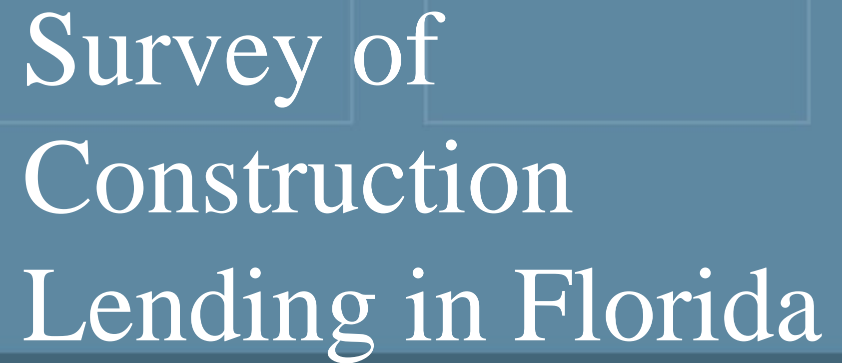
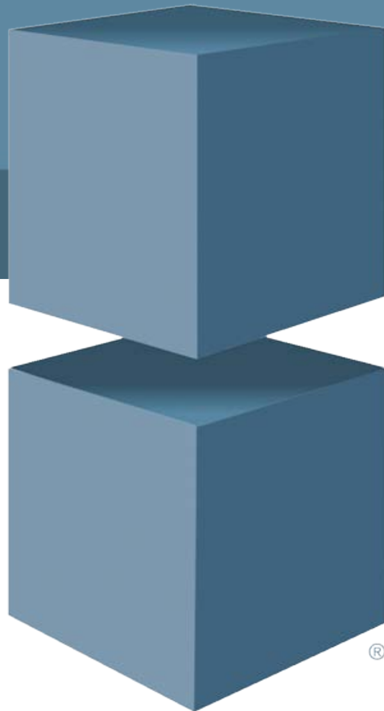


Survey of Construction Lending in Florida



Advanced Construction Law Certification Review Course

March 8-10, 2018

Ralf R. Rodriguez, Esq.

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Who is a construction lender?

A construction lender is defined as:

"any person who loans money to an owner for construction of an improvement to real property, who secures that loan by recording a mortgage on the real property, and who periodically disburses portions of the proceeds of that loan for the payment of the improvement." Fla. Stat.§713.01(17).

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A Construction Loan Agreement Must Be in Writing in Order to Be Enforced

- Requirements of Fla. Stat.§ 687.0304

- In Florida, for a construction loan agreement, or any credit agreement, to be enforceable, the agreement to loan must be manifested in writing. *See Eboni Beauty Academy v. AmSouth Bank of Florida*, 761 So. 2d 481 (Fla. 5th DCA 2000); *Metro Building Materials Corp. v. Republic Nat. Bank of Miami*, 919 So. 2d 595 (Fla. 3d DCA 2006).

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A Construction Loan Agreement Must Be in Writing in Order to Be Enforced

- Parol evidence is not admissible to contradict the unequivocal written terms of an otherwise unambiguous credit agreement. *See Silver v. Countrywide Home Loans, Inc.*, 760 F.Supp. 2d 1330 (S.D. Fla. 2011).

- Any subsequent modifications to a credit agreement must be supported by consideration. *See Coral Reef Drive Land Dev., LLC v. Duke Realty Ltd. P'ship*, 45 So. 3d 897 (Fla. 3d DCA 2010).

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Lender Liability and Duties

- Failure of the lender to fund as required by the terms of the loan agreement may allow a claim for breach of contract against the lender.

- A lender's foreclosure action may be subject to an affirmative defense where the lender negligently disbursed and grossly mismanaged the construction loan funds. *See Schaeffer v. Gilmer*, 353 So. 2d 847 (Fla. 1st DCA 1977).

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Lender Liability to the Contractor

- What happens if a contractor has direct dealings with the construction lender?
- A lender may have liability to a contractor for breach of contract.
- *Norin Mortg. Corp v. Wasco, Inc.*, 343 So. 2d 940 (Fla. 2d DCA 1977) (lender found liable to contractor where lender guaranteed to set aside specific funds from a construction loan to pay contractor).

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Lender Liability For Construction Defects As a Developer

- A lender may be liable for construction defects where it assumes control of a construction project, completes portions of the construction work, and holds itself out as “the developer” by marketing and selling the improved property. *Chotka v. Fidelco Growth Investors*, 383 So. 2d 1169 (Fla. 2d DCA 1980).

