**Securities Exchange Commission Publishes the National Association of Realtors Exemption Request Regarding the Sale of TIC Interests**

On November 13th, 2007 the SEC published the National Association of Realtors (NAR) request for exemption from certain regulations regarding the sale of Tenant in Common (TIC) interests and has formally requested public comments regarding this exemption request. Without question, this is the most significant moment in the young life of the TIC industry since the issuance of Rev. Proc. 2002-22 by the IRS in March of 2002 and, regardless of the final action taken by the SEC, the debate and actions precipitated by the exemption request will forevermore change the TIC landscape.

The formal Request for Exemption was submitted in a letter, dated October 11, 2007, by Suzanne E. Rothwell, Council in the Corporate Finance & Securities Regulation department in the Washington DC office of Skadden, Arps, Slate, Meagher & Flom LLP (Skadden) on behalf of the NAR. Generally speaking, the letter requests an exemption whereby a real estate broker who has substantial experience in commercial real estate could receive a real estate advisory fee in connection with the sale of a TIC interest that is offered and sold as a security under federal securities laws when the real estate licensee works in conjunction with a registered representative of a broker-dealer that is itself registered with FINRA (formerly the NASD). In substance, of course, the exemption request is much more complex.

Specifically, the exemption requests that the "SEC grant an exemption from the broker-dealer registration requirements of Section 15(a)(1) of the Securities Exchange Act of 1934 (the "Exchange Act") and from the reporting and other requirements specifically imposed by the Exchange Act, and the rules and regulations thereunder, on a broker or dealer that is not registered with the Commission (except Sections 15(b)(4) and 15(b)(6) of the Exchange Act), pursuant to Sections 15(a)(2) and 36(a) of the Exchange Act, to any Commercial Real Estate Professional and Real Estate Firm with which such Professional is licensed that receives a Real Estate Advisory Fee from a client in connection with the purchase of a TIC Security pursuant to a written Buyer's Agent Agreement, which fee may be paid by the client or the sponsor of a TIC Security on the client's behalf. In addition, we request that the SEC grant the exemption even though the payment of such a Real Estate Advisory Fee may reduce the sales commission or other compensation received by the Lead Placement Agent and/or Selling Broker-Dealer involved in the TIC Security Transaction."

Before we get into the guts of the exemption request, let's look at some of the background. While the use of the tenant in common structure to own real estate is as old as private property rights, their use as replacement property for 1031 tax-deferred exchanges really took off after the IRS issued Rev. Proc. 2002-22 in March of 2002. This document provided the guidelines (although not safe-harbor) for use of syndicated TIC interests as qualified replacement property. In the months that followed the issuance of the Rev. Proc. there was much debate and disagreement about whether TIC interests should be sold as real estate through real estate licensees, or as a security through registered representatives. Over the next several years most industry participants took the approach that the sale of TIC interests constituted the sale of a security and, therefore, required that the selling agent be a registered representative member of the NASD (now renamed as FINRA). In March of 2005, the NASD issued a 'Notice to

Members' (Notice 05-18) regarding the private placement of tenants in common interests. In this notice the NASD stated that when "TICs are offered and sold together with other arrangements, they generally would constitute investment contracts and thus securities under the federal securities laws." As noted in the exemption request; "The SEC staff has, in connection with one no-action request, disagreed with the view that a triple net lease arrangement that is sold to a single investor or multiple investors as tenants-in-common is not a security." In the Notice to Members, the NASD cautioned that a broker-dealer may not pay a real estate agent who is not registered as a broker-dealer for "participating in the transfer of a TIC interest that is structured as a security, nor may a member pay such real estate agent for referring TIC business that involves securities"

OK, why not just structure a TIC offering so that it does not constitute a security? Because it is very difficult, if not impossible, to structure a TIC offering in such a way that it avoids being deemed a security under both federal and state security laws (state securities laws are often much more restrictive than they are at the federal level) while still being attractive to a broad spectrum of potential purchasers. Generally speaking, federal securities laws would deem an investment to be a security if the primary managerial and profit-making responsibilities are carried out by someone other than the co-owners. These are, of course, exactly the duties that most TIC investors expect will be conducted by the sponsor. In addition, virtually every 'master-leased' property would be deemed to be a security based on existing Supreme Court decisions. As if that is not difficult enough, many states take an even more restrictive approach and deem that the mere gathering of the individual investors into a property which the sponsor located, negotiated the purchase agreement and financing, conducted the primary due diligence and coordinated the closing, would constitute a security.

