

# Old Law Creates New Problems

Two recent rulings by the U.S. District Court for the Southern District of Florida leave multifamily developers in a quandary.

UNTIL RECENTLY, THE Interstate Land Sale Full Disclosure Act (ILSA or the “act”) was a little-known federal law that few multifamily developers spent time thinking about. The law has now emerged as the weapon of choice among plaintiffs’ lawyers trying to get buyers out of contracts to purchase everything from condominium units to lots in second-home resort communities.

Most of these lawsuits are being brought by buyers who signed purchase contracts during the heyday of the real estate boom and now do not want to honor their obligations in a down market. Lawyers have focused on ILSA because if the developer is found to have violated the law,



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buyers can rescind their sales contracts (even after they close) and recover their attorney’s fees.

Unfortunately, the virtual explosion of ILSA litigation has resulted in some new and disturbing interpretations of the law by some federal courts. Developers have been scrambling to figure out how to comply with the mandates of the law in a legal environment where

different federal courts are not in agreement on what is required under the law. Multifamily developers are beginning to understand the need to develop expertise on land sales issues to protect their sales contracts from being challenged in the future.

### Some Background

ILSA was passed by Congress in 1968 to try to prevent the stereotypical shady developer from selling unsuspecting consumers unbuildable swampland in Florida. (The act became effective in its original form on April 28, 1969.) Initially limited to the sale of lots, the law also applies to the sale of condominium units (*Winter v. Hollingsworth Properties*, 777 F.2d 1444, 11th Circuit, 1985).

The law has never been particularly popular with developers. This is because if a real estate development does not qualify for a full or partial exemption from the law, the registration required under ILSA is expensive and time consuming, and requires consumers to be given a lengthy property report filled with bold-face disclosures warning buyers of the risks of purchasing property in not-yet-completed developments. If a project is required to be registered, the developer must also include certain provisions in the sales contract for the project, such as giving buyers a 20-day right to cure defaults and limiting the damages the developer can recover from a defaulting buyer to the earnest money in an amount not exceeding 15 percent of the purchase price.

If a developer violates the law, the penalties can be severe and include, among other things, the following sanctions: 1) the purchaser may rescind the trans-

action and obtain a full refund of all money paid toward the purchase of the lot or unit for up to two years following the date of the sale; 2) the developer can be liable to the purchaser for interest, court costs, expert fees, and attorneys’ fees incurred for up to three years following the execution of the purchase contract; 3) the developer can be liable in the amount of \$1,000 for each “knowing” violation of the act; and 4) the developer can be punished with fines of up to \$10,000 and/or imprisonment for up to five years if he or she is found guilty of willfully violating the act or making untrue statements to purchasers regarding the property.

### Full Exemptions

If a development qualifies for a full exemption under ILSA, the developer does not have to register the development or comply with the antifraud provisions of the act. The most common full exemption under ILSA is the “Completed Building Exemption,” which applies to the sale of land on which a completed building already exists, or the sale of “land under a contract obligating the seller to erect . . . a building thereon within a period of two years.” In order to qualify for the latter portion of this exemption, however, the purchase and sale contract must unequivocally obligate the developer to complete the unit within two years from the date the contract is signed, and must give the purchaser the right to insist on specific performance of the sales contract in the event the developer defaults on its obligations.

### Partial Exemptions

The most common partial exemption to ILSA is known as the “100 Lot Exemption,” under which a subdivision or condominium that

contains fewer than 100 lots or units is exempt from the registration and disclosure requirements of the act. However, even though the development is exempt, the developer must comply with certain antifraud provisions of the act. Among other things, it makes it illegal for the developer to mislead and omit material facts in selling lots and units in the development and requires the sales contract to state that the roads, sewers, water, gas or electrical service, or recreational amenities promised by the developer will be provided or completed.

