

INTERSTATE LAND SALES ISSUES IN  
CONDOMINIUM AND MIXED-USE  
DEVELOPMENTS

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# **Interstate Land Sales Issues in Condominium and Mixed-Use Developments**

**Jo Anne P. Stubblefield**

## **I. Introduction**

Lawyers who represent either developers of condominiums and mixed-use developments or their lenders devote a substantial portion of their time and effort to the structure and documentation of the "deal" and getting it financed. Federal and state laws regulating the sale of subdivided lands can easily be overlooked in the planning process by a lawyer who fails to recognize the risk they pose and the impact they can have on both the developer and its lender. An analysis of the scope and applicability of these laws, the availability of common exemptions, and the pitfalls of relying upon them, is critically important and should be undertaken in earnest early in the planning process. This article provides an overview of the applicability and scope of federal law regulating the sale of subdivided lands in the context of condominiums and mixed-used developments, pointing out the advantages and pitfalls of common exemptions and offering tips for the developer and its lender to avoid inadvertent violations.

## **II. Applicability of the Interstate Land Sales Full Disclosure Act.**

### **A. Scope of the Act.**

The federal Interstate Land Sales Full Disclosure Act, 15 U.S.C.A. §1701, *et seq.* (the "Act") prohibits the sale or lease of "lots" in a "subdivision" using any means of interstate commerce, unless the lots are either exempt or registered with the United States Department of Housing and Urban Development ("HUD"). The Act applies if any means of interstate commerce (*e.g.*, radio, television, print media, telephone, the mails, or other media with interstate circulation) are used to solicit offers to buy or to make offers to sell, regardless of whether the owner/developer has engaged in any advertising or other marketing or sales activities directed outside the state where the property is located<sup>1</sup>.

Although the Act was originally adopted to prohibit and punish fraud in land development enterprises<sup>2</sup>, particularly by developers selling unbuildable lots and land without access or utilities and without full disclosure, the applicability of the Act is by no means limited to the sale of swampland in Florida or even traditional platted lots. HUD's implementing regulations at 24 C.F.R. Part 1710 through 1730 (the "Regulations") define a "lot" to include "any portion, piece, division, unit or undivided interest in land [...] if the interest includes the right to the exclusive use of a specific portion of the land<sup>3</sup>." This includes units to be developed as part of a condominium,<sup>4</sup> as well as unimproved lots or parcels of land within a horizontal or

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<sup>1</sup> 15 U.S.C.A. §1703(a)

<sup>2</sup> *McCown v. Heidler*, 527 F.2d 204 (10<sup>th</sup> Cir. 1975).

<sup>3</sup> 24 C.F.R. §1710.1

<sup>4</sup> *Winter v. Hollingsworth Properties, Inc.*, 777 F.2d 1444 (11<sup>th</sup> Cir. 1985).

vertical subdivision, whether intended for residential, commercial, mixed-use, or industrial development. The term "lot" will be used in this discussion to refer to any of the above.

For the purposes of the Act, the term "subdivision" refers to any land, whether or not contiguous, which is divided or proposed to be divided into separate interests for purposes of sale or lease as part of a "common promotional plan." A common promotional plan is any plan, undertaken by a single person or a group of persons acting in concert, to offer lots for sale or lease.<sup>5</sup>

In determining whether or not a common promotional plan exists, consideration is given to whether there is (i) a thread of common ownership; (ii) same or similar name or identity; (iii) common sales agents; (iv) common sales facilities; (v) common advertising; and (vi) common inventory, although these are not the exclusive considerations<sup>6</sup>. A common promotional plan is presumed to exist if the land is contiguous, or is known, designated, or advertised as a common development by a common name<sup>7</sup>. Thus, tracts of land several miles apart could be considered a single subdivision if they have a common promotional plan. Almost certainly a mixed-use building with commercial properties on the ground level and residential floors above would be considered a single subdivision, even if the residential floors are submitted to a condominium regime that does not include the commercial space.

In light of this definition, the developer and lender must use care to consider not only the developer's property and sales practices, but also property being marketed by and practices of builders and developers of other property that could be considered part of the same subdivision. Clearly, the developer of a condominium within a mixed-use development or master planned community must take into account the impact that marketing of other property in the larger development may have on applicability of the Act to its condominium.

## **B. Availability of Exemptions.**

There are a number of full and partial statutory exemptions from the Act<sup>8</sup>. Statutory exemptions are self-determining, *i.e.*, they are automatic and need not be applied for, but the burden is on the developer to ensure that each sale qualifies for an exemption and to maintain records demonstrating that the requirements of such exemption have been met<sup>9</sup>.

