

Sellers of Undeveloped Residential Lots to Individual Purchasers May Face Serious Consequences for Violations of ILSFDA and Similar State Statutes

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This article explains the Interstate Land Sale Full Disclosure Act and its consequences for violators.

The Interstate Land Sale Full Disclosure Act (“ILSFDA” or the “Act”) and similar state registration and disclosure requirements impose both criminal and civil penalties for non-compliance with their requirements, so it is crucial that any developer selling or advertising undeveloped residential lots (including condominium units and overseas properties) to individual purchasers across state lines, via the U.S. Postal Service, or by any interstate means, review the terms of ILSFDA and strictly comply with its requirements and the requirements of similar state statutes. Although impact of ILSFDA has gone largely unrecognized to date, as the economy worsens, the Act has been used by increasing numbers of purchasers to rescind residential contracts in condominiums and subdivisions.

Interstate Land Sale Full Disclosure Act

Since 1968, ILSFDA has required that any developer selling more than 100 non-exempt subdivided residential lots as part of a common promotional plan file a statement con-

taining certain disclosures. These disclosures filed with the Department of Housing and Urban Development (“HUD”) (the “Registration Requirement”) include:

- The material conditions of the property;
- Infrastructure developments;
- The legal status of the developer;
- Forms of conveyance;
- Financial statements; and
- Encumbrances.

Details of sales that otherwise qualify for an exemption under the provisions of the Act are discussed below. Developers of such projects with more than 25 non-exempt lots must also provide property disclosure materials to any prospective purchaser prior to the execution of any contract of sale, either by conspicuous inclusion in the contract of sale or the provision of a stand alone disclosure (the “Disclosure Requirement”).

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HUD has jurisdiction over the Act from the commerce clause of the U.S. Constitution. The Act does not apply to sales that do not use any means or instruments of transportation or communication in interstate commerce such as the U.S. Postal Service. Any means of communication, including radio, television, email, or internet advertising, used in the promotion of the sale will cause the property to be subject to the Act. Therefore, for sales of 25 or more units, which are not otherwise exempt, only truly local offerings, e.g. word of mouth or sales only through an unadvertised local sales office, are likely to be exempt from compliance with ILSFDA.

The Act applies to the sale of real property only. It expressly does not apply to reservations or sale of undivided interests in real property. A "sale" occurs when a purchaser acquires an equitable interest in the property. Execution of a contract of sale qualifies as a sale under the Act.

There are a number of exemptions for ILSFDA. However, the statutory exemptions are not available if a method of disposition is adopted in order to circumvent the Act such as establishment of multiple entities to conduct a portion of the sales so that each sale falls into an exemption.

Property Sales Exempt from the Disclosure and Registration Requirements of ILSFDA

Property sales exempt from the disclosure and registration requirements of ILSFDA include:

1. Sale of lots in a subdivision containing fewer than 25 lots where residential development is permitted.
2. Sale of land, improved by the presence of a building, or a sale or lease where

the seller is obligated to erect a building on the lot within a period of two years.

3. Sale of debt or interest in a REIT, sales to a government agency, sale of cemetery lots, and *the sale of lots to another developer/builder*.
4. Sale of lots for industrial or commercial development, where such development is zoned for industrial or commercial development or subject to a similar recorded restrictive covenant limiting its use/development.

Property Sales Exempt, By Statute, from the Registration Requirement but Subject to the Disclosure Requirement by ILSFDA

Property sales exempt, by statute, from the Registration Requirement but subject to the Disclosure Requirement by ILSFDA include:

1. Sale of lots in a subdivision containing fewer than 100 lots.
2. Sale of fewer than 12 lots in any given 12 month period—this exemption cannot be recaptured once more than 12 lots are sold in a given period.
3. Scattered site development where noncontiguous parts of the subdivision contain fewer than 20 lots each and the purchaser makes a personal on-the-lot inspection. To be considered noncontiguous, the lots must not have been part of the same subdivision, sold as part of a common promotional plan or located on the same site. Lots are considered contiguous even though contiguity may be interrupted by a road, park, small body of water, recreational facility or any similar object. An example of this type of development would be a developer that buys

five scattered farms which will be subdivided into five different developments—each with fewer than 20 lots—which will be listed and sold without reference to any of the other sites.

4. Sale or lease of lots larger than 20 acres.

5. Sale of lots for construction of only single-family residences, subject to qualification requirements for the subdivision and the lots, including only single family zoning. Lots qualifying under this exemption must meet two separate subdivision requirements and eight separate lot eligibility requirements.

a. Subdivision requirements:

(i) The subdivision, or if incremental development is permitted by the local code only those portions of the subdivision being offered at any given time, must meet all local codes and standards.

