

# ADVISORY

## **SULLIVAN & WORCESTER TENANT-IN-COMMON ADVISORY**

### Tenant-in-Common Industry Focus Broker/Dealers Speak on Best Practices

The Tenant-in-Common, or TIC, industry is in the midst of explosive growth both in terms of industry players entering the field and investors seeking out such investments. As with any burgeoning area, participants are seeking efficient ways to navigate the business, legal and practical issues that inevitably arise. All stakeholders in the industry (e.g., sponsors, broker/dealers and their registered representatives, due diligence professionals, lawyers, investors, etc.) should be concerned with the development of industry norms, standards and practices. However, each such group has its own set of interests which are not always 100% aligned. The establishment of "good" or "best" practices can go a long way toward (i) building investor confidence, (ii) ensuring that the TIC industry survives for many years and (iii) avoiding a tarnished reputation due to the acts of "rogue" participants.

Recently, a group of broker/dealers, or B/D's, and due diligence professionals held a conference in Phoenix, Arizona to discuss industry "Best Practices". Certain attendees of that conference produced a memorandum summarizing their discussions and recommendations. The conference focused on four primary topics: (1) private placement memorandum issues; (2) marketing tactics; (3) due diligence requirements; and (4) procedures regarding the flow of information from sponsors. Set forth below is our understanding of the general tenor of the conference and the recommendations made by the working group. Since the recommendations were proposed by limited segments of the industry (most notably excluding sponsors and their advisors), it remains to be seen what measures will be implemented on an industry-wide basis. We note that a group of sponsors did meet in Chicago in mid-July to offer their perspective on the Phoenix conference. To our knowledge, no memorandum emerged from those discussions. Developments in this area will continue to evolve.

#### **PRIVATE PLACEMENT MEMORANDA**

Offerings of TIC interests are generally structured as "private placements" under applicable security laws. The private placement memorandum, or PPM, is the primary document prepared by the sponsor to disseminate information to B/D's and potential investors

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regarding a transaction. The PPM must include the information that the sponsor deems "material" to the investor's investment decision.

A general observation within the TIC industry is that PPM's are difficult to read and trying to compare one PPM to another leads to difficulty on the part of B/D's and investors in analyzing the range of available transactions. In general, the conference participants asserted that PPM's should be more transparent and contain more information about the investment. It was specifically suggested that PPM's contain:

- clearer disclosure of the sources and uses of cash reserves,
- a more simplified approach to disclosing costs and loads,
- lease abstracts for any lease covering more than twenty-five (25%) percent of the rentable space at a property and a complete copy of any lease covering more than fifty (50%) percent of the rentable space at the property,
- financial information on tenants who lease more than twenty-five (25%) percent of the rentable space at a property, if available (i.e., 10-K's/10-Q's for publicly-traded tenants or financial statements of private company tenants),
- the appraisal for the property or, in the alternative, such appraisal should be provided to the broker/dealers for review during due diligence,
- detailed disclosure of Revenue Procedure 2002-22, including analysis of how the offering addresses each of the 15 points set forth therein, and
- a tax opinion in a "fully reasoned format" stating that the interest being offered "should" or "will" be treated as real property for purposes of Internal Revenue Code Section 1031 (which opinion should be updated at the time of each closing during an offering).

### **MARKETING TACTICS; COMPLIANCE WITH SECURITIES LAWS**

In order to have comfort that an offering of TIC interests constitutes a private placement (meaning that you do not have to undertake certain onerous public registration requirements), sponsors and B/D's nearly always rely on the "safe harbor" provided by Regulation D of the federal securities

laws. One of the requirements for relying on the safe harbor is that no "general solicitation" may occur in connection with the offering. It is permissible, however, for B/D's to use general solicitations to find potential investors; provided that they develop a "substantive" relationship with potential investors prior to offering any securities.

From the sponsor's perspective, it is important to consider that not only its own actions, but the actions of the "selling group" impact the ability to rely on the safe harbor. The legal landscape in this area is very complex and must be analyzed on a case-by-case basis (i.e., consult your legal counsel).

Conference participants generally agreed that private placement memoranda, brochures and other like materials containing information on specific sponsors, properties or offerings (past, present or future) were not appropriate for distribution in a general solicitation. However, it was asserted that general solicitations can include discussions of the relevant tax provisions, the TIC industry generally and other items not specific to any particular sponsor, property or offering. In addition, conference participants agreed that sponsors should not participate (either by attendance, participation or re-imbusement of costs) in seminars promoted by way of a general solicitation. Of particular note, the issue of website content creating a general solicitation, inadvertently or otherwise, was not discussed.

