



New Accredited Investor Rules Impact Real Estate Securities Offerings

By *Steven R. Meier and Scott Schonfeld*

Real estate firms often raise capital by issuing equity interests in entities that own real property. Such interests are often securities under Federal and State securities laws, and any syndication or other offering must either be registered under the Securities Act of 1933 or comply with an exemption from registration. Issuers frequently rely on the safe harbor of Securities and Exchange Commission Regulation D, which includes Rule 506 that allows issuers to raise capital in a private placement. Under §201(a) of the Jumpstart Our Business Startup (JOBS) Act enacted April 5, 2012, Rule 506 was amended to permit issuers to engage in general solicitation or general advertising, provided that offers and sales are limited to accredited investors and the issuer takes reasonable steps to verify the accredited investor status of all persons to whom securities are offered in the transaction.

At present, real estate securities are predominantly offered under Rule 506(b), which restricts communications about the offering and requires only a “reasonable belief” as to the purchaser’s accredited investor status, thus allowing issuers to rely on the purchaser’s “check the box” method of indicating accredited investor status. However, because Rule 506(b) only exempts offerings made through private communications and expressly prohibits general solicitation, it substantially limits the reach of the offering.

New paragraph (c) to Rule 506 allows issuers relying on Rule to *generally* solicit and advertise private securities offerings, provided that such offers and sales are limited to accredited investors and the issuer takes “reasonable steps” to verify accredited investor status. Thus, Rule 506(c), for the first time, offers the real estate community the opportunity to solicit investors regarding a real estate securities offering via the internet, advertisements in newspapers and magazines, and other, similarly broad and novel communication channels.

Notwithstanding its benefits, Rule 506(c) presents new challenges with respect to the diligence requirements imposed on issuers. While the SEC has intentionally not articulated a definitive series of steps an issuer *must* take to ensure accredited status, it has provided a non-exclusive list of methods to verify accredited investor status.¹ These include:

- 1. Verification on the Basis of Net Income or Net Worth**, as indicated by any (i) Internal Revenue Service form that reports income (including a Form W-2 or Form 1099), (ii) bank or brokerage statements and other statements of securities holdings, and (iii) certificates of deposit;
- 2. Verification by a Reliable Third Party**, including written confirmation from a registered broker-dealer, a licensed attorney, certified public accountant, or an SEC-registered investment advisor. This method is not only convenient but attractive to investors, and particularly private funds, who do not want issuers to know more than is necessary about their business.

¹ See SEC Release No. 33-9415

3. Verification by Means of an Existing Relationship, including, any person who has previously invested in an issuer's Rule 506(b) offering as an accredited investor prior to the effective date of Rule 506(c) and remains an investor of the issuer.

The general thrust of Rule 506(c) is that representations from the purchasers themselves are not sufficient, and the issuer must corroborate the purchaser's status via either reliable third parties or from documents provided by offerees under penalty of perjury. By contrast, Rule 506(b) offerings continue to permit reliance on purchaser self-representations, so long as that reliance is reasonable.

Real estate (and other) issuers who do not adequately verify the accredited investor status of offerees in a Rule 506(c) offering may find themselves in a bind: an issuer may engage in public solicitation - believing that its offers are exempt under Rule 506(c) - only to find that its verification methods did not constitute "reasonable steps" to verify accredited investor status, with the result that the issuer has engaged in public solicitation for its securities but without the safe harbor exemption of Rule 506(c).

Rule 506(c) has substantially increased the scope of permitted fundraising activities for issuers of real estate equity. While the new channels of communication to offerees present considerable opportunity, they also present new and evolving challenges as issuers and intermediaries develop new models to verify accredited investor status. The SEC has left in place the traditional private placement paradigm that restricts solicitation but does not require potentially onerous verification methods (now in Rule 506(b)), so issuers should consider whether the benefits of public solicitation outweigh the risks involved in verifying accredited investor status.

Issuers considering a Rule 506(c) offering should pay scrupulous attention to their current or proposed diligence procedures to ensure that they can take advantage of the private offering exemption they are expecting.

Steven R. Meier is a partner in Seyfarth's Corporate practice group. *Scott Schonfeld* is an associate in the firm's Real Estate practice group. If you would like further information, please contact your Seyfarth Shaw LLP attorney, Steven R. Meier at smeier@seyfarth.com or Scott Schonfeld at sschonfeld@seyfarth.com.

www.seyfarth.com

Attorney Advertising. This One Minute Memo is a periodical publication of Seyfarth Shaw LLP and should not be construed as legal advice or a legal opinion on any specific facts or circumstances. The contents are intended for general information purposes only, and you are urged to consult a lawyer concerning your own situation and any specific legal questions you may have. Any tax information or written tax advice contained herein (including any attachments) is not intended to be and cannot be used by any taxpayer for the purpose of avoiding tax penalties that may be imposed on the taxpayer. (The foregoing legend has been affixed pursuant to U.S. Treasury Regulations governing tax practice.)

Seyfarth Shaw LLP One Minute Memo® | December 17, 2013

©2013 Seyfarth Shaw LLP. All rights reserved. "Seyfarth Shaw" refers to Seyfarth Shaw LLP (an Illinois limited liability partnership). Prior results do not guarantee a similar outcome.