

2009 HOSPITALITY LAW CONFERENCE

Resorts, Mixed-Use Projects, and Recreational Amenities: Legal Trends in Formation, Governance, and Operations



Presented on February 10, 2009 by:

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Presenters



- Maxine Hicks, Member of the firm, Managing Partner of the Atlanta office and Chair of the National Real Estate Practice Group
- She has extensive experience in the acquisition, development, leasing, state and federal regulation of real property, mixed-use community governance and municipal matters.
- Ms. Hicks has been identified in 2005, 2006, 2007 and 2008 as a “Georgia Super Lawyer” and one of the “Top 50 Women Lawyers in Georgia.”



Resorts, Mixed-Use Projects and Recreational Amenities

- I. Introduction
- II. Establishing the Resort Structure and the Relationship among the Resort Components
- III. Establishing a Club Component in a Planned Development
- IV. Establishing a Land Sales Compliance Program



Establishing the Resort Structure: *Preliminary Considerations*

- Governance structure must enable and facilitate the developer's plans.
- Considerations:
 - Identify the components:
 - Lots, condominiums, hotel, recreational facilities, golf, club, timeshare, etc.
 - Plan of disposition for each component
 - Always have an exit strategy. The importance of a well planned exit strategy is emphasized by the current market.



Establishing the Resort Structure: *Common Types*

Determine Governance Structure

- No association
 - Reserve rights and powers to developer, including right to establish an owners association at a later date.
- Single association
- Multiple associations
 - Separate associations for different types of uses (e.g., commercial, residential)
 - Master/sub-associations
 - Condominium associations
 - Tax exempt service organization
 - Special tax districts
- Committees/Agreements
 - Joint Use Committee
 - Cost Sharing Agreements
- Club membership programs
 - Equity or Non-equity
 - Mandatory or voluntary membership



Establishing the Resort Structure: *Factors Impacting Resort Structure*

- State law
- Zoning, development authority and similar conditions
- Pre-existing covenants and other seller imposed conditions
- Number and diversity of resort components



Establishing the Resort Structure: *Factors Impacting Resort Structure (continued)*

- Obligations to be fulfilled
 - Preserve appearance and standards of maintenance in resort
 - Provide shared facilities and services
 - Facilitate resort operations, conduct special events, promotion of the resort
 - Collection of assessments
 - Enforce architectural controls and use restrictions



Establishing the Resort Structure: *Factors Impacting Resort Structure (continued)*

- Developer's exit strategy
- Additional or ancillary relationship considerations:
 - Are any areas or amenities shared with adjacent land owners?
 - Management agreements
 - Operation and maintenance of master resort
 - Reciprocal Easements
 - Architectural controls
 - Brand standards and enforcement rights



Establishing the Resort Structure: *Trends*

- Authorize and integrate green technologies and recycling activities
 - Architectural requirements
 - Geothermal technology
 - Methodologies to conserve energy and water use
- Imposition of transfer fees/community enhancement fees



Establishing the Resort Structure: *Trends* (continued)

- Brands managing or participating in development of the resort
- New ways to maintain greater control:
 - Retain ownership of amenities – form mandatory private clubs
 - Air rights condominium hotel – hotel and amenities not included in the condominium



Establishing the Resort Structure: *Trends* (continued)

- More complex resort structures
 - Multiple product types offered in a single resort
 - Multiple organizations to permit interaction and integration of various components
 - Cross utilization and/or club concepts to permit use of amenities and facilities in the family of resorts



Establishing the Resort Structure: *Trends* (*continued*)

- **Preserve flexibility**

- Not a new trend, but increasingly important in these economic conditions
- Rights to respond to market demands and conditions

- **Distressed Properties**

- Due diligence in the acquisition of distressed property requires a careful review of the governing documents.
- What rights may be acquired by a successor developer?
- Does the developer have unilateral amendment rights?
- What responsibilities and obligations will be inherited?
- When do the developer's rights terminate as to:
 - The right to add or withdraw property;
 - Control of the owners association;
 - Establishing architectural controls?
- For condominiums, what is the Declarant's ability to terminate the condominium. For example, to convert a distressed condominium into rental apartments?



