SENATE STAFF ANALYSIS AND ECONOMIC IMPACT STATEMENT

(This document is based on the provisions contained in the legislation as of the latest date listed below.)

Prepared By: Regulated Industries Committee

BILL:	CS/SB 396
INTRODUCER:	Regulated Industries Committee and Senator Margolis
SUBJECT:	Community Associations
DATE:	February 7, 2007 REVISED:

	ANALYST	STAFF DIRECTOR	REFERENCE	ACTION
1.	Sumner	Imhof	RI	**Fav/CS**
2.			JU	
3.				
4.				
5.				
6.				

I. Summary:

The bill addresses changes made to the Condominium Act, the Cooperative Act, and the Mandatory Homeowners Association Act in the 2007 Special Session regarding insurance coverage by:

- clarifying and modifying language that will allow residential condominiums to self-insure, and
- updating budgets of the association if the association is in a new budget year for purposes of insurance disclosure language in condominium purchase contracts and prospectuses.

The bill addresses the gap in the 24-month period between an initial filing for a conversion and the recording of the conversion in the public records by requiring updated inspection reports when components are renovated or repaired. It revises requirements for reserve accounts that provide post purchase protection for purchasers. It provides for privity between the condominium owner and the association by providing that the owners and theassociation are third party beneficiaries to the engineer and/or architects report.

This bill substantially amends the following sections of the Florida Statutes: 718.103, 718.115, 718.116, 718.503, 718.504, 718.616, 718.618, 719.104, 719.107, 719.108, 719.503, 719.504, 720.303, and 720.308.

II. Present Situation:

The 2007 Special Session

The Governor convened a Special Session in January 2007 to address the insurance crisis in Florida. Committee Substitute for House Bill 1-A, enacted as ch. 2007-1, was passed. Part of the intent of the act is to provide homeowners with reasonable options to insure their homes by addressing the financial and regulatory methods that the property insurers and reinsurers use to do business in Florida.

The act amended provisions of the condominium act to attempt to make insurance more available and affordable for condominiums by:

- Limiting the insurance requirements in s. 718.111(11), F.S., to residential condominiums and allowing commercial condominiums to select from currently available insurance products that exist in the marketplace;
- Allowing the condominium board of directors in s. 718.111(11)(a), F.S., to consider available funds or predetermined assessment authority when determining whether they have the statutorily required "adequate insurance;"
- Creating a new paragraph in s. 718.111(11)(a), F.S., that allows for three or more communities created under chapter 718, chapter 719, chapter 720, or chapter 721, F.S., to obtain and maintain windstorm insurance coverage if it is sufficient to cover an amount equal to the probable maximum loss for the communities for a 250-year windstorm event. The probable maximum amount must be determined through the use of a competent model accepted by the Florida Commission on Hurricane Loss Project Methodology;
- Amending s. 718.111(11)(a)(2), F.S., by providing that the self-insurance be considered adequate insurance for the purposes of the section.

Condominium Conversions

In the 2006 Regular Legislative Session, Senator Margolis introduced Senate Bill 1270 which directed the Advisory Council on Condominiums 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 proposed legislation was partly in response to the article written in the Miami Business Journal, 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 identified several issues regarding the conversion process.[1] The article maintained that the current statutory law offered little protection for consumers and required limited accountability for developers. 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 companies with little assets to be attached when problems arise after the conversion.[2]

Though SB 1270 was not enacted by the Legislature, the Advisory Council on Condominiums and the Senate Regulated Industries Committee reviewed part VI of ch. 718, F.S. and provided recommendations for legislation.[3]

The Senate President approved an interim project to review the concerns raised in SB 1270, regarding post-purchase protection for purchasers of condominium conversion properties. The report provided 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 recommended 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 staff also recommended that the language should 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.

