

2014

The Practical Impacts of Requirements Imposed on Condominium Developers After the Mortgage Crisis: A Case Study of *Double AA International Investment Group, Inc. v. Swire Pacific Holdings* and How Escrow Requirements Shaped Future Financing of New Condominium Construction

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Recommended Citation

Joshua A. Berman & Jordan P. Sarason *The Practical Impacts of Requirements Imposed on Condominium Developers After the Mortgage Crisis: A Case Study of Double AA International Investment Group, Inc. v. Swire Pacific Holdings and How Escrow Requirements Shaped Future Financing of New Condominium Construction*, 27 Loy. Consumer L. Rev. 1 (2014).

Available at: <http://lawcommons.luc.edu/lclr/vol27/iss1/2>

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Joshua A. Berman*
Jordan P. Sarason**

I. INTRODUCTION

Federal involvement in securitized loans provided a buffer for lenders to make increasingly risky loans for over seventy years. As lenders took advantage of government protections, securitized loans—the primary source of financing for real estate—were packaged together into trusts and segmented by tranches, which were then

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assessed a risk factor by a rating agency, and sold together.¹ By the mid-1990s, Wall Street financiers were lending to middle-class Americans through “exotic, untested financial products”² that ultimately led to the subprime mortgage crisis of the late 2000s.³

As lawmakers rushed to absolve themselves of blame, they hurriedly passed legislation aimed at correcting those issues identified as at the core of the subprime meltdown. While the mortgage crisis was residential in nature, legislators and the courts also tried to preempt a similar financial catastrophe from occurring in the commercial markets by passing new laws and more strictly enforcing existing laws. One such example of tighter judicial enforcement is evident when analyzing cases stemming from the Florida Condominium Act, specifically Section 718.202 of the Florida Statute pertaining to sales or reservation deposits prior to closing.⁴

Section 718.202 was first passed in 1976.⁵ There have been three instances of litigation originating out of the statute through 2008⁶—ostensibly, when the mortgage crisis was realized—and there have been an additional eight suits brought forth through the end of 2013. This heightened degree of judicial activism has addressed the gamut of Section 718.202 issues: distinguishing special agents in business and corporate law;⁷ purchase and sale refund questions

¹ Alan Kronovet, *An Overview of Commercial Mortgage Backed Securitization: The Devil is in the Details*, 1 N.C. BANKING INST. 288, 289 (1997).

² Christopher L. Peterson, Symposium, *Subprime Meltdown: The Law and Finance of the American Home Mortgage Foreclosure Crisis*, 2008 Utah L. Rev. 1107, 1107 (2012).

³ Yuliya Demyanyk & Otto Van Hemert, *Understanding the Subprime Mortgage Crisis*, 24 Rev. Financ. Stud. 1848 (2011).

⁴ Florida Condominium Act, Fla. Stat. § 718.202 (2011).

⁵ Double AA Int’l Inv. Group, Inc. v. Swire Pacific Holdings, 2010 WL 1258086 at 11 (S.D. Fla. 2010).

⁶ Barrack v. State, 462 So. 2d 1196 (Fla. 4th Dist. Ct. App. 1985) (defendant’s conviction and sentence for crimes of theft of condominium deposits by prohibited use was reversed and the information dismissed because the crime was nonexistent and the charges against defendant under the statute were not properly worded); Florida Communities Hutchinson Island v. Arabia, 452 So. 2d 1131 (Fla. 4th Dist. Ct. App. 1984) (in an action for rescission of an agreement to purchase a condominium unit which was not founded on a recorded instrument or mechanic’s lien, the trial court had no authority to condition discharge of the notice of *lis pendens* upon posting of a bond by the sellers); First Sarasota Service Corp. v. Miller, 450 So. 2d 875 (Fla. 2d Dist. Ct. App. 1984) (since the escrow agent had prior written notice of a claim that there was a dispute between the purchasers and the developer under Fla. stat. § 718.202(1)(d), it disbursed escrow funds at its peril).

⁷ In re Edgewater by the Bay, LLP, 419 B.R. 511 (Bankr. S.D. Fla. 2009).

following developer statutory violations;⁸ interpretation of escrow requirements;⁹ and retrospective operation of escrow requirements.¹⁰

The thrust of some of these later cases can be traced to the mortgage crisis. As the financial markets worsened, many real estate investors lost their fortunes and sought opportunities for relief. In 2009, the U.S. Southern District Court of Florida provided the perfect mechanism for these troubled investors to relieve themselves of investments in new condominium projects in *Double AA Int'l Inv. Group, Inc. v. Swire Pac. Holdings, Inc.*¹¹ In her eighteen-page opinion, Judge Cecilia Altonaga held that, given the express language of the escrow requirement in Fla. Stat. Section 718.202(5), the developer's failure to establish two separate escrow accounts for the plaintiffs' deposit violated the statute, and rendered the purchase and sale agreement in violation of the contract.¹² This holding, which was essentially affirmed on appeal,¹³ upended the traditional financing model for new condominium construction projects.¹⁴

The Florida legislature recognized the extent of the problems posed by Judge Altonaga's opinion and moved quickly to quash attempts by investors to receive refunds on their deposits. The legislature amended Section 718.202 to include the following:

All funds deposited into escrow pursuant to subsection (1) or subsection (2) may be held in one or more escrow accounts by the escrow agent. If only one

⁸ In re Mona Lisa at Celebration, LLC, 472 B.R. 582 (Bankr. M.D. Fla. 2012); Daneri v. BCRE Brickell, LLC, 79 So. 3d 91 (Fla. 3d DCA 2012); CRC 603, LLC v. North Carillon, LLC, 77 So. 3d 655 (Fla. 3d Dist. Ct. App. 2011); In re Harbour East Dev., Ltd., 2011 Bankr. LEXIS 2509 (Bankr. S.D. Fla. 2011); In re Laketown Wharf Mktg. Corp., 433 B.R. 401 (Bankr. N.D. Fla. 2010); Degirmenci v. Sapphire-Fort Lauderdale, LLLP, 693 F. Supp. 2d 1325 (S.D. Fla. 2010); Double AA Int'l Inv. Group, Inc. v. Swire Pac. Holdings, Inc., 674 F. Supp. 2d 1344 (S.D. Fla. 2009).

⁹ *Double AA Int'l Group Inc.*, 674 F. Supp. 2d 1344; *CRC 603, LLC*, 77 So. 3d 655.

¹⁰ *In re Harbour East Dev., Ltd.*, 2011 Bankr. LEXIS at 2509.

¹¹ *Double AA Int'l Inv. Group, Inc.*, 674 F. Supp. 2d at 1344.

¹² *Id.*

¹³ *Double AA Int'l Inv. Group, Inc. v. Swire Pac. Holdings, Inc.*, 637 F.3d 1169 (11th Cir. 2011) (holding that the district court did not err in finding the contract void under § 718.202(5) for failure to maintain a separate accounting, and finding reversible error only in the district court's authorization of a private cause of action against an escrow agent).

¹⁴ Interview, Dean Douglas Bischoff, Director, University of Miami School of Law Master of Laws (LL.M.) Program in Real Property Development (Oct. 23, 2013).

escrow account is used, the escrow agent must maintain separate accounting records for each purchaser and for amounts separately covered under subsections (1) and (2) and, if applicable, released to the developer pursuant to subsection (3). Separate accounting by the escrow agent of the escrow funds constitutes compliance with this section even if the funds are held by the escrow agent in a single escrow account. It is the intent of this subsection to clarify existing law.¹⁵

Despite the inclusion of the amendment's last line—"it is the intent of this subsection to clarify existing law"—the federal bankruptcy court declined to retroactively apply the 2010 amendment, and stated the line did not change the analysis.¹⁶

This Article will analyze the aforementioned events starting with an historical survey to trace how the subprime mortgage crisis came to be and how the South Florida commercial real estate market, specifically new condominium construction financing, was affected. The authors will then discuss the legislative intent of the original Florida Statute Section 718.202, the impact of judicial activism in *Double AA Int'l Inv. Group, Inc. v. Swire Pac. Holdings, Inc.*, and the precedent set by the Florida legislature in moving so quickly to amend the statute. The Article will conclude with a discussion of the practical impacts of these events and an analysis of how risks inherent to new condominium construction financing have changed as a result of heavy investing from the Latin American markets.

II. DEVELOPING THE TRADITIONAL MODEL OF REAL ESTATE FINANCING

Many scholars identify the Great Depression-era as the source of America's late 2000s mortgage crisis,¹⁷ in large part because Fannie Mae and Freddie Mac together hold or guarantee over five trillion dollars in debt.¹⁸ Fannie Mae, a mortgage company properly known as the Federal National Mortgage Association, has grown from

¹⁵ Fla. Stat. § 718.202(11) (2011).

¹⁶ *In re Harbour East Dev., Ltd.*, 2011 Bankr. LEXIS 2509 at *10 (Bankr. S.D. Fla. 2011).

¹⁷ See Matthew Speigal, *The Academic Analysis of the 2008 Financial Crisis: Round 1*, 24 REV. FIN. STUD. 1773 (2011); Kronovet, *supra* note 1, 288; Peterson, *supra* note 2.

¹⁸ Kate Pickert, *A Brief History of Fannie Mae and Freddie Mac*, TIME (July 14, 2008), <http://content.time.com/time/business/article/0,8599,1822766,00.html>).

a New Deal response to borrowers defaulting on their mortgages¹⁹ into the publically traded,²⁰ “leading source of mortgage credit in the U.S. secondary market.”²¹ Freddie Mac was similarly launched as a government entity in 1970 to balance the market and preclude Fannie Mae from monopolizing the mortgage industry.²² These organizations, established to fix some of the time’s economic needs, grew far beyond the expectations of the individuals who pioneered them.

A. *Tracing the Historical Origins of the Financial Crisis*

Fannie Mae was among the first steps President Roosevelt took to establish a “public financial infrastructure for residential home mortgage loans.”²³ Fannie Mae, especially, fed on the advent of mortgage insurance programs at the Federal Housing Administration (FHA) and Veterans Administration (VA) that insured and guaranteed lenders against borrowers defaulting.²⁴ Congress hoped to incentivize loans for home ownership by backing all loans designated for that purpose.²⁵ As a result, banks started to loan with low down payments at low interest rates, and offered a long-term fixed rate²⁶ that accommodated American consumers.

These developments would also bear fruit in other sectors of the real estate market, most notably in the condominium partition of

¹⁹ *Id.* “During the Great Depression, as borrowers defaulted on mortgages en masse and banks found themselves strapped for cash, President Franklin D. Roosevelt and Congress created Fannie Mae in 1938 in order to buy mortgages from lenders, freeing up capital that could go to other borrowers. Although Fannie Mae began with just \$1 billion in purchasing power, the agency helped usher in a new generation of American home ownership, paving the way for banks to loan money to low- and middle-income buyers who otherwise might not have been considered creditworthy.”

