Commissioner's Annual Report

On the Offer or Sale of Securities by Permit under Corporations Code Section 25113

2018

California Department of Business Oversight

Introduction

Senate Bill 978, which became effective on January 1, 2013, mandated the Department of Business Oversight (DBO) to prepare an annual report summarizing the data collected from issuers that were granted permits to offer and sell securities pursuant to Corporations Code section 25113, subdivision (b). The Legislature intended the report to provide an annual summary of the offer and sale of permitted securities in this state. As prescribed under subdivision (d) of Corporations Code section 25113, the report is required to provide the following information:

- The general categories of investments for which permits were approved.
- The experience and net worth requirements imposed on issuers or sponsors.
- The total amount of money sought to be raised per category.
- Enforcement actions taken by the Commissioner of the DBO (Commissioner) against permitholders.
- Any other information deemed relevant by the Commissioner.

Summary

Permits

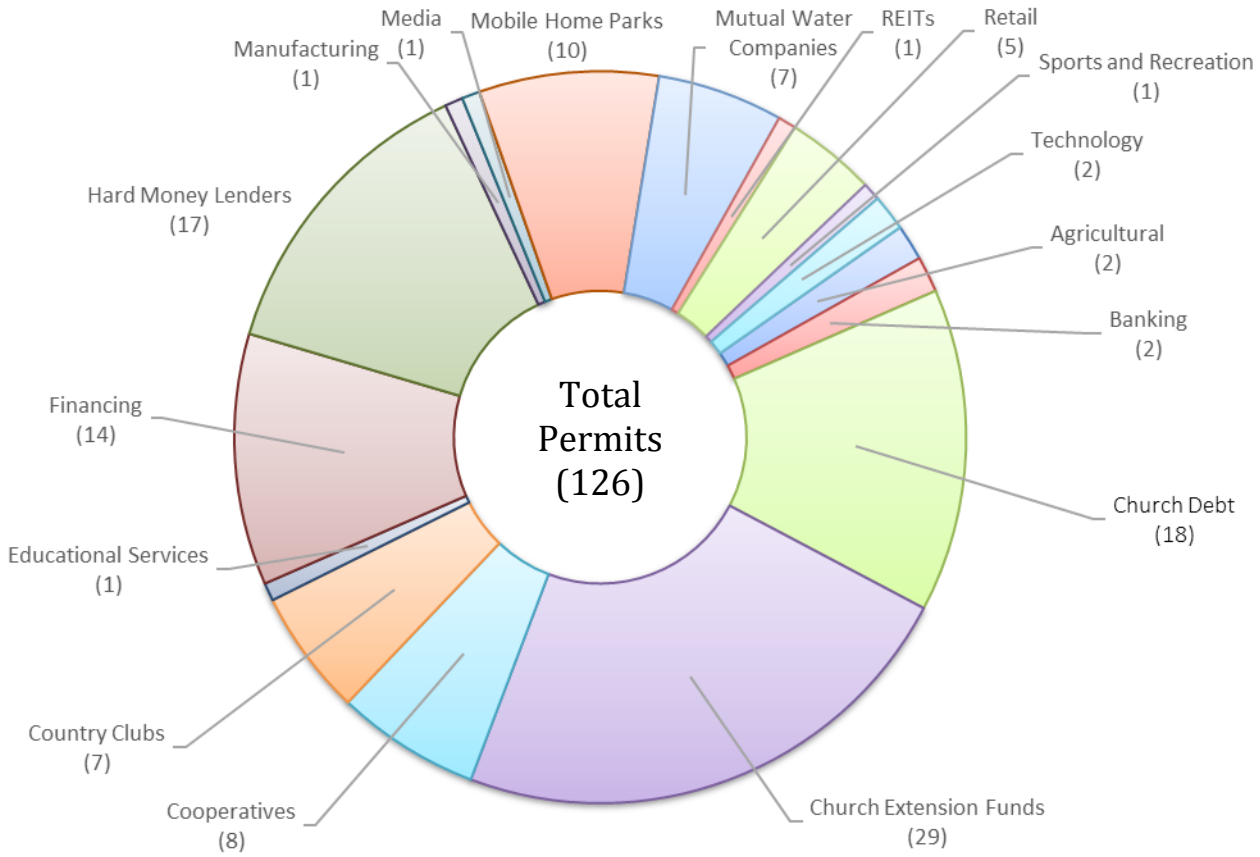
Generally, under the Corporate Securities Law of 1968 (Corporations Code section 25000 *et seq.*), the offer and sale of a security requires either a permit from the DBO or an exemption from the permit requirement. For the period of January 1, 2017 through December 31, 2017, a total of 126 permits were issued under Corporations Code section 25113.

