REISA ALERT: A GUIDE TO CERTAIN BEST PRACTICES FOR CERTAIN REGULATION D PRIVATE PLACEMENT OFFERINGS INCLUDING REAL ESTATE FUNDS, DEBT FUNDS AND DEBT OFFERINGS 2012

ALERT NUMBER: 12-01

This REISA Alert is a new guide to certain best practices with respect to certain Regulation D Private Placement Offerings, including Real Estate Funds, Debt Funds and Debt Offerings.

LIKELY INTERESTED GROUPS

- Sponsors
- Broker-Dealers
- Registered Representatives
- Attorneys
- Due Diligence Firms
- Others

AUTHOR(S) OF THIS ALERT

A cooperative effort between industry participants, including Broker-Dealers, Sponsors, Attorneys and REISA Committees and Board Members.

ATTACHMENTS

Exhibit A	–	FINRA Regulatory Notice 11-02 (“FINRA Notice 11-02”)
Exhibit B	–	FINRA Regulatory Notice 10-22 (“FINRA Notice 10-22”)
Exhibit C	–	FINRA Regulatory Notice 09-27 (“FINRA Notice 09-27”)
Exhibit D	–	NASD Notice to Members 05-18 (“NASD NTM 05-18”)

INTRODUCTION AND HISTORY

The Real Estate Investment Securities Association ("**REISA**") believes that a best practices guide is necessary to cover real estate funds, debt funds and certain debt offerings as well as to address FINRA's heightened focus on due diligence. In addition, this Guide should be considered a business practice standard that is applicable to retail distribution sales practices for private offerings under Rule 506 of Regulation D which is considered a "safe harbor" for the private offering exemption of Section 4(2) of the Securities Act. This Guide should be considered applicable to offerings made through FINRA member broker-dealers and is not intended as a guide for other types of offerings. In addition, FINRA is currently updating its position regarding many of the items discussed in this Guide and all the statements in this Guide are subject to any such updates.

*This Best Practices Guide (the "**Guide**") should not be construed as legal advice, legal interpretation, or written policies for broker-dealers, registered representatives or sponsors. Firms are urged to consult their own legal counsel for advice regarding the matters discussed herein.*

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FINRA – Regulatory Notice 10-22. "Regulation D Offerings." See, Exhibit B

FINRA – Regulatory Notice 09-27. "Member Private Offerings." See, Exhibit C

NASD – Notice to Members 05-18. "Private Placements of Tenants-in-Common Interests." See, Exhibit D

2. Suitability

Offerings of real estate alternative investment products should generally be limited to accredited investors and should be made in reliance upon the exemption from registration provided by Rule 506 of Regulation D as promulgated under the Securities Act of 1933, as amended, or other applicable exemption. Certain offerings may be suitable for unaccredited investors in limited circumstances. Any offering that is made available to unaccredited investors must comply with all of the heightened disclosure requirements imposed under Regulation D, including, but not limited to, the disclosure of audited financial statements of the issuer and the underlying asset (as applicable), as well as specific prior performance disclosures. In addition, offerings made under Regulation D, whether to accredited or unaccredited investors, should only be made to investors that meet the applicable suitability requirements. NASD Rule 2310[1] states that a broker-dealer must have reasonable grounds to believe that a recommendation to purchase, sell or exchange a security is suitable for the customer, based on the information obtained through the reasonable diligence of the broker-dealer or its registered representatives to ascertain the customer's investment profile. Based on new FINRA Rule 2111, broker-dealers have three

[1] Pursuant to FINRA Regulatory Notice 11-25, effective July 9, 2012, NASD Rule 2310 rule will be replaced by FINRA Rule 2111.

primary suitability obligations: (i) "reasonable basis," (ii) "customer specific" and (iii) "quantitative."

(A) "Reasonable Basis" Suitability Analysis

"Reasonable basis" suitability requires a broker-dealer to have a reasonable basis to believe, based on reasonable diligence, that a recommendation with respect to the security would be suitable for at least some investors. This is a general due diligence issue that does not focus on any one particular customer, but rather on the offering itself and whether the broker-dealer should even participate in the offering. The parameters of what will constitute sufficient "reasonable diligence" will vary depending upon the complexity of, and risks associated with, the security or investment strategy, and the broker-dealer's familiarity with such security or investment strategy. A broker-dealer's reasonable diligence must provide the broker-dealer (or the registered representative) with an understanding of the potential pros and cons and risks associated with the recommended security or investment strategy.

The reasonable basis suitability requirement is stressed in FINRA Notice 10-22 regarding Regulation D offerings, with which all broker-dealers participating in the sale of private placements should be familiar. In addition, the Securities and Exchange Commission (the "**SEC**") and federal courts have long held that a broker-dealer that recommends a security is under a duty to conduct a reasonable investigation concerning the security and the issuer's representations about it. Face-value reliance on an issuer's assertions will generally be found insufficient. Offerings involving alternative investments require a heightened degree of due diligence to ensure suitability, as opposed to publicly traded securities listed on an exchange, which may not require as much due diligence to satisfy the "reasonable basis" suitability test. To help satisfy the obligation to conduct a reasonable investigation, broker-dealers should gather information about the type of investment, capitalization, tax consequences, asset diversification, investment costs, liquidity, risks, fee structure, the issuer's experience with similar investments and other applicable factors associated with the offering.

(B) "Customer Specific" Suitability Analysis

"Customer specific" suitability requires that a broker-dealer have a reasonable basis to believe that its recommendation is suitable for a particular customer based on that customer's investment profile. A customer's "investment profile" includes, but is not limited to, the customer's:

(i) age,

(ii) other investments,

(iii) financial situation and needs,

(iv) tax status,

(v) investment objectives,

(vi) investment experience,

(vii) investment time horizon,

(viii) liquidity needs,

(ix) risk tolerance, and

(x) any other information the customer may disclose to the broker-dealer or its registered representatives in connection with such recommendation.

If a broker-dealer believes that a particular factor is not relevant in order for it to satisfy the customer specific suitability requirements, the broker-dealer must document with specificity its reasonable basis for believing that such factor is not relevant. Suitability determinations should be thoroughly documented and performed by registered representatives or broker-dealer principals who are trained to evaluate the relevant information. It should also be noted that an investor who is technically "accredited" may not have an "investment profile" that lends itself to a particular investment, which would make such investment unsuitable for the client and require the broker-dealer to refrain from making a recommendation to the investor regarding that particular security.

(C) "Quantitative" Suitability Analysis

"Quantitative" suitability requires a broker-dealer who has actual or de facto control over a customer's account to have a reasonable basis for believing that a series of recommended transactions, even if suitable when viewed in isolation, are not unsuitable for the customer when taken together in light of the customer's investment profile. Note that although "quantitative" suitability is typically associated with trading listed securities, it could become an issue in private placements if the broker-dealer recommends a series of private placement investments that are unsuitable for the customer in light of the customer's overall investment profile. For example, concentration of an investor's assets in a single asset class may not be suitable for many investors.

3. Broker-Dealer Supervision of Registered Representatives and Other Associated Persons

NASD Rule 3010 provides that broker-dealers selling Regulation D or alternative investments are required to establish, maintain and enforce written supervisory procedures. Supervision is the cornerstone of securities industry self-regulation and depends on broker-dealers establishing and implementing supervisory procedures and systems designed to achieve compliance with FINRA rules and federal and state securities laws. The supervisory procedures must be tailored specifically to the business of the broker-dealer and must be reasonably designed to supervise the activities of registered representatives, registered principals and other associated persons. At a minimum, the written supervisory procedures should address:

(i) Designation of properly qualified supervisors at each office location and for each type of business;

(ii) Assignment of each registered person to a supervisor;

(iii) Establishment of regular meetings (at least annually) to discuss compliance and educational matters with registered representatives and registered principals;

(iv) Utilization of reasonable efforts to determine that all supervisory personnel are qualified by virtue of experience or training to carry out their assigned responsibilities;

(v) Designation as an office of supervisory jurisdiction (OSJ) of each location and the designation of such other OSJs as the broker-dealer reasonably determines to be necessary in order to supervise its registered representatives, registered principals and other associated persons in accordance with the standards set forth in Rule 3010, taking into consideration the following factors:

(a) Whether registered persons at the location engage in retail sales or other activities involving regular contact with public customers;

(b) Whether a substantial number of registered persons conduct securities activities at, or are otherwise supervised from such location;

(c) Whether the location is geographically distant from another OSJ of the firm;

(d) Whether the broker-dealer's registered persons are geographically dispersed;

(e) Whether the securities activities at such location are diverse and/or complex; and

(f) Designation of one or more appropriately registered principals in each OSJ, including the main office, and one or more appropriately registered representatives or principals in each non-OSJ branch office with authority to carry out the supervisory responsibilities assigned to that office by the broker-dealer.

An OSJ is a location where one of the following functions occurs: (1) order execution and/or market making, (2) structuring of offerings, (3) maintaining custody of customer's funds and/or securities, (4) final acceptance (approval) of new accounts on behalf of the broker-dealer, (5) review and endorsement of customer orders, (6) final approval of advertising or sales literature for use by persons associated with the broker-dealer, except for an office that solely conducts final approval of research reports or (7) responsibility for supervising the activities of persons associated with the broker-dealer at one or more other branch offices of the broker-dealer.

