



CENTER FOR CAPITAL MARKETS COMPETITIVENESS

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September 12, 2016

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Re: Proposed Amendment to the NASAA Statement of Policy Regarding Real Estate Investment Trusts

Dear Mr. Pieciak, Mr. Heuerman, Ms. Coverman, and Mr. Stewart:

The U.S. Chamber of Commerce (“Chamber”)¹ created the Center for Capital Markets Competitiveness (“CCMC”) to promote a modern and effective regulatory structure for capital markets to fully function in a 21st century economy. We write today to express our deep concern relating to North American Securities Administrators Association, Inc.’s (“NASAA”) proposed amendments to its

¹ The Chamber is the world’s largest federation of businesses and associations, representing the interests of more than three million U.S. businesses and professional organizations of every size and in every economic sector. These members are users, preparers, and auditors of financial information.

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Statement of Policy Regarding Real Estate Investment Trusts (the “Proposed Amendments”), as we believe that these amendments will significantly impact continued investment in the real estate industry and deprive investors of all types with access to an important asset class: non-traded real estate investment trusts (“non-traded REITs”).

In short, the proposed concentration limits have been proposed without proper economic analysis and may fundamentally alter the role of non-traded REITs as important elements in many investor portfolios. These direct placement products hold billions in retirement assets and contribute to a diversified portfolio. However, the across-the-board limitations envisioned by the Proposed Amendments will limit access to the investment class, hurting investor returns and continued investment in real estate, which is vital to reinvigorating our stalled economy. Consequently, we urge that NASAA not finalize the Proposed Amendments until further economic analysis is undertaken to understand the impact of its proposal.

Our concerns are elaborated in further detail below.

Discussion

I. The Importance of Investor Access to Non-Traded REITs

The Chamber has long championed investor access to a wide variety of asset classes in order to develop a well-balanced and diversified portfolio. Importantly, ensuring investors have the right to access suitable investment vehicles is critical for markets to operate efficiently. This provides certainty and allows investors to engage in a rational and meaningful decision-making process.

We believe it is appropriate to put in place requirements and tests that correctly define persons who have the sophistication to put their money in complex vehicles and have the ability to withstand loss. Traditionally, this has been done through asset and income tests. These are objective standards that have served well in determining

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who should be allowed the designation of accredited investors. However, we also understand that differing levels of investor sophistication are important to consider in developing these tests.

In turn, we recognize that non-traded REITs are an important element of many portfolios because they often represent an opportunity for an investor to diversify their holdings with assets that have low correlation with other parts of the market, such as exchange-traded equities and fixed income investments. Direct participation programs that offer non-traded REITs also permit those without the financial resources to make direct investments in real estate to gain exposure to this asset class. Consequently, we are skeptical of attempts to limit access to investment in assets like non-traded REITs without a clear demonstration of why that limitation is needed and given the potential benefits of exposure to the asset class.

Additionally, we also note that limitations on investing in non-traded REITs directly impact capital formation, particularly with respect to commercial real estate investment across the country. Continued growth in this sector helps supports thousands of jobs in a variety of different sectors, including office buildings, apartment buildings, shopping centers, health care facilities, and elsewhere. We therefore support strong and robust economic analysis detailing the impact of limitations on non-traded REIT investment on the broader economy before adopting the Proposed Amendments.

Finally, we note that dislocations on the commercial real estate market have the potential to have collateral adverse impacts on other parts of the economy, meaning that these impacts will be felt across the business community. As further explained below, disparate standards on non-traded REIT investment across the states may arbitrarily encourage investment to migrate in more investor-friendly jurisdictions. This would be a significant and unfortunate consequence of the Proposed Amendments, which we believe was not intended by NASAA.

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II. The Proposed Amendments Are Arbitrary, Overbroad, and Do Not Consider Suitability Standards for Investors

While we appreciate that the Proposed Amendments exclude investors that meet the definition of an “accredited investor” under the federal securities laws, we are deeply concerned that the proposed “liquid net worth” test will apply an arbitration limitation on investors in direct participation programs.

First, by defining “liquid net worth” as cash, cash equivalents, and readily-marketable securities, and by excluding other assets such as an investor’s residence, the Proposed Amendments significantly limit an individual’s choice to invest in non-traded REITs. This is particularly true given that the Proposed Amendments do not explain why a liquid net worth test was chosen, as opposed to a total net worth test or some variation thereof. Additionally, NASAA could have considered whether there were certain levels of sophistication that would add an additional category of investors exempt from the “liquid net worth test” – such as those who met the educational and licensing requirements to sell securities and investments.

