Securities Commission

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Our Ref: 488-13

5 October 1995

COMMERCIAL PROPERTY OWNERSHIP AND THE SECURITIES ACT 1978

In recent times there has been a growing trend for interests in commercial property ownership schemes commonly referred to as "proportionate ownership" interests to be offered to the public in New Zealand. Quite often, in our opinion, these interests constitute securities for the purposes of the Securities Act 1978. If the Securities Act applies the offeror will be required, among other things, to register a prospectus and to appoint a statutory supervisor to represent the interests of investors.

The Securities Commission has power under section 5(5) of the Securities Act to exempt any person or class of persons from compliance with any provision of the Act or of the Securities Regulations 1983, subject to such terms and conditions as the Commission thinks fit. We think that there may be good reason for exempting promoters of "proportionate ownership" schemes from some of the provisions of the Act and Regulations where a separate certificate of title is issued under the Land Transfer Act 1952 to each interest holder. We have prepared a discussion paper on this subject. A copy is attached. We would welcome your views on this paper. We would be pleased to receive these by no later than 20 November 1995.

J. Farrell
Chief Executive

(JF\Comprop.ltr)

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COMMERCIAL PROPERTY OWNERSHIP SCHEMES AND THE SECURITIES ACT 1978

A DISCUSSION PAPER

1. In recent years there has been a growing trend in the real estate industry for interests in commercial property ownership schemes, commonly referred to as "proportionate ownership" interests, to be offered to members of the public. These schemes are typically structured so that investors receive a certificate of title under the Land Transfer Act 1952 in respect of an undivided share in the property as tenants in common. The property is then managed by a professional manager who collects rents from the tenants of the property and pays to each investor their portion thereof.

2. The question arises as to whether offers of interests in these schemes are subject to the requirements of the Securities Act 1978. The Securities Act seeks to ensure that the investing public receive sufficient information upon which to make an informed investment decision. The Act does this by requiring all offers of securities to the public to be made by way of a registered prospectus containing the information specified in the Securities Regulations 1983. The Act also requires issuers of participatory securities (any security which is not an equity security or a debt security, as those terms are defined in the Act) to appoint a statutory supervisor to monitor the interests of security holders.

3. The requirements of the Securities Act will apply to offers of interests in commercial property ownership schemes if these interests are "securities", as that term is defined in section 2 of the Securities Act. This definition is as follows:

> *" 'Security' means any interest or right to participate in any capital, assets, earnings, royalties or other property of any person; and includes -*
>
> *(a) Any interest or right to be paid money that is, or is to be, deposited with, lent to, or otherwise owing by, any person (whether or not the interest or right is secured by a charge over any property); and*
>
> *(b) Any renewal or variation of the terms or conditions of any existing security."*

4. This definition of security is very wide. The statutory aim is to ensure that the Act applies to the ever changing array of financial instruments which emerge in the market. Having said this, the Act also recognises that the protection afforded by the Act is not necessary in respect of offers of certain types of interests, even though these interests may come within the definition of "security". Section 5(1) of the Act therefore exempts offers of certain types of interests from the requirements of the Act. In particular, section 5(1)(b) of the Act exempts offers of certain interests in land from the requirements of the Act. Section 5(1)(b) provides:

> *"Nothing in Part II of this Act shall apply in respect of any estate or interest in land for which a separate certificate of title can be issued under the Land Transfer Act 1952 or the Unit Titles Act 1972, other than any such estate or interest that-*
>
> *(i) Forms part of a contributory scheme; and*
>
> *(ii) Does not entitle the holder to a right in respect of a specified part of the land for which a separate certificate of title can be so issued;"*

The term "contributory scheme" referred to in subparagraph (ii) of section 5(1)(b) is defined in section 2 of the Act as follows:

> *" any scheme or arrangement that, in substance, and irrespective of the form thereof, involves the investment of money in such circumstances that-*
>
> *(a) The investor acquires or may acquire an interest in or right in respect of property; and*
>
> *(b) Pursuant to the terms of investment that interest or right will or may be used or exercised in conjunction with any other interest in or right in respect of property; and*
>
> *(c) Pursuant to the terms of investment that interest or right will or may be used in conjunction with any interest in or right in respect of property acquired in like circumstances, whether acquired at the same time or not;-*
>
> *but does not include such a scheme or arrangement if the number of investors therein does not exceed 5, and neither a manager of the scheme nor any associated person is a manager of any other such right or arrangement."*

The reason for the section 5(1)(b) exemption would appear to be that persons acquiring such interests in land are afforded adequate protection by the law of real property in that they will have an indefeasible title to the property.

5. We understand that in 1990 certain participants in the real estate industry obtained an opinion from Mr James Farmer Q.C. concerning the application of the Securities Act to offers of interests in commercial property ownership schemes. This opinion concluded that interests in such schemes are not "securities" for the purposes of the Act and, even if they

are, the exemption in respect of estates and interests in land contained in section 5(1)(b) of the Act is applicable as investors each receive a separate certificate of title issued under the Land Transfer Act 1952.

6. The Commission does not consider that Mr Farmer's opinion applies to many of the schemes which we have been asked to review. In our view:

   (a) subscribers to these schemes are tenants in common in respect of the property. While there is unity of possession, they each hold undivided shares in the property. They therefore have an interest in each other's undivided share. This relationship appears to satisfy the definition of "security" in section 2 of the Securities Act;

   (b) these commercial property ownership schemes are "contributory schemes" for the purposes of section 5(1)(b)(i) of the Act; and

   (c) as it is impossible to physically divide each subscriber's share in respect of the land, the interest or right which each subscriber receives is not an interest or right in respect of a "specified part of the land". The exemption afforded by section 5(1)(b) therefore does not apply.