As stated in FINRA Notice 10-22, a broker-dealer that engages in Regulation D offerings must have supervisory procedures under NASD Rule 3010 that are reasonably designed to ensure that the broker-dealer's personnel, including its registered representatives:

(i) engage in an inquiry regarding the offering that is sufficiently rigorous to comply with their legal and regulatory requirements;

(ii) perform the analysis required by NASD Rule 2310 or FINRA Rule 2111, as the case may be;

(iii) qualify their customers as eligible to purchase securities offered pursuant to Regulation D; and

(iv) do not violate the antifraud provisions of federal or state securities laws or FINRA rules in connection with their preparation or distribution of offering documents or sales literature.

These procedures must be reasonably designed to ensure that each Regulation D offering is properly supervised before it is marketed to other firms or sold to customers.

Broker-dealers should also maintain and enforce written supervisory procedures to ensure that sales are made only to those who satisfy the "Who May Invest" or "Investor Suitability Requirements" section of the Private Placement Memorandum ("**PPM**"), and that neither the broker-dealer nor its registered representatives pay referral fees or otherwise share transaction-based compensation from Regulation D transactions with persons who are unregistered. A broker-dealer cannot reduce its normal sales commission for a transaction in an arrangement to allow the issuer or potential investor to pay the difference to an unregistered person for participating in the transaction or for referring business to the broker-dealer.

Supervisory procedures also should address outside business activities and private securities transactions by registered representatives. Supervisory procedures should include procedures for educating registered representatives regarding the identification and reporting of outside business activities and private securities transactions. A procedure should be implemented by which registered representatives are required to report outside activities to the broker-dealer and a procedure by which the broker-dealer can determine if such activities require the broker-dealer to approve and supervise the transactions. Supervisory procedures should also include procedures for identifying unreported activity and mandatory steps to follow up on suspected activity. Broker-dealers should be familiar with FINRA Rule 3270 (outside business activities of an associated person) and NASD Rule 3040 (private securities transactions of an associated person) and the interpretations thereunder.

Broker-dealers must also have supervisory procedures in place to ensure that gifts given by the broker-dealer and its registered representatives and other associated persons comply with FINRA Rule 3220, as discussed in Section 12, including maintaining records of these gifts.

Broker-dealers assume a higher level of supervisory responsibility when they hire a representative with a significant negative regulatory history. Routine supervision is not sufficient when a broker-dealer hires a representative who, for example, has a pattern of serious customer complaints or a disciplinary history, or for an existing representative who becomes the subject of such problems. In these instances, broker-dealers must develop and impose special supervisory practices designed to address the particular areas of concern presented by the individual representative.

Supervisory procedures must be regularly updated and consistently implemented.

4. Securities Licensing

Persons selling Regulation D alternative investment securities must have appropriate licenses to sell securities under applicable federal and state securities laws. A Series 7 license (General Securities Representative) may sell all types of private placement securities, including a REIT. A Series 22 license (Direct Participation Programs Limited Representative) may only sell equity interests in, or the debt of, direct participation programs (i.e., any program that provides for flow-through tax consequences, primarily LLCs and LPs). A Series 22 license does not qualify a registered representative to sell REITs or other corporate stock or debt offerings (a Series 62 license (Corporate Securities Limited Representative) would be required to sell such securities). The Series 82 license (Private Securities Offerings Representative) qualifies the holder to participate in the sale of private placement securities (other than municipal or government securities, and equity interests in, or the debt of, direct participation programs) as part of a primary offering. In addition, the Series 63 license (Uniform Securities Agent State Law) is required by nearly all states to demonstrate knowledge of the state-specific “blue sky” laws. Broker-dealers must have systems in place to verify that their registered representatives are only selling those types of securities that they are licensed to sell.

5. PRIVATE PLACEMENT MEMORANDUM (PPM) DISCLOSURES

Recommended practices in offering and selling a Regulation D investment include preparation of a PPM that provides full and fair disclosure of the material aspects of the offering. In considering what information is “material,” issuers and broker-dealers should consider information material if the omission of the information would alter the total mix of information made available to a prospective investor or would impact the investment decision, from a reasonable person’s perspective. The PPM should not contain any information or omit a material fact that is necessary in order to make the statement made in light of the circumstances under which they were made, not misleading.

PPMs for Regulation D offerings that are made to accredited investors only are subject to the anti-fraud requirements but are not required to contain specified information and disclosures. This Guide, however, encourages disclosures that are commensurate with the information required in a prospectus filed with the SEC even where the offering is offered and sold only to accredited investors. The SEC requires heightened disclosures when offers or sales to unaccredited investors are made. At a minimum, disclosures should be accurate, balanced, clear, concise and consistent throughout the PPM, and all facts presented in the PPM should be verifiable and supportable from independent and reliable services. The issuer should have a reasonable basis for all statements made in the PPM. Opinions of the issuer as compared to factual matters should be clearly identified. Puffery should be minimized, and superlative, exaggerated and unsupportable statements should not be included. The PPM should primarily be viewed as a disclosure document to provide the investor with a complete understanding of the offering, and only secondarily as a marketing tool.

Disclosures in the PPM must be specific for the securities offered. For example, the disclosure should be specific to the type of security offered (i.e., interest in a fund or debenture); the investment strategies of the offering (i.e., stabilized, opportunistic or distressed); the investment objectives of the offering (i.e., capital preservation, income or growth); and the underlying or target assets of the program (i.e., real estate or debt investments), among other aspects. Generic PPMs that do not disclose the particular features of the offering are not consistent with the requirements of this Guide. Two part offering documents, where one part consists of "boiler plate" disclosure and the other part consists of property specific disclosures, are strongly discouraged.

All non-financial sections of the PPM should be written in view of the SEC's plain English rules or written in a clear, concise manner that is easily read and understood by potential investors.

A PPM should be marked confidential, and the sponsor should keep track of each copy of the PPM by assigning a unique number which corresponds to the particular offeree (and broker-dealer) to which it was furnished. PPMs should not be made available on an uncontrolled basis through email or internet access, or left out on an exhibit table at a conference where tracking each copy is not possible.

A PPM should generally contain the following categorical disclosures, as modified and specified for the offering type:

(A) Cover Page and Commissions Table

The cover page should include a general description of the security being offered, the issuer's intended use of the proceeds of the offering and the terms of the offering (including, without limitation, the maximum and minimum (if any) offering amount, offering price, escrow terms and offering period). The cover page should also contain a summary of material risk factors (presented in list or bullet form in order of their importance) specific to the offering and a reference to the risk factors in the PPM. The cover page should also state if there are limitations on transferability. Finally, the cover page should include a table of the compensation to be paid to broker-dealers in connection with the offering, identifying the amount (on a dollar basis) that is to be paid on a per unit basis and in total for the minimum (if any) and maximum offering. The commissions table should be footnoted to disclose the dealer manager, if any, and with particularity the amount (on a percentage basis) and nature of each item of compensation (selling commissions, due diligence and marketing allowances and reimbursements, wholesaling compensation), as well as the amount and nature of other organizational and offering costs. No direct or indirect compensation should be paid to any broker-dealer or registered representatives that is not disclosed except as allowed pursuant to FINRA Rule 3220. The footnotes to the commission table (and other prominent section of the PPM) should disclose with particularity any categories of investors who may be offered discounts or other special arrangements in connection with the purchase of the security being offered.

In a minimum/maximum offering, the minimum offering amount should be set at an amount that provides sufficient net proceeds, together with any other funding, to carry out the issuer's business plan. The minimum amount should not be set at a lower amount simply to allow the broker-dealers to be paid sooner. In the event that the offering is sold on an "all or none" basis or has other contingencies, including a minimum, the funds must be deposited into a bank in accordance with Rule 15c2-4 of the Securities Exchange Act of 1934 (the "**34 Act**")[2]. The rules regarding what qualifies as a bank and the types of accounts the funds may be held in are very specific and many typical escrow accounts will not qualify. See Section 13 of this Guide for additional information on escrow accounts.

(B) Who May Invest or Investor Suitability Requirements

The PPM should contain a detailed section that discusses who may be offered and sold the securities. Usually this includes the relevant standards for accredited investors and any specific limitations imposed by the issuer. This section should state that if investors do not meet the standards or are deemed not to be suitable, they may not invest and have an obligation to return the PPM.

(C) Summary of the Offering

The summary of the offering should include a short summary of all the material terms of the offering, including, but not limited to, risk factors, a description of the security offered, investor rights and obligations, use of proceeds, plan of distribution, management of the issuer, assets to be acquired or acquisition criteria, business plan and objectives, compensation to the issuer and its affiliates, and conflicts of interest. Special attention should be given so that the summary is fair and balanced considering the entire mix of information in the PPM.

(D) Risk Factors

All material risk factors should be summarized in the PPM in a separate section titled "RISK FACTORS." The RISK FACTORS section should follow the "summary of the offering"

[2] See also Rule 10b-9 of the 34 Act.

section and if there is no summary, the cover page. Sponsors and their legal counsel should avoid using generic risk factors or including risk factors that are not relevant to the offering. Although some risk factor disclosures may be the same among similarly structured offerings, issuers and their legal counsel should take care to tailor and highlight specific risk factors of the offering, including specific conflicts of interest risks. The risk factors should be concise and organized logically. Within each category of risks, the specific risk factors should be prioritized, with the more material, higher probable impact risk factors located before the lesser probable impact risk factors.