Advisory Council on Condominiums

In 2004, the Legislature created the Advisory Council on Condominiums, in part to receive public input regarding issues of concern with respect to condominiums and recommendations for changes in the condominium law.[4] The issues the council is required to consider include, but are not limited to, the rights and responsibilities of the unit owners in relation to the rights and responsibilities of the association.[5] The council is also charged with recommending necessary improvements to the education programs offered by the Division of Florida Land Sales, Condominiums, and Mobile Homes and reviewing, evaluating, and advising the division about revisions and adoption of rules affecting condominiums.[6] The council is administratively assigned to the division within the Department of Business and Professional Regulation (DBPR).[7] The members of the council serve on a voluntary basis, but are entitled to receive per diem and travel expenses while on official business.[8] The council receives support from staff at

[1] Paola Iuspa-Abbott, "Condo Conversion Blues," *Daily Business Review*, 15 Aug. 2005, A8.
[2] *Id.*
[3] Meeting of the Advisory Council on Condominiums, September 15, 2006. *Condominium Conversions*, Interim Report No. 2007-136, Florida Senate Committee on Regulated Industries, October 2006.
[4] Section 5, ch. 2004-345, L.O.F.
[5] Section 718.50151(2)(a), F.S.
[6] Section 718.50151(2)(b) and (c), F.S.
[7] Section 718.50151(1), F.S.
[8] *Id.*

the division; however, these responsibilities make up less than 5 percent of the staff person's responsibility.[9]

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.[10] 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 protections to purchasing and nonpurchasing tenants.[11]

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. Each tenant has the right of first refusal to purchase the unit and the developer must provide basic background information to assist each tenant in evaluating the potential purchase.[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.

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[9] Conversation with staff, Department of Business and Professional Regulation, Florida Land Sales, Condominiums, and Mobile Homes Division, Wednesday, March 1, 2006.
[10] Section 1, ch. 80-3, L.O.F.
[11] *Florida Condominium Law and Practice*, 3d ed., s. 9.1 (The Florida Bar, 2003).
[12] Peter M. Dunbar, *The Condominium Concept, A Practical Guide for Officers, Owners and Directors of Florida Condominiums*, 8th ed., s. 2.7, 33-34 (Aras Publishing 2003).
[13] Section 718.616, F.S.; Rule 61B-24.004(1)(a), F.A.C.

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] There is no requirement for an updated report or disclosure. By not providing an updated report, there is potential for a 24 month gap from the date the of the initial filing for conversion and the actual recording of the conversion as presubscribed in rule 61B-17.005, Fla. Admin Code.

The Department of Business and Professional Regulation noted that the law is unclear as to liability of the preparer of the report to the unit owners or to the association. To be liable under a contract, a person must be in "privity"[16] with another person.

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.[17]

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

(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.[18]

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.[19]

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.[20] The disclosure must also include a letter from the county acknowledging compliance with applicable zoning requirements as determined by the municipality. 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

[14] Section 718.616(3)(b), F.S.
[15] *Id.*
[16] 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).
[17] *See Bay Garden Manor Condominium Association, Inc., v. James D. Marks Associates, Inc*., 576 So.2d 744 (Fla. 3d DCA 1991); *Florida Building Inspection Services, Inc., v. Arnold Corporation*, 660 So.2d 730 (Fla. 3d DCA 1995); and *Ocean Ritz of Daytona Condominium v. GGV Associates, Ltd.*, 710 So.2d 702 (Fla. 5th DCA 1998).
[18] Rule 61B-24.004(2), F.A.C.
[19] Section 718.616(3)(b)3., F.S.
[20] Section 718.616(4), F.S.

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 condominiums and continuing for three years, or one year after owners other than the developer obtain control of the association, whichever occurs later; 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.[21] The developer may establish and fund additional reserve accounts under s. 718.618(5), F.S., but there are no provisions for the calculation of the amount of the reserve accounts.

Compliance with s. 718.618, F.S., does not shield the developer from all liability in connection with the components involved. The statute does not foreclose other legal actions based upon negligence, misrepresentation, strict liability, or similar liability actions.[22]

III. Effect of Proposed Changes:

Condominiums

The bill amends the definition of "Land" in s. 718.103(18) by including a condominium unit.

It defines the new insurance products authorized by the 2007 Special Session A legislation as "common expenses" in s. 718.115, F.S., to include the costs of windstorm insurance acquired by the association under the authority of s. 718.111(11), F.S., including costs and contingent expenses required to participate in a self-insurance fund authorized and approved pursuant to s. 624.462, F.S.

The bill amends the specific purpose of a special assessment in s. 718.116, F.S., to include any contingent special assessment levied in conjunction with the purchase of a windstorm insurance policy authorized by s. 718.111(11), F.S.

It modifies the insurance disclosure language in Condominium Purchase Contracts in s. 718.503, F.S. It provides that the figures contained in any budget are only estimates and represent an approximation of future expenses based on facts and circumstances which exist at the time the developer prepares the budget. It further provides that the actual costs of items may exceed the estimated costs and that such changes do not constitute material adverse changes in the offering.

