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Sept. 9, 2022

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Re: Request for Comments regarding the Proposed Amendments to the NASAA Statement of Policy Regarding Real Estate Investment Trusts

Dear NASAA, Commissioner Seidt, and Mr. Heuerman:

Nareit is the worldwide representative voice for REITs<sup>1</sup> and listed real estate companies with an interest in U.S. real estate and capital markets. Nareit's members are REITs and other real estate businesses throughout the world that own, operate and finance residential and commercial real estate. Nareit's member REITs include both Listed REITs, which are real estate companies registered with the SEC and listed on an established stock exchange, and Public Non-listed REITs (PNLRs), which are public, SEC-registered real estate companies whose securities are not listed on an established stock exchange and are the subject of this submission. PNLRs participate at Nareit through the PNLR Council, which consists of 20 Nareit PNLR corporate members. The mission of the PNLR Council is to advise Nareit's Executive Board on matters of interest and importance to PNLRs.

On behalf of Nareit's PNLR Council, I appreciate the opportunity to submit the attached comments responding to the North American Securities Administrators Association (NASAA) proposed amendments to the Statement of Policy Regarding Real Estate Investment Trusts (the Proposal).

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<sup>1</sup> Through the diverse array of properties they own, finance, and operate, REITs help provide the essential real estate that revitalize neighborhoods, enable the digital economy, power community essential services, and build the infrastructure of tomorrow, while creating American jobs and economic activity along the way. REITs of all types collectively own more than \$3.5 trillion in gross assets across the U.S., with stock-exchange listed REITs owning over \$2.5 trillion in assets. U.S. listed REITs have an equity market capitalization of more than \$1.6 trillion. REITs provide everyday Americans the opportunity to invest in real estate, and 145 million Americans live in households that benefit from ownership of REITs through stocks, 401(k) plans, pension plans, and other investment funds.



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As set forth in the following comment, the PNLR Council has a number of concerns about the Proposal. In particular, the PNLR Council is concerned that the Proposal appears to be premised on an outdated understanding of the PNLR sector, which fails to take into account the ascendance of Net Asset Value (NAV) PNLRs in the marketplace over the last decade. Consequently, the PNLR Council contends that many of NASAA's proposed revisions set forth in the Proposal, including the proposed concentration limits, net worth and gross income requirements and the restrictions on sources of distributions, appear to take aim at PNLR products that are generally no longer being offered to retail investors. For these reasons, Nareit's PNLR Council requests that NASAA withdraw the Proposal.

Nareit and its PNLR Council would welcome an opportunity to discuss these matters with NASAA, and would be happy to provide NASAA with additional resource data and information regarding REITs and PNLRs generally.

Respectfully submitted,

A handwritten signature in black ink, appearing to read "Steven A. Wechsler".

Steven A. Wechsler  
President & CEO  
Nareit



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Sept. 9, 2022

VIA ELECTRONIC SUBMISSION: [[NASAAComments@nasaa.org](mailto:NASAAComments@nasaa.org), [Andrea.Seidt@com.ohio.gov](mailto:Andrea.Seidt@com.ohio.gov), and [Mark.Heuerman@com.ohio.gov](mailto:Mark.Heuerman@com.ohio.gov)]

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**Re: Request for Comments regarding the Proposed Amendments to the NASAA Statement of Policy Regarding Real Estate Investment Trusts**

Dear NASAA, Commissioner Seidt, and Mr. Heuerman,

The Public Non-Listed REIT Council (PNLR Council or Council) of Nareit submits the following comments with respect to the North American Securities Administrators Association's (NASAA) proposed amendments to the Statement of Policy Regarding Real Estate Investment Trusts<sup>1</sup> (the Proposal). The PNL Council appreciates the opportunity to comment on this Proposal.

Nareit is the worldwide representative voice for REITs<sup>2</sup> and listed real estate companies with an interest in U.S. real estate and capital markets. Nareit advocates for REIT-based real estate investment with policymakers and the global investment community. Public Non-Listed REITs (PNLRs) participate at Nareit through the PNL Council, which consists of 20 Nareit PNL corporate members. The mission of the PNL Council is to advise Nareit's Executive Board on matters of interest and importance to PNLs.

The PNL Council shares NASAA's goal of ensuring that the best interests of investors are served by their broker-dealers and financial advisers and the products that they offer. However, the Council has serious concerns about the Proposal, which we believe, if adopted, would not serve the best interests of most investors. Accordingly, we urge NASAA to withdraw the Proposal.