Risk factors should not contain ameliorative or mitigating language unless absolutely necessary to avoid obscuring a material aspect of the offering.

Risk factor disclosures will vary significantly according to the type of program, its business plan and objectives and the underlying or target assets. See Exhibit E for a list of certain risk factor topics that might be addressed in a real estate fund PPM. Other types of offerings will have different risk factors.

(E) Cautionary Note Regarding Forward Looking Statements

A section should be included in the PPM that indicates to the investor that the PPM includes forward looking statements.

(F) Estimated Use of Proceeds

The presentation of an estimated use of proceeds in a PPM should be simple and clear in order to:

(i) Increase transparency;

(ii) Provide easy to understand disclosure to investors; and

(iii) Speed the due diligence process and allow better comparisons of costs among issuers.

The information in the PPM, and more specifically in the Estimated Use of Proceeds, should clearly disclose the intended use of the offering proceeds, expenses and the amount of selling compensation or other compensation to be paid to any broker-dealer or their affiliates. Issuers are encouraged to utilize a tabular format for the presentation. The presentation should include clear disclosure of all anticipated compensation paid or payable to the issuer and their respective affiliates in connection with the offering.[3] The table should include columns for minimum (if any) and maximum offering proceeds with all uses of proceeds in each column shown as a dollar amount and as a percentage of total gross offering proceeds.

Sources of proceeds will vary significantly by the type of offering (i.e., a real estate opportunity fund offering as compared to a debenture offering) and whether the offering is a blind pool offering or is a specified offering. A "blind pool" is an offering where the property to be acquired for the fund is not known at the time of the offering and a "specified offering" is an offering where the property to be acquired is specified in the offering. Uses of proceeds, particularly net proceeds after payment of organization and offering expenses, will vary significantly by type of program. Separate rows should be included for all significant uses of funds, which should separately itemize, where applicable and material, the following projected items:

(i) Each type of fee or other compensation payable to the issuer or any affiliates and the total of such payments.

[3] FINRA has issued Regulatory Notice 11-04 which proposes to require all offerings to disclose the intended use of the offering proceeds, expenses and the amount of selling compensation to be paid to the broker-dealer and that at least 85% of the offering proceeds must be used for the business purposes identified in the PPM.

(ii) Each type of fee or other compensation payable to broker-dealers or any affiliates and the total of such payments.

(iii) Each type of cost payable (*e.g.*, acquisition/brokerage, financing, custodial) to third parties not affiliated with the issuer, any selling broker-dealers or any affiliates thereof, and the total of such payments.

(iv) Each type of reserve to be established in connection with the offering.

(v) The amount of any cash distributions or interest payments to be funded from the offering proceeds.

(vi) The amount of the proceeds to be used for the business purposes identified in the PPM; and

(vii) If any loan proceeds are being used for any other purpose other than the purchase of an investment, then it should be disclosed through itemization in the table or footnote.

Footnotes should be used to explain and provide further detail regarding amounts in the table, not to disclose amounts omitted from the table.

In the event that financing has been obtained to acquire a specific asset and certain expenses are being paid from the proceeds of such financing, the estimated use of proceeds table should include such amounts paid in a footnote. If any material amounts of other funds are necessary to accomplish the specified purposes for which the offering proceeds are raised, state the amounts and sources of such other funds needed for each such specified purpose. The use of proceeds table should not include loans as proceeds of the offering.

A sample of an estimated use of proceeds table can be found at Exhibit F and is included for illustrative purposes only. In a minimum/maximum offering, indicate the order of priority of the use of the proceeds and discuss the issuer's plans if less than the maximum proceeds are raised.

(G) Business Plan and Investment Objectives

The Business Plan section should include a detailed narrative of how the issuer will use the proceeds of the offering, the investment opportunity the issuer has identified and how the investments are intended to achieve the issuer's objectives. Depending on the complexity of the investments to be made with the proceeds, the PPM should include an explanatory, background discussion of investments that are not readily understood by the average accredited investor (i.e., commercial mortgage-backed securities or collateralized debt obligations). If the offering is a blind pool offering, the business plan should provide a detailed description of the proposed acquisitions procedures.

(H) Description of the Investment(s)

PPMs should disclose in detail the underlying assets that the issuer is acquiring with the offering proceeds in a specified offering or a detailed description of the type of assets that the issuer intends to acquire, if a blind pool offering. The PPM should describe the policies with respect to investing in the investments, indicate whether the policies may be changed by the issuer without a vote of the investors and the percentage of assets, if any, which the issuer may invest in any one type of investment. Issuers should obtain third party reports related to any specified real estate investments including an appraisal, property condition report, phase I environmental report, zoning report, title report, survey and other applicable third party reports. The issuer should be permitted to rely on such third party reports.

(i) Specified Offerings. For specified offerings, the PPM should describe the material characteristics of the assets acquired. The description in the PPM should include:

(a) The location and the general character of all material properties held or intended to be acquired by or leased to the issuer. Include information as to the present or proposed use of such properties and their suitability and adequacy for such use. Properties not yet acquired should be identified as such.

(b) A description of the market where the property is located (usually summarized in an appraisal).

(c) State the nature of issuer's title to, or other interest in, such properties (and all exceptions) and the nature and amount of all material liens or encumbrances against the properties.

(d) Discuss all financing arrangements with respect to the properties.

(e) Set forth the current principal amount of each material encumbrance, its interest and amortization provisions, its pre-payment provisions and its maturity date and balance to be due at maturity.

(f) Outline the principal terms of any material lease, a rent roll for the property and if estoppels have been obtained.

(g) Provide a summary of the material tenants at the property.

(h) Indicate any option or contract to acquire or sell any property.

(i) Outline any proposed program for the renovation, improvement or development of the property, including the estimated cost and the method of financing to be used. If there are no present plans for the improvement or development of the property indicate such and indicate the purpose for which the property is to be held or acquired.

(j) Describe the general competitive conditions to which the property may be subject.

(k) All material financial information regarding the property.

(l) All relevant information obtained from any property reports.

(ii) Blind Pool Offerings. For blind pool offerings, the PPM should describe the characteristics of the real estate to be acquired. The description in the PPM should include:

(a) The geographic area or areas in which the issuer proposes to acquire real estate or interests in real estate.

(b) The types of real estate and interests in real estate in which the issuer may invest; for example, office buildings, apartment buildings, shopping centers, industrial and commercial properties, special purpose buildings or undeveloped acreage.

(c) The method or proposed method of operating and financing the issuer's real estate should be described. Indicate any limitations on the number or amount of encumbrances which may be placed on any one piece of property or on all properties.

(d) Whether or not it is the issuer's policy to acquire assets primarily for possible capital gain or primarily for income.

(e) The amount or percentage of assets which will be invested in any specific property.

(f) A statement with respect to any other material policy with respect to real estate activities.

When a material acquisition is made, the information set forth above in (H)(i) Specified Real Estate, should be provided.

(iii) Debt Funds. For investments in real estate-related debt funds, the PPM should describe the debt acquired or to be acquired. The PPM should include:

(a) The terms of the debt to be acquired including the principal, interest and repayment terms.

(b) The types of debt; for example, first or second mortgages and whether such mortgages are to be insured by the Federal Housing Administration or guaranteed by the Veterans Administration or otherwise guaranteed or insured.

(c) The proportion of assets which may be invested in each type of debt or in any single borrower.

(d) The structure of the debt to acquired (note paper, whole pool, tranche, CDO).

(e) The status of the debt to be acquired (performing, non-performing).

(f) The nature of the security provided as collateral (indenture, collateral agreement, unsecured).

(g) A description of each type of debt in which the issuer intends to engage, such as originating, servicing and warehousing of mortgages.

(h) The types of properties subject to debt in which the issuer invests or proposes to invest; for example, single family dwellings, apartment buildings, office buildings, commercial properties and unimproved land.

(iv) Debt Offerings. For debt offerings, the use of the offering proceeds should be disclosed and, if they are to be used for the acquisition of a particular asset, such asset should be described. The PPM should include:

(a) A description of the debt instrument being acquired, including all payment terms including the maturity date, extension rights, deferred payments and any deferral rights.

(b) All collateral that secures the debt and if the debt instrument is secured by real estate, the information set forth in (H)(i) Specified Real Estate above.

(c) Any rights investors have to proceed against assets or the issuer (whether the debt is recourse or nonrecourse).

(d) The financial condition of the issuer.

(e) The terms of any guaranty and the financial condition of the guarantor.

(f) The structure of the debt, i.e., is it an offering of individual notes or is it an issuance of a debenture subject to an indenture and, if so, what are the terms of the indenture.

(I) Acquisitions and Financing (if applicable)

The PPM should disclose the terms of the acquisition of the property from the seller including, but not limited to, the price, the material representations, or lack thereof, whether the seller is affiliated with the issuer and any material indemnification provisions. If financing will be used to acquire an asset, the terms of such financing should be included. The summary should include the term of the financing, the interest rate, any guaranties required, any reserve requirements, any restrictions on transferability and potential events of default.

(J) Compensation to the Sponsor and its Affiliates.

