

July 2013

REAL ESTATE AND SECURITIES LAW ALERT

SYNDICATION OF FINANCING FOR A NEW YORK CONDOMINIUM DEVELOPMENT PROJECT TOGETHER WITH THE GRANT OF OPTIONS FOR PURCHASE OF CONDOMINIUM UNITS

The New York State Attorney General ("AG") released a Memorandum on June 19, 2013 (the "AG Memorandum") which discusses the requirements for the syndication of New York condominium development projects for vacant or new construction condominiums, in which investors in the syndication are also given the right to acquire a specified condominium unit.

According to the AG Memorandum, the AG will review this type of offering on a bifurcated basis as (1) the offer and sale of an investment interest in the project and (2) the issuance of an option to acquire one of the condominium units in the project, each of which requires that a separate regulatory filing be made with the New York State Department of Law. However, if the offering of investment interests in the project is structured as an exempt private placement, the initial regulatory filing will be in the nature of a notice filing, which should not, in most cases, create a significant additional compliance burden for the developer of the project.

Significantly, the AG Memorandum does not require that a condominium offering plan filing be made when the options are issued; provided it is clear the investors can back out of the option without additional cost to them. Each investor who receives an option should be given a description of the condominium unit being reserved for him. Additionally, the investors should be notified in boldface type that the condominium units won't be offered for purchase, and accordingly the options can't be exercised, until the developer prepares and distributes a condominium offering plan.

The AG Memorandum expressly contemplates that such an investor will be allowed to apply all or part of his investment at closing to the purchase price of the condominium.

Rule 506 of Regulation D ("Rule 506") promulgated under the Securities Act of 1933 (the "Securities Act") could be utilized to exempt the offer and sale of investment interests in the development project from registration. The principal requirements of a Rule 506 offering are the following:

- The offer and sale does not involve a public offering.
- Form D - a notice filing that requires a limited amount of information concerning the project – is filed within 15 days following the first sale of securities in the offering.
- A copy of Form D and Form 99, which is also a notice filing, are filed with the Department of Law prior to the first offers being made in New York.

continued next page

666 Fifth Avenue, 28th Floor • New York • NY 10103-0084
600 Old Country Road • Citibank Building • Garden City • NY 11530-2011
34 Pantigo Road • East Hampton • NY 11937-2607
Court Plaza North • 25 Main Street, 6th Floor • Hackensack • NJ 07601-7015

www.phillipsnizer.com

212.977.9700 Tel • 212.262.5152 Fax
516.229.9400 Tel • 516.228.9612 Fax
631.324.3950 Tel • 631.324.3622 Fax
201.487.3700 Tel • 201.646.1764 Fax

Resourceful Representation®

- If the offering is limited to “accredited investors,” no specific disclosure document must be filed with the federal and state securities authorities or provided to investors. An “accredited investor” includes an individual with a net worth in excess of \$1,000,000 or net income in excess of \$200,000 and various categories of institutional investors such as banks, insurance companies, etc.

The Regulation D exemption does not exempt the developer from compliance with the anti-fraud provisions of the federal and state securities laws, including Rule 10b-5 under the federal Securities Exchange Act of 1934. To sustain a claim under Rule 10b-5, the claimant must prove both that the defendant acted with scienter (i.e., intentionally or recklessly) and that the claimant relied on a material misstatement or omission in making its purchase. As a result, issuers of securities in a private placement exempt under Rule 506 will generally provide information about the business, financial condition and potential risks associated with an investment in the issuer even for an offering that is made only to accredited investors.

Any amounts received as a downpayment for the purchase of a condominium unit must be maintained in an escrow account until the closing of the purchase of the unit. The AG Memorandum also states that funds received from investors in the syndication offering should be held in a separate escrow account in accordance with Section 352-h of the New York General Business Law. That section provides that the proceeds of a real estate syndication should be held in trust “until actually employed in connection with the consummation of the transaction.” However, in the case of a Rule 506 offering there is no federal requirement that the proceeds be placed in escrow after consummation of the offering and accordingly New York State is restricted from adding an escrow requirement under Section 18 of the Securities Act.

The AG Memorandum does not address whether the issuance of an option would be considered subject to the disclosure requirement of the federal Interstate Land Sales Full Disclosure Act (“ILSA”). The requirement of that act, where applicable, that a property report meeting the guidelines of federal Consumer Financial Protection Bureau be distributed to purchasers only appears to apply to contracts for actual sales or leases, not options to purchase. ILSA’s restrictions on fraud still may apply.

We are available to provide counsel concerning the issues related to the subject matter expressed in this Alert, as well as other matters related to other condominium, commercial and residential real estate or securities matters. For additional information, please contact one of the attorneys named below or the attorney with whom you have a primary relationship.

Contact:	Elliot E. Falk	212.841.0584	efalk@phillipsnizer.com
	R. Brian Brodrick	212.841.0700	brodrick@phillipsnizer.com

This information is provided as a public service to highlight matters of current interest and does not imply an attorney-client relationship. It is not intended to constitute a full review of any subject matter, nor is it a substitute for obtaining specific legal advice from appropriate counsel.