

Obtaining a PUBLIC REPORT for TICs from the Department of Real Estate

BY: APRIL M. ALDERISO, ESQ.
Zacks Utrecht & Leadbetter
A Professional Corporation
The Russ Building
235 Montgomery Street, Suite 400
San Francisco, CA 94104

Public Reports (“White Papers”) & the Department of Real Estate:

The Department of Real Estate (hereafter, “the DRE”) oversees the marketing of new subdivisions in California. The DRE believes that a public report is required for sale of tenancy in common interests in buildings of five or more units where at least one unit is residential. Most subdividers (I will use the term “subdivider” throughout this article although this is not legally a subdivision) are obtaining a Public Report for these sales to avoid the risk of DRE sanctions and possibly enhance the marketability of their property. Public reports contain essential information for prospective buyers including covenants, conditions and restrictions which govern the use of property, costs and assessments for maintaining homeowners' associations and common areas, and other material disclosures. Prior to the issuance of the public report, the subdivider must file an application with the DRE and submit supporting documents. If improvements to the subdivision are not complete at the time the application is filed, the subdivider must also submit evidence that adequate financial arrangements have been made for their completion. After the subdivider conveys the last remaining lot/unit in the subdivision, the DRE's oversight ends and the homeowners association operates the subdivision. Approval is not required for TIC resales.

Cost Information:

Obtaining a public report will involve hiring a variety of professionals who will work together as a team to assemble your application. You will hire an attorney, a map surveyor, a title company, and a budget preparer. In addition, the DRE charges various fees for the different types of reports. We estimate the total cost to be between \$15,000-\$20,000.00.

- As your attorney, we would draft the Sample Purchase and Sale Agreement, the TIC Agreement, the Memorandum of the TIC Agreement, the Sample Note and Deed of Trust, Sample Junior Note and Deed of Trust (if seller-financing may be offered), a detailed Explanation of Financing Letter, and when requested by the DRE, a draft of the final public report. In addition, we fill out the lengthy RE 648 form. Please call for information on our current fees.

- The title company will prepare most of the forms required by the Department of Real Estate for free provided you close your escrow with that company and choose them for your title insurance.

- The map surveyor will take measurements, survey the property and draft unit diagrams. Fees will vary, for a 5-6 unit building we estimate around \$3,000.00. The price goes up \$300.00 for each unit above the initial five units
- The budget preparer prepares the budget for the project. They charge a flat fee around \$2,500.00 - \$3,700.00, depending on your project. This includes, answering deficiency notices, filling out 624A, and drafting certain exhibits based on the TIC Agreement.
- For a final report, the DRE charges a \$500.00 base fee+ \$10 per interest. There are also different fees for preliminary public reports and conditional public reports.

Risk Reduction Requirements:

One of the DRE's primary concerns is that due to the inherently risky setup of TIC agreements buyers are in a position where they could lose a lot if there are not adequate protection measures in place. Of special concern are properties containing blanket encumbrances, where the non-payment by another party could jeopardize an innocent owner. Therefore, the DRE imposes the following requirements for properties that have a blanket encumbrance:

- The "HOA default fund": Unless 80% or more units close at the same time, the subdivider will need to deposit cash or a surety bond into escrow for the equivalent of six months worth of Homeowner's Association dues. These dues will be determined based on the professionally prepared budget. This money is held until 80% of the TIC units close, unless the seller fails to pay the homeowner's monthly dues for the unsold TIC units. If this occurs, money from this fund may be used towards payment of the homeowner's monthly dues for the unsold units.
- The "presale requirement": If there is a blanket encumbrance, unless 80% or more units close at the same time, the seller must either deposit into escrow cash or a bond in an amount equivalent to the balance owed on the loan until 80% of the TIC sales close.
- The "mortgage default fund": Currently the law does not state who is responsible for placing money into this fund. There are three options: 1. The seller could place the money into the fund, 2. The buyers could be required to place the money into the fund directly, or 3. The sale price of the units could be raised so that the seller could take that excess money and place it into the fund.
 - A. *If there is a blanket encumbrance:* The equivalent of six months worth of payments on the loan subject to the blanket encumbrance must be placed into this fund prior to the close of the first escrow. If one or more buyers do not pay his or her share of the mortgage, money from this fund may be used to protect the interests and credit of the co-owners.
 - B. *If there is not a blanket encumbrance:* The equivalent of two months worth of assessments must be placed into this fund.

Types of Financing:

There are several methods of financing available to TIC buyers, including: group financing, wraparound financing, assumption financing, and the newest alternative, individual financing. There are pros and cons to each alternative based on each

individual project scenario. Unfortunately, the method of financing must be submitted to the DRE before the buyers are determined. Financing for large TIC projects is extremely complicated. The subdivider should discuss his or her options with an attorney, as well as his mortgage broker and real estate agent, before making a decision.

In addition, if seller-financing will be offered a sample promissory note and deed of trust must be submitted for the DRE's review. There are specific rules for offering seller-financing which should be discussed with an attorney.

Types of Reports:

A Final Public Report is the main report that allows you to market, advertise and enter into sales contracts. There are two optional types of reports for TIC subdividers who have not previously obtained a final report:

- Preliminary Public Report: This optional report is issued before the Final Report, in the early stages of applications. It allows you to take non-binding reservations on the units, as well as advertise and market the project.
- Conditional Public Report: This optional report allows you to enter into binding contracts for the units, however the subdivider cannot close escrows until the purchasers have received the Final Public Report. The Conditional Public Report is rarely used in TIC scenarios.

Estimated Time & Disclaimer:

A final report generally takes anywhere from 6 to 12 months to obtain. All efforts will be made on our behalf to promptly respond to any DRE's requests related to the documents that we drafted. However, this law firm does not guarantee that a final report will be granted. Once the DRE has all of the necessary documentation, their decision to either grant or deny the issuing of a public report is entirely in their control.