

ARTICLE:**THE INTERSTATE LAND SALES ACT: WHAT COUNSEL FOR A CALIFORNIA DEVELOPER SHOULD KNOW**

By Ella K. Gower and Jane R. Martin***

Developers in the State of California are well aware of the Subdivision Map Act,¹ the Subdivided Lands Act,² and the Davis-Stirling Common Interest Development Act,³ all of which govern the subdivision and sale of real property in California—but how familiar are developers with the Interstate Land Sales Full Disclosure Act (ILSA)?⁴ A consumer protection statute, ILSA was enacted into law to prevent fraudulent sales (or leases) of real estate. Developers should always review ILSA in the early stages of planning to confirm whether the project is subject to ILSA and if the project is subject to ILSA, whether the project qualifies for a full or partial exemption⁵ in order to avoid the harsh penalties that may result due to a violation of ILSA.⁶

ILSA Background and Scope

Following its original enactment in 1968, ILSA was administered by the U.S. Department of Housing and Urban Development (HUD). In 2010, administration and enforcement of ILSA were transferred by Congress to the newly formed Consumer Financial Protection Bureau (CFPB), which began to administer and enforce ILSA in 2011.⁷ (Some regulations and advisory materials originally promulgated by HUD continue under HUD website addresses despite the subsequent assignment of administrative responsibility to the CFPB.)

By its terms, ILSA applies to any “subdivision,” which includes any land that is located in any state that is divided or proposed to be divided into lots for the purpose of sale or lease as a part of a common promotional plan.⁸ A “common promotional plan” means a plan, undertaken by a single developer or a group of developers acting in concert, to offer lots for sale or lease; where such land is offered for sale by such a developer or group of developers acting in concert, and such land is contiguous or is known, designated, or advertised as a common

*Ella K. Gower is a shareholder of Miller Starr Regalia and co-author of Chapters 28 and 29 of the firm’s 12-volume treatise, *Miller & Starr, California Real Estate 4th*, published by Thomson-Reuters.

**Jane R. Martin is an associate practicing common interest development law in Miller Starr Regalia’s Walnut Creek office.

unit or by a common name, such land shall be presumed, without regard to the number of lots covered by each individual offering, as being offered for sale or lease as part of a common promotional plan.⁹

Developers may find their project:

- (i) not subject to ILSA;
- (ii) subject to ILSA;
- (iii) fully exempt from ILSA; or
- (iv) partially exempt from ILSA.

Project Subject to ILSA and No Applicable Exemption

If a project is subject to ILSA and it does not qualify for a full or partial exemption, it is unlawful for a developer or its agent to sell or lease subdivision lots through interstate commerce, unless the developer has filed with the CFPB a Statement of Record, including a Property Report, and provided the Property Report to the buyer or tenant before they execute a contract for purchase or lease.¹⁰ ILSA also contains extensive anti-fraud provisions aimed at deceitful promotional material, which provisions are described further below.¹¹ ILSA's requirement that there be a Statement of Record and Property Report may be satisfied by filing the documentation identified by the CFPB, but such filing may be unnecessary if pursuant to Section 1409 of ILSA the CFPB has found that either (i) the state's law requires substantially equivalent information to ILSA and such information is accurate; or (ii) the state's law provides sufficient protection for purchasers/lessees as to matters under ILSA.¹²

California's public report process under the Subdivided Lands Act has been certified by the CFPB, and as such, the CFPB will accept California's documentation (the public report process) as the Statement of Record and Property Report.¹³

A developer who has a project that is subject to ILSA and which does not qualify for an exemption must submit the documents and materials that are submitted to the California Department of Real Estate as part of the public report process to the CFPB along with a filing fee. In addition, the Developer must include in its purchase and sale agreements and in the public report specified language that satisfies the federal requirements for rescission (seven days from execution of the contract).¹⁴

Exemptions

ILSA provides for two different classes of exemptions: (1) full exemption, which removes the project from all of the requirements and provisions of ILSA; and (2) partial exemption, which removes the project from the requirement for filing the Registration Statement and obtaining a Property Report, but the project remains subject to the anti-fraud provisions of ILSA, and the purchase contract or lease must contain the provisions giving the purchaser or lessee a right to rescind.¹⁵

