

## SEC keeps quiet about proposed TIC exemption

Consolidated into single transaction, 'tenant in common' deals, often include securities

Will they or won't they? That is the question that many real estate brokers are asking today. Will the seemingly sleeping giants in the Securities and Exchange Commission grant an exemption that could dramatically affect the bottom line for real estate brokers?



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The SEC could do this by making a decision to allow real estate brokers (who are not licensed securities salespeople) to receive advisory fees in connection with the sale of tenant in common securities.

A tenant in common (TIC) is the owner of an undivided real property interest. That real property interest could be a commercial office building, a retail center or an individual residence. In the TIC industry, sponsors find properties, investors and lenders and consolidate them into a single transaction.

Depending on the elements of a transaction, a TIC interest may be sold in a way that becomes a security under an investment contract analysis. An investment contract is created if an individual makes an investment of money into a common enterprise with the expectation of making profits based solely or primarily on the efforts of others.

The sale of TIC properties often involves the sale of securities as a result of the sponsor's active participation, coordination and management of the property and transaction.

The analysis hinges on whether the investors are expecting to, and in fact make, their profit based on the efforts of the sponsor – or whether they are truly buying a real estate asset, and the profits result from the economics of the asset.

Because a picture is worth a thousand words, the concept might be more easily understood through the diagrams at left – showing one TIC product that clearly is a security and one that should not be deemed a security.

In the first diagram, you see that the sponsor master-leases the property from the TIC owners and has its affiliated property manager operate the property with no TIC owner approval of leases or lease terms.

The sponsor is the borrower of the loan and its principals guaranty the loan. Clearly, this would be considered a security because profits are based on the efforts of the sponsor.

In diagram two, the TIC owners approve and execute all leases and manage the property. The TIC owners are borrowers of the loan. The sponsor arranges aspects of the deal, and gets out, so

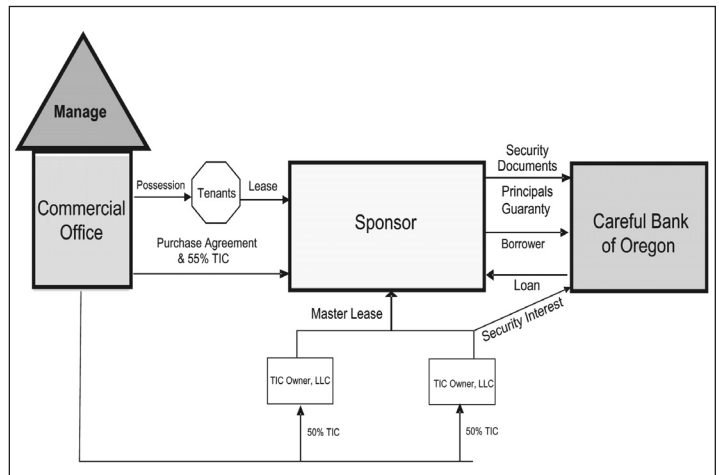
this would not likely be considered a security because profits are based on the efforts of the TIC owners.

Last October, the National Association of Realtors submitted a request to the SEC for an exemption that would allow a real estate adviser fee to be paid to a non-securities licensed real estate broker in a TIC securities transaction.

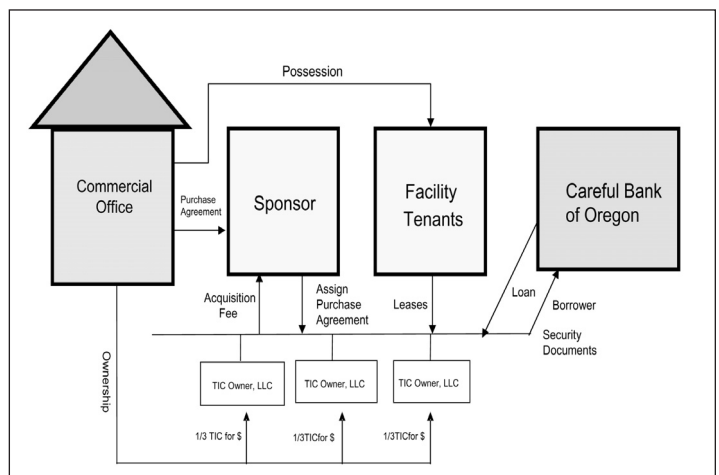
If approved, the proposed exemption would apply if the transaction included the following criteria:

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**Diagram one: Clearly a security**



**Diagram two: Not a security**



- The broker is a commercial real estate broker with substantial experience selling commercial real estate who is predominantly engaged in the sale of commercial real estate (not including TIC securities).

- The TIC interest must be sold as a security and generally sold as 1031 replacement property.
- Each buyer must receive a deed.
- There must be a written buyer's agent agreement with the broker.
- The broker can only participate in real estate-related activities.
- The broker cannot advertise a TIC security, or that it sells TIC securities.
- There must be a securities broker dealer involved in the transaction.

It is very unusual for the SEC to allow the payment of any fee to an individual that is not either a licensed securities salesperson or does not fit within their definition of a finder. As a result, the proposed exemption is quite controversial, as demonstrated by the comments that the SEC has received to date. That contro-

versy may be what is causing the delay in the adoption of an exemption that many TIC insiders believed would come about prior to the end of 2007.

As with any legislation or rulemaking, there will be many questions left unanswered if the exemption is adopted.

For example, will the SEC establish a separate enforcement arm related specifically to this exemption since real estate brokers are not subject to FINRA oversight? What will further define "substantial experience" and "predominantly engaged in"? Finally, post-exemption, will the SEC flex its regulatory muscle against real estate TIC sponsors?

The only certainty at this point is that controversy will surround any decision.

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