Inland Real Estate Investment Corporation

2901 Butterfield Road | Oak Brook, IL 60523 | 800.826.8228

inland-investments.com

September 12, 2022

Submitted Electronically - Andrea.Seidt@com.ohio.gov; Mark.Heuerman@com.ohio.gov; and NASAAComments@nasaa.org

NASAA Corporation Finance Section
Andrea Seidt, Section Chair
Mark Heuerman, Project Group Chair
North American Securities Administrators Association, Inc. (NASAA)
750 First Street NE, Suite 990
Washington, DC 20002

Re: Response to Request for Public Comments Regarding Proposed Revisions to NASAA's *Statement of Policy Regarding Real Estate Investment Trusts*

Ladies and Gentlemen:

Inland Real Estate Investment Corporation (hereinafter "Inland Investments") submits the following comments with respect to the Proposed Revisions to NASAA's *Statement of Policy Regarding Real Estate Investment Trusts*. This Comment Letter is being issued pursuant to the NASAA Corporation Finance Section's Request for Public Comment, dated July 12, 2022, and is being timely submitted prior to the September 12, 2022 public comment deadline, as extended.

INTRODUCTION

With a business track record spanning over five decades, The Inland Real Estate Group of Companies, Inc. is an industry leader and one of the nation's largest commercial real estate and financial organizations. As a business incubator, we specialize in creating, developing and supporting Inland[1] member companies that provide commercial real estate-related services and alternative investment funds, including limited partnerships, institutional funds and non-listed and listed REITs, and investment advice through our registered investment advisor.

Inland Investments is a sponsor of real estate-related securities and a part of The

[1] "Inland" refers to The Inland Real Estate Group of Companies, Inc. which is comprised of a group of independent legal entities some of which may be affiliates, share some common ownership or have been sponsored and managed by such entities or subsidiaries thereof including the Inland Real Estate Investment Corporation (Inland Investments) and Inland Securities Corporation.

Inland Real Estate Group of Companies, Inc. Inland Investments has sponsored a total of nine (9) REITs since 1994 and was the first sponsor to list a non-listed[2] REIT on the New York Stock Exchange. Inland Investments has completed six (6) full-cycle non-listed REIT programs that provided liquidity to investors. The status of other Inland Investments-sponsored REITs includes one closed offering in the operational phase, one perpetual life net asset value (NAV) REIT and one private REIT in offering. Additional information regarding NAV REITs, including their unique benefits to investors, will be discussed further below.

As an industry leader, and for the reasons discussed in detail below, Inland Investments opposes each of the Proposed Revisions to NASAA Statement of Policy regarding REITS, and provides the below Comments to the Proposed Revisions:

COMMENTS

1. **We Respectfully Remind NASAA about Anticipated Standard of Conduct Guidance.** We remind NASAA that the Department of Labor is reviewing its standard concerning fiduciary advice.[3] In 2017, NASAA "withdrew [a similar concentration limit] in light of conduct standard proposals pending before the U.S. Department of Labor."[4] Discretion suggests that NASAA await completion of this review before adopting the Proposal. Moreover, in Chair Gary Gensler's remarks before the 2022 NASAA Spring Meeting and Public Policy Symposium, he noted that the SEC is considering issuing three bulletins that would further detail agency expectations regarding Regulation Best Interest.

2. **General Summary of Comments Applicable to All NASAA Proposals**

    a. *The Proposal Will be Subject to Legal Challenge*. Any state administrator that adopts the Proposal will face legal challenge in federal and state court. The federal securities laws, including the Investment Advisers Act, the Investment Company Act and ERISA preempt the Proposal. Moreover, state law requires that state administrators follow administrative procedures in adopting a rulemaking, and many states require that NAV REITs be registered by coordination with SEC registration. The merit review envisioned by the Proposal is unlawful in many states.

    b. *Real Estate and Small Business Investment Fosters Economic Growth*. Real estate development is fundamental to economic growth and employment in the various states. The Proposal would unduly constrain growth in the real estate sector at an unpropitious time of high inflation and possible recession.

---

[2] We refer to the products discussed herein as "non-listed REITs" rather than "non-traded REITs" because their shares are not listed on a national securities exchange and because their shares are registered with the SEC, they are freely tradable. As a result, "non-listed REIT" is a more accurate description and widely adopted by industry participants.

[3] *See* https://www.dol.gov/agencies/ebsa/about-ebsa/our-activities/resource-center/faqs/new-fiduciary-advice-exemption, Q.5.

[4] Proposal at p. 3.

