



The Florida Senate

Interim Project Report 2007-136

October 2006

Committee on Regulated Industries

CONDOMINIUM CONVERSIONS

SUMMARY

This report addresses concerns raised during the 2006 Legislative Session regarding post-purchase protection for purchasers of condominium conversion properties. It provides a summary of the history of condominium conversions, the statutory requirements for a conversion, current market conditions, proposed changes to the statutory language by the Condominium Advisory Council, and recommendations by staff.

Staff recommends that legislation addressing changes to part VI of ch. 718, F.S., contain language that insures appropriate reserve amounts for problems that arise in maintaining the condominium structure and provide for updated inspection reports for components that are renovated or repaired. The language should also provide for the ability of the condominium owner to have appropriate recourse through the courts for any failure to disclose defects by the engineer and the developer.

BACKGROUND

Up until the beginning of 2006, there was a substantial increase in land and home values in Florida. This increase has led to many more residential buildings being converted to condominium ownership. Rental apartments are being turned into condominiums through the conversion process in many parts of the state. The conversion of apartments to condominiums could affect Florida's affordable housing market. Though the conversion market has slowed, experts are still of the opinion that conversions are here to stay.

The developer is required to disclose the age, type of construction, prior use, termite damage, if any, and the condition of the roof, structure, fireproofing, elevators, heating and cooling systems, plumbing, electrical systems, swimming pool, seawalls, pavement and parking areas, and drainage systems. Current law¹ requires that a developer disclose the condition of the improvements and the condition of certain components and their current estimated replacement costs.

An architect or engineer is required to substantiate "under seal"² the age of the component, the estimated remaining useful life of the component, the estimated current replacement cost of the component, including a total amount and a per-unit amount, based upon each unit's proportional share of the common expenses and the structural and functional soundness of the component.

There is concern that there is no one checking these reports and that there is no requirement to estimate the maintenance costs of the components. Once the condominium association takes over the conversion, it can be facing expensive maintenance or repairs with no recourse except a lawsuit.

An August 2005 article in the *Daily Business Journal* maintained that the current statutory law offered little protection for consumers and required limited accountability for developers.³ The article noted that once the condominium association assumes control over the converted condominium, it may face hidden structural problems and problems regarding the reserve accounts. Another criticism identified was that the corporations created for the conversion may be limited liability companies⁴ with little assets to be attached when problems arise after the conversion. Senator Gwen Margolis⁵ office has brought this issue to the committee's attention.

² Section 471.025, F.S., requires that an engineer obtain at least one seal in a form approved by board rule. All final drawings, specifications, plans, reports or documents prepared or issued by the engineer and being filed for public record and all final documents provided to the owner or the owner's representative must be signed, dated and sealed with the approved seal.

³ Paola Iuspa-Abbott, "Condo Conversion Blues," *Daily Business Review*, 15 Aug. 2005, A8.

⁴ For limited liability company see ch. 608, F.S. The members, managers, and managing members of the limited liability company are, except as provided in ch. 608, F.S., not liable for any debt, obligation, or liability of the company.

⁵ District 35

¹ See ch. 718, pt. VI, F.S.

The Condominium Advisory Council is currently reviewing part VI of ch. 718, F.S., and is proposing language to address these issues.⁶

METHODOLOGY

Staff reviewed and analyzed the current statutory provisions concerning the condominium conversion process. Staff contacted the Division of Florida Land Sales, Condominiums, and Mobile Homes in the Department of Business and Professional Regulation, individuals in the real estate and condominium industry, affordable housing representatives, consumer advocates, the Florida Housing Finance Agency, members of the Condominium Advisory Committee, real estate market experts and university study centers such as the Shimberg Center for Affordable Housing at the University of Florida.

