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REAL ESTATE INVESTMENTS AS SECURITIES:
THE SUFFICIENCY OF THE HOWEY TEST

Real estate investment opportunities have mushroomed in recent years as investors from all socioeconomic levels are being lured by the prospect of reaping substantial profits, of acquiring tax shelters, or of providing themselves a home. Faced with various kinds of real estate development schemes, these investors need to be protected from unwittingly entering into fraudulent promotions. The purpose of this section is to examine the kind of protection afforded by present security statutes and to determine whether the definition of "security" currently relied on by the courts is adequate for the kinds of problems encountered by real estate investors. Three types of schemes will be examined: land syndications, condominiums, and cooperative housing corporations.

Congress, in the Securities Act of 1933 and the Securities Exchange Act of 1934, listed several specific and general types of instruments which were to be regarded as securities. The United States Supreme Court, however, in SEC v. W.J. Howey Co. found these statutory definitions to be inadequate and formulated a new test to aid in the adjudication of securities cases. This test in its most distilled form announced that a security is created when "the scheme involves an investment of money in a common enterprise with profits to come solely from the efforts of others." 208

205. The Acts gave as examples of specific securities transactions notes, stocks, treasury stocks and bonds; and as examples of general transactions certificates of interest or participation in any profit-sharing agreement, investments contracts, or any interest or instrument known as a security.
206. 328 U.S. 293 (1946). Prior to the Howey decision, the Supreme Court in SEC v. C.M. Joiner Leasing Corp., 320 U.S. 344 (1943), had considered whether an investment scheme in real estate was a security. In Joiner, a promoter sold assignments in small lots of oil and gas leases with the prospect of substantial profits if the test wells on the leases proved successful. Although the investor received an interest in real estate, the Court found that the purpose was mainly to provide the capital to drill test wells. The test used to determine if these investments were securities was not whether the asset received was a formal certificate such as a stock or bond, but "what character the instrument is given in commerce by the terms of the offer, the plan of distribution, and the economic inducements held out to the prospect." Id. at 352-53.
208. Id. at 301. Recently, federal courts have liberalized the requirement in Howey that the profit must come solely from the efforts of others and have allowed limited participation of the investor in the scheme. See SEC v. Glenn W. Turner Enterprises, Inc., 474 F.2d 476 (9th Cir.), cert. denied, —U.S.—, 94 S. Ct. 117, 38 L. Ed. 2d

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Since the Howey test was formulated, the number of types of investments has significantly increased. With the advent of this increased activity, the ability of the Howey test to provide sufficient protection to investors has recently come under strong criticism by legal commentators.

One commentator, Professor Coffey, argues that the Howey test fails to give due consideration to the risk to which the investor's capital is subjected. This risk factor is described as the "single most important economic characteristic which distinguishes a security from the universe of other transactions." This lack of consideration for the risk factor is said to have arisen because too much emphasis has been placed on the inducement of future profits, causing the risk factor to be overshadowed. Additionally, Coffey contends that in every security transaction three essential elements must be present. First, the investor's "initial value" must be subjected to the risk of an enterprise with which he is unfamiliar; second, the investor must lack control over this enterprise; and third, the investor must be induced to expect some "reasonable benefit over and above the initial investment." Coffey, however, finds the Howey test not completely without merit, pointing out the Supreme Court's admonition that in securities regulation, substance and economic reality should be considered over form.

A second commentator, Professor Long, criticizes the Howey test because it deals only with an investment contract and is not adequately adaptable to the complex, ever-changing financing schemes that are coming upon the scene. According to Long, an investment may be cash, property or services and not merely "money" as the Howey test requires. Secondly, the term "common enterprise" should be replaced by the word "venture," which means "a concerted effort to bring about some particular result or group of results." Long further contends that although there is some expecta-

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210. Id. at 375.

211. Id. at 412. Initial value is whatever the investor furnishes the promoter whether it be cash, property or services.

212. Id. at 376.


214. Id. at 161.

215. Id. at 162. Long used the term "venture" to exclude "those investments where the benefit expected comes about through unrelated activities or a general change in economic conditions." Id. at 162. See 1 L. LOSS, SECURITIES REGULATION 491 (2d ed. 1961), wherein Professor Loss makes a similar distinction:

[No investment contract is involved when a person invests in real estate, with the hope perhaps of earning a profit as a result of a general increase in values concurrent with the development of the neighborhood, as long as he does not do so as a part of an enterprise whereby it is expressly or impliedly understood that the property will be developed or operated by others.

