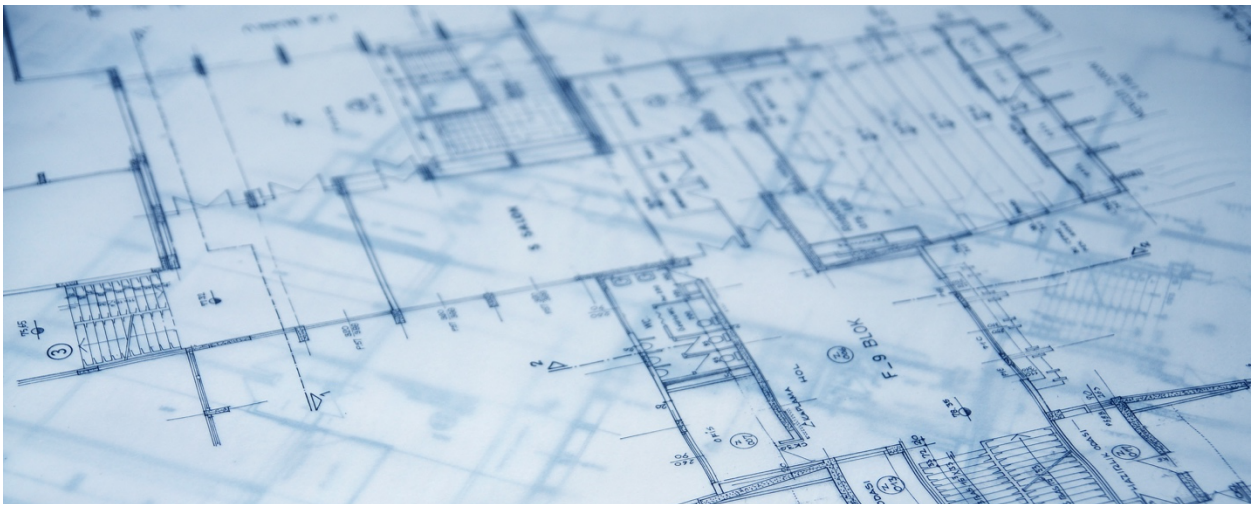
COMMON EXEMPTIONS USED FOR REAL ESTATE SYNDICATIONS AND FUNDS

By Jason Powell, Esq.

Foster Garvey



OVERVIEW

In connection with determining the offering structure and categories of investors for a real estate securities offering, the sponsor and the sponsor's securities counsel must select the applicable securities exemptions upon which the sponsor will rely upon in conducting the offering.

This white paper will analyze a few of the most commonly used exemptions used by sponsors of real estate securities offerings - Regulation D, Rule 506(b), Regulation D, Rule 506(c) and Regulation A+.

REGULATION D, RULE 506(B)

Under Rule 506(b), an issuer may sell an unlimited dollar amount of its securities to an unlimited number of accredited investors and up to 35 non-accredited investors. Among other things, an accredited investor is someone who has $200,000 in annual income ($300,000 if married) or $1 million in net worth (excluding equity in a home). Any non-accredited investors participating in a 506(b) offering must, either alone or with a purchaser representative, have sufficient knowledge and experience in financial and business matters to be capable of evaluating the merits and risks of the prospective investment.

The issuer may not engage in general solicitation or advertising to market a 506(b) offering. Neither general solicitation nor advertising are defined, but there are examples of general solicitation and advertising, including advertisements published in newspapers and magazines, communications broadcast over television and radio and seminars where attendees have been invited by general solicitation or advertising.

An issuer may offer and sell securities to persons with whom it, or anyone acting on its behalf, has a pre-existing substantial relationship. A "pre-existing" relationship is one where the issuer—or someone acting on the issuer's behalf such as through the issuer's principals, a broker-dealer or an investment adviser—has formed a relationship with the prospective investor prior to the commencement of the offering. The existence of a pre-existing relationship is determined based on the specific facts and circumstances of each relationship.

An issuer may also solicit prospective investors the issuer has been introduced to who are members of an informal, personal network of individuals or investors, such as angel investor groups. As a rule of thumb, if all members of the group or network are sophisticated and experienced in the type of investment being offered, an issuer may solicit members of the group without violating the prohibition on general solicitation and advertising.

If an issuer intends to offer or sell securities to unaccredited investors in a 506(b) offering, the issuer is required to provide the disclosures described by Rule 502(b), which include certain financial information and non-financial information. Although the rules on private placements require only that information be furnished to unaccredited investors, in practice given the anti-fraud provisions, an issuer's disclosure package should be provided to all investors, whether accredited or not.

The issuer must provide the disclosure package before the sale of securities. Specific disclosure must be made regarding resale limitations and other restrictions on transferability. An issuer must also make itself available to all prospective investors so that they may ask questions and receive answers concerning the terms and conditions of the offering and obtain any additional information which the issuer has in its possession or may reasonably acquire without unreasonable effort or expense.

