# HYATT & STUBBLEFIELD, P.C.

# The Client Letter

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This newsletter addresses current issues and developments in the law relating to development of planned communities. It is published periodically for distribution to clients and friends of Hyatt & Stubblefield, P.C., Attorneys and Counselors. The information presented is not intended as specific legal advice to any person. Principles of law expressed in this newsletter are subject to change from time to time.


## *Federal Land Sales Update: Changes in Interpretation of Registration Requirements*

Several court decisions have been rendered over the last few years with differing interpretations of the Federal Interstate Land Sales Full Disclosure Act (15 U.S.C. § 1701, *et al*., "**ILSA**"). Unfortunately, the latest rulings are not in keeping with Guidelines published by the Department of Housing and Urban Development ("**HUD**"), upon which developers have been relying for more than a decade. The latest rulings could be considered a sea change in the way exemptions under ILSA are viewed.

ILSA is designed to discourage fraud in the purchase or lease by consumers of real estate by imposing various requirements on the sale or lease of lots. For purposes of ILSA, the term "lots" includes condominium units, and the term "subdivision" includes a condominium building or project. ILSA is a comprehensive statute requiring sellers to furnish prospective purchasers with pertinent information about lots offered for sale pursuant to a common promotional plan. Since ILSA is an anti-fraud statute utilizing disclosure as its primary tool, it requires a "statement of record" to be filed with HUD. The statement of record includes a property report that must be given to all purchasers in advance of their signing any contract to purchase a lot or unit, unless the sale qualifies for one of several exemptions.

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There are "full" exemptions to ILSA which are set out in 15 U.S.C. Section 1702(a). Several of the exemptions most commonly relied upon by residential developers and home builders under this subsection include: (1) the sale or lease of lots in a subdivision containing less than 25 lots; (2) the sale of a lot/home package by use of a contract which obligates the seller to construct a home on the lot within two years of the date of contract (the "**Improved Lot Exemption**"); and (3) the sale of lots to a builder for the purpose of engaging in the business of constructing buildings or for resale to the general public. 15 U.S.C. Section 1702(b) sets forth several "partial" exemptions to ILSA. Under the "partial" exemptions, the seller is exempt from the registration requirements and certain other disclosure requirements, but the seller is not exempt from other ILSA requirements designed to protect consumers. One of the more commonly used "partial" exemptions is the sale or lease of lots in a subdivision containing fewer than 100 lots (the "**99-Lot Exemption**").

A common issue addressed by the courts is whether the exemptions can be combined to exempt from registration a project containing more than 99 lots. This approach, commonly known as "stacking" exemptions, has been sanctioned by HUD in its published Guidelines and in a number of HUD advisory opinions, as well as by various courts. 61 Fed. Reg. 13,596-01, 13,604 (Mar. 27, 1996) (HUD Guidelines Part V(a)). Significantly, the HUD Guidelines expressly contemplate relying upon the 99-Lot Exemption to exempt sales that occur before the lots in excess of 99 have been sold in exempt transactions. The courts in several recent cases, however, have rejected HUD's interpretation of this exemption.

A series of recent decisions "stirred the soup" as it relates to stacking exemptions, beginning with the case of *200 East Partners, LLC v. Gold*, 997 So.2d 466 (Fla. Dist. Ct. App. 2008). In that case, a condominium developer had obtained a HUD advisory opinion sanctioning its intent to rely upon the 99-Lot Exemption combined

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with the Improved Lot Exemption to exempt the sale of units from registration. The advisory opinion acknowledged that sales would be made under the 99-Lot Exemption before sales were made under the Improved Lot Exemption. While the court stated that it did not challenge the propriety of a developer piggybacking exemptions, it found HUD's advisory opinion "unpersuasive" to the extent that it would permit the developer to wait until the first sale in excess of 99 to qualify the remaining units for exemption. The court ruled that the developer had failed to "perfect" exemptions for all units in the condominium by filing appropriate contract forms with the state agency prior to entering into the first contract of sale, and therefore, the sale was not exempt. This decision was significant in that neither the statute, the HUD regulations under ILSA, the HUD Guidelines, or the HUD advisory opinion set forth any express requirement or procedures for "perfecting" exemptions before the first sale and not all states require filing of sales contract forms with a state agency, leaving open the question of how one would "perfect" the exemptions in states that have no contract filing requirement.

Just two months later, in the case of *Gentry v. Harborage Cottages-Stuart, LLLP*, 602 F. Supp. 2d 1239 (S.D. Fla. 2009), a federal district court imposed a different standard for combining exemptions when it rejected the developer's claim of exemption under the 99-Lot Exemption combined with an intent to rely upon the Improved Lot Exemption for sales of units in excess of 99, notwithstanding that it apparently had "perfected" both exemptions by the *200 East Partners* standard. The court stated that there was no evidence in the record that the developer had a "legitimate business purpose" for selling some lots under one exemption and other lots under a different exemption. In the absence of such evidence, the court concluded that the seller's method of disposition was adopted for the purpose of evading ILSA's requirements, and therefore, the exemption was not available.

