Memorandum on Partial Termination of Common Interest Communities

FROM: Jim Smith, Reporter

TO: Subcommittee to Consider Partial Termination: Bill Breetz, Carl Lisman, Dave Ramsey

DATE: Dec. 28, 2020

At our August 2020 informal Zoom session on UCIOA, the suggestion was made that the Drafting Committee might consider adding language to authorize partial terminations of communities and that Florida's condominium act might provide a useful start might provide a useful starting point. Accordingly, the draft considered at the Drafting Committee's November 2020 meeting included new proposed language for a partial termination provision to be added to UCIOA Section 2-118, *Termination of Common Interest Community*. The draft provision, set forth as proposed new Section 2-118(m), is closely based on the Florida act, modified to take account of the scope and terminology of UCIOA.

At the November 2020 meeting the Drafting Committee discussed new Section 2-118(m), authorizing partial terminations, but did not reach a conclusion as to (1) whether we ought to include a partial termination provision in our UCIOA termination section and (2) if so, whether it should look like the language in the November 2020 draft. Members wanted more information about the Florida provision that serves as the basis for the present draft. After the meeting on November 25, the reporter sent an email to members of ACREL seeking advice on the subject. This memorandum includes information and suggestions received by the reporter from the following attorneys: Mark Grant, Rich Linquanti, Brian Meltzer, and Jo Anne Stubblefield.

II. Partial termination in Florida

Section 718.117 of the Florida condominium act,[1] like UCIOA Section 2-118, originally addressed only total (regular) terminations. In 2011, the Florida legislature amended Section 718.117 to add partial termination provisions. The impetus for the new partial termination provisions was one particular condominium project named Grande Oaks Preserve, which failed financially in 2009 after the burst of the housing bubble and the collapse of the residential mortgage loan market. The developer had declared all three phases of the project and had built some, but not all, of the planned buildings. The developer and the existing buyers of units negotiated a partial termination, which turned over control of the condominium association to the buyers, required that the developer pay for unfinished work, eliminated the unbuilt units, and conveyed the property where they would have been located to the developer.[2] Although the Grande Oaks Preserve

[1] Fla. Stat. § 718.117.

[2] For more details, see Peter M. Dunbar, et al., *Partial Termination, Good Things Can Happen to Bad Projects*, 87 Fla. B.J. 47 (2013).

partial termination was accomplished without a partial-termination statutory provision, the legislature enacted the new Florida partial-terminations in 2011 to "clarify the procedures for the partial termination of a condominium property."[3]

The Florida statute has the following special provisions for partial terminations:

- An optional termination plan may apply to "all or a portion of the condominium property."[4]
- The Florida condominium act requires that all unit owners must agree to a change in shares of common expenses.[5] This requirement does not apply to a plan of total termination. This exemption applies to a partial termination only "if the ownership share of the common elements of a surviving unit in the condominium remains in the same proportion to the surviving units as it was before the partial termination."[6]
- "In a partial termination, the plan of termination . . . must also identify the units that survive the partial termination and provide that such units remain in the condominium form of ownership pursuant to an amendment to the declaration of condominium or an amended and restated declaration. In a partial termination, title to the surviving units and common elements that remain part of the condominium property specified in the plan of termination remain vested in the ownership shown in the public records and do not vest in the termination trustee."[7]
- "In a partial termination, the plan does not vest title to the surviving units or common elements that remain part of the condominium property in the termination trustee."[8]
- "In a partial termination, the aggregate values of the units and common elements that are being terminated must be separately determined, and the plan of termination must specify the allocation of the proceeds of sale for the units and common elements."[9]
- "In a partial termination, liens that encumber a unit being terminated must be transferred to the proceeds of sale of that portion of the condominium property being terminated which are attributable to such unit."[10]
- "In a partial termination, the association may continue as the condominium association for the property that remains subject to the declaration of condominium."[11]
- A "partial termination of a condominium does not bar the filing of a new declaration of condominium . . . for the terminated property or any portion thereof. The partial termination of a condominium may provide for the simultaneous filing of an amendment to the declaration of condominium or an amended and restated declaration of condominium by the condominium

