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Revision to Florida Condominium Act Clarifies Foreclosure Purchaser Liability

On June 1, 2010, Florida Governor Crist signed into law Session Bill 1196 (the "Bill"), amending the Florida Condominium Act (Chapter 718 of the Florida Statutes) (the "Act") to more clearly provide what liabilities a purchaser of multiple units in a condominium has with respect to developer liabilities imposed by the Act. The Bill, which becomes effective July 1, 2010, contains many important provisions affecting community associations and condominiums. This Alert addresses one aspect of the Bill which provides some help to foreclosing lenders who are faced with the question of whether they can or should assume some of a developer's rights and responsibilities under an existing condominium declaration.

Well-drafted condominium declarations reserve to the developer certain rights related to the initial development, marketing, and operation of the community so that the developer is able to see the project to completion with minimal interference by other owners. These rights typically include the rights: i) to maintain model units and sales and management offices; ii) to add real estate to the community or withdraw real estate from the community; iii) to exercise easements over the community in order to complete development; iv) to control the owners association by appointing members of the board and exercising a weighted vote in association matters; v) to pay reduced assessments; vi) and to unilaterally amend the declaration.

Most lenders do not have the desire, expertise, or authority to become developers and complete the community, market the completed units, and administer the association during the development period, and so a foreclosing lender's initial inclination may be not to acquire any of these rights of the initial developer. Additionally, by taking on these rights, foreclosing lenders may take on liabilities for actions of the prior developer. But the bundle of developer rights may be needed to maintain the marketability of the undeveloped and unsold portions of the community and enable a developer purchasing from the foreclosing lender to build out and sell the community, maintaining control of the association during that time. So the lender is left to weigh the benefits of taking these rights against the burdens of assuming liability for its defaulting borrower's obligations as declarant.

Florida condominium developers fall under the requirements of both the Act and the rules and regulations of the Division of Florida Land Sales, Condominiums and Mobile Homes (the "Division") as set out in Chapter 61-B-15 – 25, 45 and 50 of the Florida Administrative Code (the "Regulations").

The existing definition of "developer" in the Act extends only to parties creating a condominium, or offering condominium parcels for sale or lease in the ordinary course of business, and it is unclear whether a foreclosing lender or other foreclosure purchaser acquiring multiple units and later disposing of them would be selling them "in the ordinary course of business," thus becoming a developer under the terms of the Act. The Regulations muddy the waters somewhat by making any party offering more than seven condominium parcels a "developer" for purposes of filing under the

Act, unless all of the units are offered and conveyed to a single purchaser in a single transaction. Some Florida practitioners were concerned that if a purchaser of multiple units became a developer for filing purposes under the Regulations, it might inherit developer liabilities generally.

The Bill defines a "***bulk assignee***" as a party acquiring more than seven condominium parcels and receiving an assignment and assumption of all of the rights of the developer as set forth in the declaration of condominium or in the Act by written instrument recorded as an exhibit to the deed or by separate instrument in the public records of the county in which the condominium is located. The Bill also defines a "***bulk buyer***" as a party who acquires more than seven condominium parcels but does not receive an assignment of developer rights, other than the right to conduct sales, leasing, and marketing activities within the condominium; the right to be exempt from the payment of working capital contributions; and the right to be exempt from any rights of first refusal which may be held by the condominium association and would otherwise be applicable to subsequent transfers of title from the bulk buyer.

While the Bill provides that a bulk assignee generally assumes and is liable for all duties and responsibilities of the developer under the declaration and the Florida Condominium Act, it exempts the bulk assignee from what would seem to be the most troublesome obligations relating to what its assignor developer did (or failed to do) in the past. Specifically, the Bill provides that a bulk assignee is ***not*** liable for:

a. Warranties, except with respect to its own work;

b. In a conversion project, funding of converter reserves or provision of converter warranties;

c. Providing a cumulative audit of the association's finances from the date of formation of the association (but the bulk assignee is to provide an audit for the period during which the assignee elects majority of the board);

d. Liabilities arising out of or in connection with actions taken by the board or the developer appointed board members before the bulk assignee elects majority of the board;

e. Failure to fund previous assessments or to resolve budgetary deficits in relation to a developer's right to guarantee assessments; however, if a bulk assignee receives the right to guarantee the level of assessments and fund budgetary deficits under Section 718.116 of the Act, then the bulk assignee does assume and is liable for all obligations of the developer with respect to that guarantee, including reserve funding to the extent required by law, as long as the guarantee remains in effect. (The bulk assignee that did not receive an assignment of the rights of the developer to guarantee the level of assessments is not liable for that guarantee, even though it may have succeeded to other developer rights, but is liable to pay assessments in the same manner as the owners of other units.)