FINDINGS

The Roth Act

In 1980, the Legislature enacted Part VI of the Condominium Act (ch. 718, F.S.), also known as the Roth Act, which addresses condominium conversions.⁷ The Roth Act was the result of a detailed report prepared by James S. Roth, the Director of what was formerly known as the Department of Business Regulation, Division of Florida Land Sales and Condominiums. The Roth Report recommended that legislation be enacted to provide sufficient time and information so that tenants could make informed decisions about conversion of their rental facilities and to provide protections to purchasing and non-purchasing tenants.⁸

In summarizing the Roth Act, Peter M. Dunbar provides in his book *Condominium Concept*:

Part VI of the Condominium Act is devoted exclusively to condominiums which are created when existing improvements are converted to a residential condominium. This part of the Act provides protections to the existing renters in the building and to prospective purchasers of the converted condominium units. Renters are entitled to written notice of the proposed conversion and an option to extend their current lease.⁹

⁶ The Advisory Council on Condominiums is created by s. 718.50151, F.S., and is composed of seven members to advise the Division of Florida Land Sales, Condominiums and Mobile Homes on condominium issues and to recommend changes in the condominium law.

⁷ Chapter 80-3, L.O.F.

⁸ *Florida Condominium Law and Practice*, 3d ed., s. 9.1 (The Florida Bar, 2003).

⁹ Peter M. Dunbar, *The Condominium Concept, A Practical Guide for Officers, Owners and Directors of*

Each tenant has the right of first refusal to purchase the unit 180 days before the intended conversion. Ninety days before the intended conversion, the developer must deliver the price and terms of the purchase, the economic information required in s. 718.604, F.S.¹⁰ and the disclosure documents required by ss. 718.503 and 718.504, F.S.¹¹ The tenant has the right of first refusal to purchase the unit 45 days after personal delivery of the purchase materials.¹²

Section 718.616, F.S., requires each developer of a residential condominium to provide to new prospective purchasers and the ultimate owners of converted condominium units the same basic disclosures that are required in all condominium developments.¹³ The developer must disclose the following information concerning the improvements:

- Date and type of construction;
- Prior use;
- Existence of any termite damage or infestation and whether it has been treated properly. A report from a certified pest control operator must substantiate the inspection.

The developer must also disclose the condition for each of the components listed in s. 718.616(3)(a), F.S. The components include the roof, structure, fireproofing and fire protection systems, elevators, heating and cooling systems, plumbing, electrical systems, swimming pools, seawalls, pavement and parking areas, and drainage systems.

The developer must also disclose the components' age, estimated remaining useful life, estimated current replacement cost, and structural and functional soundness.¹⁴ The disclosure must be substantiated by attaching a copy of a certificate by a Florida licensed architect or engineer under seal.¹⁵

The disclosure of the age of each component is measured in years from the later of :

Florida Condominiums, 8th ed., ss. 2.7, 33-34 "Aras Publishing 2003".

¹⁰ In summary form this information includes mortgage financing, estimated down payment; alternative financing and down payments; monthly payments of principal, interest, and real estate taxes; and federal income tax benefits.

¹¹ Sections 718.503 and 718.504, F.S., provide for the developer disclosure documents required in contracts for sale of condominiums and the prospectus or offering circular which is required for condominiums of more than 20 residential units, respectively.

¹² Section 718.612, F.S.

¹³ Section 718.616, F.S.; Rule 61B-24.004(1)(a), F.A.C.

¹⁴ Section 718.616(3)(b), F.S.

¹⁵ *Id.*

- (a) The date when the installation or construction of the existing component was completed; or
- (b) The date when the component was replaced or substantially renewed.¹⁶

The developer is not required to certify that the replacement or renewal meets the requirements of the then-applicable building code. However, for purposes of funding a reserve account, this certification is required. The estimated current replacement cost of the component must be given as a total amount and as a per-unit amount based on each unit's proportional share of the common expenses.¹⁷

If the proposed condominium is situated within a municipality, the disclosure must include a letter from the municipality that acknowledges that it has been notified of the proposed conversion.¹⁸

Section 718.618, F.S., requires that once a conversion has taken place, the developer has to create financial safeguards for the condominiums. The developer must either: (1) establish reserve accounts for capital expenditures and deferred maintenance; (2) give implied warranties of fitness and merchantability for a period of three years beginning with the notice of intended conversion and continuing for three years, or the recording of the declaration to condominium and continuing for three years, or one year after owners, other than the developer obtain control of the association, whichever occurs later, but in no event more than five years; or (3) post a surety bond in an amount which would be equal to the total amount of all required reserve accounts payable to the association.¹⁹