Indeed, more, not less, capital is necessary to make housing affordable to middle income families. Recent surveys of public non-listed REITs indicated that approximately 63% of their investments in multifamily housing support workforce housing, defined as multifamily housing with rent less than 25% of mean family income in the surrounding area. Multifamily housing made up 17.3% of non-listed REIT holdings as of June 30, 2020.

The Proposal also would limit investment in business development companies that help capitalize small business. NASAA thus would stifle access to capital by small and mid-sized U.S. companies, including minority-owned, women-owned and veteran-owned, that may not have access to traditional sources of capital. Many of those businesses lack access to the deep capital markets that finance the activities of large corporations. Alternative investment strategies provide a critical source of capital to these firms and other small businesses, allowing them to expand and grow with terms more flexible than those offered by bank loans.

c. *Investors Need Diversification*. REITs continuously offered and regularly redeemed at net asset value ("NAV REITs") are the only publicly-registered non-listed REITs offered today.[5] Investors buy NAV REITs for many reasons, including portfolio diversification away from the stock and fixed income markets. Diversification is particularly important during a time of stock market volatility. NAV REITs can also provide a hedge against inflation and a source of income. The Proposal would obstruct investors' ability to invest in these portfolio-diversifying investments.

d. *A National Product Deserves a National Standard*. Any state action should comport to the federal standards, including Regulation Best Interest, and should not conflict with federal regulation. We agree that the 2007 guidelines are out of date because of the transformation of the industry and new federal regulations. The Proposal, which merely adds new, additional requirements to the outdated 2007 guidelines rather than actually updating the guidelines, is not the answer. Ensuring that requirements are consistent across state boundaries and do not conflict with federal standards, would better protect investors.

e. *The Proposal is a Product of Bias*. The Proposal would harm retail investors and stunt economic growth because it is the product of bias and a lack of understanding concerning the NAV REIT market. The Proposal is simply unsupported by the facts. NASAA has provided little data – except for a discredited article[6], a discredited NASAA survey,[7] and the mischaracterization of

[5] While no lifecycle REITs are currently being offered, many are still in an operational phase and continue to be regulated by the Commission.

[6] NASAA relies on Mallett and McCann, *Further on the Returns to Non-Traded REITs*, The Journal of Wealth Management Winter 2021. Their analysis has been refuted. *See* Selman, *Non-Traded REIT Performance: A Response to Mallett and McCann*, The Journal of Wealth Management Fall 2022.

Federal courts have observed on a number of occasions that McCann's work cannot be relied upon. One court

FINRA data.[8] NASAA provides no economic analysis to support any part of the Proposal. Indeed, the proposal seems motivated by a hostility towards the SEC's regulation of broker-dealers. It is perhaps not surprising that NASAA would propose unworkable requirements on NAV REITs, since they are one of the few publicly traded products that NASAA's members still regulate.

3. **State Regulators Need to Understand NAV REITs.** The Proposal fails to distinguish lifecycle REITs from NAV REITs, the type of non-listed publicly-registered REIT that is almost exclusively sold today. NAV REITs are transparent vehicles with lower fees, largely due to requirements that FINRA imposed on non-listed REITs in 2015, when the federal regulator issued guidance concerning valuation transparency and share pricing.

   a. *Characteristics of NAV REITs*. NAV REITs are primarily Maryland corporations that elect to be taxed as real estate investment trusts for federal income tax purposes. They are managed by an external advisor under an advisory agreement, subject to oversight by an independent board of directors with a fiduciary duty to the shareholders. They conduct monthly, rigorous calculation of net asset value using an independent valuation advisor. Every REIT asset is appraised at least annually, and typically a third-party valuation firm is actively involved in the process. A valuation committee who approves the NAV is comprised of independent board members who have a fiduciary responsibility to the shareholders. The board also appoints an independent valuation advisor who calculates NAV based on internationally recognized guidelines. NAV REITs also continuously offer their common stock at NAV per share.

   NAV REITs provide liquidity by a share repurchase plan with monthly (2% of NAV) and quarterly (5% of NAV) limits. They provide portfolio diversification from traditional stocks and bonds through exposure to geographically diverse opportunities across a range of asset types.