There are also several regulatory exemptions from the Act<sup>10</sup>. Some regulatory exemptions require filing an application with HUD requesting the exemption and setting forth

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<sup>5</sup> 15 U.S.C.A. §1701(4).

<sup>6</sup> These considerations are set forth in Guidelines for Exemptions Available Under the Interstate Land Sales Full Disclosure Act, originally codified at 24 C.F.R. Part 1710, App. A, which HUD issued as an interpretive rule, not a substantive regulation. Appendix A was deleted from the published regulations and moved to a non-codified set of guidelines in 1996, and may now be found in the Federal Register at 61 Fed. Reg. 13,596-13,611 and on HUD's web site at <http://www.hud.gov:80/offices/hsg/sfh/ils/ilsexempt.cfm>.

<sup>7</sup> 15 U.S.C.A. §1701(4).

<sup>8</sup> See 15 U.S.C.A. §1702.

<sup>9</sup> 24 C.F.R. §1710.4(d).

<sup>10</sup> See 24 C.F.R. §§1710.14 - 1710.16.

the basis for the request<sup>11</sup>. A filing fee and various documents must be submitted with the request, and there is no guarantee that the request will be granted.

If the lots qualify for a full statutory exemption, the Act does not apply. If the lots qualify for a partial statutory exemption or a regulatory exemption, the lots need not be registered and the developer need not deliver a Property Report to purchasers, but the anti-fraud provisions of the Act still apply<sup>12</sup>. The anti-fraud provisions impose constraints on advertising and require the inclusion of specific provisions in each contract<sup>13</sup>.

It is not necessary for all of the lots in a subdivision to satisfy the requirements for the same exemption. Various exemptions may be combined to exempt all of the lots, or some lots may be registered and others sold in reliance upon an exemption. However, any lots that do not clearly satisfy the requirements for an exemption must be registered.

### **III. Requirements for Non-exempt Transactions.**

#### **A. Filing Requirements.**

Unless a particular sale or lease is exempt from the registration requirements, the Act requires preparation and filing of a "Statement of Record" with HUD's Office of Interstate Land Sales Registration. The Statement of Record consists of two parts: a detailed disclosure document referred to as the Property Report, and an Additional Information and Documentation section (or "AID") that provides additional information and documentation to support the representations made in the Property Report<sup>14</sup>. The process of preparing a Statement of Record for filing generally takes 30 days or longer, depending upon how quickly the client is able to provide the required information. If HUD has not responded with a deficiency letter within 30 days after filing, the registration automatically becomes effective<sup>15</sup>.

Each time the developer adds a new phase of non-exempt lots to the project, it must file a consolidated Statement of Record amending and updating the previous Statement of Record to include the required information regarding the additional lots. The consolidated Statement of Record must be approved and obtain an effective date before sales contracts may be signed for the additional lots<sup>16</sup>.

Once registered, the developer is required to file an amendment with HUD within 15 days after the date it knows, or should have known, of any change in a material fact relating to the registered lots<sup>17</sup>. In addition, the developer is responsible for filing an Annual Report of

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<sup>11</sup> See 24 C.F.R. §§1710.15 and 1710.16. The exemptions provided under 24 C.F.R. §1710.14 are self-determining.

<sup>12</sup> 24 C.F.R. §1710.4(b).

<sup>13</sup> 15 U.S.C.A. §1703(a)(2) and 24 C.F.R. §§1710.4(b) and (c), §1715.15, §1715.20, §1715.25.

<sup>14</sup> 24 C.F.R. §1010.100(a). HUD has established a program under 24 C.F.R. §1710.500 for certification of states which HUD determines to have substantially equivalent state laws regulating the sale of subdivided land and will accept a copy of the state filing, along with such additional materials as specified by agreement with such state, in lieu of a Statement of Record for projects registered in a certified state.

<sup>15</sup> 15 U.S.C.A. §1706(a).

<sup>16</sup> 24 C.F.R. §1710.22(b).

<sup>17</sup> 24 C.F.R. §1710.23.

Activity within 30 days of each anniversary of the effective date of the initial Statement of Record<sup>18</sup>.

The filing fee for each initial registration and each amendment is \$800 if there are 200 or fewer lots and \$1,000 for 201 or more lots<sup>19</sup>. In addition, there is an \$800 filing fee for each Annual Activity Report that reflects 101 or more registered lots remaining to be sold<sup>20</sup>. If a project is registered with HUD and later reaches a point where all of the remaining lots are eligible for exemption, the registration may be suspended or terminated, thereby avoiding the need to renew and update it on an annual basis thereafter<sup>21</sup>.

