

CVM regulates investments in condo-hotels

It has been a while since investments in condo-hotels¹ and capital markets is a relevant topic of discussion. The hotel and the real estate markets usually offer to the public the opportunity of investment in hotel enterprises structured as condo-hotels. However, differently from what might appear to those unfamiliar with the capital markets regulation, the way such investments are designed does not represent simply the sale of hotel real estate units, but in fact the sale of securities.

The marketing of condo hotels can involve collective investment contracts (CICs), regarded as securities when offered publicly to the extent they promise remuneration linked to the results of the hotel business².

Many developers and hotel managers were notified by the Brazilian Securities Commission (CVM) about this and several administrative proceedings were commenced to apply possible sanctions to the practice. Open to the reality of the industry, CVM has consistently waived the fulfillment of certain regulatory requirements. This resulted in the Resolution CVM No. 734, of March 17, 2015, dealing with waivers of regulatory requirements in CIC public offerings.

After a long process of public hearing, CVM has recently published Instruction CVM No. 602, of August 27, 2018, which regulates public offerings in the market of condo-hotels. Until then, the applicable rules to the public offerings of CICs were Instruction CVM No. 400, of December 29, 2003, which regulates public offerings in general, and the abovementioned Resolution No. 734, which was revoked by Instruction No. 602.

The most important points of the new regulation are: (i) the hotel operator not being necessarily considered as an offeror of securities, (ii) the exemption of hiring an intermediary institution to make the offering and (iii) the possibility that the offering is open to the public in general.

Initially, the rule corrects an error of the Resolution No. 734, by not including the hotel operator in the concept of offeror and, consequently, not making him subject to the related liabilities. From now on, the hotel operator will only be considered as an offeror if it actively takes part in the public offering. However, the reduction of liabilities of the hotel operator is limited. That is because, given its importance to the hotel enterprise, CVM requires that the hotel operator certifies that the information related to the enterprise and its risks, available in the offering prospectus and in the financial and economic feasibility studies, is true, consistent, correct and sufficient.

¹ In general, structures that seek to raise funds for hotel construction promising profits based on the result that would be expected for the hotel operation.

² As per Article 2, item IX, of the Law No. 6,385, of December 7, 1976.

The main obligations of the hotel operator before investors are the elaboration and disclosure of financial statements of the hotel enterprise, which must be audited by an independent auditor registered at CVM. From the third year after the hotel has started operating, the members of the condominium may exempt the hotel operator from such obligations. CVM could have been even more flexible, excluding the necessity of waiting such three-years period. It did not do so considering the importance of the information for a potential investor that decides to acquire CICs in a follow-on public offering, after the hotel has started operating. This rationale is doubtful, since the financial statements may contain outdated information, depending on the moment that the referred CIC acquisition occurs. Lack of information may be more advantageous to investors than a decision based on data that do not reflect the current scenario.

Furthermore, the hotel operator is exempt from being registered as securities issuer if it is exclusively a CIC issuer, which makes a CIC public offering less burdensome.

Another change that could significantly lead to cost reduction of a CIC public offering is the exemption from the obligation to hire an intermediary institution integrating the securities distribution system. If that is the option, the offeror has the burden of overseeing the activity of the real estate brokers in charge of attracting the investors. CVM understands that in this case the offeror must make sure that public offering complies with the CVM regulation, an obligation that would otherwise be imposed on the intermediary institution. The liability of the offeror before CVM is always subjective; since it depends on proof of failure in overseeing real estate brokers.

The main victory of the market in the public hearing leading to Instruction No. 602 was the widening of the target public of the offering. CVM accepted the market contention that it would not be necessary to restrict the public to qualified investors. Thus, CIC offerings under Instruction No. 602 may seek any sort of investor.

Even though Instruction No. 602 requires registration of the CIC public offering, this is not necessary (i) in small offers³, (ii) when the enterprise is already operating and has already been subject to a registered public offer or had a previous public offer registration of which was waived by CVM, (iii) if there is a simultaneous registered offer and (iv) if the offer occurs between the end of a registered offer or an offer registration of which was waived and the date of disclosure of financial statements that present hotel operational revenues for the first time. In the first case, CVM recognizes that the costs related to the obtainment of offer registration would be incompatible with the profile of the investors. In the second case, it is understood that

³ Defined as the sale in a given year of rights corresponding to up to ten autonomous units per investor.

the investors have enough information, since the hotel is already operating and was already analyzed by CVM. In the third case, CVM also recognizes that the investor has enough information, since there is a simultaneous registered public offer. Finally, CVM understands that it would not be necessary to require registration in the last hypothesis due to the recent offer related to the same enterprise.

Instruction No. 602 is not applicable to CIC public offers that involve the sale of rights in voluntary condominiums, that remain subject to Instruction No. 400. CVM considers that the new rule, simpler than Instruction No. 400, should only be applicable to development of buildings for the sale of autonomous units under Law No. 4,591, of December 16, 1964.

Instruction No. 602 has entered into force on the date it was published. However, offerings that, at date of publication of the new rule, had already obtained waiver of registration or whose waiver request was under analysis, may be kept in the previous legal regime (Instruction No. 400 and Resolution No. 734), upon offeror's choice within 60 days from enactment of the new rule.

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