[3] Id.
[4] Fla. Stat. § 718.117(3).
[5] Fla. Stat. § 718.110(4).
[6] Fla. Stat. § 718.117(4).
[7] Fla. Stat. § 718.117(11)(a).
[8] Fla. Stat. § 718.117(11)(b).
[9] Fla. Stat. § 718.117(12)(a).
[10] Fla. Stat. § 718.117(12)(b).
[11] Fla. Stat. § 718.117(18).

association for any portion of the property not terminated from the condominium form of ownership.[12]

Florida has an unusual voting procedure for terminations, both total and partial. A plan of termination requires a vote of 80 percent of the total voting interests, but a plan of termination cannot proceed if 5 percent of more of the total voting interests have rejected the plan by negative vote or written objection. The "veto provision" at first was 10 percent but was tightened to 5 percent by a statutory amendment in 2017. Florida applies the same voting and approval rules to total and partial terminations; unit owners have the same voting rights whether their unit is designated for termination or continuation.

The Florida termination provisions (Section 718.117) are highly complicated. Two types of terminations are allowed, both for total and partial terminations. Florida's experience with hurricane damage to condominium properties led to the enactment of provisions allowing termination for "economic waste" or "impossibility." Later the legislature added what are called "optional termination" provisions that do not require economic waste or impossibility.

Florida amended its termination provision in 2015 to add protections for unit owners when a "bulk owner" has acquired at least 80 percent of the voting interests in an association. The protections include (1) a requirement that non-bulk owners are compensated with at least 100 percent of the market value of their units; (2) a requirement that owners whose units qualify as homestead property receive relocation payments; and (3) a lockout period of 5 years after the recording of a condominium declaration when termination may not take place. The motivation for the "bulk owner" rules was to counteract the phenomenon of "condominium deconversions" that occurred after the housing bubble burst of 2008. In prior years Florida had experienced a dramatic rise in the conversions of rental properties to condominiums, and the housing crash led to the failure of many ongoing condominium conversions, which had units that could not be sold. Investors (bulk buyers) bought into these failing projects to make money by "deconverting" them back to rental properties. The "bulk owner" rules are controversial. Some Florida lawyers believe they are overly restrictive and cause more harm than benefits.[13]

The Florida legislature has continued to add more restrictions on condominium terminations. Unit owners and lienholders have a right to contest a plan of termination by mandatory nonbinding arbitration. If they fail to do so, they may not bring an action in court to challenge the plan of termination.[14]

In 2017, an amendment added a requirement of agency approval of plans of termination. After approval of a vote by the association, the plan of termination must be

[12] Fla. Stat. § 718.117(19).
[13] See Martin Schwartz, *Termination of Condominium Terminations?*, 89 Fla. B.J. 51 (2015); reporter's telephone call with Mark Grant.
[14] Fla. Stat. § 718.117(3)(e).

submitted to the Division of Florida Condominiums, Timeshares, and Mobile Homes of the Department of Business and Professional Regulation, which examines the plan to determine whether it satisfies the procedural requirements and the other conditions required by the Florida statute.[15]

The Florida statute makes terminations, including partial terminations, hard to accomplish. One consequence is that some condominium unit owners who seek a partial termination have attempted to accomplish their objective by amending the declaration of condominium, rather than meet the voting and other requirements of the termination provision (Fla. Stat. § 718.117). Two Florida trial courts have recently upheld this strategy. In one case, a condominium declaration required 100% unit owner approval to terminate but allowed a two-thirds vote to amend the declaration.[16] A supermajority of 88% voted to amend the declaration to allow termination with 80% unit-owner approval. This succeeded. The second case approved exactly the same strategy – amending the declaration to get rid of a requirement that termination requires a unanimous vote of the unit owners – but left open a question as to the process by which dissenting unit owners may be forced to sell after termination.[17]

II. Partial termination as it now stands under existing UCIOA provisions

Whether the Drafting Committee should propose a new partial termination provision depends in part on whether existing UCIOA provisions already provide adequate methods for terminating some, but not all, of the units in a community in circumstances in which that outcome may be said to be desirable.

