EPISODE 1272

[INTRODUCTION]

0:00:00.0 Mauricio Rauld Essentially the new rule allows us to do something today that we weren't able to do a year ago. Attention, been a year already that it's been in effect, but it allows us to start our syndication using a 506(b) exemption, which is probably the most popular one that most people use, and then in the middle of the syndication literally pivot and stop that 506(b) offering and start and continue, let's put it that way, continue the raise under 506(c) and therefore start advertising in general and accepting your credit investors only.

[INTERVIEW]

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Whitney Sewell: This is your daily real estate syndication show. I'm your host, Whitney Sewell. Today, we welcome back guest Mauricio Rauld.

He's the founder and CEO of Premier Law Group. You've heard him numerous times on the show, he's an expert around the legal aspect of our business, and he's helping us to ensure that we're not operating in any gray area, which I do know to operate in a gray area, and I know you as the operator do not as well, and you have a passive investor who wants to work with operators that are also doing everything they can to be as legal as possible, which is what we want, and Mauricio is helping us with that. And today we're gonna discuss, maybe there's an option for that sophisticated investor that wants to become a credit or way for him to do that if he doesn't have that million dollars net worth or maybe the $200,000 of income yet, you know, annually. There's another way that potentially he could become accredited, and I've not heard many people talk about this either, but there is a way to do it, there's a commitment to make that happen, but Mauricio's gonna go into that. But then, there are also maybe some potential changes in the near future that will make this process easier for a sophisticated investor to become accredited, so it could change our industry in a big way, and how we work with investors, what investors can invest in these types of deals, and you're gonna hear some insight into that today from Mauricio.

Mauricio, welcome back to the show. It's been a long time, but you've been on the show numerous times. We've talked about some great topics that any, really, operator or even passive investor should be... operator should be aware of for sure. But even passive investors should have some understanding of these things as well, and so there's been some changes recently I'm looking forward to discussing with you. Welcome back to the show.

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Mauricio Rauld: Thanks for having me back, Whitney. This is episode five for me, this is a record for me. I don't know if it's a record for you, but super excited about this.

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WS: You're a part of the industry that's so important in our business and have an insight into those things, expertise really, right, that we must have on our team. Today specifically, you've brought to light some changes recently that can be so valuable to operators, right? And the investors, but that I feel like they need to know about. I want us to jump through some pros, cons, and things obviously that they need to know about, but let's dive in. Obviously, 506(b) to 506(c), we don't have to dive in really what, you know, b versus c, some of those things specifically 'cause I know we've done numerous shows about that, but I, you know, let's dive right into what does that mean? And, you know, what have you seen change? And what does this mean for the operator? Let's talk about it.

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MR: Yeah, this is probably the biggest change that I've seen that not too many people are talking about, not sure too many people know about. So, and to be honest, quite honest, we've only started doing it, we probably had five or six people actually do this, but I'll just give you sort of cliff notes and we'll dive a little bit deeper. Essentially the new rule allows us to do something today that we weren't able to do a year ago. Attention, been a year already that it's been in effect, but it allows us to start our syndication using a 506(b) exemption, which is probably the most popular one that most people use, and then in the middle of the syndication literally pivot and stop that 506(b) offering and start and continue, let's put it that way, continue the raised under 506(c) and therefore start advertising and generally accepting your credit investors only. It's fascinating because when I first came across this thing, when I was reading a proposed rule back in November of almost, what is that? About a year and a half ago back in November, and I was only reading this proposed rule and I came across this section where it set this and I'm like "it makes sense," but I'm like, "there's no way they're gonna allow this" because it's essential you're doing... you're taking non-accredit investors in a deal that you're also advertising, which as you guys know is a big no-no. And so, because it was November, you know, Christmas is coming up on the holidays, like I didn't get a chance to do a deep dive and it actually became effective when the final rule came out, and eventually, I think it was January, February, but became effective in March of last year, and I wanted to do a deep down 'cause it was so... I wanna say revolutionary 'cause almost like it's too good to be true. I did the deep dive and started honestly talking about it not too long ago, probably three or four months ago 'cause I really wanted to make sure we had it right.