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tion of a benefit in all securities, this benefit need not be "material or tangible and certainly not payable in money alone." The final element is satisfied if the investor does not possess any direct control over the investment enterprise. Succinctly stated, Long's test is:

A security is the investment of money or money's worth in the risk capital of a venture with the expectation of some benefit to the investor where the investor has no direct control over the investment or policy decisions of the venture.

Long, then, emphasizes both the risk to which the investor's capital is subjected and the degree of control the investor exerts in the management of the enterprise. The purpose of the subsequent subsections will be to determine the applicability of the Howey test to land syndications, condominiums and cooperative housing corporations. Some factual situations demonstrate the deficiencies of the Howey test. It will be seen that the tests proposed by Coffey and Long may provide more realistic yardsticks for determining the presence of a security.

REAL ESTATE LAND SYNDICATIONS

Real estate land syndication is a popular method of investment whereby the wealth of several investors is combined to purchase potentially valuable property. The preferred form of a real estate syndication is the limited partnership. This preference can be accounted for both by the freedom from liability which the limited partners enjoy and by the income tax advantages which are afforded a partnership. In establishing a partnership,

217. Id. at 171. This lack of control prevents the investor from having any influence over the management of the enterprise; he thus has no voice in its success or failure. Conversely, where a person has the right to participate in the direct management of his investment he is aware of the activities and has the opportunity to exert some influence over them.
218. Id. at 174 (emphasis omitted).

The decision as to what is the best legal entity to use for a real estate land syndication depends on the results desired by the investors. In addition to the limited partnership form, the investor can utilize the status of a corporation, a general partnership, a joint venture, a trust, or a real estate investment trust. Normally, the investors will want to use a form which creates little or no liability for them personally to repay the capital borrowed, allows them to borrow a large portion of the purchase price, passes on the taxable income and any loss to them, and requires a minimum of reporting to governmental regulatory bodies.

Although there are several different legal entities available, there are disadvantages to each which make them undesirable to particular investors. The corporate form allows the investors to avoid any liability and to acquire the needed capital, but the income is subject to corporate income taxes as well as state franchise taxes (required in some jurisdictions). Even if the corporation elects to be taxed as a partnership...
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the general partner, usually the promoter, selects a piece of property which he believes to have development potential and then attempts to interest several investors in underwriting the venture. Those wishing to participate as limited partners sign letters of commitment and pay their respective portions of the earnest money. After the earnest money is collected, the general partner procures the property and assigns it to the limited partnership. At this time, the limited partners turn over the remainder of the money promised and the general partner executes the necessary notes. The general partner also pays all taxes and oversees the everyday management of the property until a new buyer is found. After finding a new buyer, the general partner arranges the sale and, with the consent of the limited partners, sells it for a profit which is then apportioned among the partners.

Because the limited partners invest in a common enterprise expecting profits to be realized from the efforts of others, the implications of the existence of a security in this type of investment under Howey are evident. These implications, however, become even clearer in view of the guidelines established in a 1967 release by the Securities and Exchange Commission:

Under the Federal Securities Laws, an offering of limited partnership interests and interest in joint or profit-sharing real estate ventures generally requires registration of the offering. This registration process involves a thorough examination of the offering to determine its compliance with federal and state securities laws. The registration process can be complex and costly, and it may require the preparation of extensive disclosure documents. As a result, limited partnerships are often structured to avoid registration requirements. These structures may involve the use of limited liability companies or corporations, which are less regulated than partnerships under federal securities laws.

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(through Sub-chapter S provisions) this decision adds further difficulties because the size of the corporation is then strictly limited to 10 investors and no more than 10 percent of the income can be derived from rents and royalties.

A general partnership provides the income tax advantages desired, i.e., the income is distributed to the partners who are individually liable for it, and the partnership is not required to pay a franchise tax. However, each partner is jointly and severally liable which could easily bankrupt the small investor. Another form, the joint venture, is very similar to the general partnership except the joint venture is created for a single specific purpose. All the advantages and disadvantages applicable to the general partnership apply equally to it.

Finally, the trust and the real estate investment trust fail to provide the advantages offered by other forms either because real estate land syndications in the form of trusts are forbidden by some state statutes, or as is the case with the real estate investment trust, the regulatory requirements imposed are so complex that unless the scheme is a multimillion dollar one, the effort and expense of formation renders this method undesirable.