   NAV REITs offered today must be distinguished from the legacy lifecycle REITs that appear to be the concern of NASAA. As their name implied, lifecycle REITs, which are sector focused, have a "lifecycle" that is intended to terminate with a liquidity event such as a share listing or an acquisition. Investors typically

---

has concluded that a report McCann prepared was "deeply flawed," as it "contained several significant errors" that caused McCann to "improperly" and "erroneously" analyze market data. *In re Fed. Home Loan Mortg. Corp. (Freddie Mac) Sec. Litig.*, 281 F.R.D. 174 (S.D.N.Y. Mar. 27, 2012). That court also observed that McCann conceded that his analysis in another study was not correct and that McCann's testimony was "unreliable and unpersuasive." *Id.* at 181. And the Fifth Circuit noted that McCann provided inconsistent testimony in two related arbitrations, which McCann attributed to the fact that "one of his staff members had failed to account for certain internally-priced securities in the calculations, and that correcting the mistakes had generated different numbers." *Morgan Keegan & Co., Inc. v. Garrett et al.*, No. 11-20736 (5th Cir. Oct. 23, 2012) (per curiam).

[7] ANALYSIS OF NORTH AMERICAN SECURITIES ADMINISTRATORS ASSOCIATION'S (NASAA) REG BI SURVEYS Prepared by Greenwald Research FEBRUARY 2022, available at https://greenwaldresearch.com/wp-content/uploads/2022/02/Analysis-of-NASAA-Surveys-on-Reg-BI-Greenwald-Research-2.22.pdf.

[8] *Id*. at 12-13.

paid a 7% load upon purchase and indirectly bear the REIT's "offering and organization expenses" of up to 5% each year. Lifecycle REITs typically offered regular redemptions by their shareholders, but the older form of lifecycle REIT offered less liquidity than more recent lifecycle REITs. [9]

In contrast, NAV REITs continuously offer their shares at NAV over an indeterminate life. The NAV REIT is not intended to terminate with a liquidity event. It offers redemptions at NAV of up to 2% of its shares per month, 5% per quarter and up to 20% of NAV per year —an approximately *four-fold* increase from the amount of liquidity offered by earlier forms of lifecycle REITs.

NAV REIT fees are lower than those of the lifecycle REITs. The majority of NAV REIT shares are sold without any load through fiduciary investment advisers rather than commissioned broker-dealers. [10] Formerly, it was not uncommon for a legacy lifecycle REIT to include acquisition fees, financing fees, development fees and disposition fees as part of its fee structure. NAV REITs have eliminated the traditional acquisition and disposition fees.[11] NAV REITs primarily pay their external advisors an annual asset management fee (typically no more than 1.25% of NAV or 1.0% of asset cost), and a performance fee based on investor returns, with the intent to better align sponsor and shareholder interests.

b. *Regulation of NAV REITs*. NAV REITs must register their public offerings with the SEC and file annual, quarterly and current SEC reports. FINRA Rule 2231 ensures enhanced transparency regarding the impact of upfront fees on investment value and changes in investment value over time. Updated values are provided to customers on their account statements.

   Most purchases are recommended by registered investment advisers with a fiduciary duty, regulated by the SEC and the states. NAV REITs also are purchased through registered broker-dealers under Regulation Best Interest and other SEC and FINRA rules.

4. **States Shouldn't Suffocate Local Business.** Capital formation in the NAV REIT sector has been a significant source of economic activity and employment, supporting thousands of jobs in the health care facilities, apartment buildings, shopping centers, office buildings and industrial warehouses. By arbitrarily limiting each investor's interest in NAV REITs, any state that adopts the proposal will impede investment in local business.

5. **States Shouldn't Disempower Their Own Residents.** As the world emerges from the

---

[9] In contrast to older lifecycle REITs, current lifecycle REITs in the market offer liquidity of up to 10-20% per annum.

[10] In 2020, only .8% of non-listed REIT shares sold had a full load commission, while 38.3% of sales were in low load share classes and 61% of sales were in no load share classes purchased on a fee-based platform. (Source Stanger Market Pulse).

[11] NAV business development companies provide similar transparency, independent valuation, and liquidity.

worst of the pandemic, gas prices are at their all-time high. Food prices are rising the fastest in 42 years. Inflation and interest rates are on everyone's minds. Economists are predicting stagflation or potential recession. With these critical economic headwinds along with recent geopolitical events from lockdowns in China and Russia's invasion of Ukraine many investors need portfolio diversification, some protection from inflation, and a source of income. Alternative asset strategies like real estate offer investors the ability to hedge volatility and inflation, and weather the storm. NAV REITs offer a tax benefit on every dollar invested and deliver benefits like long term property appreciation and rental income. We encourage NASAA to recognize the purpose of real estate investment and its importance to the financial plans of many retail investors. The Proposal would discourage investment in a diversifying asset. It would hamper investor choice when macroeconomic events make diversification so important.

