Everyone knows that if you buy, sell, lease or manage real estate for yourself (these are what I will call “brokerage-type activities”), that you do not have to be a licensed real estate broker. Most people would think it odd that I even raise the subject.

But what if your best friend invests in a deal with you, and you get a bigger share of the profits, or a fee, for doing the hands on work, rather than being a mere passive investor? Most people would not think that this simple fact would change the legal situation, but this is where they would be wrong. As soon as you are engaging in any brokerage-type activities on behalf of another person, and are being compensated for it, you need to be licensed as a real estate broker, unless you are covered by an exemption. Violation of this law is a Class 6 felony. See A.R.S. § 32-2165.A

Fortunately there are exemptions for which your clients might qualify. See A.R.S. § 32-2121.A Unfortunately, the language of the most likely statutory exemption candidate for commercial real estate partnerships or syndications is highly convoluted. And to qualify for that exemption, you need to avoid a lot of pitfalls.

A.R.S. § 32-2122.A. states that:

“A. This article applies to any person acting in the capacity of a:
  1. Real estate broker.
  2. Real estate salesperson.
  3. Cemetery broker.
  5. Membership camping broker.

B. It shall be unlawful for any person, corporation, partnership or limited liability company to engage in any business, occupation or activity listed in subsection A without first obtaining a license as prescribed in this chapter and otherwise complying with the provisions of this chapter.”

A.R.S. § 32-2101.47 defines a “real estate broker” through an exhaustive list of activities. I have italicized some of the more innocuous activities that might trap the unsuspecting.

“Real estate broker” means a person, other than a salesperson, who, for another and for compensation:

(a) Sells, exchanges, purchases, rents or leases real estate or timeshare interests.
(b) Offers to sell, exchange, purchase, rent or lease real estate or timeshare interests.
(c) Negotiates or offers, attempts or agrees to negotiate the sale, exchange, purchase, rental or leasing of real estate or timeshare interests.

(d) Lists or offers, attempts or agrees to list real estate or timeshare interests for sale, lease or exchange.
(e) Auctions or offers, attempts or agrees to auction real estate or timeshare interests.
(f) Buys, sells, offers to buy or sell or otherwise deals in options on real estate or timeshare interests or improvements to real estate or timeshare interests.
(g) Collects or offers, attempts or agrees to collect rent for the use of real estate or timeshare interests.
(h) Advertises or holds himself out as being engaged in the business of buying, selling, exchanging, renting or leasing real estate or timeshare interests or counseling or advising regarding real estate or timeshare interests.
(i) Assists or directs in the procuring of prospects, calculated to result in the sale, exchange, leasing or rental of real estate or timeshare interests.
(j) Assists or directs in the negotiation of any transaction calculated or intended to result in the sale, exchange, leasing or rental of real estate or timeshare interests.
(k) Incident to the sale of real estate negotiates or offers, attempts or agrees to negotiate a loan secured or to be secured by any mortgage or other encumbrance upon or transfer of real estate or timeshare interests subject to A.R.S. § 32-2155 (C). This subdivision does not apply to mortgage brokers as defined in and subject to title 6, chapter 9, article 1.
(l) Engages in the business of assisting or offering to assist another in filing an application for the purchase or lease of, or in locating or entering upon, lands owned by the state or federal government.
(m) Claims, demands, charges, receives, collects or contracts for the collection of an advance fee in connection with any employment enumerated in this section, including employment undertaken to promote the sale or lease of real property by advance fee listing, by furnishing rental information to a prospective tenant for a fee paid by the prospective tenant, by advertisement or by any other offering to sell, lease, exchange or rent real property or selling kits connected therewith. This shall not include the activities of any communications media of general circulation or coverage not primarily engaged in the advertisement of real estate or any communications media activities that are specifically exempt from applicability of this article under A.R.S. § 32-2121.
(n) Engages in any of the acts listed in subdivisions (a) through (m) of this paragraph for the sale or lease of other than real property if a real property sale or lease is a part of, contingent on or ancillary to the transaction.

And note that Department of Real Estate Substantive Policy Statement No. 2005.04 includes among the acts requiring licensing merely “directing inspectors, appraisers, and maintenance and repair people.”
As we have seen, there is a broad list of activities requiring the licensing of persons involved in real estate. This would include most all developers using investor funds, and syndicators, unless their particular situation can fit within an exemption. Let us look at some of these exemptions.

First, note that the typical acts of a transactional real estate attorney would require licensing if it were not for A.R.S. § 32-2121.A.3, which states that:

“A. The provisions of this article do not apply to:

... 3. An attorney in the performance of the attorney’s duties as an attorney. Nothing in this paragraph shall be construed to allow an attorney to otherwise engage in any acts requiring a license under this article.”

Attorneys need to be cautious since this exemption is a limited exemption and does not grant open ended authority for someone licensed as an attorney to engage in real estate brokerage activities for hire. It merely allows an attorney to conduct the traditional activities of an attorney without needing to be licensed as a real estate broker. If an attorney engages in the activities of a traditional real estate broker, for example, if an attorney were to accept a fee for introducing a real estate seller to a real estate buyer, then the attorney would have to be licensed as a real estate broker in order to accept the fee, unless he could fall within some other exemption.