The limited partnership, therefore, which provides adequate means both of acquiring financing capital and of passing income received to the partners, without necessitating either the incurring of personal liability or the complying with burdensome regulatory requirements, is the most desirable entity to use. See Sonfield, The Texas Limited Partnership as a Vehicle for Real Estate Investment, 3 ST. MARY'S L.J. 13, 15-17 (1971). See generally Berger, Real Estate Syndication: Property, Promotion, And The Need For Protection, 69 YALE L.J. 725 (1960).


eraly constitutes an offering of a "profit sharing agreement" or an "investment contract" which is a "security" within the meaning of Section 2(1) of the Securities Act of 1933. . . . [T]he investor provides the capital and shares in the risk and the profits; the promoter or third party manages, operates and controls the enterprise, usually without active participation on the part of the investor. . . .

The investor's interest in the enterprise may be evidenced by formal certificates or by part ownership of the assets used in the enterprise. In determining what is an investment contract, substance and economic reality prevail over the form of the transaction involved. . . . Therefore, if the promoters of a real estate syndication offer investors the opportunity to share in the profits of real estate syndications or similar ventures, particularly when there is no active participation in the management and operation of the scheme on the part of the investors, the promoters are, in effect, offering a "security."222

These SEC guidelines establishing land syndication as a possible vehicle whereby securities are offered223 are consistent both with the Howey "substance over form" principles as well as Professor Coffey's thesis that the risk which the investor's capital must bear is a basic element of a security. Additionally, in stating that "the investor provides the capital and shares in the risk and the profits"224 the SEC's position closely parallels what Coffey termed a "proprietary interest," entitling the investor to a share of the enterprise's assets as well as a share of the enterprise's losses.225

In addition to the SEC release concerning the status of real estate syndications, several state courts have determined that an investment in a land syndication is a security.226 In an Illinois case, Sire Plan Portfolios v. Carpenter,227 the plaintiff sold fractional undivided interests in an income-producing apartment house. Under the agreement, the record title was to be transferred to an individual named by the plaintiff as trustee, for the benefit of all the investors. When the title passed to the trustee, the plaintiff conveyed to each investor an interest in the property as tenants-in-common. The plaintiff was to manage the building, pay all the expenses and distribute all the profits on a pro rata basis. The court, applying the Howey test,

223. The Uniform Limited Partnership Act § 10 prevents the limited partner from performing any managerial functions. This inactivity as well as the transferability of the certificates of limited partnership support the conclusion that land syndications are securities. See generally Greenwood, Syndication of Undeveloped Real Estate and Securities Law Implications, 9 Hous. L. Rev. 53, 59 (1971).
held that there was no difference between managing an apartment house and managing a citrus grove, as in Howey, for distant investors. The court further stated:

The profits and income, if any, resulting from the Sire plan are produced by the efforts of Sire and its nominees in managing its properties, purchased with the money of many distant investors in small fractional undivided interests, without the investors having real control of the enterprise.

It appears from the holding of the court in Sire and from the provisions of the SEC release that the Howey test includes within the definition of a security all real estate land syndication schemes employing the limited partnership form. Whenever the limited partnership form is used in a land syndication arrangement, it includes both a general partner who is actively engaged in the management of the enterprise and one or more passive limited partners who do not participate in the management. Their passivity marks the transaction as a security as much as their expectation of profit from the sale of the property at a higher price.

CONDOMINIUMS

Condominiums are also preferred types of investments because the owner is given a fee title in the unit with all the tax advantages of homeownership. The fee interest is restricted to the interior walls and the air space contained between them; all other parts of the dwelling, such as the exterior walls, are held in common ownership with the other owners. In acquiring the fee interest, the buyer must accept all the covenants, conditions and restrictions contained in the purchaser contract with the restrictions being enforced by a board of directors elected by the owners.

At first, commentators pointed toward the time of purchase as being the important factor in determining whether the transaction involving a condominium was a security. A purchase before the unit was completed could be interpreted as the furnishing of risk capital, whereas purchase after completion would involve no risk factor. The subsequent relationship

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228. Id. at 79-80.
229. Id. at 80-81.
between the unit owners and the management likewise did not warrant the finding of a security because each unit owner participated in the maintenance and upkeep of his own unit. Initially, concern with the application of the securities laws to condominiums was directed only toward those condominiums occupied on a full time basis and not to those used primarily for resort or vacation purposes.