Establishing the Resort Structure: *Trends* (continued)

- Planning up front helps provide increased flexibility throughout the life of the project and improve exit options at the end of the project



Special Issues with Club Component / Amenities in Planned Development

Options for ownership of recreational amenities:

- Private Club
 - Non-equity right to use
 - Equity Club
- Ownership by Homeowners Association (Bundled Membership)



Equity vs. Non-Equity Club

- **Equity Club**
 - Members have an ownership interest in the club
 - Member responsibility for governance of club and for its financial obligations
 - Potential for upside or downside as value of membership fluctuates
- **Non-equity Club**
 - Developer, through separate club entity, owns and controls management of the club
 - Members not subject to capital or operating assessments
 - Easier to enter into reciprocal arrangements using non-equity club



Membership Payment

- Membership Deposit: Club has obligation to refund a fixed percentage (typically 80% to 100%) of the member's deposit at a time certain in the future (typically 30 years); favorable tax treatment on the refundable portion of the deposit; refund upon resignation of membership typically occurs on a 4-to-1 basis;
- Membership Fee: Amount paid to club is non-refundable; often used for lesser expensive membership classifications;
- Membership Contribution: Term typically used for equity club membership acquisition



Mandatory vs. Voluntary Membership

- **MANDATORY**

- Membership in the club is required for all residential lot/unit owners
- Requires the recordation of mandatory membership provisions either in the CCRs, the deed of conveyance of each lot/unit or in a separate Club Declaration

ADVANTAGES

- Ensures initiation fees and dues income stream
- Non-payment of dues could be assessed against lots/units;
- Less uncertainty about membership and users of amenities over long term

DISADVANTAGES

- Potential restraint upon alienation issues if dues increases or future initiation fees become unreasonable
- Potential marketing issues



Mandatory vs. Voluntary Membership (*continued*)

- **VOLUNTARY MEMBERSHIPS**

ADVANTAGES

- No potential concern with having to sell a lot or unit together with a club membership
- No concerns about restraint upon alienation issues

DISADVANTAGES

- No guarantee as to number of memberships issued
- Members may resign the membership in the future



Club Membership Documents

Club Membership Documents—focal point of implementation of the membership structure

- i. Membership Plan—sets forth the terms of membership privileges and obligations
- ii. Rules and Regulations—the general rules for use of the club's facilities, guest privileges, charging privileges, and related matters;
- iii. Membership Application—relevant background questions of prospective members;
- iv. Membership Agreement—establishes the member's obligation to pay an initiation deposit or fee, as well as the club's obligations related to transfer of the membership;
- v. FAQs—Summary of frequently asked questions with answers;
- vi. Schedule of Dues, Fees and Charges; and
- vii. Membership Certificates.



Exit Strategies for Non-Equity Clubs

- Equity Conversion—Membership plan would provide the option, but not the obligation, to convert club to equity-owned club at a date certain or upon issuance of certain number of memberships; plans typically set up to cause equity conversion to occur unless a substantial majority of members petitioned not to convert
- Reserved right to convey club to homeowners association
- Right of First Offer/First Refusal
- Private Sale of club



Escrow of Membership Deposits

- When club memberships are sold prior to construction of some or all of the facilities, the initiation fees are escrowed to reduce the likelihood that the deposit will be considered to be “at risk” and that the sale of club memberships will be considered a security
- Release of fees can be phased as amenities are completed
- Important to determine status of escrowed funds as part of due diligence in acquisition of distressed development with club



Important Provisions to Review When Examining Existing Membership Documents for Developments/Clubs to be Acquired