The PPM should include, in a tabular format, information regarding each type of compensation payable to the issuer or its affiliates, the anticipated amount of the compensation, both at the minimum (if any) and maximum offering amount, and any conditions to the payment of the compensation (i.e., investor hurdles, market limitations). Issuers should arrange the tabular presentation according to compensation payable in each stage of the investment (offering, operating and liquidation/disposition). The compensation should include any compensation paid to any affiliate of the issuer, whether direct or indirect, such as a real estate commission paid by the seller to the issuer or an affiliate on the acquisition of the real estate.

(K) Sponsor and Management

The PPM should include a detailed description of the investment background of the sponsor, with a particular emphasis on the aspects of the sponsor's background that support its expertise with respect to the business plan of the issuer, as compared to general background information that does not bear directly on its abilities. The description of the management should include detailed biographies of each key executive and key employee of the sponsor and manager or general partner of the issuer, including such person's work history for at least the past five years and related titles in such capacities, positions with affiliates of the sponsor, educational background (by school, degree and year of completion), personal or corporate bankruptcies or criminal proceedings occurring within the past ten years and those that are otherwise material, and any active material litigation in which such person is a named party and any past litigation that would be material to an investor's decision to invest.

(L) Prior Performance

(i) Information concerning the financial performance of all currently operating and completed offerings previously sponsored by the sponsor or any of its affiliates should be included in the PPM. A narrative overview of the prior performance of the sponsor should be included in a section of the PPM dedicated to prior activities of the sponsor and refer to additional more detailed disclosure contained in the PPM or in an appendix to the PPM. The detailed disclosure should be presented in tabular format (see Exhibit G) for currently operating and fully completed programs with similar investment objectives to those of the current offering if they were offered during the ten-year period prior to the date of the PPM. Public company sponsors may provide Guide 5 prior performance tables as an acceptable alternative. Sponsors and their legal counsel should carefully review the investment objectives of prior real estate programs to determine if those programs share similar investment objectives with the current offering. If there is not a sufficient number of similar programs, it may be advisable to use all prior programs of the sponsor in discussing prior performance.

(ii) Currently Operating Programs. With respect to currently operating programs, a separate table detailing financial results for each prior program should be included in the PPM and should be presented on a cash or accrual basis, at the discretion of the sponsor, but in any case in a consistent manner. Each table should be designed to compare actual twelve-month operating results to those projected in the PPM related to each prior offering, as applicable, and the columns should match the periods contained in such projections from inception. In cases where the PPM for a prior offering did not include any projections, calendar years should be used. When properties are being presented on a calendar-year basis, or fiscal-year basis, updated year-end data should be included in any subsequent PPMs (or supplements) within 90 days.

Each row should include a comparison of actual to projected results (as described above). Any fees payable to the sponsor or any of its affiliates that were deferred in any year should be disclosed below the table in narrative format. All uses of cash paid to the sponsor or an affiliate should be separately identified so that an investor can easily determine the amounts paid to the sponsor and its affiliates. Exhibit G of this Guide provides the suggested format and fields of information for presentation and inclusion in the PPM of prior performance on currently operating programs.

Narrative disclosure should be included in the PPM with respect to any prior program (regardless of whether it has or had investment objectives similar to those of the current offering) that is experiencing or has experienced any material adverse business developments. Material adverse business developments will depend on the type of program and might include, but are not limited to, the following:

(a) Actual performance materially below initial projections;

(b) Unanticipated or material anticipated vacancies;

(c) Material tenant defaults or delinquencies;

(d) Capital/development expenditures in excess of budgeted amounts; and

(e) Unanticipated environmental or other property or title issues.

Known material adverse developments should be disclosed notwithstanding the fact that a program has not yet liquidated its assets and its ultimate returns are not known.

(iii) Completed Programs. Disclosure for completed programs should provide overall performance data for investors in prior programs in tabular form. Where the source of distributions to investors was provided either directly or indirectly from funds provided by the sponsor or its affiliates, this fact should be disclosed in narrative disclosure. Exhibit G-2 provides the suggested format and fields of information for presentation and inclusion in the PPM of prior performance for completed programs.

Exhibit G-2 provides an additional format for inclusion of operating and completed properties within the PPM. The combination of the more detailed information contained in the format of Exhibit G-1, with the summarized format of Exhibit G-2, will provide enhanced disclosure and understanding by the investor.

(M) Conflicts of Interest

The PPM should contain a section that discloses the potential conflicts of interest that may arise with respect to the management of the issuer resulting from the affiliated relationships between the issuer and the manager or general partner of the issuer or other entities controlled by the manager or general partner. A clear and concise description of these conflicts of interest is essential to an investor's understanding of how management may be influenced by factors other than the interests of investors. This disclosure should discuss any mitigation procedures that have been adopted by the issuer, or the absence and consequence of such procedures.

(N) Summary of Operative Documents

The PPM should summarize the material terms of all operative documents related to the offering and the operation of the assets to be acquired including, without limitation:

(i) Limited liability company agreements, partnership agreements, articles of incorporation and bylaws, as applicable;

(ii) Joint venture agreements;

(iii) Management agreements;

(iv) Indentures, paying/collateral agent agreements and pledge/security agreements;

(v) Loan agreements.

Other documents detailing an investor's rights with respect to the securities offered should be summarized, including separate redemption/liquidity agreements and plans, put or call agreements, and reinvestment plans.

(O) Plan of Distribution

The Plan of Distribution section should detail all arrangements made with regard to the distribution of the securities. Any underwriting, brokerage or other arrangements and related compensation should be disclosed. Any cost sharing, cost reimbursement or profit or back-end sharing must be disclosed. Material terms of selling agreements or indemnification of FINRA members should be disclosed. Any early investor incentives, volume price agreements, fee waivers and similar provisions should also be disclosed.

(P) Description of Securities Offered

The PPM should include a section that describes the nature of the securities being offered, including whether the security is an equity or debt investment in the issuer or other investment contract, and all material terms and conditions of the securities.

(Q) Restrictions on Transferability

The PPM should include a section that discusses any restrictions on transferability, including a secondary market transaction, arising from federal and state securities laws, tax laws and specific limitations imposed by the terms of the program. Issuers should clearly identify that a Regulation D investment will have limited or no liquidity and may not be sold unless registered or an exemption from registration exists.

(R) Federal Income Tax Section

PPMs should include a detailed analysis of all of the material federal income tax issues relating to an investment in the securities being sold. The disclosure should be clear and note any variance with applicable tax guidance. Topics should include federal income tax treatment of the interest (i.e., will it be a pass-through investment for tax purposes), treatment of debt, treatment of fees paid and potential unrelated business taxable income. However, the disclosure should stress that investors consult their own tax attorneys or CPAs with respect to their particular facts and circumstances.

(S) State Tax Section.

The PPM should include a description of the relevant state income tax provisions, if material.

(T) ERISA.

The PPM should include a section that addresses the investment risks for pension plans and other qualified plans.

(U) Supplements

A supplement to a PPM must be issued when there are material changes in the information disclosed in the original PPM during the offering period; and, if a blind pool, when there is a reasonable probability that the property will be acquired. The supplement information supersedes that of the original PPM and should be made available to the investor to read in its entirety before any investment is made. A PPM is incomplete without all current supplements being provided to an investor. If subscription documents are submitted to the issuer prior to the issuance of any supplement disclosing any material changes, but after such changes are known or are reasonably probable, the underlying investment agreements should be re-sent to the investor to allow time to read the supplement or provide the investor with a right to rescind the investment if the investment was already accepted. Issuers should review supplement disclosures with legal counsel to determine if the disclosures require other affirmative action on the part of the issuer, such as a rescission offer or reconfirmation of the investor's investment.

6. Legal Opinions

(A) Partnerships (including Limited Liability Companies)

Offerings for entities that intend to be treated as partnerships for tax purposes (i.e., limited partnerships and limited liability companies) should include a legal opinion from a reputable lawyer or law firm that the partnership or limited liability company will be treated as a partnership for federal income tax purposes. The partnership or limited liability company should also receive a legal opinion that the entity has been legally formed and in good standing in its state of formation and that the entity has the legal authority to take the actions described in the PPM.

(B) Debt Offerings

Debt offerings should include a legal opinion that the debt instruments should be treated as debt, and not equity, for federal income tax purposes.

7. Marketing Materials

The PPM is the disclosure document for Regulation D offerings. In addition to the PPM, sponsors and broker-dealers may wish to produce and distribute other materials used for marketing the offering (e.g., flip books, pamphlets, presentations, glossy brochures, etc.). The two primary concerns raised by the production of marketing materials are consistency with the PPM and preservation of the exemption from registration provided by Regulation D.

(A) Consistency with the PPM

Information contained in marketing materials must conform to, and be consistent with, the information disclosed in the PPM. It is strongly encouraged to provide a PPM with the distribution of any marketing materials. Marketing materials should be fair and balanced. As with a PPM, puffery should be minimized, and superlative, exaggerated and unsupportable statements should not be included. Federal and state anti-fraud laws, which, among other things, prohibit making material misstatements or omissions in connection with an offering, apply to marketing materials. A disclosure should be made that the marketing materials do not constitute an offer to sell or a solicitation to buy any securities and that the information contained in the marketing materials is subject to the information provided in the PPM and that no purchase can be made without receiving and reviewing the PPM. A prominent referral to the risk factors section in the PPM should be included in every marketing piece; for multi-page marketing pieces, a list of significant risk factors should be included prominently in the marketing materials (i.e., not relegated to the last section) in a font consistent with the other information in the marketing materials. Marketing materials should direct prospective investors to the PPM for additional information. Broker-dealers may want to submit all marketing materials to FINRA for approval prior to use.