The bill amends s. 718.503(1)(c), F.S., to provide that updated estimates of the operating budget be provided at closing if the association is in a new budget year. The estimate is not to be considered an amendment that modifies the offering if the changes to the budget were the result of matters beyond the developer's control. Changes in budgets of any master association, recreation association, or club and similar budgets for entities other than the association are also not to be considered amendments that modify the offering.

[21] Section 718.618, F.S.
[22] *Supra* at note 8, s. 9.50.

The bill modifies the disclosure language for insurance in the Condominium Prospectus in s. 718.504(21), F.S., by requiring a statement in conspicuous type that the budget is prepared in accordance with the condominium act, is a good faith estimate and represents an approximation of future expenses based on facts and circumstances existing at the time of preparation. It further provides that any changes in actual cost from the estimated cost do not constitute material adverse changes in the offering.

It creates s. 718.504(21)(e), F.S., to clarify that the budget is a good faith estimate made at the time of the filing of the offering circular with the division and any subsequent increased amounts on any item which are beyond the developer's control are not considered amendments that give rise to rescission rights as provided in the section[23] nor do such increases, modify, void, or otherwise affect any guarantee of the developer.

Condominium Conversions

The bill amends s. 718.616, F.S. to require a dated report on the conditions of improvements, certain components and their current estimated replacement cost. It revises the list of components to include pilings, docks, concrete that includes roadways and walkways, and irrigation systems to the conversion inspection report.

It revises the information that must be disclosed and substantiated by an architect or engineer to include the age and useful life of the component as of the date of the report.

It creates s. 718.616(2)(c)-(e), F.S., to:

- Provide that the unit owners and association are in privity with the engineer and/or architect by providing that each unit owner and the association are third-party beneficiaries of the disclosure report;
- Require a supplemental inspection report for any structure or component that is renovated or repaired after completion of the original report and prior to the recording of the declaration of condominium;
- Require the developer to provide annual updates prior to recording the declaration of condominiums if the declaration is not recorded within one year after the date of the original report;
- Prohibit the report from containing representations on behalf of the development regarding future improvements or repairs and to require that the report be limited to the current condition of the improvements.

The bill amends s. 718.618(1)(b), F.S., to clarify that, to fund a reserve account, the age of a structure should be determined based on the age of the structure or component as disclosed in the inspection report and requires rounding the age to the nearest whole year. It requires that the architect or engineer determine the age of the component based on the criteria in the statute. Section 718.618(1)(d), F.S., is amended to provide that the vote to waive or reduce the funding of reserves required by s. 718.112(2)(f), F.S., does not affect or negate the reserve obligations arising out of s. 718.618, F.S.

[23] S*ee* Technical Deficiencies section.

It clarifies s. 718.616(5), F.S. by providing that when the developer establishes and funds an additional converter reserve account, the amount of funding must be the product of the estimated current replacement cost of a component, as disclosed and substantiated pursuant to s. 718.616(3)(b), F.S.,[24] multiplied by a fraction, the numerator of which is the age of the component in years and the denominator of which is the total estimated life of the component in years.

It deletes the provision in s. 718.616(6), F.S., that specifies which components the developer must provide an implied warranty of fitness and merchantability when the developer fails to establish reserve accounts or as an alternative to establishing a reserve account.

It creates s. 718.618(10), F.S., to require the developer to disclose in conspicuous type in the contract for sale which purchaser protection option the developer will establish, reserve accounts, a warranty of fitness and merchantability, or a surety bond.

Cooperatives

It amends s. 719.104, F.S., to authorize cooperatives to participate in the self-insurance programs authorized in the 2007 Special Session A.

It creates s. 719.107(1)(e), F.S., to provide that common expenses include the costs of windstorm insurance acquired by the association under the authority of s. 718.111(11), F.S., including costs and contingent expenses required to participate in a self-insurance fund authorized and approved pursuant to s. 624.462, F.S.

It amends s. 719.108(9), F.S., to provide that the specific purposes of any special assessment include any contingent special assessment levied in conjunction with the purchase of a windstorm insurance policy authorized by s. 719.104(3), F.S., and that any excess funds may, at the discretion of the board, either be returned to the unit owners or applied as a credit toward future assessments.