Compliance with s. 718.618, F.S., does not shield the developer from all liability in connection with the components involved nor does it foreclose other legal actions based upon negligence, misrepresentation, strict liability, or similar liability actions.²⁰

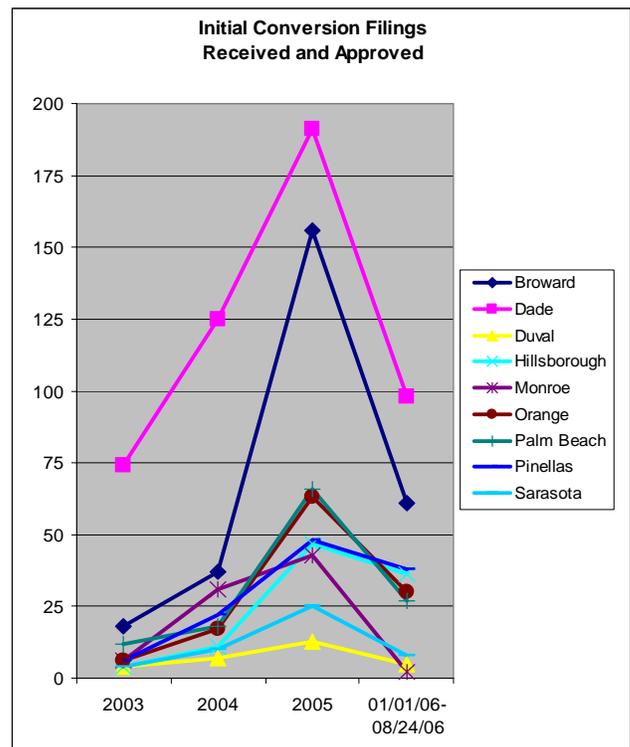
Current Trends in the Rate of Condominium Conversions

Condominium conversions have increased since the inception of the Roth Act in 1980. A significant increase occurred between July 2003 and December 2005. It has only been since the beginning of 2006 that a downward shift has taken place. In many areas of the state, property that had been converted to condominiums has reverted back to rental apartments. A June 2006 article in realestatejournal.com cites data from McCabe Research & Consulting²¹ that shows that the 2006 South Florida housing market, an area that had

been extremely active, had begun to slow down. The data showed that eight converted complexes containing 2,156 units had reverted to rentals.²² Quoting Jack McCabe, the Chief Executive of McCabe Research & Consulting, LLC, the article states that the figure compares with about 62,904 units that were converted, or were beginning to be converted, in the area since 2004.

The article reports that industry watchers say this current trend is not necessarily bad for the apartment and condominium markets. The influx of condominium conversions led to a decrease in apartments with inflated rents. With the reversion taking place it could ease the upward pressure on rents.

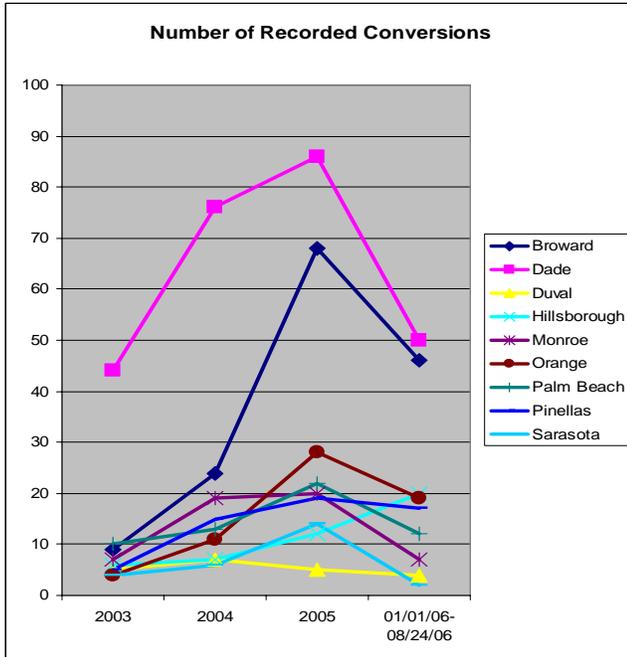
South Florida is not the only area of the state feeling the effects of decline in conversions. The numbers are down throughout the state as evidenced by the charts below.²³



²² *The Wall Street Journal Online* (last visited 0 Sept. 2006). <http://www.realestatejournal.com/buysell/markettrends/20060608-dunham.html?refresh=on>.