(B) General Solicitation Considerations

It is strongly recommended that the marketing material and PPM be distributed together to ensure that the marketing material is distributed only to investors and prospective investors with substantive pre-existing relationships with the issuer, the broker-dealer or a registered representative. Materials labeled "Broker-Dealer Use Only" must not be distributed to or used with investors. It is strongly suggested that no marketing materials should be for the exclusive use of broker-dealers but that all information should be in compliance with the provisions of (A) above.[4]

8. General Solicitations made by Broker-Dealers and their Registered Representatives.

The importance of Regulation D's prohibition on general solicitations in Rule 506 offerings was highlighted in NASD NTM 05-18. In response, REISA (formerly TICA) issued TICA Alert 05-02 (Exhibit H). Although NASD NTM 05-18 and TICA Alert 05-02 specifically address tenant in common syndications, participants in all industries are encouraged to review NASD NTM 05-18 and TICA Alert 05-02 and, when conducting private placements, consider the concepts presented therein as they relate to general solicitations.[5]

Advertisements and other general solicitations, including seminar presentations, that are made to those persons with whom a broker-dealer or its registered representative have no substantive pre-existing relationship must be generic in nature and may not include an offer of securities. In this manner, a general solicitation may be used by a broker-dealer to build a potential client base for future product offerings. However, offers of securities may only be made to those persons identified through such a general solicitation (i) after a substantive pre-

[4] The Jumpstart Our Business Startups Act of 2012 (the "JOBS Act"), which was recently enacted, provides that certain limited general solicitation will be permitted with respect to Regulation D offerings. The implementation of the JOBS Act will not occur for approximately 90 days. This Guide will be updated when the provisions of the JOBS Act have been implemented.

[5] See footnote (4) above.

existing relationship has been established, and (ii) of a product that became available to the broker-dealer after the establishment of the relationship and that was not contemplated to be offered prior to the time the relationship was established.

Items that could constitute an offer of securities through general solicitation and would therefore <u>be impermissible</u> when made to persons with whom the broker-dealer or its registered representative has no substantive pre-existing relationship include:

(i) PPMs;

(ii) Offering specific flyers, brochures or the like;

(iii) Advertisements that may be considered an offer;

(iv) Any reference to a specific offering including non-specific summaries;

(v) Corporate sponsor brochures, even if there is no reference to products or sales;

(vi) References (written or oral) to past or closed offerings, those currently available and future offerings;

(vii) Attendance by a sponsor representative (such as a wholesaler) at a seminar arranged or involving material participation by a broker-dealer or a registered representative;

(viii) Participation in or reimbursement of the seminar's costs by a sponsor;

(ix) The naming of a particular sponsor in an advertisement or other communication; or

(x) Information concerning a specific offering on the public area (non-password protected) of representative's or broker-dealer's website accessible to persons with whom the broker-dealer has not yet established a substantive pre-existing relationship.

The following items are more likely to be considered generic and may be included in a general solicitation or advertisement to persons with whom the broker-dealer or its registered representative have no substantive pre-existing relationship:

(xi) Discussion of the Internal Revenue Code or tax issues of an industry's product type;

(xii) Discussion of regulations and other tax authorities;

(xiii) Discussion of industry concepts that do not mention an offering or sponsor;

(xiv) Discussion of political, economic or even scientific news (especially in energy subjects) not specific to an offering or sponsor;

(xv) Reference materials that do not refer to a specific offering or sponsor; or

(xvi) Other items not specific to a particular offering or sponsor.

However, even the foregoing, when deemed connected to an offering, could be found to be a violation of the prohibition against general solicitation. Further, there are a number of circumstances where the determination whether a communication is generic is not clear.

The above discussion concerns general solicitations where there is no substantive pre-existing relationship with the potential investor. When a pre-existing substantive relationship does exist, the foregoing prohibitions do not apply to communications with that investor. For instance, a general communication, such as a seminar or mailing to persons with whom a registered representative has a substantive pre-existing relationship (such as existing clients) would be permitted, and the above limitations concerning generic-only material and sponsor participation in costs or seminars do not apply.

9. General Solicitations made by Sponsors

A sponsor must not engage in any general solicitation.[6] Items that would constitute an offer of securities through general solicitation by the sponsor and would therefore be impermissible include:

(i) Advertisements, mailings and similar items made to investors with no substantive pre-existing relationship;

(ii) Cold calling investors with no substantive pre-existing relationship;

(iii) Articles, notices or other communications regarding an offering published in any newspaper, magazine or similar media or broadcast over television or radio;

(iv) Any sponsor seminar or meeting whose attendees have been invited by general solicitation or advertising;

(v) Attendance by a sponsor representative (including a wholesaler) at a seminar presented by the broker-dealer or registered representative where there was no substantive pre-existing relationship between all of the attendees and that representative;

(vi) Presentation or distribution of sponsor or offering information at a seminar where there was no substantive pre-existing relationship between all of the attendees and that sponsor;

(vii) Participation in or reimbursement of a seminar's costs by a sponsor where the attendees at the seminar do not have a substantive pre-existing relationship with the registered representative presenting at the seminar;

[6] See footnote (4) above.

(viii) Placing information concerning an offering on a public area (non-password protected) of a sponsor's website, soliciting investors or placing offerings or information on social media platforms; and

(ix) Hiring, paying or otherwise contracting with a "finder" or other third party to do any of the above activities.

10. Due Diligence

(A) General Obligations

FINRA and applicable securities laws require broker-dealers to perform an appropriate level of due diligence for every private placement which they are engaged to sell. Broker-dealers may not rely solely upon the accuracy of information supplied by the issuer or its agents, but must engage in an independent due diligence investigation that is customized for each offering. Some offerings may have certain unique features that require additional due diligence. In addition, the nature and extent of due diligence that is required will vary with the circumstances of each issuer and offering.

FINRA Notice 10-22, which is FINRA's most current statement on the due diligence obligations of broker-dealers states:

> . . . a BD may not rely blindly upon the issuer for information concerning a company nor may it rely on the information provided by the issuer and its counsel in lieu of conducting its own reasonable investigation. While BDs are not expected to have the same knowledge as an issuer or its management, firms are required to exercise a "high degree of care" in investigating and independently verifying an issuer's representations and claims.
>
> In the course of a reasonable investigation, a BD must note any information that it encounters that could be considered a "red flag" that would alert a prudent person to conduct further inquiry.

FINRA Notice 10-22 also says that a BD should retain records and documentation of its process and results of its due diligence investigations. These records may include meetings, documents reviewed, including third party reports, interviews and other items, along with the dates and persons involved.

NASD NTM 05-18 also provides useful guidance on the due diligence responsibilities of broker-dealers:

> NTM 03-71 reminds members that the type of due diligence that is appropriate will vary from product to product. FINRA staff believes that it is not appropriate for members to rely on representations made by the sponsor in an offering document. While the nature and extent of verification will vary with the facts and circumstances related to particular sponsors and offerings, members should make a reasonable investigation to ensure that the offering document does not contain false or misleading information. Such an investigation could include background checks of the sponsor's principals, review of the agreements (e.g., property management, purchase and sale, lease and loan agreements) and property inspection. In addition, if the offering document contains projections, members should understand the basis for those projections, and the degree of likelihood that they will occur. For example, members should determine whether any projected yields can reasonably be supported by the property operations.

Further, FINRA Notice 10-22 provides specific examples of the type of due diligence investigation to be conducted:

> A BD's reasonable investigation must be tailored to each Regulation D offering in a manner that best ensures that it meets its regulatory responsibilities. Accordingly, a single checklist of possible practices for a BD engaged in Regulation D offering will not suffice for every offering and mechanical reliance upon a single checklist may result in inadequate investigation.

FINRA Notice 10-22 goes on to describe some of the appropriate due diligence investigations, including reviewing governing documents, historical financial statements, audited financials (if available), reviewing past securities offered, inquiries concerning pending or past litigation or regulatory problems, reviewing management and internal controls of the issuer, business plans, financial models and assumptions of the offering, inspecting assets and reviewing third-party reports.

NASD Notice to Members 05-48 indicates that even though a broker-dealer may outsource certain functions to third party providers, the broker-dealer is not relieved of its ultimate responsibility for compliance with all applicable federal securities laws and regulations. Thus, the broker-dealer should have procedures in place to evaluate third party providers including a due diligence analysis of all of its current or prospective third party service providers to determine whether they are capable of performing the outsourced activity and the broker-dealer has an ongoing obligation to oversee, supervise and monitor the third party service provider's performance.

(B) Due Diligence of Sponsor

A thorough review of the Sponsor is a critical element with respect to the offering. The following information regarding the sponsor should be reviewed:

(i) Description of the sponsor, including the management thereof;

(ii) Historical financial information of the sponsor, if available and its affiliates;

(iii) Analysis of anticipated compensation in all forms to the sponsor and its affiliates;

(iv) Audited financial statements or a credit check for the sponsor and its principals;

(v) Litigation, regulatory and bankruptcy check on the sponsor and its principals (i.e., owners and other control persons);

(vi) Banking references;

(vii) Legal and accounting references;

(viii) Review of sponsor's operations, including, but not limited to, organizational documents, insurance coverage, succession plans, buy-sell agreements, internal control procedures, human resources, technology, sales and marketing practices and investor services; and

(ix) Assessment of the capabilities of the managing broker-dealer, if any, whether internal or external.