A. Is partial termination allowed under Section 2-118?

UCIOA Section 2-118, *Termination of Common Interest Community*, does not expressly authorize a partial termination, but it is possible that its machinery may be used to accomplish one. Section 2-118 establishes a baseline requiring an affirmative vote of 80% of the votes in the association for a "total" termination of a project. The declaration may require a higher percentage including unanimity.

Section 2-118(c) authorizes termination agreements that require the sale of all of the units following termination. A termination with a sale of all the units and common elements to an unrelated buyer obviously cannot accomplish a partial termination. This is the classic "total termination." But Section 2-118(c) also authorizes termination agreements that do not provide for the sale of "the real estate constituting the common interest community." The language of Section 2-118 does not indicate whether a hybrid is allowed – a termination agreement that describes some units to be sold and some units not to be sold. Such a hybrid termination agreement could provide that the unsold units

[15] Fla. Stat. § 718.117(3)(e).
[16] Terzian v. Yachtsman's Inn Condo. Ass'n, Case No. 15-CA-000072-P (Monroe Cty. Circuit Ct. Aug. 11, 2015).
[17] Adams v Surf House Condominium Case No. 15-CA-000072-P (Miami-Dade Cty. Circuit Ct. Oct. 17, 2018).

are to be constituted as a new common interest community, with the preparation and recording of a new or restated declaration. In effect this means that some of the unit owners have reached an agreement to form a new community, either as part of the termination agreement or perhaps as a side agreement. If this works, it amounts to a partial termination. Because Section 2-118 does not expressly prohibit a termination agreement that calls for the sale of only some units and only some common elements, probably it is allowed.

B. Partial termination by exercise of development rights

One of the development rights allowed by UCIOA is the withdrawal of "real estate from a common interest community,"[18] which includes units.[19] The declarant may use this right to terminate only units that are unsold, whether built or unbuilt.[20] UCIOA Section 2-110(d) imposes conditions on this right. To withdraw less than all of the units, the declaration must describe a "separate portion" of real estate subject to the withdrawal right and "it may not be withdrawn after a unit in that portion has been conveyed to a purchaser."[21] So the outcome here is that a declarant, including a successor declarant, may use its withdrawal right to accomplish a partial termination, but the partial termination cannot eliminate any sold units without the consent of the all owners of sold units.

A point of vocabulary is revealed by review of the UCIOA language governing development rights. UCIOA uses the terms "withdraw" and "withdrawal" to refer to the

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[18] The UCIOA definition of "development rights is a bit odd:

> Section 1-103, *Definitions*. . . .
> (16) "Development rights" means any right or combination of rights reserved by a declarant in the declaration to:
> (A) add real estate to a common interest community;
> (B) create units, common elements, or limited common elements within a common interest community;
> (C) subdivide units or convert units into common elements; or
> (D) withdraw real estate from a common interest community.

The definition's language expressly allows a development right to "create units" but does not mention deleting units. But the right to withdraw real estate clearly includes real estate containing units. This is demonstrated by the language of Section 2-110(d), quoted in note 21 *infra*.

[19] All real estate within the boundaries of common interest community is either common elements or units. See the definition of "common elements," UCIOA § 1-103(6) (note – there is a hanging phrase "other interests" in subparagraph (B) of the definition, but the apparent intent is that "other interests" means "other than units."

[20] UCIOA § 2-110(d), quoted in note 21 *infra*.

[21] "Section 2-110, *Exercise of Development Rights*. . . .
(d) If the declaration provides, pursuant to Section 2-105(a)(8), that all or a portion of the real estate is subject to a right of withdrawal:
(1) if all the real estate is subject to withdrawal, and the declaration does not describe separate portions of real estate subject to that right, none of the real estate may be withdrawn after a unit has been conveyed to a purchaser; and
(2) if any portion is subject to withdrawal, it may not be withdrawn after a unit in that portion has been conveyed to a purchaser."

shrinkage of a community interest community. This is precisely the same as the concept of "partial termination" under Florida law and generally, at least when the real estate being withdrawn includes units. If the Drafting Committee decides to add text or comments dealing with "partial termination," care should be taken to use terms consistently. One approach might be to modify the existing UCIOA withdrawal provisions rather than add a "partial termination" provision.

