Regulation A+: An Alternative to Private Placements and Initial Public Offerings

Article
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Regulation A+ went into effect in 2015. Although Regulation A+ has been around for a couple of years, its use is just beginning to become more mainstream. Since Regulation A+ was promulgated, the SEC has qualified 81 Regulation A+ offerings seeking to raise approximately $1.5 billion. As developers and investors gain more awareness of, and comfort with, Regulation A+, it is likely to completely change the way developers and investors raise the equity necessary for a new project or acquisition. Regulation A+ (sometimes referred to as a "mini-IPO" or as an "on-ramp to IPO") allows investors to raise up to $50 million in a 12 month period from the general public, with streamlined initial and ongoing compliance costs. This means a greater pool of investors without all of the costs of a traditional IPO or without the need to have a predetermined list of investors.

As discussed in our February 2017 article, Alternative Financing Strategies in a World of Rising Interest Rates, equity is a component of any real estate development or investment. Traditionally, real estate developers and investors have increased the equity available for a real estate project through private placements, or sales of securities to a discreet pool of high-net worth or otherwise sophisticated investors. Private placements are authorized under Regulation D of the United States Code of Federal Regulations and are exempt from the registration requirements of the Securities Act of 1933, which have costly compliance requirements both for the initial public offering and for ongoing compliance requirements.

Tier I

There are two different sets of requirements that must be met under Regulation A+, which are determined based on the amount of investors' funds being raised. Developers and investors seeking to raise $20 million or less in a 12 month period fall under the Tier I requirements of Regulation A+. A Tier I offering must meet the following requirements:

1. The company must be a U.S. or Canadian company (limited liability company, corporation, etc.);
2. The company cannot raise funds for the purpose of acquiring a to be determined company or other merger and acquisition purposes (a "blank

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3. The company cannot raise funds for the purchase of fractional shares of gas or mineral interests;
4. The offering can raise no more than $20 million; and of that $20 million, only $6 million can be raised through the sale of securities by affiliates of the selling entity;
5. The company cannot exceed net assets of $10 million and cannot have more than 2,000 investors or more than 500 non-accredited investors without complying with the ongoing registration requirements under Section 12(g) of the 1934 Exchange Act;
6. The company must prepare an offering statement that is qualified by the Securities and Exchange Commission;
7. The company may submit its offering statement to the SEC for review confidentially and work to incorporate those changes required by the SEC before actually submitting the offering statement and conducting the offering;
8. The company may distribute advertising materials to the general public before or after its offering statement is approved and qualified by the SEC, so long as its advertising materials clearly state the status of the offering statement and so long as the offering statement is submitted at least 21 days before any securities are sold; and
9. The company must submit Form 1-Z after the offering is terminated and has no further reporting requirements beyond Form 1-Z.

Tier I offerings are also required to comply with the various states' securities laws, or "Blue Sky Laws." It is important that companies conducting Tier I offerings limit the offerings to residents of those states in which it has complied with the Blue Sky Laws. Failure to do so could result in the company being subject to liability under state securities laws, which often include a right of rescission. There is an organization that assists in streamlining the registration of Tier I offerings in the state or states in which a Tier I issuer wishes to sell securities. While the registration of Tier I offerings in more than one state can increase the up-front cost of the offering, the lack of ongoing reporting requirements helps offset such costs over the life of a project.

Tier II

Developers and investors are allowed to raise up to $50 million under Tier II offerings. The requirements for Tier I and Tier II are very similar, but Tier II offerings are subject to the following additional requirements:

1. Non-accredited investors are limited in the amount of their individual investments to an amount not to exceed (a) 10% of the greater of annual income or net worth (for natural persons); or (b) 10% of the greater of annual revenue or net assets at fiscal year-end (for non-natural persons);

2. Tier II offerings must include audited financials in their offering statements (financial statements are required for Tier I offerings, but they need not be audited); and
3. Tier II offerings are also subject to ongoing public reporting requirements generally every 6 months as well as within 4 days of any fundamental change events (e.g., replacement of certifying accountants, change of control, departure of key personnel).

In exchange for the ongoing reporting obligations, issuers under Tier II offerings are exempt from the registration requirements under Section 12(g) of the 1934 Exchange Act. This means that issuers utilizing Tier II offerings can accept investments from more than 500 non-accredited investors and have more than 2,000 equity holders. Further, Tier II offerings preempt the Blue Sky Laws, meaning that issuers can avoid having to comply with each individual states' securities laws. Such preemption allows for an even broader pool of investors at a lower compliance cost.

Resale of Securities

Securities purchased in a private placement under Regulation D are non-transferrable due to the fact that such securities are not issued to the public. The return on investment for Purchasers of securities in a Regulation D offering often required waiting for a liquidity event (i.e., sale of the project or taking on of additional debt to redeem investors) or relying on distributions from the issuer based on the cash-flow of the project. Under Regulation A+, the shares or other equity interests are freely transferrable except for the limitation on resale by affiliates of the issuer. However, there currently is a very small secondary market upon which to sell such securities. Therefore, while not prohibited by law, resale of securities purchased in a Regulation A+ offering may be difficult due to the lack of a secondary market on which to sell such securities.

Conclusion

The information above is a brief outline of how Regulation A+ functions, and what it can offer to smaller companies and investors. Each company's situation will be different and its ability to utilize Regulation A+ will depend on its particular situation. However, Regulation A+ represents a previously unheard of opportunity to raise substantial sums of capital through the sale of debt and/or equity securities to the general public, while minimizing the regulatory cost burden traditionally associated with such capital raising activities. Regulation A+ can be used by operating companies of all sizes that need additional capital for new product lines, expansion of production capacity or other business needs, or companies that need additional capital and have outgrown their local venture capital options but that are not ready to go public. Regulation A+ can also be used by real estate development and acquisition companies to facilitate new projects or to assemble portfolios of real estate.