Second, the Proposed Amendments do not state why “10%” is the correct numerical threshold in determining the percentage of liquid net worth an individual may invest in a non-traded REIT, its affiliates, and other non-traded REITs. In fact, placing an arbitrary limit may inadvertently lead an adviser to act against an investor’s best interest as proper portfolio asset allocation is determined on a case by case basis. Before finalizing the Proposed Amendments, the NASAA should undertake quantitative analysis estimating the impact of the 10% limit on investment access, as well as the potential broader economic impact. We also note, because non-traded REITs are typically required to establish minimum investor suitability standards, as well as income and net worth standards, the need for a 10% threshold is undermined.

Third, these amendments should not apply across the board to non-traded REITs, its affiliates, and other non-traded REITs as currently proposed. By drafting the limitation in this manner, NASAA is also proposing to limit investment in business development companies, commodity pools, and other direct investments

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currently available to investors. It is inappropriate to lump these categories of asset classes together under the rubric of an “affiliate” of a non-traded REIT. Similarly, it is also inappropriate to classify all non-traded REITs in one category, given their unique investment characteristics.

Finally, we believe that NASAA must note that it is not regulating in a vacuum given several federal and state regulatory protections already afforded to investors, including FINRA standards on suitability. For example, the Investment Advisers Act of 1940 requires investment advisers to act as fiduciaries for their clients, including an affirmative duty to act in good faith, make full and fair disclosure of all material facts, and employ all reasonable care to avoid misleading clients. NASAA should reexamine the Proposed Amendments in light of these protections and also consider how a uniform concentration limit may actually conflict with these regimes.

In sum, we believe that there are serious deficiencies with the limitations on investment access to non-traded REITs as put forth in the Proposed Amendments. Without appropriate economic analysis, many investors will lose access at least one important asset class, if not more, without proper justification.

III. The Proposed Amendments May Result in a Patchwork of Regulatory Systems and Raise Costs for Investors

In addition to these requirements, the Proposed Amendments also permits a state securities administrator to modify any portion of a concentration standard (lower or higher) according to fourteen enumerated standards, including the REIT’s use of leverage, potential shareholders, liquidity or REIT shares, and complexity of the offering. The Chamber believes that there will be very few circumstances in which a state securities administrator will decide to lower the suitability standard based on these enumerated standards. More importantly, given the inherent differences between the states, their investor base, and potential offerings, we believe that a “patchwork” of different standards will inevitably result.

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Such a patchwork may result in investor confusion, as standards on investment access may vary from state to state, which may lead to increased litigation. In addition, given that an administrator will need to approve a sponsor's concentration limit for non-traded REITs, the review and offering process may be extended and may become more costly. These two consequences may raise the cost of investing in non-traded REITs, further limiting investor access to this asset class. Consequently, if NASAA moves forward with a concentration limit, it should not be modifiable from state to state.

Request for Roundtable

Given the concerns listed above, CCMC believes that NASAA should host a roundtable composed of representatives from the non-traded REIT industry and their customers to identify unintended consequences of the Proposed Amendments, the regulation at the state and federal levels that currently protects investors, and the costs and burdens of the Proposed Amendments on capital formation and investor return. Such a roundtable will assist NASAA in better understanding how the Proposed Amendments will work and it may be needed to avoid unintended, adverse consequences.

Conclusion

We strongly urge that NASAA not finalize the Proposed Amendments without a thorough economic analysis of the proposal's impact on an investor's access to non-traded REITs, the downstream impact on the real estate industry, and the broader impact on the economy. This is especially true given the significant issues raised with respect to the Proposed Amendments' liquid net worth test, the 10% limitation, the application of the limitation to a non-traded REIT, its affiliates, and other non-traded REITs, and the "patchwork" of regulations that will result from states applying the Proposed Amendments in different manners. We thank you for your consideration

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of these comments and would be happy to discuss these issues further with you or your staff.

Sincerely,

A handwritten signature in black ink, appearing to read "Andres Gil". The signature is fluid and cursive, with the first name "Andres" written in a larger, more prominent script than the last name "Gil".

Andres Gil