

LAND SALES REGISTRATION: POTENTIAL PITFALLS FOR NONCOMPLIANT SUBDIVISION DEVELOPERS

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"It is easier to ask forgiveness than permission."

In 20 years of representing resort developers across the nation I have heard this phrase stated on countless occasions. Sometimes, developers rely upon this maxim to avoid the costly legal and operational expenses incurred in connection with land sales registration activities. Other times, developers become so focused on their sales activities that they refuse to tolerate delays associated with regulatory compliance.

While a developer may defer the need to scrutinize the applicability of seemingly technical laws to their business, no resort developer can afford to totally disregard the application of the Interstate Land Sales Full Disclosure Act (the "Act") to their business.

Generally, the Act will have some sort of application to developers of large scale lot subdivisions with one hundred (100) or more lots in current or proposed inventory. While compliance with the Act may appear to be a technical inconvenience, a developer's failure to comply with all aspects of the Act may result in the following civil penalties, criminal actions, and other practical concerns:

- (a) any person who violates the provisions of the Act or the regulations prescribed thereunder, or any person who willfully makes an untrue statement of material fact or omits to state any material fact in a statement of record shall, upon conviction, be fined to not more than Ten Thousand Dollars (\$10,000) nor imprisoned not more than five (5) years, or both.
- (b) any person who violates the requirements of the Act shall, in addition to criminal penalties, be subject to civil money penalties in an amount equal to One Thousand Dollars (\$1,000) for each violation (everyday during which a developer is out of compliance constitutes a violation) with a maximum civil money penalty amount not to exceed One Million Dollars (\$1,000,000).
- (c) If the foregoing doesn't serve to chill a developer's business decision to "ask forgiveness", then maybe the following practical concern will: every sophisticated receivables portfolio lender or purchaser is fully aware of the existence of the Act

and the developer's obligation to comply. Given the Act's provisions that allow purchasers the right to rescind their transactions with a noncompliant developer for a two (2) year period after the date of their sale, virtually no lender will finance the portfolio if the developer is not otherwise in compliance with the Act. In other words, all of the developer's hard work in developing his leads, closing his sales, and developing a portfolio will result in no substantive monetary yield to the developer.

A developer's ability to comply with the Act is totally fact dependent. Just because a developer in a nearby community is exempt from the Act's applicability, there is no assurance that you will be exempt. If a developer does not qualify for an "exemption" from the Act's applicability, then the developer must "register" the property.

The following is a summary of those statutory and expressly authorized exemptions which are found in the Act:

Statutory Exemptions. The Act specifically does not apply to the following:

- (a) the sale of lots in the subdivision containing fewer than 25 lots;
- (b) the sale of improved land whereupon a residential building or a condominium is constructed, or where the developer has a mandatory obligation to construct such a building within two years;
- (c) sales of cemetery lots;
- (d) sales of lots to bona fide builders; and
- (e) industrial or commercial development sales.

Expressly Authorized Exemptions. Additionally, the Act expressly provides for the following exemptions:

- (a) 100 lot exemption - applies to subdivision containing fewer than 100 lots. Note that substance rather than form governs and regulators will consider reserved-for-future-development property to be included within the calculation even though not expressly platted. Qualification for this exemption requires substantial care and due diligence.
- (b) 12 lot exemption - applies when no more than 12 lots are sold in any successive 12

month period.

- (c) scattered site subdivision - the sale of 20 or fewer noncontiguous lots.
- (d) 20 acres lots.
- (e) Single family residence exemption - applies to a subdivision which is fully regulated by municipal government wherein no direct mail or other solicitation or promotional techniques are used. All property must be zoned single family and must be located on a paved street. A unit of local government or a property owners association must have accepted street maintenance responsibilities. Potable water, sewage disposal and electricity must have been extended to the lot. The deed must be delivered within 180 days after execution of the sales contract. Title insurance must be in effect and the purchaser must make a personal on-the-site inspection.
- (f) Manufactured home exemption.
- (g) Intra-state exemption. Sales must be limited solely and exclusively to persons residing in the same state as the subdivision. This exemption is somewhat transparent in that any sale which fails to meet the intra-state requirement will retroactively disqualify the developer from the exemption's availability. Additional special contractual provisions are also required for compliance.
- (h) Metropolitan's statistical area exemption. Of primary importance is the fact that the principal residence of the purchaser must be within the same metropolitan statistical area as the subdivisions. This creates the same problems as does the intra-state exemption. Additional rather substantive requirements are also required prior to effectiveness.
- (i) Miscellaneous. The Secretary of the Housing & Urban Development may also carve out special exemptions and unique circumstances. These exemptions are usually difficult to obtain.

It is important to note that several of the exemptions referenced above require filings with the Department of Housing and Urban Development. Failure to properly qualify for an exemption subjects the Developer to civil and criminal penalties.

Registration. If the developer is unable to meet any of the exemptions from the applicability of the Act, the developer must begin the somewhat time consuming and expensive process of "registering" his subdivision with the Department of Housing and Urban Development, Office of Interstate Land Sales Registration. The following represents a summary of those steps with which a

developer must comply in pursuing the registration process:

- (a) Generally. If a subdivision does not qualify for an exemption from the registration process, a registration statement must be prepared and filed with the Department. The registration is comprised of two primary components: the statement of record and the property report.
- (b) Statement of Record - Generally. The statement of record is a document that is filed with the Department. A filing fee of \$1,000 is required. The statement of record addresses the following issues in quite thorough and substantive detail: Developer ownership and structure, general plan of subdivision, title information and land use, title insurance policy matters, nature of liens and encumbrances, submission of operative deeds and contracts, submission of plats and environmental studies, submission of restrictions, water utility discussion, water, sewer, electricity and other discussion, developer financial information, recreational facilities and amenities discussion, subdivision characteristics and climate, property owners association information, etc.
- (c) Property report - While the statement of record is received and reviewed exclusively by the Department, regulations require that a property report be prepared, submitted to the Department along with the statement of record, and also submitted to all property owners prior to the execution of their contract. Developer's must retain a signed receipt page evidencing the property owner's receipt of the property report. Generally the property report covers the following issues: method of sale, type of deed, encumbrances and mortgages, mortgage release provisions, title insurance, escrow structure and payments, lot use restrictions, plats and zoning matters, environmental, roads, access throughout subdivision, water and sewer and other utilities, developer financial information, local fire, police and other services, recreational facilities, subdivision characteristics and climate, property owners association structure, etc.
- (d) Rescission - It is important to note that the Act requires a seven day rescission or "cooling off" period which begins to run upon the execution of a purchase contract. Moreover, the failure to deliver a property report to a prospective purchaser (or otherwise qualify with certain aspects of the Act) entitles the purchaser to a two-year rescission period.

Compliance with the Act is time consuming and costly, but the criminal and civil penalties, as well as practical problems associated with non compliance are totally unacceptable. It is important to note that developer's compliance with the Act does not excuse that developer from complying with the land sales registration laws of various states into which the developer may

market its subdivision. Moreover, a variety of other federal laws including the Truth in Lending Act, Fair Debt Collection Practices Act and Real Estate Settlement Practices Act must be complied with in order to insure compliance with all federal law and with those conditions which finance companies establish as a prerequisite to providing lending or portfolio acquisition services to the developer.