However, as stated in the Skadden letter: "Based on our survey of state real estate license laws and discussions with state real estate regulators, they believe that at least 42 states view the sale of a TIC Security as involving the sale of an interest in real property that is subject to state real estate laws, regardless of whether such investments are also considered to be subject to state securities laws." Further, the Skadden letter stated: "Accordingly, we believe that many states recognize that real estate considerations are a major component in the sale of a TIC Security and that, therefore, purchasers should receive the protections afforded by relevant state real estate laws even if the transaction is also subject to state securities laws."

So, the bottom line is that, under federal and state securities laws, most, if not all, TIC offerings are deemed to be a security (under which only securities-licensees can receive compensation), but in most states, the sale is also subject to state real estate laws (under which only real estate licensees can receive compensation).

The Skadden letter states: "We believe that the state statutory and regulatory framework implies that many states have made a policy determination that the protection of a purchaser of real estate, including a TIC security, is enhanced when the purchaser receives real estate services from a Commercial Real Estate Professional. In comparison, an associated person of a broker-dealer may not be qualified to provide information on the nature and characteristics of comparable real estate unless the person also holds a real estate license. Because of their extensive training and experience in matters relating to real estate and the predominant role of real estate in a TIC Security Transaction, NAR believes that Commercial Real Estate Professionals would provide valuable guidance and assistance to a purchaser of a TIC Security."

Based on this statement, it would seem that the appropriate course of action for any real estate licensee who wants to also sell TIC Securities would be that they also obtain the appropriate securities licenses and that any securities licensee would also obtain the appropriate real estate licenses. After all, if the extensive real estate training as a real estate licensee will provide valuable guidance and assistance to the purchaser of a TIC Security, why wouldn't the extensive securities (and investor protection) training as a securities licensee provide equal protection and guidance when considering an investment that is, in fact, a security?

Why? Because, in the words of the Skadden letter: "[w]e believe that it would be impractical and unduly burdensome to require that the Commercial Real Estate Professional have passed a securities law examination and become registered as an associated person of a registered broker-dealer in order to continue to provide real estate assistance to its client in connection with the client's consideration of one or more TIC Security properties, along with other non-security properties, because the Commercial Real Estate Professional will be predominately engaged in sales of real estate other than TIC Securities, would be required to register in numbers of states to meet state securities registration requirements, and will be involved only on a limited basis in the securities law aspects of any TIC Security Transaction."

Unfortunately, this argument does not seem to make much sense. There are many aspects of professional life where more than one designation or license is required to conduct a service or to sell a product and there are many situations where very similar products require very dissimilar licenses. For example, an investor can exchange into Operating Partnership units in a REIT. Does NAR intend to make the argument that REIT shares should be sold by real estate licensees? As a matter of fact, most of the securities licensees that we know who sell TIC Securities also hold a real estate license, even though they may never use that license in a non-TIC transaction. Why can't that work in reverse for real estate licensees who want to sell TIC Securities properties?

Notwithstanding our disagreement with NAR's argument against dual licensing, we do agree that it makes sense to have persons with appropriate commercial & investment real estate activity provide advice to investors, especially those who are burdened with the short and stringent time frames of a 1031 exchange. As stated in the Skadden letter: "Many TIC Security investors have previously established business and client relationships with Commercial Real Estate Professionals and the Real Estate Firm with which such Professional is licensed, in many cases because the Commercial Real Estate Professional previously acted as the "seller's agent" for the purpose of selling the investor's existing commercial or residential property." The letter further states: "However, unless the Commercial Real Estate Professional can be compensated for providing additional real estate services as a "buyer's agent" to the client with respect to the purchase of a TIC Security, the Commercial Real Estate Professional is unlikely to be willing to continue to assist the investor. Fair enough, we are professionals who are rightfully looking to be compensated for our services. We still think that there is a simple mechanism for this through dual licensing, but let's see what the NAR is requesting.

The NAR has requested that the exemption allow "Commercial Real Estate Professionals" to receive a "Real Estate Advisory Fee" from a client in connection with the sale of a TIC Security. The fee would be paid pursuant to a written "Buyer's Agent Agreement", which would allow the fee to be paid by either the client or the sponsor of a TIC Security on the client's behalf. It is

anticipated that the fee would come out of the sales commission or other compensation received by the Selling Broker-Dealer involved in that TIC Security Transaction. In effect, there would be a fee sharing arrangement between the Commercial Real Estate Professional and the Selling Broker-Dealer.

The definition of a Commercial Real Estate Professional is somewhat broad as used in the Skadden letter, but it is intended that real estate licensees with "substantial experience", as evidenced by professional designations, dollar volume and number of commercial real estate transactions, time spent dealing in commercial real estate transactions and/or education relating to commercial real estate matters, would qualify as being a Commercial Real Estate Professional for purposes of the exemption.