²⁰ *Id.* (“Fannie Mae grew so large over the years that in 1968, with the pressures of the Vietnam War straining the national budget, President Lyndon Johnson took Fannie Mae’s debt portfolio off the government balance sheet; Fannie Mae was converted into a publicly traded company owned by investors.”); *see generally Fannie Mae*, WALL ST. J. (Jan. 31, 2014, 3:59 PM), <http://quotes.wsj.com/FNMA>.

²¹ *Company Overview: Who is Fannie Mae Today?*, FANNIE MAE, <http://www.fanniemae.com/portal/about-us/company-overview/about-fm.html> (last visited Sept. 22, 2014).

²² Pickert, *supra* note 18.

²³ Peterson, *supra* note 2, at 1107.

²⁴ Kronovet, *supra* note 1, at 291.

²⁵ *Id.*

²⁶ *Id.*

the commercial real estate sector.²⁷ In 1961, the National Housing Act, Section 234²⁸ authorized the FHA to insure mortgage loans secured by condominium laws where states had passed such legislation.²⁹ Subsequently, those states that had not established laws governing condominium regimes did so, which proved critical to the growth of the condominium form of ownership.³⁰ As condominium ownership became more popular in the 1960s, new developments financed by traditional construction loans became commonplace.³¹ While most loans were long-term and financed by insurance companies, savings banks, too, provided “permanent loans” for smaller projects.³² These loans were repaid out of the proceeds of individual unit sales.³³

Carl Fisher, of Miami Beach, pioneered the notion of using condominiums to meet population growth in South Florida,³⁴ and the results, while mixed at first, were eye-catching. Developers enhanced apartment complexes with recreational facilities and sold units quickly, which paid off construction loans, recovered initial investments, and generated handsome profits from sales and annuities.³⁵ Thrifts, savings and loans banks, and insurance companies—a group that is considered the “traditional providers of debt capital for commercial real estate”³⁶—protected their interests by imposing strict pre-sale conditions on the construction loans,³⁷ but buyers were still more than willing to sign contracts for apartments they could only see on bulletin board sketches.³⁸

²⁷ The essential definition of commercial real estate is, in this Article, borrowed from a report Elizabeth Warren wrote for the Congressional Oversight Panel. Commercial real estate is defined by financial supervisors as “‘multifamily’ property and ‘nonfarm nonresidential’ property. Commercial properties are generally income-producing assets, generating rental or other income and having a potential for capital appreciation.” ELIZABETH WARREN, CONG. OVERSIGHT PANEL, Pub. L. No. 110-343, FEBRUARY OVERSIGHT REPORT: COMMERCIAL REAL ESTATE LOSSES AND THE RISK TO FINANCIAL STABILITY (2010) at 5.

²⁸ National Housing Act, 12 U.S.C. § 1715(y) (1989).

²⁹ Richard Kane, *The Financing of Cooperatives and Condominiums: A Retrospective*, 73 ST. JOHN’S L. REV. 101, 102 (1999).

³⁰ *Id.*

³¹ *Id.* at 104.

³² *Id.*

³³ *Id.* at 105.

³⁴ *Id.*

³⁵ *Id.* at 106-07.

³⁶ Kronovet, *supra* note 1, at 295.

³⁷ Kane, *supra* note 29, at 108.

³⁸ *Id.* at 109.

B. *The Development of a Secondary Mortgage Market*

Fannie Mae continued buying these residential and commercial securitized loans as lenders' financing spigots opened and, by 1968, occupied too large of a space for President Johnson's liking; he split the organization into the aforementioned privatized company, and the Department of Housing and Urban Development (HUD) administered Government National Mortgage Association ("Ginnie Mae") which was specifically responsible for government special assistance and housing support programs.³⁹ When Freddie Mac was created not long thereafter in 1970, the nation got its first glimpse of the secondary mortgage market, which would eventually hold and service loans originated elsewhere.⁴⁰

The active secondary market would prove quite large, which yielded novel financing techniques.⁴¹ In 1970, Ginnie Mae offered the world its first look at how mortgage-backed securities might be publically traded, wherein revenue comes from loans in which the underlying loan is backed by property.⁴² Investors were guaranteed full and timely payment of principle and interest as their investments were backed by the United States.⁴³ Freddie Mac broadened the field of mortgage-backed securities in 1983, when it introduced the collateralized mortgage obligation (CMO), which will be discussed later.⁴⁴

Fannie Mae and Freddie Mac, which went public in 1989,⁴⁵ have come under heavy criticism of late because they have become too big to fail.⁴⁶ The organizations raise money from pension funds, mutual funds, and foreign sources, as well as a variety of other

³⁹ Kronovet, *supra* note 1, at 291-92.

⁴⁰ Fed. Hous. Fin. Agency, *A Brief History of the Housing Government-Sponsored Enterprises*, OFFICE OF THE INSPECTOR GENERAL, available at <http://fhfaoig.gov/Content/Files/History%20of%20the%20Government%20Sponsored%20Enterprises.pdf> (last visited Sept. 22, 2014).

⁴¹ Kronovet, *supra* note 1, at 292.

⁴² *Id.*

⁴³ *Id.*

⁴⁴ *Id.* at 293.

⁴⁵ Pickert, *supra* note 18.

⁴⁶ Dawn Kopecki, *Fannie, Freddie Are Too Big to Fail, Lawmakers Say (Updated)*, BLOOMBERG NEWS, (July 10, 2008, 6:52 PM), available at <http://www.bloomberg.com/apps/news?pid=newsarchive&refer=home&sid=a8TSO UOgFPFw>.

sources,⁴⁷ which gives both the kind of dominance over global economies that forced the Federal Reserve and U.S. Treasury to guarantee those investments.⁴⁸

C. *Securitization of the Commercial Real Estate Market*

As the capital markets became more innovative by securitization, the commercial real estate markets found they needed to turn to nontraditional sources of funding as well. The OPEC oil embargo of 1973-74 caused interest rates to spike and doomed many projects' success.⁴⁹ Developers who had already pre-sold a majority of units in the buildings could not correct for higher construction costs, which led to many developers simply choosing to default and lenders to foreclosure.⁵⁰ As these financial institutions became flush with illiquid assets, individuals were pulling their money out of their coffers to invest in higher-yield instruments.⁵¹ This left banks, which had employed those coffers to issue home mortgage loans, in a bind:

Would-be retirees could not sell their homes in the North because the prospective purchasers for those homes could not obtain mortgage financing to do so. Even when those retirees were able to rid themselves of their real estate obligations in other parts of the country, loans were not available for them to purchase the units owned by the banks in retirement locations.⁵²

Lenders, who were subjected to heavy pressure legislatively and by the market, were left with little choice but to write-down the value of the properties, partner with developers to complete the projects, and sell the units at heavy discounts,⁵³ for a "profit."⁵⁴

By the late 1970s, lenders were willing and able to jump back into the commercial real estate market to finance new projects.⁵⁵ The financiers who got back into the market in the early stages of the recovery were soon posting profits suitable to entice some of their

⁴⁷ Pickert, *supra* note 18.

⁴⁸ *Id.*

⁴⁹ Kane, *supra* note 29, at 110-11.

⁵⁰ *Id.* at 111-12.

⁵¹ *Id.* at 112.

⁵² *Id.* at 113.

⁵³ *Id.* at 114.

⁵⁴ *Id.* The ability to report a profit was enabled by creative accounting that acknowledged that sale prices outstripped previously heavily written-down book values for the developments.

⁵⁵ Kane, *supra* note 29, at 114.

previously burned lending contemporaries back into the field.⁵⁶ By the 1980s, the market was thriving again.⁵⁷

D. Florida Legislative Action to Regulate Condominium Pre-Sale Activity

During the late 1970s, many state legislatures passed laws regulating the various aspects of preconstruction financing of new condominium developments. One such state was Florida, which addressed this topic through Florida Statute Section 718.202 in 1976.⁵⁸ The statute, which addresses specifically the sales and reservation deposits prior to closing, has been amended eight times since its inception,⁵⁹ most notably in 2010 following a wave of litigation during the mortgage crisis.⁶⁰

The Florida Legislature created Chapter 718 following six years of revisions to provisions “to protect buyers ‘who placed deposits with developers’ for preconstruction condominiums.”⁶¹ The initial provisions, enacted in 1970, were contained in Florida Statute Section 711.25 and housed three subsections pertinent to the instant case, *Double AA Int’l Inv. Group, Inc. v. Swire Pac. Holdings*. The first required sellers to have a special account for deposits that was prohibited from commingling with the seller’s other accounts before the buyer was made aware of the commencement of construction on his unit.⁶² After that notice, the second provision permitted developers to withdraw funds from that special account for construction purposes so long as the presale contract contained a warning that such allocations were allowable.⁶³ The final provision held developers accountable for misuse of funds with the threat of embezzlement charges.⁶⁴

In 1974, the Florida Legislature opted to transfer Section 711.25 to Section 711.67, amending the legislation to require developers to:

⁵⁶ *Id.*

⁵⁷ *Id.* at 115.

⁵⁸ *Double AA Int’l Inv. Grp. Inc.*, 2010 WL 1258086, at *11.

⁵⁹ Fla. Stat. § 718.202 (2011).

⁶⁰ *E.g.*, *Double AA Int’l Inv. Grp. Inc.*, 2010 WL 1258086.

⁶¹ *Id.* at *6 (citing Michael Anderson, *Legal Protection for Florida Condominium and Cooperative Buyers and Owners*, 27 U. MIAMI L. REV. 451, 459 (1973)).

⁶² *Id.* at *7.

⁶³ *Id.* at *9.

⁶⁴ *Id.*

[e]stablish an escrow with a bank or trust company having trust powers, an attorney who is a member of the Florida Bar, or a title company authorized to do business in the State of Florida, with whom shall be deposited all payments received by the developer from the buyer of such parcel upon the sale price of the parcel until the amount deposited shall equal 5 percent of the sale price. The escrowed funds may be deposited in separate accounts or in common escrow or trust accounts or commingled with other escrow or trust moneys handled by or received by the escrow agent.⁶⁵

These changes are notable in the explicit requirements for developers to use escrow agents and to deliberately separate the accounts with a five percent protected deposit. Given how these legislative developments transpired, it is clear that the legislature intended for presale construction procedures to protect buyers against the kind of developer defaults that left owners with little recourse in years prior.

The Florida Legislature decided in 1976 to create Chapter 718 from the Florida Condominium Act. In the process, the protected deposit was increased from five to ten percent, escrow agents were given flexibility to determine how best to maintain the protected deposits, and the release of deposits was elucidated for four potential scenarios.⁶⁶ Further changes to the diction and structure of the Act⁶⁷

⁶⁵ Fla. Stat. § 711.67(1) (Supp. 1974).

⁶⁶ See § 711.67(1) (Supp. 1974); compare with § 711.202 (Supp. 1976).