## **B. Marketing and Sales Constraints.**

Unless a lot is exempt from registration under the Act, no sales contracts or leases may be signed until the Statement of Record is approved by HUD and becomes effective<sup>22</sup>. However, the developer may enter into non-binding reservations and accept cash deposits. To qualify as a non-binding reservation, additional affirmative action must be necessary on the part of the purchaser for the reservation to be converted to a binding contract and the purchaser must be entitled to cancel the reservation and obtain a full refund of the deposit at any time prior to entering into a binding contract<sup>23</sup>.

The Guidelines indicate that purchasers' deposits made pursuant to a reservation agreement must be held in an escrow account maintained by an independent financial institution having trust powers<sup>24</sup>. Clearly the intent of this requirement is to ensure that the funds are under the control of an independent escrow agent who understands the fiduciary duties that service as an escrow agent entails and can be trusted to fulfill them. This intent would be circumvented if the seller, a real estate broker involved in the transaction, or the developer's attorney serves as escrow agent, even if the deposits are actually placed in an account at a bank having trust powers, since the escrow agent, rather than the bank, would have control over the disbursement of the funds held in escrow.

At such time as the Statement of Record is effective and the developer is free to enter into binding contracts, the Regulations require specific language to be included in all contracts for the sale of non-exempt lots. Each contract must contain notice of the requirement that the purchaser receive a Property Report prior to signing the contract and notice of the purchaser's right to rescind the contract<sup>25</sup>. If the developer is representing that it will provide roads, utilities, or recreational amenities to serve the lots, the contract must also contain a specific obligation to do

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<sup>18</sup> 24 C.F.R. §1710.310(a).

<sup>19</sup> 24 C.F.R. §1710.35(b).

<sup>20</sup> 24 C.F.R. §1710.35(d)(1).

<sup>21</sup> 24 C.F.R. §1710.310(c)(7)(iii).

<sup>22</sup> 24 C.F.R. §1710.1 defines a "sale" as any obligation or arrangement for consideration to purchase or lease a lot directly or indirectly. HUD considers a sale to have occurred when the purchaser signs the contract.

<sup>23</sup> Part III(a) of Appendix A-Guidelines for Exemptions Available Under the Interstate Land Sales Full Disclosure Act, referenced in Note 6.

<sup>24</sup> Id.

<sup>25</sup> 24 C.F.R. §1710.209(f)(3).

so, including a completion date<sup>26</sup>. The obligation to complete by that date may be conditioned only upon contingencies such as acts of God, strikes, material shortages, or other grounds that are legally sufficient to establish impossibility of performance in the jurisdiction where the project is located<sup>27</sup>.

Unless a deed is delivered within 180 days of the date the purchaser signs the contract, or the contract includes a statement giving the purchaser the right to rescind the contract at any time within two years following the date the purchaser signs, the contract for the sale of a non-exempt lot must also include (i) a provision for notice to the purchaser and a 20-day opportunity to cure before the purchaser may be declared in default; and (ii) a provision limiting the seller's right to retain the purchaser's deposit upon such a default to no more than 15% of the purchase price, exclusive of interest, or the seller's actual damages, whichever is greater<sup>28</sup>.

Non-exempt lots, as well as lots sold in reliance upon partial exemptions from the Act, are subject to the anti-fraud provisions of the Act and Regulations. The anti-fraud provisions include a number of sales practices that are identified as unlawful<sup>29</sup> and an extensive list of additional sales practices that are deemed misleading and may be used to evaluate a developer's or agent's representations in determining whether violations of the Act and Regulations have occurred<sup>30</sup>.

The Regulations require the inclusion of a conspicuous disclaimer statement in all printed material and literature used in connection with the sale or lease of registered lots, except billboard advertising and classified advertising of less than a specified size<sup>31</sup>.

### **C. Disclosure to Purchasers and Rescission Rights.**

The developer must deliver a copy of the printed Property Report to each purchaser of a non-exempt lot prior to signing a purchase contract<sup>32</sup>. In addition, the developer must make copies of its financial statements and the restrictive covenants, if any, affecting the property available to purchasers upon request<sup>33</sup>.

In a non-exempt transaction, the Act permits a purchaser or lessee to rescind the purchase or lease within seven days after signing the purchase contract or lease, or within any longer period provided by state law<sup>34</sup>. If the purchaser or lessee did not receive a Property Report prior to signing the contract or lease, or the deed will not be delivered within 180 days and the contract does not contain the default provisions described above, the rescission period is extended to two years from the date that the purchase or lessee signed the contract or lease<sup>35</sup>.

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<sup>26</sup> 24 C.F.R. §1710.209(f)(3) (iv) and 24 C.F.R. §1715.25(a).

<sup>27</sup> 24 C.F.R. §1710.209(f)(3)(iv) and 24 C.F.R. §1715.15.

<sup>28</sup> 24 C.F.R. §1710.105(d).