- Generally, a lender who simply forecloses on a construction loan will not be liable for defects unrelated to the lender’s active construction on the property. *Port Sewall Harbor and Tennis Club Owners Ass'n, Inc. v. First Federal Savings and Loan Ass'n of Martin County*, 463 So. 2d 530 (Fla. 4th DCA 1985).

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Lender Liability For Construction Defects As a Developer

- However, in 2013, the Florida Supreme Court disapproved of the holding in *Port Sewall* with respect to implied warranty obligations.
- In *Maronda Homes*, a HOA brought a civil action against the developer for breach of the implied warranties of fitness for a particular purpose, merchantability, and habitability arising out of alleged defective construction of private roads, drainage systems, retention ponds, and underground pipes in the subdivision. *Maronda Homes, Inc. v. Lakeview Reserve Homeowners Ass'n, Inc.*, 127 So. 3d 1258 (Fla. 2013).

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Lender Liability For Construction Defects As a Developer

- The Florida Supreme Court held that, if the improvement provides an "essential service" to the habitability of a home, then the implied warranties of fitness and merchantability apply. *Maronda Homes, Inc. v. Lakeview Reserve Homeowners Ass'n, Inc.*, 127 So. 3d 1258 (Fla. 2013).
- Therefore, a lender that assumes control of a project may be responsible for implied warranties if a residence, or the improvements immediately supporting the residence, are not reasonably fit for the ordinary or general purpose intended.

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Lender Liability For Failure to Disclose Latent Defects

- A lender must disclose known latent defects when it participates in the marketing and sale of a residential project to the public. *See Johnson v. Davis*, 480 So. 2d 625 (Fla. 1985).

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Lender’s Duty to Inspect, Audit, and Manage a Project

- Generally, a lender’s responsibility with regard to a construction project is limited to lending money, and the lender will not have liability to a borrower or third parties for any inspections or audits it carries out in connection with protecting its loan interests.

See First Wisconsin National Bank of Milwaukee v. Roose, 348 So. 2d 610 (Fla. 4th DCA 1977) and *Sobi v. First South Bank, Inc.*, 946 So. 2d 615 (Fla. 2d DCA 2007).

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Lender’s Duty to Make Proper Payments

Who pays who?

- Fla. Stat.§713.06(2)(d): “[a]ny lender who, after receiving a notice [to owner], pays a contractor on behalf of the owner for an improvement shall make proper payments as provided in paragraph (3)(c) as to each such notice received by the lender.”

- Fla. Stat.§713.13(7): “[a] lender must, prior to the disbursement of any construction funds to the contractor, record the notice of commencement in the clerk’s office.” *See Napolitano v. Security First Federal Sav. and Loan Ass’n.*, 533 So. 2d 948 (Fla. 5th DCA 1998).

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Lender and Final Payments

What if a contract is terminated before completion?
What are the final payment affidavit rules?

1. Contractor must provide lender with a Final Payment Affidavit. Fla. Stat. §713.06(3)(d)1.

2. Lender shall retain the final payment until the Final Payment Affidavit is furnished by the contractor (if not, lender may be liable to the owner for improper payment). Fla. Stat. §713.06(3)(d)5 and (d)6.

3. Lender must give a contractor ten (10) days' written notice (after receipt of Final Payment Affidavit from the contractor) before making payment directly to other lienors due money under any subcontracts. Fla. Stat. §713.06(3)(d)2.

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Lender and Final Payments

- In the event the payment due in the contractor's Final Payment Affidavit will be insufficient to pay all lienors giving notice, the lender "shall pay no money to anyone until such time as the contractor has furnished him or her with the difference." Fla. Stat. §713.06(3)(d)3.

- If 10 days have passed since lender received the Final Payment Affidavit and the contractor has not furnished the difference, the lender can determine the amount due each lienor pursuant to the terms of the direct contract between the contractor and the owner. Fla. Stat. §713.06(3)(d)3.

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Equitable Lien, Unjust Enrichment, and *Quantum Meruit* Claims

- The Equitable Lien Doctrine is firmly established in Florida.

- Equitable liens are employed to combat fraud and misrepresentation or other circumstances requiring special equity.

- In addition to an equitable lien claim, a *quantum meruit* claim may be asserted against a lender. *See Banks v. Steinhardt*, 427 So. 2d 1954 (Fla. 4th DCA 1983) (contractor's claim for *quantum meruit* could exist coextensively with equitable lien claim).

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Equitable Lien, Unjust Enrichment, and *Quantum Meruit* Claims

- An equitable lien claim and/or an unjust enrichment claim against the lender requires completion of the project. *See J.G. Plumbing Service, Inc. v. Coastal Mortgage Co.*, 329 So. 2d 393 (Fla. 2d DCA 1976); *Giffen Industries of Jacksonville, Inc. v. Southeastern Associates, Inc.*, 357 So. 2d 217 (Fla. 1st DCA 1978).