6. Two aspects of the Proposal would especially limit investment choice of state residents:

a. *Addition of Concentration Limits*. NASAA's Third Proposed Revision identified in its Request for Public Comment states as follows:

> NASAA recommends that a 10 percent concentration limit be structured to apply to the issuer, its affiliates, and other non-traded participation programs.[12]

In reality, this Proposal would not structure a standardized 10 percent concentration limit. The thrust of the concentration limit provision would require the sponsor to propose a concentration limit *particular to its own REIT*, and for the state administrator to consider whether to accept the limit based upon an infinite list of factors. These factors would include "the REIT's use of leverage," "balloon payment financing," "potential variances in cash distributions," "prior performance," or "any other relevant factors."[13] The state administrator could adopt the sponsor's proposed limit or demand that the sponsor accept a higher or lower limit. The impacted issuer may not be afforded notice of the factors considered or the process followed in reaching a determination, thus leaving issuers with little recourse. The state administrator also could establish a limit that applies to all NAV REITs that apply for registration in the state. The 10 percent concentration limit would apply only if the state does not establish its own concentration limit. If adopted, the application by fifty-four jurisdictions will be anything but uniform, which is already informed by the current lack of uniformity in state concentration limit practice.

The new concentration limits would apply not only to retail investment in non-listed REITs, but also to securities of an affiliate and in "other non-traded direct participation programs." NASAA asserts that the concentration provision will "limit investor risk,"[14] but federal regulation already addresses this risk. In

[12] Proposal at p. 7.
[13] Proposal, III.D.
[14] Proposal at p. 3.

particular, NASAA justifies these limits because of their incorrect perception of NAV REIT illiquidity and NASAA's special concern for elderly investors. SEC and FINRA rules already require that broker-dealers and investment adviser consider the portfolio concentration and liquidity needs of each investor, and the SEC and FINRA have emphasized the responsibilities of their regulated firms to supervise recommendations to senior investors. Moreover, NAV REITs must provide full disclosure to retail investors and issuers take strict liability under the Section 11 of the Securities Act for this disclosure.

NASAA essentially proposes to address through state securities registration its concerns about how these products are sold by broker-dealers and investment advisers. If NASAA has any concerns about how these rules are being enforced, then it is a matter to be taken up with those regulators, not directed to issuers who cannot control the sales practices of financial intermediaries.

Among the affiliated securities that could be covered by the concentration limit are publicly listed securities or investment company securities. NASAA has not explained why the mere fact that these securities are issued by an affiliate would not justify an exception. If an investor held one share of a non-listed REIT, she would be unable to purchase any investment company managed by an affiliate of the REIT in excess of 10% of her liquid net worth. The Investment Company Act of 1940 provides the most comprehensive federal regulation of any security. There is simply no basis for such a restriction on the purchase of shares in registered investment companies or any other affiliated security. Indeed, by limiting the securities of affiliates, NASAA would discourage the entry of the types of sponsors who will provide high-quality, transparent investments: large asset management companies with an established record and a platform of wide investment choices.

Finally, there is no specificity in time provision for evaluating the concentration limits, for example, "at the time of recommendation" or "at the time of the transaction". Perhaps NASAA does not expect investment advisers and broker-dealers to monitor continued compliance with the concentration limits, but if it does, this feature would be unworkable. For example, a customer might not exceed the concentration limit at the time of the initial subscription for primary shares, but over time, due to the investor's participation in the REIT's dividend reinvestment (DRIP) program, the investor could trip the concentration limit. An investor also might find that the stocks in her portfolio declined in value so that her concentration in NAV REITs exceeds the applicable state limit, even though she has not purchased another REIT share. Even a customer who owns shares at the time that his state adopts the concentration limits might inadvertently violate them. There is no grandfather provision for such a customer.

The Proposal also lacks a grandfather provision for existing REITs to include the concentration limits in the charter. The Proposal would require that REITs incorporate the concentration limits into their charters, and it would apply to any existing REIT that files a follow-on offering of its shares. Without grandfathering, such a REIT would have to obtain the approval of its shareholders for a charter amendment through a proxy vote, a time-consuming and expensive process with little benefit to the investing public.