A "bulk buyer" (that is, a party acquiring seven or more condominium parcels but not receiving an assignment of developer rights) is liable for the developer's obligations only to the extent provided in the Bill (generally relating to its own actions and to filing with the Division and making disclosures to its purchasers, as detailed below), and other developer duties or responsibilities expressly assumed in writing by the bulk buyer.

The Bill also mitigates the bulk assignee's responsibilities to the association at turnover. The Act provides for transfer of control of the association based on the percentage of units conveyed by the developer. The Bill provides that transfers by bulk assignees to successor bulk assignees do not constitute conveyances to purchasers other than the developer for determining when turnover occurs. Upon turnover of the association, the bulk assignee is not required to deliver association documents and information not in its possession, provided that it has made a good faith effort to obtain those documents and materials and certifies to the association that such documents and materials were not obtainable.

New Section 718.706 of the Florida Condominium Act, added by the Bill, imposes filing requirements on both bulk assignees and bulk buyers, including the filing of updated prospectuses or offering circulars or supplements thereto; an updated Frequently Asked Questions and Answers sheet; an executed escrow agreement pursuant to Section 718.202 of the Act (if required); and certain financial information, which may be qualified to disclaim responsibility for information not available to the bulk assignee or bulk buyer. In addition, a bulk assignee must file with the Division a description of all rights assigned to the bulk assignee and deliver a disclosure statement to each purchaser stipulating that it is not responsible for warranties of its predecessor developer and, in case of a conversion project, that it has no obligation to fund converter reserves or provide converter warranties.

The Bill also limits the bulk assignee's right to take certain actions with respect to the association and its finances, including any reduction of reserves and the use of reserves for anything other than authorized reserve expenditures.

Finally, the bulk assignee or bulk buyer must comply with requirements regarding contracts entered into by the association during the period of its control of the association.

Under the hopeful assumption that the current economic circumstances are temporary, the Bill only allows a party to be classified as a bulk assignee or bulk buyer if it acquires the condominium parcels before July 1, 2012, as determined by the recording of the deed of conveyance.

Questions that seem to remain unanswered include the following:

1. What constitutes "rights of the developer" for determining if a bulk buyer is a bulk assignee? Section 718.703(1)(b) makes a party acquiring more than seven condominium parcels a "bulk assignee" if it receives "an assignment of some or all of the rights of the developer as set forth in the declaration of condominium or this chapter." The declaration will typically create easements in favor of the developer for ingress, egress and utilities, in connection with the development of the property, and confer on the developer the unilateral right to bring new real estate into the condominium. If a lender's mortgage encumbers rights appurtenant to the foreclosed parcel under the declaration, would the mortgage comprise an "assignment" of some or all of the developer rights? Presumably not, because such rights would be established as appurtenances running with the land under the declaration and would not need to be transferred by "a written instrument recorded as an exhibit to the deed or as a separate instrument in the public records of the county."
2. For a developer that desires to obtain the rights of the developer and become a bulk assignee, what means is there of forcing the developer that holds those rights to transfer them by "a written instrument recorded as an exhibit to the deed or as a separate instrument in the public records"? Is transfer of those rights by language in the foreclosure deed sufficient, or is some separate instrument signed by the developer holding the rights needed?
3. What is the status of a party fitting the definition of a "bulk buyer" or "bulk assignee" and who acquired its condominium parcels prior to July 1, 2010, the effective date of the Act? Section 718.704 (4) seems to provide that unless the transfer of the condominium parcels was made "with the intent to hinder, delay, or defraud any purchaser, unit owner, or the association, or if the acquirer is a person who would be considered an insider under s. 726.102 (7)," the transferee will be a bulk buyer or bulk assignee under the Act. So these parties will be bulk assignees or bulk buyers without having the ability to have chosen that status.

With this new legislation in place, lenders that own or are anticipating foreclosing condominium projects need to determine whether they want to become "bulk assignees" as opposed to merely "bulk buyers." An alternative would be not to take on either status, but to seek appointment of a receiver to dispose of the unsold portions of the property. This analysis will depend on the stage of development of the project, any known disputes regarding the project, and the anticipated time frame for disposition of the foreclosed units. In any event,

if either status is desired, the parcels must be acquired before July 1, 2012.

The lender acquiring parcels in a substantially built out project may very well desire to take only the limited "marketing" related developer rights and not be a "bulk assignee." For a project in earlier stages of development, however, the need for the developer's rights will likely outweigh concerns over the liabilities of the developer imposed on a bulk assignee and result in a decision to become a bulk assignee. Indeed, since the burden of filing with the Division and making required disclosures to purchasers is imposed on both bulk assignees and bulk buyers, and bulk assignees are relieved from liability for those developer responsibilities likely to create significant exposure, there would seem to be little reason for a foreclosing lender not to become a bulk assignee.