<sup>29</sup> 24 C.F.R. §1715.24.

<sup>30</sup> 24 C.F.R. §1715.25.

<sup>31</sup> 24 C.F.R. §1715.50.

<sup>32</sup> 15 U.S.C.A. §1703(a)(1)(B)

<sup>33</sup> 24 C.F.R. §1710.209(g)(3) and 24 C.F.R. §1710.212(i)

<sup>34</sup> 15 U.S.C.A. §1703(b) and 24 C.F.R. §1715.2

<sup>35</sup> 15 U.S.C.A. §1703(c) and 24 C.F.R. §1710.209(f)(3).

Consumers have not been reluctant to seek rescission of contracts claiming that a developer improperly failed to register. HUD may also initiate investigative and enforcement action on its own, based upon tips from competitors, disgruntled sales agents, citizens groups or others who may be interested in shutting down the developer's marketing efforts. Consequently, it is important to both the developer and its lender that the project either is registered or that the availability of an exemption from registration is clearly established and documented.

#### **IV. Reliance upon Exemptions in the Context of a Condominium or Mixed-Use Project.**

There are a total of 16 different statutory exemptions<sup>36</sup> and 8 different regulatory exemptions<sup>37</sup> that may be available to exempt some or all of the sales in a particular project. However, only two are likely to be available for the typical vertical condominium or mixed-use project that will contain more than 25 units and has a projected sales rate of more than 12 units per year. In a project that also includes horizontal development, other exemptions may be available to exempt commercial or industrial parcels and lots intended for single-family residential development, but for purposes of this article our discussion will focus on exemptions for the vertical portion of the development.

##### **A. Full Exemption.**

The only full exemption from the Act that is likely to apply in the context of a residential condominium containing more than 25 units intended for individual sale is the exemption set forth in 15 U.S.C. §1702(a)(2) and commonly known as the "improved lot" exemption. This provision exempts the sale or lease of improved land on which there is a residential, commercial, condominium, or industrial building, or pursuant to a contract that obligates the seller or lessor to erect such a building within a period of two years<sup>38</sup>.

In interpreting this exemption, HUD takes the position that the unit must either be complete and ready for occupancy, with all necessary and customary utilities in place, at the time the purchaser signs the contract, or the contract must contain a binding obligation for the seller to complete it within two years of the date the purchaser signs the contract. It is not sufficient for the contract to obligate the *buyer* to complete the unit within two years, as might be the case in a luxury condominium where the seller is merely selling "shell" units, with the buyers hiring their own architects and contractors to do custom build-outs. The obligation to complete must rest with the seller. Therefore, if custom build-outs are part of the marketing plan for the condominium, it may be necessary to look to other exemptions or register prior to entering into contracts.

HUD considers a contract binding only if (i) it does not allow nonperformance by the seller at the seller's discretion; (ii) it permits delays beyond the two-year period only for Acts of God, casualty losses, material shortages, or similar events that are legally recognized as defenses

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<sup>36</sup> 15 U.S.C.A. §1702(a) sets forth 8 full statutory exemptions and 15 U.S.C.A. §1703(b) sets forth 8 additional partial statutory exemptions.

<sup>37</sup> 24 C.F.R. §1710.14 sets forth 6 self-determining regulatory exemptions. 24 C.F.R. §1710.15 and §1710.16 describe two additional regulatory exemptions which are available only if granted by HUD.

<sup>38</sup> 15 U.S.C.A. §1702(a)(2).

to contract actions in the jurisdiction where the project is located; and (iii) it does not limit the buyer's right to damages or specific performance to enforce such obligation<sup>39</sup>.

In order to satisfy the requirement that the contract be binding, the seller's obligation should not be conditioned upon the buyer taking further steps, such as submitting floor plans to the seller for approval<sup>40</sup>. However, in the case of a multi-unit building, HUD does permit a "pre-sale" clause conditioning the completion of construction or closing of title on obtaining contracts within a stated period of time, not to exceed 180 days, for the sale of a specified percentage of the total number of units planned for the building. In a single-phase project, the 180 days is counted from the date the first purchaser signs a sales contract. In a multi-phase project, the presale period may be reserved on a phase-by-phase basis, with the 180-day period for each phase counted from the date the first purchaser signs a sales contract in each phase<sup>41</sup>.

In light of HUD's interpretation regarding the buyer's remedies for the seller's nonperformance, the contract cannot simply provide that the purchaser is entitled to a refund if the unit is not completed within the two-year period; it must allow the purchaser to sue for damages or specific performance. Although it is not necessary that the contract contain an express provision granting such rights, it cannot limit the purchaser's right to pursue them<sup>42</sup>.