In summary, the proposal would create a nightmare for investment advisers and broker-dealers that, perhaps, NASAA did not contemplate. An investment adviser or broker-dealer would have to (1) keep track of each state administrator's concentration limit, (2) determine whether any state administrator imposes a different concentration limit for any NAV REIT that the firm offers, (3) for every retail customer, apply the proper concentration limit to the particular REIT, to any affiliate of the REIT, and to any other "non-traded direct participation program" as defined by that state administrator, (4) keep track of any changes to any concentration limitation made by any state administrator, (5) monitor every retail customer's state of residency, liquid net worth, and investment in NAV REITs, affiliated products, and "non-traded direct participation programs," to ensure that the concentration limitations are maintained.[15]

The language of the concentration limit is unclear. As previously mentioned, one might interpret it to permit REIT-specific and general limits in one state and to require maintenance of the limits throughout the holding period. Moreover, NASAA leaves open the possibility of wide-ranging interpretation of terms such as "direct participation program" and "liquid net worth." The first term is undefined and the second is defined so broadly as to offer little guidance. For example, "liquid net worth" is defined to include "readily marketable securities." This term could include securities that are listed on an exchange, securities that are sold over the counter, or securities that are otherwise available for resale on a public forum. Moreover, neither NASAA nor any state has ever defined "direct participation program," and in fact, non-traded REITs are excluded from FINRA's definition of direct participation program. Direct participation program is a tax and not securities concept. Based on FINRA's DPP definition, and state practice, non-traded BDCs would, however, be included in the concentration limits.

Finally, the 2016 proposed revisions to the statement of policy would have provided a carve-out for accredited investors, a provision that the Proposal does not include. By prohibiting even accredited investors from investing more than 10% of the liquid net worth in the products covered by the concentration limits, investors would find it easier to buy privately placed securities subject to little regulation, than to invest in publicly-offered, federally-registered securities, some of which are governed by the Investment Company Act. This absence of a carve-out for accredited investors would diminish investor protection, not improve it. NASAA's disagreement with the SEC over its current accredited investor standard for private, unregulated products does not justify the failure to

---

[15] The Proposal refers to investors who purchase non-listed REITs. The language could be read to require application of the limits throughout the life of an investor's holding of non-listed REITs.

include an exception for those investors in highly regulated, publicly offered securities.

b. *Raising Gross Income and Net Worth Requirements*. NASAA's Second Proposed Revision identified in its Request for Public Comment would increase the gross income/net worth requirements that limit investment choice, and index them to inflation on a backward-looking basis to 2007. In fact, there is no justification for any income or net worth limitation, which are incompatible with the federal scheme of securities regulation. Publicly offered securities registered under the Securities Act of 1933 must provide full disclosure to investors and issuers take strict liability under Section 11 of the Act. Because of this disclosure regime, retail investors may invest in these securities regardless of their income or net worth. Issuers of privately placed securities need not provide similar disclosure and for that reason the ability of investors to purchase these securities is limited. For example, the SEC's accredited investor standard applies only to some private placements under Regulation D.

   The gross income/net worth requirements are also unnecessary for another reason. NAV REITs are distributed through registered broker-dealers and investment advisers who must comply with Reg BI or the investment adviser fiduciary duty. In fulfilling these requirements broker-dealers and investment advisers must consider, among other matters, the income and net worth of the retail investor. The gross income/net worth requirements serve little purpose for investors in NAV REITs.

   NASAA's proposal to increase these limitations has a cruelly ironic twist. NASAA justifies the increase so that past inflation is better reflected, but the increase itself would *deprive investors of an inflation hedge.* NASAA is sensitive to inflation only when it limits investor choice.[16]

   Finally, NASAA's REIT Guidelines address the general policy of establishing minimum income and net worth standards "for which there is not likely to be a substantial and active secondary market." For legacy lifecycle REITs, there was no such market until a liquidity event although today certain secondary markets exist for such products. However, NAV REITs offered today provide a continuous liquidity program, thus obviating the need for net worth and income restrictions.

7. **States Shouldn't Impose Multiple Conduct Standards Either Directly or Indirectly Through Issuer Disclosure.** As a preliminary matter, NASAA argues that the REIT Guidelines must be updated to account for the new federal conduct standards known as Regulation Best Interest. However, there is no direct conflict or lack of clarity in any of NASAA's issuer/product guidelines that necessitate any revision or update pursuant to Reg BI. Reg BI is in fact a product-agnostic standard. Creating additional standards

[16] Perhaps to avoid this irony the SEC has declined to increase the accredited investor standard in Regulation D.

under issuer guidelines creates confusion and additional obligations for both sponsors and broker-dealers not required by Reg BI.

Under the Proposal each person selling, recommending or providing investment advice with regard to a REIT (including a publicly-listed REIT) would have to:

> make every reasonable effort to determine that such sale, recommendation or investment advice is in compliance with applicable conduct standards and is a suitable and appropriate investment for each shareholder.[17]

a. *A Panoply of Conduct Standards*. The Proposal would define "conduct standards" to include Reg BI, ERISA, and applicable fiduciary duties. Moreover, under the Proposal broker-dealers and their associated persons would have to:

> act in the best interest of the retail customer at the time the recommendation is made, without placing the financial or other interest of the broker-dealer or associated person making the recommendation ahead of the interest of the retail customer.[18]

This best interest standard resembles only the care obligation under Reg BI, but it is set forth separately in the Proposal.

