Florida Condominium Projects and ILSA
By Mario A. Iglesias

Beginning in the mid-1990s, there was a growing trend in Florida in which average buyers would purchase condominiums during a development's pre-construction phase with no intention of ever occupying the unit. These buyers would sign contracts only to reassign or "flip" the unit as soon as construction was completed. This trend, fed by other forces beyond the scope of this discussion, led to an interesting phenomenon in the South Florida real estate market by the time the market reached its peak around 2003. By that time, most new condominium units were being sold to investors (locally and colloquially referred to as "Flippers"), and would never be occupied by the original homeowners. It was not uncommon to find buyers camped out overnight outside of a sales center upon the announcement of a new project. A buyer could easily have signed a contract to purchase a unit for $500,000, and then "flip" that contract for a price well over $800,000 just one year later. As such, real estate developers rushed ahead with as many new projects as they could physically – and financially – handle at a time.

In the mad dash to develop condominium units to feed this growing market, which led to as many as 60,000 new units in Miami-Dade County alone, real estate developers had to make business decisions that carried material legal consequences. One such decision was whether to register the project with the U.S. Department of Housing and Urban Development (HUD) under the federal Interstate Land Sales and Full Disclosure Act (ILSA).

Under Florida law, most residential real estate condominium projects were subject to the disclosure and other requirements of the Florida Condominium Act (Ch. 718, Fla. Stat.). If the project involved fewer than 100 units, then it was exempt from HUD registration requirements under ILSA. Nevertheless, developers of projects involving more than 100 units preferred to avoid a HUD registration under ILSA and sought other exemptions.

A Florida real estate developer might find significant disadvantages if a project was subject to ILSA. First, ILSA compliance could potentially double the costs involved in not only preparing an offering circular and all the related documents under the Florida Condominium Act, but also in preparing a statement of record with HUD and a property report for the condominium buyer. Moreover, if the project was subject to ILSA, there were certain contractual provisions that could not be included in the purchase and sale agreement. If the project was exempt under ILSA, then a developer would be permitted to retain the full deposit collected from the buyer upon a default, even if the amount exceeded 15% of the purchase price. If the purchase was subject to ILSA, however, the developer's recovery in default would be capped at 15% of the purchase price. Additionally, a developer/seller would be required to provide a defaulting buyer with 20 days written notice and an opportunity to cure any default – a speed bump that would not apply if the project was exempt.

The curious fact about the real estate market during the "condo boom" was that many developers elected to exempt their project from ILSA's registration requirements by obligating themselves to substantially complete units within two years from the date that the buyer signs a sales contract. This two-year exemption was the most popular one utilized by South Florida real estate developers, particularly those with building projects with between 100 and 300 units. In fact, in

some cases, developers would piggyback exemptions by offering to sell 99 units under the "100 Lot" exemption with the remaining units sold under the two-year exemption. It was believed that the developer could complete a project of this size within two years following the date the units were pre-sold. The truth was that by 2003, there were no condominium projects in excess of 100 units that could be substantially completed in two years.

At the height of the market, most buyers closed on their condominium purchases whether or not they had cancellation rights under ILSA. The world changed following the meltdown of the real estate bubble, and in South Florida in particular, the market for the 60,000-plus new units vanished. In hindsight, these new units could never have been fully absorbed if the buyers had actually intended to live in them. When the bubble burst, it exposed the fact that more than 80% of South Florida condominium buyers were "pretending" to buy units for residential purposes when they were ultimately purchased as financial investment vehicles.

The result, among other things, was that the sale of residential condominium units would not trigger the application of the very laws that were designed to force disclosures addressing investment-based factors. After all, ILSA and the Florida Condominium Act are legislation designed to protect a homebuyer. Ironically, the pre-sale of condominium units is exempt from the registration requirements of the Securities Exchange Act of 1934. With the developments that have unfolded since the peak of the condo market, perhaps this law should have applied to the pre-sale of condominiums. It would have required disclosures of the actual factors being applied to most buyer decisions at that time.

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Hindsight Over Condo Sales

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Mario Iglesias: Disclosure laws should have been applied to pre-sales of units, rather than upon completion.