But yeah, so in the old days, you weren't allowed to do that because of something called integration, right? So if you try to do a 506(b) or even a 506(c) and you try to get non-accredited or artificially break them up into two, the (inaudible) gonna be like no, no, no, that's not gonna work. That's basically... we're gonna treat that as one offering. But with this, what happened actually, Whitney is they actually changed the integration rules. It really comes from that main change. They changed all these integration rules, the integration rules were super complicated and (inaudible) five factors and all this nonsense, and now they really simplified them, and part of the simplification, this issue came up.

And in fact, one of the commentators who was actually reviewing the post rule came up with this thought, it's like, "Hey, really nice if we were allowed to start with a 506(b) and then, if at some point we need to do switch over to 506(c) that would be awesome if you guys... meaning the FCC could approve that?" And I was thinking, "Yeah, of course, it would be nice." And the other comment is like, "No, that's nonsense. I would be basically allowing advertising in a 506(b) (inaudible). What do you... that's kind of a way to get around the rule and I'm like, yeah. But then the rule came out, and that's exactly what... not only did the rule come out, but the SC specifically comment, and I said, "Yes, we are taking the... guidance, so to speak, that if you did start an offering under 506(b), stop, mid-raise pivoted and then started to do 506(c) that would be something that would be allowed.

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WS: Wow. Got a bunch of questions, of course, but you know, I'm just thinking through as the operator, why not do this?

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MR: That's a great question. I mean, some people don't need it. We've actually had a couple of clients that have started this process, but then end up raising all the capital into 506(b) so they don't actually need to do the pivot, but that's a great question. Like why not? Now, one of the things that you've gotta keep in mind is you are kind of doing two separate off, even though it's the same exact deal, right? You're raising money for a particular project, and it's the same LLC, it's virtually the same documents, we update them a little bit but it's very... substantially the same documents, but we do have some best practices that we've kind of implemented so there's not on our own, just to make sure that we're super clean.
And so, one of the things we do recommend is making that decision ahead of time, right? So making that decision before you start raising that, "Hey, this is something I may wanna do, so I wanna have it in my back pocket," so let's structure it in such a way that would allow us to easily and smoothly and without any doubt, do this transition from a b to a c. So the answer is, I don't know why everybody wouldn't do it. Especially, Whitney, those clients that, you know, we get calls from clients like, "I really wanna do a 506(c). I'm kind of at that point, but I've got non-accredited, right? I've got my investors that I've been in here the past, I've got a bunch of non-accredits, I'd love to get them in there as well," this is a way to do that, get all your non-accredited and then pivot.

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WS: So, one way that we have done this in the past, Mauricio, I love your opinion about this as well, but is that you know, we launched a 506(c) fund, right? And then we said... to just, and to make it as clean like you were talking about is possible, we just want no gray area, of course, we closed the fund, I said, "Okay, this day it's closed." Well, you know, we're like a week later, we launch a special purpose vehicle, but it's a 506(b) entity right, and then we raise its 5 million, which allows it to become accredited, well, what's it doing that... we just invested in the fund. So it was a way for us to kinda back door, you know, allow sophisticated investors, you know, the same benefit. But this seems more simple to me.

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MR: This is so much simpler if that's the right word. Yeah, there are some safeguards that we like to take into account, you know, for example, even though it's not... doesn't say anything about this in the law and the rule, but we like to, for example, create separate classes, right? So class A for example would be your 506(b) raise and the class B for example would be your 506(c), that way when you're advertising, it's very clear that you advertising for the B shares only and you're not really commingling 'cause that's the key, right? The key is to literally create that sort of proverbial Chinese wall where when you're doing the 506(b) at the beginning, you're fully compliant with 506(b), right? No messing around that says, "Yes, you can bring in some non-accredited sophisticated, but you've gotta have a pre-exist," usually a pre-existing substantive relationship. There's no advertising, none of that stuff. You really are complying 100% with that b offering.