In short, the Proposal might be read to impose four conduct standards:

- the conduct standard that federal or state law already imposes on the person selling, recommending, or providing investment advice (Reg BI, ERISA, fiduciary duty);
- a state law requirement that the investment be "suitable;"
- a state law requirement that the investment be "appropriate;" and
- a state law requirement that the investment be in the retail investor's "best interest."[19]

NASAA provides no explanation about how these various conduct standards would interact with one another or about the contours of the state law requirements. The Proposal would offer state administrators a jump ball to impose the conduct standards however he pleases, under whatever facts he chooses, without any expectation of consistency with the SEC, FINRA, or other state administrators. Those standards may further be defined by court interpretation.

---

[17] Proposal, III.C.1.

[18] Proposal, III.C.1.

[19] The Proposal also would impose "suitability" and "appropriateness" standards on broker-dealers who recommend non-listed REITs to non-retail customers. Proposal, III.C.1.

b. *NASAA Criticism of Reg BI is Undeserved*. NASAA has consistently expressed disappointment with Reg BI, citing to the NASAA Regulation Best Interest surveys to justify the Proposal. The surveys and resulting reports asserted that "many broker-dealer firms have not made materially changes to their policies, procedures, or practices regarding the sale of non-traded REITs or other complex, costly, and risky products to retail investors since the passage of Reg BI." In response to the reports the IPA and a large group of interested parties engaged Dr. Matthew Greenwald, a recognized expert in survey research, to carefully review the NASAA surveys. Dr. Greenwald uncovered significant deficiencies, including NASAA's lack of objectivity, failure to collect information on key actions firms have taken pertinent to Reg BI and the best interests of their clients, and unstated agenda focusing on certain apparently disfavored products.[20]

c. *Conduct Standards Should be Product Agnostic*. NASAA would impose conduct standards on a particular product, NAV REITs, but the Reg BI conduct standards themselves are product agnostic. No provision of Reg BI addresses specific types of securities. The adoption of this neutral approach was a specific decision of the SEC. Similarly, ERISA and the investment adviser fiduciary duty is not applied according to the security being recommended. The Proposal would distort these conduct standards by applying them only to NAV REITs.

d. *Sponsors Cannot Supervise Independent Financial Intermediaries*. The Proposal would require a sponsor to make every reasonable effort to determine "that the purchase of shares, recommendation or advice is a suitable and appropriate investment for each shareholder and/or complies in compliance with applicable conduct standards."[21]

Perhaps NASAA did not intend that issuers police the conduct of financial intermediaries over whom they have no control, no supervisory authority, and no access to the relevant information. If that is the intention, then the Proposal will be unsuccessful. As a practical matter no sponsor is able to determine whether a purchase complied with the conduct standards of a broker-dealer, investment adviser or its representatives. The sponsor cannot be presumed to have expertise in Reg BI, ERISA or the investment adviser fiduciary duty.

Moreover, broker-dealers and investment advisers would find that their supervision of associated persons has been complicated by the intrusion of this issuer oversight. The Proposal would foster multiple overlapping supervisory systems, regulated by the SEC, FINRA, and the states, generating confusion and costly compliance that does not serve investors and, indeed, may provide less protection.

---

[20] NASAA also relies on data concerning customer complaints about non-listed REITs. NASAA fails to consider the context of these complaints, whether they concern the product itself or other aspects of the sale, and whether any of these complaints concern NAV REITs rather than legacy lifecycle REITs. NASAA similarly refers to claims of elder abuse, without any context.

[21] Proposal, III.C.5.

e. ***Regulators Should Not Impose Conduct Standards Through Prospectus Disclosure***. The Proposal would require sponsors to disclose the following in the final prospectus:

> the responsibility of the sponsor and/or each person selling shares or providing a recommendation on behalf of the sponsor or REIT to make every reasonable effort to determine that the purchase of shares, recommendation or advice is a suitable and appropriate investment for each shareholder and/or/ in compliance with applicable conduct standards, based on information provided by the shareholder regarding the shareholder's financial situation and investment objectives.

The Proposal thus would incorporate the sponsor's supervisory responsibility over the broker-dealer or investment adviser into the prospectus. NASAA's intention appears to be the subjection of sponsors to strict liability under Section 11 of the Securities Act for failure to meet this disclosed responsibility. State administrators and consumer groups sometimes complain about the length of NAV REIT prospectuses,[22] but the Proposal would add information that is of little use to investors, since every sponsor would be subject to the same requirement.

