REAL ESTATE INVESTORS GONE WILD: CAN I GET OUT OF MY CONTRACT?

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During the meteoric rise in real estate values through 2005, many investors entered the condominium market hoping to make a quick dollar reselling their units pre-construction. Developers responded with a flurry of new construction. Now, roughly two years later, the construction dust has settled, the market has declined, and developers are calling the investors to the table to close on their contractual obligations. The dilemma faced by the investor is: to close on the unit; walk away from the deal and forfeit the deposit that can exceed several hundred thousand dollars; or if there are grounds, rescind the contract and demand return of the deposit. For most investors, the associated carrying costs of a purchased unit will quickly exceed the amount of the original investment, making closing an unattractive option. For most, if not all developers, allowing a purchaser to avoid the contract is an unattractive option as well. As a result, litigation generally ensues.

In determining whether to litigate this issue, both parties must consider, amongst other factors, whether any material changes to the condominium offering adversely impact the offeree, and whether the contract complies with the Interstate Land Sales Act.

In a condominium project of any magnitude, development changes inevitably occur. The Condominium Act requires every contract for sale contain a clause providing that any amendment to the offering that materially changes the offering in a manner adverse to the buyer allows the buyer to cancel the contract. §718.503, Fla. Stat. (2007). A material change is defined under Florida law as: "to a significant extent or degree." Adverse is defined as a change that is "contrary to one's interest or welfare[, or] unfavorable." Courts have found that both an increase of $12,168.00 in annual costs for utilities, and unilateral increases in costs from $10,384 to $17,122 for custom features in the unit are grounds for cancellation. However, even though the substitution of the developer is a material change, one court found that it did not constitute an adverse change to the buyer. Hence, the purchaser was not entitled to rescind the contract. As the foregoing rulings illustrate, whether a change is material and adverse must be analyzed on a case-by-case factual basis.

Additionally, developers of large scale condominium projects are subject to the requirements of the federal Interstate Land Sales Act. 15 U.S.C.A. §1701 *et seq.* ("ILSA"). ILSA requires that a developer submit cumbersome registration materials with the Dept. of Housing and Urban Development and provide a property report to the purchaser. Failure to provide the purchaser with the property report provides the purchaser with the statutory right to revoke the contract within two years of signing the contract. A developer can exempt themselves from the ILSA filing requirements by including in the contract a two-year construction completion date. In most cases, the developer seeks out the

exemption. While some contracts include an unequivocal guarantee of completion within two years, most contracts contain force majeure provisions, which allow the developers to complete construction within two years except for delays caused by the "Acts of God," labor and material shortages, or other delays arising from situations out of the developers control.

According to the HUD Guidelines interpreting ILSA, to be exempt from the ILSA reporting requirements, the two-year construction obligation must not be illusory. To determine if the obligation is illusory, state contract law is applied. If the obligation is illusory under state contract law, then it is illusory under ILSA. The HUD Guidelines generally state that an obligation will not be considered illusory if it includes a provision allowing for delays that are legally recognized defenses to performance. The doctrine of force majeure as a defense to a breach of contract action is a well established legal defense under Florida law. Accordingly, based on the HUD Guidelines, the inclusion of the force majeure provision does not render the two-year obligation illusory.

However, in Samara Development Corp. v. Marlow, the Florida Supreme Court stated that the two-year build obligation in a contract must be unconditional; it must not be limited or affected in any way. 556 So.2d 1097 (Fla. 1990). The specific question addressed by the Samara Court was whether limiting a purchaser's remedies on breach to either specific performance or return of the deposit rendered the two-year build obligation illusory, to which the Court answered affirmatively. Read broadly, Samara suggests that the inclusion of a force majeure provision also renders the two-year build obligation illusory as the obligation is not "unconditional."

The First District Court of Appeals in Hardwick Properties, Inc. v. Newbern did not read Samara so broadly. 711 So.2d 35 (Fla. 1st DCA 1998). It found that the two-year build obligation at issue was not, as a matter of law, illusory simply because it limited a purchaser's remedy to damages other than special and consequential damages. The Hardwick court quoted the contract's force majeure provision, but made no comment as to its effect. Presumably, the Court would have allowed rescission of the contract if it read the Samara decision broadly. The current debate that requires appellate resolution is whether, standing alone, the inclusion of a force majeure provision renders the two-year build obligation illusory.

The Fifteenth Circuit, in G.L. Homes of Lake Charleston Associates, LTD v. Arbid, held that the inclusion of a force majeure provision providing for delays due to labor and material shortages did not create an unconditional obligation to complete construction within two years. Accordingly, the purchasers were able to rescind the contract due to the developer's failure to comply with ILSA requirements. Locally, Judge Dubensky from the Circuit Court of the Twelfth Judicial Circuit sitting in Manatee County has ruled otherwise. Holinsky v. Riveria Dunes Development Partners, LLC, Case No. 2007-CA-001318. In Holinsky, Judge Dubensky reasoned that the Samara decisions dictates that the two-year construction obligation must be unconditional as to factors within the developer's control, not to factors outside of its control; i.e. acts of God, material and labor shortages, etc. Accordingly, Judge Dubensky denied the Plaintiff's motion for summary judgment. Another case of local interest addressing the same issue is Stein v. Paradigm Mirasol, LLC, Case No. 2:07-CV-

71-FTM-29DNF, currently pending in the United States District Court for the Middle District of Florida, Fort Myers Division. At the time of this writing, a ruling had not yet been issued.

The current state of uncertainty in the law, accompanied by the real estate slump in southwest Florida, will certainly generate some interesting litigation in the next few years as more projects are completed, and more investors are called to the table to close on their units. Careful review of the factual circumstances and creative advocacy will determine if a claim for avoidance of the contract and return of the deposit exists.

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