

STATE OF NEW JERSEY  
BUREAU OF SECURITIES  
P.O. Box 47029  
Newark, New Jersey 07101  
Telephone: (973) 504-3600

**IN THE MATTER OF:**

DAVID LERNER ASSOCIATES, INC.  
(CRD# 5397)

Respondent.

**CONSENT ORDER**

BEFORE CHRISTOPHER W. GEROLD, BUREAU CHIEF

Pursuant to the authority granted to Christopher W. Gerold, Bureau Chief of the New Jersey Bureau of Securities (“Bureau Chief”), under the Uniform Securities Law (1997), N.J.S.A. 49:3-47 et seq. (“Securities Law”), and after investigation, careful review and with due consideration of the facts and statutory provisions set forth below, the Bureau Chief hereby finds that there is good cause, it is in the public interest, and it will preserve resources to enter into a Consent Order (“Consent Order”) with David Lerner Associates, Inc. (“DLA”), and DLA hereby agrees to resolve any and all issues in controversy regarding the specific conduct described herein on the terms set forth in this Consent Order.

**WHEREAS**, the New Jersey Bureau of Securities (the “Bureau”) is the State agency with the responsibility to administer and enforce the Securities Law;

**WHEREAS**, N.J.S.A. 49:3-67 authorizes the Bureau Chief from time to time to issue such Orders as are necessary to carry out the provisions of the Securities Law, upon a finding that the

action is necessary and appropriate in the public interest or for the protection of investors or consistent with the purposes fairly intended by the provisions of the Securities Law;

**WHEREAS**, the Bureau has conducted an investigation into certain activities of DLA as set forth in this Consent Order;

**WHEREAS**, in conjunction with the Bureau investigation, DLA conducted its own internal investigation, reported the results of its investigation to and otherwise provided substantial cooperation with the Bureau, including manually reviewing numerous customer files, providing information, documentary evidence and other materials to the Bureau in a conclusory manner regarding its sales of three non-publicly traded Real Estate Investment Trusts (“REITs”), Apple REIT Seven, Inc. (“Apple 7”), Apple REIT Eight, Inc. (“Apple 8”) and Apple REIT Nine, Inc. (Apple 9”);

**WHEREAS**, in addition to the efforts of its internal operational and compliance staff, DLA has employed outside counsel and consultants at significant expense to assist in its cooperation with the Bureau;

**WHEREAS**, DLA has made certain representations and has provided certain findings and related information and documentation relating to its offer and sale of Apple 7, Apple 8 and Apple 9 including the identification of certain accounts that either did not meet the prospectus eligibility requirements at the time of the sale of the REITS or for which DLA is unable to demonstrate that the accounts met the eligibility requirements at the time of sale;

**WHEREAS**, DLA further represents that since the inception of the Bureau’s investigation, in April 2013 DLA updated and augmented its existing REIT sales suitability standards, procedures and requirements as a separate module within the firm’s written supervisory procedures manual and has enhanced its operational and supervisory review

relating to the sale of all illiquid product;

**WHEREAS**, the Bureau is relying upon the representations, findings, information and documentation made by DLA in entering into this consent;

**WHEREAS**, DLA and the Bureau Chief wish to resolve these issues without the expense and delay that formal proceedings would involve;

and

**WHEREAS**, this Consent Order concludes the investigation by the Bureau, action by the Bureau Chief and any civil or administrative action that could be commenced, pursuant to the Securities Law, on behalf of the Bureau Chief, as it relates to seeking civil monetary penalties or other relief against DLA for the specific conduct described herein solely as it relates to DLA.

The Bureau Chief makes the following findings of fact and conclusions of law, which DLA neither admits nor denies:

#### **Factual Background**

1. David Lerner Associates, Inc. (DLA), CRD No. 5397, has been registered with the Bureau as a broker-dealer since July 13, 1983. DLA maintains a main address of 477 Jericho Turnpike Syosset, New York. DLA has operated two branch offices in New Jersey since 2004.
2. Since 1992, DLA served as best efforts underwriter and sole distributor for a series of ten (10) Apple non-traded real estate investment trust (“REIT”) programs sponsored by Glade M. Knight.
3. Three of these non-traded REIT programs, Apple 7, Apple 8 and Apple 9 (together, the “three Apple REITs”) were registered with the Bureau as of March 3, 2006, July 19, 2007,

and April 25, 2008, respectively. Each was formed to invest in extended stay hotels and other income producing real estate in select metropolitan areas in the U.S., with the primary objective of long-term ownership. The public offerings of each of the three Apple REITs were also registered with the SEC and other state regulatory agencies, and the registration statements for each were declared effective by the SEC's Division of Corporation Finance. Apple 7, Apple 8 and Apple 9 each became a full SEC reporting company upon the effective date of their respective initial registration statements.