⁶⁷ Judge Altonaga's opinion laid out those changes which expanded the consumer protection provisions:

The word "escrow" was inserted in subsection (2): "All payments in excess of the 10 percent of the sale price. . . shall be held in a special escrow account by the developer or his agent and may not be used by the developer prior to closing the transaction, except as provided by subsection (3) or except for refund to the buyer." Subsection (3), which set out the conditions for using the construction deposits, was revised to include a direct reference to subsection (2). "(3) If the contract for sale of the condominium unit so provides, the developer may withdraw escrow funds in excess of 10 percent of the purchase price from the special account required by subsection (2) when the construction of improvements has begin. The language regarding a buyer's option to void was removed from subsection (3) where it had previously been limited only to violations of that subsection, and was set out as a wholly new subsection applicable to the entire Section. Effectively, the Legislature imposed strict liability on the

strengthened the consumer protection and voiding provisions, in part by adding criminal penalties and referring specifically to multiple escrow accounts.⁶⁸ These clarifications continued to address many of legislative concerns that had been brought about by the previously described crisis.

The 1979 Legislature amended Chapter 718 to address reservation agreements, which were the outgrowth of developers attempting to generate revenue prior to the sale of condominiums,⁶⁹ thereby skirting around the need to comply with the statute. Several later amendments through the end of the 1988 legislative session further clarified the protected deposit procedures and how the escrow agent may disburse funds.⁷⁰

E. Securitizing the Markets to Novel Construction Financing Techniques

On a national scale, investment creativity was expanding far beyond the boundaries first envisioned by President Roosevelt. Whereas the original securitized loans were mortgages that were supposed to encourage home buying, the 1980s saw many other products—health care receivables and student loans, to name a couple—securitized⁷¹ by using special purpose vehicles (SPV)⁷² without any sort of collateral backing. This was a marked change from the days when non-mortgage asset securitization was mainly commercial paper-based,⁷³ and likely came about as a result of deregulated bank lending.⁷⁴

As the capital market was printing money on the concept of SPVs, two distinct and important changes were occurring in the

developer in favor of the buyer.

(*Double AA Int'l Inv. Grp., Inc.* 2010 WL 1258086, at *11-12 (citing § 718.202(2) (Supp. 1976)); § 718.202(3) (Supp. 1976); § 718.205(2) (Supp. 1976).

⁶⁸ See § 711.67(1) (Supp. 1974); compare with § 711.202 (Supp. 1976).

⁶⁹ *Double AA Int'l Inv. Grp., Inc.*, 2010 WL 1258086, at *12.

⁷⁰ See generally *Double AA Int'l Inv. Grp., Inc.*, 2010 WL 1258086.

⁷¹ Kronovet, *supra* note 1, at 295.

⁷² *Id.* at 294. The Sperry Corporation created a subsidiary (a SPV) to serve as an entity for the securitized transaction of issuing lease-based notes and sold computer operating leases to the SPV, which then offered fixed rate notes backed by the pledges of the leases.

⁷³ *Id.*

⁷⁴ See Bertrand Renaud, *The 1985 to 1994 Global Real Estate Cycle: An Overview*, 5 J. OF REAL ESTATE 13 (1997) (“Fresh out of their secure regulated environment, banks tended to underestimate the risks they faced with the new borrowers.”).

commercial real estate market that would substantially increase the influence Wall Street had over that sector. The first was the aforementioned creation in 1983 of the collateralized mortgage obligation,⁷⁵ a tradable security backed by mortgages that is divided into tranches.⁷⁶ These investment tranches group mortgages together by assessed risk and allow for different classes of investors to buy packages ranging from low-risk, determined reward to high-risk, high-reward.⁷⁷

The second monumental change transpired as the developers adapted a new means to combat municipal attempts to regulate rent prices.⁷⁸ As cities moved to stabilize rent prices, developers had another idea in mind: convert apartment buildings into condominiums and cooperatives.⁷⁹ “For landlords who find themselves beset with rising costs for maintenance and utilities, complaints from tenants, and the growing influence of rent control ordinances, conversion may seem an ideal way out of an uncomfortable position.”⁸⁰ Borrowers took advantage of lender’s hasty efforts to compete with one another, receiving loans on a fully exculpated basis,⁸¹ with little investment by the converter.⁸² This appears to be one of the earliest examples of lenders in commercial real estate markets making loans on security interests that were not tangible in nature,⁸³ and is a strong early

⁷⁵ Pickert, *supra* note 18.

⁷⁶ Peter Dellgren & Mattias Larsson, *Collateralized Mortgage Obligation and the Subprime Crisis* (May 25, 2009) (unpublished M.S. thesis, Uppsala University) (on file with Department of Business Studies, Uppsala University).

⁷⁷ Kronovet, *supra* note 1, at 293.

⁷⁸ Kane, *supra* note 29, at 123.

⁷⁹ *Id.*

⁸⁰ Dale A. Whitman, *Financing Condominiums and Cooperatives*, 13 *TULSA L. J.* 15, 39 (1977).

⁸¹ Kane, *supra* note 29, at 123. Lenders who allowed for fully exculpated loans were limited to foreclosing on the security interest of the defaulting borrower, and were precluded from filing against the borrower’s other investment assets.

⁸² Whitman, *supra* note 80, at 40. Apartment buildings that underwent conversion were worth as much as forty percent more once they were buildings with individual unit owners. *Id.* at 39. Interim loans to finance conversions are “usually limited to 75 or 80 percent of the property’s value *as a condominium*” but this would likely approach the full value of the rental project. *Id.* at 40. As such, borrowers oftentimes had to put in about ten percent of the conversion costs in order to obtain an interim loan. *Id.*

⁸³ See Kane, *supra* note 29, at 123.

Lenders made bulk-unit loans to developers with respect to which security interests were classified as: (a) developer-unsold shares in cooperatives (in which case the lender took a security interest

example of a trend towards real estate securitization.⁸⁴

Lenders were eager to get involved in conversions for the same reason that developers were trying to borrow money: the profit margins involved in conversions are considerable.⁸⁵ Lenders were primarily concerned with cash flows during the conversion period, as the converter had to account for interest payments, operating costs of the rental properties during the transition period, and assessments to the new owner's association.⁸⁶ As important as lenders' reliance on these projections were, lenders seemingly failed to learn from the commercial real estate market collapse of the 1970s; "although these estimated sales prices were frequently tested by appraisals, the values of the appraisals were predicated on then-soaring (and in hindsight, grossly unrealistic) values."⁸⁷ Further, these lenders failed to take the developers' promises to make substantial improvements during the conversion with a necessary grain of salt.⁸⁸

Predictably, the commercial real estate market collapsed at the end of the 1980s; developers walked away from their projects instead of investing their personal funds, and lenders were left with empty securities and forced, once again, to take massive write-downs.⁸⁹

in the shares of stock and the proprietary lease owned by the developer); (b) developer-unsold condominium units (in which case the developer's bulk lender took a mortgage or deed of trust on the units); or (c) developer-sold units (in which case, since the only remaining interest that the developer would have after the unit was sold would have been whatever purchase-money security interest that the developer may have retained in either a co-op or a condo, the developer's bulk-lender took collateral assignments of the purchase-money loan documents and security taken back by the developer from the new unit purchasers).

⁸⁴ Crocker H. Liu, *The Integration of the Real Estate Market and the Stock Market: Some Preliminary Evidence*, 3 J. OF REAL EST. FIN. AND ECON. 261 (1990).

⁸⁵ See Kane, *supra* note 29. Buildings could be expected to worth as much as forty percent more than they were as rental properties, with only small common area improvements needed.

⁸⁶ Whitman, *supra* note 80, at 41.

⁸⁷ Kane, *supra* note 29, at 123.

⁸⁸ *Id.* The Nebraska legislature attempted to fill empty developer promises by passing legislation defining brochures, drawings, and other promotional materials concerning condominium developments as express warranties; holding developers accountable for pre-purchase promises became one mechanism for ensuring that projected cash flows were accurate and lenders could issue notes in good faith. *Id.* (citing Doris Ware McCall, *New Law on Condos Means Developers Must Own Up to Promises*, OMAHA WORLD-HERALD (Sept. 18, 1983), available in 1983 WL 2097588).

⁸⁹ Kane, *supra* note 29, at 124.

Individual unit-owners found their buildings unmaintained and the debt service unpaid, which led, oftentimes, to the helpless owners losing their interests in a foreclosure of the building mortgage.⁹⁰ The developers were, for all intents and purposes, protected against any litigation unit owners might take against them by business entities similar to SPVs found in capital markets.⁹¹ Somewhat surprisingly, many courts held for the non-owner rent-protected tenants to continue occupying units after banks had foreclosed on the building.⁹² This development compounded the agony felt by the now twice-burned commercial real estate financiers.

F. Integrating the Commercial Real Estate Markets with Capital Markets

The world entered the first international commercial real estate crash in 1990, at which time a “precipitous asset deflation” commenced.⁹³ On the international stage, governments “followed a ‘good bank-bad bank’ approach to solve the solvency problems of distressed financial institutions. They have created asset-management companies to dispose of problem assets in the least disruptive way possible.”⁹⁴ In the United States, the asset-management company was a quasi-governmental body called the Resolution Trust Company (RTC),⁹⁵ which was essentially a federal deposit insurance company for thrifts.⁹⁶

American politicians made the decision that banks could not be allowed to fail, so the RTC was created with the charge of “liquidating the assets of insolvent thrift institutions and using the revenue to recoup government outlays.”⁹⁷ Generally considered a

⁹⁰ *Id.* at 126.

⁹¹ *Id.*

⁹² *Id.* at 127.

⁹³ Renaud, *supra* note 74, at 28.

⁹⁴ *Id.* at 31.

⁹⁵ *Id.* at 32.

⁹⁶ Kronovet, *supra* note 1, at 295-96.

⁹⁷ WARREN, *supra* note 27, at 18. The Warren report details the drastic consequences of the market crash:

One consequence of the thrift and banking crisis of the late 1980s and early 1990s was the sharp decline in the number of banks and thrifts: in 1980, there were 14,222 banks, but only 10,313 by 1994. The thrift industry contracted from 3,234 savings and loans in 1986 to 1,645 institutions in 1995. The banking sector also had become more concentrated over this period, with the 25 largest

success,⁹⁸ the RTC was set up to sell real estate loans through a securitization vehicle to lower transaction costs and avoid vultures.⁹⁹ By 1993, the RTC securitized \$14 billion, and people had come to favor securitized loans.¹⁰⁰ The RTC was closed in 1995 as its asset-deposition duty had been functionally fulfilled.¹⁰¹

As thrifts, savings and loans banks, and insurance companies dried up, there opened a gaping financing void in the market. Capital markets had been increasingly integrated¹⁰² into commercial real estate markets as a result of technological innovations, deregulation of government restrictions¹⁰³ on the barriers between the markets, and by increased securitization of the markets.¹⁰⁴ Wall Street investment banks bought into all cash flows that theoretically could be securitized, regardless of what specifically secured those cash flows.¹⁰⁵

The outcome of this heightened degree of integration was that commercial real estate financing started to resemble individual home mortgage financing. Traditional lenders—the same thrifts, savings and loans banks, and insurance companies who had sworn never again to get involved in financing real estate¹⁰⁶—identified that Wall Street’s involvement afforded them a low-risk opportunity to jump into the market as middle men who would issue loans and sell them as a

institutions holding 29.3 percent of insured banking deposits in 1980, growing to 42.9 percent in 1994.