(C) Due Diligence for Real Estate Funds

Real estate funds generally involve the sale of membership, partnership interests or beneficial in entities that own, directly or indirectly, interests in real estate or real estate-related assets. Real estate funds can be either specified offerings or blind pools. The type of due diligence to be completed varies based on the type of fund that is being offered. If a fund is a specified offering or if one or more assets are identified in a larger blind pool offering, the following information should reviewed.

(i) Purchase Agreement for the asset;

(ii) Title documents, including a summary of all exceptions (i.e., CC&Rs, easements, etc.) and survey;

(iii) Third party appraisal;

(iv) Environmental site assessment;

(v) Zoning report;

(vi) Seismic report (if applicable);

(vii) Mold report (if applicable);

(viii) Current rent roll;

(ix) Leases (including estoppels, if applicable);

(x) Property financial information;

(xi) <u>Pro forma</u> budget for remainder of current year and full following year;

(xii) Information regarding any financing to be obtained to acquire or develop the property including loan commitments and loan documents, if available;

(xiii) Any other material contracts or documents related to the specific property.

Blind pool offerings will not have available the above information initially, but when a material investment is identified to be purchased by the blind pool fund, the above due diligence should be completed, either by the broker-dealer directly or by any due diligence firm utilized for the offering, and summarized in a supplement to the PPM.

(D) Due Diligence for Debt Funds

Debt funds generally involve the sale of membership or partnership interests in entities that acquire or make loans. Debt funds can either be specified offerings or blind pool offerings. Due diligence on specified offering debt funds should include a review of the following:

(i) Debt instrument and other loan documents related to any debt to be acquired;

(ii) Information regarding the borrower under any debt to be acquired, including financing information, information regarding the borrower's business and background information (UCC, litigation and bankruptcy searches);

(iii) Information regarding the security or collateral for any debt to be acquired;

(iv) Information regarding payment history of the borrowers under any debt to be acquired; or

(v) Does the issuer have all appropriate licenses if it makes loans?

Blind pool offerings will not have available the above information initially, but when there is a reasonable probability that a material investment will be purchased by the blind pool fund, the above due diligence should be completed and the terms of the investment should be included in a supplement to the PPM.

The review of the sponsor due diligence outlined in (B) above should also occur.

(E) Due Diligence for Debt Offerings

Debt offerings can be structured to be general obligations or may be secured by a specific obligation. In any debt offering, due diligence must be completed with respect to the sponsor-borrower, including:

(i) Identity of the borrower – is the borrower a special purpose entity with no assets?;

(ii) Identity of any guarantors and a summary of the terms of the guaranty (i.e., bottom or top guaranty);

(iii) Proposed use of proceeds (i.e., can the funds be used for any purpose including general needs of the borrower or are they restricted to certain uses such as the acquisition of assets);

(iv) Financial information of the borrower and any guarantor including actual balance sheets and pro forma for the issuance of the debt;

(v) Terms of repayment;

(vi) Existence of an indenture, including the name and history of the trustee and terms of such indenture; and

(vii) As to convertible debentures and convertible notes, full details on the class of equity obtained upon conversion as well as all terms and conditions of conversion rights.

If a debt offering is being made in order for the borrower or an affiliate to acquire a specific asset, due diligence with respect to such asset should be completed (see above for a summary of the real estate items to be reviewed with respect to real estate). The review of the sponsor due diligence outlined in (B) above should also occur.

11. Offering Time Frames

To allow sufficient time for sponsors, broker-dealers, and registered representatives to properly evaluate a particular offering, while working within the framework of the prohibition of general solicitations, information should be shared with the various parties involved in the offering during the following time periods.

(A) Sponsor Evaluation Period

While a sponsor is initially contemplating an offering and beginning the initial stages of preparing the offering documents, no information should be shared outside of the sponsor company and its advisors (including outside due diligence reviews). Each sponsor should evaluate its policies carefully to determine if sponsor marketing personnel should know about the possible offering at this early stage. To prevent the premature disclosure of information to broker-dealers and registered representatives, no pre-marketing or announcements of any kind are to be made during this time period.

(B) Contemplation Period

This is necessary to determine when and to what investors offers may be made under the general solicitation rules addressed above.

During the time the offering is contemplated but not made available for sale, broker-dealers and due diligence professionals should receive the initial due diligence package, described above. This will allow them to begin due diligence and prepare for the final due diligence kit and PPM. To prevent registered representatives from beginning sales efforts, and to prevent investors from subscribing prior to the finalization of the PPM and the execution of a selling agreement with the applicable broker-dealer, no final PPM should be released at this time.

(C) Broker-Dealer Due Diligence Cooling Off Period

A cooling off period for a specific broker-dealer should follow issuance of the final PPM and complete due diligence package to the broker-dealers. During this time period, issuers should not accept any subscription documents. This time period should be long enough to allow the broker-dealer to conduct adequate due diligence, but should be five business days at a minimum. The same limitations on providing information to the registered representatives applicable in the Contemplation Period also apply during this time.

(D) Selling Agreements

PPMs may not be distributed to clients of any broker-dealer unless and until there is a signed selling agreement between the broker-dealer firm and the managing broker-dealer or sponsor, as applicable.

(E) Subscription Acceptance

Issuers may establish their own criteria to determine which investors will be included in the offering. Generally, the PPM and subscription agreements should specify a time frame under which a potential investor will be accepted or rejected for an investment. This time frame should generally be between 15 days and 30 days, but may be longer or shorter, as required.

12. Rules for Gifts, Travel, Entertainment, and Personal Purchases of Securities by Registered Representatives

Every sponsor, broker-dealer, and registered representative should act in the best interests of an investor in the sale of a Regulation D product. All of the following may be subject to a specific broker-dealer's more restrictive policies.

(A) Influencing or Rewarding Employees of Others

FINRA Rule 3220 states that no broker-dealer or person associated with a broker-dealer may, directly or indirectly, give or permit to be given anything of value, including gratuities, in excess of $100 per individual per year to any person associated with a broker-dealer (including a registered representative) in connection with the business of the broker-dealer. A gift of any kind is considered a gratuity and is valued at the higher of cost or market value. Broker-dealers and registered representatives should note that the annual limit is based on the combined total of gifts and gratuities given by the broker-dealer and all associated persons of that broker-dealer. No sponsor, directly or through a captive broker-dealer, should offer and no registered representative should accept gifts, gratuities or services where (1) the value exceeds the annual FINRA limit or (2) they are based on the achievement of a sales target.

Exclusions to FINRA Rule 3220 can be found in the Notice to Members 06-69, published in December 2006, and include gifts of *de minimis* value (i.e., substantially less than $100) or promotional items of nominal value displaying a firm's logo or commemorating a business transaction (e.g., Lucite tombstones). Only gifts that are related to the business of the broker-dealer are covered by Rule 3220. Following FINRA interpretive materials, personal gifts to commemorate a life event are excluded from Rule 3220 if the registered representative, versus the broker-dealer, is paying (without reimbursement from the broker-dealer) and the gift is customary and reasonable. A determination of whether a gift relates to the business of the employer of the recipient should be made in connection with all gifts.

(B) Travel Expenses

Sponsors may provide registered representatives with an opportunity to participate in due diligence trips and training and education meetings, provided (1) the expenses associated with the visits are reasonable, (2) the registered representative obtains prior approval from its broker-dealer to attend the trip or meeting, (3) attendance is not conditioned upon achievement of a sales target or similar incentive, and (4) the location is appropriate to the purpose of the meeting. Examples of such trips may include site visits to a significant or representative asset of the program, the sponsor's main offices, or educational seminars that may be held regionally. Reasonable expenses are defined as being customary for a given location and would not be viewed by a reasonable person as being extravagant, or to be of such a nature as to exert undue influence upon the recipient. The registered representative should inform his broker-dealer in advance of such trips, including an agenda, and list of clients or other participants that are affiliated with the registered representative. Spouses or guests of the registered representative may not be reimbursed for their expenses.

(C) Reimbursement of Expenses

All cash reimbursements should be processed through the registered representative's broker-dealer. Sponsors are permitted to provide travel arrangements and hotel accommodations directly for the benefit of the registered representatives, but not their spouses or other guests.

(D) Entertainment

Sponsors may host clients and their guests at an occasional meal, sporting event, theater production or comparable entertainment event, providing that it is neither so frequent nor so extensive as to raise any question of propriety. Attendance at events should not be tied to a requirement for future, or recognition of past, business. The registered representative should be aware of his or her broker-dealer’s policies and procedures regarding gifts and entertainment and should consider those and notify the broker-dealer when appropriate.

If a representative of the sponsor is not personally in attendance, the cost of admission at the event would be treated as a gift. The expense of attendance must be valued at the higher of cost or market value, and may not be discounted on the theory that the tickets would not otherwise be used.

