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Phone: +1 646 783 7100 | Fax: +1 646 783 7161 | customerservice@law360.com

The Florida Condominium Termination Trap

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Martha A. Hartley

Just when lenders and servicers thought they had seen it all with crowded dockets, understaffed courts, increased foreclosure times, mandatory mediation, trial mortgage modifications, last-minute bankruptcy petitions and litigation tactics, which much too often fell somewhere between sloppy and sanctionable, now comes yet another problem — the condominium termination. Never heard of it? Well, read on, because lenders and investors can lose the collateral and receive pennies on the dollar in recovery!

In response to the proliferation of distressed and unsustainable condominium projects throughout the state, the Florida Legislature in 2007 amended Fla. Stat. Section 718.117,[1] hoping to strike a balance between the collective nature of a condominium and the inherent problem of collective action. Previously, absent a more lenient provision in the condominium declaration itself, condominium termination required 100 percent approval by unit owners and mortgagees. The 2007 statutory revision reduced the approval threshold to 80 percent of the unit owners as long as no more than 10 percent of the unit owners objected to the plan in writing. See Fla. Stat. 718.117(3).

Any lien holder who will not be paid in full as a result of the termination must either consent to the plan of termination or file an objection to the plan in accordance with the procedures described below. Advance consent by a mortgage holder is not required; therefore, the notice and objection procedures discussed below are critical to mortgagees and servicers.

As the condominium recession in Florida grew, investors sensed an opportunity to acquire condominium units at historically low, distressed prices, and many began to acquire all of the remaining unsold units in a distressed condominium — a bulk purchase — and then added to their investment by purchasing additional individual units. In some cases, the condominium developer itself reacquired some of the units it had sold, with a view toward converting the project to a rental community.

Most of these condominium projects were "fractured" in that many unit owners were absent and not participating in association meetings, not paying assessments and under water with respect to their mortgage loans. These conditions led to foreclosures by both mortgage holders and the condominium associations with respect to its liens for assessments.[2] The bulk purchasers or developers often had to

shore up the association budgets with their own funds in order to maintain the projects or complete construction. Bulk purchasers and developers saw the new, easier termination statute as a means to get out from under this budget burden and add value to their investment by converting the project from a condominium to a multifamily project.

How does a condominium termination work in practice? Briefly, the termination trustee (usually the condominium association itself) records a plan of termination that meets the statutory requirements — approval by at least 80 percent of the voting interests without affirmative disapproval by more than 10 percent of the voting interests. The plan usually authorizes the termination trustee to sell the condominium property (including all mortgaged units) at current fair market value as established by an independent appraisal.[3] This sale creates a pool of money (termination proceeds) to pay unit owners and lien holders in accordance with their record priority.

Upon the effective date of the plan, by operation of law, record title to the units transfers to the termination trustee and any lien on a unit automatically transfers to the termination proceeds. The termination trustee does not need to obtain either a deed from the unit owner or a mortgage satisfaction or release from the mortgage holder.

In cases where the unit owner is "under water" with its mortgage loan, the fair market value of the unit will not be sufficient to pay the remaining balance of the mortgage. The mortgage holder will receive all of the termination proceeds allocable to that unit but will have a deficiency remaining. The termination does not affect the lender's right to seek a deficiency judgment.

As a practical matter, the effect of the termination is to put the mortgage holder in the same position as if it had foreclosed its mortgage and then sold the unit for its fair market value. This can actually work to the lender's advantage by avoiding foreclosure time and costs. It can be disadvantageous, however, where the lender believes that the actual value of the unit is substantially more than the fair market value as determined in the termination appraisal. Additionally, in cases where, despite being under water, the unit owner is managing to keep the mortgage current, the lender may be disadvantaged by having that performing loan turn into a defaulted loan.

A mortgage holder may formally object to a plan of termination. However, the more practical route may be to negotiate with the bulk purchaser or developer to achieve a more favorable outcome for itself. This may come in the form of an agreed short sale (at a higher price than appraised value) prior to the effective date of the plan. Most plans permit individual unit sales to occur in the normal course prior to the effective date of the plan. Thus, anything that can be accomplished through an agreed sale process is available until the date the plan becomes effective and the mortgage lien transfers to termination proceeds.

Lien holders and particularly servicers should beware that there is a potential trap! That trap is how notice of the termination may be made and failure to timely respond to such notice. Failure to respond to notice of the termination could affect lien position and the payoff funds received.

How can the mortgage interest be protected? First be aware that although the statute provides for notice in two ways, the first, constructive notice through recording the notice of termination in the public records of the county where the condominium is located,[4] is unlikely to provide any notice at all. Lenders and servicers have little reason to examine real estate records following the loan origination so this "notice" is fiction.