⁹⁸ *Id.*

⁹⁹ Kronovet, *supra* note 1, at 295-96.

¹⁰⁰ *Id.* at 296.

¹⁰¹ Renaud, *supra* note 73, at 22.

¹⁰² Integration and its antonym segmentation are a technical finance terms with specific meanings that are rooted in how risky a given investment may be. Markets that develop separately are likely considered segmented at the onset, and investors do not necessarily earn the same expected return between two given markets. Liu, *supra* note 5, at 22. As markets became more reliant on one another, to the point that their risk factors are considered “systemic risk[s] relative to the *overall* market index,” they are considered integrated. *Id.* at 261.

¹⁰³ According to Bertrand Renaud of the World Bank Financial Sector Development Department, some examples of financial deregulation include: (a) the abolition of interest-rate controls or cartels that fixed these rates; (b) the abolition of direct controls on credit expansion; (c) the development and improvement of money, bond, and equity markets, and (d) the deregulation of fees and commissions in financial services. Renaud, *supra* note 73, at 21.

¹⁰⁴ David C. Ling, *The Integration of Commercial Real Estate Markets and Stock Markets*, 27 REAL EST. ECON. 483, 505 (1999).

¹⁰⁵ Kane, *supra* note 29, at 128.

¹⁰⁶ *Id.*

package to the investment banks.¹⁰⁷ The process worked as follows:

A property buyer would approach a bank and request money to facilitate the purchase. In return, the bank would receive a mortgage and a promissory note. Traditionally, the buyer would pay down the mortgage over a number of years, and the bank would keep the mortgage as a portfolio loan. With the proliferation of securitization, the bank might instead sell the mortgage and promissory note on the secondary market to a Wall Street financier for cash. The mortgage would then be packaged with many other mortgages and put into a trust, into which all debt service cash flows would go. The trust would be divided into several tranches, with the most risk averse at the top, and the highest risk/reward ratio at the bottom. A rating agency determines the degree of risk of each tranche, which is then put to market at each level.¹⁰⁸

This process would prove fatal in bringing about the financial crisis.

One reason that the crisis would prove so immense was because the technology bubble burst of 2001 scattered investors fearful of new industries back to traditional investments, such as real estate.¹⁰⁹ Public real estate investment trusts (“REITS”)—which essentially embody the idea of making private ownership of commercial real estate available to the public with a stock offering—had gained popularity in the early 1990s, and continued to deliver a strong return on investment through the 2001 financial crisis.¹¹⁰

Studies have found that in the years leading up to the mortgage crisis, as investors were moving back into the safe haven of traditional investments such as real estate,¹¹¹ the quality of primary loans gradually declined. One such study, conducted by Federal Reserve Bank of Cleveland analyst Yuliya Demyanyk and New York University Stern School of Business Professor Otto Van Hemert,

¹⁰⁷ *Id.* at 128-29.

¹⁰⁸ Alex Schimel, Lecturer in Law, University of Miami School of Law, In-class guest lecturing on the mortgage crisis and its roots (Sept. 17, 2013).

¹⁰⁹ WARREN, *supra* note 27, at 16.

¹¹⁰ *See id.* at 16-17.

¹¹¹ *Id.* at 16; *see also* Marilyn B. Cane & Jennifer C. Erdelyi, *1031 Tenant in Common Exchanges: A “Tic”king Time Bomb at the Intersection of Real Estate, Securities, and Tax Law?*, 14 U. MIAMI BUS. L. REV. 273, 273 (2006) (stating that the unpredictability of the stock market also served as an impetus for investors to be “drawn into the commercial real estate market in record numbers”).

concluded, “[a]ll types of mortgages were issued, with lower and lower credit standards. . .the market became ever more willing to make higher-risk loans and the public responded by taking them out. The loan particulars were of secondary importance.”¹¹² Even as these lenders were underestimating the performance of their loan pools,¹¹³ they hedged their bets by increasing the loan interest rates.¹¹⁴ Another study by Michigan Ross School of Business Professor Amiyatosh Purnanandam found that lenders were cognizant that they were perhaps overly exposed to risk, and that those loans they sold on the secondary market were substantially more likely to default.¹¹⁵

And default those borrowers did. Global financial markets took a drastic hit starting on August 9, 2007, in large part because of “protracted periods of low risk premiums.”¹¹⁶ This crisis was primarily residential in nature, which is why former Federal Reserve Chairman Alan Greenspan asserted “[t]he current credit crisis will come to an end when the overhang of inventories of newly built *homes* is largely liquidated, and *home* price deflation comes to an end.”¹¹⁷ The commercial market was tangentially affected by the mortgage crisis, despite the fact that loan underwriting and equity requirements were loosened for both types of real estate.¹¹⁸

G. *Today’s Model of Preconstruction Financing of Condominium Development*

The Warren report highlights significant differences between the financing of residential and commercial real estate properties that illustrate why the commercial crash was less severe than its residential

¹¹² Spiegel, *supra* note 17, at 1777.

¹¹³ As former Chairman of the Federal Reserve of the United States Alan Greenspan described in a Wall Street Journal opinion piece, “risk had become increasingly underpriced as market euphoria, fostered by an unprecedented global growth rate, gained cumulative traction.” Alan Greenspan, *The Roots of the Mortgage Crisis*, WALL ST. J. (Dec. 12, 2007), at A19.

¹¹⁴ Spiegel, *supra* note 17, at 1776.

¹¹⁵ *Id.* Spiegel summarizes Purnanandam’s study as follows:

[Purnanandam] finds that a one-standard-deviation increase in a bank’s propensity to sell off its loans increase[d] the subsequent default rate by about 0.45%. Given how low default rates are in general, this actually represents an overall increase of 32%. That is, if one expected a mortgage default rate of about 6% overall, then those sold off would see a rate of about 8%.

¹¹⁶ Greenspan, *supra* note 112.

¹¹⁷ *Id.* (emphasis added).

¹¹⁸ WARREN, *supra* note 27, at 11.

counterpart:

Unlike most residential borrowers, commercial borrowers tend to be real estate professionals. Commercial borrowers are also expected to pay debt service from property income rather than from personal income, unlike homeowners. Consequently, some of the loan structures that are used in the residential mortgage market, such as stated income loans or low introductory interest rates, are not available in the commercial market. In addition, the different tax treatment of commercial and residential properties (especially the allowance of depreciation of commercial properties) creates incentives for different types of ownership and financing structures.¹¹⁹

Commercial development is often financed with one of two types of short-term construction loans, generally issued by a depository institution:¹²⁰ “ADC,” for “acquisition, development, and construction” or “C&D,” for “construction and development.”¹²¹ Many banks require a substantial amount of preconstruction sales to help project the earning potential of the development for the purposes of loan issuance.¹²²

ADC loans typically are recourse loans issued with adjustable rates.¹²³ Unlike the fully exculpated loans¹²⁴ that were hastily issued at the peak of conversion sales, these recourse loans left the developer’s general assets fully unprotected so as to be recoverable against in the event of developer default.¹²⁵ This is a remarkable change merely twenty years after lenders were stumbling over one another to give developers the best possible incentives to borrow. This imbalance of power may protect lenders by forcing developers to use the best possible prognostication tools to forecast revenue, but the owners of individual units are still left hanging high and dry by the process.

For quite a while, new condominium owners who bought their unit preconstruction were contractually limited as to how they might recover their deposits from developers with whom they had invested. Developers were seemingly only accountable to lenders to meet their

¹¹⁹ *Id.* at 9.

¹²⁰ *Id.* at 9-10.

¹²¹ *Id.* at 9.

¹²² *Id.* at 10.

¹²³ *Id.*

¹²⁴ *See supra* note 80.

¹²⁵ *Id.*

goals and promises, but the consumer protections of statutes like Florida Statute Section 718.202 lay dormant and forgotten until 2009. In *Double AA Int'l Inv. Group, Inc. v. Swire Pac. Holdings, Inc.*, Judge Cecilia Altonaga restored, albeit temporarily,¹²⁶ the legislated teeth necessary to hold developers accountable to their individual unit owners as well.

III. PRACTICAL IMPACT OF § 718.202 AND JUDGE ALTONAGA'S DECISION

In 2009, the standard practice of allocating preconstruction development funds was put to the test in *Double AA Int'l Inv. Group, Inc. v. Swire Pac. Holdings, Inc.* The case arises from a condominium sale from a development named "Asia" on Brickell Key, in Miami, Florida.¹²⁷ The development consisted of 123 apartments, 24 of which Swire, the developer for the project, agreed to complete within two years.¹²⁸ In September 2004, Double AA International Investment Group entered into a reservation agreement with Swire for a unit in the Asia development condominium.¹²⁹ The condominium unit sold for \$1,160,000.00 with a 20% deposit of \$232,000.00.¹³⁰ On April 16, 2006, in accordance with Section 718.202(3), the Lawyers Title allowed the developer to withdraw escrow funds in excess of 10% of the purchase price for construction expenses.¹³¹ The funds in excess of 10% amounted to \$116,000.¹³²

This case was brought forth because when the deal failed to close, Swire did not return the \$232,000.00 deposit despite the Plaintiffs' demands that this was necessary because they were exercising their right to void the Purchase and Sale Agreement.¹³³ The pertinent issue of the complaint deals with the fact that Swire was potentially in violation of Section 718.202 after it failed to establish

¹²⁶ See Part II.

¹²⁷ *Double AA Int'l Inv. Group, Inc. v. Swire Pac. Holdings, Inc.*, 674 F. Supp. 2d 1344, 1346 (S.D.F.L. 2009), *aff'd*, 637 F.3d 1169 (11th Cir. 2011).

¹²⁸ *Id.*

¹²⁹ *Id.*

¹³⁰ *Id.*

¹³¹ *Id.* See also Fla. Stat. § 718.202(3) ("If the contract for sale of the condominium unit so provides, the developer may withdraw escrow funds in excess of 10 percent of the purchase price from the special account required by subsection (2) when the construction of improvements has begun.

¹³² *Double AA, Int'l Inv. Group, Inc.*, 674 F. Supp. 2d at 1346.

