



HIDDEN TRAPS

Builders should watch for the pitfalls of the Interstate Land Sale Full Disclosure Act. BY MATTHEW WEINSTEIN



Many project delays in the housing market today are outside of a developer's control — poor sales, insufficient capital markets to finance transactions and bureaucratic red tape, just to name a few. These delays have resulted in dire consequences in the housing industry, ranging from stalled projects to bankrupt developers. Yet some of these problems might have been preventable with a little extra effort from the developer. Compliance with the Interstate Land Sales Full Disclosure Act (ILSA) is one such basic step that will substantially help limit harm to the homebuilder.

ILSA was enacted in 1968 to protect consumers from fraud and abuse in the sale or lease of land. Congress enacted the ILSA legislation with the purpose of reigning in overzealous developers and protecting naïve purchasers in many emerging areas, particularly Florida's swampland.

ILSA's anti-fraud goal is primarily accomplished through the imposition of certain requirements on developers that, if not complied with, serve as a basis for revocation of a purchase and sale agreement for up to two years after such an agreement is signed. Developers that are covered by ILSA are required to register a Statement of Record with the U.S. Department of Housing and Urban Development (HUD), and to prepare a property report for each purchaser before signing. They then must allow for at least a seven day rescission period after signing.

In addition to these primary requirements, ILSA also prohibits numerous marketing and sales practices that are considered unlawful.

Requirements for Sale or Lease of Lots

For the developers that cannot claim an exemption, ILSA sets out an extensive list of requirements that must be met with respect to the sale or the lease of a lot. If any of these requirements are violated, ILSA grants purchasers a private right of action against the offending developer.

For example, it is unlawful for a developer to: sell or lease any lot unless a statement of record with respect to such lot is in effect; sell or lease any lot unless a printed property report has been furnished to the purchaser or lessee in advance of the signing of any contract or agreement by such purchaser or les-

'[Project] delays have resulted in dire consequences in the housing industry.'

see; sell or lease any lot where any part of the statement of record or the property report contains an untrue statement of a material fact or omits to state a material fact required to be stated therein; or display or deliver to prospective purchasers or lessees advertising and promotional material which is inconsistent with information required to be disclosed in the property report.

It should be noted that HUD also set various technical regulations under ILSA that provide further direction as to what constitutes unlawful, deceptive or misleading sales practices in violation of ILSA regulations that are not the subject of this article. For example, developers may not, as a sales inducement, represent that any lot has good investment potential or will increase in value unless it can be established in writing that such statement is true based on empirical facts.

Required Contents of Property Report

In situations where the ILSA is applicable, it is unlawful for a developer to sell or lease a property without furnishing a printed property report to the purchaser in advance of the signing of any contract or agreement for purchase of the property. The document must contain all information that the HUD secretary has deemed necessary.

The property report may not be used for promotional purposes before the statement of record becoming effective. And then, the report must be used in its entirety. In addition, no advertising may state that the secretary approves or recommends a particular subdivision. Additionally, no portion of the report may be underscored, italicized or even printed in a bold font.

The following disclaimer statement must also be displayed below the text of all printed material and literature used in connection with the sale or lease of units for which an effective Statement of Record is on file with HUD:

"Obtain the Property Report required by Federal law and read it before signing anything. No Federal agency has judged the merits or value, if any, of this property."

Revocation Options Under ILSA

What sets ILSA apart from many other non-disclosure, fraud or developer fault scenarios is that under ILSA, a buyer or tenant need not prove damages in order to invoke monetary and non-monetary remedies. In the event of a failure to comply with ILSA's requirements, damages are presumed per se even if no damages are actually proven. Yet it is the type of damage that is permitted by a jilted buyer or tenant that makes ILSA unique.

From the perspective of the developer, the most troublesome aspect of ILSA is the contract revocation remedy for the buyer. In addition to the seven-day review and revocation period following the signing of the contract or agreement, revocation of the agreement of sale may also be

Matthew I. Weinstein is a member in the real estate department and real estate and construction industry practice group at Cozen O'Connor. He has extensive experience representing real estate developers, shopping center, office and industrial owners and landlords in all aspects of the acquisition, development, financing, leasing and disposition of commercial developments. For more information, call (215) 665-4199, email matthewweinstein@cozen.com, or visit www.cozen.com.



'ILSA sets out an extensive list of requirements that must be met.'

granted at the option of the purchaser or lessee for two years after signing of a contract or agreement – even if the purchaser has closed on the property – if the contract does not provide a number of specific disclaimers.

Many lenders and certainly developers assume, incorrectly in the case of ILSA, that the sale of a unit is final and that the only liability retained by a developer post closing are punch list and warranty items. What ILSA creates is effectively a lemon law for land without the requirement of actually showing harm but simply by showing a failure to follow the statute.

Coordination Between Developer and Contractor

While a substantial number of the requirements above are the responsibility of the developer, the contractor is not entirely protected. He may also be vulnerable to third-party liability, notwithstanding the construction contract. This would be due to the fact that certain information relied upon by the purchaser is related to the work performed by the contractor. For example, if the contractor's plans and specifica-

tions are inaccurate in any material respect, such a misrepresentation to the purchaser may permit the purchaser to revoke their agreement of sale.

The developer may then request indemnification as to the developer's loss due to such revocation. It is important for the developer and contractor to keep an open line of communication and verify the accuracy of all work performed by the contractor in connection with the project.

While adherence to ILSA will not necessarily sell more units or open up the capital markets or cut through bureaucratic red tape, by keeping ILSA in mind when developing housing projects, many potential pitfalls may be avoided. ♦