7. For the reasons set out in paragraph 6 above, the Commission believes that offers of many interests in commercial property ownership schemes to the public are required to comply with the requirements of the Securities Act, that is, they must be made by way of a registered prospectus and an approved independent statutory supervisor must be appointed to monitor the interests of investors. We have made our views known to certain real estate companies who have recently been promoting such ventures. There is now a growing unease within the real estate industry on the question. Some industry participants have sought further legal advice and, as a result of that advice, have applied to the Commission for an exemption from compliance with the registered prospectus and statutory supervisor requirements of the Act.

8. The applicants consider that it is desirable to put the application of the Securities Act to the offering of such interests beyond doubt. The Commission agrees. The applicants consider that the most expedient means of achieving this is for the Commission to exercise its power of exemption under section 5(5) of the Securities Act in respect of all offers of such interests, subject to appropriate terms and conditions. We should be grateful to receive the views of industry participants to this suggestion.

9. If it is agreed that a general or class exemption is the appropriate approach, the question arises as to the nature of the terms and conditions of such an exemption. These will need to provide appropriate protection to investors in lieu of the protection afforded by the Securities Act. The following may serve as a guide to the possible terms and conditions which the Commission might impose:

   (1) that it is a condition of the investment contract that the subscriber for the securities will be issued with a certificate of title under the Land Transfer Act 1952 in respect of his/her undivided share in the commercial property;

(2) that no subscription monies for the securities will be accepted unless an investment contract containing the condition referred to in (1) above has been entered into;

(3) that all subscription monies for the securities are held in trust in an audited trust account maintained by either a solicitor or trustee company pending delivery to the subscriber of a certificate of title;

(4) that every subscriber has, before entering into the investment contract, been provided with a written statement signed and dated by the directors of the offeror which:

(a) describes the property to be purchased;

(b) states the purchase price to be paid for the property;

(c) describes the scheme for the purchase of the property and the interests in the scheme being offered;

(d) states the remuneration and other benefits which shall be received by the offeror for establishing and promoting the scheme and the manner in which this remuneration shall be taken;

(e) describes and (where practicable) quantifies all liabilities (including potential and contingent liabilities) that a person will or may incur as a holder of the interests being offered;

(f) contains details of any covenants or other encumbrances on or to be registered on the certificate of title in respect of the property;

(g) contains or has attached a copy of a report by a registered valuer who has no relationship with the offeror or any director of the offeror that could be perceived as having the potential to influence the exercise of his/her professional judgement in respect of the property to be purchased, that is signed by the registered valuer and dated no earlier than two months prior to the subscriber's receipt of the written statement;

(h) that the report of the independent registered valuer referred to in (g) above contains the following information:

(i) the name and address of the registered valuer and a brief description of that registered valuer's qualifications;

(ii) a statement that the valuation report is made by the registered valuer as an independent registered valuer;

(iii) a description of the property to be purchased;

(iv) a list of any encumbrances appearing on the certificate of title in respect of the property as at the date of the valuation report;

(v) material details concerning any local authority requirements which shall be required to be complied with in relation to the property after it has been purchased and an estimate as to the cost associated with such compliance;

(vi) material details concerning any local authority zoning restrictions in respect of the property and the implications of such restrictions in terms of the potential use of the property and the potential profit which may be generated thereby;

(vii) details concerning any option or buyback arrangements and any rental guarantees in relation to the property;

(viii) the land value and the capital value (as those terms are defined in the Valuation of Land Act 1951) of the property as shown on the most recent government valuation of the property and the date of that valuation;

(ix) the present use of the property and the proposed use of the property;

(x) any current rental being paid in respect of any existing leasehold interest in the property and any other material matters concerning existing leasehold arrangements;

(xi) the opinion of the registered valuer as to the land value and capital value of the property free of encumbrances;

(xii) the basis upon which the valuation is made and any assumptions used in making the valuation;

(xiv) a statement by the registered valuer as to the amount of income that the property can be reasonably expected to produce on an annual basis under conditions prevailing at the time the report is made;

(xv) a statement that the registered valuer has consented to the distribution of the report to prospective subscribers in the scheme and that, as at the date of the report, the registered valuer has not withdrawn that consent;

(i) contains material details concerning any leasehold agreement that has been entered into with regard to the property and states where copies of the agreement may be inspected free of charge;

(j) contains material details of any management agreement that has been entered into with regard to the maintenance of the property, including the management fee, and states where copies of the agreement may be inspected free of charge;

(k) contains any other information which would be material to the subscriber's decision as to whether he/she should invest in the scheme; and

(l) contains the following statement:

" IMPORTANT NOTICE

Prospective investors are advised that the issuer, in making this offer, relies on an exemption granted by the Securities Commission from the obligation to disclose under the Securities Act 1978 and Securities Regulations 1983 information that is material to the making of an informed investment decision. This document may therefore not contain the information normally required to be disclosed by the Securities Act 1978 and the Securities Regulations 1983 in a registered prospectus. Prospective investors should seek professional advice before investing in the securities. "

(m) states the names and addresses of the following persons associated with the scheme and describes their role in the scheme:

(i) the offeror and the directors of the offeror,

(ii) the manager of the scheme and, if that person was not the person first appointed as the manager of the scheme, the person first appointed as the manager of the scheme,

(iii) the solicitor or company referred to in paragraph (3) above,

(iv) the sales organisation (if any) through whom the offer of the securities is to be made to the subscriber.

10. The Commission would be grateful to receive the views of industry participants in respect of the above conditions.

11. Submissions to the Commission in respect of the above should be in writing and should be addressed to:

Mr Richard Shires
Securities Commission
P.O. Box 1179
WELLINGTON

Submissions should reach the Commission by no later than 20 November 1995.

4 October 1995
(Comprop.DP)