The Real Estate Advisory Fee would be paid to the Commercial Real Estate professional (or to the Real Estate firm with which they are licensed, collectively referred to as a "RE Participant") pursuant to a written Buyer's Agent Agreement. Prior to discussing a specific TIC Security property with a client, the RE Participant and the client must enter into a written agreement which shall obligate the RE Participant to solely represent the client in connection with the purchase of a TIC Security. The agreement must identify every RE Participant who is to share in the Real Estate Advisory Fee and must state the aggregate maximum amount of the fee. The fee can be expressed as a fixed dollar amount or based on a predetermined formula such as a fixed percentage of the property's full price or of the cash paid (equity investment) for the property.

The way that the exemption request is drafted, the RE Participant would negotiate and execute the Buyer's Agent Agreement prior to introducing the client to a Selling Broker-Dealer. How would the RE Participant and the Selling Broker-Dealer agree on the fee-split if the Buyer's Agent Agreement is executed prior to the introduction to the Selling Broker-Dealer? What if the fee negotiated by the RE Participant equaled such a large share of the total fee that the Selling Broker-Dealer is unwilling to accept their share? What if the offering structure for the specific TIC Security property did not provide for a fee as large as agreed to in the Buyer's Agent Agreement, or if it does not provide for payment to non-securities licensees? What if, in any of these circumstances, that specific TIC Security property is the most suitable replacement property for the client? Will we see a drive to the bottom where Commercial Real Estate Professionals base their choice of Selling Broker-Dealer on who will accept the lowest share of the fee, as opposed to who will provide the best service to the client? How do we equitably resolve these questions?

Perhaps most importantly, the Commercial Real Estate Professional may discuss the real estate characteristics of a TIC Security property with the client and can arrange for the client to inspect a TIC Security property before introducing the client to the Selling Broker-Dealer. The Commercial Real Estate Professional must, however, arrange an introduction with the Selling Broker-dealer upon the client advising the Commercial Real Estate Professional that they are considering the purchase of a specific TIC Security property.

Frankly, to us this is the most troubling aspect of the exemption request. One of the largest issues that securities licensees deal with is suitability of any given investment opportunity for a specific client. It is our understanding that the issue of suitability is the number one reason for enforcement action by the SEC. As Registered Reps, we are forced to reject many potential clients each month because of suitability issues and even those prospects for who TIC Securities

properties may be suitable in general will not find all, or even most TIC Security properties to be suitable for their specific circumstances.

Suitability and the need to truly understand the client, their needs, desires, resources and obligations, was at the heart of the NASD Notice 05-18 and is at the heart of prohibitions against general solicitation of investment such as TIC Security properties. According to the principles of suitability and solicitation, we should not even discuss a specific TIC Security property with a client until we have gone through an appropriate process of determining their suitability for a specific TIC Security property, let alone arranging for them to tour a specific TIC Security property.

How is the Selling Broker-Dealer (or, more directly, the Registered Rep to whom the client has been referred) going to control this process if they have already toured the property? According to some sponsors of TIC Securities properties, 80% to 90% of all investors who tour a TIC Security property end up acquiring an interest in the property. How will the Selling Broker-Dealer possibly dissuade a client from investing in a TIC Security property, that the client has toured and is enamored by, based on regulatory-mandated suitability requirement? We think that this may lead to 'broker-dealer shopping' by some Commercial Real Estate Professionals who are not as focused on the need for suitability in a securities transaction.

To complicate matters, the exemption request includes a provision whereby if the Selling Broker-Dealer does disqualify a potential investor because of suitability reasons, the client can simply write a letter affirming that they want to proceed with the transaction notwithstanding the Selling Broker-Dealer's determination. While this may seem reasonable, it opens a can or worms. What if the deal goes bad? Will the client then claim that they were compelled to buy the property and that they were talked into writing the affirmation letter (and maybe even provide with the language)? Will state and/or federal securities regulators give the affirmation letter any weight, or will they consider the broker-dealer's obligation to observe suitability requirements to be above and beyond the clients desire to invest in the property?

Beyond suitability, the ability to discuss the characteristics of specific TIC Security properties gives rise to the concern of disclosure and representations. In the real estate world, the use of 'puffery' is a long-established practice. When used by well-intentioned real estate licensees, puffery is not meant to misrepresent a property, as the comments are not necessarily meant to be taken literally, but to give color to aspects that might not be so colorful in the black and white of a formal description. In a TIC Securities offering, however, puffery is a much more slippery slope as it is easy to cross the line from adding color to the facts to coloring the facts and changing the disclosures themselves. This could cause the investor to make an inappropriate investment decision and could lead to significant liability for a broker…but for which broker if puffery is legal for the real estate licensee but not for the security licensee.