*Gentry* was soon followed by *Double AA Int'l. Inv. Group, Inc. v. Swire Pac. Holdings, Inc.*, 674 F. Supp. 2d 1344 (S.D. Fla. 2009), in which a different judge, addressing a case with similar facts and claims, found that the developer's desire to maintain flexibility and save the time and money involved in registration was a legitimate business purpose for structuring the purchase agreements to make use of the combined exemptions from registration available under ILSA.

Significantly, none of these decisions went so far as to eliminate the possibility of combining exemptions to exempt the sale of lots or units in a project containing more than 99 lots, nor did they require that all lots in excess of 99 be sold in exempt transactions before the developer could enter into contracts in reliance upon the 99-Lot Exemption. These cases simply imposed additional requirements – either "perfecting" the exemptions or a "legitimate business purpose" -- in order to take advantage of the combined exemptions.

In January 2010, the court in *Bodansky v. Fifth on the Park Condo, LLC*, 732 F. Supp. 2d 281 (S.D.N.Y 2010), addressing another case of a condominium purchaser seeking to rescind its purchase, considered and rejected the standards established in *200 East Partners* and *Gentry* in favor of HUD's interpretation of its own regulations as set out in the HUD Guidelines, citing several cases as authority for the proposition that the regulating agency's interpretation is entitled to deference and is "controlling unless plainly erroneous or inconsistent with the regulation." The court noted that HUD regulations make eligibility for exemptions self-determining and require only that the developer maintain records to support the exemptions upon which it is relying. It then went on to hold that the developer was entitled to rely upon the 99-Lot Exemption combined with the Improved Lot Exemption where fewer than 99 units had been sold in the condominium prior to completion of construction of the remaining units, even though the developer admitted that it was unaware of ILSA until shortly before the plaintiff sought to rescind its purchase.

It was in this muddied water that the U.S. District Court for the Eastern District of Virginia was asked in March 2010 to determine eligibility of certain lot sales for exemption under the 99-Lot Exemption in the cases of *Nahigian v. Juno-Loudoun, LLC*, No. 1:09cv725, 2010 WL 1381637 (E.D. Va. Mar. 30, 2010) and *Rensin v. Juno-Loudoun, LLC*, No. 1:09cv1391, 2010 WL 1138318 (E.D. Va. Mar. 17, 2010). In each case, the plaintiffs were seeking to rescind their purchase of single family lots in a 164-lot single family development in which 14 lots had been sold to builders, 17 lots had been sold to the public, and the rest remained unsold. The developer asserted reliance upon the 99-Lot Exemption for the sales to Nahigian and Rensin, with a plan to sell no more than 99 lots to the public and the rest to builders in reliance upon the "builder" exemption under 15 U.S.C. Section 1702(a)(7). In denying a motion for summary judgment, the court rejected *Bodansky*, holding that the defendants were not entitled to rely upon the 99-Lot Exemption for the sales to non-builders until all lots in excess of 99 had been sold in transactions exempt under Section 1702(a). The *Nahigian* and *Rensin* decisions represent a significant departure from HUD's interpretation of the statute and a long line of cases sanctioning the combination of exemptions.

Less than two months after the *Nahigian* and *Rensin* decisions, the U.S. District Court for the Southern District of Florida in *First Global Corp. v Mansiana Ocean Residences, LLC*, 09-21092-Civ (May 25, 2010), cited *Rensin* for the proposition that the determination of the number of non-exempt lots in a subdivision must be made at the time the purchaser signs the contract. Concluding that future sales cannot be excluded from the count until they are made under

an exempt transaction, the court held that the developer was not entitled to rely upon the 99-Lot Exemption for the sale to the plaintiff and thus had violated ILSA.

More recent cases at the appellate level have continued to uphold this approach. The 2nd Circuit Court of Appeals determined in *Bodansky v. Fifth on the Park Condo, LLC*, 635 F.3d 75 (2nd Cir. Mar. 15, 2011), that eligibility for exemption must be determined at the time the purchaser signs a contract to purchase the particular lot. A developer may not utilize the 99-Lot Exemption to sell the first 99 unimproved lots in a larger subdivision unless the remaining lots planned for the community qualify for the Improved Lot Exemption or another exemption under Section 1702(a) at the time those first 99 buyers sign purchase contracts. The 5th Circuit Court of Appeals phrased it another way, holding that, if at the time of contract for a lot in the subdivision, the subdivision as described to the purchaser contains 100 or more lots that are not already exempt under one of the full exemptions in Section 1702(a), the developer may not take advantage of the 99-Lot Exemption. *Nickell v. Beau View of Biloxi, LLC*, 636 F.3d 752 (5th Cir. Mar. 28, 2011).