In 1999, banks were amongst those who successfully lobbied the legislature to add an exemption so their employees could handle the management and disposition of foreclosed properties. A.R.S. § 32-2121.A.17 now states that “The provisions of this article do not apply to ... a corporation [which] through its officers and employees ... purchases, sells, exchanges, rents, leases, manages or pledges its property if both of the following apply: (a) The activity is only incidental to the business of the corporation[, and] (b) The officers and employees engaged in the activity do not receive special compensation or other consideration for the activity.”

This Subsection 17 exemption does not apply to most developers and syndicators, however, since they typically run afoul of both of the requirements of subparts (a) and (b).

So what exemption might a developer or syndicator fall within? A developer or syndicator’s best chance is to be able to utilize A.R.S. § 32-2121.A.1., which states that:

“The provisions of this article do not apply to:

A natural person, a corporation through its officers, a partnership through its partners or a limited liability company through its members or managers that deals in selling, exchanging, purchasing, renting, leasing, managing or pledging the person’s or entity’s own property, including cemetery property and membership camping contracts, and that does not receive special compensation for a sales transaction or does not receive special compensation or other consideration including property management fees or consulting fees for any property management services performed, if the majority of an officer’s, partner’s, member’s or manager’s activities do not involve the acts of a real estate broker, cemetery broker or membership camping broker as defined in section 32-2101.”

Since most developers utilize a limited liability form of operating entity, we will talk in terms of the exemption’s applicability to an LLC, however, the analysis is almost identical for a corporation or partnership. Note as we proceed that each of the requirements to meet this exemption are cumulative, and that we must satisfy all of the requirements contained within this section in order to qualify for the exemption.

The first requirement and pitfall we must overcome is the requirement that the LLC must be dealing with the entity’s own property and acting through its members or managers. The question arises as to how this requirement should be interpreted where the manager of the LLC is itself another LLC or corporate entity. The manager entity is not dealing with its own property, since it is dealing with the ownership entity’s property. But to say the managing entity is running afoul of this exemption since it is not dealing with its own property would seem to render this exemption useless, so one would hope the Department of Real Estate does not seek to interpret this requirement in such a limiting manner.

Nevertheless, the State of Arizona has taken some surprising positions in the past on this subject, and one must be wary. For example, the Attorney General opined in Op. Atty. Gen. No. 57-29 that a corporation buying and selling options on real estate is not dealing with its own property and, therefore, must be licensed as a real estate broker.

The next requirement to consider is that the manager (or managing member) must “not receive special compensation for a sales transaction or does not receive special compensation or other consideration including property management fees or consulting fees for any property management services performed ...” (Italics added.) The statutory scheme does not contain a definition of “property management services.” Most real estate development operating agreements provide for some special compensation to be paid to the manager for a variety of services. If the services are limited to planning, zoning, designing and developing the property, arguably these services are not what is meant by “property management services,” although no case could be found on point. If the property is fully developed, and a separate fee is paid for managing the developed property, then it would seem likely that the separate fee for managing the property...
property would be for “property management services,” taking the situation out of the exemption, and the manager would need to be licensed. And if a “disposition fee” is being paid to the manager, then this would likely be “special compensation for a sales transaction” taking the situation out of the exemption, and a license would be required. Syndicators that acquire previously developed properties to manage for profit and/or subsequent resale on behalf of the entities they have created would run afoul of this exemption, if not licensed, since syndicators typically charge a separate fee for their property management services.

Given the lack of guidance in the statute and regulations, and the lack of case law interpreting this exemption, one must ponder the risk that the Department of Real Estate might take the position that a manager receiving a development fee or disproportionate share of the profits might be deemed to be receiving “special compensation” for a sales transaction or property management services.

The final requirement of the exemption to consider is that a majority of the manager or managing member’s activities may not “involve the acts of a real estate broker.” This must be evaluated on a case by case basis to determine what percentage of the person’s activities are brokerage in nature versus something else. And Op. Atty. Gen. No. 63-22-L would lead one to the conclusion that even if the managing LLC entity is not required to be licensed, if an employee of the LLC is primarily engaged in brokerage type activities, then that employee must be licensed, even if he receives only a salary and no “special compensation” for his services to the company.

In addition to the exemptions discussed above, there are other limited exemptions to be found in A.R.S. § 32-2121.A., and you should review these so you will know if any of them are applicable in your client’s situation.

In a nutshell, here are all the requirements you must meet to qualify for the most likely of the exemptions for commercial real estate partnerships under A.R.S. § 32-2121.A.1:

If the ownership of the property in question is through an entity (e.g. a partnership, corporation or limited liability company), only the partner, officer, member or manager of the relevant entity can conduct the brokerage-type activities. [Note that this responsibility may not be able to be delegated to a mere employee of the managing partner, corporate officer, or manager of the LLC, unless the employee is a licensed broker.]

The person or entity in question can only deal in its own property. [But the question remains open in the situation where there is a second LLC acting as manager of the LLC that owns the property. Is the manager-LLC then dealing with its own property?]

The person or entity handling the brokerage-like activities cannot receive “special compensation” for handling a sales transaction or property management function. [But what constitutes “special compensation”? What about a flat monthly fee? Or a bigger share of the profits?]

A majority of the managing person’s activities cannot constitute brokerage-like activities. Once a majority of an individual’s time is spent on brokerage-like activities, they can no longer qualify for this exemption.