REGULATION D, RULE 506(C)

With the adoption of the regulations for Rule 506(c), issuers are now allowed to advertise and generally solicit their investment opportunities to the general public. Under Rule 506(c) there is no limit on the amount of capital that an issuer can raise. Under Rule 506(c), the issuer can create a website to solicit the funds or hold seminars or meetings with potential investors where the issuer can solicit investment funds from those in attendance. This is a significant difference between Rule 506(c) and Rule 506(b). Under Rule 506(b), investors can self-certify by selecting the accredited investor category that the investor qualifies for.

There is, however, one catch under Rule 506(c): the issuer can only accept funds from accredited investors. The verification requirement that all purchasers be accredited investors contrasts with Rule 506(b). This verification rule is a new requirement for Rule 506(c) and is always required if an issuer generally solicits and markets to investors. The U.S. Securities and Exchange Commission (SEC) has set forth four non-exclusive safe harbors that are sufficient for an issuer to show compliance with the verification requirement. The SEC also allows a general principles-based framework in order to determine whether, under the particular facts and circumstances of each case, an issuer has taken reasonable steps to verify investor status. An issuer that fails to meet one of the non-exclusive safe harbors can still rely on a facts and circumstances analysis of the reasonableness of the steps it took to verify accredited status under the general principles-framework.

The following are the four non-exclusive safe harbors issuers rely on to satisfy the verification requirement under Rule 506(c):

1. Analyzing a natural person's US tax documentation to verify income in the past two years, combined with obtaining a written statement of the investor's expectation for income in the current year;
2. Reviewing an investor's consumer credit report and bank and brokerage statements, US credit reports or real estate appraisals to confirm net worth;
3. Using a third-party registered or licensed professional, such as an attorney, certified public accountant, or broker to provide written confirmation that the investor is indeed verified as accredited; or
4. If an investor invested in an issuer's Rule 506(b) offering as an accredited investor before the effective date of rule 506(c) and the same investor and issuer are involved, the issuer is deemed to satisfy the verification requirement in Rule 506(c) by obtaining a certificate from the investor indicating that the investor is an accredited investor.

In general, the safest method is to use a third-party licensed professional to conduct this review and provide the issuer with a verification letter.

Under the general principles-based framework, whether the steps taken to verify investor status are "reasonable" is an objective determination by the issuer in light of the particular facts and circumstances of each investor and transaction.

The factors that the issuer should consider include:

1. The nature of the investor and the type of accredited investor that the investor claims to be;
2. The amount and type of information that the issuer has about the investor; and
3. The nature of the offering, such as how the investor was solicited to participate in the offering, and the terms of the offering, such as a minimum investment amount.

The SEC has indicated that the issuer may rely upon, in addition to other reliable sources, information obtained from publicly available filings with government regulatory bodies, third-party information that is reasonably reliable (such as pay stubs indicating a natural person's income for the last two years) or third parties that are in a position to verify a person's accredited status (such as accountants, securities brokers and attorneys). With respect to the nature of the offering and the manner in which the purchaser was solicited, the greater the general solicitation by the issuer, the greater the measures the issuer must take to verify accredited status. For example, issuers soliciting on a website generally available to the public must take greater measures to verify accredited status than issuers soliciting for an offering with a substantial minimum investment on a website available only to a pre-selected group of high net worth individuals.

Utilizing the principle-based approach to verify accredited investor status means the issuer is relying on the judgment of its team. Taking that approach creates the risk that at any point the SEC might determine that the issuer's judgment was flawed. And if even a single investor has not been properly verified, the issuer may lose its Rule 506(c) exemption.

REGULATION A+

Regulation A + is divided into two tiers, Tier 1 and Tier 2.

TIER 1

Under Tier 1, an issuer can raise up to $20 million in any 12-month period. In connection with any offering under Regulation A, all investors must be provided with, or given information to access, an offering circular. For Tier 1 offerings, this offering circular must also be filed with, and is subject to review and qualification by, the SEC, as well as by the securities regulator in the states where the offering is being conducted.

One notable characteristic of a Tier 1 offering is that issuers relying on Tier 1 need not obtain an audit and do not have ongoing reporting requirements other than a final report on the status of the offering.

TIER 2

Issuers offering securities under Tier 2 can offer up to $75 million in any 12-month period. As with Tier 1, all investors must be provided with, or given information to access, an offering circular. For Tier 2 offerings, the offering circular is subject to review and qualification by the SEC but is not subject to review by state securities regulators.

Issuers offering securities under Tier 2 are subject to ongoing reporting requirements. Like public companies that regularly disclose their financial results, issuers raising money under Tier 2 must also file regular reports with the SEC. Tier 2 issuers are only required to file a semi-annual (Form 1-SA) and annual report (Form 1-K) as well as interim current reports (Form 1-U) upon the occurrence of certain enumerated events.