Some developers have tried to get around the requirements of the act by doing a series of smaller related projects rather than one big project. This, however, is not allowed under ILSA because when counting the number of units or lots in a community for the purpose of determining if an exemption is available, all of the lots and units that could be considered part of a “common promotional plan” must be counted as being a part of the development. A “common promotional plan” is any plan undertaken by a single developer or a group of developers acting together to offer lots or units for sale or lease. If developers are acting in concert, if the land in question is contiguous, if the land is known or advertised as a common development or with a common name, if there are common sales facilities and common advertising, it is likely that the U.S. Department of Housing and Urban Development (HUD) will find that a common promotional plan exists, although each situation is evaluated on a case-by-case basis.

### Combining Exemptions

ILSA allows exemptions to be combined or stacked in order to maximize the number of lots

or units in a community that are exempt from the act. So, for example, the Completed Building Exemption and 100 Lot Exemption can be combined where the first through 99th lot or unit put under contract are each deemed to be partially exempt from the act under the 99 Lot Exemption, and the 100th unit or lot put under contract along with all subsequent lots and units put under contract are fully exempt under the Completed Building Exemption (provided the developer agrees to complete them within two years).

### Getting an Exemption

Under ILSA, developers can qualify for an exemption under something of an honor system. If one or more exemptions apply to a development to such an extent that the entire development is either fully or partially exempt from the provisions of the act, the developer is not required to file for an exemption. In cases where there is uncertainty about whether a project is eligible for an exemption, developers can seek an advisory opinion from HUD (which administers ILSA) on the issue. While requesting an advisory opinion adds some costs to a project and can cause delays, the opinion provides a limited degree of assurance for developers when deciding whether to proceed under an exemption or whether to move forward with full registration of their subdivision or condominium. Unfortunately, despite years of developers relying on such advisory opinions, some courts are now saying that such opinions are of little value and that only they can decide whether a project is eligible for an exemption.

### The Pugliesse Problem

In October 2007, the U.S. District Court for the Southern District of Florida determined in the case of *Pugliesse v. Pukka Development*

that the 99 Lot Exemption applied only if buyers were given the same rights that they would have had if the development had been registered (*Pugliesse v. Pukka Development*, No. 07-14040-CIV-LYNCH, So. D. Fla., October 3, 2007).

The court reached the conclusion even though HUD had previously issued an advisory opinion where it reached just the opposite conclusion. As a result, buyers were given the right to rescind their sales contracts and recover their attorneys’ fees. This effectively invalidated every pre-construction contract entered into by the developer. Not surprisingly, the same court restated its holding in *Meridian Ventures, LLC v. One North Ocean, LLC*, several months later (No. 07-80061-CIV, So. D. Fla., December 14, 2007). These cases are apparently being appealed.

### The Fallout

Despite the fact that no one, including HUD, ever thought that developers relying on the 100 Lot Exemption needed to include specific provisions in their purchase agreements previously only required by nonexempt projects, the fact that a federal district court has ruled otherwise leaves developers in a quandary. While a good argument can be made that the court misinterpreted ILSA in the *Pugliesse* decision, the challenge faced by developers is whether they want to literally bet the success or failure of their real estate developments on the case being overturned. Unfortunately, few developers can afford to take this bet with so much on the line.

So, what are the lessons for developers after *Pugliesse*? The first is that advisory opinions from HUD may not be worth the time, effort, and cost to obtain. Instead, if developers are concerned enough about compliance with ILSA to seek an advisory opinion, they may want to bite the



In light of the regulatory uncertainty surrounding the Interstate Land Sale Full Disclosure Act, Novare Group decided to register Catalyst, a residential tower planned for Charlotte, North Carolina.

bullet and simply do a full HUD registration. If the development has been registered, the ability to file lawsuits under ILSA is much more limited. Lawyers can argue that the developer did not comply with what the developer promised in the property report. However, questions regarding the adequacy of the property report and the sales contract generally fall by the wayside. After *Pugliesse*, the only safe harbor left to developers is to follow the new rule: “When in doubt, register the project.” **MFT**

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