4. Between March 2006 and December 2010 ("Relevant Time Period"), DLA sold 364.5 million units of the three Apple REITs and raised an aggregate \$4 billion in proceeds, used to purchase multiple hotels.

5. Effective March 2014, Apple 9 completed its merger with Apple 7 and Apple 8 and changed its name to Apple Hospitality REIT, Inc. ("AHR"). On May 18, 2015, the shares of AHR were listed and began trading on the New York Stock Exchange ("NYSE") under the trading symbol "APLE". DLA asserts that to date AHR is current with its SEC filings

6. DLA asserts that at current traded levels and including distributions received, no APLE shareholder who was an investor in the initial public offering of any of the three Apple REITs has experienced a loss on a total return basis.

#### **Real Estate Investment Trusts Are Complex, Illiquid Investment Products**

7. A real estate investment trust ("REIT") is generally an entity that owns and often manages income-producing real estate.

8. REITs are either publically traded on a recognized exchange, non-traded with limited disclosures or entirely private offerings.

9. Non-traded REITs are not listed on public securities exchanges. Certain Non-traded

REITs have characteristics which make them riskier for investors. For instance:

- a. Non-traded REIT products are generally illiquid as they have no public trading market and a liquidity event typically does not occur until 5-7 years after an offering's inception. REIT prospectuses contain repurchase provisions; however, the non-traded REIT may not be able to satisfy all repurchase requests and typically there is a limitation on the number of repurchases per year. Additionally, repurchase provisions are restrictive. Typically, there is a one-year holding period, requests that are satisfied in the first several years are done so at a price below the original offering price, and repurchase programs can be suspended or terminated.
- b. Many non-traded REITs pay distributions from invested capital back to investors, or from debt, as opposed to providing distributions of earnings from real estate holdings. An investor in a non-traded REIT may confuse distributions for a yield on or dividends from the investment. These distributions are often a return of investor capital, which may reduce the investor's return on investment or borrowings, which must later be repaid.
- c. The three Apple REITs had selling commissions equal to 7.5% of the offering price and a marketing expense allowance equal to 2.5% of the offering price, which were paid from the offering proceeds.

#### **The Bureau's Investigation of the three Apple REITs**

10. In October 2012, the Bureau received several complaints from investors regarding DLA's sale of the three Apple REITs, and began an investigation into DLA's conduct regarding the sale of the three Apple REITs.

11. After the Bureau contacted DLA regarding potential failures in DLA's compliance system with regard to sales of the three Apple REITs, DLA agreed to undertake a comprehensive review of the sales of the three Apple REITs to New Jersey accounts, including contracting with a consultant, working with outside legal counsel, reporting the results of its investigation to and otherwise cooperating with the Bureau.

12. At the direction of the Bureau, the consultant reviewed all 15,748 of DLA's New Jersey accounts to determine whether the investors met the three Apple REIT prospectus suitability standards.

13. During the course of the consultant's review, the consultant also identified which accounts did not contain adequate documentation to make a suitability determination.

**DLA Did Not Follow its Own Compliance Requirements for the Sale of Non-Traded REITs**

14. DLA maintained a written compliance manual and written supervisory procedures ("Supervisory Procedures") during the Relevant Time Period.

15. The Supervisory Procedures provide specific guidelines regarding the sale of "Private Offering REITs" and "private and Non-traded REITs" to investors. The guidelines require that:

- a. Investors satisfy suitability requirements for specific REITs; and
- b. Investors sign, and DLA maintain, subscription agreements.

16. On or about June 30, 2010, DLA instituted "Enhanced Supervisory Procedures related to REIT Purchases" ("Enhanced Procedures").

17. As a part of these Enhanced Procedures, customers seeking to purchase units in a non-traded REIT were required to sign a REIT Subscription Agreement and Investor Acknowledgement of Risk Form, which contained risk disclosures. Prior to June 30, 2010, the

REIT Subscription Agreement and Investor Acknowledgement of Risk Form were in use, but were not documented as part of the Supervisory Procedures.

18. During the Relevant Time Period, DLA did not comply in all respects with its compliance requirements. Specifically, DLA failed to either obtain or maintain a signed REIT Subscription Agreement and Investor Acknowledgement of Risk Form from at least 40 New Jersey investors, out of 15,748 New Jersey accounts reviewed.