Securities offered under Tier 2 may be listed on a national exchange to the extent that the issuer applies for listing and meets the listing requirements for that particular exchange. In such circumstances, the issuer is required to comply with more extensive ongoing reporting requirements as if it were a public company including, for example, the requirement to file quarterly reports.

Eligible Securities

Equity, debt and convertible securities (including guarantees of such securities) are eligible for sale under both Tier 1 and 2 of Regulation A +.

Eligible Companies

Only issuers both organized and with their principal place of business in the United States or Canada are eligible to engage in a Regulation A+ offering. An issuer will be considered to have its "principal place of business" in the United States or Canada for purposes of determining eligibility to use Regulation A+ if its officers, partners or managers primarily direct, control and coordinate the issuer's activities from inside the United States or Canada.

The following types of companies cannot use Regulation A+

1. Companies subject to reporting under the Securities Exchange Act of 1934 (Exchange Act), other than voluntary filers;
2. Investment companies and business development companies;
3. Blank check companies;
4. Companies subject to bad actor disqualification;
5. Companies with fractional undivided interests in mineral rights;
6. Companies who failed to file ongoing reports required by Regulation A+; and
7. Companies that are, or have been, subject to an SEC order denying, suspending or revoking the registration of a class of securities within five years before the filing of the offering statement.

Investor Restrictions

If relying on Tier 1, there are no limitations on who can invest or how much one can invest. Under Tier 2, unless the offered securities will be listed on a national securities exchange when the offering is qualified, investors fall into one of the following categories:

Accredited investors; and

1. Non-accredited investors who are subject to investment limits based on the greater of annual income and net worth.
2. Tier 2 issuers are required to inform investors of these investment limitations.

Issuers may rely on an investor's representation of compliance with the limitations, unless the issuer knows, at the time of sale, that the representation is untrue.

Testing the Waters

Issuers can obtain indications of interest from potential investors, a practice known as "testing the waters." An issuer using Regulation A can test the waters both before and after filing the offering statement with the SEC. Marketing materials used after the offering statement has been publicly filed with the SEC must be accompanied by a current preliminary offering circular or contain information on how the most current preliminary offering circular can be obtained. This requirement can be satisfied by providing a website where the preliminary offering statement is available, including the SEC's site, EDGAR.

Issuers must include testing the waters materials as an exhibit to the offering statement when it is either first submitted for nonpublic review or first filed (and must update the exhibit with substantive changes in the testing the waters materials after the initial nonpublic submission or filing). Issuers and intermediaries using testing the waters materials after the offering statement has been publicly filed with the SEC must update and redistribute the marketing materials. To the extent that the materials themselves or the preliminary offering circular become inaccurate or inadequate in any material respect, the materials must be redistributed in a substantially similar manner to how they were originally distributed.

Regardless of whether an issuer tests the waters prior to its offering being qualified, the issuer must deliver a copy of the preliminary offering circular to prospective purchasers at least 48 hours before a sale. Testing the waters marketing materials remain subject to antifraud and other civil liability provisions of federal securities laws.

ABOUT THE AUTHOR

As a results-oriented dealmaker, Jason enjoys creating solutions that bring together great people, projects and capital.

When working on sophisticated business and financing transactions, Jason focuses on the big picture to ascertain his clients' strategic business direction and formulate risk mitigation strategies to protect corporate capital and profitability. His extensive experience includes advising businesses, lenders, investors, startups, and real estate investment companies and developers across the United States, on business transactions from formation to exit, acquisition, due diligence, real estate securities offerings, joint ventures, disposition and financing of real estate.

Passionate about real estate investing, Jason frequently speaks, writes and teaches on the topic, and is also a real estate investor himself. He has authored two books about private money lenders and is working on an eBook focusing on real estate syndication. Jason leads Foster Garvey's Real Estate Funds & Syndications Team.

CONTACT

jason.powell@foster.com | 503.553.3185

Foster Garvey

SEATTLE	PORTLAND	WASHINGTON, D.C.	NEW YORK	SPOKANE	BEIJING
1111 Third Avenue Suite 3000 Seattle, WA 98101	Bank of America Financial Center 121 SW Morrison Street 11th Floor Portland, OR 97204	Flour Mill Building 1000 Potomac Street N.W., Suite 200 Washington, D.C. 20007	100 Wall Street 20th Floor New York, NY 10005	618 West Riverside Avenue, Suite 300 Spokane, WA 99201	821 South Tower Beijing Kerry Center 1 Guang Hua Road Chaoyang District Beijing, PRC 100020
T: 206.447.4400 F: 206.447.9700	T: 503.228.3939 F: 503.226.0259	T: 202.965.7880 F: 202.965.1729	T: 212.431.8700 F: 212.334.1278	T: 509.777.1600 F: 509.777.1616	T: 86.10.8529.9880 F: 86.10.8529.9881