General Categories of Investment

In 2017, the DBO issued securities permits in the following categories of investment: agriculture, banking, church debt, church extension funds, cooperatives,[1] country clubs, educational services, financing,[2] hard money lenders,[3] manufacturing, media, mobile home parks, mutual water companies, real estate investment trusts (REITs), retail, sports and recreation,[4] and technology.

[1] Cooperatives include hardware retailers, grocers, and professional services providers.
[2] Financing includes non-profit 501(c)(3) and for-profit companies financing through debt.
[3] Hard money lenders include mortgage pools and fractional interest investments.
[4] In 2017, only one permit was issued under this category.

2017 Permits Issued by Category



Investor Suitability Standards

The Commissioner has broad discretion under the Corporate Securities Law of 1968 to set standards for the offer and sale of securities. The Commissioner may require investors to meet specific qualifications related to experience, level of financial responsibility, tax status, or any other criteria the Commissioner deems necessary.[5] These "investor suitability" standards are imposed as needed and depend upon the securities issued. As reflected in the table below, both the least stringent and most stringent standards varied by category of investment in 2017. For some investment categories, the suitability standard imposed was limited to California residents.[6] In most cases, however, the Commissioner restricted the offer and sale of the securities to persons having a minimum gross income and minimum net worth or limited the percent of net worth a person could invest.

[5] Cal. Code Regs., tit. 10, § 260.140.01.
[6] Cal. Code Regs., tit. 10, § 260.001, subd. (e).

Investor Suitability Standards

Category of Investment	Least Stringent Standard	Most Stringent Standard
Agricultural	For Farmers and producers of agricultural products	$75,000 net worth or $50,000 gross income and 50 plus 10% or 150,000 net worth plus 10% or no more than $2,500 per 12 months
Banking	Available only to existing shareholders	Available only to existing shareholders
Church Debt	California residents only	$250,000 net worth or $70,000 gross income and $70,000 net worth plus 10% net cap
Church Extension Funds	For church members or affiliates of the church through program activity	For church members or affiliates of the church through program activity
Cooperatives	California residents only	$2,500 max in 12 months or $75,000 net worth and $50,000 net income plus 10% net cap or $150,000 net worth plus 10% net worth cap
Country Clubs	$500,000 net worth or $65,000 gross income and $250,000 net worth plus 10% net worth cap	$1,000,000 net worth or $100,000 gross income and $500,000 net worth or $200,000 gross income annually
Educational Services	$75,000 net worth or $50,000 gross income and $50,000 net worth	$75,000 net worth or $50,000 gross income and $50,000 net worth
Financing	California residents only	$500,000 net worth or $65,000 gross income and $250,000 net worth plus 10% net worth cap
Hard Money Lenders	$225,000 net worth or $60,000 gross income and $60,000 net worth plus 10% net worth cap	$500,000 net worth or $65,000 gross income and $250,000 net worth plus 10% net worth cap
Manufacturing	For employees of the issuer only	For employees of the issuer only
Media	$75,000 net worth or $50,000 gross income and $50,000 net worth	$75,000 net worth or $50,000 gross income and $50,000 net worth
Mobile Home Parks	California residents only or prior relationship with the officer or director of the park	California residents only and minimum age of 55
Mutual Water Companies	Residents of limited dwellings only	Residents of limited dwellings only
Real Estate Investment Trusts	$250,000 net worth or $70,000 gross income and $70,000 plus 10% net worth cap	$250,000 net worth or $70,000 gross income and $70,000 plus 10% net worth cap
Retail	10% net worth cap	$250,000 net worth or $70,000 gross income and $70,000 plus 10% net worth cap
Sports and Recreation	$75,000 net worth or $50,000 gross income and $50,000 net worth plus 10% net worth cap	$75,000 net worth or $50,000 gross income and $50,000 net worth plus 10% net worth cap
Technology	For employees of the issuer only	Available only to existing shareholders

Standards for Issuers or Sponsors

Experience Requirements

The securities permit application requires the issuer to explain the applicant's business experience. The DBO evaluates the issuer's explanation along with other information provided in the application. The Corporate Securities Law of 1968 imposes no experience requirement that applies to all issuers. However, regulations promulgated by the DBO set experience standards for issuers or sponsors in a real estate program[7] and oil and gas offerings.[8]

In a real estate program, the general partner of the sponsor must have at least two years of real estate experience or other experience relevant to acquiring and managing the types of properties sought by the program.[9] Additionally, any affiliate providing service to the program must have no less than four years of experience in the kind of service being rendered or otherwise demonstrate knowledge and experience to render the proposed services.[10]

