



## **SEC issues first (but not last) response to NAR letter**

December 28, 2007 - Financial Digest

Public comments invited On November 9, the Securities and Exchange Commission (SEC) issued a much-anticipated notice (Release No. 34-56779; File No. S7-26-07) (the "Notice") concerning an application submitted on behalf of the National Association of Realtors (NAR) requesting an exemption from federal broker-dealer registration and reporting requirements under the Securities Exchange Act of 1934 (the "1934 Act").

The notice will certainly be viewed as anti-climactic by those who were hoping for a definitive ruling. However, by formally requesting public comment, the SEC ultimately should benefit from the feedback and analysis certain to be forthcoming from interested parties throughout the securitized tenant-in-common (TIC) industry. Further, it is likely that new issues will be raised during the comment period that will require more consideration than previously thought. Thus, the SEC may not issue a definitive ruling before the end of 2007 as some TIC industry experts were predicting.

**What is NAR Asking For?**

Simply put, NAR is asking that licensed real estate brokers and agents be afforded the opportunity to provide certain advisory services to potential TIC investors and receive compensation for those services without risk of being deemed an unlicensed securities broker-dealer in violation of federal law. The current consensus in the TIC industry is that securities broker-dealers and registered representatives are prohibited from sharing sales commissions or paying referral fees to licensed real estate professionals for client referrals or other services rendered in connection with the offer and sale of TIC securities.

More specifically, the notice includes a variety of restrictions and limitations, including the following:

- (i) **Eligibility Criteria.** Not all real estate professionals would benefit from this requested exemption. The exemption would be available only to licensed real estate brokers and agents who are predominantly engaged in the sale of commercial real estate (not including TIC securities) and who have "substantial experience" in the sale of commercial real estate.
- (ii) **Documentation Requirements.** The relationship between the real estate professional and investor must be memorialized in a buyer's agent agreement (the agreement) prior to any discussions regarding a specific TIC transaction. A signed copy of the agreement must be delivered to the securities broker-dealer acting as placement agent for the TIC offering at or prior to closing. NAR suggests that the agreement should memorialize, among other things:
  - (a) A statement that the real estate professional represents solely the investor;
  - (b) The identity of all real estate professionals who may receive compensation in connection with services provided under the Agreement;
  - (c) The maximum amount of the advisory compensation to be paid by the investor to those real estate professionals listed in the agreement;
  - (d) Educational information concerning TIC offerings in general;

- (e) Statements as to information and services the real estate professional can provide either before or after introducing the investor to a securities broker-dealer;
- (f) Statements confirming that the securities broker-dealer is responsible for compliance with applicable federal and state securities laws; and
- (g) A representation from the real estate professional that he or she has substantial experience in commercial real estate.

The NAR request also suggests a mechanism whereby an investor can deliver a written affirmation confirming his or her intent to proceed with a TIC transaction, notwithstanding a determination by the selling broker-dealer that the investment is not suitable for the investor. This is one of several aspects of the notice that likely will garner significant public comment.

(iii) Compensation and Services. Eligible commercial real estate professionals would be entitled to receive a real estate advisory fee (the advisory fee) for services rendered to potential TIC investors. There is no discussion concerning the permissible amount of the advisory fee, only that the maximum amount payable must be memorialized in the agreement. The permissible real estate advisory services contemplated in the notice include:

- (a) Locate, identify, and obtain information about potential TIC transactions;
- (b) Coordinate tours or site visits of potential TIC properties;
- (c) Provide advice on comparative characteristics of alternative real estate investments that meet the investor's specifications;
- (d) Discuss financing alternatives;
- (e) Evaluate and advise the investor concerning transaction documents (e.g., TIC agreements, master leases, etc.); and
- (f) Provide general (but not legal) tax assistance to the investor regarding section 1031 exchanges.

(iv) Other General Conditions. Presumably to limit the scope of its exemption request, NAR suggested a variety of additional restrictions on the permissible activities of real estate professionals in this context, including prohibitions against:

- (a) TIC-related advertising as part of the real estate professional's general business and marketing activities;
- (b) Fee sharing with any real estate professional not otherwise eligible under the conditions of the requested exemption;
- (c) Handling of investor funds;
- (d) Negotiating TIC investment terms or otherwise acting on behalf of the investor;
- (e) Participating in the structuring of a TIC transaction with the sponsor, issuer, placement agent, or other parties; and
- (f) Assisting in obtaining or negotiating financing for a TIC transaction.

Potential Ramifications

and Unanswered Questions

If the exemption is granted in its current form, ramifications to the TIC industry might include:

- \* Broader distribution network for TIC securities.
- \* Closer relationships between commercial real estate brokers and securities broker-dealers.
- \* Increased regulatory compliance mechanisms.
- \* Increased regulatory scrutiny.

The notice yields a number of questions about the addition of commercial real estate brokers into the TIC securities field, including the following:

(a) The notice states that a real estate broker may discuss the real estate characteristics of a TIC security property and arrange inspections of a TIC security property prior to introducing the prospective purchaser to the selling broker-dealer. What steps will be required to ensure these activities do not result in the real estate broker engaging in general solicitation or advertising that would jeopardize the issuer's private placement exemption under regulation D?

(b) Is it likely that purchasers would pay the real estate advisory fee to the real estate broker directly, rather than by an allocation of some portion of the broker-dealer's commission? Will real estate brokers be willing to waive portions of their fees that exceed amounts agreed to be allocated by the securities broker-dealers?

(c) How will efforts to comply with regulation d's prohibition against general solicitation and advertising be impacted if the NAR request is granted?

(d) Does the proposed exemption require that a TIC securities offering be structured to include a lead placement agent to be able to include real estate brokers in the marketing process?

(e) Will the proposed requirement that a real estate broker be "predominantly engaged" preclude real estate brokers from specializing in TIC securities transactions?

What Happens Next?

There is a 30-day comment period during which the public may offer feedback on the request. Parties interested in submitting comments should respond before the December 17 deadline by e-mailing [rule-comments@sec.gov](mailto:rule-comments@sec.gov) or using the SEC's online comment form at <http://www.sec.gov/rules/other.shtml>. File No. S7-26-07 should be referenced in the subject line. The SEC staff will consider any such input in making its decision, which will then be presented to the full commission for consideration.

Eric Perkins, Esq., and William Tate, Esq., are members of the real estate securities group at Hirschler Fleischer, Richmond, Va.

New York Real Estate Journal - 17 Accord Park Drive #207, Norwell MA 02061 - (781) 878-4540