With the ever increasing expansion of resort condominiums, the SEC issued a release which attempted to guide their development and to alert promoters to their responsibilities under the Securities Acts. The lease implies that the Howey test is applicable in determining when an offering of a condominium is a security. The application of the test, however, was expanded by the SEC's recognition that the investor did not have to be totally inactive and that the renting of other units was an economic inducement to the investor which could be considered profits. In addition, any one of the following three factors listed by the SEC would cause an offering of a condominium to be a security:

1. The condominiums, with any rental arrangement or other similar service, are offered and sold with emphasis on the economic benefits to the purchaser to be derived from the managerial efforts of the promoter, or a third party designated or arranged for by the promoter, from rental of the units.
2. The offering of participation in a rental pool arrangement; and
3. The offering of a rental or similar arrangement whereby the purchaser must hold his unit available for rental for any part of the year, must use an exclusive rental agent or is otherwise materially restricted in his occupancy or rental of his unit.

In accord with these guidelines promulgated by the SEC is the holding in SEC v. Marasol Properties, wherein the defendants were permanently enjoined from selling condominium units because the sale was considered to be an offering of unregistered securities. The court applying the Howey test held that "[t]he offer to sell or the sale of condominium units for the primary purpose of investment rather than occupancy by the purchasers,

235. SEC Securities Act Release No. 5347 (January 4, 1973), 1 CCH Fed. Sec. L. Rep. ¶ 1049, at 2070 (1973). The purpose of this release was to alert persons engaged in the business of building and selling condominiums and similar types of real estate developments to their responsibilities under the Securities Act and to provide guidelines for a determination of when an offering of condominiums or other units may be viewed as an offering of securities. Resort condominiums are one of the more common interests in real estate, the offer of which may involve an offering of securities.
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coupled with an undertaking to arrange continuing rental for the benefit of the purchasers" constituted a security. The court continued saying that whether the security was in the form of an "investment contract" or "a certificate of interest or participation in a profit-sharing agreement" was of no consequence.

The result in the Marasol case also points up the distinction the SEC release makes between two types of resort condominium plans—those which emphasize "the economic benefits to the purchaser to be derived from the managerial efforts of the promoter, or a third party designated or arranged for by the promoter," and those wherein the investor is left free to do whatever he wishes with his own unit and is not induced into investing by representations of potential future benefits.

This distinction is significant because investment transactions where the economic benefits result from the efforts of the promoter are securities; while investment transactions where the investor's economic benefits result solely from the unit owner's own efforts fall outside of the securities regulation field.

It is apparent then that investments in resort condominiums and those used for full-time occupancy are viewed differently by the SEC. Contracts for the purchase of condominiums for full-time occupancy are not readily adaptable to rental pooling arrangements or investment schemes that might call for action by the SEC. Closer scrutiny, however, is demanded of a transaction involving a resort condominium to determine if it falls within

239. Id. at 94,662.
240. Id. at 94,662.
242. San Diego-Maui Group, [1971-1972 Transfer Binder] CCH Fed. Sec. L. Rep. ¶ 78,444, at 80,970 (September 7, 1971). In his application for a no-action letter, the promoter stated that he hoped to sell condominiums in Hawaii and that the unit owners would be tenants-in-common in a nearby hotel. When the individual owners were not using their units, the hotel management was to rent them out, and the income received to be pooled and distributed to all owners regardless of whether their unit was rented. The SEC replied that because of the rental pooling arrangement and the reliance on the efforts of others the investment would be considered a security. Id. at 80,971. See Edward S. Jaffry, [1971-1972 Transfer Binder] CCH Fed. Sec. L. Rep. ¶ 78,395, at 80,881 (August 25, 1971). For a discussion of rental pooling arrangements see Rohan, The Securities Law Implications of Condominium Marketing Programs Which Feature a Rental Agency or Rental Pool, 2 Conn. L. Rev. 1 (1969).
243. Culverhouse, [Current Binder] CCH Fed. Sec. L. Rep. ¶ 79,612, at 83,639 (October 5, 1973). The promoter here wished to sell condominium units primarily as retirement homes. No rental pooling arrangements were contemplated, although a rental service was available if an individual unit owner wished to rent his unit. In such a case, all rent less the normal brokerage fee went directly to the unit owner. There were no restrictions on occupancy nor was any emphasis placed on the benefits which could be received by renting. Under these circumstances the SEC held that there was no security investment involved. Id. at 83,639. See Surfides Condominiums, [1971-1972 Transfer Binder] CCH Fed. Sec. L. Rep. ¶ 78,686, at 81,447 (January 7, 1972); Innisfree Corp., [1973 Transfer Binder] CCH Fed. Sec. L. Rep. ¶ 79,398, at 83,154 (April 5, 1973).
the ambit of securities regulation. The SEC guidelines for condominiums are not all-encompassing but are restricted to only those condominium transactions where the investor loses managerial control of his investment pursuant to the provisions of the purchase contract, where he is induced to invest in anticipation of future economic benefits, or where he benefits regardless of whether his unit is rented or not. In the absence of mandatory provisions and rent pooling arrangements, the transaction is not a security even though the owner personally rents the unit continually and occupies it only infrequently. This is because the condominium owner does not rely on the efforts of others to make a profit and does not lack control over the manner in which his unit is leased.