In an oil and gas offering, the general partner or its chief operating officers must have at least three years of relevant oil and gas experience demonstrating the knowledge and experience to manage the operations.[11] Additionally, the general partner or any affiliate providing services to the program must have at least four years of relevant experience in the services being rendered or otherwise demonstrate sufficient knowledge and experience to perform the proposed services.[12]

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[7] Cal. Code Regs., tit. 10, § 260.140.111.1.
[8] Cal. Code Regs., tit. 10, § 260.140.122.1.
[9] Cal. Code Regs., tit. 10, § 260.140.111.1.
[10] *Id.*
[11] Cal. Code Regs., tit. 10, § 260.140.122.1.
[12] *Id.*

Net Worth Requirements

The report required under Corporations Code section 25113, subdivision (d), must include the "minimum, maximum, and average net worth required of those persons to whom permits are issued for each category."

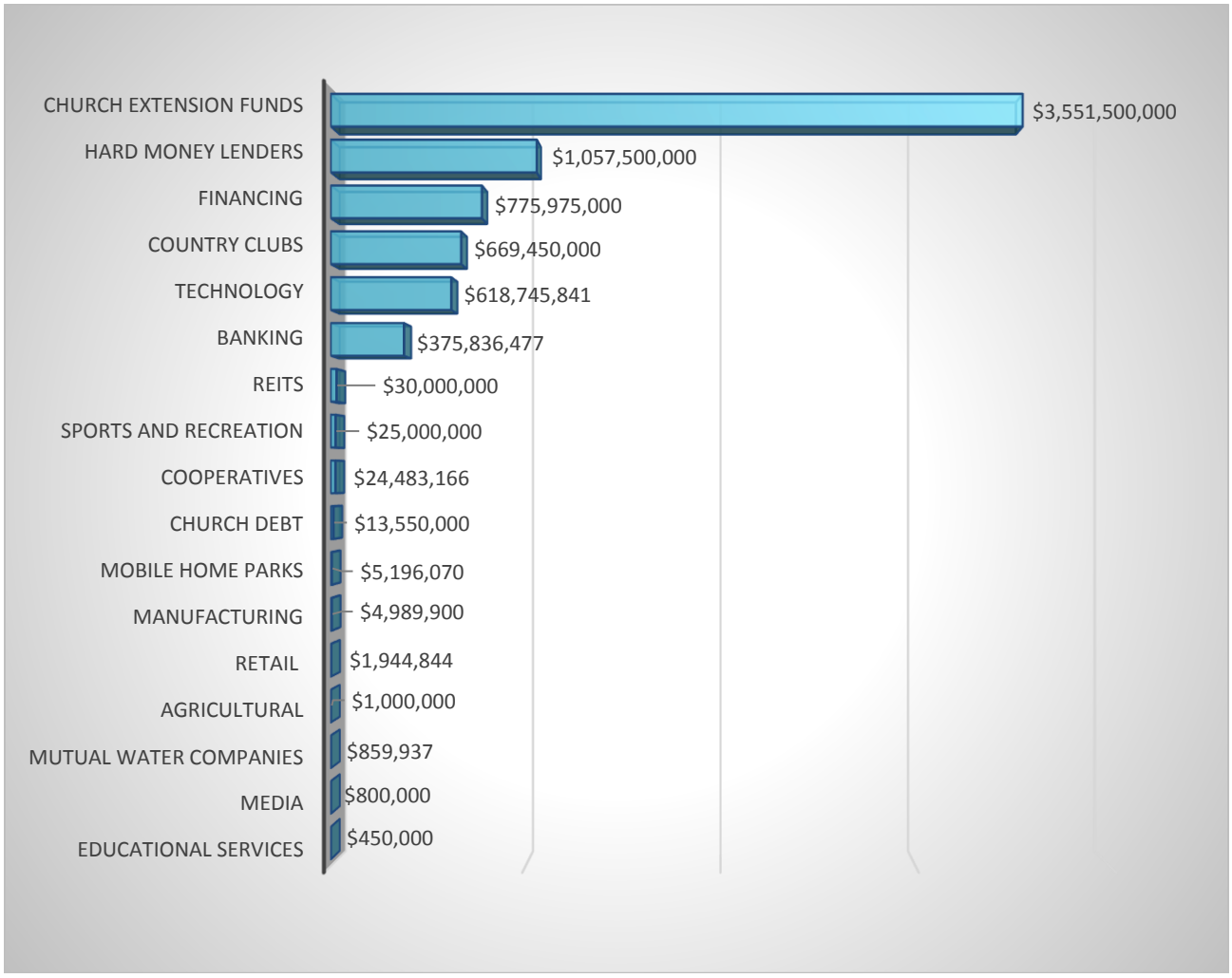
The Commissioner, however, generally does not require specific net worth or minimum capital requirements for the issuer or sponsor unless required to do so by a specific rule. As such, regulations governing REITs,[13] real estate programs,[14] and oil and gas interests[15] specify net worth requirements.

