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THE INTERSTATE LAND SALES FULL DISCLOSURE ACT: WHAT RESIDENTIAL DEVELOPERS NEED TO KNOW ABOUT THE "IMPROVED LOT EXEMPTION"

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As a consequence of the collapse of the residential condominium market, many contract purchasers have sought creative ways to rescind their purchase and sale agreements and receive a return of their deposit monies. Some have looked to the Interstate Land Sales Full Disclosure Act (the "ILSA"). Unless a developer complies with the ILSA's registration and disclosure requirements, holding purchasers to their contracts might well depend upon the developer's qualification for one of the exemptions from such requirements provided for in the statute.

Enacted by Congress in 1968, the ILSA requires developers to register a Statement of Record with the U.S. Department of Housing and Urban Development, and prepare a Property Report, prior to the sale of any condominium unit. The developer must provide each purchaser with a copy of the Property Report prior to the purchaser's signing of a purchase and sale agreement, and the right to cancel the purchase and sale agreement within seven days after such signing (or a longer rescission period, if mandated by state law). The Property Report is an extensive and detailed document that must include general information about the property, as well as other information such as risks associated with buying the land, title and land use matters, property financial and operating information, subdivision characteristics, general topography, statements of present condition, and any unusual conditions affecting the property.

If a developer fails to comply with the registration and disclosure requirements of the ILSA, the purchaser has the right to rescind the transaction for up to two years after the date upon which the purchaser signs a purchase and sale agreement, even if the transaction has closed. The developer, and the developer's agents (which might include the owner entity), could also be subject to civil and criminal penalties, and could potentially face an injunction prohibiting further sales of units at the property until such time as the developer fully complies with all of the registration and disclosure requirements of the ILSA.

The ILSA provides several exemptions from its registration and/or disclosure requirements, depending on the nature of the property. The most heavily litigated exemption is known as the "Improved Lot Exemption" or the "Two-Year Exemption." Under this exemption, a developer is exempt from complying with the ILSA's requirements if the transaction involves "the sale or lease of land under contract that obligates the seller or lessor to complete the construction of a building thereon within a period of two years." 15 U.S.C. §1702(a)(2).

To qualify for the Improved Lot Exemption, the developer must have an actual and unconditional commitment to complete construction within two years after the date upon which the purchaser signs the purchase and sale agreement. This commitment might be called into question, and the developer might lose the benefits of the Improved Lot Exemption, if the agreement contains certain typical provisions and limitations. For example:

- Provisions that give the developer the right to perform or not, at its discretion, upon the happening of certain *force majeure* events are impermissible, because they essentially eliminate the developer's "unconditional" commitment to complete construction. There are, however, certain *force majeure* protections that are acceptable for purposes of the Improved Lot Exemption, which protections are governed by state law and therefore vary by state.
- Provisions that impermissibly limit the purchaser's remedies for the developer's default, such as those that preclude the purchaser from pursuing an action for specific performance, will cause the developer to lose the exemption, because there is no contractual mechanism for the purchaser to compel the developer to complete construction.

- Pre-sale contingency clauses, under which the developer reserves the right to cancel the transaction if the developer is unable to sell a certain number of units within a specified time period, will compromise the exemption unless the contingency expires within 180 days after the date upon which the purchaser signs the agreement and the right to cancel the transaction can be exercised by either party.

A purchaser's rights under the ILSA are determined as of the time when the purchase and sale agreement is signed. As a result, if the agreement contains provisions that are inconsistent with an actual and unconditional commitment on the part of the developer to complete construction within two years, the Improved Lot Exemption will not be available to the developer. Consequently, barring full disclosure under the statute, or the developer's qualification for another exemption, the purchaser will have the right to rescind the transaction during such two year period and obtain a refund of the purchaser's deposit monies, even if the developer actually completes construction within the requisite two-year period and even if the transaction has closed.

Although the case law is still developing, the recent ILSA cases should serve as a call to developers to re-evaluate provisions that are often glossed over as "boilerplate language" in typical form purchase and sale agreements, and eliminate those that might be deemed by a court to render discretionary the obligation to complete construction. This re-evaluation must take into account the laws of the jurisdiction(s) in which the developer is operating. *Please contact any of Cozen O'Connor's Real Estate Attorneys for assistance with such a re-evaluation or for more information concerning the Interstate Land Sales Full Disclosure Act.*

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