Why Florida's New Condo Termination Bills Are Problematic

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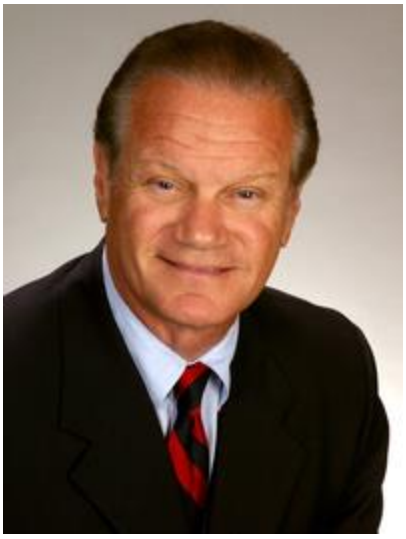
The authors of this article recently published an article with Law360 titled "A Condo Termination Bill That Could Satisfy Public Outcry." The original article discussed the proposed text of an amendment to Florida Statute Section 718.117, regarding the termination of condominiums in Florida. The original article was written about a proposed bill approved by the Real Property and Probate Section of The Florida Bar (the "section's bill"), which was intended to encourage investors to purchase failing condominiums while, at the same time, safeguarding minority condominium owners' interests.



Mark F. Grant

However, soon after the authors' original article was published, another bill was filed, namely HB643 and its companion, SB1172 (the "filed bills"). The filed bills eliminate many of the planned benefits of the section's bill. The filed bills include provisions that those in the real estate industry find problematic. As a result, the authors cannot support the filed bills in their current form.

The filed bills will affect the lives of thousands of individuals who will own Florida condominiums, as well as investors who wish to purchase Florida condominiums when Florida experiences its next real estate downturn. Termination of a condominium is sometimes the most feasible alternative, especially when dealing with older condominiums needing significant repairs to meet building codes and regulations. In some instances, where the repairs are too expensive, costing more than the value of the units, owners needed a solution. In order to better understand the importance of the up and coming amendment, and the issues within, it will be helpful to understand the past. This was true in the original article and remains true here. The past issues must be recognized and acknowledged, so that the mistakes are not made twice.

Before 2007, Florida's Condominium Act provided that unless the declaration of condominium held otherwise, a 100 percent vote of unit owners in a condominium was required to terminate the condominium. As many older declarations did not provide otherwise, a 100 percent vote of the owners was needed to terminate those condominiums.

As noted by the Legislature, certain owners were "extracting an excessive portion of the

termination proceeds at the expense of the other unit owners."[1] Just one unit owner was capable of halting the termination process. This clearly needed to change, and was subsequently changed, by the Florida Legislature in 2007.[2] Indeed, the Legislature changed the law to provide that a vote of 80 percent of the unit owners could terminate the condominium unless more than 10 percent objected, recognizing that less than 10 percent of unit owners in a condominium should not be able to veto the will of the vast majority of the other unit owners.

In 2008, the Florida real estate economy, like the rest of the country, was hit by a terrible recession. Many condominiums were built or rental buildings were converted to condominiums, but only a small percentage of the units were sold. No one was willing to rescue these condominiums, "which results in part from the devaluing of real estate in this state."[3] The Distressed Condominium Relief Act was created, in 2010, to encourage bulk purchasers to rescue failing condominiums. However, another problem arose when bulk purchasers realized that there was greater value in terminating the condominium and converting the buildings into pure rental projects. In doing so, some unit owners were losing their homestead, resulting in the need for change.

This leads us to the current filed bills before the Legislature. In sum, the current version of the filed bills is troubling. As the authors' original article stressed, "[we] cannot go backwards and require 100 percent vote to terminate a condominium, as some advocate. This would halt forward progress and plunge us into the past where there was a disincentive to rescue distressed condominiums. There must be a balance between bulk purchasers and those individuals who reside in the condominium." The current version of the filed bills may plunge us back into the past, and in some instances, may make matters worse. The filed bills raise several concerns.

