Don’t Derail Your Syndication!

With the recent passing of the JOBS Act, raising capital just got easier. The general rule has been to raise capital you either had to register your securities through a public offering or qualify under one of the private offering exemptions of the Securities Act of 1933, as amended (the “Act”). The most common exemptions relied on have been under Regulation D issued by the SEC and specifically under Sections 506(b) and 506(c). For real estate syndications, these deals are generally set up as private placements exempt from registration under Rule 506(b), which allows an unlimited amount of money to be raised from an unlimited number of accredited investors (and up to 35 non-accredited investors). For those wanting to advertise, Rule 506(c) can be used but is restricted to accredited investors only.

In order to qualify for one of the exemptions, you have to follow a strict set of rules and regulations regarding your securities and your manner of offering. Failure to comply with these rules could mean disqualification from the exemption and result in a violation of the Act for offering unregistered securities.

Before the JOBS Act, if you wanted to advertise your offering, a full-blown registration or a mini-registration was the only way to go. Unless you had an established network of potential investors where your offering didn’t have to rely on general solicitation and advertising, getting the word out on your offering was nearly impossible without registration. However, with the passing of the JOBS Act, the rules regarding general solicitation in connection with a private offering were relaxed and provided a narrow window where advertising would be permitted through Rule 506(c). Along with this opening allowing for general solicitation and advertising also came with it a whole new host of rules to qualify for this new exemption.

The private offering exemptions afford small companies raising capital a tremendous opportunity to raise capital to grow their businesses without the burdens and costs of registration. However, along with this opportunity comes a need for increased diligence. When relying on an exemption, it's vital that you stay within parameters and rules outlined under your specific exemption. For real estate syndications, promoters are urged to be mindful of the most vital rules as to not run afoul of the regulations and derail your syndication. Many of the missteps involve non-accredited investors who require more thorough screening and more comprehensive disclosure than their accredited counterparts.

The following is a list the most common mistakes that can derail a syndication:

- Accepting non-accredited investors without providing adequate disclosures.
- Improperly screening prospects for accredited investor status or when taking non-accredited investors improperly screening for financial sophistication.
- Not providing all required disclosures and documentation and in the proper order.
- Improperly verifying accredited investor status under 506(c), which allows for advertising.
- Taking an investor under Rule 506(b) without establishing a previous substantive relationship.
- Advertising or making general solicitations when not permitted.
- Paying commissions to unlicensed sales personnel.
- Making misstatements or omissions in your docs.
- Improper distribution of your offering documents allowing them to get into the wrong hands. It's important to keep track of each offering packet and earmark each one to a particular offeree.
- Forgetting to file appropriate SEC and state notice filings. Just because it's an exempt offering doesn't mean there aren't state filing requirements.

Check with the states in which you make offerings to understand and meet the notice requirements.

- Going beyond the scope of the business outlined in your offering documents (i.e., saying you're acquiring a specific property but using the money to acquire another property).
- Making oral or written offerings before providing adequate disclosures and documentation.
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Be sure to get experienced counsel in securities law before, not after you start raising capital. Doing so could help you avoid civil and criminal implications.