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SOLVING THE PUZZLE

GUEST EDITOR

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Public Offering Statements – Necessary Evil or Protective Shield Against Liability?

Real estate disclosure laws for New Jersey common interest communities have been in effect since the advent of the New Jersey Planned Real Estate Development Full Disclosure Act ("PREDFDA")[1] in 1977. Moreover, "retirement communities" have been required to register offering materials since 1970 pursuant to the New Jersey Retirement Community Full Disclosure Act.[2] Beginning in 1990, out of state residential developments offered for sale in New Jersey have been governed by the Real Estate Sales Full Disclosure Act[3] since 1990 and previously by its predecessor statute.

During this evolution of over 30 years, various lessons have been learned the hard way by developers of both regulated and unregulated projects who have failed to adequately disclose material adverse facts to prospective purchasers.[4] Unfortunately, many builders, especially those who have not been threatened with exposure to substantial liability under these laws or under the New Jersey Consumer Fraud Act[5] have failed to appreciate the prophylactic impact of a well-crafted public offering statement. Rather they often mistakenly view the document as just another governmental approval and obstacle that must be obtained and overcome for the fruition of the development.

On the front end, the legal fees and related costs for the public offering statement (the "book") and the timing of the registration are the paramount and often sole concerns for many inexperienced builders. Insulation against potential liability for inadequate disclosure claims by the unit owners or their condominium or homeowner associations is relatively unimportant and often escapes these developers completely. However, the fact that these claims include the potential for double or treble damages under PREDFDA and the New Jersey Consumer Fraud Act usually commands their attention.

Although public offering statements can only provide limited protection against construction defect and warranty claims, full and expansive disclosure of other salient facts can effectively help protect a developer against many other types of claims. Specifically, I would list for the unwary several areas of potential liability to which they may be more vulnerable and which adequate disclosure in the public offering statement may help to avoid.

1. *Association budgets* that either "lowball" the estimated costs or fail to adequately detail the basis for each line item in the foot notes.

2. *Reserve schedules* that omit (i) basic physical components that will need replacement and/or (ii) provide for unrealistic useful lives. For instance, the failure to provide for roof replacement or a 50-year useful life for a roof would be good examples.

Page 4

3. *Adverse physical or environmental conditions* that may impact upon the value or enjoyment of the property. The Nobrega and Strawn case cited in Note 4 are typical examples. Although the New Residential Construction Off Site Conditions Disclosure Act[6] affords protection against liability for off-site conditions, the public offering statement is the key to avoiding liability for on-site circumstances such as radon, chemical contamination which has been remediated, the risk of golf balls in golf course communities, future construction that may block a view or significantly increase traffic or noise (i.e. a shopping center).

4. *Security issues* such as the staffing of gate houses and the number and designation of which hours security will be provided. Both gatehouses and roving security operations should be addressed in detail, as well as any differences in staffing or cost between the construction period and after the development is completed.

5. *Community services* to be provided and the salient facts as to the means and cost for same, i.e. (i) whether bus service for an active adult community includes the purchase or lease of the bus, or (ii) if the irrigation system of a community included both individual and common property and to what extent.

6. *Sponsor's subsidy of operating deficits* is a very precarious issue and must be clearly spelled out as to duration and Sponsor's right to elect to subsidize on an annual basis. Also, the subsidy should expressly exclude unit owner delinquencies or reserve contributions.

7. *Use of Membership Fees or Working Capital Contribution.* If a developer expects to utilize these sources of funds to supplement the cash flow of the Association and to reduce the operating deficit prior to Unit Owner Control, this fact needs to be clearly stated.

The foregoing items are only the tips of the iceberg and there are often many other problem areas that need to be addressed during the preparation of an application for registration and the public offering statement.

Experience dictates that the more disclosure there is in these documents, the less potential there is for liability during transition.

Although sales and marketing concerns are important, my view is that the disclosure of negative facts will seldom result in the loss of a sale of a good product. Hopefully, before any business decisions are made in this regard, there will always be an awareness of the liability for non-disclosure and a sensitivity to the primary pitfalls in the preparation of offering materials.

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[1] *N.J.S.A. 45:22A-21 et esq.*

[2] *N.J.S.A. 45:22A-1 set esq.*

[3] *N.J.S.A. 45:15-16.27 et seq.*

[4] *See Nobrega v. Edison Glen Associates, 167 N.J. 520, 2001 involving failure to disclose a nearby Superfund site and Strawn v. Canuso, 140 N.J. 43, concerning non-disclosure of a nearby abandoned hazardous waste site.*

[5] *N.J.S.A. 56:8-1 et seq.*

[6] *N.J.S.A. 46:3C-1*

Page 5