C. Partial termination by amending the declaration

The declaration must describe all units created at the time of execution and recording of the declaration.[22] As a general matter, it is always possible for an amendment to the declaration to add more units or subtract existing units. An amendment that subtracts existing units is a partial termination of the common interest community.

UCIOA Section 2-117, *Amendment of Declaration*, governs the amendment process. The baseline rule requires a "vote or agreement of unit owners" holding at least 67% of the votes in the association.[23] The declaration may specify "a different percentage for all amendments or for specific subjects of amendment" and may require "the approval of another person as a condition of its effectiveness."[24]

The baseline rule calling for a supermajority 67% vote to amend the declaration has a number of statutory exceptions set forth or cross-referenced in Section 2-117.[25] Section 2-117(d) states: "Except to the extent expressly permitted or required by other provisions of this [act], no amendment may create or increase special declarant rights, ***increase the number of units***, change the boundaries of any unit, or change the allocated interests of a unit, in the absence of unanimous consent of the unit owners" (emphasis added). Note the highlighted language. Subsection (d) requires the unanimous consent of unit owners to "increase the number of units" unless the declaration contains express language that specifies a possible future increase. But this section says nothing about an amendment that ***decreases*** the number of existing units.

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[22] Section 2-105(a)(5), *Contents of Declaration* ("The declaration must contain: . . . in a condominium or planned community, a description of the boundaries of each unit created by the declaration . . . or in a cooperative, . . . a description . . . of each unit created by the declaration . . . ."). Most declarations also will expressly state the number of units created, but UCIOA does not require such a statement. Instead, UCIOA requires "a statement of the maximum number of units that the declarant reserves the right to create," id. § 2-105(a)(4), which presumably is relevant only if the declarant has reserved a development right to create more units.

[23] UCIOA § 2-117(a).

[24] Id.

[25] "Section 2-117, *Amendment of Declaration*. (a) Except in cases of amendments that may be executed by a declarant under Section 2-109(f) or 2-110, the association under Section 1-107, 2-106(d), 2-108(c), 2-112(a), or 2-113, or certain unit owners under Section 2-108(b), 2-112(a), 2-113(b), or 2-118(b), and except as limited by subsections (d), (f), (g), and (h), the declaration, including any plats and plans, may be amended only by vote or agreement of unit owners of units to which at least [67] percent of the votes in the association are allocated, unless the declaration specifies a different percentage for all amendments or for specific subjects of amendment."

Subsection 2-117(d) contains ambiguity. One plausible interpretation is that subsection (d) does not apply to the decrease (subtraction) of units, with the result that the baseline 67% vote applies to a decrease. In other words, a partial termination requires a 67% vote.[26] Under this view, UCIOA specifies a different vote for total terminations and partial terminations. Section 2-118 requires an 80% vote for total terminations, and Section 2-177 allows a partial termination accomplished by a declaration amendment with a 67% vote. Query whether this contrast is appropriate. This may not raise a problem when the units taken away by a partial termination are all unbuild units, perhaps in an anticipated phase that is no longer practical, but what about a partial termination that removes units owned by purchasers?

Subsection 2-117(d) is ambiguous because there is at least one other plausible interpretation. The subsection requires the unanimous consent of unit owners to "change the allocated interests of a unit," and the subtraction of units (even only one unit) necessarily will have the change the allocated percentage interests of all remaining units. So perhaps Subsection 2-117(d) does require the unanimous vote of unit owners to accomplish a partial termination. But this is uncertain because of the introductory words "[e]xcept to the extent expressly permitted or required by other provisions of this [act]." This exception may apply, dispensing with the unanimous-vote requirement, because UCIOA requires that the declaration contain an allocation of the allocated interests for "each unit" and those allocations must add up to 100%.[27]

III. Concluding remarks

Partial terminations, at least of condominium properties, probably take place in all jurisdictions, at least occasionally, even when the state condominium statute does not expressly address partial termination. The Florida experience described above demonstrates this, as the partial termination of the Grande Oaks Preserve condominium project was accomplished before the Florida legislature added the partial-termination provisions. The reporter has not discovered any other state that has a condominium act that expressly addresses partial terminations.