Issuer Standards

Category of Investment	Minimum Net Worth	Maximum Net Worth	Average Net Worth
Agricultural	$10,051,594	$23,941,227	$16,996,410
Banking	$13,952,347	$181,585,000	$97,768,674
Church Debt	$324,179	$93,886,239	$8,931,846
Church Extension Fund	$962,117	$215,600,000	$41,847,942
Cooperatives	($101,468)	$5,333,000,000	$751,227,925
Country Clubs	($6,631,172)	$78,191,000	$20,092,711
Educational Services	($250,005)	($250,005)	($250,005)
Financing	$776,544	$128,370,349	$29,695,549
Hard Money Lenders	$75,852	$42,056,789	$7,298,929
Manufacturing	$16,043,876,100	$16,043,876,100	$16,043,876,100
Media	$414,893	$414,893	$414,893
Mobile Home Parks	($964,069)	$24,609,756	$6,226,757
Mutual Water Companies	$59,794	$23,056,491	$7,597,884
Real Estate Investment Trusts	$73,364,189	$73,364,189	$73,364,189
Retail	$16,748	$1,137,560	$321,330
Sports and Recreation	($10,200)	($10,200)	($10,200)
Technology	$1,194,906,000	$1,197,324,000	$1,196,115,000

[13] Cal. Code Regs., tit. 10, § 260.140.91.
[14] Cal. Code Regs., tit. 10, § 260.111.2.
[15] Cal. Code Regs., tit. 10, § 260.140.122.2.

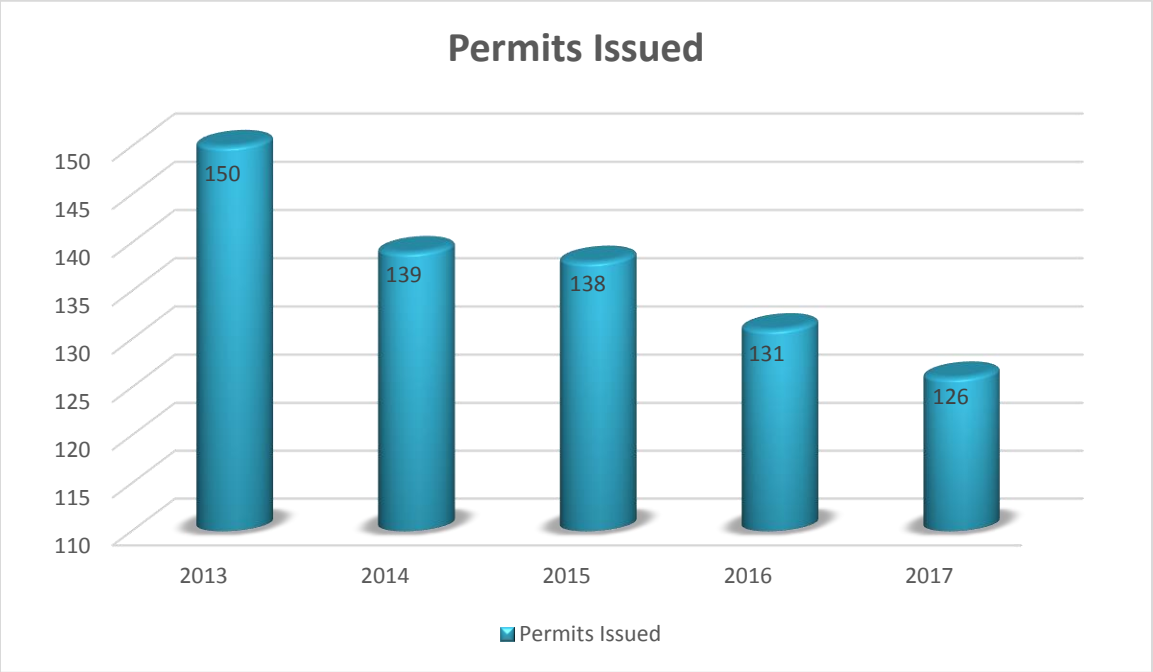
Total Amount Sought to be Raised by Category



Total: **$7,157,281,235**

Enforcement Actions

In 2017, the DBO took no enforcement action against any of the issuers that received a permit under Corporations Code section 25113.

Yearly Trends

In 2017, the number of permits issued under Corporations Code section 25113 decreased by three percent, representing a 19 percent decline over the past four years.