Then, what we like to do is when we make the decision, like say, today is the day that we actually... we gotta terminate. So we not only make a declaration that we terminated the offer, but we like to do a written consent or resolution essentially, again, we're documenting everything, it's all about documentation. And so we document that we terminate. And by the way, when we say terminated, we need to terminate, right? No straggling checks that come in or wires or any documents. I mean, when you terminate it, you are done with the 506 BPs and then we do that resolution, and then the next day or that afternoon, we start 506(c), but remember at that point we're fully complying with 506(c)s. So yes, we're advertising, but we're also limiting ourselves to only accredited investors and we're taking reasonable steps to verify that they're accredited. We just gotta play it very cleanly and there is an update to the document, you know, as you know, Whitney, I know you do a lot of 506(c)s, there are certain languages in there that would be in a 506(c) offering that wouldn't necessarily be in a 506(b), and so we do update the doc. The sponsor usually updates also the business plan, 'cause now they need to raise less money is slightly different all that stuff. But the key, like everything else, is just disclosure, just making sure everybody understands that this is what you're doing and you're disclosing to the accredited investors that you have non-accredits in the deal and all that stuff, so as long as it's above board, this is just a great tool. Just another tool in our toolbox doesn't mean that it's for everybody, doesn't mean it solves all your problems, but it's something to consider moving forward, this is something that seems appealing to you.

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WS: It doesn't matter which one you start with, 506(b), 506(c), what kind of best practice there that you've seen?

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MR: Yeah, 100%. So this only applies when you go from a 506(b) to a 506(c), right? So we still cannot go from a c to a b because of a couple of things. Number one, when you start with a 506(c), you are obviously by then already advertising is we can't go back and what the SEC really doesn't want you to do, what they absolutely don't want you to do is put out some communication, some advertising out there. You're gonna capture non-accredits, right?

So if you're on... you do a blast, you have no control as to how wide that net is but what the SEC definitely doesn't want you to do is to capture, non-accreditors through that advertising and they say, "Oh, you know, you're not really... you're not... I'm sorry, you're not eligible for this deal, but guess what? I've got another deal over here. Let me put you into this 506(b) deal." You still have to go through that those we've talked about in the past episodes, those eight steps to take somebody that you just met through that advertising, which was illegal. You obtain that person's contact information legally 'cause you're doing a 506(c), but then you gotta take those steps to take them from that stranger to having a substantive relationship and then you can only offer them a subsequent deal, right, subsequent to that time that you became... had a subjective relationship.

So c to a b is always a no-no. B to a c used to be a no-no, or at least if you were able to pull it off in some way, you certainly would have to kick out all of your non-accredit investors. This rule is specific to when you start with A, B, and then go to a C, or any other... by the way, I want to say c. It could be any other exemption that allows (inaudible) could be regulated crowdfunding or reggae or anything that allows advertising after the fact.

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WS: What about the documentation for the operator? I know, you know, when we're doing a 506(b), obviously we are... I mean, we're so meticulous about ensuring we have a documented pre-existing relationship, right? You know, every call, every interaction that we can possibly document, we try to do that just in case we're ever out of it, we can say, "No, I've known Mauricio for two years.

You know, he's invested with us this many times, we've had conversations about investing, we've had conversations about kids, you know, whatever we... you know, like we have that relationship and we can prove it. What about doing this and changing from b to c? Any thoughts around documentation on the operator side that they need to consider?

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MR: I love that you brought that up because any time you're doing a b the documentation fee, I mean I always remind people that it's your burden to prove what exactly you just mentioned. You know, if something happens down the road, it gets challenged and you say, "Hey, how did you meet Mauricio?" Your memory is not gonna remember how you met me, or well, maybe as we did, but you're not gonna remember what and when you met him, how many times you call, what kind of information, so documenting that is so key, and some people go to some unison extremes and sort of recording all the calls and just having... 'cause it's really your burden, so that's critical. But on the 506(c) route, one of the nice things about c is, you know, there aren't that many limitations, so you don't have to worry about your investors having to read pre-existing relationships with those investors.

You don't have to worry whether they're sophisticated or, you know, suitable, that they are accredited. So the only requirement for you on the c really is just to take those reasonable steps necessary to verify that they are in fact accredited. And I know you do this, Whitney, but I highly recommend not doing that on your own, there are plenty of third-party verification companies out there that will verify that so that documentation piece really should be outsourced and even CPA letters, which a lot of people rely on. I'm seeing more and more people that more and more CPAs that are being reluctant to sign those verification letters because of the way that it's... it basically shifts the burden to them, so they're always trying to come back and change the language of the letter to make the liability last, which of course makes that verification almost worthless.

So, even with verifications, I like to use a third party, but in terms of documentation with these specific, yes, continue to do the documentation on the b side, and then the corporate resolution is really the one that we've focused on documenting that. So we have, you know, ideally, again, go overboard, maybe have that notarized, so there's no dispute as to what day that resolution took place and what day everybody agreed that you were terminating the 506(b) and then as of the data that resolution moving forward, you were gonna do 506(c) and comply fully with that exemption.