¹³³ *Id.*

two separate escrow accounts for the \$232,000.00 deposit.¹³⁴ According to the Plaintiffs, the language in Section 718.202 clearly requires the creation of an escrow account for 10% of the purchase price and another, separate account, for any deposit in excess of 10%. Double AA and Rodriguez contend that this failure renders the Purchase and Sale Agreement void, entitling them to a full return of the deposit.¹³⁵ Swire argued that this theory “has no support in the Statute’s plain language,” and that “[n]o part of the statute requires a developer to maintain more than one escrow account.”¹³⁶

By contending that the language in Section 718.202 allows a buyer to receive a full refund of their deposit should a developer default or a deal fail to close, Double AA created a potentially catastrophic problem to the entire preconstruction financing system that has been in place in the state of Florida since the 1970s.

According to University of Miami School of Law Associate Dean Douglas K. Bischoff, it was common practice for commercial real estate developers to place all deposits into a single escrow account.¹³⁷ However, Dean Bischoff noted that Florida developers still complied with Section 718.202(3) by only withdrawing funds in excess of 10% of the purchase price. These developers never contemplated creating two separate escrow accounts because the legal system did not appear to require it. A serious issue would arise if every preconstruction buyer began to demand a full refund of its deposits because of the interpretation of Section 718.202. Construction on condominiums throughout the state would be postponed or ended altogether as funding quickly ran out.

The timing of *Double AA* came during the height of the mortgage crisis, at a time when the South Florida commercial real estate market was experiencing a “dramatic deterioration of commercial real estate fundamentals”¹³⁸:

Increasing vacancy rates and falling rental prices present problems for all commercial real estate loans. Decreased cash flows will affect the ability of borrowers to make required loan payments. Falling commercial property values result in higher LTV

¹³⁴ *Id.* at 1348.

¹³⁵ *Id.*

¹³⁶ *Id.* (alteration in original). Swire cites subsection 1 and 2 of the statute, claiming that only a single account need be created because the statute does not say a “different” escrow account, or “other” escrow account.

¹³⁷ Interview with Douglas Bischoff, Associate Dean for Adjunct Faculty, University of Miami School of Law, in [Coral Gables], [FL] (Oct. 15, 2013).

¹³⁸ WARREN, *supra* note 27, at 27.

ratios, making it harder for borrowers to refinance under current terms regardless of the soundness of the original financing, the quality of the property, and whether the loan is performing. False Construction loans are experiencing the biggest problems with vacancy or cash flow issues, having the highest likelihood of default, and have higher loss severity rates than other commercial real estate loans.¹³⁹

In order to determine the meaning of Section 718.202, Judge Altonaga cites to *Bhd. Of Locomotive Eng'rs & Trainmen Gen. Comm. Of Adjustment CSX Transp. N. Lines v. CSX Transp., Inc.*, which states that “[t]he primary principle of statutory construction requires courts to give effect to the plain meaning of the words used ‘in their ordinary and usual sense.’”¹⁴⁰

A. Judge Altonaga’s Plain Meaning Interpretation of Section 718.202

In *Double AA*, Judge Altonaga was faced with the issue of whether a failure to establish two separate escrow accounts when deposits are above 10% of the purchase price violates Section 718.202 so as to render the contract voidable.¹⁴¹ The language of the statute that aided in its interpretation was that all payments in excess of 10% of the purchase price are earmarked for the construction of the condominium and to be held in a “special” escrow account.¹⁴² Judge Altonaga determined that the Florida legislature intended for the modifier “special” to differentiate separate accounts for payments up to 10% and payments in excess of 10%.¹⁴³

The opinion continues with a plain meaning interpretation of the words of Section 718.202 through Judge Altonaga’s understanding that subsection 3 further proves the statute calls for separate accounts. This Section states that if the contract so provides, a developer may withdraw funds in excess of 10% “from the special account required

¹³⁹ *Id.* at 23.

¹⁴⁰ *Bhd. Of Locomotive Eng'rs & Trainmen Gen. Comm. Of Adjustment CSX Transp. N. Lines v. CSX Transp., Inc.*, 522 F.3d 1190, 1194-1195 (11th Cir. 2008) (quoting *Caminetti v. United States*, 242 U.S. 470, 485-86 (1917)).

¹⁴¹ *Double AA Int'l Inv. Group, Inc.*, 674 F. Supp. 2d at 1348.

¹⁴² *Id.* at 1349. FLA. STAT. § 718.202(2) (“3) (“[T]he developer may withdraw escrow funds in excess of 10 percent of the purchase price from the special account required by subsection (2) when the construction of improvements has begun.”).

¹⁴³ *Double AA Int'l Inv. Group, Inc.*, 674 F. Supp. 2d at 1349.

by subsection (2).”¹⁴⁴ Judge Altonaga reasoned that the language in this subsection would be completely meaningless if the statute required only one escrow account.¹⁴⁵ The plain meaning reasoning makes sense because if the state intended to only require one escrow account, then there would be no point to include the other subsections.¹⁴⁶

Therefore, Judge Altonaga’s holding stated that:

Swire violated Section 718.202 by failing to establish two separate escrow accounts. Accordingly, the Court grants summary judgment to Plaintiffs as to Count II, a declaratory judgment that Swire violated Section 718.202, and Plaintiffs are therefore entitled to a refund of their deposit funds from Swire and Lawyers Title, plus interest, under Florida Statute Section 718.202(5).¹⁴⁷

The United States Court of Appeals for the Eleventh Circuit affirmed Judge Altonaga’s decision.¹⁴⁸ However, the Eleventh Circuit focused on Swire’s contention “that the requirements of section 718.202 are met by a ‘separate accounting’ of the funds placed in escrow in excess of ten percent. . .even if all of the deposited funds are kept in a single account.”¹⁴⁹

According to the record, Swire had only one escrow account for *all* of the preconstruction deposits.¹⁵⁰ Everything was in one account, with only a separate buyer’s transaction log for each condominium unit.¹⁵¹ However, the Eleventh Circuit reasoned that the transaction log did not separate the protected 10% from the deposits in excess of 10% of the purchase price.¹⁵² Two distinct columns were

¹⁴⁴ *Id.* (quoting § 718.202(3)).

¹⁴⁵ *Id.* (“The language and various sections of the statute clearly contemplate two separate escrow accounts: one for payments of up to 10 percent of the purchase price, and a second, separate account for any payments beyond 10 percent of the purchase price.”)

¹⁴⁶ *Id.* (“If the only issue was the disbursement of funds, the statute could have very easily been written to state that. The statute, as written, however, calls for separate accounts for the separate levels of deposits.”).

¹⁴⁷ *Id.* at 1351.

¹⁴⁸ *Double AA Int’l Inv. Group, Inc. v. Swire Pac. Holdings, Inc.*, 637 F.3d 1169, 1171 (11th Cir. 2011) (aff’g Count I against Defendant Swire, rev’g and remanding Count II against Lawyers Title).

¹⁴⁹ *Id.* at 1170-71.

¹⁵⁰ *Id.* at 1171 (emphasis added).

¹⁵¹ *Id.*

¹⁵² *Id.*

placed in the account to distinguish the separate accounts, but the “columns simply were not utilized to keep track of the deposits at issue in this case.”¹⁵³ The escrow agent received no indication of which funds were protected under Section 718.202(1).¹⁵⁴ Therefore, not only did Judge Altonaga determine that the contract was voidable for a failure to create two escrow accounts, the Eleventh Circuit also held:

[R]egardless of whether the statute requires one escrow account or two, the district court did not err in finding the contract voidable under Section 718.202(5) for failure to maintain a separate accounting, and therefore did not err in ordering the full return of Plaintiffs’ deposits plus interest. Swire’s argument that this issue was not before the district court lacks merit as the issue was raised before the district court, evidence about the separate accounting was presented, and we see no error in the district court’s reaching this issue.¹⁵⁵

The result of *Double AA*, at the height of the mortgage crisis, thus appeared to bring to reality the catastrophic fear for commercial real estate developers mentioned by Dean Bischoff, and simultaneously brought “hope to contract holders hungry for [a] successful strategy to help them recover their deposits.”¹⁵⁶ However, this beacon of hope for buyers searching for an avenue to retain their 20% deposits did not last very long.

IV. AMENDING SECTION 718.202 – REACTION AND AFTERMATH OF SECTION 718.202

Just days after the March 30 ruling by Judge Altonaga, lawyers representing developers from across Florida marched on Tallahassee to push for an amendment to Section 718.202.¹⁵⁷ The proposed amendment “shows how quickly an industry can get the Florida Legislature to act in their favor.”¹⁵⁸ This amendment was a part of the larger Senate Bill 1196, attempting to revamp the way

¹⁵³ *Id.*

¹⁵⁴ *Id.*

¹⁵⁵ *Id.* (footnote omitted)

¹⁵⁶ Paola Iuspa-Abbott, *Bill would reverse ruling on deposit accounts; Win could be overturned; CONDO MELTDOWN*, THE MIAMI DAILY BUSINESS REVIEW, May 28, 2010, at A1.

¹⁵⁷ *Id.*

¹⁵⁸ *Id.*

Florida governs condominiums.¹⁵⁹ Subsection 11 states:

If only one escrow account is used, the escrow agent must maintain separate accounting records for each purchaser and for amounts separately covered under subsections (1) and (2). . . Separate accounting by the escrow agent of the escrow funds constitutes compliance with this section even if the funds are held by the escrow agent in a single escrow account.¹⁶⁰

Proponents of the amendment wanted the change to apply retroactively in order to void the March 30 ruling and other deposit recovery complaints.¹⁶¹ Senator Mike Fansano, who co-sponsored the amendment in addition to the rest of Senate Bill 1196, commented that “he never intended to hurt consumers”:

We did everything we could based on the information that was given to us. . . I will be glad to check into it further. We can certainly change the law if we feel it may not be as consumer friendly as we hoped it would be”[, but] the change to Section 718.202 would help close a loophole that allowed contract holders with no legitimate reason to cancel their agreements and retrieve their deposits. “If you have a legitimate reason where the developer did not fulfill his or her contractual agreement, certainly you should be able to get the money back.”¹⁶²

Alexander Lian, who represented Double AA, immediately commented that he already had a plan to combat any attempt to get the *Double AA* ruling thrown out.¹⁶³ Lian argues there is no way the current Florida legislature could have possibly known what legislators in the 1970s meant when Section 718.202 was initially enacted.¹⁶⁴ Ultimately however, on June 1, 2010, the amendment was signed into law by the Florida legislature, setting the stage for the final battle over preconstruction deposits. The question of whether Section 718.202(11) would apply retroactively was left up to Florida’s judicial system.

¹⁵⁹ *Id.*

¹⁶⁰ FLA. STAT. § 718.202 (2014).

¹⁶¹ Iuspa-Abbott, *supra* note 156.

