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## U.S. Land Sales Laws: Complying With The Federal Interstate Land Sales Full Disclosure Act – Part I

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A successful marketing campaign for real estate, like most products, often involves a multi-state and international target market. Marketing initiatives for consumer products may include websites, electronic mail, postal mail and other forms of communication. Similarly, consumers are using these methods to shop for real estate. A real estate developer has potential purchasers located in multiple states and countries. Having such a large consumer base and utilizing convenient methods of communicating with potential purchasers can be a great asset, provided the developer is in a position to take advantage of it. For residential real estate marketed and/or sold within the United States this takes planning.

A successful real estate development requires a lot of planning and attention to detail. Attention is focused on design, construction, marketing and sales. In the United States, however, there is another very important aspect of real estate development that many developers ignore – often because they are unaware it exists until it is too late – and that is compliance with federal and state interstate land sales laws. Unless applicable

interstate land sales laws are complied with, a developer could find its marketing plans severely curtailed.

The marketing and sale of real estate lots<sup>1</sup> within the United States, regardless of whether the property is located within the United States, is regulated at the federal level under the Interstate Land Sales Full Disclosure Act (15 U.S.C. §1701, *et seq.*) (the “Federal Act”), and the regulations promulgated thereto (C.F.R. § 17001.1, *et seq.* (1991)) (the act and related regulations are collectively referred to herein as the “Federal Laws”). In addition to the Federal Laws, many states (and the District of Columbia) have promulgated their own interstate land sales laws. Prior to marketing and selling residential property, the transaction must qualify as exempt from federal and applicable state registration or the subdivision in which the property is located must be registered with the Interstate Land Sales Registration Division, Office of Manufactured Housing and Regulatory Functions, U.S. Department of Housing and Urban Development (“HUD”) and applicable restricted states. Developers who fail to comply with federal and state land sales laws risk civil and criminal penalties as well as rescission of sales contracts by purchasers. With proper planning, however, an interstate land sales compliance program can be created for a development to help developers avoid such penalties and reduce the rescission risks. The primary focus of this article is the Federal Laws; state land sales laws are a full discussion in themselves and are discussed only briefly here.

### **I. Federal Land Sales Laws**

Except in the case of an exempt transaction, a developer may not sell<sup>2</sup> lots through the use of any means or instruments of transportation or communication in interstate

commerce or the mails (including without limitation postal services, telephone lines and electronic mail) within the United States, unless the subdivision<sup>3</sup> in which the lots are located is registered with HUD pursuant to the Federal Laws. This means a developer and its agents cannot mail promotional materials or other information about the subdivision into or within the United States or return telephone calls or email requests for information about the subdivision, even if such request is unsolicited, which calls or emails originate in the United States, until the subdivision is registered with HUD. Given the impact the Federal Laws have on the ability to market and sell subdivided land within the United States, it is important to consider land sales compliance issues early on in the planning and development stage of a subdivision that may be marketed in the United States. Discussions with legal counsel knowledgeable in the area of interstate land sales early on in the planning and development of a subdivision will enable a developer to develop a plan for compliance with the Federal Laws that will complement the developer’s marketing schedule and objectives.

### **A. Registration**

To register a subdivision with HUD a Statement of Record must be filed with, and an effective date issued by, HUD. The Statement of Record consists of the Property Report and the Additional Information and Documentation (“AID”). The Property Report must be distributed to each purchaser located within the United States at the time of solicitation and/or sale, prior to the purchaser’s execution of a sales contract. The Property Report provides full disclosure of specifics relating to the subdivision including descriptions of the infrastructure and recreational facilities, local community services,

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property owners association(s), real estate taxes, title encumbrances and restrictions on use of the lot, closing costs, and access to and within the subdivision. The purchaser must acknowledge receiving the Property Report by signing a receipt. The AID contains documents supporting all of the disclosures made in the Property Report and is not distributed to purchasers.

The Statement of Record is comprehensive, and adequate lead time needs to be built into a land sales compliance plan to allow for preparation of the Statement of Records and review by HUD. To determine a timeline for preparation and filing of a HUD registration, count back from the date the developer wants to commence marketing initiatives in the United States by mail or any other means of interstate communications system. As a general rule, six months should be allotted to prepare and obtain acceptance of a HUD registration. Registration with HUD can be accomplished more quickly, in some circumstances, but six months is a fair estimate of the average preparation and review time. And remember, this is only to comply with the federal registration process. Depending on the target market, states identified for a particular subdivision, additional state registrations may be required before marketing activities and/or sales may be conducted and made in specific states (state registration is discussed in more detail below).

## B. Exemptions Under The Federal Act

The Federal Act provides three types of exemptions: (1) full statutory exemption; (2) partial statutory exemption; and (3) regulatory exemption. The first two types of exemptions are based on a subdivision as a whole while the third type, regulatory exemptions, allow for exemption of individual lots.