Moreover, securities regulators should not use disclosure as a means to apply conduct standards on market participants. Any conduct standard should be framed according to the practices of those to whom it will apply and developed through public rulemaking. By indirectly enforcing conduct standards through disclosure, the Proposal would ignore the nature of the firms to whom the standards would apply. A disclosure regime would provide no avenue for an investment adviser or broker-dealer to seek an interpretation of the conduct standards. It also would expose issuers to unnecessary litigation risk without providing any benefit to shareholders.

8. <u>The Fourth Proposal Would Impose Unwarranted Restriction on Use of Proceeds</u>

As it relates to NASAA's Fourth Proposal, Inland Investments believes that the Proposal would impose an unwarranted and incomprehensible prohibition on the use of proceeds with the following Proposal:

> The REIT may not have an investment objective or strategy to source regular distributions with gross offering proceeds from

[22] The length of the prospectus is greatly influenced by the disclosure rules and regulations applicable to the registration statements of non-listed REITs, including the SEC's Form S-11 and the NASAA REIT Guidelines, and are a result of additional disclosure requests by the SEC, FINRA and state regulators. We note that each Prospectus contains a "Prospectus Summary" or similar section, thereby providing a helpful summary of the Prospectus.

the sale of shares.[23]

Including, without limitation, because the meaning of this provision is vague and obscure, it is impossible to predict how a state administrator would define certain terms like "investment objective or strategy," "source," or "regular distributions." As such, this ill-defined and arbitrary prohibition will have discriminatory effects against new REITs entering the market. More specifically, this prohibition will affect new REITs who do not yet generate sufficient cash flow for distributions.

The Proposal might prohibit any payment of dividends in excess of earnings. All types of REITs (both non-listed and exchange-listed) routinely pay distributions in excess of 100% of net taxable income, deducting depreciation from earnings when calculating net income. Because cash flow is greater than net taxable income, there is no economic return of capital in these situations.

Further, the Proposal would create new federal and state law, and prohibit a practice that other state laws permit and that is an essential determination of a REIT's board of directors. As with most NAV REITs, Inland Investment's active REITs are incorporated in the State of Maryland. This proposal would prohibit a practice that Maryland law permits and that is an essential determination of a REIT's board of directors. More specifically, Maryland law permits the use of proceeds for distribution if it is approved by the board of directors, which has a fiduciary obligation to both the REIT and its stockholders. The ability to make determinations on how to fund distributions, through offering proceeds or otherwise, is an essential function of the board. Maryland law has solvency tests that address any concerns about the overpayment of distributions; the REIT's board must determine that the REIT will be able to pay its debts as they become due and that after any distribution the REIT's assets will exceed its liabilities.

Moreover, the Proposal could jeopardize a company's status as a REIT, which must distribute dividends to stockholders equal to at least 90% of its net taxable income each year (determined without regard to the dividends-paid deduction and excluding net capital gain).

More importantly, the SEC does not prohibit the payment of distributions from offering proceeds. The SEC has explicitly addressed this point and does not object to non-listed REITs paying distributions in excess of cash flow from operations, provided that the REITs include disclosure in the prospectus regarding the source of the cash used to cover the shortfall, such as offering proceeds or debt, as well as appropriate risk factor disclosure.[24] Rather than restricting distributions, the SEC has published disclosure guidance[25] that requires non-listed REITs to present, on a quarterly basis, the source or sources used to fund distributions. Because this disclosure is available each quarter,

---

[23] Proposal, V.E.1.

[24] SEC Division of Corporation Finance, CF Disclosure Guidance: Topic No. 6, Staff Observations Regarding Disclosures of Non-Traded Real Estate Investment Trusts, July 16, 2013, *available at* https://www.sec.gov/divisions/corpfin/guidance/cfguidance-topic6.htm ("SEC Disclosure Guidance: Topic No. 6").

[25] SEC Disclosure Guidance: Topic No. 6.

investors have adequate historical information regarding the sources used to fund distributions prior to making an investment decision. Further, broker-dealers and other firms engaged by broker-dealers to perform due diligence can review the historical distribution coverage to determine if they should make an investment in the REIT available to their clients. These firms pay close attention to distribution coverage, and a failure to demonstrate full coverage or positive trends toward full future coverage could result in firms suspending or terminating selling agreements.

In addition, as it relates to NAV REITs, those raising capital today publish their net asset value on a daily or monthly basis. To the extent that one of these NAV REITs pay distributions from sources other than cash flow from operations, this will result in a reduction in NAV. The regular publication of NAV allows transparency into the value of the REIT's shares. This transparency makes NASAA's proposal unnecessary because a NAV REIT that overpays distributions will see reductions in NAV over time, which, along with the distribution disclosure described above, provides investors with the information they need to make an informed investment decision.