¹⁶² *Id.*

¹⁶³ *Id.*

¹⁶⁴ *Id.*

A. To Be Retroactive or Not To Be Retroactive, That is the Question

CRC 603, LLC v. North Carillon, LLC represented the ultimate decision on the Section 718.202 issue that flooded South Florida's court system with lawsuits during the commercial real estate bust. The issue that the Third District Court of Appeals faced was "whether the 2010 amendment alters the analysis set forth in *Double AA* or the application of that analysis to the 2006 contracts and 2009 causes of action by the buyers."¹⁶⁵ Thus, the pertinent question in *CRC 603* sets out to determine the validity of retroactively applying Section 718.202(11). Just as the outcome in *Double AA* proved to be important to Florida's commercial real estate market, Judge Salter equally understood the crucial significance of *CRC 603*: "The stakes are significant for the parties and for others—one consequence of the current real estate recession in South Florida is that many prospective condominium buyers are attempting to void the purchase contracts they signed in what hindsight now discloses was an irrationally exuberant real estate market."¹⁶⁶

In *CRC 603*, the developer argued that the 2010 amendment to Section 718.202 clarified the amendment overall, and could therefore be applied retroactively, thus applying to this case.¹⁶⁷ However, Judge Salter believed the 2010 amendment was more than an attempt to clarify existing law,¹⁶⁸ Salter's opinion notes that decades-long gaps between the enacting of a statute and its clarification will disallow the ability of any statute to be applied retroactively.¹⁶⁹ The original statute and the amendment in *CRC 603* are separated by much more than a decade; the 2010 amendment comes 25 years after Section 718.202

¹⁶⁵ *CRC 603, LLC v. North Carillon, LLC*, 77 So. 3d 655, 659 (Fla. Dist. Ct. App. 2011), *rev'd*, 135 So. 3d 274 (Fla. 2014.).

¹⁶⁶ *Id.* at 657

¹⁶⁷ *Id.* at 659 "(The developer also argues that the amendment is procedural and remedial in nature, such that it applies to contracts and causes of action in existence upon the effective date. If the 2010 amendment applies to May 2006 contracts and a December 2009 cause of action, then the single escrow account for the '10 percent' and 'in excess of the 10 percent' deposits complies with section 718.202 and the developer and escrow agent need only prove that they kept 'separate accounting records' for each purchaser and the amounts deposited under section 718.202(1) and the amounts deposited or withdrawn under section 718.202(2) and (3).")

¹⁶⁸ *Id.* at 660.

¹⁶⁹ *Id.* at 660 (*See also* *State Farm Mut. Auto Ins. Co. v. Laforet*, 658 So. 2d 55, 62 (Fla. 1995) ("It would be absurd. . .to consider legislation enacted more than ten years after the original act as a clarification of original intent; the membership of the 1992 legislature substantially differed from that of the 1982 legislature.")).

was enacted.¹⁷⁰

Judge Salter further noted the 2010 amendment could not be applied retroactively because the Florida Constitution prohibits it.¹⁷¹ Article 1, Section 10, of the Florida Constitution states that “[n]o bill of attainder, ex post facto law or law impairing the obligation of contracts shall be passed.”¹⁷² Thus, despite the intention of the Florida Legislature that the 2010 amendment and new Section 718.202(11) be applied retroactively, the court concluded, “this would impermissibly impair each buyer’s pre-amendment contract rights.”¹⁷³

This decision by Florida’s Third District Court of Appeals, in conjunction with Judge Altonaga’s decision in *Double AA*, resulted in two cataclysmic losses for developers in Florida’s deposit recovery disputes¹⁷⁴ at the peak of the financial crisis. The result was disturbing because the opinion gave no mention of an apparent advisory opinion issued by the State of Florida to developers.¹⁷⁵ The guidance to developers on the issue of Section 718.202 suggested that separate accounting records would suffice.¹⁷⁶ Clearly the advice was misguided and developers who tailored their preconstruction financing accounting in this manner were severely harmed by Judge Altonaga’s and Judge Salter’s decisions. Therefore, for all cases leading up to the 2010 amendments, purchasers now had a strong and convincing argument to recover their entire deposit.

B. *The Florida Supreme Court’s Final Say on Section 718.202*

On January 23, 2014, the Florida Supreme Court handed down the final ruling in the North Carillon battle with *CRC 603*.¹⁷⁷ In the ruling, Judge Canady agreed that the retroactive effect would be unconstitutional, but disagreed “with the Third District’s conclusion that the 2010 amendment made a substantive change in the law”.¹⁷⁸ Thus, the Florida Supreme Court reversed the Third District’s decision because it “conclude[d] that the contracts were not voidable

¹⁷⁰ *CRC*, 77 So. 3d at 660.

¹⁷¹ *Id.*

¹⁷² Prohibited Laws, Fla. Const. art. 1, § 10.

¹⁷³ *CRC*, 77 So. 3d at 661.

¹⁷⁴ Hugo Alvarez, *Florida Appellate Court Ruling Significantly Favors Buyers in Condo Deposit Recovery Disputes*, MIAMI REAL ESTATE ATTORNEY BLOG (Sept. 25, 2011) <http://www.miamirealestateattorneyblog.com/deposit-recovery>.

¹⁷⁵ *Id.*

¹⁷⁶ *Id.*

¹⁷⁷ *North Carillon, LLC v. CRC 603, LLC*, 135 So. 3d 274 (Fla. 2014).

¹⁷⁸ *Id.* at 275-76.

under the statutory provisions in force in 2006, when the contracts were entered.”¹⁷⁹

First, because the Court clearly concludes the language of Section 718.202 is ambiguous, it turns to the statutory history to resolve the ambiguities.¹⁸⁰ Strangely though, after failing to sort out the ambiguities, Judge Canady and the Florida Supreme Court are attempting to resort to the rule of lenity,¹⁸¹ usually used for ambiguous criminal statutes, to resolve this civil case.

In analyzing the statutory history, the Court points out a different issue in the wording that was not raised by Judge Altonaga in *Double AA*. The Court recognizes that the word “special” did not have any intended meaning for an escrow account at all.¹⁸² In fact, “[t]he word ‘special’ originally was employed in the statute to designate not an escrow account but an account of the seller/developer that was not comingled with the funds of the seller/developer”¹⁸³:

In 1976, the Legislature adopted the Condominium Act and made revisions to the deposit statute. The dividing line between the two types of buyer deposits changed from five percent of the sale price to ten percent of the sale price, and the term “special account” in Section 711.67(2), Florida Statutes (Supp. 1974), became a “special escrow account” in Section 718.202(2), Florida Statutes (Supp.1976). See ch. 76-222, § 1, Laws of Fla. Notwithstanding the addition of the word “escrow” to the account description in Section 718.202(2), the statute continued to state that the account for deposits over ten percent of the sale price could be held “by the developer” subject to the condition that the funds were not to be used by the developer prior to closing. § 718.202(2), Fla. Stat. (Supp.1976).¹⁸⁴

In the end however, the Court determined that “the complex statutory history [did] not satisfactorily resolve the ambiguity in the 2006 statute.”¹⁸⁵

¹⁷⁹ *Id.* at 276.

¹⁸⁰ *Id.* at 277.

¹⁸¹ *Id.* at 277-78.

¹⁸² *Id.* 278.

¹⁸³ *Id.*

¹⁸⁴ *Id.* at 278-79.

¹⁸⁵ *Id.* at 279.

C. *The Bizarre Use of the Rule of Lenity*

After concluding that Section 718.202 could not be clarified through a historical perspective, Judge Canady turned to North Carillon's argument that when the language of a statute "is susceptible of differing constructions, it shall be construed most favorably to the accused."¹⁸⁶ Although normally applied in criminal cases, North Carillon claims, and the Court agrees, that the rule of lenity is applicable here because Section 718.202(7) states that failure to comply with the statute is a felony of the third degree.¹⁸⁷ Citing several United States Supreme Court cases, Judge Canady determined that the rule of lenity applies because such statutes must be interpreted consistently, whether they are encountered in a criminal or noncriminal context.¹⁸⁸

Therefore, the rule of lenity requires the statute to be viewed favorably to the developer. Thus, "[s]uch a construction authorizes the maintenance of deposits required by both subsection (1) and subsection (2) of Section 718.202 in a single escrow account. The buyers' claims against North Carillon for the maintenance of deposits in a single escrow account, therefore were properly dismissed by the trial court."¹⁸⁹

D. *Significance of Judge Canady's Ruling*

The 6-1 decision that Florida law does not require maintenance of separate escrow bank accounts for the deposits of preconstruction buyers was a significant victory for developers statewide that contracted before July 1, 2010. Amazingly, this was the first time in Florida that a court applied the rule of lenity to a civil case.¹⁹⁰

The importance of the decision lies with the fact that this case could lead to hundreds of similar lawsuits throughout Florida, with buyers "seeking to recover hundreds of millions of dollars of deposits by suing to rescind preconstruction contracts following the housing bust."¹⁹¹ Although the retroactive issue of Section 718.202(11) was

¹⁸⁶ *Id.* (citing FLA. STAT. § 775.021 (2014)).

¹⁸⁷ *North Carillon*, 135 So. 3d at 279.

¹⁸⁸ *Id.* at 279-80.

¹⁸⁹ *Id.* at 280.

¹⁹⁰ Caren Berg, *Florida Supreme Court Rules in Favor of Developers Regarding Handling of Escrow Funds*, YAHOO FINANCE (Feb. 3, 2014, 12:19 PM) <http://finance.yahoo.com/news/florida-supreme-court-rules-favor-171909953.html>

¹⁹¹ *Id.*

not settled officially by the Court, it clearly indicated that the Third District Court of Appeals decision violating retroactivity would have been correct.

E. South Florida's Second Condo Boom: Reaction to the Bubble Burst and Section 718.202

South Florida's commercial real estate was hit particularly hard when the last condo boom crashed. When Lehman Brothers' failure brought the entire financial system of the United States to the brink of an economic meltdown, "more than 60,000 condo units were on the resale market in the fourth quarter of 2008."¹⁹² Swire, the developer from *Double AA*, was part of a Miami market with 22,000 residential units for sale in 2008.¹⁹³ Miami became known as the poster child for speculation and overbuilding when the condo bubble burst.¹⁹⁴

One of the main contributing reasons to South Florida's crisis was that buyers who used Section 718.202 to void their preconstruction condo contracts when prices tanked, then looked to real estate brokerage firms to get back their twenty percent deposits.¹⁹⁵ To make matters worse, developers who had an oversupply of units went to these brokerage firms demanding that commission advances be returned for deals that fell apart.¹⁹⁶ Steven Owens, president of Swire, acknowledged that many thought the oversupply would last for decades and effectively crippled South Florida's commercial real estate market.¹⁹⁷

¹⁹² Peter Zalewski, *Lenders Provide Nearly \$900 Million in Financing for New South Florida Condo Projects*, CBC MIAMI (Aug 26, 2013), <http://cbcamiami.com/lenders-provide-900-million-in-new-construction-loans/>.

¹⁹³ Greg Allen, *In Miami, A New Condo Boom Revives Hopes of Housing Recovery.*, NPR (Jan. 22, 2013, 3:24 AM), <http://www.npr.org/2013/02/22/172602696/in-miami-a-new-condo-boom-revives-hopes-of-housing-recovery>.