The SEC guidelines thus expand the *Howey* test and appear to incorporate several concepts from the various critics including the suggestions that the receipt of an economic benefit need not be exclusively in terms of cash and that managerial efforts, not merely token involvements, are critical in the determination of the “solely through the efforts of others” test. The benefit derived may be in the form of a reduction of the maintenance fees and the tax advantage received and the involvement must be one that controls the investment. Nevertheless the skeletal elements of the *Howey* test must be present before a transaction will be considered a security.

**COOPERATIVE HOUSING CORPORATIONS**

The third type of real estate investment to be considered is the cooperative housing scheme, whereby a corporation is formed to purchase an apartment building. The tenants buy “stock” in the corporation entitling them to a lease in the apartment building and a vote in the election of directors who manage the corporation.244 Although there are disadvantages inherent in the type of financing required,245 the tax benefit received often outweighs any negative aspects.246

244. Miller, *Cooperative Apartments: Real Estate or Securities?* 45 B.U.L. REV.
245. See Anderson, *Cooperative Apartments in Florida: A Legal Analysis*, 12 U. MIAMI L. REV. 13, 14 (1957); Note, *Cooperative Housing Corporations and the Federal Securities Laws*, 71 COLUM. L. REV. 118, 120-22 (1971). The disadvantages are: 1) the investor does not own legal title to the apartment and his possession can be terminated against his will and through no fault of his own if the corporation does not pay the mortgage notes; 2) stock in a cooperative housing corporation is generally not acceptable as collateral; 3) the investor surrenders much of the sovereignty which the fee owner has over his home; and 4) the history of cooperative apartments is not good during recession. Anderson, *Cooperative Apartments in Florida: A Legal Analysis*, 12 U. MIAMI L. REV. 13, 14 (1957).
246. INT. REV. CODE OF 1954, § 216. The advantages gained by investing in cooperative housing corporations are 1) deductions for real estate taxes paid by the corporation on the land and the building; 2) deductions for the interest paid by the corporation on its indebtedness under the contract of acquisition, construction, and upkeep of the building or its indebtedness on the acquisition of the land on which the building is situated; and 3) a depreciation deduction for wear and tear of the portion of the building used in a trade or business or for the production of income.
Although several characteristics of a security can be seen, a problem often arises in determining whether an investment in a cooperative housing corporation is merely a real estate venture or a security which, under the Howey test, must involve some motive for profit. A recent federal district court decision, in which no security interest was found, illustrates this difficulty of fulfilling the profit motive. In Forman v. Community Services, Inc.\textsuperscript{247} the plaintiffs were tenants of a non-profit, state-financed housing cooperative designed for low income families. The plaintiffs claimed violation of the anti-fraud provisions of the Securities Acts of 1933 and 1934 and the selling of unregistered securities. The misrepresentation alleged was that when the tenants were asked to participate in the cooperative in 1967, the monthly rental rate per room was $23.02 plus $1,350, the cost of a share of stock in the cooperative corporation. By 1973, however, the cost had risen to $35.27 per room.