Full Exemption

There are numerous full exemptions as discussed below, but the most commonly applicable are the sale or lease of lots containing fewer than 25 lots (the “Fewer than 25 lots exemption”) and the sale or lease of improved land (the “Improved lots exemption”). Developers should first consider whether their developments fall within these two exemptions. The following types of transactions are fully exempt from the provisions of ILSA:

(1) **Fewer than 25 lots.** The sale or lease of lots in a subdivision containing fewer than 25 lots.¹⁶ If a subdivision contains 25 or more lots, but fewer than 25 are offered for sale (for example, some lots are dedicated to the public for a park), those sales would be exempt.¹⁷

(2) **Improved lots.** The sale or lease of land that is improved by a residential, commercial, or industrial building, or where there is a contract obligating the seller to erect such a building within a period of two years.¹⁸ For a building to be considered complete, it must be physically habitable and usable. For example, a residential structure must have all necessary and customary utilities. The two-year period begins on the date the purchaser signs the contract. The contract must now allow nonperformance by the seller at the seller’s discretion or alter the obligation of the seller to build.¹⁹

(3) **Note sales.** The sale of evidence of indebtedness secured by a mortgage or deed of trust on real estate.²⁰ The sale of such notes is exempt, but the underlying sale of land is not exempt.²¹

(4) **Sale of REIT securities.** The sale of securities issued by a real estate investment trust.²²

(5) **Sale to government.** The sale or lease of real estate by or to any government or government agency.²³

(6) **Cemetery lots.** The sale or lease of cemetery lots.²⁴

(7) **Sales to developers.** The sale or lease of lots to a person in the business of constructing residential, commercial, or industrial buildings on the lot purchased.²⁵

(8) **Commercial or industrial lots.** The sale or lease of property that is zoned for industrial or commercial development, or which is restricted to such use by recorded restrictions. In order for this exemption to apply, the following additional conditions must be met: (a) local authorities have approved access from such real estate to a public street or highway; (b) the purchaser or lessee is a business entity (corporation, trust, partnership or other business entity) engaged in commercial or industrial business; (c) the purchaser or lessee is represented in the transaction by a person of its own selection; (d) the purchaser or lessee affirms in writing to the seller that it is either purchasing or leasing substantially for its own use or has a binding commitment to sell, lease, or sublease to another business entity engaged in commercial or industrial business and is not affiliated with the seller or agent; and (e) a title insurance policy is issued showing that title is vested in the seller or lessor.²⁶

Partial Exemption

In the event that a full exemption does not apply, developers should then consider whether the development could qualify for one of the many partial exemptions, the most common of which are the 100-lot exemption, the single-family residence exemption, and the condominium unit exemption. The following types of transactions are exempt from the registration and disclosure requirements of ILSA, but remain subject to the anti-fraud provisions of ILSA and the rescission rights of the purchaser or lessee:

(1) **100-lot exemption.** The sale or lease of lots in a subdivision containing fewer than 100 lots that is not otherwise exempt.²⁷ A developer of a subdivision containing 129 lots could qualify if, for example, at least 30 lots are sold in transactions that are exempt because the lots had completed homes erected on them.²⁸

(2) **12-lot exemption.** The sale or lease of the first 12 lots in a subdivision in a 12-month period commencing with the date of sale of the first lot, and the

subsequent sale of not more than 12 lots in any succeeding 12-month period, as long as no more than 12 lots were sold during the preceding 12-month period.²⁹

(3) **Scattered site exemption.** The sale or lease of lots in a subdivision in which each noncontiguous part contains no more than 20 lots, and the purchaser or lessee (or the spouse thereof) has made a personal, on-site inspection of the lot purchased or leased, prior to signing the sales contract or agreement to purchase or lease.³⁰

(4) **20-acre lots exemption.** The sale or lease of lots in a subdivision in which each of the lots is at least 20 acres (inclusive of easements).³¹

(5) **Single-family residence exemption.** The sale or lease of a lot within a city or county that specifies minimum standards for subdivision development if the subdivision:

- (a) is zoned for single family residential development;
- (b) meets the requirements of all of the applicable codes;
- (c) is located on a paved street meeting local standards for a public road, or a bond is posted for such a road's construction and the public entity or homeowners association accepts maintenance responsibility;
- (d) adequate water, sewage disposal, and electricity have been extended to the lot, or the local entity is required to install such facilities within 180 days of closing;
- (e) the title is conveyed by a grant deed or warranty deed free from encumbrances within 180 days after the signing of the sales contract;
- (f) the purchaser receives title insurance vesting marketable title in the purchaser subject only to exceptions approved by the purchaser;
- (g) the purchaser or lessee has made a personal inspection of the lot prior to executing the purchase contract or lease; and
- (h) there were no promotional offers to induce the purchaser or lessee to visit or to purchase or lease the lot.³²

(6) **Mobile home site exemption.** The sale or lease of a lot for use by a mobile home where the contract obligates the seller to complete all improve-

ments for the placement of the mobile home on the lot within a two-year period, and the purchaser's funds are placed in escrow with instructions to return them to the buyer if all improvements are not properly completed and the mobile home is not placed on the lot within the two-year period. The subdivision also must comply with all local codes; water, sewer, and electrical service and access roads must be extended to the lot; and the buyer must receive marketable title.³³

(7) **Intrastate exemption.** A sale or lease of a lot by a developer engaged in intrastate sales if:

- (a) the lot is free and clear of all encumbrances;
- (b) the purchaser or lessee has made a personal on-site inspection;
- (c) the developer is subject to the laws of the state where the lot is located;
- (d) each lot (unless exempt under some of other exemption) is sold or leased to a resident of the state where the lot is located; and
- (e) the purchase or lease contract contains an estimate of the time for, and person responsible for, the completion and maintenance of all public or common facilities and amenities, and a provision giving the purchaser or lessee the right to rescind the contract for a period of seven days (the "intrastate exemption").³⁴

(8) **Metropolitan statistical area exemption.** The sale or lease of a lot within a subdivision that contains fewer than 300 lots if the principal residence of the purchaser is within the same standard metropolitan statistical area as the lot purchased or leased. In addition, in order for the sale or lease to be exempt:

- (a) the lot must be free and clear of liens and encumbrances when the contract is signed;
- (b) the purchaser or lessee must make an on-site inspection;
- (c) the purchaser or lessee must have a seven-day period of rescission;
- (d) the contract must contain disclosures regarding the completion of public and common facilities and amenities and a disclosure of any liens or restrictions;

- (e) the developer must execute and supply to the purchaser a written instrument designating an in-state agent for service of process; and
- (f) the developer must file a written affirmation of compliance with these requirements with CFPB by January 31 each year.³⁵

(9) **Condominium unit exemption.** The sale or lease of a condominium unit that is not otherwise exempt under the first class of exemptions, if the unit meets the following definition: a unit of residential or commercial property to be designated for separate ownership to a condominium plan or Declaration, provided that upon conveyance (A) the owner will have sole ownership of the unit and an undivided interest in the common elements appurtenant to the unit, and (B) the unit will be an improved lot.³⁶

(10) **Additional regulatory exemptions.**

- (a) **Inexpensive lots.** The sale or lease of a lot for less than \$100;
- (b) **Five-year lease.** The lease of a lot for a term of less than five years;
- (c) **Lot sales to developers.** The lease or sale of lots to developers;
- (d) **Adjoining lot.** The sale or lease of lots to a purchaser who owns an adjoining lot that has a building on it;
- (e) **Lot sales to government.** The sale or lease of real estate to a government agency; and
- (f) **Sales of leased lots.** The sale of a lot to a person who has leased and resided primarily on the lot for at least the year preceding the sale.³⁷

Even if a developer qualifies for a partial exemption, the developer must still comply with the anti-fraud provisions of ILSA. With respect to the sale or lease, or offer to sell or lease, any Lot not fully exempt, it is unlawful for the developer to use any advertising or promotional materials that would operate as a fraud or deceit upon a purchaser, that would be misleading to purchasers, or that contain any misrepresentation or omission of material facts or untrue statements.³⁸ Also prohibited are representations that roads, sewer, water, gas, or electric services or recreational amenities will be provided or completed by the developer without so stipulating in the contract of sale or lease.³⁹