First, although the filed bills provide that all third-party unit owners "must be compensated at least 100 percent of the fair market value of their units," the filed bills contain additional language providing a higher payout for those who object to the termination of the condominium. The filed bills state, "the allocation of the proceeds of the sale of condominium property to owners of units dissenting or objecting to the plan of termination shall be 110 percent of the purchase price, or 110 percent of the fair market value, whichever is greater." This language is problematic.

The use of the term "purchase price" isn't clear although we know it means the original price paid by the unit owner. Not only does the language provide a financial incentive to vote against termination, but also it will likely result in an increased number of failed votes for termination, even in troubled, deteriorating condominiums where termination is desperately needed. If a unit owner is offered either 100 percent of fair market value or 110 percent of fair market value, which would the unit owner choose? Essentially, the proposed amendment gives condominium unit owners this choice, ignores the natural desire of unit owners to sell for a higher amount, and promotes individual greed over community interests.

For example, imagine the following scenario: Condominium "X" is deteriorating, and property values are falling. During a meeting of the unit owners, they decide that a vote should be taken regarding termination of the condominium. The vote requires 80 percent owner approval under existing Florida law (because the declaration of condominium does not state otherwise). An

initial “straw vote” shows 81 percent of the unit owners are projected to vote for terminating the deteriorating condominium.

Unit owner A, who is a supporter of the termination, had discussions with other unit owners and predicts that the majority vote will be to terminate, regardless of whether he votes for or against the termination. As a result, and to receive a bigger payout, unit owner A votes against termination. He will receive at least an extra 10 percent above fair market value for his unit, if the condominium terminates. Now, if several other unit owners follow suit to receive bigger payouts, the projected 81 percent approval would fall below 80 percent, and the termination would fail. Thus, the condominium would remain in a state of decay.

The current versions of the filed bills create this problem, by providing a financial incentive to vote against termination. Unit owners now have an incentive to vote against termination, or at least an incentive to play the odds, to scheme and ensure they end up on the lucrative side of the payout.

Second, to compound the problem discussed above, the current version of the filed bills also provide that, after an unsuccessful vote for termination of the condominium has been taken, a new vote may not be taken for 18 months. Using the same example as above, the unit owners in Condominium “X” would be stuck paying taxes and other expenses to maintain a failing, deteriorated condominium for an additional 18 months — and perhaps even longer — needlessly. Indeed, the 2007 version of the law was created because some owners where holding out for more cash, in an attempt to “play the system.”

The filed bills not only ignore this fact, it also promotes and encourages such behavior. Rather than promoting cooperation amongst condominium owners for the greater good of the community, the filed bills promote and encourage individual greed.

Third, the filed bills provide a huge disincentive to bulk purchasers to buy unsold units and rescue ailing communities. As a result of the Distressed Condominium Relief Act, bulk purchasers acquired 80 percent or more of the units in many “fractured” condominiums and saved the other unit owners from a complete collapse of the condominium regime. Depending on the market, these bulk purchasers may find greater value in terminating the condominium and converting the buildings into pure rental projects, rather than maintaining the existing condominium.

Keep in mind that terminating a condominium, in the first place, could only occur as proscribed by statute or declaration. The filed bills state that the termination provisions do not apply to a condominium created by conversion until seven years pass from the date of the initial recording of the declaration of condominium. If the developer goes bankrupt during that time, the property could sit idle for as long as six or seven years. The purpose of the Distress Condominium Relief Act was to rescue “broken” or “fractured” condominiums. The authors fear that the filed bills will have the opposite effect.

Fourth, another disincentive to bulk purchasers is the language in the filed bills, which state: “A plan of termination is not effective unless the outstanding first mortgages of all third-party unit

owners are satisfied in full before, or simultaneously with, the termination." Although this would be helpful to the unit owner, and his lender, it is an unrealistic burden, and a disincentive to bulk purchasers. Indeed, bulk purchasers enter the scene to rescue ailing condominium communities not as an act of pure kindness, but because they are taking a business risk and hope to profit. This is the reality of the situation. Requiring them to pay off the first mortgages of all third-party unit owners would, in most circumstances, dramatically increase the bulk purchasers' costs and reduce their profits.