**DLA Agents Sold the Three Apple REITs in Violation of Prospectus Suitability Standards**

19. The three Apple REITS contained prospectus suitability standards that stated:

[E]ach purchaser of Units must certify that he has either (1) a minimum annual gross income of \$45,000 and a net worth (exclusive of equity in home, home furnishings and personal automobiles) of at least \$45,000, or (2) a net worth (similarly defined) of at least \$150,000.

20. DLA's Supervisory Procedures during the Relevant Time Period required that "[i]nvestors satisfy suitability requirements for specific REITs."

21. During the Relevant Time Period, DLA agents sold units in the three Apple REITs in violation of prospectus suitability standards to at least 282 New Jersey accounts, out of 15,748 New Jersey accounts reviewed.

**DLA Supervisors Approved Sales of the Three Apple REITs to Investors Who Did Not Satisfy the Prospectus Suitability Standards**

22. DLA's Supervisory Procedures, in compliance with FINRA Rule 2310, stated:

RRs [registered representatives] must have a reasonable basis for recommending securities transactions. Recommendations should be based on information known about the customer including new account information and updates to new account information. Information of particular importance includes the customer's other security holdings, financial situation and needs, and stated investment objectives.

23. The Supervisory Procedures required customers to complete a new account application, also known as a “Suitability Profile”, when opening an account. The Supervisory Procedures assigned the responsibility to ensure compliance to the “designated supervisor.” The Suitability Profile was signed by both the “I.C.”, the agent on the account, and the Principal, the supervisor.

24. The Supervisory Procedures also required that customer’s information be updated within 30 days of changes and at least every 36 months. Customers were to be provided with the new account information on record and asked for any changes or updates at least every 36 months.

25. The subscription agreement for the three Apple REITs contained the following language:

To substantiate compliance with Rule 2810 of the FINRA Conduct Rules, the undersigned Registered Representative hereby certifies: I have reasonable grounds to believe, based on information obtained from the investor(s) concerning investment objectives, other investments, financial situation, and needs and any other information known to me, that the investment in the REIT is suitable for such investor(s) in light of financial position, net worth and other suitability characteristics.

26. The subscription agreement was required to be signed by both the “registered representative” and the “General Securities Principal.”

27. Even with all of the above referenced policies and procedures and certifications, DLA supervisors approved sales of the three Apple REITs to 282 of 15,748 New Jersey investors who did not qualify under the prospectus suitability requirements.

**DLA Violated Numerous Books and Records Requirements in Connection with the Sale of the Three Apple REITs**

28. The Securities Law provides that “[e]very registered broker-dealer and investment adviser shall make and keep those accounts, correspondence, memoranda, papers, books and



other records as the bureau chief by rule prescribes...” N.J.S.A. 49:3-59(b).

29. N.J.A.C. 13:47A-1.10 prescribes, “[a]ll broker-dealers shall keep at their principal place of business, open to inspection of the Bureau of Securities of the State of New Jersey, all books and records required to be kept by the Securities and Exchange Commission or by the Bureau of Securities.” 17 CFR 240.17a-3 dictates what books and records are required to be made by broker-dealers. It states:

For each account with a natural person as a customer or owner . . . An account record including the customer's or owner's name... employment status (including occupation and whether the customer is an associated person of a member, broker or dealer), annual income, net worth (excluding value of primary residence), and the account's investment objectives... 17 CFR 240.17a-3(a)(17)(i)(a).

30. It further states:

A record indicating that . . . The member, broker or dealer has furnished to each customer or owner within three years of the effective date of this section, and to each customer or owner who opened an account after the effective date of this section within thirty days of the opening of the account, and thereafter at intervals no greater than thirty-six months, a copy of the account record or an alternate document with all information required by paragraph (a)(17)(i)(A) of this section... The member, broker or dealer shall include with the account record or alternative document provided to each customer or owner an explanation of any terms regarding investment objectives. The account record or alternate document furnished to the customer or owner shall include or be accompanied by prominent statements that the customer or owner should mark any corrections and return the account record or alternate document to the member, broker or dealer, and that the customer or owner should notify the member, broker or dealer of any future changes to information contained in the account record. 17 CFR 240.17a-3(a)(17)(i)(b)(1).

31. Pursuant to 17 CFR 240.17a-4, such records must be preserved for “at least six years after the earlier of the date the account was closed or the date on which the information was

replaced or updated.”

32. There were no available books and records regarding customer annual net worth, incomes and/or investment objective in at least 40 DLA New Jersey accounts that held the three Apple REITs.

### CONCLUSIONS OF LAW

33. DLA’s failure to ensure that the investors satisfied the three Apple REITs’ prospectus suitability standards violated DLA’s own policies and procedures and constitutes a failure to reasonably supervise pursuant to N.J.S.A. 49:3- 58(a)(2)(xi).