It amends the disclosure language for cooperative contracts in s. 719.503(1)(a), F.S., to provide that figures contained in any budget delivered to the buyer prepared in accordance with the cooperative act are estimates only and represent an approximation of future expenses based on facts and circumstances existing at the time of the preparation of the budget by the developer. The actual costs of the items may exceed the estimated cost but do no constitute material adverse changes in the offering.

It creates s. 719.503(1)(c), F.S., to provide that if the closing on a contract occurs more than 12 months after the filing of the offering circular with the division, the developer shall provide a copy of the current estimated operating budget of the association to the buyer at closing. The estimate is not to be considered an amendment that modifies the offering if the changes to the budget were the result of matters beyond the developer's control. It further provides that changes

[24] This section provides for the information to be substantiated by an architect or engineer certificate under seal.

in budgets of any master association, recreation association, or club and similar budgets for entities other than the association shall not be considered amendments that modify the offering.

It creates s. 719.504(20)(d), F.S., to provide that the estimated operating budget for the cooperative and the association, and a schedule of the unit owner's expenses that is attached as an exhibit contain a statement in conspicuous type that the budget contained in the offering circular is prepared in accordance with the cooperative act and is a good faith estimate only and represents an approximation of future expenses based on facts and circumstances existing at the time of its preparation. The actual costs may exceed the estimate but such changes do not constitute material adverse changes in the offering.

It creates s. 719.504(20)(e), F.S., to provide that each budget the developer prepares for an association be done in good faith and reflect accurate estimated amounts for the required items in the section at the time of filing of the offering circulars with the division, and subsequent increased amounts of any item included in the association's estimated budget which are beyond the control of the developer are not considered an amendment that gives rise to rescission rights set forth in s. 719.504(1)(a) or (b), F.S.,[25] nor shall the increases modify, void, or otherwise affect any guarantee of the developer contained in the offering circular or any purchase contract.

Homeowners' Associations

It creates s. 720.303(11), F.S., to provide that windstorm insurance coverage for a group of no fewer than three communities created and operating under ch. 718, ch. 719, ch. 720, and ch. 721, F.S.[26] may be obtained and maintained if the insurance is sufficient to cover an amount equal to the probable maximum loss for the communities for a 250-year windstorm event. The probable maximum loss is determined through the use of a competent model that has been accepted by the Florida Commission on Hurricane Loss Projection Methodology. The insurance coverage is deemed adequate windstorm coverage for purposes of this chapter.

It amends s. 720.308(3), F.S., to authorize a mandatory homeowners' association board of directors to make assessments in conjunction with the self-insurance funds authorized and operating pursuant to s. 624.462, F.S.

It amends s. 720.308(4), F.S., to provide that the section does not apply to an association if the association was created in a community that is included in an effective development-of-regional-impact development order as of October 1, 1995.

The act is effective upon becoming a law.

IV. Constitutional Issues:

A. Municipality/County Mandates Restrictions:

None.

[25] *See Technical Deficiencies section.*

[26] Chapter 718, F.S., relates to condominiums, ch. 719, F.S., relates to cooperatives, ch. 720, F.S. relates to mandatory homeowners' associations and ch. 721, F.S., relates to vacation and timeshare plans.

B. Public Records/Open Meetings Issues:

None.

C. Trust Funds Restrictions:

None.

V. Economic Impact and Fiscal Note:

A. Tax/Fee Issues:

None.

B. Private Sector Impact:

The Department of Business and Professional Regulation (department) states that the bill provides developers with certainty regarding their liability for conversion warranty issues by clarifying existing law and allowing developers to post conversion reserves for any of the common elements. The department further indicated that the bill increases the protections to unit owners by designating them as beneficiaries to the conversion inspection report.

C. Government Sector Impact:

The department states that if enacted the bill may generate some additional calls to the department's call center, however a fiscal impact is not anticipated.

VI. Technical Deficiencies:

The reference to rescission rights in the amendment to s. 718.504(21)(e), F.S., should refer to s. 718.503(1)(a) and (b), F.S. The reference to rescission rights in the amendment to s. 719.504(20)(e), F.S., should refer to s. 719.503(1)(a) and (b), F.S.

VII. Related Issues:

According to the department, the current law allows developers to choose one of three purchaser protection options: conversion reserves, surety bonds or warranties. The department states that it is not clear whether there are any surety companies that will issue a surety bond for this purpose, and conversion warranties provided by developer Limited Liability Corporations (LLC) may provide little protection if the LLC has no assets.

VIII. Summary of Amendments:

None.