Felhaber Larson Fenlon & Vogt
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REAL ESTATE REPORT

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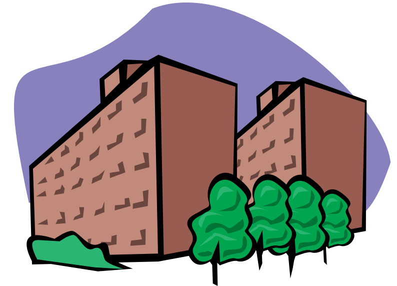
THE INTERSTATE LAND SALES ACT; TRAP FOR THE UNWARY

Recent cases decided by the U.S. District Court for the Southern District of Florida have raised serious questions regarding the availability to builders and developers of the so called "100 Lot Exemption" under the federal Interstate Land Sales Full Disclosure Act (the "ILSA"). The ILSA is a federal statute, administered by HUD, that governs the offer and sale of residential and commercial parcels of real estate, defined in the ILSA as "lots," to consumers, utilizing any means of interstate commerce. The term "lots", by definition, includes condominium, townhouse and cooperative units, as well as platted lots and other parcels of real estate. The ILSA requires that the offer or sale of unimproved lots (1) must be registered with HUD, or (2) must be offered or sold under an exemption from the ILSA.

Historically, the ILSA has not been a prominent factor for builders and developers because exemptions are often available and no registration or other action is required to qualify for an exemption. One of the most common exemptions is the "100 Lot Exemption," which exempts the offer or sale of fewer than 100 lots in any single project.

In summary, the Florida courts held that in order to qualify for the 100 Lot Exemption the purchase agreement for the lot must contain certain ILSA buyer-protection provisions, as follows: (1) that the buyer has a 20-day cure period following a notice of a default, and (2) that, in the event of a buyer default, the seller may retain deposits or payments made by the buyer in the maximum amount equal to 15 percent of the purchase price, exclusive of interest, or the amount of the seller's actual damages, whichever is greater. Previously, consistent with the position taken by HUD, such provisions were not required to be used in the purchase agreements.

Under the Florida courts' rulings, a failure to include the mandated language in a purchase agreement provides to the buyer a variety of remedies, the most critical of which is the right to rescind the purchase agreement. This rescission right may be exercised by the buyer at any time within two years following the date of signing the purchase agreement, regardless of whether the purchase transaction has closed. This presents a significant down-side risk for builders and developers if the Florida courts' position is adopted in Minnesota or nationally.



There are various factors for a builder or developer to consider in determining what, if any, action to take with respect to its purchase agreements in projects with fewer than 100 lots. Some of the most common factors to consider are: (1) the Florida court decisions are not yet the law in other jurisdictions such as Minnesota, but there is some risk because the issue has now become visible to buyers and their attorneys; (2) in projects currently under development, changing purchase agreements may raise a "red flag" with buyers or their legal counsel; and (3) in new projects, the mandated language can be used with little negative impact on the seller, except to the extent that the deposit exceeds 15 percent of the purchase price.

Despite the fact that the court decisions affect only the Florida jurisdiction, the decisions present a serious matter for consideration by builders and developers. The most significant risk lies in the possibility that buyers may be able to successfully assert the previously mentioned two year rescission right. The safest approach in new projects with fewer than 100 lots is to include the mandated 100 Lot Exemption language in the purchase agreements, or to qualify for a different ILSA exemption. As to whether to change the purchase agreement language in current projects, each project should be evaluated on its own merits and a risk/reward decision made by the builder/developer. We are currently assisting our clients in resolving these issues.

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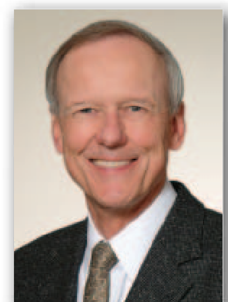

THE PERSONAL SIDE OF PERSONAL GUARANTEES

There is nothing more personal than a personal guaranty.

Business owners often go to great lengths to minimize the risk of personal liability. At a minimum, a prudent business owner will operate his or her business under the protection of a corporation, limited liability company or other form of business entity, buy liability insurance to protect against liability and take steps in the operation of the business to reduce exposure to personal liability.

But, when it comes to borrowing money or obtaining credit, it is often difficult, if not impossible, to avoid going "personal".

Most of us, if put in our lender's shoes, would want the same thing. Our lender wants to make sure we have every incentive to repay the loan, including (and maybe most importantly) the risk of personal liability. A lender's hook into the personal assets of the business borrower is an important part of the deal for the lender and, even in good times, it can be difficult to avoid signing a personal guaranty. Once the guaranty is signed, life is never quite the same again. Being personally liable for a business debt brings cold hearted reality to every business dream.

So, with little chance of avoiding a personal guaranty, are there any strategies for reducing their reach? The answer is yes, but it requires some forethought and planning.

Before we go there, however, there is a bit of comforting information for those business owners who have signed a personal guaranty and own a homestead in joint tenancy with a spouse.

In 2004, the Minnesota Supreme Court decided the case of *Kipp v. Sweno*. The case involved homeowners who obtain a personal judgment against the builder who built their home. After obtaining the judgment, the homeowners sought to foreclose on the builder's home. The builder was married and owned his homestead in joint tenancy with his spouse.

There is a law in Minnesota which protects the homestead against the claims of creditors but only up to $300,000.00 in equity ($750,000.00 if the homestead is used primarily for agricultural purposes). In this case, the creditors claimed that the equity in the builder's homestead exceeded the limit. (At the time this case was decided, the limit was $200,000.) The court ordered the sale of the homestead and the builder appealed. The case raised a number of legal issues, but the issue which carried the day dealt with the fact that the builder owned his homestead in joint tenancy with his spouse. The central question of the case was whether, with a judgment against only the builder, could the creditors foreclose against the couple's homestead and eliminate the interest of the builder's spouse in the homestead?

