



REAL ESTATE ALERT

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Recent Federal Court Ruling on Rescission of Condo Deposits

- Implications for developers, sponsors and lenders
- Why now is the time to review offering plans and contract forms

A federal court judge in Manhattan this week allowed a buyer to rescind his condo sales contract and recover his deposit, even though he had defaulted on the terms of the purchase agreement. The ruling was the latest by a federal court to apply the Interstate Land Sales Full Disclosure Act (ILSA)—an act originally intended to prevent fraud in sales of undeveloped land—to apartment sales in New York. The ruling was particularly curious—and potentially damaging to condo sponsors and their lenders—because the developer had attempted to comply with ILSA by filing the required documents with the Department of Housing and Urban Development. If upheld on appeal, the ruling has the potential to drastically change the way in which New York condo units are sold and recorded.

ILSA requires that the property description be in recordable form, but the court, recognizing that a property description is not recordable in New York, ruled that the contract of sale had to be recordable instead. But in New York, contracts are not normally recordable (in fact, they're normally prohibited from being recorded) because doing so would create a lien on the unit. Further, in the early stages of an offering, a contract can't even be in recordable form, so you couldn't record it even if you wanted to. This is because in order for a contract to be recordable, it has to have a property description, which requires a tax lot number, and tax lot numbers in New York are not assigned until an offering plan is declared effective and the declaration is filed.

It could be therefore be impossible in the early stages of a deal to meet the requirements as interpreted by this court even if the developer and the lender intended to comply. Even attempted compliance with ILSA may not protect you from having to grant rescission to condominium purchasers.

Although this case will likely be appealed, all contracts in projects subject to ILSA filings in New York, typically those with 100 or more units, would appear to be subject to this decision, even if the developer has otherwise complied with ILSA.

What this means to you:

As a developer, you should re-examine your offering plans and contract forms and make appropriate changes before executing new contract agreements.

As a lender, you should monitor the situation closely.

And in both instances, you should contact competent counsel for help in reviewing existing contracts with buyers who are attempting to rescind.

For more information on this, or other condo/co-op issues, please contact Douglas Heller at (212) 592-1454 or dheller@herrick.com.

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