²³ Data was provided by DBPR's Division of Land Sales Condominiums and Mobile Homes. The number of filings for conversions with the division versus the number of actual recorded conversions is significantly different as evidenced by the charts above. A developer has 24 months from the time the division accepts a letter of filing for a conversion to create to condominium pursuant to s. 718.104, F.S.

¹⁶ Rule 61B-24.004(2), F.A.C.
¹⁷ Section 718.616(3)(b)3., F.S.
¹⁸ Section 718.616(4), F.S.
¹⁹ Section 718.618(7), F.S.
²⁰ *Supra* at note 7, s. 9.50.
²¹ <http://www.mccabersearch.com/pages/1/index.htm>, (last visited 20 Sept. 2006).



(The years provided in the charts represent calendar years January through December except as otherwise stated.)

| Total number of recorded conversions and their units approved in Florida by county from 1/1/06 through 8/23/06 | | |
|--|---------|-------|
| County | Project | Units |
| Dade | 50 | 3,998 |
| Broward | 46 | 7,137 |
| Orange | 19 | 3,975 |
| Palm Beach | 12 | 1,731 |
| Hillsborough | 20 | 2,879 |
| Pinellas | 17 | 1,957 |
| Duval | 4 | 1,306 |
| Monroe | 7 | 25 |
| Seminole | 6 | 1,608 |
| Sarasota | 2 | 72 |
| Leon | 7 | 267 |
| Lee | 7 | 1,680 |

Source: Department of Business and Professional Regulation

Effects on Affordable Housing

The Florida Housing Finance Corporation (FHFC) expressed concern over the rate of conversions and the affects on affordable housing during the 2006 Legislative Session. The FHFC states that part of the market for affordable housing comes from conventionally financed rental units. With the 26,717 rental units being converted in 2005, the FHFC predicted that about 10 percent of the subsidized housing was up for conversion. (There are approximately 265,000 subsidized rental units in Florida.)²⁴

²⁴ From the 2005 Final Report of the Affordable Housing Study Commission. <http://www.floridahousing.org/ahsc/AnnualReports/2005AnnualReports/> (last visited 20 Sept. 2006)

The Affordable Housing Study Commission²⁵ reported that 40,000 affordable housing units are over 30 years old and another 43,000 units are more than 20 years old. Additionally, the commission reported that the affordability period was set to expire on over 15,000 units by the end of 2005 and another 12,000 by 2010. The affordability period ranges from 15 to 50 years depending on the program and year in which the units were built. Developers receive tax credits if they receive funding from the FHFC and will in turn be required to place limitations on rents.

The costs to develop affordable housing have increased faster than the funding for federal and state programs resulting in FHFC Housing financing fewer rental units each year.

However, the FHFC states that the decline in conversions in 2006 has given some relief to the affordable housing market. It reports that they are not presently getting requests to convert their affordable housing. Additionally, no conversions have been approved by their board and only one is under consideration –24 units in Miami Beach, which the developer has proposed to replace with 48 affordable rental units in Miami.²⁶

Problems with conversions

Despite the decline in conversions, experts opine that this is only a temporary slowdown and that the market has adjusted itself to address the glut of inventory and the artificially inflated market values. Market values have been inflated due to speculator activity and the increase in insurance rates and property taxes.²⁷

Senator Margolis introduced Senate Bill 1270 during the 2006 Regular Legislative Session. The bill directed the Advisory Council on Condominium to review part VI of ch.718, F.S. and to evaluate whether such provisions provided adequate post-purchase protection for purchasers of condominium conversion properties and recommend any proposed legislation needed to improve the protection provided by part VI of ch. 718, F.S. The council was directed to report its findings and recommendations to the Legislature by November 30, 2006.

