

FEELING ILL OVER ILSA (Interstate Land Sales Full Disclosure Act)

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The Interstate Land Sales Full Disclosure Act

The federal Interstate Land Sales Full Disclosure Act, commonly known as "ILSA," prohibits the sale or lease of "lots" in a "subdivision" using any means of interstate commerce (radio, internet, print media, television, etc.), unless the lots are exempt or the seller or lessor files a Statement of Record with the recently-created Bureau of Consumer Financial Protection (CFPB), a sub-agency of the Department of Treasury. (On July 21, 2011, enforcement of ILSA shifted from the Office of Interstate Land Sales Registration, which was a sub-agency under the Department of Housing and Urban Development (HUD) to the CFPB. The CFPB was established pursuant to the Consumer Financial Protection Act of 2010 (Dodd-Frank), and was created to enhance consumer protection as a result of the recent housing market crash. The existing HUD rules will continue in effect until the CFPB publishes revised rules). The applicable 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 land." A "subdivision" refers to any land, whether or not contiguous, which will be divided into separate interests for sale or lease as part of a "common promotional plan." A common promotional plan is any plan undertaken by a single person or group of persons acting in concert to offer lots for sale or lease. In determining whether a common promotional plan exists, consideration is given to, among other things, whether there is a thread of common ownership; same or similar name or identity; common sales agents and/or sales facilities; common advertising; and/or common inventory. Thus, parcels of land located miles apart could be considered a single subdivision if they are part of a common promotional plan.

The Exemptions

There are several full and partial exemptions from filing a Statement of Record with the CFPB. One of the most commonly used exemptions is the improved lot exemption, which exempts the sale or lease of improved land on which construction of the lot is already complete or will be completed within two years pursuant to a contract that obligates the seller or lessor to do so. When using the improved lot exemption, developers must be careful not to make force majeure clauses in their purchase contracts too broad, or limit specific performance or other remedies, or unwittingly include contingencies on the seller's obligations to perform. These are potential violations that could cause a project to fall outside the exemption.

The other commonly used exemption is the 100-lot exemption, which exempts the sale of lots within a subdivision that contains less than 100 lots.

When using this exemption, developers must be mindful of the definition of lot, which may include structures or spaces such as parking spaces or storage facilities if they are made available for separate ownership. Such structures or spaces may count toward the 99 lot limit. Developers must also bear in mind that the lots in one project could be considered part of the same common promotional plan with lots in another project. Something as simple as a newspaper ad or promotional advertising on a website of two or more projects could cause a project to lose the exemption. Developers should consult with counsel when drafting their sales contracts and developing marketing strategies to make sure their projects are in compliance with ILSA. If a sales contract does not contain required language and/or contains prohibited language, the project will not be exempt even though it contains less than 100 lots or is completed within two years.

Proceed With Caution

Many developers have "piggy-backed" these exemptions by selling the first 99 lots in their project under the 100-lot exemption and then selling the remaining lots using the improved lot exemption. Developers should exercise extreme caution, however, when combining these exemptions in this manner. Recently, several courts have held that this piggy-backing approach will not be effective unless the developer can show that, at the time a purchase contract is signed, all lots are actually exempt and not that the developer simply intends to sell the lots under an exemption at some point in the future. In other words, timing for the use of these exemptions matters and all lots must be exempt at the time the purchaser signs the contract. In a subdivision containing more than 99 lots, any lots over 99 must be exempt before the developer can take advantage of the 99-Lot Exemption. Several courts have also recently held that in order to piggy-back these exemptions the developer must show a legitimate business purpose for using the exemptions and that they are not being used solely for the purpose of evading ILSA requirements.

Given these recent court decisions and the myriad of potential pitfalls, developers should consult with competent counsel to determine whether their projects should be registered with the CFPB or are otherwise eligible for exemption. Failure to comply could result in the return of purchasers' deposits years after initial sales even after the sales have closed, as well as significant penalties and fines. ■

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