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WS: What about disclosures in the beginning, like two investors? Like, should we... I like how you said earlier, but you need to make this decision ahead of time, and I think even if you're a (inaudible) it would be great to be able to show this and see that somehow as well. You know, this wasn't like a last minute, "Oh, my goodness. We can't raise the money, now we have to go do something," right? And so, make that decision upfront that you're going to do this and... oh and, you know, should we announce that?

Should that be in our documents, our investors, or when we first make that first blast out about the deal? You know, should it be known or is that gonna raise red flags then or, you know, we don't wanna hold anything back that they need to know, so how do you think about that?

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MR: Yeah, great question. No, disclosure... there's ever doubt you wanna disclose, right? So this is something we have. Now, usually is the business plan itself, but again, you don't have to blow it out of proportion, just some lying in there that just lets them know, "Hey, this is a b that's gonna, you know, we accept non-accredit but we're gonna go to a c," and it's gonna be very clear. But one of the other reasons I like splitting the classes between class A and class B, or however you wanna split them, is that when somebody's going through the PPM and the operating, you can't miss that.

There's all references to A and B. Now, this really three classes, 'cause of a B, and then the operator of the sponsor is the C class or whatever. So, it's gonna be very obvious to them, at least at the beginning, that they're all gonna be though, so you definitely wanna disclose that, and especially for, you know, a credit investor. I think the fact that you're all gonna have non-accredit investors in the deal, that's a disclosure, some accredited may not like that, you know, because which I think there's some merit to that, but with non-accredited, there seems... there's always a little bit more a risk that somebody's not gonna be happy, or if there's a cash call, for example, it's much less likely that a non-accredit investor will be able to make the cash call. So those are material disclosures we wanna make, and so again, I think in the business plan, you don't have to make a huge think about it. It could even be a footnote somewhere when you're describing that's a 506(b) or even where it says 506(b) to say, "506(b) and we reserve the right to convert to a c."

But it's gonna be very clear in the PPM because you're gonna have these extra classes where somebody on is like, "What is this extra class for?" And it's gonna be very... To be clear also, we do this extra class, by the way, literally as there are zero differences, so the way we've created these, they'd have the same amount of voting rights, they have the same... i's the same price, it's the same everything, it's just literally the one class is offered pursuant to one exemption or the other. Doesn't need to be that way, you could certainly change them if you want it to, so you could theoretically start a 506(b). That's another reason to do the class, is a class at maybe $50,000 minimum because there a lot of non-accredited and then when you flip it and you start selling Class B, that minimum could be $100,000 or $200,000 because now you know they're all gonna be accredited, so you don't have to change them. The way we start these off is their zero difference, but you can certainly incorporate differences as you like.

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WS: No, that's a great insight. Just disclosing that upfront and if we even need to or how we think about that. But what about just any dos and don'ts? I mean, as far as this process... or I actually had another question that I wanted to remember to ask you, is this really like just two separate funds? I mean, are we like launching two separate funds here? One 506(b), 506(c), and somehow they're connected? I was just trying to think through that. I know used in a different class, I'm just trying to think through the structure of that legally and help the listener to think through that as well.

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MR: It's two separate offerings. Little distinction, there are two separate offerings, one's a 506(b) and one 506(c), but it's the same... if you wanna use the word fund, it's the same fund. It's the same syndication, "syndication." And, if you're doing a project-specific, it's the same project. I'm still raising. If you're buying a 100-unit apartment building, both b and c is to raise that million dollars to buy the 100-unit apartment building, and it's the exact same offering, and so it's the same. Not only is it the same project, if you're doing project-specific, but it's also the same LLC, you're not having to create multiple LLCs. The only difference is that they are two separate offerings, so separate offerings, but the same fund or same syndication.

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WS: Okay, no, that's awesome, that's great. It helps me to understand that. I hope that helps us as listeners as well. Any other best practices that we should keep in mind when we're thinking about potentially doing before we move to a few final questions?