## **B. Partial Exemptions.**

One of the partial exemptions most often relied upon to avoid registration under the Act is found at 15 U.S.C.A. §1702(b)(1) and is commonly known as the "100-lot exemption" (although the "99-Lot Exemption" would be a more appropriate name). This provision exempts the sale of lots in a subdivision that contains *fewer than* 100 lots that are not otherwise exempt under a full statutory exemption from the Act<sup>43</sup>. Thus, a condominium or mixed-use development containing no more than 99 units would be exempt from registration, as would a project containing a greater number of units if those units in excess of 99 were eligible for a full statutory exemption, such as the improved lot exemption.

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<sup>39</sup> See Part IV(b) of Appendix A - Guidelines for Exemptions Available Under the Interstate Land Sales Full Disclosure Act and *Samara Development Corp. v. Marlow*, 556 So.2d 1097 (Fla. 1990). But see also *Hardwick Properties, Inc. v. Newbern*, 711 So. 2d 355 (Fla. Dist. Ct. App. 1998), finding that a contract clause permitting general damages but limiting recovery of special or consequential damages should not disqualify the transaction from the exemption since the seller remained "exposed to damages for breach which are sufficient to constitute a substantial economic risk under the circumstances."

<sup>40</sup> But see *Soo v. Maumelle Co.*, 897 F. Supp. 414 (E.D.Ark. 1994), in which the court found that a contractual requirement that the purchaser submit plans meeting specific architectural standards for the seller's approval were "reasonable steps in the process of construction" and did not prevent the seller from relying on the exemption since the seller's approval was based on objective criteria and not exercisable in the seller's discretion. The district court's decision was affirmed by the 8<sup>th</sup> Circuit Court of Appeals. However, in an amicus brief filed in support of the appellants, HUD took the position that the two-step process established by the contract, in which the seller's obligation to build arose only at the buyer's option, with the full burden of initiating the construction process on the buyer, was inconsistent with the Act's intent to exempt only the purchase of a building or a building to be completed in the near term.

<sup>41</sup> *Id.*

<sup>42</sup> *Id.*

<sup>43</sup> 15 U.S.C.A. §1702(b)(1) and 24 C.F.R. §1710.6.

This exemption can be very useful in the context of a high-rise condominium when the construction lender imposes a presale condition to funding of the construction loan, requiring that a certain percentage of the units be under contract before funding the loan. Quite often, the projected construction period from commencement to completion of a high-rise can be 18 months or longer, making it very risky for a developer and its lender to rely upon the improved lot exemption because the developer cannot be sure that it will meet the presale requirement in time to start and complete construction before expiration of the 2-year period required under the sales contracts. If the lender's presale requirement can be met with 99 or fewer contracts, the developer can rely upon the 100-lot exemption for those contracts and then wait to accept contracts on the remaining units until safely within the two-year completion period required to satisfy the improved lot exemption for those contracts. With this approach, it is not necessary to specifically identify the "reserved" units<sup>44</sup>.

If using this approach of combining exemptions, it is critical to both the developer and the lender that the sales process be closely monitored to ensure that no more than 99 units are sold before the developer is in a position to meet the requirements of the improved lot exemption. If the sales staff get overly enthusiastic in trying to satisfy the lender's requirements and accept more than 99 contracts, simply lose count, or fail to coordinate with one another to ensure that the 99-unit maximum is not exceeded, the exemption will not be available for any of the contracts entered into, resulting in prior sales being voidable at the purchaser's option<sup>45</sup>. At such time as the developer and lender are comfortable that the requirements of the improved lot exemption can be satisfied, the contract must be modified to include the contractual obligation to complete within two years and satisfy the other requirements described in Part V.A. of this article.

In determining the total number of units for purposes of this exemption, it is important to bear in mind the prior discussion regarding the "common promotional plan." If the units to be sold are, or could be construed as, part of a larger development in which other properties are sold under the same common promotional plan, those other lots must be counted in determining whether the 99-lot limitation can be met. For example, if a condominium is the first phase of a planned community that may ultimately contain single family lots, commercial lots, and perhaps other condominiums, the developer of the initial condominium must consider how those other lots will be marketed and sold and its ability to ensure that they qualify for a full statutory exemption from registration at the time of sale so as not to count against the 99 lots that the developer desires to exempt in the initial condominium.

The desirability of relying upon this exemption may also affect the structure of the condominium itself. Frequently, the developer of a high-rise condominium or mixed-use development will want to sell parking spaces as separate "parking units" in order to be able to offer each purchaser a reserved parking space. Since the applicability of the Act is not limited to residential properties, and the definition of "lot" is not limited to habitable structures, each parking unit, storage unit, or similar space created within a condominium and made available for separate ownership is considered a "lot" for purposes of the 100-lot exemption. Thus, a 75-unit

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<sup>44</sup> See Part V(a) of Appendix A - Guidelines for Exemptions Available Under the Interstate Land Sales Full Disclosure Act.

