

ASK THE FORMER REGULATOR

Expert Analysis

Group of Friends Looking To Buy Condo Should Consider Syndicate Act First

Question: I am a developer who was approached by a small group of friends that want to pool their money and build a condominium in upstate New York. Specifically, the small group has asked me to act as a turnkey developer. Is this type of transaction possible in New York under the Martin Act?

Answer: The short answer to your question is yes, it is possible, but not without careful planning among all parties involved. From what you describe, it appears as though the small group of friends is looking to engage in an investment in real estate, which is regulated by the New York Real Estate Syndicate Act (the Syndicate Act), codified at N.Y. Gen. Bus. Law § 352-e, and

By
Erica F.
Buckley



the governing regulations found at 13 NYCRR Part 16. The Syndicate Act clarifies that the Martin Act not only regulates the offer and sale of cooperative inter-

Generally, the Syndicate Act requires that an offering statement or prospectus be filed with the Real Estate Finance Bureau before any funds are solicited from investors.

ests in realty (i.e., cooperatives, condominiums, homeowners' associations, timeshares, and seniors communities) but certain participation interests or investments in real estate as well. In such instances where a group of

individuals wish to pool money to develop a cooperative interest in realty, their first obligation is to meet the requirements of the Syndicate Act.

Generally, the Syndicate Act requires that an offering statement or prospectus be filed with the Real Estate Finance Bureau before any funds are solicited from investors. See N.Y. Gen. Bus. Law § 352-e(1)(a). This may also include the solicitation of funds among friends, such as the transaction you describe. Moreover, the Martin Act would also require the issuer of such securities to register as a broker-dealer, unless an exemption from registration is available. See N.Y. Gen. Bus. Law §§ 359-e and 359-f. Despite the statutory requirement to file an offering statement or prospectus and register as a broker-dealer, the Department of Law has promulgated various policy statements that identify exceptions to the filing requirements of the

ERICA F. BUCKLEY is the practice leader for the cooperative and condominium team at Nixon Peabody. She is the former chief of the Real Estate Finance Bureau at the New York Attorney General's office.

statute. In fact, a small group of friends as you describe might be able to qualify for a no-filing letter, which would obviate the need to file an offering statement or prospectus and registration as a broker-dealer with the Department of Law altogether.

Under the terms of Policy Statement 105, available at https://ag.ny.gov/sites/default/files/policy_statement_105_w_cover.pdf, certain investor groups are exempt from the requirement to file an offering statement or prospectus with the Department of Law prior to offering certain investments in real estate. Under the scenario you describe, the following categories may be applicable:

- Small Private Offerings—an offering among nine or fewer friends with a pre-existing relationship, each of whom are sophisticated and possess the means for the investment;
- Offerings to a Cohesive Group—an offering made to a group where all investors are members of one or more cohesive groups and the transaction is negotiated at arms-length; and
- Nonpromoter Transactions—an offering where there is no separate promoter or promoter group selling interests to investors, where

all investors have a preexisting relationship, the terms of the transaction are mutually agreed to and negotiated among all investors, and there is an absence of fees or commissions related to the transaction.

Assuming the small group of friends can meet one of the categories above, they would still be required to request a no-filing letter from the Department of Law in accordance with Policy

Since you also state that you may be acting as a turnkey developer of a condominium project, there would also be an additional filing made to the Department of Law to address the formation of the condominium.

Statement 105, which requires an affidavit with various representations about the issuers and the nature of the proposed real estate transaction.

It should be noted that given the COVID-19 pandemic, the Department of Law has temporarily suspended the processing of all policy statements under the Syndicate Act. See Real Estate Finance Bureau Memorandum re Temporary Submission and Review Policies and Procedures Due to COVID-19 State

of Emergency (updated Sept. 18, 2020), available at https://ag.ny.gov/sites/default/files/temporary_submission_and_review_policies_and_procedures_due_to_covid-19_state_of_emergency_9-18-2020.pdf. The updated guidance provides a 90-day grace period for syndicates to comply with the Syndicate Act upon expiration of COVID-19 emergency policies and procedures. Therefore, if the small group is looking to begin working together during the COVID-19 state of emergency, all parties should be mindful that a retroactive application must be submitted to the Department of Law at some point in the foreseeable future.

Since you also state that you may be acting as a turnkey developer of a condominium project, there would also be an additional filing made to the Department of Law to address the formation of the condominium. All parties should note that Policy Statement 105 expressly states that it does not apply to cooperative interests in realty, and therefore the statutory requirements of the Martin Act still govern the formation of the condominium. Moreover, the Department of Law issued an agency guidance document in 2013 entitled Real Estate Syn-

dication Offerings That Include Rights to Acquire Condominium Units, available at https://ag.ny.gov/sites/default/files/pdfs/bureaus/real_estate_finance/Effective-memos/Memo%20re%20Syndications%20and%20Condominium%20Units.pdf, which clarified that participation interests and cooperative interests in realty are distinctly different offerings, and as such, separate filings must be made to the Department of Law. Moreover, this guidance document also states that as a matter of policy, the Department of Law will not grant a “no action” letter in lieu of filing an offering plan for sales of condominium units related to syndication offerings. The scope and applicability of this statement may be open to interpretation, and it could potentially be argued that the requirement of filing an offering plan may only apply in situations where the initial investment in real estate is subject to the Syndicate Act, and therefore if an investment in real estate qualifies for no-filing treatment, a no-action letter may in fact be possible in circumstances where a cooperative interest in realty is also contemplated. The Department of Law has the discretion to issue a no-action letter in cases where it deems

the protections of the Martin Act as unnecessary. It might consider a no-action letter in a circumstance where a small group formed a syndicate to develop a project together, especially in cases where all investors were involved in all aspects of the project and where the entire investor groups states that they are not in need of the protections of the Martin Act. *See People v. Michael Glenn Realty*, 106 Misc. 2d 46 (Sup. Ct. 1980). Issuance of a no action letter is within the discretion of the Attorney General.

Finally, you should be aware of the scope of the Martin Act, which could potentially regulate a turnkey developer. Under the Martin Act, a principal is defined as “every person or firm directly or indirectly controlling any broker or dealer.” N.Y. Gen. Bus. Law § 359-e(1)(d). Moreover, regulations governing cooperative interests in realty more narrowly define principal and sponsor, which should guide your role in the transaction. For example, for a new construction condominium, a principal is defined as:

all individual sponsors, all general partners of sponsors that are partnerships, all officers, directors and shareholders of a corporate sponsor that are actively involved in the

planning or consummation of the offering, and all other individuals who both (i) own an interest in or control sponsor and (ii) actively participate in the planning or consummation of the offering, regardless of the form of organization of sponsor.

13 NYCRR § 20.1(c)(2).

Therefore, you will want to take this into consideration when negotiating business terms with the syndicate, so as to ensure that the business transaction is not designed in such a way as to trigger Martin Act obligations for you if the understanding of the parties is that you, as developer, are merely a contractor.