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Kahr Notes

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"Kahr Notes" is an electronic newsletter from Kahr Real Estate Services LLC that carries interviews, news and original research. This month's issue is going to 484 readers.

If you know of someone who would enjoy receiving this newsletter, please pass it along.

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In "Kahr Notes" this month:

1. Opening Shot - Need free help?
2. Interview - Craig Effrain, corporate securities lawyer

1. Opening Shot - Need free help?

Welcome to the New Year and Volume 2 of Kahr Notes.

It's funny how an editorial theme can arise from two separate events. The theme for this month is the cost of good help.

In my interview with Craig Effrain, a specialist in corporate and securities law, we discuss why cutting corners can be extremely expensive and how doing it the right way (and paying the lawyer) is often the best choice.

While he's entirely right that being cheap when picking your attorney can be extremely expensive in the long run, there is still a good deal to be had with student labor.

I will be teaching a graduate seminar on Market and Feasibility Analysis this coming semester in the Master's of Real Estate program at New York University. All the students in my class will be separated into teams and will complete a market and feasibility analysis on a site somewhere in the City of New York. Do you have a site that you'd like to suggest for analysis?

My preference would be that they'd get to work on a real project and it might as well be yours. It's one of those rare situations where everybody wins; my students get to work on an actual development deal and you get a team of four smart and capable students who want to solve your problems. Call me to discuss your site and I'll see if it's appropriate for my class. My preference is that the site be one that is already

under your control (by option or ownership) and that you have materials that you can provide the team to analyze and work with such as architectural drawings, cost estimates, and the like.

Good luck in all your endeavors and you'll hear from me again in a month.

Regards,

Joshua Kahr
Editor/Publisher, Kahr Notes

P.S. If you know of someone who would like to be interviewed for the newsletter, e-mail me your suggestion. If they work in real estate and have a story to tell, I'd love to speak with them.

2. Interview with Craig Effrain

KN: This is Joshua Kahr, publisher of Kahr Notes, and I'm sitting here with Craig Effrain. Craig is an attorney at Stursberg & Veith in New York City where he specializes in corporate and securities law. Today, we're going to talk about private placements and raising money for real estate deals.

Good afternoon, Craig. I'm glad you could join me for lunch. Let's start with something straightforward. Why did you decide to become a lawyer?

CE: While in college I planned on attending business school, but started having doubts during my year at the London School of Economics. After graduating from college I went to work for a commercial bank, Sovereign, which was subsequently merged with NCNB to become NationsBank. I was in a management training program and rotated through different bank divisions, such as retail, commercial and international banking. I decided that although I didn't dislike banking, I was looking for something different. I decided to go to law school, and instead of being a banker or businessman, I'd be a lawyer advising bankers and businessmen.

I hated my first day of law school, and so did most of the other students. The first week isn't much better, but that's the ritual you go through with law school. In my second and third year I was able to concentrate in business and corporate law, and found my niche, so to say. When I graduated from George Washington University Law School I was awarded the Richard Teberg prize for outstanding performance in corporate law. I then decided to continue my legal education. I spent a year at New York University and got my LLM, which is a Master's of Law, in corporate and securities law.

KN: After law school, you went right into doing corporate securities work?

CE: While I was at New York University, I worked part time for an attorney that did corporate and securities work and securities litigation.

One of the clients I got involved with was the representative of an Eastern European financial institution. They were attempting to set up an executing broker-dealer for Russian and Eastern European institutions wishing to trade securities on US markets. They also wanted to act as an adviser for Eastern European companies desiring to raise capital on US and western capital markets.

It was an interesting opportunity and enabled me to travel to Russia and work with companies just exploring capitalism. It though was also very difficult. Irrespective of the issue of crime that was a problem in Russia, I found that the bigger problem

was their mindset. We got involved in complicated cross border brokerage transactions and business issues that no one had the answers to from a legal standpoint.

At the time, NASDAQ was working with Russia and helping them set up a clearing system. I would get questions from my client which were highly complex and involved, which no one had the answers to yet, and they'd expect me to look it up in some book and get back to them in five minutes. No one had the answers yet to these cross border transactions with Russian institutions.

Another problem was the financial statements we'd get from these companies. They were a mess. I could see then that it would be a long time before Russian companies would fully appreciate or understand what was required for them to be fully integrated with Western capital markets.

It reached a point where I became extremely frustrated and decided to move back into the firm environment.

KN: Let's talk for a moment about the private placement process. What is your involvement?

CE: It depends on the client. I do everything from preparing a private placement memorandum or offering statement, drafting all the subscription documents, and doing all the governmental filings. In securities law you need to be concerned with filing in the states and with the federal government. If you've got investors in various states, you need to be concerned in the filing requirements in each state.

KN: Are you also raising money for them?

CE: I have made contacts over the years that I can introduce people to but in today's market it's not easy. I also won't introduce anyone unless I am the attorney. With regards to the legal preparation, clients have different needs. Some of them come to you and say that they know who they want to raise money from and we'll say, "Give us the paperwork so we know that it's done right".

Other people will be planning on raising money by using a broker dealer or placement agent. I'll negotiate a placement agency agreement with the agent and work with them to get the offering completed properly. And then of course, you have people that have no idea how to go about and raise money or from whom. I'm always happy to sit down and structure something that works based on their objectives.

KN: So real estate people typically come to you and they say....