(ii) The promotion plan for the subdivision may not offer, by any means or instruments of interstate communication, gifts, trips, dinners, or other inducements to visit the subdivision or purchase lots.

b. Lot requirements (each lot must comply with each requirement):

(i) Each lot meets the minimum standards of development specified by the local government or State where such lot is located, lots located in jurisdiction that lack these standards are not eligible for this exemption. The regulations must include standards for:

- (A) Lot dimensions;
- (B) Plat approval and recordation;
- (C) Roads and Access;
- (D) Drainage;
- (E) Flooding;
- (F) Water supply; and
- (G) Sewage disposal.

(ii) Each lot sold must either be zoned for single-family residence, or if there is no zoning ordinance in effect, by covenants or restrictions to single-family residences which include manufactured homes, townhouses, and residences for one to four family use.

(iii) Each lot must be located on a conforming street or highway which is acceptable to the local jurisdiction or, if the street is incomplete, the Developer must have posed a bond or other surety with the local jurisdiction for the full cost of completion.

(iv) The HOA or local jurisdiction must have accepted or be obligated to accept the maintenance obligation for the street. If the HOA is obligated to maintain the street the HOA must provide a good faith estimate of the maintenance cost for the first 10 years of the its obligations.

(v) Water, Sewage and Electricity

(A) At the time of closing potable water, sewage, and electricity must be extend to the property or the local government must be obligated, by statute or agreement, to install same within 180 days after closing.

(B) Subdivisions without central water or sewage.

(1) Developer must provide assurances, which may be from a hydrologist or the local health department, that there is adequate year round access to potable water for the subdivision.

(2) Developer must provide assurances that each lot is approved, or will be approved at closing, for the installation of a septic tank. *Developers selling lots not approved are at risk of losing their exemption in the event approval and closing does not occur within 180 day of the contract date.*

(vi) Contract for sale must have

a closing date and close within 180 days of contract execution and Developer must convey by warranty deed free of monetary liens or encumbrances.

(vii) At time of closing a current title commitment, policy or title opinion given to the purchaser showing that marketable title to the lot is vested in the seller and that the lot is only subject to exceptions approved in writing by the purchaser.

(viii) *The purchaser or purchaser's spouse must personally inspect the lot prior to contract execution.*

6. Sale of mobile home lots.

7. Intrastate sales including sales restricted to residents of the state unless non-resident sales are otherwise exempt from ILSFDA Disclosure and Registration requirements or under exemptions 6 or 8.

8. Sales restricted to residents of the Metropolitan Statistical Area where the subdivision is located, provided the subdivision contains fewer than 300 lots.

Property Sales Exempt, By Regulation, from the Registration Requirement but Subject to the Disclosure Requirement

Property sales exempt, by regulation, from the Registration Requirement but subject to the Disclosure Requirement include:

1. Sale of inexpensive lots (sale price less than \$100).
2. Leases of limited duration (less than 5 years) without automatic renewal.
3. Sale of adjoining lots.
4. Lot sales to a government entity.
5. Sale of leased lots (usually mobile home lots).

For any sales exempt from the Registration Requirements but not the Disclosure Requirements, the developer must incorporate the disclosures into its contract of sale or provide a stand alone disclosure prior to the "sale" of the lot.

Remedies

The Act provides purchasers and HUD with civil remedies, including the right of revocation, and may impose criminal penalties on developers who do not comply.

Civil remedies include a suit at law or equity for violation of the Act in which the court may consider the value of the lot and time of purchase and time of suit in determining damages if any and also enforce the revocation rights under the Act. There is a three year statute of limitation for an individual purchaser's civil actions. HUD may additionally impose a "civil money penalty" up to \$1,000 per violation, with a maximum penalty of \$1,000,000, for violations by any person in a one year period. There is no stated limitations period for HUD civil actions.

Federal criminal penalties for a willful violation of the Act, including willfully making an untrue statement of material fact or making material omissions, may include a fine of up to \$10,000 and/or imprisonment for up to five years. There is no stated limitations period for criminal acts.

In addition to the ILSFDA, a number of states—including South Carolina—have parallel registration and disclosure laws which mirror the requirements of the ILSFDA. These laws require sellers to register the proposed sale of out-of-state subdivisions with the state *and* federal government if the offering is in the state or to South Carolina residents. HUD will accept the state filings in

lieu of the standard federal filing from four states:

- Arizona;
- California;
- Florida; and
- Minnesota.

To assist developers with compliance, HUD will issue advisory opinions regarding the compliance requirements of any particular development upon request.

Even if a project qualifies for an exemption, developers must carefully evaluate if changes in a marketing plan or delivery schedule will cause a particular project to lose its exempt status and result in a violation of ILSFDA. Failure to comply may constitute a default by a borrower under existing project financing agreements and therefore jeopardize the project financing.