¹⁹⁴ Martha Brannigan, *ISG: Selling the Dream of a Miami Condo*, MIAMI HERALD, Oct. 27, 2013, available at Access World News 201310270000KNRIDDERFLMIAMIH_d364207718ce7f752a187ff7e95a6832.

¹⁹⁵ *Id.*

¹⁹⁶ *Id.*

¹⁹⁷ ALLEN, *supra* note 193.

V. WHY DID THE COMMERCIAL REAL ESTATE CRASH HIT SOUTH FLORIDA SO MUCH HARDER THAN THE REST OF THE COUNTRY?

After the housing market crashed in 2007, many predicted the commercial real estate market would face a similar fate.¹⁹⁸ In 2010, the same year Section 718.202 was amended, Elizabeth Warren's Congressional Oversight Panel predicted foreclosures, loan defaults and a national crisis of disastrous proportions.¹⁹⁹

However, on average nationally, the crash never reached the meltdown that the housing market experienced.²⁰⁰ According to Nin-Hai Tseng of CNNMoney, even though prices across the commercial real estate market declined nearly 40% during the housing crisis, it never reached the foreclosure and default scale of the housing market.²⁰¹ Nationally, commercial real estate, including the market for hotels, malls, apartments, and office buildings,²⁰² was not nearly as overbuilt as the residential market. However, South Florida was one of the few exceptions to the minimized commercial downward spiral. While struggling commercial owners "enjoyed continuous flow of income by way of rents from tenants,"²⁰³ South Florida had an oversupply from new condominiums and thousands of empty units.²⁰⁴

Tseng also commented that national attention was taken away from the commercial sector because so many workers, materials, and resources were devoted to home construction.²⁰⁵ Additionally, even though construction projects picked up after the housing bubble burst, this increase did not last long because the financial crisis occurred shortly thereafter.²⁰⁶

In South Florida, it appears the opposite of Warren's and

¹⁹⁸ Nin-Hai Tseng, *Why The Commercial Real Estate Crash Never Came*, FORTUNE (Sept. 23, 2013, 3:44 PM), <http://finance.fortune.cnn.com/2013/09/23/commercial-real-estate-hilton/>.

¹⁹⁹ WARREN, *supra* note 27, at 138.

²⁰⁰ TSENG, *supra* note 198.

²⁰¹ *Id.*

²⁰² *Id.*

²⁰³ *Id.*

²⁰⁴ See Peter Zalewski, *Six Years After Condo Crash, 100 New Towers Proposed*, THE SUNNY ISLES BEACH REPORTER (Feb. 9, 2013), <http://sibreporter.net/2013/02/miami-herald-six-years-after-condo-crash-100-new-towers-proposed/>; see Peter Zalewski, *Lenders Provide Nearly \$900 Million in Financing for New South Florida Condo Projects*, CBC MIAMI (Aug 26, 2013), <http://cbciami.com/lenders-provide-900-million-in-new-construction-loans/>.

²⁰⁵ TSENG, *supra* note 198.

²⁰⁶ *Id.* Supported by comments from Susan Wachter, real estate and finance professor at the University of Pennsylvania's Wharton School of Business.

Tseng's predictions and analyses actually occurred. As stated above, South Florida (most notably Miami) was the global poster child for speculation and overbuilding and represented one of the worst commercial real estate disasters of any city in the country. What is surprising however, is how quickly and incredibly strong the market has bounced back. The nightmare years of 2007-10 now feel like a distant memory as South Florida's commercial market has rebounded with immense strength and on the surface, has the opportunity to alter the landscape of the entire region.

A. South Florida's New Commercial Real Estate Boom – Buyer-Deposit Model

The structure of financing the commercial real estate industry in South Florida during the late 2000s was similar to that of the rest of the country. Generally

[t]he structure of the industry and the manner in which commercial real estate development occurs involves a series of financing efforts at each stage of the life of the development. In a typical scenario, the life cycle of most large commercial real estate projects starts with a promoter who forms a limited partnership. With relatively little in the way of capital as a percentage of the total funding required to build out the project, the promoter secures an option to buy land. Using appraisals based on comparables of developed properties and with capital raised from limited partners, the real estate developer obtains interim financing to begin construction of the development. During the construction phase, the promoter is lining up longer term financing based on projections of future cash flows from the project.²⁰⁷

However, new condominium construction planned for Miami and the rest of South Florida has seen such a large resurgence recently because of an innovative approach to preconstruction financing. As reported in the Miami Herald in 2012, "banks are mostly still balking at lending for condominium construction, though much of the glut from the last debacle has been absorbed sooner than predicted."²⁰⁸

²⁰⁷ Robert J. Lahm, Jr., Charles R.B. Stowe, Patrick R. Geho, *Commercial Real Estate (CRE) Market – Next Meltdown or Recovery on the Way?*, 4 RES. IN BUS. & ECON. J., Aug. 2011, at 1, 5-6.

²⁰⁸ Martha Brannigan, *New Condo Financing Model Has Merit – and Risk*,

Despite the reticence of banks, brokerage firms and developers are confident that this time around South Florida real estate is on firmer ground because developers are now persuading “cash-rich buyers, mostly foreigners, to plunk down big deposits on preconstruction deals for cutting-edge towers that are touted as nothing less than transformational.”²⁰⁹

Developers and brokers are confident that South Florida real estate can avoid the catastrophic oversupply of unsold condominium units from the past. One reason is that there is a new method of preconstruction financing that has gained popularity throughout the South Florida market. Currently driving the new boom is what has been dubbed as the “buyer-deposit model”²¹⁰:

Under that approach, condo buyers—mostly cash-rich foreigners looking for an investment or a second home—pony up big deposits on pre-construction units, typically upwards of 50 percent of the purchase price. (For Apogee Beach and MyBrickell, buyers agreed to pay a whopping 80 percent of the purchase price in a series of payments before closing.) Developers generally can use the buyers’ deposits to finance construction, except for the 10 percent that is escrowed.²¹¹

Argentinian developer Jose Luis Melo, who runs the Melo Group real estate company, takes credit for bringing this commonly utilized South American model to Miami and the rest of South Florida.²¹² Melo says that when Miami’s market imploded, he decided to implement the model most developers use in his native Argentina.²¹³

This model has proved sufficiently popular even though the unit buyers become mere unsecured creditors for the creation of the

MIAMI HERALD (Oct. 27, 2013), <http://www.miamiherald.com/2012/09/03/2983520/new-condo-financing-model-has.html> [hereinafter Brannigan, *New Condo Financing*].

²⁰⁹ *Id.*

²¹⁰ Martha Brannigan, *ISG: Selling the Dream of a Miami Condo*, Miami Herald (Oct. 27, 2013), <http://www.miamiherald.com/2013/10/27/3711974/isg-selling-the-dream-of-a-miami.html> [hereinafter Brannigan, *ISG*].

²¹¹ *Id.*; FLA. STAT. §718.202 (2014).

²¹² Kevin Gray, *Miami Real Estate Revival a Boon for Latin American Developers*, Reuters (Mar. 10, 2013), <http://www.reuters.com/article/2013/03/10/us-usa-housing-miami-idUSBRE92905O20130310>.

²¹³ *Id.*

condominiums.²¹⁴ The risk facing buyers in this emerging construction model is considerable. It has become the buyers, not the banks²¹⁵ who are in danger of losing their money because these interest-free deposits mean that if a project fails, other creditors will have priority over their unsecured deposits. Any bank that lends to a developer traditionally requires collateral and “[c]onstruction companies also usually have priority rights to get paid.”²¹⁶ This leaves condominium buyers low on the priority totem pole should the developer fail to complete a project.

Another risk inherent in this new-to-South-Florida-model is that buyers do not receive a mortgage or any type of collateral while making the 50%-80% down payments. Thomas Lehman, a bankruptcy attorney with Levin Kellogg Lehman Schneider + Grossman notes, “[y]ou’re putting a lot of money at risk with a developer on a promise to complete the project. You’re not getting a mortgage and you’re not getting collateral. You’re getting a promise.”²¹⁷

William Sklar, a real-estate attorney at Akerman Senterfitt, also commented on this new South American-influenced model: “Banks lending for construction typically track a project’s progress before disbursing each stage of funding. But with the new model, buyers are placing more trust in the developer. ‘Who is looking at how funds are being spent? No one really is doing that.’”²¹⁸

Further criticism of the buyer-deposit model is that these huge interest-free deposits will scare away many potential buyers, leaving builders unable to sell the thousands of units left over from the market crash, as well as units in new buildings relying on this method to finance construction. Developers, however, welcome customers who are willing to pay up to an 80% deposit before the first shovel of dirt even moves. According to David Martin, president and chief operating officer at Terra Group, “[t]he supply of buyers is less, but they’re more real. They’re not relying on debt.”²¹⁹ Because of the large deposits, buyers are less likely to walk away, thus avoiding many of the Section 718.202 issues from the past. Unlike the preconstruction model that led Miami to be known as the poster child of America’s housing bust,²²⁰ when these new buildings begin

²¹⁴ Tseng, *supra* note 198.

²¹⁵ Brannigan, *New Condo Financing*, *supra* note 208.

²¹⁶ *Id.*

²¹⁷ *Id.*

²¹⁸ *Id.*

²¹⁹ *Id.*

²²⁰ N. Carillon, *supra* note 177.

construction, they will already be fully funded.

Amid plans to construct new buildings throughout South Florida and attempts to finally sell the thousands of empty units, a lingering question still remains: If banks are balking at funding developments because of looming memories of the 2008 commercial real estate crash, who are these cash-rich buyers fueling the latest South Florida condominium boom?

B. *How Latin America Saved Miami*

The revival of South Florida's commercial real estate market, with Miami at the epicenter, actually began during the crisis as thousands of Miami's condominiums sat empty.²²¹ Despite the rampant vacancies, Melo, the pioneer of the buyer-deposit model, decided to buy land for \$1.4 million in downtown Miami in late 2010.²²² Although there was harsh criticism of his \$1.4 million purchase, all 98 condominiums sold in just five months, with construction starting only a few months later.²²³ The condominiums were amazingly snapped up by wealthy Latin Americans who have long invested in South Florida property. This time, however, the resurgence in Miami is getting an extra lift from South American developers like Melo. "Increasingly, developers from Argentina, Brazil, Mexico and Venezuela are getting into the act to meet demand from Latin Americans looking for a stable place to park their money and to make extra income through rentals."²²⁴

How do developers sell yet to be built condominiums to buyers who do not even live in the United States? Today, technology and sales offices play an important role in the buyer-deposit model, as "snazzy websites and a glossy brochure"²²⁵ are utilized to create 3D visuals of the building, including individual units, to present to potential buyers. Also, the Latin American developers have strong ties to foreign real estate brokers that serve as the backbone for many businesses looking to sell proposed condominium units to foreign investors.²²⁶

Another reason the Latin American market has become so

²²¹ Gray, *supra* note 212.

