

Developing An Interstate Land Sales Compliance Strategy: A State Land Sales Law Perspective – Part I

**M. Maxine Hicks
and Linda E. Ragan Warnke**

EPSTEIN BECKER & GREEN P.C.

As discussed in our article “U.S. Land Sales Laws: Complying With The Federal Interstate Land Sales Full Disclosure Act,”¹ the marketing and sale of residential real estate is regulated under the Federal Interstate Land Sales Full Disclosure Act (“ILSFDA”)² and, in many states (and the District of Columbia), under state land sales laws.³ This article discusses the impact of state land sales laws on a developer’s marketing and sales program for residential subdivided land and condominium units.

Many states regulate the marketing and sale of out-of-state projects to their residents. These states are typically referred to as “Closed States.” In a Closed State, the real estate market is closed to a developer of an out-of-state project until the developer has complied with the state’s land sales laws. With today’s changing market, it is increasingly important for developers to understand the application of state land sales laws, and to develop a land sales compliance strategy before sales and marketing activities begin.

M. Maxine Hicks is a Member of the Firm in the Real Estate and Health Care and Life Sciences Practices in the firm’s Atlanta office, where she manages the real estate section. Linda E. Ragan Warnke is an Associate in the Real Estate practice in the firm’s Atlanta office, where she focuses on commercial real estate development.



**M. Maxine
Hicks**



**Linda E. Ragan
Warnke**

I. Triggering State Land Sales Laws

Approximately half of all states are Closed States. Whether a particular state will be a Closed State for a project depends on several factors, such as where the project is located, whether the project is registered under ILSFDA, and the type of product being offered (e.g., undeveloped lots, completed homes, condominium units).

In Closed States, no marketing, solicitation or sale of an interest in a project may occur unless the project complies with the state’s land sales laws. Most Closed States take the position that advertising in the state,⁴ sending email or placing telephone calls into the state, or mailing marketing materials or information into the state – even in response to an unsolicited request for information – will subject the person or entity conducting such activities to the applicable state land sales laws.

A common situation developers face is where a prospective purchaser from a Closed State calls or emails the developer requesting information about the project. Unless the developer has complied with the land sales laws of the Closed State from which the call or email came, no information regarding the project may be provided

to the prospective purchaser. While a potential sale may be lost, it is important that each member of the developer’s sales team understands the risks and knows how to respond. Educating sales personnel and providing them with preapproved responses for such scenarios can help prevent inadvertent violations of land sales laws.

Another common scenario arises when a developer maintains a website for a project through which consumers may correspond directly with the developer. Many websites include a “Contact Us” link through which prospective purchasers request that information about the project be mailed to them. Again, requests from a person in a Closed State may not be responded to with information about the project unless the project complies with that state’s land sales law. A developer can help protect itself by adding a filter to the website that provides an automatic response to requests received from a Closed State informing the consumer that due to his or her state’s land sales laws, the developer is not permitted to provide information about the project.

Developers who fail to comply with state land sales laws risk civil and criminal penalties, as well as revocation or rescission of sales contracts by purchasers. Therefore, it is important for developers and their sales teams to understand what activities trigger a state’s land sales laws in order to avoid inadvertent violations that could prove very costly in the long run. With proper planning and training, an interstate land sales compliance program can be created to help developers avoid such risks.

II. Possible Exemptions

Prior to marketing and selling a project

Please email the authors at mhicks@ebglaw.com and lragan@ebglaw.com with questions about this article.

in a Closed State, a developer must comply with, or establish that the project is exempt from, that state's land sales laws. Registration under, or exemption from, ILSFDA does not mean that the project is exempt from a particular state's land sales laws. Thus, in addition to ILSFDA, the land sales laws of each target state must be considered.

Similar to ILSFDA, many Closed States provide exemptions from land sales laws for qualifying projects. While the land sales laws of each Closed State are not uniform, there are certain exemptions that many Closed States offer. Two of the common exemptions offered by Closed States are discussed below.⁵

Project Size Exemptions.

A number of states provide an exemption from land sales laws for projects of a certain size. Most states that offer this type of an exemption limit its application to small projects, typically with no more than 10 to 25 lots or units. A few states provide an exemption for larger projects. New Jersey, for example, provides an exemption for projects with less than 100 lots.