In addition to discussing the characteristics and arranging tours of specific TIC Securities properties, the Commercial Real Estate Professional would be allowed to conduct the following activities regarding TIC Securities properties:

- Advise clients on comparative characteristics of alternative properties that meet the client's specifications. These characteristics could include market data, financial projections, tenant-related information, financing aspects, property reserves and physical

or environmental issues (including potential sources of expert assistance regarding these issues).

- Discuss with clients various financing alternatives including the amount of leverage, current lending rates, payment options and potential sources of financing (but, they can not assist the client in obtaining financing in the case of a TIC Security).
- Evaluate and advise clients about documents relating to TIC Security properties, such as TIC agreements, master leases, management & operating agreements, tenant leases, financial statements and transaction documents.
- Provide general, but not legal, tax assistance to clients regarding the requirements and complexities to be satisfied in a 1031 tax-deferred exchange.

Given NAR's argument that real estate licenses should not be required to obtain their securities licenses partially because of the limited number of transactions expected to be conducted by any individual Commercial Real Estate Professional, we have to wonder how they will have the appropriate level of experience to advise their clients regarding TIC agreements, transaction documents and/or TIC-centric financing issues. For example, we work with many real estate operating companies who have billions of dollars of experience, but who turn to us for advice regarding these issues because they understand the significant differences between single-borrower, non-securities transactions and multi-borrower, securities transactions.

In its conclusion the Skadden letter states: "We believe that the knowledge of Commercial Real Estate Professionals with substantial experience in commercial real estate contributes to helping a potential purchaser to understand and properly evaluate the real estate aspects of various TIC Securities and non-securities commercial properties that are available for the purchaser's consideration and that such purchasers benefit from receiving the independent assistance of a Commercial Real Estate Professional, acting as a "buyer's agent". Given the conditions of the exemption that will limit the role of a Commercial Real Estate Professional and Real Estate Firm with which such Professional is licensed that would receive a Real Estate Advisory Fee, we believe that an exemption from registration and regulation of the Commercial Real Estate Professional and the Real Estate Firm as a broker-dealer is appropriate in the public interest and consistent with the protection of investors."

We too believe that the knowledge of real estate licensees with significant commercial and investment real estate expertise will greatly benefit any investor in real estate, be it TIC Securities property or any other form. That is why we are a real estate brokerage first and foremost. As a result, we are, somewhat reluctantly, in favor of the proposed exemption. But our favor for the exemption is more in concept than as proposed in the formal request.

We are very concerned about the proposed ability for a RE Participant to discuss specific characteristics about and arrange tours of TIC Securities properties before the introduction to a Selling Broker-Dealer. We do not understand how a fee sharing arrangement works where the side that signs the fee agreement with the seller (the Selling Broker-Dealer with the sponsor of the TIC Security property) has no say in how that fee gets split with the RE Participant, as the RE Participant may have previously signed a Buyer's Agent Agreement, which must state the amount of the Real Estate Advisory Fee. We are concerned that suitability considerations will be cast aside if the client can simply write a letter of affirmation to overcome a trade that is rejected by the Selling Broker-Dealer for suitability reasons. We do not know how liability will be

equitably divided between the brokers when their licenses subject them to different standards regarding marketing methods, disclosure and permissible statements about the investment.

We are very pleased that the SEC has requested public comments regarding this exemption request and we understand that this is only the second time that the SEC has sought public comments regarding an exemption request. We will certainly submit our comments (preferably jointly with our broker-dealer) and we hope that any other interested parties will submit their comments as well. We are hopeful, that faced with a sufficiency of thoughtful comments, the SEC will be able to craft an exemption that serves the investor first and foremost, while creating a fair and balanced playing field between the RE Participants and the broker-dealer community.

Comments to the SEC can be made electronically or in hard-copy (hard-copy comments should be submitted in triplicate). The comment period will end on or about December 20, 2007, so all comments should be delivered before that date. All comments should reference File No. S7-26-07 on the subject line.

Comments should be addressed to:

Ms. Nancy M. Morris
Secretary
Securities and Exchange Commission
100 F Street, NE
Washington, DC 20549
Electronic comments should be sent to: rule-comments@sec.gov.

We also want to hear your comments. Do you favor the requested exemption? Do you object to the requested exemption? Either way, what are your issues, comments and concerns? We will publish an update to this article next month and will include a summary of your comments in that update. **Send comments regarding this article or a request for a copy of the SEC publication and the Skadden letter to: info@capharbor.com.**

As an aside, for those of you who are amused, bemused or confused by such things, the SEC's publication of the exemption request took up 11 pages, but attached to the exemption request was the analysis of the requested exemption's impact on the Paperwork Reduction Act…which used 13 pages for its analysis!