²²² *Id.*

²²³ *Id.*

²²⁴ *Id.* (Peter Zalewski, principle of real estate consultancy Condo Vultures describes the Latin American presence as a "coming of age period" in construction and development.).

²²⁵ Brannigan, *ISG*, *supra* note 194.

²²⁶ *Id.*

much more involved in South Florida commercial real estate stems from recent currency devaluations in Brazil, Argentina and Venezuela.²²⁷ Especially in Argentina, the weakening peso and increasing inflation (resulting from its \$100 billion default in 2001) propelled many Argentines to move their money to the United States.²²⁸ There are few safe investments left in the country, and foreign properties allow Argentines a place to put their savings and an opportunity to make extra money through rentals.²²⁹ As Eduardo Blasco, a financial consultant in Buenos Aires notes, “Argentines don’t want any more Argentine risk.”²³⁰

In Brazil, housing prices are extremely high and as of early 2012, the Brazilian Real goes “roughly twice as far. . . as it did 10 years ago.”²³¹ Condominiums in Rio de Janeiro are in excess demand and are going for \$2,000 to \$3,000 per square foot in the high-end areas compared to about \$1,000 to \$2,000 in Miami.²³² So, considering the strengthening Real and high prices in Brazil, a Brazilian buyer looking to buy a Miami condominium for \$2 million would have been looking at spending \$4 million on that same condo just ten years ago.

While South Florida is attractive to many groups of people such as retirees and snowbirds, the wealthy Latin Americans are the ones providing the jumpstart to the commercial real estate market. So well known is the Latin attraction to Miami that in real estate circles, the city has earned the nickname “the Capital of Latin America.”²³³ In 2012, Argentines passed Brazilians to become the most active Latin American group buying real estate in South Florida, quickly renaming North Beach “Little Buenos Aires.”²³⁴ Latin Americans understand

²²⁷ Gray, *supra* note 212.

²²⁸ Alexei Barrionuevo, *Argentines Turn Cash Into Condos in Miami*, N.Y. Times (Sept. 13, 2012), http://www.nytimes.com/2012/09/16/realestate/argentines-turn-cash-into-condos-in-miami.html?_r=0.

²²⁹ *Id.*

²³⁰ *Id.*

²³¹ Jason Margolis, *Brazilian Home Buyers Spark a Miami Comeback*, The World (Feb. 22, 2012), <http://pri.org/stories/2012-02-22/brazilian-home-buyers-spark-miami-comeback> (quoting Daniel Ickowicz, the director of sales for Elite International Realty).

²³² Alexander Britell, *How Latin America Saved Miami*, The Real Deal (Nov. 3, 2012), http://therealdeal.com/issues_articles/how-latin-america-saved-miami/.

²³³ Luis Iglesias, *Latin America Real Estate Developers Thrive in Miami*, Miami Real Est. News Blog (Mar. 21, 2013), <http://miamirealestatenewsblog.com/latin-american-real-estate-investment-in-miami/>.

²³⁴ *Id.*

the popularity of Miami investments and as condominium prices slowly continue to rise in the area, they are hoping to make a large chunk of money. In 2012, according to a survey conducted by Florida Realtors, “35 percent of all foreign buyers in Florida have come from Latin American countries—the largest buying bloc of any region coming to South Florida.”²³⁵ This buying power has greatly contributed to the \$10.7 billion that foreign investors have brought in Florida sales from 2011 to 2012.²³⁶

Without the Latin American influx in South Florida, there would likely still be tremendous oversupply from 2008. In 2013, of the 22,000 residential units unsold in Miami, amazingly only about 12,000 remain.²³⁷ In addition, less than 2,000 units are unsold from “a pool of nearly 49,000 units created since 2003 in South Florida’s largest coastal markets of Greater Downtown Miami, South Beach, Sunny Isles Beach, Hollywood, Hallandale Beach, Fort Lauderdale, Boca Raton and West Palm Beach as of June 30 [2013].”²³⁸

C. Lenders Are Opening the “Financing Spigot”²³⁹ in Miami-Dade, Broward and Palm Beach

It appears that in the past 20 or so months, banks have begun to recognize the potential success of the buyer-deposit model. As developers sell out units using buyer deposits between 30% and 80% to cover the cost of financing, banks are becoming more active in financing condo projects because “[t]he return of financing for proposed condo towers is significant.”²⁴⁰

Banks seem fairly confident in the buyer-deposit model, as lenders have provided nearly \$900 million (as of August 25, 2013) in financing to condominium developers for more than 150 proposed projects in South Florida.²⁴¹ The lending provides developers the

²³⁵ Britell, *supra* note 232.

²³⁶ *Id.*

²³⁷ Greg Allen, *In Miami, A New Condo Boom Revives Hopes of Housing Recovery*, Nat’l Pub. Radio (Feb 22, 2013), <http://www.npr.org/2013/02/22/172602696/in-miami-a-new-condo-boom-revives-hopes-of-housing-recovery> (quoting Stephen Owens, president of Swire).

²³⁸ Peter Zalewski, *Lenders Provide Nearly \$900 Million in Financing for New South Florida Condo Projects*, Miami Herald (Aug. 25, 2013), <http://www.miamiherald.com/2013/08/25/3583603/lenders-provide-nearly-900-million.html>.

²³⁹ *Id.*

²⁴⁰ *Id.*

²⁴¹ *Id.*

ability to purchase the actual development sites as well as begin construction on the towers, examples of which include: \$160 million for the planned Mansions at Acqualina tower in Sunny Isles Beach, \$105 million for the planned Echo Aventura Project with two towers in Northeast Miami-Dade County, and \$50 million for the proposed BeachWalk condo-hotel tower in Hallendale Beach.²⁴² Two banks that have financed the most include Alabama's Regions Bank, with nearly \$250 million allocated, and New York City's NorthStar Realty Finance Corp, with more than \$125 million in financing.²⁴³

However, the lending of these banks has been overshadowed by a \$214 million loan that New York/South Florida based Dezer Development closed with Wells Fargo for construction of the Porsche Design Tower Miami at 18555 Collins Avenue in Sunny Isles Beach.²⁴⁴ This is one of the largest single loans for any construction project in the Southeast United States, and features 132 units—two-thirds of which have already been secured, resulting in \$535 million in sales.²⁴⁵ Dezer expects the remaining units to be sold by the end of the year in a building that features a “one-of-a-kind automobile lift system, which will allow owners to park their vehicles directly next to their units.”²⁴⁶

Perhaps more good news stemming from the implementation of the buyer-deposit model is that the return of financing for proposed condominium towers may lead to a reduction in the percentage of buyer deposits.²⁴⁷ Any sort of reduction would widen the pool of potential buyers who, previously, were much more afraid than their foreign counterparts to “entrust developers with such large financial commitments.”²⁴⁸

D. Risks of Using the South American Playbook

The risk involved with the new condominium preconstruction model has shifted from the banks to the buyers, who are in danger of huge losses if a building goes south and fails to close. Unlike many

²⁴² *Id.*

²⁴³ *Id.*

²⁴⁴ Oscaro Pedro Musibay, *Porsche Design Condo Gets Record \$214 Million Financing*, S. FLA. BUS. J. (Sept. 23, 2013), <http://www.bizjournals.com/southflorida/news/2013/09/25/porsche-design-condo-gets-record-214m.html?page=all>.

²⁴⁵ *Id.*

²⁴⁶ *Id.*

²⁴⁷ Zalewski, *supra* note 238.

²⁴⁸ *Id.*

American buyers, Latin Americans are comfortable with big deposits because they are customary in their home countries.²⁴⁹ These Argentines, Brazilians, Colombians, Venezuelans and others view Miami as a solid long-term investment because of the City's perception as one of the cosmopolitan capitals of the world.²⁵⁰

What is interesting about these payment deposits is that they are similar to an unsecured loan.²⁵¹ If a project fails, then other creditors—such as banks or construction companies—have priority over unit buyers and have greater rights to get paid.²⁵² However, even more interesting is the fact that South American investors do not seem to be affected by this risk. In their home countries, very high interest rates and “historically high inflation make financing riskier and more expensive,” but those issues are not at the forefront of Miami and United States investing.²⁵³

In terms of risk in the eyes of developers, the Miami today is not the Miami of the early 2000s, and this new strategy has been viewed as necessary to prevent speculators from coming back to the city to flip apartments like they did in the past.²⁵⁴ While the supply of buyers may be less, they are more real because the high payment deposits weed out speculators who were the main cause of the problems in the previous condominium boom.²⁵⁵

Developers realize this new financing strategy is great for business because of the reduced risk they must incur, but there have been some critics of the model. For example, “it has motivated developers to build more towers for the rich—mostly with foreigners in mind, though they rarely want to admit that—and not for middle-class Americans who simply cannot afford the big down payments.”²⁵⁶ The problem here is that towers for the rich could keep lenders from returning to traditional lending practices as well.²⁵⁷

Another issue centers on the fact that developers may decide

²⁴⁹ Brannigan *New Condo Financing*, *supra* note 208.

²⁵⁰ *Id.*

²⁵¹ *Id.*

²⁵² *Id.*

²⁵³ Alexei Barrionuevo, *In Miami, Using the South American Playbook*, N.Y. Times (Dec. 6, 2012), http://www.nytimes.com/2012/12/09/realestate/in-miami-using-the-south-american-playbook.html?pagewanted=1&_r=2&adxnml=1&adxnmlx=1392652150-lj4Y4%20xDKkLGAhIasHjoeA& [hereinafter Barrionuevo, *In Miami*].

²⁵⁴ *Id.*

²⁵⁵ Brannigan, *New Condo Financing*, *supra* note 208.

²⁵⁶ Barrionuevo, *In Miami*, *supra* note 253.

²⁵⁷ *Id.*

to cut corners because they are not worrying about required inspections from banks during construction to ensure that all standards are being met.²⁵⁸ With banks out of the way, developers do not have to stress about that pressure.

In the end however, it is the buyers with the “nonrefundable skin in the game,” and they bear the most risk.²⁵⁹ Still, these investors are not uneducated, and will not sink their money into projects that they believe will fail, particularly where they are guaranteed by no more than a handshake and a promise.

E. Is the Latest Condominium Boom Sustainable?

One possible issue to watch for in the future is if “lenders start to loosen their purse strings to allow for less equity and high leverage in developments.”²⁶⁰ Also, while it was noted above that a reduction in the percentage required for buyer deposits would bring in a larger amount of buyers, developers still need to be wary “because the less skin in the game, the more likely a buyer will choose not to close.”²⁶¹

However, if lenders, developers, and buyers have long enough memories to avoid creating another boom-and-bust condo cycle, then we can look forward to the completion of immaculate projects in the future. Buildings such as Porsche Design Tower Miami, and a visionary \$10 billion project in Bayfront predicting development by 2020 will help redesign the entire landscape of South Florida.

²⁵⁸ *Id.*

²⁵⁹ *Id.*

²⁶⁰ Brannigan, *ISG*, *supra* note 194.

²⁶¹ *Id.*