CE: The ones that I've been involved have typically involved forming an LLC. They've got a project, and they want to take advantage of people who want to put money into the project and so you form the LLC and draft the operating agreement. Typically, there will be tax issues involved. Depending upon their complexity I may recommend to bring in a tax lawyer to also advise. When it comes time to raise funds, I'll prepare all the government filings.

I haven't been involved in too many large-scale real estate transactions. Typically, I've worked with the small to mid-sized ones.

KN: Define small.

A few people putting money into a project to buy a complex or a building... anywhere from less than a million to about two million dollars depending on the

size of the project.

KN: From the time they walk in the door, how long does it take to prepare documents and do the filings?

CE: Depends. If we have to prepare offering material and file it with New York, for example, it's going to take some time to have it prepared properly. The operating agreement may also take some time. The amount of time depends on how much work is required, how much drafting is required, how much is presented to me to work from, who the investors are, and how the thing is going to be structured. It could take a few weeks to a month or two.

The operating agreement is the document that sets forth the rights and interests of the parties to the venture. If it's a simple structure, it won't take much time to prepare. Most deals aren't simple, though. Everyone's got their concerns and interests and it needs to be properly drafted into the operating agreement.

After all the paperwork's prepared, we then have to file it with the state. In New York, you shouldn't do anything until you get a filing response back from the state.

KN: Because?

CE: Legal requirement. There are always exceptions and things you can do but you must understand the laws and what the limits and guidelines are.

KN: You and I both know that a lot of real estate players don't always do it the right way.

CE: Not just them.... I went to a dinner party last night and spoke with a government lawyer about a big area in the law that I believe a lot of people are breaking and they're not even aware of it. There are a lot of people you see in deals that act as a finder, introducing and bringing in investment for these deals. A lot of them are really acting as broker-dealers and should register as brokers. The securities laws require people acting as brokers to be registered. In many instances these finders don't even realize they're breaking the law. They don't realize how easy it is to step over the line from being a finder.

The SEC investigates this and can prosecute people that should be registered, but I doubt it's their top priority.

KN: My understanding is that it's not difficult to set yourself up as a broker dealer. I mean there is paperwork involved but there's not an unreasonable amount of money required.

CE: It's not unreasonable but there is no doubt that it takes some time and money. Filing with the SEC isn't that complicated but you also need to register with NASD. There is paperwork involved and legal fees.

It's an expense and an ongoing regulatory issue. The SEC and NASD are going to require you to provide ongoing information.

It's never anyone's favorite to provide ongoing information about themselves.

KN: And pay lawyers....

CE: Yes, and pay lawyers. It's a heavily regulated field; you'll need legal assistance.

KN: Let me ask another question on the finder's fee issue because I think a lot of people are breaking the law in how they are raising money. A lot of people don't

understand what the finder's fee structure is. Could you explain it?

CE: Let me give you an example. A company wants to raise \$2,000,000. The company is approached by someone who calls himself a finder. He says, "I know the right party that you need to go to and I'm sure they're going to want to put money into your company. I'm going to want a 5% cash fee and 5% of any stock that is sold".

The percentages change but that's a typical situation.

The company thinks this is great, everything works out, and they raise the money.

If that "finder" is doing that on an ongoing basis, they're really stepping over the line. There is a whole list of factors that you need to look at. If it's an isolated case, say an attorney refers someone, that's what you'd traditionally call a finder. It's an isolated occurrence. It's not the lawyers business to raise money, and he is not in the securities industry.

On the other hand, if its someone doing this on an ongoing business, and they have work experience in the securities industry, and they're helping negotiate the transaction, that may fall within the definition of a broker, and you'd have to be registered. There are a lot of companies doing that and they call themselves finders or consultants. They'll say that they're not involved in negotiations and they'll try to limit it anyway they can. The SEC however takes a narrow interpretation of what is a finder.

KN: Is the company that hires the finder breaking the law?

CE: No, but it could cause some problems.

If the company at some point goes public, they need to file with the SEC and the states. The regulators will pour through that company's history and they'll ask questions on past private placements.

For example, there was a company I represented that was incorporated in New Jersey. Both the SEC and New Jersey asked questions about previous financings. We had to prove that the people involved in previous transaction were not required to be broker dealers.

If the company gets bought out, the buyer is also going to go through these issues in detail. It may not kill a deal, but it doesn't help, and it will make things more complicated and expensive.

KN: Have you seen the SEC become more aggressive in the wake on Enron and other scandals?

CE: Yes. Starting last summer I saw some tougher questions. They were really looking closely at some of the registration statements I was working on. They were asking tough questions and demanding complete responses. They didn't want another Enron, anymore than anyone else. They don't want to get caught again in the same situation.

KN: Let's say that you're a small developer. You've got the contract in hand and you'd like to raise two million. What now?

CE: Do you know where the money is coming from? How you will raise the money will in many instances drive the equation and determine how we'll move forward from a legal perspective. If you don't have the investors yet, give yourself enough

time to prepare an offering statement and get it done right.

You're going to need to set parameters for the sort of investors that you're going to approach. That will then have an effect on the type and volume of documentation that you're going to present to your investors.

If you have all the investors in place and the structure in mind, then we are talking about a different kind of deal, and one which can be completed much faster.

KN: The question I'd like to close with is this: I've seen sometimes where a developer has the offering memorandum and other marketing materials such as photos and glossy handouts and it's not entirely clear if that other material was approved. Thoughts?

CE: Submit everything.

KN: Thanks for your time.