The filed bills discourage bulk purchasers from coming to the rescue of ailing condominiums. If unit A is now worth $100,000 due to a decline in the market, but has a first mortgage of $200,000, why would one pay more than fair market value? This section makes condominium ownership essentially a risk-free investment. As with any property, the value may go up, or down, depending on the market. In most instances, bulk purchasers would have come in to purchase distressed, "broken," and/or "fractured" condominiums. This of course means that the property value has dropped. However, if the filed bills pass, many bulk purchasers will shy away from purchasing, and saving, distressed condominiums when the next real estate downturn occurs. Therefore, although it is laudable to safeguard owners' investments in their units, one must ask "at what cost?" The filed bills ignore that question.

Although the original intention of the filed bills was to help minority unit owners in broken condominiums facing termination, the unintended consequences of the filed bills will actually hurt these minority unit owners by making terminations economically unfeasible. If terminations are economically unfeasible for bulk purchasers, it will make it impossible for the minority unit owners to get out of their existing mortgage debt. Although the minority unit owners will be able to remain in their units because the termination of the condominium will be stopped, they will remain obligated to continue to pay on their mortgage loans, which are in excess of their units' current fair market value.

They will also be unable to sell their units because there are few, if any, buyers willing to buy into a condominium where 80 percent or more of the units are operated as rentals and there is no financing available for buyers of units in broken condominium projects. FNMA, VA and FHA will not lend on units in condominiums where the vast majority of the units are being rented, rather than being owner-occupied. Therefore there will be a significant decrease in property values resulting in decreased tax revenue for local governments.

The minority unit owners will also become obligated to make payments to their condominium association to fund significant reserve requirements that typically have been unfunded for many years by the developer or lenders' real estate-owned (REO) departments that have taken over the developer's units. Reserves are required to be funded unless a majority of the owners agree to waive the funding of reserves. Because these condominium communities have not been properly maintained, the minority unit owners will be subject to special assessments (as will the bulk owner) to pay to improve the condominium property up to the level it should be. Thus without a termination, these minority unit owners will be subject to substantial financial burdens.

Lastly, the sponsors of the filed bills believe that the changes in the law will be applied retroactively to help existing minority unit owners. But it is the authors' belief that the changes

in the law may not be applied retroactively as they impair contract rights in an unconstitutional manner.

As of the writing of this second article, there are ongoing discussions with the sponsors of the filed bills and other interested legislators to revise the filed bills and bring in many of the provisions of the section's bill that are designed to protect owners whose units are their homestead. These are the unit owners most deserving of protection; not investor-owners.

The authors stated in their last article that condominium living is not for everyone. "It is a unique style of living with greater degree of restrictions when compared to single-family homes. This style of living, as with everything, has its pros and cons. Those who choose to venture into condominium living should understand all aspects of what they are purchasing." If the filed bills go unchanged or altered, and become Florida law, minority unit owners will be in worse shape now and when the next real estate downturn occurs.

Note: The foregoing article was written before the authors learned that the filed bills' sponsors have agreed to make changes to the bills. Assuming that the proposed changes are made, the bills will be more compatible with the section's bills. The authors plan to write another article assuming the changes to 718.117 become law.

—By Mark F. Grant and Raul Valero, Greenspoon Marder Law

Mark Grant is a shareholder in Florida-based Greenspoon Marder Law's real estate group and is Florida Bar Board-certified in real estate law.

Raul Valero is an associate in Greenspoon Marder Law's litigation group, where he concentrates his practice in complex commercial litigation.

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[1] Florida Staff Analysis, S.B. 314, 3/29/2007.

[2] For a full understanding of the History Behind the Termination Section of the Condominium Act, please see Mark Grant and Raul Valero, A Condo Termination Bill That Could Satisfy Public Outcry, Law360 (Feb. 3, 2015).

[3] Id.