The court described the issue faced as a question of whether “a ‘share’ of a state-financed and supervised, non-profit cooperative housing corporation [is] a ‘security’ within the meaning of the federal securities laws.”\textsuperscript{248} The facts revealed that the tenants invested, not with the purpose of seeking future profits, but with the hope of obtaining housing they could afford. The shares purchased paid no dividends, there was no contemplated apportionment of any earnings, and when a tenant left, he was required to sell the share back to the corporation for the amount of the original purchase price. The shares were incapable of producing any profit because of prohibitions both in the corporation’s bylaws and in the state law which authorized the housing corporation.

The plaintiffs, however, contended that there were two basic grounds for bringing the transaction within the ambit of the federal securities laws. First, there was an investment in “stock” of the cooperative housing corporation and securities of this type were specifically enumerated in the Securities Acts of 1933 and 1934. Secondly, the plaintiffs contended that the transaction was in the nature of an investment contract that satisfied the elements of the Howey test. The court felt that the “stock” purchased was not a determinative factor because the spirit of the Howey test demanded that the court “look through the name of an instrument to its essential characteristics and determine whether it fits the standarized, well-settled meaning of ‘stock.’”\textsuperscript{249} The test the court applied to the term “stock” was whether there was “any right to any apportionment of tangible profits”; a test which the court found that the share involved in this corporation clearly did not meet.\textsuperscript{250}

\textsuperscript{248}. Id. at 1120 (emphasis omitted).
\textsuperscript{249}. Id. at 1127.
\textsuperscript{250}. Id. at 1127.
To bring the transaction under the Howey test as an investment contract it was necessary to satisfy its three requirements. Two of the three essential elements, the existence of a common enterprise and the deriving of profits from the efforts of others, were fulfilled; but the third element, profit, was unfulfilled. The plaintiffs attempted to fulfill this requirement by contending that "profit" and monetary savings were the same. This would require, as the court expressed it, an expansion of the definition of profit to include savings of money that might have otherwise gone for more expensive housing; or the social gain to be had in quality housing for minimal expense. Put another way, the profit expected by Co-op City residents was the invaluable hedge against the skyrocketing real estate market in New York City.251

Because there was no precedent for such an argument in any federal court252 and because of the radical extension of Howey that was sought, this contention was deemed unpersuasive.253

Alternatively, the plaintiffs contended that the court should accept the risk capital test and "read the tangible profit motive out of the Howey test."254 This test allowed the investor the protection of the securities laws if he risked his capital investment, even if he never expected a tangible monetary profit. This argument was also rejected because the cooperative housing corporation came under the auspices of the state and the state guaranteed that the investor would be reimbursed for exactly what he invested; therefore, there was no risk to his investment.255 The court went on to point out that the legislative history of the Securities Acts never contemplated that the term "profit" be given any meaning other than cash or "anything which could be converted to it through the commercial ingenuity of man."256 Since the only possible profit the tenant could derive from participation in the cooperative housing corporation was a monetary savings on the court of housing, the court found the profit motive, essential to the Howey test, to be lacking.257 The court was cognizant of the fact that the arrangement was designed primarily to furnish adequate housing for low-income families. Thus, to have decided the case differently would not only have expanded Howey beyond reasonable bounds, but it also could have thwarted the public policy of providing inexpensive housing for low-income residents of New York City.

251. _Id._ at 1130.
252. _Id._ at 1130 n.42.
253. _Id._ at 1131.
254. _Id._ at 1130.
255. _Id._ at 1130.
256. _Id._ at 1131.
257. _Id._ at 1130-31.
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Either Professor Coffey's or Professor Long's proposed tests would have made the extension of the profit element that the plaintiffs sought an easier task, for each requires that the investment yield an expectation of money or money's worth or some kind of benefit to the investor. Certainly inexpensive housing vis-a-vis the generally high cost of housing is a valuable benefit to any resident, whether rich or poor. The additional elements of these commentators would also be satisfied: First, the cooperative formed was a "venture" (i.e., "a concerted effort to bring about some particular result"
258) organized to provide housing; and second, the direct control of a corporation such as in Forman, because of its enormous size, was necessarily in the hands of the managers, not the tenants.

Another recent federal district court case, 1050 Tenants Corp. v. Jakobson,
260 in which a factual situation similar to that in Forman was presented, the Howey test was found to be applicable. In Jakobson, a cooperative housing corporation was formed wherein the stockholders were entitled to a proprietary lease in apartments in a stylish upper class neighborhood. Approximately 60 residential apartments were to be leased and other units were to be rented for commercial purposes. The income received from the rental of these commercial units was to be used to offset and reduce the building maintenance fees charged each resident. The court held that the arrangement constituted a security, first, because the statutory definition in the Securities Acts states "[t]he term 'security' means any . . . stock"
261 and the defendants failed to offer any "persuasive reason why the phrase 'any . . . stock' . . . should be read restrictively,"
262 and second, because the shares satisfied the three-pronged Howey test.