- *See CTX Mortg. Co., LLC v. Advantage Builders of Am., Inc.*, 47 So. 3d 844, 846-847 (Fla. 2d DCA 2010) (holding that builder failed to establish that lender's retention of the undisbursed construction funds was inequitable and that the "rationale for awarding an equitable lien on undisbursed construction funds to a contractor who has completed construction is unjust enrichment").

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Equitable Lien, Unjust Enrichment, and *Quantum Meruit* Claims

- June 11, 2015 decision by 1st DCA: *Jax Utilities Management, Inc. v. Hancock Bank*, 164 So. 3d 1266 (Fla. 1st DCA 2015).
- Contractor sued construction lender in connection with failed housing development project, asserting common law equitable lien and unjust enrichment claims.
- Trial Court granted summary judgment for lender; contractor appealed.
- 1st DCA held that, as a matter of first impression, Fla. Stat. §713.3471(2) – governing responsibilities of construction lenders – precluded contractor's common law claims.

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Equitable Lien, Unjust Enrichment, and *Quantum Meruit* Claims

- *Jax Utilities Management, Inc. v. Hancock Bank*, 164 So. 3d 1266 (Fla. 1st DCA 2015) – 1st DCA's rationale:

- Plain language of Fla. Stat.§713.3471(2)(b)-(c) evinces a legislative intent to displace common law remedies.
  - Lender is liable to contractor through a statutory cause of action.
  - Contractor's statutory claim may not interfere with any foreclosure action and "may not be the basis of any claim for an equitable lien or for equitable subordination of the mortgage lien."

- Statute "is so repugnant to the common law that the two cannot coexist."

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Equitable Lien, Unjust Enrichment, and *Quantum Meruit* Claims

- *Jax Utilities Management, Inc. v. Hancock Bank*, 164 So. 3d 1266 (Fla. 1st DCA 2015).

- Takeaways:
  - 1st DCA failed to acknowledge that numerous cases after Fla. Stat. §713.3471 was enacted in 1992 continued to rely on common law theories of recovery.
  - Unless the Florida Supreme Court reverses the *Jax Utilities* decision, or other DCAs rule otherwise, contractors attempting to assert common law equitable lien and unjust enrichment claims should also assert a claim based on Fla. Stat.§713.3471.

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Lender's Decision to Cease Disbursement of Construction Funds

- Where a borrower defaults on its loan obligations, a construction lender may decide to cease disbursements of construction loan funds.

- Lender must give proper notice as required by Fla. Stat. §713.3471(2)(a): Written notice to the contractor and all subcontractors (and any lienor who has previously given the lender notice) within 5 business days of making the decision to cease further advances under the construction loan.

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Lender's Decision to Cease Disbursement of Construction Funds

- If the lender fails to give the required written notice, the lender is liable to the contractor to the extent of the actual value of the materials and direct labor costs furnished by the contractor plus 15 percent for overhead, profit, and all other costs from the date on which the notice of the lender's decision not to fund should have been served on the contractor and the date on which the notice of the lender's decision is served on the contractor. Fla. Stat. §713.3471(2)(b).

- *J.G. Plumbing Service, Inc. v. Coastal Mortgage Co.*, 329 So. 2d 393 (Fla. 2d DCA 1976) (construction lender should not be permitted to affirmatively mislead subcontractors and materialmen so as to induce them to continue to work upon and supply materials to the job to their detriment).

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Lender's Liability Limited to Amount of Undisbursed Construction Funds

- The lender's liability for failure to provide written notice under Section 713.3471(2)(a) is not greater than the amount of the undisbursed construction loan funds at the time notice should have been given, unless the failure to give notice was done for the purpose of defrauding the contractor. Fla. Stat. §713.3471(2)(c).

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Determining Priority Between Mechanic's Liens and Mortgages Attaching to Real Property

- Liens of persons in privity (contractor) and of persons not in privity with the owner (subcontractor) shall attach and take priority at the time of recordation of the Notice of Commencement. Fla. Stat. §713.07(2); Fla. Stat. §713.05; Fla. Stat. §713.06.

- In the event no Notice of Commencement is recorded, these liens shall attach and take priority as of the time the Claim of Lien is recorded. §713.07 (2).

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Determining Priority Between Mechanic's Liens and Mortgages Attaching to Real Property

- Liens for Professional Services (architect, landscape architect, interior designer, engineer, or surveyor and mapper) and liens for Subdivision Improvements attach at the time of recordation of the Claim of Lien and take Priority as of that time. Fla. Stat. §713.07(1); Fla. Stat. §713.03; Fla. Stat. §713.04.