The Supreme Court said no. The Court carefully analyzed the longstanding policy in Minnesota to protect the homestead and noted that, by allowing this personal judgment to be foreclosed, the joint tenancy between the builder and his spouse would be severed and she would lose her interest in the home even though she was not liable for the debt.

> The holding in *Kipp v. Sweno* protects the homestead owned by spouses in joint tenancy from creditors with a judgment against only one of the joint tenants.

After this case was decided, the legislature expanded the homestead protection by enacting a statute which requires, among other things, that the creditor obtain a court order before attempting to force the sale of the homestead. The court, not the creditor, determines whether or not the owner's equity exceeds the $300,000 ($750,000 for agricultural homesteads) statutory limit. In addition, the statute extends protections not only to non-debtor joint tenants but also to non-debtor life tenants and non-debtors who have the right to inherit the homestead under state statute.

There are also a few things a business owner can do to limit the reach of a personal guaranty. Here are some ideas:

1. **Have More Than One Option**
   When looking to borrow, have more than one option. Some banks and other financial institutions, and some trade creditors, may be willing to limit the reach of a personal guaranty when competing for your business.

2. **Limit the Exposure/Business Partners**
   You may want to ask the lender to limit your exposure under a personal guaranty to your percentage interest in the company. So, for example, if you have three partners and you each own 33.33% interest in the company, ask your lender to limit your liability under

a personal guaranty to one-third of any claimed amount. Some lenders will accommodate such a request.

3. **Spouse as Business Partner**
Consider whether you want to include your spouse as a co-owner of your business. Banks and other lenders typically want all those with an ownership interest in the business to sign a personal guaranty when the business takes out a loan. (Some banks will waive the personal guaranty requirement if the business partner owns 20% or less in the company.) While there are many factors to consider, limiting a spouse's exposure to business debts is an important goal. In the *Kipp v. Sweno* case, if both husband and wife were liable, the homestead would have been lost.

4. **Limit the Length of the Personal Guaranty**
If you will be reducing the amount of the loan over time, you may want to ask your lender to consider limiting the personal guaranty to the first two or three years of the loan with the thought that your real estate or other assets which secure the loan will, at that point, provide adequate protection for repayment to the lender.

5. **Avoid Self Renewing or Blanket Personal Guarantees**
Often, when working with suppliers, a business owner may sign a personal guaranty at the start of the relationship without realizing that this personal guaranty will continue indefinitely or renew automatically. I recently reviewed a 12 year old guaranty which a trade creditor was asserting as a basis for personal liability. You may want to put a sunset date on a personal guaranty or negotiate with the trade creditor to eliminate or limit the reach of the personal guaranty after you have established yourself as a reliable borrower.

Personal guarantees are a reality few business owners can avoid. However, if presented with a guaranty, attempt to limit its scope and impact by requesting reasonable limitations.

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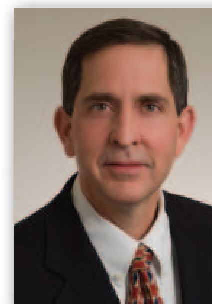


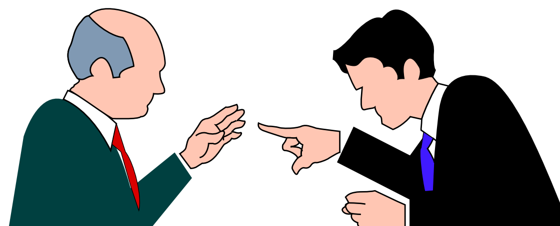
CONSTRUCTION CONTRACTS ARE "PRO CHOICE"

At Least for Dispute Resolution

In late 2007, the construction industry saw the release of both the ConsensusDOCS and revisions to the American Institute of Architects ("AIA") standard form contracts. Significantly, both sets of contracts depart from the trend requiring mandatory arbitration in dispute resolution.

ConsensusDOCS and AIA permit the contracting parties to choose the method for dispute resolution. The new contracts provide that parties can "check the box" to indicate whether arbitration or litigation will be used for the binding resolution of disputes.

This change has not gone unnoticed by the American Arbitration Association ("AAA"). The AAA, with its well-known and widely-used Construction Arbitration Industry Rules, was the primary beneficiary of the prior presumption in favor of arbitration. In response to the change by the AIA and ConsensusDOCS, the AAA has begun a media campaign, including advertising entitled "The Risks of Not Choosing AAA Arbitration in the New AIA and ConsensusDOCS Contracts."



The new ability to select the appropriate method of dispute resolution constitutes an implicit recognition that arbitration is not the best approach in all situations. The presence of "choice" in dispute resolution will require discussion with legal counsel, and will present a topic for negotiation when analyzing AIA or ConsensusDOCS construction contracts.

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Mark Your Calendars!

FELHABER SEMINARS

Plan to attend one of our upcoming seminars, with timely discussions on a variety of legal topics.

Multiemployer Seminar
Thursday, May 29, 2008

HIPAA Training Seminar
Wednesday, June 18, 2008

Labor & Employment Seminar
Friday, October 10, 2008

Approximately one month ahead of the seminar date, you can register online at www.felhaber.com and review the event's agenda.

Log on to www.felhaber.com for more seminar information.

Catherine Sjoberg, Felhaber attorney, serves as editor of this publication. Please contact her at csjoberg@felhaber.com if you have any story ideas or comments you would like to share.

Real Estate Report

The Real Estate Report is an update on legal developments. It is not intended to be legal advice and should not be relied upon without consulting competent legal counsel.

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