- Right to create additional classes of memberships
- Right to conduct promotional events/issue promotional memberships
- Memberships should be able to be issued to an entity or multiple owners of lot/unit
- Right of club to establish reciprocal use agreements with other clubs
- Exit strategies available
- Right to amend the club membership documents
- Rights of first offer/first refusal/other member rights upon transfer of club
- Limits on number of memberships to be issued
- Promises for delivery of future amenities
- Accounting of Membership Deposits/Refund obligations



Special Considerations for Marina Governance

Relevant factors in evaluating value and options of marina:

- Terms, conditions, and restrictions of governmental permits and approvals
- Evaluation of relationship of marina to balance of project
- Existence of amenities governance structure for other associated project amenities
- Existing Commitments to other project stakeholders



Marina Governance Options

- **Long-term Leaseholds of Slips**

ADVANTAGES

- Relatively simple ownership structure;
- Ensures a stream of leasehold income to developer;

DISADVANTAGES/CHALLENGES

- Potential liability issues of private ownership of marina;
- Long term leases may be inflexible over time and short-term leases allow owners to terminate;



Marina Governance Options (*continued*)

- **Dockominium**

ADVANTAGES

- Allows developer to sell property interests up front and generate profit on the marina;
- Ownership interests are freely alienable;

DISADVANTAGES/CHALLENGES

- Documents must comply with the state condominium act, including restrictions on control of the Association;
- The underlying governmental permits may cloud title to the transfer of a dockominium interest;



Marina Governance Options (Part Two)

- **Marina Association**

ADVANTAGES

- Creates a nonresidential owners association that is not subject to the requirements of the condominium act or homeowners statutes; association control by developer can continue for lengthy period of time;
- The marina association can assess the slip owners for maintenance, minimizing risk of developer subsidization of the marina;
- Ability to limit membership of marina association (and ability to use the docks) to certain parties, such as project lot owners;

DISADVANTAGES/CHALLENGES

- Only an easement use right can be conveyed to use the Slip—less of an interest than in a dockominium conveyance;
- Association administration requirements;



Marina Governance Options (Part Two *continued*)

- **Club Membership**

ADVANTAGES

- Affords control over slip transfers/operations of the marina
- Exit strategy upon sell-out of all units;
- Restricts the private slips to certain members;
- Potential appreciation in value if equity club;

DISADVANTAGES

- Cumbersome administration requirements;
- Difficult for club members to transfer their interests;
- Potential depreciation in value



Current Considerations with Lake Clubs/Marinas/Yacht Clubs

- Permitting battles and opposition
- Protection of endangered species such as right whales and manatees
- Dockominiums and the Public Trust Doctrine
- Technology Agreements for Marinas
- Parking Issues and Permission of Liveaboards
- Additional challenges with fuel dispensing
- Dredging, control of water bottoms, and ownership of upland



Implementing a Land Sales Compliance Program - Federal

- **Interstate Land Sales Full Disclosure Act, 15 U.S.C. § 1701, et seq. (“ILSFDA”)**
 - Enacted in 1968, effective April 28, 1969, ILSFDA was patterned after the 1933 Securities Act
 - Consumer protection statute
 - Administered by the United States Department of Housing and Urban Development (“HUD”)



Implementing a Land Sales Compliance Program – Federal *(continued)*

- **Full Exemptions**

- Exempt from all provisions of ILSFDA.
- Commonly used Full Exemptions:
 - (Less than) 25 Lot Exemption
 - Improved Lot Exemption
 - Sales to Builder Exemption

- **Partial Exemptions**

- Exempt from registration with HUD but not from prohibition on unlawful or misleading sales practices and contract disclosures (“Anti Fraud Provisions”).
- Commonly used Partial Exemptions:
 - Single-Family Residence
 - (Less than) 100 Lot Exemption
 - Twelve Lot Exemption
 - Intrastate Exemption



Implementing a Land Sales Compliance Program – Federal *(continued)*

- **Combining Exemptions**
 - Certain exemptions can be combined:
 - **EXAMPLE:** A subdivision of 125 lots would be exempt from registration under ILSFDA if:
 - 99 lots sold to individual purchasers (100 Lot Exemption),
 - 16 lots sold to builders (Sales to Builder Exemption), and
 - 10 lots sold with an obligation of the seller to construct a home on the lot within 2 years (Improved Lot Exemption).