- For Professional Services in direct privity with the owner, no lien shall be acquired until a Claim of Lien is recorded. Fla. Stat. §713.03.

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Determining Priority Between Mechanic's Liens and Mortgages Attaching to Real Property

- All liens shall take priority over any encumbrance, conveyance, or demand not recorded against the property prior to the time such liens attached. Fla. Stat.§713.07(3).

  - *Adamson v. First Federal Sav. and Loan Ass’n of Andalusia*, 519 So. 2d 1036 (Fla. 1st DCA 1998) (mechanic’s lien had priority over purchase money mortgage that was recorded after the Notice of Commencement).

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Determining Priority Between Mechanic's Liens and Mortgages Attaching to Real Property

- If construction ceases or the direct contract is terminated before completion and the owner desires to recommence construction, the owner may pay all lienors in full or pro rata share prior to recommencement, in which event all liens for the recommenced construction shall take priority from such recommencement. Fla. Stat.§713.07(4).

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Determining Priority Between Mechanic's Liens and Mortgages Attaching to Real Property

- Fla. Stat. §713.06(4)(a): In determining the amounts to pay the lienors, the owner or court shall pay or allow such liens in the following order:
  - Liens of all laborers;
  - Liens of all persons other than the contractor;
  - Liens of the contractor. (A contractor must provide the Owner with a Final Payment Affidavit, pursuant to Fla. Stat. §713.06(3)(d), without which the contractor has no right of lien and no right to demand final payment.)

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Notice of Termination

- Fla. Stat. §713.132: An owner may terminate the period of effectiveness of a notice of commencement by executing, swearing to, and recording a notice of termination that contains:
  - (a) The same information as the notice of commencement;
  - (b) The recording office document book and page reference numbers and date of the notice of commencement;
  - (c) A statement of the date as of which the notice of commencement is terminated, which date may not be earlier than 30 days after the notice of termination is recorded;
  - (d) A statement specifying that the notice applies to all the real property subject to the notice of commencement or specifying the portion of such real property to which it applies;

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Notice of Termination

- Fla. Stat. §713.132 (cont'd): An owner may terminate the period of effectiveness of a notice of commencement by executing, swearing to, and recording a notice of termination that contains:
  - . . .
  - (e) A statement that all lienors have been paid in full; and
  - (f) A statement that the owner has, before recording the notice of termination, served a copy of the notice of termination on the contractor and on each lienor who has a direct contract with the owner or who has served a notice to owner. The owner is not required to serve a copy of the notice of termination on any lienor who has executed a waiver and release of lien upon final payment in accordance with Fla. Stat. §713.20.

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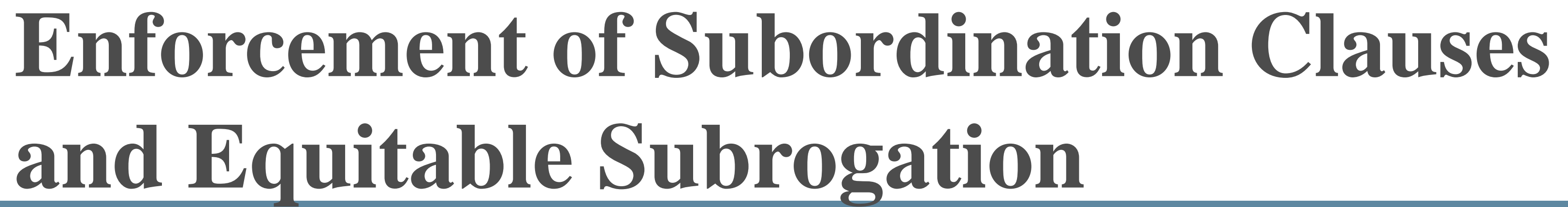

Enforcement of Subordination Clauses and Equitable Subrogation

- Subordination clauses are enforceable in Florida. Fla. Stat. §727.114(2).

  - *See Southern Floridabanc Federal Sav. and Loan Ass'n v. Buscemi*, 529 So. 2d 303 (Fla. 4th DCA 1998) (holding that subsequent mortgage took priority over prior mortgage, which contained subordination provision, even though no subordination agreement was executed in connection with subsequent mortgage and even though subsequent mortgagee was not party to prior mortgage).

- Subordination clauses can often work to a contractor's detriment.

- A right to claim a lien may not be waived in advance. Fla. Stat. §713.20(2).