The bill required that the report examine ss. 718.616 and 618, F.S. as they relate to:

²⁵ The Affordable Housing Commission is created by s. 420.609, F.S. and is required to report to the Governor, President of the Senate, and Speaker of the House of Representatives on providing affordable housing programs.
²⁶ Communication with FHFC dated 8/14/06.
²⁷ Jack McCabe, Chief Executive, McCabe Research and Consulting and Peter M. Dunbar, Esq.

- 1) Whether the disclosures required by s. 718.616, F.S., provide adequate information to the purchaser; whether more specific guidelines regarding the contents of the reports should be established; and whether the creation of privity²⁸ or potential liability between persons who certify such disclosure reports and the unit owners should be addressed; and
- 2) Whether the provisions of s. 718.618, F.S., which require developers to fund reserve accounts or alternatives to such accounts, are adequate or should be modified.

The proposed legislation was partly in response to the article written in the Miami Business Journal noted above, the City of Miami Beach's complaints regarding certain failed condominium conversions within the city, and other concerned constituents who voiced their concerns to Senator Margolis.

The article maintained that the current statutory law offered little protection for consumers and required limited accountability for developers.²⁹ The article noted that, once a condominium association assumes control over the converted condominium, it may face hidden structural problems and problems regarding the reserve accounts. Another criticism identified was that the corporations created for the conversion may be limited liability companies with little assets to be attached when problems arise after the conversion.³⁰

The issue of privity between the condominium owners and the engineer and/or architects who inspect a building prior to conversion has been called into question by three Florida appellate cases. In *Bay Garden Manor Condominium Association, Inc., v. James D. Marks Associates, Inc.*, 576 So.2d 744 (Fla. 3d DCA 1991), the court was presented with the question of whether an engineering firm, that provides false information in its structural reports as to the physical condition of the building that was being converted from apartments to condominiums, may be liable in tort to subsequent purchasers of the condominium units with whom there is no contractual relationship.

²⁸ Privity is defined as the "connection or relationship between two parties, each having a legally recognized interest in the same subject matter (such as a transaction, proceeding, or piece of property); mutuality of interest; privity of contract." Privity of contract is that "relationship between the parties to a contract, allowing them to sue each other but preventing a third party from doing so. The requirement of privity has been relaxed under modern laws and doctrines of implied warranty and strict liability, which allow a third-party beneficiary or other foreseeable user to sue the seller of a defective product." Black's Law Dictionary (8th ed. 2004).

²⁹ *Supra* at note 3.

³⁰ *Id.*

The court stated that the economic loss rule³¹ should not be applicable in this case since engineering is a profession and the engineers were hired to prepare reports of a structural inspection in order to guide others in business decision. The court remanded the case for a decision on three main questions: 1) whether the inspection reports were false; 2) whether the unit owners were persons who relied on the opinions; and 3) whether the unit owners suffered pecuniary loss based on reliance on the information.

This decision was called into doubt in the case of *Florida Building Inspection Services, Inc., v. Arnold Corporation*, 660 So.2d 730 (Fla. 3d DCA 1995). In the case the court considered whether a private roof inspector, who was hired by a lessee of a warehouse, owes a duty of care to a third party sub-lessee, not in privity with the inspector, who has incurred an economic loss. The court stated that the facts of the cases did not justify an exception to the economic loss rule since the third party lessee was fully capable of assuring the condition of the roof by choosing and hiring its own inspector rather than relying on the lessee's inspector.

In the third case, *Ocean Ritz of Daytona Condominium v. GGV Associates, Ltd.*, 710 So.2d 702 (Fla. 5th DCA 1998), the court held that the economic loss rule barred a negligence action by a condominium association against an architectural consultant employed by an engineering company, that was employed by the developer. The court held that the economic loss rule does not limit the number of potential defendants subject to a contract claim, it merely limits the causes of action that might be brought against them.

City of Miami Beach Ad Hoc Condominium Taskforce Recommendations

Because of serious issues with condominiums, the City of Miami Beach established an Ad Hoc Condominium Reform Taskforce.³² The taskforce has prepared recommendations for changes to Part VI of ch. 718, F.S., for the City Commission to include in the City's Legislative agenda for the 2007 Session.