Implementing a Land Sales Compliance Program – Federal (*continued*)

- **Registration**

- Prepare and Submit a Statement of Record (“SOR”) to HUD
- SOR includes 2 primary components
 - Property Report
 - Additional Information and Documentation (“AID”)
- 30 Day Review Period
- Filing fee of \$800 (if less than 201 lots) to \$1000 (if 201 or more lots)



Implementing a Land Sales Compliance Program – Federal (*continued*)

- **Property Report**

- Includes a description of the infrastructure and amenities, construction schedules, restrictions on use of a lot, real estate taxes, title encumbrances, and costs associated with the purchase of a lot.
- A current effective Property Report must be provided to a purchaser before a contract is signed or the contract will be open to rescission by purchaser for up to 2 years, which right survives closing.
- The purchaser must acknowledge receiving the Property Report by signing a receipt.

- **AID**

- Contains the supporting information and documentation for the disclosures made in the Property Report.
- Not distributed to purchasers.



Implementing a Land Sales Compliance Program – State

- **If marketing outside the situs state**

- About half the states in the U.S. require some form of registration prior to permitting the offer or sale of out-of-state subdivided land in the state (“Closed States”).
- Compliance with ILSFDA is separate and distinct from compliance with state land sales laws - exemption from ILSFDA does not mean a project will be exempt from a state’s land sales laws.
- Registration requirements vary between states and based on product type (e.g., completed homes, unimproved lots, condominium units).
 - State registrations often require one or more of the following:
 - A disclosure document (e.g., a public offering statement);
 - An application;
 - Project and purchase documents;
 - Title evidence;
 - Advertising materials; and
 - A registration fee. State fees range between \$100 to \$30,000 per registration.



Implementing a Land Sales Compliance Program – State *(continued)*

- **Triggering State Jurisdiction**

- Typically, advertising in, mailing information or documents into, or directing any communication into the state (mail, e-mail, telephone), even in response to an unsolicited request for information, will subject a developer to the land sales laws of such state.



Implementing a Land Sales Compliance Program – State *(continued)*

- **Exemption from State Land Sales Laws**
 - Exemption from or registration under the ILSFDA does not provide an exemption from registration under state laws
 - Some states provide an exemption based on size, often for projects of 25 lots or less
 - Some states provide an exemption similar to the federal Improved Lot Exemption
 - Exemptions under state law may not be self-determining; in some cases, application for exemption and an order confirming the exemption may be required
- **Abbreviated State Registrations**
 - Some states provide a shorter registration process for subdivisions registered under ILSFDA.
 - Many states allow the submission of a Federal SOR in lieu of some of the state registration requirements (i.e., the federal Property Report may be submitted in lieu of a state specific public offering statement).



Implementing a Land Sales Compliance Program – Federal and State

- **Foreign property marketed in the U.S.**
 - The applicability of ILSFDA and state land sales laws are to a transaction is determined by where the offer/sale activity occurs, not by the location of the property.
 - Property located outside the United States, but marketed within the United States may be subject to ILSFDA and the land sales laws of market states.



Implementing a Land Sales Compliance Program – Federal and State *(continued)*

- **Violations of ILSFDA and State Land Sales Laws**
 - ILSFDA - Penalties include, without limitation, contract rescission, specific performance, civil penalty of \$1,000 per violation up to a maximum of \$1,000,000 per person, per year and criminal penalties up to \$10,000 and/or imprisonment up to 5 years.
 - States – vary, typically include contract rescission, civil penalties, and/or criminal penalties.



