CARLTON FIELDS

New Condominium Exemption To The Interstate Land Sales Full Disclosure Act

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As we previously reported, a significant amendment to the Interstate Land Sales Full Disclosure Act (ILSA) becomes effective on March 26, 2015. HR2600 adds an exemption from registration for a “condominium unit.” This is a so-called “b” exemption, meaning the anti-fraud rules of ILSA will still apply to condominium unit sales. This alert provides an updated analysis of the amendment.

The new exemption appears to be quite simple, and for most condominium projects first being marketed after March 25, it will be. The contract must stipulate that the developer will provide or complete necessary roads, sewers, water, gas and electric service and that any recreational amenities represented will be provided. It is advisable that the contract specify that both seller and buyer want and intend the unit to be exempt from ILSA registration for some specified business reason (however minimal), such as accelerating time to market or reducing cost, and that the contract include a savings clause.

The amendment defines a “condominium unit” to require that, upon conveyance, it will be an “improved lot.” Unfortunately, that term is not defined in the amendment or elsewhere in ILSA. If a condition to closing is that the condominium units will have certificates of occupancy issued, there should be no issue. Such units will be “improved” upon conveyance under any definition. But if a unit might be conveyed “designer ready,” a question may arise as to whether it is improved. The best guess is that the courts will look to local law to determine if the unit is finished to such a state as to be “improved.” Local building codes might require, for example, the installation of a sanitary fixture, running hot and cold water, electrical fixtures and some kind of floor covering as a prerequisite to completion.

A bolder approach would be to interpret “improved lot” as applying to the land, not the building. An argument might be made that “improved” lot means any improvement, or more conservatively, all improvements needed to support the erection of a building that could be completed to a certificate of occupancy, such as access roads or drives, utilities to the building site, and grading for drainage. Under such an interpretation, not only would a “designer ready” condominium unit be exempt, but so, too, would a land condominium with no built residence. There exists no indication, however, that HR 2600 was intended to extend to a land condominium within residential improvements constructed thereon.

The amendment presents a potential trap for a developer who is misled into believing that the condominium units in a mixed lot/townhouse/condominium project can be ignored in determining if the lots and townhouses satisfy the exemption for fewer than 100 lots (the “99 Lot Exemption”). They may not be ignored because the rules for “piggy-backing” do not allow excluding units exempt under subsection 1702(b), only under subsection 1702(a). The condominium units are a subsection (b) exemption.

ILSA will continue to apply to units in projects already registered with the Consumer Financial Protection Bureau (CFPB), the agency that administers ILSA and under contract before March 26, 2015. A convincing analysis by the Southern District Court in California concluded recently that the new ILSA amendments cannot be applied retroactively to effect consumers already entitled to ILSA’s coverage. We believe that the developer must continue to file amendments and annual reports as ILSA requires.

Here, things may get complicated. CFPB has advised that starting March 26, 2015, it will not accept any filings, amendments, annual reports, or suspensions for condominium projects, already registered or not. We hope this is not CFPB’s final word on the subject. Since ILSA does not require delivery to a consumer after contract of any amendments, continuing amendment and annual report filings might not make any sense, but there must be some way to close the

registration. If CFPB rejects all attempts to file or terminate, the developer should preserve the evidence of rejection, thereby establishing good faith and the impossibility of further compliance.

With the current lack of procedure from the CFPB, the developer has several imperfect choices for units in projects registered with the CFPB before March 26, 2015, but not yet under contract at that date. Again, the best choice would be to attempt to terminate the registration. If that is not available administratively, the developer will need to choose between ignoring the exemption and continuing to distribute the property report to consumers, or claiming the new condominium unit exemption and ignoring the registration. No court case has tested whether a project can have both registered and exempt units.

The choices are fairly clear for a developer whose condominium project is not otherwise exempt and not yet registered. One is not to enter into contracts for the sale of units until March 26, 2015. This does not preclude pre-contract activities, including advertising and taking nominal and fully refundable reservation deposits. The other is to register before March 26, 2015 and begin to enter into contracts. Depending on whether the CFPB offers a better alternative in the future, one possible submission approach to the CFPB is to try to build in a self-termination provision to the registration, such as describing the units to be covered by the registration to be only those for which a contract is entered into on or before March 26, 2015. The hope is that this will avoid the issue of what to do with contracts entered into after March 26, as discussed above.

If the real estate market remains relatively stable for the next two years, it is not very likely that the transition issues will present any great difficulties as a practical matter. And this amendment to ILSA is very welcome. ILSA should never have been interpreted to apply to condominium units, which present none of the potential abuses involving sales of desert and swamp land.