

Faulty Condo Disclosure Cancels Sale

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(This article originally appeared in the March 31, 2005 issue of the *Washtenaw Business Review*)

Condominium developers must fully understand the information required in a disclosure statement since state courts have forced developers to cancel purchase agreements and refund down payments to buyers because the documents were incomplete.

Michigan law requires that developers provide buyers with specified information and that the buyer has nine business days after receiving it to withdraw from the sales agreement. The nine-day window begins when all of the information is provided.

A recent Michigan Court of Appeals case, *Shinney v. Cambridge Homes*, illustrates the importance of a proper disclosure statement.

The case involves a common practice among Michigan developers and builders: The developer contracts to sell the unit (without building) with a minimal or no down payment. The builder contracts with the buyer to build the dwelling (or the interior improvements), with the buyer making a substantial down payment to the builder.

Although the builder and developer are usually separate entities, the unit purchase agreement and the building contract often refer to each other, contain cross-default provisions, and are executed at the same time. The intent is often that the developer will not sell the unit to the buyer unless the buyer enters into a building contract with one or more designated builders that may be related in some way to the developer.

Because of the close relation and integration of the documents, courts tend to view the dual contract arrangement as a single transaction in which all of the terms are reviewed to discover the intent of the parties.

One reason for the dual contract arrangement is to avoid the legal requirement that the owner's down payment to a condo developer be escrowed and not released until the "must be built" are completed. "Must be built" are common elements maintained by the condo association such as roads, utilities, clubhouse, pool, sidewalks, or entrances.

Since the developer and builder may want to use the deposit immediately, the bulk of the down payment is paid directly to the builder as part of the building contract. Only a small deposit, if any, is paid to the developer and held in escrow. This approach is entirely legal. However, there are pitfalls for the builder and developer.

In *Shinney*, the developer and builder were separate entities. Each had its own contract with the buyer; and, importantly, the buyer paid a \$100,000 down payment to the builder. The buyer sued the developer and builder, seeking to withdraw from the agreements and obtain a refund.

Because the developer failed to include the address and prior condominium experience of the builder in its disclosure statement, the court allowed the owner to withdraw from the unit purchase agreement.

The court also permitted the owner to recover its deposit from the builder (and not the developer) because the deposit had been paid to the builder. The withdrawal and refund were granted by the court even though the nine-day withdrawal period had expired because the court ruled that the withdrawal period did not commence until all of the required information was provided by the developer to the buyer.

Other critical information easily missed by developers when preparing disclosure statement includes:

- Prior experience with condominium projects of any management agency or real estate broker.
- Legal proceedings involving the condominium project or the developer.
- Other material information that informs the buyers about the unique characteristics of the particular condominium project.
- Factors that might reasonably affect a prospective buyer's decision to accept or reject the offer to purchase the condominium unit.

The *Shinney* case illustrates the huge impact that a defective disclosure statement can have on a developer or builder. It also explains why I often see my associate, condo guru Sandy Sorini Elser, poring over statements for compliance even though developers are typically focused more on getting to market.

Good lawyers understand the balance between legal compliance and the needs of the marketplace, but developers must be aware that failure to provide a complete disclosure statement imposes considerable risk on them.

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