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Equitable Subrogation

- Subrogee must make payment to protect its own interests.
- Subrogee has not voluntarily made the payment.
- Subrogee was not primarily liable for the debt.
- Subrogee paid the debt in full.
- Subrogation will not prejudice any third party.

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Equitable Subrogation Cases

- *Suntrust Bank v. Riverside National Bank of Florida*, 792 So. 2d 1222 (Fla. 4th DCA 2001) (bank would be entitled to equitable subrogation unless such a finding would result in any injustice to the rights of other parties).

- *Wolf v. Spariosu*, 706 So. 2d 881 (Fla. 3d DCA 1998) (lender's lien was superior to intervening lienholder's lien, where the agreement under which lender discharged the first two mortgages provided that lender was subrogated to the rights of the first mortgagee).

- *Cf., Biscayne Inv. Group, Ltd. v. Guarantee Management Services, Inc.*, 903 So. 2d 251 (Fla. 3d DCA 2005) (developer's equitable subrogation claim could not stand because developer failed to allege that it was not primarily liable for the debt).

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- The case of *CDC Builders, Inc. v. Biltmore-Sevilla Debt Investors, LLC; Brian McBride; Riviera Biltmore, LLC; and Riviera Sevilla, LLC* (Case No. 3D13-603), filed in the Third District Court of Appeal, was significant to the construction industry.

Facts of the Case:

- Developer formed a single-purpose entity ("Developer Company 1"), which took out a construction loan and hired Contractor to build single family residences. Developer Company 1 subsequently terminated Contractor for convenience, but instructed Contractor to complete in-progress homes.

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Facts of *CDC Builders, Inc.* (cont.)

- Contractor brought suit for nonpayment and completed the in-progress homes. Contractor subsequently recorded a construction lien and amended its complaint to foreclose the lien.

- When the construction loan matured, Developer Company 1 received a loan extension and then formed a separate entity (Developer Company 2), which took out a separate loan to completely pay off and purchase the matured construction loan from the Lender.

- Developer Company 2 filed an action to foreclose on the construction loan against Developer Company 1.

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Facts of *CDC Builders, Inc.* (cont.)

- The foreclosure action included the Contractor (as a lienor), who asserted affirmative defenses alleging (i) satisfaction of debt (i.e., merger through alter ego); and (ii) unclean hands. The Contractor also filed a counterclaim alleging fraudulent transfer of the subject property.

- Trial Court granted summary judgment in favor of Developer Company 2.

- Developer Company 2 subsequently purchased the property from Developer Company 1 at the foreclosure sale for a pittance, wiped out the Contractor's lien, and retained the improved property.

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Facts of *CDC Builders, Inc.* (cont.)

- The Contractor argued that Developer Company 2 was an insider-controlled entity created for the sole purpose of enabling the debtors to avoid liability to the Contractor for its claims by transferring their primary assets through a sham foreclosure action.

- However, the Trial Court agreed with Developer Company 2 that there was no evidence of fraud, a fraudulent transfer, or of improper purpose in the record.

- The Appeal to the Third District followed.

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Facts of *CDC Builders, Inc.* (cont.)

- The Third District Court of Appeal issued an Opinion on September 17, 2014, reversing the parts of the final judgment that adjudicated the Contractor's rights, noting that "persons cannot do indirectly what they are not permitted to do directly," and remanding for further proceedings regarding the Contractor's counterclaim and affirmative defenses.

- The Developer subsequently filed a Motion for Rehearing, Rehearing En Banc, Clarification, and/or Certification of Conflict and/or Questions to Florida Supreme Court, which was denied by the Third DCA in December 2014.

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Facts of *CDC Builders, Inc*. (cont.)

- On March 4, 2015, the trial court issued an Order reopening the case, and on March 10, 2015 the trial court issued a Case Management Order setting trial in October 2015.
- On April 22, 2015, the trial court issued an Order reinstating the Contractor's construction liens and staying the case pending resolution of an earlier related case filed by the Contractor against the Developer Companies, which was set for trial in February 2016.
- In February 2016, the case proceeded to a non-jury trial with the trial court determining that CDC perfected its claim of lien in regards to at least one of the property sites in question and deferred ruling on the lien foreclosure issue as against Developer Co. 2 pending resolution of Developer Co. 2's mortgage foreclosure case and Contractor's counterclaims and cross-claims alleged therein.
- The Parties thereafter settled their claims.

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Potential Implications

- If Developer Company 2 had prevailed, this case could have established an inequitable precedent (albeit under specific facts) allowing developers a method to avoid and extinguish statutory lien rights without having to pay contractors, materialmen, and/or laborers despite having obtained the benefit of work performed or materials provided to the project without payment pursuant to their contracts.

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QUESTIONS?

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