### **DUE DILIGENCE REQUIREMENTS**

Broker/Dealers have a responsibility to recommend only "suitable" investments to their clients. Part of the process of determining the suitability of a TIC offering is for the B/D to become familiar with the sponsor, the property and the specifics of the offering. While the nature and extent of due diligence that is required varies under the circumstances, participants agreed that B/D's may not rely solely on information provided by the sponsor. Citing the "Notice to Members" issued by the NASD in March, 2005, it was recommended that due diligence investigation should include:

- background checks of the principals of the sponsor,
- review of the agreements relating to the transaction,

- an inspection of the property, and
- analysis of any assumptions and projections provided by the sponsor.

In addition to these substantive areas of analysis, conference participants suggested that due diligence materials simultaneously be distributed electronically (followed by hard copies) to all participating B/D's (consistent with the time frames discussed below) to allow sufficient time for conducting due diligence and to maintain a level playing field among the various firms.

#### **FLOW OF INFORMATION FROM SPONSOR; SUGGESTED PROCEDURES**

In any TIC offering, the flow of information is critical and there are many competing factors at work. For example, one such factor is the balancing of the sponsor's desire for a quick selling process against the ability of the investor to absorb all relevant information. At the conference, a framework for the timing of the dissemination of offering-related information was proposed. The proposed framework (see chart on following page) consists of the following five time periods:

- Sponsor Evaluation Period. Described as the time a sponsor is evaluating a property and preparing the PPM; no information about the offering should be disclosed to anyone outside the sponsor company.
- Contemplation Period. Described as the time when information about an offering is shared with the marketplace. It is recommended that the sponsor issue a uniform announcement to all B/D firms on the same day and that an initial due diligence package be provided. During this time only "sanitized" information should be shared with registered representatives.
- Broker/Dealer Cooling Off Period. Described as the time when a final PPM and complete due diligence package is sent to the broker/dealers. This period should last a minimum of five (5) days.
- Marketing Cooling Off. Described as the time when the PPMs are distributed to registered representatives for distribution to their clients (and it is only during this time that such materials should be sent to such parties). This period should be long enough to allow the registered representatives time to review the offering themselves and with their clients. This period should last a minimum of five (5) days.
- Order Acceptance Period. Described as the time beginning after the conclusion of the Marketing Cooling Off Period and the only time a sponsor should accept client paperwork for an offering. However, if client paperwork is received prior to this time period, it should be held aside and deemed accepted on the first day of the Order Acceptance Period.

#### **MISCELLANEOUS**

In addition to the primary topics discussed above, the following additional recommendations were also made at the conference:

- Closing documents. Once the transaction has concluded, closing documents should be sent to the B/D home office, the registered representative and the investor.
- Investor Communications. B/D's should receive copies of all communications sent to the investor.
- Variance Reports. Sponsors should distribute variance reports showing the status of the property as compared to the projections in the PPM on a regular basis. This obligation should appear in the TIC Agreement.
- Private Letter Rulings. By December 31, 2005 each sponsor should be pursuing a private letter ruling from the IRS for their structure.

#### **CONCLUSION**

As noted at in the introduction, the conference's suggested "Best Practices" represents the viewpoint of only certain segments of the TIC industry. The practical and legal issues facing the industry are complex and accepted practices will continue to evolve along with the industry itself.

For further information regarding broker/dealer or securities issues involving TIC offerings please contact Sullivan & Worcester's TIC Practice Group.

<b>Time Periods and Flow of Information</b>					
	<b>Sponsor Evaluation Period</b>	<b>Contemplation Period</b>	<b>B/D Due Diligence Cooling Off Period</b>	<b>Marking Cooling Off Period</b>	<b>Order Acceptance Period</b>
Broker/Dealer	None	Initial Due Diligence Package and more specific information as it becomes available	Final PPM and Due Diligence Package and all other material information	Any material information	Any material information
Registered Representative	None	Sanitized information that is not so detailed as to allow the identity of the property to be known	Final PPM*	Any material information	Any material information
Client	None	None	None	Final PPM and any other requested material information*	Final PPM and any other requested material information*

\*Only after Sponsor's receipt of a client-signed form documenting a substantive relationship with representative.

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