<sup>45</sup> Id.

condominium that would otherwise be eligible for exemption can lose that exemption if more than 24 parking spaces or storage spaces are created as "units" in order to enable the developer to sell and separately deed them to purchasers.

It is also important to remember that the 100-lot exemption is only a partial exemption from the Act; although it exempts the sale of up to 99 lots from registration, each of those sales must comply with the anti-fraud provisions of the Act discussed earlier. Thus, the contracts for the sale of each of those lots must obligate the seller to provide all promised roads, utilities, and recreational amenities.

## **V. Remedies for Violations of the Act.**

### **A. Revocation of Contract.**

In any non-exempt transaction under the Act, failure to deliver to the purchaser or lessee a Property Report meeting the requirements of the Act prior to the purchaser's signing of the contract, or failure to include in the contract an adequate description of the lot or the default provisions required by the Act, entitles the purchaser or lessee to revoke the contract at any time within two years from the date the purchaser signed the contract, whether or not title to the lot has transferred to the purchaser<sup>46</sup>. The revocation right exists even if the purchaser or lessee received, orally or through other documents, substantially all of the information that would have been required to be included in a Property Report<sup>47</sup>.

Upon revocation, the purchaser or lessee is entitled to a refund of all money paid under the contract; however, if title to the lot has already transferred to the purchaser, the purchaser's right to a refund is conditioned upon (i) tendering to the seller or lessor a deed or other instrument reconveying his right or interest in the lot; and (ii) both the physical condition of the lot and the title to the lot being substantially similar to the condition in which they were originally transferred to the purchaser or lessee<sup>48</sup>. Thus, if the purchaser or lessee has made improvements to the lot, or has encumbered the lot with a mortgage, revocation would not be an option. In such a case, the purchaser or lessee may instead sue for damages under 15 U.S.C.A. §1709(a) of the Act<sup>49</sup>.

### **B. Civil Liability.**

In addition to failure to deliver a property report as required, other violations that may subject a developer or its agent to civil liability in an action by a purchaser or lessee under the Act include (i) failure to register with HUD and have an effective Statement of Record on file at the time of a non-exempt sale or lease; (ii) sale or lease of a lot pursuant to a Statement of Record that contains any untrue statement of material fact or omits any material fact that the Act or regulations require to be disclosed; (iii) use of advertising or promotional materials that are

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<sup>46</sup> 15 U.S.C.A. §1703(c) and (d).

<sup>47</sup> *Gaudet v. Woodlake Development Co.*, 413 F. Supp. 486 (ED Tenn. 1975); *Rockefeller v. High Sky, Inc.*, 394 F. Supp. 1005 (ED La. 1975).

<sup>48</sup> 15 U.S.C.A. §1703(e).

<sup>49</sup> At least one court has taken the position that a buyer may rescind the sale and obtain a refund or sue for damages, but may not do both. See *Gaudet v. Woodlake Development Co.*, referenced at note 47.

inconsistent with the information required to be disclosed in the property report; or (iv) failure to comply with the anti-fraud provisions of the Act<sup>50</sup>. In any such action, the court may order damages, specific performance, or other relief as it deems appropriate, and may consider, among other things, the contract price, the amount the purchaser actually paid, the cost of any improvements to the lot, and the difference between the fair market value of the lot at the time of contract and at the time the relief is determined<sup>51</sup>. The purchaser may also recover interest, court costs, reasonable attorneys' fees, fees for an independent appraisal of the property, and expenses of travel to and from the lot<sup>52</sup>.

The statute of limitations for actions based on violations of the Act is generally three years from the date the purchaser signed the contract, although actions based on fraud or certain misrepresentations and omissions may be brought any time within three years from the date of discovery or the date discovery should have been made by the exercise of reasonable diligence<sup>53</sup>. If a purchaser who is entitled to revoke a contract and obtain a refund notifies the developer or its agent of such revocation within the two-year period provided by the Act and the developer fails to honor the purchaser's revocation right, then the purchaser has up to three years after the date of signing the contract to bring an action to enforce such revocation right<sup>54</sup>.

### **C. Administrative Sanctions and Criminal Penalties.**

HUD has broad powers under the Act and Regulations to conduct investigations, suspend a Statement of Record and commence administrative proceedings to terminate an exemption<sup>55</sup>. In addition to other administrative sanctions, the Secretary of HUD may impose civil money penalties of up to \$1,000 per violation, not to exceed \$1,000,000 during any 1-year period, for willful violations of the Act or Regulations. In the case of a continuing violation, each day constitutes a separate violation<sup>56</sup>. Willful violations are also subject to criminal penalties, which may include fines of up to \$10,000 and imprisonment for up to 5 years, or both<sup>57</sup>.