9. **Any State Adopting the Proposal Will Face Legal Challenge.** Any state that adopts the Proposal will face legal challenge in state and federal court.

    a. *State Adoption Would Violate Federal Law*. The federal securities laws and ERISA would preempt the Proposal. A state administrator would run the risk of not only invalidating its adoption of the Proposal, she also might lose authority to adopt NASAA policies or even issue interpretive guidance.

       For example, because the Proposal would apply to federally-registered investment advisers, the Investment Advisers Act of 1940 would preempt it.[26] Moreover, the Proposal would impose a concentration limit not only for investment in non-listed REITs but other securities offered by the sponsor and its affiliates, some of which may be registered investment companies.[27] The Investment Company Act law would preempt the Proposal.[28] ERISA also would preempt the Proposal, since it would apply to investment advisers and broker-dealers who recommend REIT shares to employee benefit plans[29] and would require that the sponsor make every reasonable effort to determine that the purchase complies with ERISA.[30]

[26] Proposal, I.B.8. ("conduct standards" includes federal fiduciary duties). Section 203A of the Investment Advisers Act preempts the states from exercising jurisdiction over federally-registered investment advisers, other than by investigating individual cases of fraud and deceit.

[27] Proposal, III.D.

[28] The Investment Company Act preempts states from *even indirectly* registering or qualifying these securities.[28] Investment companies need only provide a notice filing to states in which they intend to offer their shares.

[29] Proposal, III.C.1 (recommendation or advice to "a shareholder")..

[30] Proposal, III.C.5; I.B.8. ("conduct standards" includes ERISA). ERISA section 514(a) provides that, except as otherwise provided in section 514(b), title I and title IV "shall supersede any and all State laws insofar as they may now or hereafter relate to any employee benefit plan."

These are a few examples of the many ways in which federal law would preempt any state administrator's adoption of the Proposal.

b. *__State Adoption Could Violate State Law__*. A state administrator's adoption of the Proposal could also violate state law. Some state administrators attempt to adopt NASAA statements of policy without rulemaking prescribed by state statute. This failure to provide the public with a reasonable opportunity to comment and to participate in lawful administrative proceedings can be challenged in state court.

Moreover, *the Proposal itself* contemplates a violation of state law. NAV REITs are registered by coordination under most states. Registration by coordination typically occurs "at the moment" of SEC registration.[31] The purpose of this provision is to ensure that state registration is coordinated with the primary regulator of these offerings, the SEC. Official commentary to the Uniform Securities Act (1956) makes clear that registration by coordination "is designed to achieve simultaneous effectiveness at the federal and state levels."[32] The Commentary further provides that registration by coordination "limits the Administrator to requiring only such information as is filed with the SEC."[33]

The Proposal would require state administrators to apply conditions on any offering that are different from those approved by the SEC, such as gross income and net worth restrictions, disclosure of conduct standards, and concentration limits.[34] It would be impossible for NAV REIT offerings to be registered simultaneous with SEC registration as state registration-by-coordination requires. Implementation of the Proposal would violate state law requiring registration by coordination of NAV REITs.
The Proposal similarly would violate *state notice filing provisions*. It would impose a concentration limit not only for investment in NAV REITs but other securities offered by the sponsor and its affiliates, including advisers to tender-offer and interval funds.[35] These securities are the subject of notice filing in all states.

__CONCLUSION__

In conclusion, for the reasons discussed in detail above, Inland Investments opposes the proposed revisions to NASAA's *Statement of Policy Regarding Real Estate Investment Trusts* identified and discussed in the July 12, 2022 Request for Public Comment.

Please note that Inland Investments stands ready to engage in meaningful dialogue

[31] *See, e.g.*, Maryland Section 11-503(c); Ohio Revised Code Section 1707.091(C).

[32] Uniform Securities Law (1956), Section 303(c).

[33] See Sec. 303(b)—Filing same as with SEC. https://www.nasaa.org/wp-content/uploads/2021/10/1956-Uniform-Securities-Act-with-NASAA-Updates-and-Commentary.pdf.

[34] The REIT Guidelines themselves violate state registration by coordination requirements by requiring merit review of securities that are simultaneously registered under state law "at the moment" of SEC registration.

[35] Proposal, III.D.

with NASAA regarding our comments above and any other areas of mutual interest.

Respectfully submitted,

Inland Real Estate Investment Corporation

Mitchell A. Sabshon, Chief Executive Officer