The court had little difficulty in bringing the facts of this case within Howey for there was unquestionably a common enterprise, there was a definite reliance on others to manage the cooperative apartments and there was a very real expectation of profit. The investor's clear expectation of profit, however, was the dominant factor in the court's decision. A profit motive was discernible from participation in the cooperative because the sale of shares at a higher price was not prohibited,
264 the initial inducement to incorporate was to gain tax deductions
265 and income was derived from the

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263. Id. at 1175-77.
264. Id. at 1176. The transfer of the stock was not prohibited but the corporation had to give its consent. Id. at 1176.
265. Id. at 1176 where the court stated that "[s]uch [a] direct monetary benefit, by any other name, is still profit."
renting of professional office space which reduced each resident's monthly maintenance charges. 266

As is evident from the Forman and Jakobson decisions, cooperative housing corporations will not be uniformly held subject to securities regulations. With the critical "profits" test of Howey under attack by commentators as well as talented, imaginative counsel, and no precise guidelines offered by the SEC concerning cooperative housing corporations, 267 promoters and prospective investors are faced only with uncertainty.

The principal consideration of this section has been whether the Howey test has kept pace with the varied developments in real estate investments. Because real estate land syndications normally use the limited partnership form, courts have had little difficulty in finding that such investments are securities for two reasons; first, the requirements of the three-pronged Howey test are fulfilled; second, the SEC's guidelines as to real estate syndications clarify the conditions under which such an investment is or is not a security. A land syndication, by its very nature, is formed with the anticipation of a profit on the property purchased. This profit motive and the total reliance on the talents and efforts of the general partner inevitably lead to the conclusion that there is a security interest involved.

Condominiums similarly find coverage under the Howey test. Condominiums, resort or otherwise, are securities if they are sold with 1) restrictions on use and occupancy, 2) requirements that the rents from the unit must be pooled with those of the other tenants, and 3) the requirements that a particular rental agent must be used. The presence of one of these elements indicates a security investment and not merely the investment in real estate as a "second home."

266. As characterized by the court: "While this income would not result in dividends to the shareholders, but merely a reduction in their monthly maintenance charges, this is merely a difference in degree, or quantity of profits, rather than a difference in kind." Id. at 1176.

267. There is some indication that the SEC considers cooperative housing corporations and condominiums similarly in determining when a security investment is involved. SEC Securities Act Release No. 5347 (January 4, 1973), 1 CCH Fed. Sec. L. Rep. ¶ 1049, at 2070 (1973) which states:

Although this release speaks in terms of condominiums, it applies to offerings of all types of units in real estate developments which have characteristics similar to those described herein.

Id. at 2070-71.

Further evidence of this attitude is found in a report of the SEC Real Estate Advisory Committee, [1972-1973 Transfer Binder] CCH Fed. Sec. L. Rep. ¶ 79,265, at 82,722 (October 12, 1972), which states:

Registration of offerings of cooperative dwelling units should be treated in substantially the same manner as condominium units inasmuch as the form of ownership is primarily a matter of local law or personal preference and represents no substantial difference in relation to the federal securities laws.

Id. at 82,775.
Further inquiry is necessary to determine if the Howey test provides adequate coverage of a cooperative housing corporation. Of the three elements specified in Howey, the profit motive requirement is the most difficult to satisfy in a housing cooperative. Usually, the cooperative housing corporation is formed to provide the investor with housing, not future profits. Two alternative theories have been suggested to bring an investment in a housing cooperative under the protection of the securities laws when the Howey test proves inadequate. The first suggestion is that if there is an expectation of apportioned profit from the “stock” purchased in the housing corporation, it is sufficient to bring the investment within the specific definitional coverage of the Securities Acts. The second suggestion is that the risk-capital test, supported by Professors Coffey and Long and several state courts, should be applied. This test alleviates the problem of having to fulfill the profit motive. The dominant feature of a security investment is the risk to the tenant’s investment; except in a case such as Forman v. Community Services, Inc. where the state’s guarantee eliminated any risk, there will always be a risk even if there is no readily discernible profit.