34. DLA’s conduct described above constitutes a failure to make and keep accurate books and records pursuant to N.J.S.A. 49:3-59(b).

35. Pursuant to N.J.S.A. 49:3-70.1, the violations described above constitute a basis for the assessment of an administrative penalty against DLA.

36. The Bureau Chief finds the following relief appropriate and in the public interest.

**THEREFORE**, it is on this 24<sup>th</sup> day of May 2017, **ORDERED** and **AGREED** that:

37. DLA shall pay ~~Six Hundred and Fifty Thousand~~ dollars (\$650,000.00) to the Bureau upon execution of this Consent Order as follows:

- a. DLA is assessed a civil monetary penalty in the amount of Seven Hundred Thousand dollars (\$700,000.00), of which Two Hundred Thousand dollars (\$200,000.00) is permanently suspended for DLA’s substantial cooperation with

the Bureau investigation;

- b. DLA is assessed One Hundred Thousand dollars (\$100,000.00) in costs; and
- c. DLA shall pay Fifty Thousand dollars (\$50,000.00) which shall be placed in a fund to be used for the Bureau's investor education program.

38. Payment of the funds shall be made by attorney trust fund account check, certified check or other guaranteed funds, made payable to "State of New Jersey, Bureau of Securities", and delivered to "New Jersey Bureau of Securities 153 Halsey Street, 6<sup>th</sup> Floor, Newark, New Jersey 07102." The civil monetary penalty payment shall be deposited in the Securities Enforcement Fund, pursuant to N.J.S.A 49:3-66.1.

#### **ADDITIONAL PROVISIONS**

39. This Consent Order shall not bind any person not a party hereto, except as provided herein. Each of the undersigned has read this Consent Order, understands it, and agrees to be bound by its terms.

40. DLA shall cooperate with the Bureau in any related litigation, investigation, order, and/or proceeding. Cooperation with the Bureau is material and shall include, but is not limited to:

- a. voluntarily and promptly appearing, without a subpoena and at its own expense, to serve as a witness and testify completely and truthfully in any related litigation, investigation, order, and/or proceeding;
- b. voluntarily and promptly attending and fully participating in any meetings requested by the Bureau;
- c. agreeing to and complying with the terms of the Consent Order; and
- d. voluntarily and promptly responding to the Bureau's requests for documents or

information.

41. This Consent Order is not intended to be a final order based upon a violation of any laws or regulations that prohibit fraudulent, manipulative or deceptive conduct and is not intended by the Bureau to subject Respondent to any disqualifications under the laws of the United States, any state, the District of Columbia, Puerto Rico, or the U.S. Virgin Islands, or under the rules or regulations of any securities or commodities regulatory or self-regulatory organization.

42. DLA consents to the form, content and entry of this Consent Order. Accordingly, DLA waives the following rights:

a. To be afforded an opportunity for hearing on the Bureau Chief's findings of fact and conclusions of law in this Consent Order; and

b. To seek judicial review of, or otherwise challenge or contest, the validity of this Consent Order.

43. DLA agrees that solely for the purposes of settling this matter, or any future proceedings by the Bureau solely related to the conduct herein, this Consent Order shall have the same effect as if proven and ordered after a full hearing held pursuant to N.J.S.A. 52:14B-1 et seq.;

44. This Consent Order shall not disqualify Respondent from any business that it otherwise is qualified, licensed or permitted to perform under applicable securities laws of New Jersey. Any disqualifications from relying upon this state's registration exemptions or safe harbor provisions that arise from the Consent Order are hereby waived.

45. This Consent Order shall not bind any person not a party hereto, except as provided herein.

46. DLA has read this Consent Order, understands it, and agrees to be bound by its terms. DLA understands that it had the right and opportunity to consult with an attorney regarding this Consent Order.

47. No employee, official or person representing the Bureau or the State of New Jersey has made any additional promise or representation to DLA regarding this Consent Order. Nothing contained herein shall in any manner be construed to limit or affect any position that the Bureau, any other government, or any person, including investors, may take in any future or pending action not specifically encompassed herein.


48. In the event that DLA violates this Consent Order, the Bureau Chief may vacate this Consent Order and take further action against DLA under the Securities Law.

NEW JERSEY BUREAU OF SECURITIES

By:   
Christopher W. Gerold  
Bureau Chief

DAVID LERNER ASSOCIATES, INC.

DATED: May 22, 2017

By:   
Name: Joseph C. Pickard  
Title: EU Fund General Counsel