New Requirements Re California Investors

Companies that are planning an offering with California investors should be aware of a new California bill that takes effect on January 1, 2013, Senate Bill 978.

Information to Be Provided When There Are Non-Accredited Investors

One provision of SB 978 requires the offering company to provide additional information regarding the nature of the proposed offering on a form prescribed by the Commissioner of Corporations. The requirement applies to all the usual California exemptions if the offering includes any person who is not an accredited investor: Subdivisions (e), (f), (h), and (n) of Corporations Code Section 25102 and subdivision (p) of Section 25100. (Some of these can be used by out-of-state entities.) Apparently it does not apply to Rule 506 offerings or California qualification by permit offerings.

The information to be provided includes the names of the issuer's officers and directors if a corporation, or managers if an LLC, or general partner if a limited partnership. In addition the information must include a list of any state and federal licenses required to further the purposes of the investment, and the names of all licensed persons who will undertake those activities.

The other provisions basically affect offerings involving a promissory note secured by real estate or a "business opportunity". ("Business opportunity" is defined as the sale or lease of a business.) Some of these provisions are technically aimed at real-estate brokers, but California law requires a real-estate license for those types of offerings.

Requirements for Notes Secured by Real Estate

Any sale or offer of notes or undivided interests in a note (meaning percentage interests in a note) that are secured directly by real property must comply with the following requirements.

First, the bill requires that the amount of the note sold, together with any unpaid amounts on senior liens, cannot exceed specified percentages of the current market value of the properties. For commercial and income-producing properties, this is 65%; for single-family residences that are not owner occupied, 75%; and for single-family residences that are owner-occupied, 80%. If the loan is partly for rehabilitation or construction work, the completion value of the property can be used if certain requirements are met.

A copy of an appraisal or a real-estate broker's valuation of the property must be delivered to the purchaser. In addition, the purchaser of the note must be advised of the right to receive a copy.

Further, the purchaser must sign a statement saying that either 1) the investment will not exceed 10% of the purchaser's net worth, exclusive of home, furnishings, and automobiles, or 2) the investment does not exceed 10% of the purchaser's adjusted gross income for federal income tax purposes for the last tax year.

Sophistication and Suitability of Investors Buying Notes Secured by Real Property

SB 978 also imposes additional requirements on real-estate brokers involved with the offering of notes secured by liens on real property or on a business opportunity. (As a practical matter, an offering of notes secured by the sale or lease of a business would be uncommon.)

Note that California law requires a real-estate license if an entity (or person) sells his/her/its own promissory notes or brokers others' promissory notes to investors when those notes are secured directly or collaterally by a lien on real property or on a business opportunity.

Specifically the broker must make reasonable efforts to ensure the following:

(1) All persons to whom the notes or interests are sold can be reasonably assumed to have the capacity to understand the fundamental aspects of the investment by reason of their educational, business, or financial experience.

(2) All persons to whom the notes or interests are sold can bear the economic risk of the investment.

(3) The investment in the notes or interests is suitable and appropriate for the purchaser, given the purchaser's investment objectives, portfolio structure, and financial situation.

The broker is to make these determinations based on information obtained from the purchaser. This information must include at least, the age, investment objective, investment experience, income, net worth, financial situation, and other investments of the prospective purchaser. These records must be maintained for at least four years.

Although use of an investor questionnaire is not required, a broker is deemed to have complied if the broker uses an investor questionnaire in the form approved by the Commissioner and obtains updated questionnaire responses on an annual basis.

Information to Be Provided to Investors Buying Notes Secured by Real Property

Further, SB 978 also imposes additional requirements on real-estate brokers involved with the offering of notes secured by liens on real property or on a business opportunity. (Again, as a practical matter, an offering of notes secured by the sale or lease of a business would be uncommon.)

Specifically the broker must provide prospective investors with the following information:

1) The address of the real property securing the note.

2) A copy of an appraisal on the real property, unless the prospective purchaser waives this, in which case a copy of the broker's written estimated fair market value of the securing property with backup data must be provided.

3) The age, size, type of construction, and a description of improvements to the property.

4) The identity, occupation, employment, income, and credit data about the prospective borrower or borrowers.

5) The terms of the promissory note(s).

6) Information about the other existing or anticipated liens on the property.7) Provisions for servicing of the note(s).

8) Information regarding any joint beneficiaries.

9) A detailed statement of the intended use and disposition of the funds being solicited.

10) A statement that the broker has a responsibility to make reasonable efforts to determine that the loan is a suitable and appropriate investment for the lender.

Offerors selling notes secured by real-estate need to ensure that as of January 1 they are complying with these provisions.

Bruce E. Methven

****

For more information on securities laws, head to Background on the Securities Laws: http://thecaliforniasecuritiesattorneys.com/?page_id=41

To join the newsletter list, go to http://thecaliforniasecuritiesattorneys.com/ and complete the eNews signup box.

Forward To a Friend: http://tinyurl.com/forward-to-friend

Bruce E. Methven, 2232 Sixth Street Berkeley, CA 94710
Phone: (510) 649-4019; Fax: (510) 649-4024
www.TheCaliforniaSecuritiesAttorneys.com
CaliforniaSecuritiesAttorneys[at]gmail.com