As with ILSFDA, when counting the total number of lots or units to determine whether an exemption based on project size is available, it is important to understand which lots or units to count. This typically depends on the statutory definition of "subdivision." Under ILSFDA, "subdivision" is defined as any land divided or proposed to be divided into lots (or units), whether contiguous or not, for the purpose of sale or lease as part of a common promotional plan.⁶ In turn, ILSFDA defines "common promotional plan" as a plan undertaken by a single developer (or group of developers acting in concert) to offer lots for sale or lease where such land is contiguous or is known, designated or advertised as a common unit or by a common name.⁷ A number of Closed States have adopted similar definitions for the terms "subdivision" and "common promotional plan." Under these definitions, what constitutes a subdivision can extend beyond what is typically considered a single project. Thus, if a developer maintains a website that contains links to multiple projects, use of that single website may be deemed a common promotional plan, in which case the total number of lots and units in all of the projects combined would be counted for purposes of determining whether a particular project qualifies for an exemption based upon the number of lots or units offered.

Improved Lots/Units.

Some Closed States provide an exemption from land sales laws for projects that

qualify for the "Improved Lot Exemption" under ILSFDA. Under ILSFDA, if a unit or lot is sold complete with a residential dwelling or pursuant to a contract obligating the seller to complete the unit or a home on the lot within two years of the date the purchaser signs the purchase agreement, the sale is exempt from ILSFDA.⁸ In many Closed States that offer an Improved Lot Exemption, the exemption is self-determining. A few, however, require the developer to apply for the exemption.

III. Compliance Requirements

State land sales laws are not uniform, and the compliance process varies by state. Some states do not require a project to be registered but do require specific disclosures to be provided to purchasers before signing a contract. Most Closed States, however, require a developer to register the project with a particular agency, often the State's Real Estate Commission or Department of Real Estate.

State registration requirements range from simple to very comprehensive. Closed States typically require, among other things, one or more of the following: (a) registration of the project with a state agency; (b) distribution of a property report (often referred to as a public offering statement) prior to execution of a reservation agreement or sales contract; and (c) affiliation of a real estate broker licensed in the Closed State where the project is being marketed. Certain states have contract disclosure requirements, escrow requirements for contract deposits, and other prerequisites, such as qualifying to do business in the state, prior to submitting a registration application. A number of Closed States also have specific advertising disclosures that must be included in all marketing materials distributed within the Closed State. Several Closed States also require proposed marketing materials to be filed prior to their use.

As previously noted, federal registration under ILSFDA will not exempt a project from compliance with the land sales laws of a Closed State. A federal registration may, however, simplify the state registration process because some states provide a shorter registration process for projects registered under ILSFDA. For example, a Closed State that requires preparation of a state property report will often accept a federal property report in lieu of the state report. This reduces the preparation time for state registration and helps streamline the compliance process for the sales team by reducing the number of disclosure doc-

uments that must be provided to purchasers.

State filing fees also vary. Some states impose a flat fee while others base the fee on the number of lots or units being registered. Currently, state registration fees typically range from \$100 to \$3,500, with the exception of New York, where the fee can run as high as \$20,000.

Once registered, there are ongoing compliance requirements. Most Closed States require a land sales registration to be renewed annually. In addition, if information about a project changes, an amendment to the registration typically must be filed with the applicable state agency.

IV. Possible Penalties For Non-Compliance

While penalties that may be imposed for violation of a state's land sales laws vary, they typically include one or more of the following: revocation or rescission of sales contracts; cease and desist orders; fines; and criminal charges against the developer, its directors, officers, employees and agents. A broker's or agent's license also may be suspended for such violations.

Scrutiny of a developer's compliance with land sales laws continues to intensify and comes from both regulatory agencies and purchasers alike. In today's market, purchasers are increasingly looking for ways to back out of their real estate contracts, and savvy attorneys are looking to land sales laws to advance noncompliance arguments to achieve this objective for their clients. A developer can help protect itself and its investment in a project by taking the time to understand the applicable land sales laws and to develop and implement a land sales compliance program.

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² 15 U.S.C. §§1701, et seq.

³ ILSFDA is not addressed in this article except to the extent it relates to a particular aspect of state land sales laws. For a thorough discussion of ILSFDA, please see our earlier article as referenced above.

⁴ 15 U.S.C. §§1701, et seq.

⁵ Before utilizing any exemption, the specific requirements of the particular state should be carefully reviewed.

⁶ 15 U.S.C. §1701(3).

⁷ 15 U.S.C. §1701(4).

⁸ 15 U.S.C. §1702(a)(2). There are certain contractual requirements applicable to this exemption under ILSFDA and certain Closed States, which requirements are not discussed in this article.