(E) Gift & Entertainment Logs

Registered representatives should maintain a log that lists all gifts and entertainment received. The log should be available for inspection upon request of their broker-dealer and/or potential investors. This log is separate from the broker-dealer’s records created in performing its supervisory duties.

A broker-dealer must maintain a supervisory system reasonably designed to achieve compliance with FINRA Rule 3220. This system should be reasonably designed to ensure that gifts in relation to the business of the employer of the recipient given by the broker-dealer and its associated persons to employees of clients of the broker-dealer are (i) reported to the broker-dealer, (ii) reviewed for compliance with FINRA Rule 3220, and (iii) maintained in the broker-dealer's records. This should include provisions reasonably designed to ensure that an associated person who is making a gift is not responsible for determining whether such gift is personal rather than in relation to the business of the recipient's employer. Items of *de minimis* value or nominal promotional or commemorative items are not subject to FINRA Rule 3220's record-keeping requirements.

(F) Purchasing of Interests by Registered Representative for Own Account

Any time a representative is purchasing a program's securities for his or her own account, other than increasing the equity purchased in lieu of commissions or closing costs to the registered representative, he or she cannot be treated more favorably than any other investor.

13. Subscription Paperwork and Recordkeeping

Broker-dealers are required by NASD Rule 3110[7] (books and records) to maintain books, accounts, records, memoranda, and correspondence in conformity with applicable law, including SEC Rules 17a-3 and 17a-4. Together, Rules 17a-3 and 17a-4 require broker-dealers to create and preserve, in an easily accessible manner, a comprehensive record of each securities transaction they effect and their securities business in general, including communications with customers. Rule 17a-3 requires broker-dealers to generate certain records, including trade blotters, asset and liability ledgers, income ledgers, customer account ledgers, securities records, order tickets, trade confirmations, trial balances and various employment related documents. The record keeping format, medium, and retention period must comply with SEC Rule 17a-4. While some of the records must be retained for at least 3 years, certain other records must be retained for at least 6 years. Broker-dealers should be familiar with (i) SEC Release No. 34-47806 (electronic storage of broker-dealer records), which expresses the SEC's view that broker-dealers may store records in electronic form so long as such records are preserved exclusively in a non-rewriteable and non-erasable format, and (ii) NTM 03-33 (instant messaging), which cautions against the unmonitored use of real-time instant messaging and reminds broker-dealers that the supervisory requirements for electronic communications should be based on the content and audience of the message, and not merely the electronic form of the communication.

[7] Pursuant to SR-FINRA-2010-052, NASD Rule 3110 will be superseded by FINRA Rule 2268, FINRA Rule 4510, et. seq., FINRA Rule 3110 and FINRA Rule 240. The effective date for the new FINRA rules has not been determined as of the date of these Best Practices.

Subscription agreements and related offering materials are records that must be retained for at least three years, and broker-dealers should have written procedures regarding the process for approving the securities transactions. Such written procedures should provide that all reviews and approvals of the securities transactions must be made by one or more properly licensed registered principal and documented in writing. To facilitate such review and approval, subscription agreements and other instructions accompanying subscription documents should direct potential investors to send all completed subscription documents to the managing broker-dealer, or, if none, to the issuer.

In addition, subscription agreements should include a signature block for the registered representative that sold the securities and such registered representative's broker-dealer firm. The registered representative and the broker-dealer should represent that they have reasonable grounds to believe that, on the basis of information supplied by the subscriber concerning his or her investment objectives, other investments, financial situation and needs and other pertinent information that (i) the subscriber is an accredited investor, (ii) the subscriber meets the investor suitability requirements established by the issuer, (iii) the investment is suitable for the subscriber, (iv) the subscriber has a net worth and income sufficient to sustain the risks inherent in acquiring the securities, and (v) a pre-existing relationship with the subscriber existed before the contemplation or initiation of the offering. A verification should also be provided that the subscription either does not involve a discretionary account or, if so, that the subscriber's prior written approval was obtained by the broker-dealer. If a sponsor receives a subscription agreement and related documents lacking the broker-dealer's signature, the sponsor should immediately notify the broker-dealer of the situation and suspend processing of the subscription documents until such signature arrives. Sponsors should not make any changes or modifications to any investor paperwork.

The subscription agreement may request that the subscriber direct the sponsor to release all information related to the investment on a go-forward basis to the registered representative and broker-dealer firm. However, such request should provide an investor with the ability to decline such release.

If an offering is contingent (i.e., the minimum offering has not been met or the release of investor funds is dependent on some other event), all investor funds should be directed to be deposited in an escrow account with a third party bank. The escrow should be subject to a three-party agreement between the issuer, the managing broker-dealer (or, if none, each broker-dealer firm that executes a selling agreement for the securities) and the bank that complies with the requirements of SEC Rule 15c2-4 and the no-action letters and other interpretive guidance issued with respect to such rule. In the event that a broker-dealer receives any customer funds during the time that the escrow account is in effect, the broker-dealer should forward such amounts to the escrow agent by noon of the next business day. The issuer may, upon the occurrence of the contingency releasing the escrowed funds, issue a supplement to the PPM that allows all future funds to be sent directly to the issuer and the escrow account may be closed.

14. Investor Communication

The issuer should communicate all relevant information concerning the property to the investor on a regular and continuous basis. The issuer should provide to each investor, and with the investor's consent, their registered representative, broker-dealer or other party they deem appropriate both "acceptance to closing" and "post closing/perpetual" correspondences. The issuer should provide for changes in consent and maintain appropriate records supporting the authorization to release client information.

(A) Acceptance to Closing Communication

(i) Welcome Letter (with Subscription Agreement). Acknowledges receipt of initial documents; explains acceptance of investment procedures, welcomes the investor to the investment, explains distributions and investor relations contact.

(B) Post Closing/Perpetual Communication

(i) Distributions. Distribution checks or direct deposits should be prompt and as specified in the PPM. If distribution checks are delayed for any reason or the amount varies by more than 10% of the projected amount, investors should be notified immediately with a detailed explanation.

(ii) Quarterly Reports. It is highly recommended that detailed quarterly reports become standard practice. Some sponsors prefer monthly reports. Reports typically contain:

(a) Cover letter with an executive summary;

(b) Investment performance summary (specific quarter and since inception summary);

(c) Point out any significant variance (more than 5%) from the expected numbers;

(d) Provide disclosure on performance (actual vs. plan);

(e) Operating financials; and

(f) Capital improvements, if applicable.

(iii) Annual (Actual) Reports/Operating Budget Package. This is the most detailed report, to be mailed annually as soon as practicable after year-end. This Guide supports transparency regarding the performance of offerings. Performance reports for each program should compare current performance to the PPM pro-forma and annual budgets. This reporting should include, at a minimum, effective gross income, expenses, net operating income, current cash flow, and the balance in each reserve. Provide disclosure on performance (actual vs. plan) and point out any significant variance (more than 5%) from the expected numbers. It is preferred that the annual financial information is audited, certified or reviewed by an independent accounting firm.

(iv) Year End Reporting. Investors in partnerships (including limited liability companies) will receive a K-1 that will report the annual income and loss. Investors in note and debenture programs will receive a Form 1099 that will report interest paid during the year. Year end reporting should include a concise letter issued no later than March 15 with the sponsor's CFO or other accounting contact information with the summary of pertinent tax information sheet.

(C) Other Communications:

(i) Future Year Operating Budget. Expectations for the coming year operating budget and financial statement should also include any lease/rent increases, if applicable, and anticipated special assessments, if applicable.

(ii) Distribution Rate Change Letter. Notification should be given to investors, representatives, and broker-dealers of any distribution changes, positive or negative, with appropriate explanations, at least 30 days prior to effective date.

(iii) Conference Calls. Investor group calls are particularly useful for challenged investments or to make a substantive announcement. Some issuers may do a short quarterly or annual summary call. Many issuers record the call and send the information to all investors and their registered representatives, to be sure that the information is disseminated to those unavailable for a conference.

(iv) Major Decisions. To the extent that the investors have the right to vote on any decisions of the fund, a consent and explanation of the decision should be sent to the investors. The voting provisions in the operating agreement (or partnership agreement) should be followed.

CONCLUSION

The information provided in this Guide is general in nature and sponsors and broker-dealers should ensure that (i) all investors are suitable for the investment, (ii) all securities and broker-dealer rules are complied with, (iii) all material information that would be material to an investor's decision is disclosed and (iv) all of the information included in the PPM is accurate.

EXHIBIT A

FINRA Regulatory Notice 11-02

Executive Summary

The SEC approved FINRA's proposal to adopt rules governing know-your-customer and suitability obligations for the consolidated FINRA rulebook. The new rules are based in part on and replace provisions in the NASD and NYSE rules.

To view the full notice, please visit:

http://www.finra.org/web/groups/industry/@ip/@reg/@notice/documents/notices/p122778.pdf

EXHIBIT B

FINRA Regulatory Notice 10-22

Executive Summary

FINRA reminds broker-dealers of their obligation to conduct a reasonable investigation of the issuer and the securities they recommend in offerings made under the Securities and Exchange Commission's Regulation D under the Securities Act of 1933—also known as private placements.

Regulation D provides exemptions from the registration requirements of Section 5 under the Act. Regulation D transactions, however, are not exempt from the antifraud provisions of the federal securities laws. A broker-dealer has a duty—enforceable under federal securities laws and FINRA rules—to conduct a reasonable investigation of securities that it recommends, including those sold in a Regulation D offering.