A developer that qualifies for a partial exemption must also provide the

purchaser with a seven-day right of rescission. Specifically, any contract for the sale or lease of a lot may be revoked by the purchaser or lessee until midnight of the seventh day following the execution of such contract and such contract shall clearly provide this right.⁴⁰ If the purchaser is entitled to a longer revocation period by operation of state law, that period automatically becomes the Federal revocation period and the contract must reflect the longer period. If the purchaser revokes the contract during this “cooling-off period,” the purchaser is entitled to a full refund of all money paid.⁴¹

In general, a developer is not required to submit any documentation or obtain a determination from CFPB to operate under any exemption; however, the developer should maintain records to demonstrate that the requirements of the exemption have been met.⁴²

ILSA Guidelines and Advisory Opinions

The Interstate Land Sales Registration Division publishes Guidelines to clarify policies and positions with regard to the exemption provisions of ILSA and its implementing regulations.⁴³ The Guidelines are intended to assist developers in determining whether or not a real estate offering is exempt from any or all of the requirements of ILSA.⁴⁴

If a developer has questions as to whether or not a project qualifies for any of the exemptions, a developer may obtain an advisory opinion from the CFPB by submitting a request for an advisory opinion with information on the exemption that the developer believes is applicable along with the required filing fee.⁴⁵

Buyer Remedies for Failure of Developer to Comply with ILSA

If the project is subject to ILSA, no exemption is applicable, and a buyer does not receive the Property Report prior to executing the contract, the buyer may rescind the contract within two years of execution.⁴⁶

In addition, a buyer may rescind a contract within two years of executing the contract⁴⁷ unless within 180 days after the buyer signed the contract, the developer delivered a warranty deed conveying the lot free and clear of encumbrances and further provided that the contract contains the following provisions:

(1) **Lot Description:** a description of the lot that makes such lot clearly identifiable and which is in a form acceptable for recording by the appropriate

public official responsible for maintaining land records in the jurisdiction in which the lot is located;

(2) **Notice of Default or Breach:** that, in the event of a default or breach of the contract or agreement by the purchaser or lessee, the seller or lessor (or successor thereof) will provide the purchaser or lessee with written notice of such default or breach and of the opportunity, which shall be given such purchaser or lessee, to remedy such default or breach within 20 days after the date of the receipt of such notice; and

(3) **Refund Amount:** that, if the purchaser or lessee loses rights and interest in the lot as a result of a default or breach of the contract or agreement that occurs after the purchaser or lessee has paid 15 percent of the purchase price of the lot, excluding any interest owed under the contract or agreement, the seller or lessor (or successor thereof) shall refund to such purchaser or lessee any amount which remains after subtracting (A) 15 percent of the purchase price of the lot, excluding any interest owed under the contract or agreement, or the amount of damages incurred by the seller or lessor (or successor thereof) as a result of such breach, whichever is greater, from (B) the amount paid by the purchaser.

In order to effect the rescission, the buyer should inform the developer in writing of their decision to cancel the contract and receive a refund.⁴⁸ In the event that a developer refuses to cancel the contract or issue a refund, a buyer should contact the CFPB.⁴⁹

Upon rescission, the buyer is entitled to all money paid under the contract (if the property is in similar condition).⁵⁰ Attorney's fees, costs, and appraiser fees may also be recovered.⁵¹

Developer Penalties

The CFPB may issue a suspension order that prohibits the developer from selling a lot in the subdivision and/or may seek injunctive relief for a violation of ILSA.⁵²

ILSA also allows the CFPB to impose criminal penalties of up to five years imprisonment and a fine for a violation.⁵³ And, the CFPB may issue a civil penalty for each violation.⁵⁴

Conclusion

ILSA was enacted to protect buyers from fraud and abuse. Developers should

be careful to review ILSA at the beginning stage of project entitlement. Failure to do so could result in contract rescission, suspension of sales, and civil and criminal penalties. Federal regulations for registration and exemption are found at 24 C.F.R. §§ 1701 et seq., as well as online at http://www.access.gpo.gov/nara/cfr/waisidx_01/24cfrv5_01.html. The CFPB's exemption guidelines may be found online at <http://www.hud.gov/offices/hsg/ramh/ils/ilsexemp.cfm>. Developers should review the guidelines and/or seek an advisory opinion if there are questions about the applicability of ILSA and/or any of its exemptions.