## **VI. Special Concerns for the Lender.**

A lender considering a development loan for a high-rise condominium or vertical mixed-use development should be actively involved in the developer's decision regarding whether or not to register the project with HUD. If the decision has already been made to rely upon an exemption, the lender should carefully evaluate that decision and the risks of noncompliance before committing to the loan. In some cases, it may be in the lender's best interest to require registration as a condition of making the loan.

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<sup>50</sup> 15 U.S.C.A. §1709 and §1703(a).

<sup>51</sup> 15 U.S.C.A. §1709(a).

<sup>52</sup> 15 U.S.C.A. §1709(c).

<sup>53</sup> 15 U.S.C.A. §1711(a).

<sup>54</sup> 15 U.S.C.A. §1711(b).

<sup>55</sup> 15 U.S.C. A. §1714 and 24 C.F.R. Part 1720.

<sup>56</sup> 15 U.S.C.A. §1717a.

<sup>57</sup> 15 U.S.C.A. §1717.

### **A. Timing Issues.**

Unless the developer is able to rely solely on the 100-lot exemption, or is able to combine the 100-lot exemption with the improved lot exemption as discussed above, the lender must get comfortable that the developer can deliver completed units within two years of the date the purchasers sign their contracts. It needs to carefully analyze the project, the proposed construction schedule, and the presence of factors such as the difficulty of getting construction materials delivered to the site, unusual soil conditions, labor and material shortages, and other factors that could delay construction, to determine whether the proposed construction schedule is realistic.

If there is more than a remote risk that construction of the units will not be completed within two years from the date the purchasers sign their contracts, the best option may be to require the developer to register. If the developer has already entered into contracts, it will be necessary, upon the Statement of Record becoming effective, to deliver the Property Report to each purchaser with an existing contract and request that they execute an agreement terminating their existing contract and enter into a new contract containing the language discussed under Part III.B. Of course, there is a risk that they will cancel the original contract without executing a new one, or worse, insist on proceeding under their original contract with the result that, if their original contract is not adequate to meet the requirements of the improved lot exemption, they could rescind at any time within two years thereafter<sup>58</sup>. If the contract is adequate to satisfy the exemption requirements but the completed unit is not delivered within two years of the date the purchasers signed their contracts, the developer will be in default and will be subject to the unlimited remedies that must be made available to the purchaser to enforce such obligation<sup>59</sup>.

Even if the lender is comfortable that the project is capable of being constructed within the two-year period, it will want to be sure that the developer and its general contractor have a proven track record of completing projects on time and have all necessary approvals and permits in hand before sales are made that would trigger the two-year clock. It should also consider establishing deadlines by which the developer must meet its presale requirement for funding of the construction loan and start construction in order to ensure ample time to complete construction of the building and each presold unit before expiration of the two-year period. Finally, it should require that the construction contract include a substantial liquidated damages clause to encourage completion on schedule.

### **B. Contract Compliance.**

The lender will want to review the proposed sales contract form and any existing sales contracts to ensure that they satisfy the contract requirements discussed in Part IV.A. or B above applicable to the exemption on which the developer is relying. The loan documents should require the lender's prior approval of any proposed changes to the contract to ensure that the form is not modified in a manner that would cause the contract not to comply with such requirements.

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<sup>58</sup> See note 47, *supra*. In this situation, the lender should consider whether to count the "at risk" sales for purposes of satisfying its presale requirement.

<sup>59</sup> See note 42, *supra*.

If the developer is relying on the improved lot exemption and contracts have already been entered into when the developer approaches the lender for a construction loan, the lender should set up an aging report to assist it in evaluating the number of existing contracts and the dollar amount that will be "at risk" each month that project completion is delayed. The lender will want to be certain that purchasers' deposits are being held in escrow, just in case the two-year deadline is not met and purchasers elect to cancel their contracts or sue for damages.

### **C. Related Developments.**

If the developer is relying on the 100-lot exemption, the lender needs to investigate thoroughly the possibility that other developments by the same developer or its affiliates, or other developments associated in any way with the planned project could cause the 99-lot limit to be exceeded. For example, is the project part of a planned community in which other parcels of land are being developed and sold without registration? If so, do those properties qualify for full statutory exemptions from registration, or must they be counted against the 99-lot maximum?

### **D. Fraud and Misrepresentations.**

Whether or not the project is registered, and regardless of which exemption the developer may be relying upon, the lender should require assurances that the developer's marketing approach and advertising comply with the anti-fraud provisions of the Act<sup>60</sup>. This should include a review not only of marketing brochures and print advertising, but radio advertisements and Internet advertising as well<sup>61</sup>.