**1. Full Statutory Exemptions.** There are a number of transactions that qualify for a full statutory exemption from the Federal Act. A transaction that is fully exempt from the Federal Act is exempt from all provisions of the Federal Act, including registration and the anti-fraud provisions (discussed below). The following summary highlights several of these transactions:

a. *Less Than Twenty-Five Lots.* The sale or lease of lots in a subdivision containing less than twenty-five lots is exempt from the Federal Act. If a subdivision contains more than twenty-five lots, but fewer than twenty-five are offered pursuant to a common promotional plan (because, for example, several lots have been permanently dedicated for public park use), the sale of the residential lots are exempt. As defined under the Federal Act, "common promotional plan" means a plan, undertaken by a single developer or a group of developers acting in concert to offer

land for sale or lease and such land is contiguous or is known, designated or advertised as a common unit or by a common name. (15 U.S.C. § 1701(4)). In contrast to the foregoing example, if a developer acquires fewer than twenty-five lots in a larger subdivision, and continues to act in concert with the developer of the balance of the subdivision, the offering may be subject to the Federal Act.

b. *Improved Lots.* The sale of (a) land on which there is a residential building ready for occupancy; or (b) unimproved land for which the sales contract specifically obligates seller (referred to herein as developer) to construct a residential building thereon to be completed within two years from the date the purchaser executes the sales contract is exempt from the Federal Act. A building is deemed complete when it is physically habitable and usable for the purpose for which it was purchased or leased. For example, a residential building is complete when ready for occupancy, with all utilities connected.

A contract between a developer and purchaser for the purchase of a lot qualifying under this exemption must obligate the developer to complete construction of the residential building within two years of the date the purchaser signs the sales contract and must not allow nonperformance by the developer at his or her discretion. In addition, the sales contract must not negate the purchaser's right to specific performance, although that right need not be specifically stated. For example, a contract which restricted the purchaser's remedies for the seller's failure to build a dwelling unit within two years of the earnest money deposit was held not to satisfy the requirements of the Act in *Markowitz v. Northeast Land Company*, 906 F.2d 100 (9th Cir. 1990); and a contract which listed the purchaser's remedies as return of the deposit or specific performance, but excluded damages, did not meet the conditions for the exemption in the view of the Florida Supreme Court in *Samara Development Corp. v. Marlow*, 556 So.2d 1097 (Fla. 1990).

The sales contract may allow for nonperformance or delays beyond the two-year building period for reasons not within the developer's control if such provisions are legally recognized as defenses to contract actions in the jurisdiction where the building is to be constructed. Accordingly, provisions allowing for time extensions for acts of God, casualty losses or material shortages are generally permissible. In a multi-phased subdivision, the obligation to build within two years does not require completion of the entire subdivision within that period, but only completion of the phase in which the lot sold is to be located.

c. *Sales To Builders.* The sale of land to any person who acquires the land for the pur-

pose of engaging in the business of constructing a residential building or for resale to persons engaged in such activity is exempt from the Federal Act. A sale or lease of land to a person for construction of his own home is not exempt from the Act under this clause.

d. *Zoned Or Restricted Real Estate.* The sale of real estate which is zoned for industrial or commercial development or which is restricted to such use by enforceable covenants is exempt from the Federal Act, provided certain conditions are met. One such condition is the approval by local authorities of access to a public road running at least to the legal boundary of the subdivision, if not to each lot. In addition, unless waived by the purchaser, a title policy or opinion must be issued in connection with the lot sale showing title vested in the developer, subject only to exceptions approved in writing by the purchaser or lessee prior to recording of the deed or execution of the lease. The purchaser must be a duly organized business entity engaged in commercial or industrial business and represented by a representative of its own selection (a sole proprietor is not excluded from representing himself). The purchaser must provide specific affirmations in writing, including for example, that the purchaser is engaged in commercial or industrial business and is purchasing the real estate substantially for its own use, or has a binding commitment to sell, lease, or sublease the property to an entity which is a duly-organized business entity engaged in commercial or industrial business. The affirmations should be retained by the developer for the longer of three years or for the period of the applicable statute of limitations in the jurisdiction.

e. *REIT Securities.* The sale of Securities issued by a real estate investment trust.

f. *Government Sellers/Lessors.* The sale or lease of real estate by any government or government agency, including city, state, and foreign governments as well as the United States government. This exemption does extend to apply to sales or leases by federal or state chartered, regulated, or insured institutions.

<sup>1</sup> "Lot" is defined as any portion, division, unit, or undivided interest in land located in any state or foreign country if the interest includes the right to the exclusive use of a specific portion of the land (i.e., each lot, completed home, and condominium unit is a "lot" for purposes of HUD.) (24 C.F.R. § 1701(b)).

<sup>2</sup> The term "sale" is defined by the HUD regulations to mean any obligation or arrangement for consideration to purchase or lease a lot directly or indirectly and includes the term lease (and the term "seller", as used by HUD, includes the term "lessor"). (24 C.F.R. § 1701(b)).

<sup>3</sup> A "subdivision" is defined as any land located in any state or in a foreign country, divided or proposed to be divided into lots, contiguous or not, for the purpose of sale or lease as part of a common promotional plan. (24 C.F.R. § 1701(b)).