

Legal News Alert is part of our ongoing commitment to providing up-to-the minute information about pressing concerns or industry issues affecting our tenant-in-common clients and colleagues.

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## SEC May Open Door for Commercial Real Estate Brokers in TIC Transactions

On November 9, 2007 the U.S. Securities and Exchange Commission (SEC) published a "[Notice of Application ... for Exemptive Relief](#)" (Notice) that may significantly impact the commercial real estate industry in general and the commercial real estate brokerage and tenant-in-common (TIC) industries in particular<sup>1</sup>.

Ever since the adoption of Revenue Procedure 2002-22 (Rev Proc) by the Internal Revenue Service (IRS), the key milestone in creating the TIC industry, there has been tension between the securities industry and the real estate industry as to which should control the sales process of TIC interests to investors. In the Rev Proc, the IRS effectively determined that TIC interests are real estate, not securities, for tax purposes. This led many in the TIC industry to assume that TIC interests could be sold as real estate, not as securities, and accordingly that commercial real estate brokers, not securities registered representatives, could earn commissions on the sale of TIC interests. In the first few years after the Rev Proc, the TIC industry was roughly evenly split between "real estate" sponsors and brokers and "securities" sponsors and registered representatives. More recently, however, the securities regulators have become more actively involved in warning participants in the TIC industry that offerings of TIC interests generally are characterizable as securities offerings for securities law purposes<sup>2</sup>. This has changed the balance in the TIC industry to something more like 80 percent securities and 20 percent real estate, with the real estate sector shrinking rapidly. As only licensed securities representatives can earn commissions for selling securities, commercial real estate brokers have been left out in the cold. As a result, the National Association of Realtors (NAR) decided to approach the SEC for some relief, which after significant preliminary discussions between the NAR and the SEC, with input from the Tenant-In-Common Association (TICA) and senior members of the TIC industry, turned into the Application, which is the subject of the Notice.

What legal effect does the Notice have? What "exemptive relief" is being contemplated? Here are the key points:

- The Notice has no legal effect; it starts what will be a three- to six-month process, which may yield no relief or different relief from what the NAR has requested. However, based upon the prior history of such requests, and the time and effort put in to the Application, it is likely that the requested relief in much the form requested will be granted. The NAR and the TIC industry are already making plans for the changes in business practices that will result if the Application is granted.
- If granted, the exemption would allow any licensed real estate broker "who is predominantly engaged in and has substantial experience in the sale of commercial real estate" to receive a "real estate advisory fee" from a purchaser of a TIC interest.

<sup>1</sup> See, "[Notice of Application of the National Association of Realtors for Exemptive Relief Under Sections 15 and 36 of the Exchange Act and Request for Comment](#)", SEC Release No. 34-56779 (Notice).

<sup>2</sup> See NASD "Notice to Members-Non-Conventional Investments 03-71"

## ABOUT FOLEY

Opportunities in the fast-growing and ever-evolving TIC industry abound — as do potential regulatory hurdles and legal pitfalls. As a leader in the TIC industry, Foley's TIC attorneys can help you maximize success through our experienced legal counsel in Private Placement Memoranda for TIC and Delaware Statutory Trust Offerings; TIC offering; Circular 230 compliant "should" tax opinions; TIC real estate acquisitions; nationwide financing representations; and sophisticated, third-party due diligence reports.

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- The real estate advisory fee could be paid on behalf of the purchaser by the issuer of the offering, "which could, thereby, reduce the commission or other compensation received by a registered broker-dealer involved in the TIC Security transaction."
- The exemption is limited to transactions where the investor receives a deed representing a fractional interest in real estate that qualifies as "replacement property" under Section 1031 of the Internal Revenue Code.
- The real estate broker may discuss the real estate characteristics of the subject property and inspect the property with his or her client, but must introduce the client to a licensed securities representative when the client advises him that he is considering purchasing an interest in the property.
- The real estate brokers are subject to a number of restrictions, including no general solicitation, no participation in closing, and no handling of client funds.
- The securities representative retains his or her normal obligations, including doing a suitability analysis on the investor and maintaining transaction records.

Much of the detail is in the footnotes, including what it means to have "substantial experience," and what is included in the term "commercial real estate." Much also remains murky, particularly the permitted interaction among the investor, the registered representative, and the commercial real estate broker. For example, is there a difference between a real estate broker introducing a prospect to a registered representative and a registered representative introducing a client to a real estate broker? At what point does the suitability analysis take place? What happens if the real estate broker gives no meaningful real estate advice? The NAR clearly has gone to some lengths to require that the commercial real estate broker play a meaningful role in the process, and not just act as a referral source earning a referral fee, but this worthy purpose may result in a fair amount of confusion as to roles, particularly in the early stages of a transaction.

One thing is clear, however. Both the commercial real estate brokerage community and the TIC industry have reacted positively to the proposed exemption. For commercial real estate brokers, the exemption will open up a new source of revenue and at least some continuing control over their real estate clients. For the TIC industry, although some securities representatives are concerned that they will be forced into fee splitting, the general reaction is that the commercial real estate brokers will bring more investors into the TIC pipeline, creating more revenue for everyone. With that as a motivating factor, there likely will be many more positive comments than negative and the ultimate adoption of the exemption appears likely.

We will continue to monitor and report on the process as it continues.