## **VII. Advantages and Disadvantages of Registration under the Act.**

### **A. Advantages.**

Despite the hassle and expense of registering with HUD, there are a few advantages. While the marketing staff cannot represent that HUD has "approved" the project, filing with HUD and delivering a Property Report to prospective purchasers disclosing substantial information about the project tends to give the project some credibility with prospective purchasers who are not otherwise familiar with the developer or may be reluctant to enter into contracts before they can see what they are buying.

Registration also allows the developer greater flexibility in construction scheduling and eliminates the concern that exists when relying on the improved lot exemption about delivering the completed unit within the two-year period required under the improved lot exemption (although purchasers will likely want some outside date for delivery.) It eliminates the risk that

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<sup>60</sup> Although the anti-fraud provisions would not apply to condominium units sold under the improved lot exemption, the lender will want to avoid the risk that the sales practices and representations considered unlawful or misleading under the Act and Regulations could form the basis for a claim of fraud or misrepresentations under state law.

<sup>61</sup> Although beyond the scope of this article, such review should also verify compliance with advertising and disclosure requirements under the state's condominium act, if applicable, and land sales regulations in other states where the advertising materials will be disseminated or accessible via the Internet.

exists when relying on the 100-lot exemption that sales in other projects outside the developer's control could cause the 99-lot maximum to be exceeded. It also allows the developer and its attorney greater ability to limit the purchasers' remedies in the event of the developer's default.

Registration also provides some protection from future claims by disgruntled purchasers that they were not given material information about the project or were misled. Each Property Report bears an effective date and contains a receipt<sup>62</sup> that the purchaser must sign at the time of delivery, providing a record of exactly what information the purchaser was given and when it was delivered.

If the project will be marketed outside of the jurisdiction in which it is located or the marketing staff wants to be able to respond to inquiries from residents of other states that regulate the sale of subdivided land, registering with HUD can greatly simplify the time and cost of registering in those states. There are at least 12 states that may accept a HUD Statement of Record, alone or with minimal supplemental materials, in lieu of the disclosure documents and registration submittals required under their statutes<sup>63</sup>.

## **B. Disadvantages**

Perhaps the primary disadvantage to registering in the eyes of most developers is the time and expense involved in preparing a Statement of Record and obtaining an effective date from HUD. Gathering the information required to be included in the Statement of Record requires an intensive effort on the part of the developer and, if the information provided is incomplete, inaccurate, or misleading, can result in liability for the developer that would not otherwise exist. The process generally takes a minimum of 60 days, during which the developer can only accept non-binding reservations. The legal fees associated with preparation of a Statement of Record depend, to a great extent, on how complex the project is and how quickly the developer is able to gather and provide the necessary information to the attorney handling the registration. As a result, they can vary significantly from one project to another and it is very difficult for the attorney to give an accurate fee estimate.

A secondary consideration is the requirement that the Statement of Record be amended each time a new phase is added to the project and each time there is any material change in the information that the Act and Regulations require to be included in the Statement of Record. When there is a material change, sales must be suspended until the amendment is filed with HUD and becomes effective<sup>64</sup>. Notice of the change must be given to purchasers and could trigger attempts to rescind. There are often difficulties in determining whether a particular change is "material" and in establishing a system to ensure that when material changes occur, the lawyer is notified promptly so that an amendment can be filed in a timely manner, keeping the suspended sales period to a minimum.

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<sup>62</sup> See 24 C.F.R. §1710.118.

<sup>63</sup> These currently include Connecticut, Georgia, Illinois, Kentucky, Massachusetts, Nevada, New Hampshire, Oklahoma, Pennsylvania, Rhode Island, South Carolina, and Utah.

<sup>64</sup> An amendment becomes effective on the thirtieth day after filing unless HUD has notified the developer in writing of an earlier effective date or of suspension of the filing. 24 C.F.R. §1710.21(a).

The continuing reporting requirements under the Regulations<sup>65</sup> also create a burden for the developer that would not exist if selling under an exemption from registration. It is important that the developer and its lawyer establish a tickler system to ensure that those reporting requirements are met.

### **VIII. Conclusion.**

While recognizing the disadvantages of registration, the developer and its lender must evaluate such disadvantages in light of the risks associated with relying upon exemptions from registration. Quite often, the time and expense of registration pale in comparison to the potential for disruption of a project, loss of contracts, and liability to purchasers that can arise when attempting to rely on an exemption from registration in an uncertain situation. Familiarity with the applicability of the exemptions and the risks that they can pose is critical to assisting the developer and lender in evaluating the options to ensure compliance with the Act.

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<sup>65</sup> See note 18, *supra*.