What Is This Private Placement Memorandum And Why Do I Have To Read It?
Part I
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Several months ago in this magazine I published an article about my observations of the tenant-in-common (TIC) industry as a result of my attendance at the Tenant-In-Common Association (TICA) symposium held earlier this year in Salt Lake City.

Since then I have received a number of calls from readers of the magazine some of whom had already completed a tax-deferred exchange by purchasing an interest in a property as a TIC.

A question that always seems to come up is why they are handed a huge document known as a Private Placement Memorandum (PPM) and told that they need to read it. They always questions why they are being asked to read a securities document when they are investing in real estate. Please review my TICA symposium article for a detailed discussion on the difference between a security for securities purposes and a security for income tax purposes.

I don't want to get into a long dissertation about the securities laws, but some background information may be helpful to your understanding of why you are being given a PPM and asked to read it. Section 5 of the 1933 Securities Act clearly states that it is "unlawful for any person, directly or indirectly to sell a security unless a registration statement has been filed, or to sell a security or deliver a security after the sale unless a registration statement is in effect."

The time involved and the costs associated with the sponsor registering a security for public distribution is prohibitive unless they are raising hundreds of millions of dollars. There are some exemptions to registration but really do not help small businesses such as those that sponsor TIC offerings.

Fortunately on April 15, 1982 Regulation D (commonly referred to as Reg D) became effective. It is the key exemption for those companies that want to raise money by selling equity. By using a PPM pursuant to the Reg D offering rules, TIC sponsors can meet the requirements of the Securities Act in a manageable fashion, while still providing prospective investors with the disclosures and protections required by the Act.

Unfortunately many of the marketers of TIC properties are new to the securities industry and have never worked with Reg D PPM's prior to jumping on the TIC bandwagon. I have been in the securities business over 20 year and have specialized in working with rental property owners for over 10 years. So I thought it might be of value to you to learn a little bit about this document from someone who has read and studied more of them than he cares to admit and who can tell you how to use this document to your advantage.

Because of the importance of understanding the information in this document I will need to split this article into two parts. Look for the second half in next month's issue.

As a real estate investor you normally just receive a broker package from the broker offering to sell you a property on behalf of his client. Within this package is a disclaimer page. The following is a word for word excerpt from a broker package from a nationally known real estate brokerage firm for a $25,000,000 apartment complex in the San Francisco Bay Area that they are offering to sell;

> "This information package has been prepared to provide summary information to prospective purchasers and to establish a preliminary level of interest in the property described herein. It does not, however, purport to present all material information regarding the subject property, and it is not a substitute for a thorough due diligence investigation. In particular, (Broker Name removed) and Seller have not made any investigation of the actual property, the tenants, the operating history, financial reports, leases, square footage, age or any other aspect of the property, including but not limited to any potential environmental problems that may exist and make no warranty of representation whatsoever concerning these issues. The information contained in this package has been obtained from sources we believe to be reliable; however, (Broker Name removed) and Seller have not conducted any investigation regarding these matters and make no warranty or representation whatsoever regarding the accuracy or completeness of the information provided. Any pro formas,

> projections, opinions, assumptions or estimates are *used for example purposes only* (emphasis added) and do not necessarily represent the current or future performance of the property".

To make a long story short it is *caveat emptor* (buyer beware) in the real traditional real estate business. It is your responsibility to verify all of the information that is in the brokerage package.

In the world that I live in, the world of securities, it is disclose, disclose more and then disclose what you have already disclosed. As licensed securities representatives we are obligated not only to know our clients financial situation and financial goals, but we are also obligated to make sure that they are provided with accurate information in regards to a prospective investment. And to do that we use the PPM, or Private Placement Memorandum.

While most tax attorneys would agree that a properly structured TIC investment should qualify to be real property (not a security) for exchange purposes, they would also agree that for distribution and sales purposes the SEC would consider them to be a security and absent an exemption from registration, a private security can only be offered to an investor by providing them a copy of a PPM. So, this why are you being asked to read a PPM that could easily be three quarters of an inch thick.

In general a security is defined as a group of individuals, joining together for a common business purpose, with an anticipation of profit, using the entrepreneurial efforts of another party. All of the TIC offerings that I have ever seen seem to fit this definition to a tee, thus leading me to believe they would be a security for sales purposes.

A PPM should disclose everything the investor of a new offering will need to know to make an informed investment decision. The PPM will also include the subscription document, which is the actual sales contract for the offering. This document will be prepared by a law firm hired by the investment sponsor to make sure that the sponsor discloses every material detail about the offering.

A PPM is designed to be a stand-alone document that allows the investor to make an informed investment decision. You may also be given an Investment Summary with glossy pictures and fancy charts and graphs and is much easier to read than the PPM. This is legal as long as the information in the Investment Summary conforms to the information in the PPM. On this document there must be a disclaimer that says that the information in the Investment Summary does not constitute an offer to sell securities and that only the PPM can make that offer. In addition, most reputable sponsors will add the phrase that this document is not to be given to potential investors without also giving them the PPM prior to or at the time they are given the Investment Summary.

So unlike a broker package from a real estate broker that disclaims any responsibility for providing you with accurate information about the property being offered for sale and leaving all of the due diligence up to you, the PPM provides you with most of the information you will need to know to make an informed investment decision.

Since securities are sold only through members of the National Association of Securities Dealers (NASD) you can assume that a number of independent firms will scrutinize each offering not only to protect their investors but also to protect themselves from potential liability for failing to verify material information contained in the PPM.

As stated previously, the PPM is very thick due to the fact that is has to provide you with all of the information necessary to make an informed investment decision. A typical TIC PPM will contain the following:

- The cover page and securities legends;
- Suitability standards for investors;
- Summary of the offering;
- Use of proceeds;
- Description of the property;
- Plan of distribution of the securities;
- Risk factors;

- Federal income tax consequences;
- Management and compensation;
- Summary of Tenant-In-Common agreement;
- Summary of the property management agreement;
- Legal matters;
- Documents available for inspection;
- Financial projections;
- Various exhibits;
- Tax opinion.

Although my clients that are attorneys and engineers will read the PPM word for word, I know most of the investors I speak with will not take the time to read this very large document and the exhibits that go with it.

In next months article I will walk you through the more important sections of the PPM so that you will know what they are intended to tell you and so that you will know the right questions to ask the person making the offering to you.

Until next month, if you are approached by someone offering to sell you a TIC property to complete your 1031 tax deferred exchange you need to ask him or her whether or not the offering is being made through a Reg D Private Placement. If they say no, then ask them if they can provide you a copy of the “No Action Letter” from the Securities and Exchange Commission (and applicable state counterpart) that the interest or transaction is not a “security.” If they cannot provide you with this letter then you may not want to jeopardize your exchange by investing in that property.

Steven D. Meahan, CFP®, is the president of Tax Reduction and Investment Strategies, Inc., a full-service financial planning company that specializes in working with the owners of rental real estate and business owners. If you have any questions please call him on his direct toll-free line at 1-888-825-1294. All investments and tax strategies have risks and compliance requirements that should be reviewed by professionals. The information presented in this article is for general and educational use only. No specific offerings are made