On a slightly different subject, the court in *Bacolitsas v. 86th & 3rd Owner, LLC*, No. 09 Civ. 7158, 2010 U.S. Dist. LEXIS 99642 (S.D.N.Y. Sept. 21, 2010), examined the requirement of 15 U.S.C. Section 1703(d) that the lot be described in the contract in a form "acceptable for recording" and the requirement of 24 C.F.R. 1710.105(d)(2)(iii)(A) that the contract contain a "legally sufficient and recordable lot description." The court ruled that the statute requires the lot description be included in "a document that is in a form capable of being recorded." This means that the purchase contract must satisfy local recording statute requirements, perhaps requiring one or more witnesses, a notary signature, and sometimes requiring specific page margins. It is our understanding that this case is presently on appeal to the 2nd Circuit Court of Appeals.

Where does this leave those who may already have sold lots in reliance upon HUD's interpretation and prior case law sanctioning the combining of exemptions? Unfortunately, regardless of where the project is located, it seems likely that these latest cases could result in a new wave of claims under ILSA by purchasers seeking to rescind their purchases. As the courts consider these claims, there is a heightened possibility that they will look beyond HUD's interpretation of the statute and regulations to find violations of ILSA, opening the door to even more rescissions. However, it is also worth noting that a purchaser has only two years to first seek rescission from the seller, so the statue of limitations may have already run in many cases. Nonetheless, as the residential real estate market improves and developers resume lot sales, new thought will have to be given to whether registration is required under ILSA under the latest court interpretations.

# FHFA Proposed Guidance on Private Transfer Fee Covenants

On August 16, 2010, the Federal Housing Finance Agency ("**FHFA**") announced proposed guidance which, if adopted, would restrict Fannie Mae and Freddie Mac and all Federal Home Loan Banks from dealing in mortgages on properties in communities with "private transfer fee covenants." Transfer fee covenants are a type of covenant on the land that requires the payment of a fee when the property is transferred. Transfer fee covenants, as a legal concept, have been widely used in communities all across the country for many years for a variety of beneficial purposes.

FHFA is an independent federal agency established by the Housing and Economic Recovery Act of 2008 to regulate and oversee regulated entities. FHFA's mission is to provide effective supervision, regulation and housing mission oversight of Fannie Mae, Freddie Mac and the Federal Home Loan Banks to promote their safety and soundness, support housing finance and affordable housing, and support a stable and liquid mortgage market.

In a February 8, 2011 announcement in the Federal Register, FHFA commented that it had received over 4,210 comment letters on the proposed guidance from a broad spectrum of individuals and organizations. A number of groups expressed concern that the proposed Guidance, if adopted, would have a widespread adverse impact on an already struggling housing market, denying home buyers access to mortgage financing and impairing marketability of homes in communities with private transfer fee covenants.

In the February notice, FHFA proposed moving beyond "guidance" and into formal rulemaking. However, it proposed to carve out an exception for transfer fees paid to homeowners associations, condominiums, cooperatives, and 501(c)(3) and 501(c)(4) organizations if the fees are required to be used exclusively for purposes that directly benefit the property encumbered by the transfer fee covenant. While FHFA did accept comments on proposed rulemaking through April 11, 2011, it has not yet issued the actual text of any proposed rules. As additional information is available, we will keep you updated.

## Responsibility for Administering Interstate Land Sales Changes

The Department of Housing and Urban Development has had responsibility for administering the Federal Interstate Land Sales Full Disclosure Act (15 U.S.C. § 1701, *et al.*, "**ILSA**") since ILSA's enactment more than 40 years ago. However, on July 21, 2011, that responsibility will transfer to the Consumer Finance Protection Bureau ("**CFPB**"), a new federal agency created under the Dodd-Frank Wall Street Reform and Consumer Protection Act of 2010. The CFPB is tasked with regulating consumer financial products and services in compliance with federal law.

The division of Nonbank Supervision will have oversight of ILSA under the direction of Peggy Twohig. Previously the director of the Office of Consumer Protection and Policy in the United States Department of Treasury, Twohig also spent 17 years with the Federal Trade Commission. The CFPB still appears to be getting organized, and we do not yet know its plans for overseeing ILSA enforcement or land sales registrations. More information about the CFPB is available on its website: www.consumerfinance.gov.

## Inside News

- Jo Anne Stubblefield was a guest speaker at the American Planning Association's 2011 National Conference held in Boston on April 8-12, 2011. Her presentation addressed the topic of integrating local government regulation and private land use covenants. A copy of the paper she presented is available under the "Resources" tab on our website at www.hspclegal.com.

- Jo Anne was also a guest speaker at the Recreational Development Council (Gold Flight) council day program at the ULI Spring Council Forum held in Phoenix on May 19, 2011. An outline of her remarks, entitled "The Evolution of Community Governance: Adapting to New Challenges," is also available under the "Resources" tab on our website.

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