ENDNOTES:

¹Gov. Code, §§ 66410, et seq.

²Bus. & Prof. Code, §§ 11000 to 11200.

³Civ. Code, §§ 4000 to 6150.

⁴15 U.S.C.A. §§ 1701 et seq.

⁵15 U.S.C.A. § 1702.

⁶15 U.S.C.A. § 1702(b).

⁷6 Fed. Reg. 43569 (July 21, 2011).

⁸15 U.S.C.A. § 1701(3).

⁹15 U.S.C.A. § 1701(4).

¹⁰15 U.S.C.A. § 1703(a).

¹¹15 U.S.C.A. § 1703(a)(2).

¹²15 U.S.C.A. § 1708(a)(1).

¹³Cal. Dept. of Real Est., Subdivision Public Report Application Guide (Rev. June 2011), at p.7.

¹⁴*Id.* at p.46.

¹⁵15 U.S.C.A. § 1702(b).

¹⁶15 U.S.C.A. § 1702(a)(1).

¹⁷United States Department of Housing and Urban Development, "Full Disclosure Act Exemptions," https://www.hud.gov/program_offices/housing/rmra/ils/ilsexemp.

¹⁸15 U.S.C.A. § 1702(a)(2).

¹⁹United States Department of Housing and Urban Development, "Full Disclosure Act Exemptions," https://www.hud.gov/program_offices/housing/rmra/ils/ilsexemp.

²⁰15 U.S.C.A. § 1702(a)(3).

²¹United States Department of Housing and Urban Development, "Full Disclosure Act Exemptions," https://www.hud.gov/program_offices/housing/rmra/ils/ilsexemp.

²²15 U.S.C.A. § 1702(a)(4).

²³15 U.S.C.A. § 1702(a)(5).

²⁴15 U.S.C.A. § 1702(a)(6).

²⁵15 U.S.C.A. § 1702(a)(7).

²⁶15 U.S.C.A. § 1702(a)(8).

²⁷15 U.S.C.A. § 1702(b)(1).

²⁸United States Department of Housing and Urban Development, “Full Disclosure Act Exemptions,” https://www.hud.gov/program_offices/housing/rmra/ils/ilsexemp.

²⁹15 U.S.C.A. § 1702(b)(2).

³⁰15 U.S.C.A. § 1702(b)(3).

³¹15 U.S.C.A. § 1702(b)(4).

³²15 U.S.C.A. § 1702(b)(5).

³³15 U.S.C.A. § 1702(b)(6).

³⁴15 U.S.C.A. § 1702(b)(7).

³⁵15 U.S.C.A. § 1702(b)(8).

³⁶15 U.S.C.A. § 1702(b)(9).

³⁷12 C.F.R. § 1010.14.

³⁸15 U.S.C.A. § 1703, subd. (a)(2).

³⁹15 U.S.C.A. § 1703, subd. (a)(2).

⁴⁰15 U.S.C.A. § 1703, subd. (c).

⁴¹United States Department of Housing and Urban Development, “Full Disclosure Act Exemptions,” https://www.hud.gov/program_offices/housing/rmra/ils/ilsexemp.

⁴²12 C.F.R. § 1010.4.

⁴³United States Department of Housing and Urban Development, “Full Disclosure Act Exemptions,” https://www.hud.gov/program_offices/housing/rmra/ils/ilsexemp.

⁴⁴United States Department of Housing and Urban Development, “Full Disclosure Act Exemptions,” https://www.hud.gov/program_offices/housing/rmra/ils/ilsexemp.

⁴⁵12 C.F.R. §§ 1010.17, 1010.35.

⁴⁶15 U.S.C.A. § 1703, subd. (c).

⁴⁷15 U.S.C.A. § 1703, subd. (d).

⁴⁸15 U.S.C.A. § 1703, subd. (d).

⁴⁹ <https://www.consumerfinance.gov/complaint/> TTY/TDD: (855) 729-2372.

⁵⁰15 U.S.C.A. § 1703(e); 12 C.F.R. § 1011.5.

⁵¹15 U.S.C.A. § 1709(c).

⁵²15 U.S.C.A. § 1714(a).

⁵³15 U.S.C.A. § 1717.

⁵⁴15 U.S.C.A. § 1717a(a)(2).