Instead, the critical notice for the lien holder or servicer will be limited to a certified letter that the termination trustee must, by statute, send to "lienors of all units at their last known addresses" advising that "a plan of termination has been recorded." See718.117(15)(a). The certified letter must provide the book and page number of the public records in which the plan was recorded, notice that a copy of the plan shall be furnished upon written request, and notice that the unit lienor has the right to contest the fairness of the plan. Id.

The mortgage lien holder's right to contest the termination plan is both time-sensitive and narrow in scope. Subsection (16) of Florida Statute 718.117 provides:

(16) RIGHT TO CONTEST. A unit owner or lienor may contest a plan of termination by initiating a summary procedure pursuant to s. 51.011 within 90 days after the date the plan is recorded. A unit owner or lienor who does not contest the plan within the 90-day period is barred from asserting or prosecuting a claim against the association, the termination trustee, any unit owner, or any successor in interest to the condominium property. In an action contesting a plan of termination, the person contesting the plan has the burden of pleading and proving that the apportionment of the proceeds from the sale among the unit owners was not fair and reasonable. The apportionment of sale proceeds is presumed fair and reasonable if it was determined pursuant to the methods prescribed in subsection (12). The court shall determine the rights and interests of the parties and order the plan of termination to be implemented if it is fair and reasonable. If the court determines that the plan of termination is not fair and reasonable, the court may void the plan or may modify the plan to apportion the proceeds in a fair and reasonable manner pursuant to this section based upon the proceedings and order the modified plan of termination to be implemented. In such action, the prevailing party shall recover reasonable attorney’s fees and costs.

The key factors to note in protecting the right to object to a plan of termination follow:

(1) An objection to the plan must be made through filing a complaint in court. A letter or phone call of objection to the termination trustee, developer or bulk purchaser is not sufficient.

(2) The complaint must be filed within 90 days after the plan is recorded — not within 90 days of when the certified notice is dated or received. The statute requires the certified mail notice to be sent within 30 days after the plan is recorded in the public records. Therefore, by the time the certified letter is received, there may be 60 days or fewer in which to file an objection. Be sure to obtain a copy of the recorded plan so that you know the date of recording and can calculate your deadline.

(3) The certified notice must be sent to the last known address of the lien holder. This is usually the notice stated within the recorded mortgage. If the mortgage has been assigned without recording an assignment or if servicing of the mortgage has been transferred to a servicer, the termination trustee may have no way of knowing the current mortgage holder or servicer or its current address. For this and other reasons, strongly consider recording all assignments of mortgage as promptly as possible and also consider recording some notice of servicing rights, if applicable. Any recorded instrument that advises the termination trustee of the proper notice address should be sufficient. Although the termination trustee is not legally obligated to send notice to a servicer, most prudent trustees will do so if they have recorded notice of the servicing relationship and the servicer's address.

The bottom line is that unless the mail department or person reviewing the mail is made aware of the extreme time-sensitivity of notices of termination and directs the notice to the proper party for disposition, it may languish unread or without appropriate action until the 90-day time period has

expired. There is little your attorney can do after expiration!

Never has the mail room been so important as literally thousands of condominium units may be at stake. So, who is reading your mail and can they protect you from the Florida condominium termination trap?

—By Martha A. Hartley and Russell Buchanan, Baker Donelson Bearman Caldwell & Berkowitz PC

Martha Hartley is a shareholder in Baker Donelson's Orlando, Florida, office. Russell Buchanan is an associate in the firm's Tallahassee, Florida, office.

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[1] Available online at http://www.flsenate.gov/Laws/Statutes/2013/718.117

[2] As attorneys have become more comfortable with revisions to the Condominium Act, and as values have stabilized and improved, condominium associations have become increasingly aggressive, not only through the use of independent foreclosures, but also through attachment to rental proceeds in order to satisfy past due assessments. See 718.116(11)(a), Fla. Stat. In many cases, this provision seemingly runs afoul of the assignment of rents held by a lender, or with the provisions of the declaration itself, to the extent it did not adopt and incorporate future changes to Chapter 718.

[3] See 718.117(12)(b) ("the portion of proceeds allocated to the units shall be further apportioned among the individual units. The apportionment is deemed fair and reasonable if it is so determined by the unit owners, who may approve the plan of termination by any of the following methods: 1. The respective values of the units based on the fair market values of the units immediately before the termination, as determined by one or more independent appraisers selected by the association or termination trustee ...").

[4] See, e.g., Smith v. FDIC, 61 F.3d 1552, 1557 (11th Cir. 1995) (Florida recognizes three forms of notice; express actual notice, implied actual notice and constructive notice.)

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