At the July 10, 2006 meeting, the Taskforce voted to provide the City Commission with the following recommendations related to condominium conversions to be included in the city's legislative agenda for the Florida Legislature:³³

³¹ This rule generally bars a tort action for purely economic loss in order to protect a defendant in the absence of privity of contract between the two disputing parties from unlimited liability for all economic consequences of a negligent act.

³² See City of Miami Beach Afteraction Agenda for December 7, 2005:

<http://www.miamibeachfl.gov/newcity/agendas/aa120705.pdf> at page 53 (last visited 22 Sept. 2006).

³³ The Task Force offered other recommendations related to condominiums but not specific to conversions.

- Amend F.S. 718.616 (4), to expand the content of the municipal letter to include disclosure of all outstanding building code violations.
- Amend F.S. 718 to require that all outstanding building code violations be resolved prior to State approval of a condominium conversion.
- Amend F.S. 718.616 to require submission by the applicant to the local governing body of those items required to be disclosed pursuant to a conversion.
- Amend F.S. 718.616 to expand disclosure requirements to include:
 - (1) outstanding municipal code (building, use, etc.) violations on the premises
 - (2) date of most recent recertification
 - (3) accounting of the status of the capital replacement and repair reserve funds
 - (4) current capital contracts in effect
 - (5) any litigation regarding the premises
 - (6) listing of all outstanding municipal or contractor liens
 - (7) all current municipal occupational licenses and uses for the premises.

Advisory Council on Condominiums Recommendations

Though SB 1270 died in committee, the Advisory Council on Condominiums has been reviewing part VI of ch. 718, F.S. since 2005.³⁴ The chair of the Advisory Council on Condominiums, stated that the proposed language provides for 1) Insuring appropriate reserve amounts for capital expenditures and deferred maintenance; 2) Closing the gap in the 24-month period between an initial filing for a conversion and the actual recording of the conversion in the public records by insuring that updated inspection reports are provided in cases where components are renovated or repaired; and 3) Addressing the lack of privity between the condominium owner and the engineer or architect who provides the report.

The work product language being considered includes:

- Disclosures of components be made contemporaneous with the date of the inspection report;
- Requirements that a supplemental inspection report be prepared for any structures or components that are renovated or repaired after the completion of the original inspection report and prior to the recording of the declaration of

condominium;³⁵

- Each unit owner, and the association are beneficiaries of the inspection report prepared and issued under the seal of the architect or engineer;³⁶
- The age of any component or structure that the developer is required to fund a reserve account be measured in years, rounded to the nearest whole year;³⁷
- The amount of converter reserves funded by the developer for each structure or component is determined based on the age of the structure or component as disclosed in the inspection report. The age of the component would be determined by the architect or engineer;³⁸
- The amount of funding for the converter reserve accounts be the product of the estimated current replacement cost of the component, as disclosed and substantiated pursuant to s. 718.616(3)(b), F.S., multiplied by a fraction, the numerator of which shall be the age of the component in years, and the denominator shall be the total estimated life the component in years;³⁹
- The developer choose any one of the post purchase protections provided in this section for each of the structures or components listed in the conversion inspection report. The developer must disclose, in the documents required to be furnished purchasers, the type of post-purchase protection that is to be provided for each structure or component: funded reserve accounts, warranties, or surety bond.

RECOMMENDATIONS

Staff recommends that legislation addressing changes to part VI of ch. 718, F.S., contain language that insures appropriate reserve amounts for problems that arise in maintaining the condominium structure, and provide for updated inspection reports for components that are renovated or repaired. The language should also provide for the ability of the condominium owner to have appropriate recourse through the courts for any failure to disclose defects by the engineer and the developer.

³⁴ Final Report of the Condominium Advisory Council, December 2005.
http://www.state.fl.us/dbpr/lsc/condominiums/advisory-council/report_2005.pdf (last visited 26 Sept. 2006)

³⁵ This language addresses concerns in problems with the 24-month gap that can occur between the filing for the conversion and the recording.

³⁶ This provides privity between the condominium owner and the engineer who provides the report.

³⁷ This language addresses the concerns over post-purchase protections.

³⁸ *Id.*

³⁹ *Id.*