five years from the recording of the declaration during which a bulk owner cannot terminate a condominium. Originally the bill had a lockout period of seven years. Even a five-year lockout, however, would have made it impossible to revert most of the conversions in the last downturn. The effect of such a lockout may make it impossible to resuscitate failed conversion projects in the future.

Furthermore, if a plan of termination is not barred by the lockout period, but fails to obtain the required number of votes, the period for any re-vote is increased from 180 days to 18 months. This requirement would derail most plans by investors seeking a timely turnaround of their investment in the project.

- *Protection of Owners* — The termination reform bill has several protections for owners in a residential condominium being terminated by a bulk owner. These protections vary depending on the status of an individual owner.

All owners must receive 100 percent of the fair market value of their units. In determining fair market value, units sold at wholesale or distressed prices cannot be considered in the valuation. Similarly, units sold through bankruptcy or through foreclosure cannot be considered. It is far from clear what constitutes a unit sold at wholesale or one sold at distressed prices. In fact, during a downturn, like the one following the great recession, all the units were sold at distressed prices or through foreclosure sales. It is not clear how someone would determine the fair market value of units following another major downturn if all sales of comparable units were eliminated because they were at distressed prices.

With respect to any owner granted homestead status, in addition to receiving fair market value for his or her unit, such owner is entitled to receive a relocation payment of 1 percent of the purchase price. Furthermore, if such owner objects to the plan of termination and purchased from the developer, the price payable for his or her unit cannot be less than 100 percent of the price paid to the developer.⁶ This requirement was adopted to protect owners making untimely purchases at the top of the market. It would have made acquisition of distressed projects unfeasible in the last downturn since typically, based on the frothy market, prices were set far above realistic values.

All owners current in monetary obligations to the association and in their mortgage payments are entitled to have their mortgages satisfied in full upon payment of their allocated share of the proceeds of their unit. In other words, any deficiency between the unpaid balance of the mortgage and the unit's proceeds from the termination would be

extinguished and a lender would have to accept such proceeds in full satisfaction of its loan. This might be considered an instance of Robin Hood-based legislation, taking from the rich to give to the poor. Although likely binding on mortgages executed after the effective date of the statute, it appears there are substantial constitutional impediments to applying this statute to pre-existing mortgages.

If an owner is “in occupancy of a unit” at the time a plan of termination is adopted, such owner has a right to obtain a lease for 12 months following the termination of the condominium if the new owner of the property is renting units to the public in the project. The new lease is to be on the same terms as those rented to outsiders. While it might not be clear whether the “in occupancy” requirement applies to an owner who spends four weeks a year in the unit, it appears clear that any investor-owner renting his or her unit would not qualify for a lease.

• *Reporting Requirements* — The termination reform bill requires that a plan of termination submitted for approval when a bulk owner is involved contain certain disclosures. Any plan that is approved must be recorded in the public records under the existing termination statute.

One of the disclosures is that the plan contains the names of the individuals who directly or indirectly control the unit owner or who hold at least a 20 percent interest in the bulk owner. The plan of termination also needs to disclose the date each unit held by a bulk owner was acquired and the total compensation paid for such unit, whether or not included in the purchase price. Furthermore, the plan of termination must disclose any relationship between any member of the board of directors and the bulk owner.

Although there might be benefits to the owners in these required disclosures, it is not clear why such disclosures have to be in a recorded document. The existing condominium law requires many disclosures regarding a developer and the project, but these disclosures appear in the prospectus, not in a recorded instrument.

Perhaps more significantly, there is a requirement that if a bulk owner has elected all of the board members, the nonbulk unit owners must be entitled to elect at least one-third of the board prior to the approval of the plan of termination. The mechanics of the operation of this requirement are not clear. Is it necessary to have an election with the 60-day notice requirement for the nonbulk owner board member or members before any plan can be proposed? Such a result would extend the termination process by at least 60 days. If the bulk owner has elected all of the board members, how helpful is the requirement of a minority representation on the board in determining whether the plan of termination will be adopted? What happens if the plan of termination is not approved by the required number of votes? Does the nonbulk owner-director or directors stay in place, or can they be replaced with other bulk-owner designees? These are some issues that will have to be dealt with in the implementation of this law.

• *Disputes* — Finally, revised F.S. §718.117(16) substitutes mandatory nonbinding arbitration under §718.1255 for an expedited judicial proceeding as a method of resolving 1) the fairness of apportionment of sale proceeds; 2) the issues of satisfaction of mortgages in excess of proceeds paid to the lender; and 3) that the appropriate number of votes to approve a plan of termination has been obtained. It is unclear why a nonbinding proceeding is being substituted for a binding expedited proceeding. It appears that rather than facilitating the resolution of these issues, the amendment is prolonging resolution and making it more expensive and uncertain. In challenging any arbitration decision, the parties are left with nonexpedited judicial proceedings and a two-step rather than one-step process.

Conclusion

Real estate has always been a cyclical industry experiencing ups and downs. While the great recession may have been a once-in-a-lifetime event, future busts are readily foreseeable. The fact that some unit owners were placed in an untenable position of losing their homes and facing a deficiency claim on their mortgages seems to have obliterated the salutary effect of restoring housing accommodations after a catastrophic housing event or addressing the reality of an aging stock of condominiums whose repair costs may exceed their value.

The human effect on owners purchasing at the top or near top of the market may be heartbreaking. These situations were limited and possibly could have dealt with a more surgical approach by the legislature. The solution adopted by the legislature may look good in the short term, but may have a devastating effect on the housing market in any next sustained downturn.

¹ See Ch. 718.117 (2006).

² Ch. 2007-226.

³ See Alexander Britell, Renewal of Bulk Buyer Law Could Drive SF's Suburbs, *The Real Deal*, Apr. 17, 2012.

⁴ See Editorial: Flawed Condo Law is Assault on Property Rights, *The Tampa Tribune*, Sept. 12, 2014; Mary Shanklin, Developers Force Condo Owners Out of Homes, *Orlando Sentinel*, Feb. 24, 2015; letter to Gov. Rick Scott from Rep. Carl F. Zimmerman (Aug. 25, 2014).

⁵ *Krasowski v. Madison Oaks Condominium Association*, Case No.: 13-009033 CI-7, Circuit Court, Pinellas County, Florida.

⁶ Note that Fla. Stat. §718.117(3)(c) indicates it applies only to residential condominiums but subparagraph (3) grants to an "owner-occupied operating business" the right to receive at least the purchase price paid to the developer.

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