Partial terminations, like total terminations, do not present significant problems when all the unit owners vote or agree to the outcome. When everyone agrees, it does not matter what the documents says, and no statute should block the desired outcome.

The important issue to consider is when partial terminations are appropriate when

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[26] *See* Brian Meltzer, et. al., *Time to Rehab the Aging Condominium Concept: Fixing Problems Uncovered by the Great Recession*, Practical Real Est. Lawyer 37, 43 (Sept. 2017): "Some first-generation condominium statutes require the approval of a large super majority, up to 100 per-cent of unit owners and 100 percent of the lenders, to terminate a condominium. Such an approval requirement is, in most cases, extremely difficult to attain. Unless the statute or the declaration specifically prohibits modification of the termination provisions, it may be possible to amend the declaration to provide for a lower threshold."

[27] Section 2-107(e), *Allocation of Allocated Interests*. See also Section 2-107(c): "If units may be added to or withdrawn from the common interest community, the declaration must state the formulas to be used to reallocate the allocated interests among all units included in the common interest community after the addition or withdrawal.

some owners (or perhaps lienholders or other interested parties) disagree or fail to give affirmative consent. As indicated above in Part II, under UCIOA partial terminations may take place if initiated by a declarant or successor declarant pursuant to a reserved development right to withdraw property, even if existing unit owners dissent. In addition, there seems to be no impediment to accomplishing partial termination by a vote of unit owners to amend the declaration either to add or modify a termination provision or, directly, to delete certain units and related real estate and modify plats and plans as appropriate. Generally, a supermajority vote (UCIOA specifies 67%) suffices. The two Florida trial court decisions discussed above in Part I demonstrate how this can work.

Another issue under UCIOA as it now stands is whether Section 2-118, which plainly applies to total terminations, may be interpreted to authorize partial termination, as discussed in Part IIA. It may be best to clear this up, either by allowing only a total termination under this section or authorizing a partial termination with a sale of only the units and related real estate that is not to continue in a common interest community.

UCIOA Section 2-118 as it now stands regulates all total terminations, treating them the same way regardless of the reason for termination. As the Florida act indicates, it's possible to provide different rules for terminations that are sought for different reasons. UCIOA presently has only one special rule, set forth not in Section 2-118 but at the end of Article 2 in Section 2-124, *Termination Following Catastrophe*.[28] This provision does not relax the voting requirements for termination, unlike Florida's statute when there is proof of "economic waste" or "impossibility," and Section 2-124 does not address catastrophic damage to only part of the community. This provision might be expanded in scope.

Another issue to consider is whether a partial termination provision, if recommended by the Drafting Committee, should apply uniformly to all common interest communities. Florida applies its rule only to condominiums, and it's possible that a statutory rule is not necessary, or should be markedly different, for planned communities or cooperatives.[29] When a traditional planned community is fully built-out, the problem of economic obsolescence years after development may not need a "solution" by partial termination accomplished by a supermajority vote of owners. In addition, planned communities are not susceptible to the problem of certain condominium buildings becoming less valuable as owner-occupied units, with the prospect of creating market value by converting a building to rental real estate.

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[28] Section 2-124: "If substantially all the units in a common interest community have been destroyed or are uninhabitable and the available methods for giving notice under Section 3-121 of a meeting of unit owners to consider termination under Section 2-118 will not likely result in receipt of the notice, the executive board or any other interested person may commence an action in [insert appropriate court] seeking to terminate the common interest community. During the pendency of the action, the court may issue whatever orders it considers appropriate, including appointment of a receiver. After a hearing, the court may terminate the common interest community or reduce its size and may issue any other order the court considers to be in the best interest of the unit owners and persons holding an interest in the common interest community."

[29] *See* email from Jo Ann Jo Anne Stubblefield to reporter (Nov. 30, 2020).