Moreover, any broker-dealer that recommends securities offered under Regulation D must meet its suitability requirements under NASD Rule 2310 (Suitability), and must comply with the advertising, supervisory and record-keeping rules of FINRA and the SEC.

To view the full notice, please visit:

http://www.finra.org/web/groups/industry/@ip/@reg/@notice/documents/notices/p121304.pdf

EXHIBIT C

FINRA Regulatory Notice 09-27

Executive Summary

Effective June 17, 2009, new FINRA Rule 5122 requires FINRA member firms and associated persons that engage in a private placement of such firm's securities or those of a control entity (member private offering or MPO) to comply with certain disclosure and filing requirements and limitations of the use of proceeds.

The new rule provides additional regulation of certain private placements, which are generally excluded from the scope of existing rules, including FINRA Rule 5110 (Corporate Financing Rule - Underwriting Terms and Arrangements) and NASD Rule 2720 (Distribution of Securities of Members and Affiliates - Conflicts of Interest), because these existing rules generally apply only to public offerings. The text of FINRA Rule 5122 is set forth in Attachment A of this Notice.

The rule will not apply retroactively to any offerings that have already commenced selling efforts as of the effective date, June 17, 2009.

To view the full notice, please visit:

http://www.finra.org/web/groups/industry/@ip/@reg/@notice/documents/notices/p118735.pdf

EXHIBIT D

NASD Notice to Members 05-18

Executive Summary

This Notice addresses Section 1031 tax-deferred exchanges of real property for certain tenants-in-common ("TIC") interests in real property offerings.1 In a TIC exchange, interests in real property are exchanged for instruments that generally are securities for purposes of the federal securities laws and NASD rules.2 This Notice reminds members that when offering TIC interests that are securities to customers, members and their associated persons must comply with all applicable NASD rules, including those addressing:

- suitability;
- due diligence;
- splitting commissions with unregistered individuals or firms;
- supervision; and
- recordkeeping.

In addition, members relying on private offering exemptions from the registration requirements of the Securities Act of 1933 must ensure that their manner of offering TIC interests complies with all applicable requirements, including the prohibition on general solicitation.

To view the full notice, please visit:

http://www.finra.org/web/groups/industry/@ip/@reg/@notice/documents/notices/p013455.pdf

EXHIBIT E

Example of Risk Factors in a PPM

The following is a summary of RISK FACTORS in a real estate program blind pool offering showing the headings and subheadings (the specific text has been deleted). This is purely illustrative and is not intended to rule out other specific risk factor disclosures that the sponsor deems to be material in another offering or type of offering. Subheadings provide ease in navigating and locating using a table of contents. The more a program relies on the tax attributes of the issuer or the security, the more relevant the tax risk factors become and should be moved towards the front of the Risk Factor Section. The Risk Factors should start with the most material risk factor first.

RISK FACTORS

Real Estate Risks

General Risks of Investment in the Projects.

Unspecified Investments.

Uncertainty as to Extent of Diversification.

Affiliated Sellers.

No Purchase Agreements for Future Projects.

No Environmental Indemnity.

Illiquidity of Real Estate Investments.

Occupancy and Renewal of Leases.

Difficulty Attracting New Tenants.

Joint Ventures.

Possible Delays in the Sale or Refinancing of Projects.

Earthquakes, Hurricanes and Floods.

Uninsured Losses.

Regulatory Matters.

Toxic Mold.

Uncertain Economic Conditions.

Compliance with the Americans with Disabilities Act.

Easements.

Zoning.

Lack of Representations and Warranties.

Competition.

Appraisals.

No Audited Results of Operation.

Rehabilitation Risks.

Amenities as Potential Liabilities.

Condemnation of Land.

Financing Risks

No Loan Commitments; Leverage.

Availability of Financing and Market Conditions.

Unknown Loan Terms.

Balloon Payments.

Carve-Outs to Nonrecourse Liability.

Recourse Liability.

Restrictions on Transfers.

Current Volatility in Credit Markets.

Variable Interest Rates and Interest Only Loans.

Events of Default.

Risks Relating to the Formation and Internal Operation of the Company

New Venture.

Limited Experience of Manager.

Limited Resources of the Manager.

Potential Adverse Effects of Delays in Investments.

Use of Proceeds to Pay Organization Expenses.

No Guaranteed Cash Distributions.

Use of Proceeds Not Limited.

Loss of Uninsured Bank Deposits.

Additional Working Capital Requirements.

Reliance on Management.

Property Management.

Limited Approval Rights Regarding Operation of the Projects.

Conflicts of Interest.

Receipt of Compensation Regardless of Profitability.

No Financial Statements of the Manager.

Lack of Diversification.

Loss on Dissolution and Termination.

Liability of Members.

Limitation of Liability/Indemnification of the Manager.

Limitation of Liability/Indemnification of Property Manager.

Members Will be Bound by Decision of Majority Vote.

Risks Relating to Private Offering and Lack of Liquidity

Limited Transferability of Units.

Right of First Refusal.

Limited Repurchase Rights.

Speculative Investment.

Determination of Unit Price.

Offering Not Registered With the SEC or State Securities Authorities.

Private Offering – Lack of Agency Review.

Private Offering Exemption – Compliance with Requirements.

Projections.

Private Offering Exemption – Limited Information.

Purchase of Units by the Manager or its Affiliates.

Estimates, Opinions and Assumptions.

No Representation of Members.

Investment by Tax-Exempt Purchasers.

Subsequent Investors May Have a Greater Opportunity to Review Company's Investments.

Exemption from Investment Company Act of 1940.

Compensation of Selling Group Members.

Lack of Firm Commitment Underwriting.

Tax Risks

General Tax Risks.

Risk of Audit.

Tax Classification of the Company.

Unrelated Business Taxable Income.

Sale or Disposition of Company Property.

Possible Disallowance of Various Deductions.

Limitations on Losses and Credits from Passive Activities.

Allocations of Net Income and Net Loss.

Successive Owners of Units.

Taxable Income in Excess of Cash Receipts.

Potential Limitation of Net Loss.

Alternative Minimum Tax.

Accuracy Related Penalties and Interest.

State Income Taxes.

Changes in Federal Income Tax Law.

EXHIBIT F

Sample Estimated Use of Proceeds

	Minimum Offering		Maximum Offering	
	Amount	Percentage of Gross Proceeds	Amount	Percentage of Gross Proceeds
Gross Offering Proceeds	$000,000	100.00%	$00,000,000	100.00%
Organization and Offering Expenses	$ 0,000	0.00%	$000,000	0.00%
Selling Commissions	$0,000	0.00%	$000,000	0.00%
Marketing and Due Diligence	$0,000	0.00%	$000,000	0.00%
Placement Fee	$0,000	0.00%	$000,000	0.00%
Wholesaler Fee	$0,000	0.00%	$000,000	0.00%
Acquisition Fee to [_________]	$0,000	0.00%	$000,000	0.00%
Reserves	$0,000	0.00%	$000,000	0.00%
Available for Investment	$000,000	00.00%	$00,000,000	00.00%
Total Application	$000,000	100.00%	$00,000,000	100.00%

The above table is merely a basic form. The actual estimated use of proceeds table included in a PPM should be tailored to the specific transaction. In addition, the table should include footnotes, where appropriate, to explain the payment of certain items.

EXHIBIT G

Prior Performance Reporting Templates - Summary Reports

- Operating Properties or Programs (G-1)
- Completed Programs (G-2)

EXHIBIT G-1

Property	Type	Location	Acg Date	Equity	LTV	Purchase Price	Current Dist % (A)	PPM Distribution % (B)	Current NOI (C)	PPM NOI (D)	Foot-notes
OPERATING PROPERTIES OR PROGRAMS											
Towne Centre	Retail	Dollars	1/15/08	$12,000,000	58%	$20,689,555	6.0%	6.0%	$1,350,000	$1,350,000	1
NOTES:											

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Exhibit G-2

Property	Type	Location	Acquisition Date	Sale Date	Equity	Purchase Price	Sales Price	Hold Period in MO's	Avg Annual Return %	Notes
COMPLETED PROGRAMS										
Towne Centre	Retail	Dollars	1/15/08	$12,000,000	$12,000,000	$20,689,555	$27,000,000	60	10.52%	

Defined Terms:

A – Current Distribution — Annualized distribution rate on equity for the quarter prior to the issuance of this report.

B – PPM Dist % — PPM distribution rate on equity for the year in which this report is issued

C – Current NOI — NOI for the test calendar year, updated by May 1 of the year following the calendar year

D – PPM NOI — PPM NOI for the last calendar year, updated when “Current NOI” is updated.

EXHIBIT H

TICA ALERT 05-02

In March of 2005, National Association of Securities Dealers, Inc. (“NASD”) published Notice to Members 05-18 regarding private placements of tenant in common interests (“TICs”). This TICA Alert is intended to:

1. communicate to the TICA Membership the full text of NASD Notice to Members and remind TICA Members that it must be followed to the extent applicable
2. provide information to TICA members regarding the prohibition on general solicitations with respect to Regulation D private placements of TICs so that TICA members can better evaluate their course of conduct

To view the entire alert, please visit:

http://www.reisa.org/Alert-05-02.pdf