Implementing a Land Sales Compliance Program – Federal and State *(continued)*

- **Distressed Property**

- Land sales violations by a predecessor developer could effect successor developers.
 - For example, sales contracts assumed by the successor developer may be open to rescission by purchasers.
 - Failure to provide a Property Report, opens contracts up to a 2 year right of rescission – this right survives closing.



Implementing a Land Sales Compliance Program

- **Use of ILSFDA by Purchaser's Counsel.**
- Technical violations
 - For example, arguing that a Property Report fails because a required disclosure was included in the wrong section of the Property Report.
 - Failure to provide a fully executed Cost Sheet.
- Substantive violations
 - For example, the failure to include required disclosures in the Property Report.
 - Failure of the sales contract to include required provisions.
 - Failure to include the 7 day rescission disclosure.
 - Inclusion of an overly broad *force majeure* provision in a contract purporting to comply with the Improved Lot Exemption.



Implementing a Land Sales Compliance Program *(continued)*

- **Improved Lot Exemption.**
 - The contract must not negate the purchaser's right to specific performance.
 - The contract may allow for a delay in the two-year build period *only* for reasons legally recognized as defenses to contract actions in the situs state.
 - There has been a lot of litigation on whether a contract relying on the Improved Lot Exemption really obligated the seller to complete construction within two years.
 - In Samara Dev. Corp. v Marlow, 556 So.2d 1097, (Fla., Feb. 8, 1990), the Florida Supreme Court ruled that the contract must contain an unconditional commitment to complete construction within 2 years. This decision is very pro-consumer protection.
 - Some courts have distinguished Samara or refused to follow it, however it remains good law.
 - Many court's are looking at the *force majeure* provisions of contracts. If the *force majeure* provision is too broad the protection of the Improved Lot Exemption is lost and the contract may be open to rescission by the purchaser.



Implementing a Land Sales Compliance Program (*continued*)

- **100 Lot Exemption**

- Pugliese v. Pukka Development, Inc., 2008 WL 5142296, (C.A.11 (Fla.), Dec. 09, 2008).
 - This case involved a condominium developer that relied upon the 100 Lot Exemption.
 - The District Court held that the 100 Lot Exemption does not include exemption from the contract requirements under 15 U.S.C. §1703(d).
 - legal description, notice and cure period, and cap on damages.
 - The District Court disregarded an opinion letter from HUD.
- The U.S. Court of Appeals reversed the District Court, holding that a project partially exempt under ILSFDA is not subject to the contract requirements under §1703(d).
 - The Court of Appeals found that the buyer's reading of ILSFDA improperly added language to the statute.
 - The United States filed an *amicus* brief supporting the position that ILSFDA does not require the contract provisions to be included.



CASE STUDY: Issues for Consideration

Illustrative Mixed-use Resort



Major Components:

- Stand-alone retail village
- Residential Condo Units above retail units
- Golf Course
- Marina
- Water Park
- Hotel and Conference Center
- Structured Parking Facility



Governance Structure Considerations

- Adoption of Comprehensive Overlay Governance REA/Declaration
- Imposition of Design Standards/Architectural Controls/Use Restrictions
- Addressing Cost-Sharing Obligations
- Special Issues with Mixed-Use buildings;
- Requirements/Standards Related to recreational amenities



Amenities Governance

- Basic Club establishment
- Options for relationship between hotel amenities and club amenities
- Golf as included, upgraded, or separate membership
- Marina club membership/governance options
- Maintaining flexibility/reserving rights/promotional use



Land Sales Component

- Interstate Land Sales Act with respect to lots and condominium units
- Common promotional plan and applicability of exemptions
- Sales contract terms and disclosures
- State land sales regulation



Summary Points

- Importance of assessing stakeholders and interests at outset
- Mixed-use resort projects—many interrelated moving parts
- Lack of interrelationship of key resort components may hinder future development options

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