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MR: I think the best practice is just to treat those two offerings completely separate, right and when you're doing the b, treat it as a b, like you are... because you are doing a 506(b), so comply fully with that law, and then when you do that pivot, which is also a best practice for the corporate resolution, then you comply fully with that 506(c). So you're not gonna be taking any non-accredited and you're taking reasonable steps to verify. Don't... don't commingle those. Try and think of them in your mind as two complete separate offerings, even though it's the same LLC, it's the same project, everything else is in same, even though the second set of documents will be slightly different.

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WS: So, we need to make sure I have all those funds in from the 506(b) before, say, we do a switch?

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MR: Yeah, you don't want any straggle. So... yeah, 'cause a lot of times somebody signs the docs and maybe the wires, you know, I sent the wire, but it hasn't hit your account, like literally,

you wanna make sure that there's nothing. And same with documents like, "Hey, make sure all the documents are in, that they're all signed, that you've audited your documents" because you are literally ending and terminating. Because once you go to the c, you can't just go back and re-open to go, you know, "I forgot to do something here" or somebody forgot to do, you know, we wanna make sure that we really are very clear, that's why we have that corporate resolution. I think it helps in best practices to make a very clear delineation as to when we stopped making offers, accepting monies, and accepting documents from the 506(c).

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WS: I can see the need to just be very clear about that upfront to your investors like, you have three weeks, we have to have your money in that amount of time, or you're just not getting in the deal because we're switching to a 506(c). You know, if they're accredited, well fine, they can get in 506(c) offering, right? But those sophisticated, being very clear.

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MR: And that brings up another great kind of a best practice, is if you're gonna do this, start early, right, because, you know, this is not the deal for you to do wait until due diligence is over and you're 100% sure you being forward then you start the process and you're tight against the clock. This is something you wanna start right from the get-go, as soon as you know you're getting into a contract. Reach out to your attorney because yes, it's gonna take time, maybe not a... it's not gonna take months but you're gonna have to talk to your non-accredit business, "Hey, look this is open for a week," or two weeks tops, and so if you don't get it now, you know, we're gonna terminate this 'cause you've gotta get going, you've gotta figure out once you get everybody in your non-accredits, you gotta flip it over to the c. So, starting early would be another good practice.

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WS: Mauricio, what about some habits, maybe daily habits that have helped... your discipline about that have helped you achieve success? Maybe something that's changed or maybe the things that you're honing in on since we've talked last?

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MR: You know, I continue my habit of getting up not even at the crack of dawn. Today, I was up at 4:30, but just getting up early is such a big thing for me because it gives me a good couple of hours even before, you know, before the kids get up and the (inaudible) kids up, so I've got all that time on now. Granted, since the last time we talked, I do have two puppies, and so now I gotta take care of them in the morning, get them out and get them fed and everything. But that hour and a half that I have in the morning, that's really where I focus on myself, I'm big on personal development, that's what I'm focusing on. My goal is to focus on the big picture, and that's by far I made the biggest difference in my life and where I am now.

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WS: To integrate more, the same way. How do you like to give back?

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MR: I'm trying to educate the syndication community. So that's how, you know, I just try and put as much content. It takes a lot of time to put at this content. I'm trying to make it pure value-add and not trying to do anything else with it, so that's kind of where I'm spending most of my time these days, producing content. You know, hopefully, add value to all the real estate syndication in the community.

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WS: You're definitely doing that. Grateful for your giveback today. I just think just this topic is brand new, I don't think we've ever talked about that on the show, and so I think it's gonna be very helpful to many operators to think through, or maybe this is something I should consider. You know, we can get our sophisticated but hey, we can still advertise in a couple of weeks, right? Or four... three or four weeks, whatever. Very helpful. Appreciate your time, Mauricio. And we look forward to talking to you again tomorrow.

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MR: It sounds like a plan. Thanks, Whitney.

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WS: Tell the listeners out today how they get in touch with you.

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MR: The other thing I get back is on Wednesday evenings I do a live, a Q and A live, and so you can do that at my website mauriciorauld.com/live. And every week we talk about some topic, have some guests, and anything again, that adds value to a real estate syndicate.

[END OF INTERVIEW]

[OUTRO]

0:20:34.0 WHITNEY SEWELL Thank you for being a loyal listener of the real estate syndication show. Please subscribe and like the show, and share it with your friends so we can help them as well. Don't forget, to go to lifebridgecapital.com, where you can sign up and start investing in real estate today. Have a blessed day.

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