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<sup>1</sup> NASAA, Request for Public Comment, Proposed Revisions to NASAA Statement of Policy Regarding Real Estate Investment Trusts, July 12, 2022, available at <https://www.nasaa.org/wp-content/uploads/2022/07/Request-for-Public-Comment-on-Amendments-to-NASAA-REIT-Guidelines-2022.pdf>.

<sup>2</sup> Through the diverse array of properties they own, finance, and operate, REITs help provide the essential real estate that revitalize neighborhoods, enable the digital economy, power community essential services, and build the infrastructure of tomorrow, while creating American jobs and economic activity along the way. REITs of all types collectively own more than \$3.5 trillion in gross assets across the U.S., with public REITs owning approximately \$2.5 trillion in real estate assets. U.S. listed REITs have an equity market capitalization of more than \$1.6 trillion. REITs provide everyday Americans the opportunity to invest in real estate, and 145 million Americans live in households that benefit from ownership of REITs through stocks, 401(k) plans, pension plans, and other investment funds.

As a foundational matter, the PNLR Council is troubled that the Proposal appears to be premised on an outdated understanding of the PNLR sector, a perspective that fails to take into account the ascendance of Net Asset Value (NAV) PNLRs over the last decade. NAV PNLRs are products that are distinct in many material respects from Lifecycle PNLRs, which are no longer being offered to new investors.<sup>3</sup> In large part, NASAA's proposed Guidelines appear to be animated by concerns relevant to financial products that are no longer being offered to investors. Yet, the Proposal would operate to severely limit the ability of investors to invest in NAV PNLRs, which are products that could provide many investors a reasonable pathway to gain exposure to real estate.

For this reason, among others, Nareit respectfully requested<sup>4</sup> that NASAA extend the comment period for this Proposal and provide the public with an additional 30 days to provide input and we thank NASAA for extending the comment period. Our detailed comments on the Proposal follow and are summarized in the bullets below. The PNLR Council also wishes to acknowledge and endorse the comment letters filed by the Institute for Portfolio Alternatives and the U.S. Chamber of Commerce. These letters also raise important concerns related to the Proposal that the Council believes that NASAA should consider before taking further action.

## Summary of PNLR Council Comments

- Background on REITs and PNLRs
- The Proposal is Premised on an Outdated View of the PNLR Sector
- The Proposal's Sweeping Concentration Limits are Misguided, Unworkable, and Unnecessary
- Structuring the Concentration Limit to Restrict Affiliate Investments Exacerbates the Problems
- Increasing the Gross Income and Net Worth Requirements for PNLRs is Unjustified
- Restrictions on Use of PNLR Proceeds are Unwarranted
- The Proposal's Additional Conduct Standards are Unwarranted
- Conclusion

## Background on REITs and PNLRs

REITs in the United States may be public companies whose securities are registered with the Securities and Exchange Commission (SEC) and listed on an established stock exchange (so-called listed REITs); private REITs whose securities are exempt from SEC registration and do not trade on national stock exchanges; or public companies whose securities are registered with the SEC, but are not listed on an established stock exchange (PNLRs) which are the subject of this comment letter.<sup>5</sup> Both listed REITs and PNLRs own, manage

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<sup>3</sup> With respect to 2022, as of May 2022, NAV PNLRs have raised \$18.885 billion, which constitutes virtually all of the funds raised in the PNLR sector for the year. See, Stanger, press release, July 2022 available at <https://12exx71wc3m46es1m3w8fvx1-wpengine.netdna-ssl.com/wp-content/uploads/2022/07/Press-Release-6-24-2022-NT-REIT-Fundraising.pdf>.

<sup>4</sup> Joint Trade Comment to NASAA (Aug. 2, 2022) available at <https://www.nareitphotolibrary.com/m/545432dca9d14735/original/Joint-Letter-to-NASAA-Extension-Request-pdf.pdf>

<sup>5</sup> For a chart explaining the differences in REITs, see [https://reit.com/sites/default/files/2022-06/2022%20FINAL\\_REIT%20Types\\_06.3.22.pdf](https://reit.com/sites/default/files/2022-06/2022%20FINAL_REIT%20Types_06.3.22.pdf)

and lease investment-grade, income-producing commercial real estate in nearly all property sectors. PNLRs, like listed REITs, are subject to the statutory operating framework set forth in Section 856 of the Internal Revenue Code (the Code) intended to ensure that REITs confine their activities to the business of real estate as a landlord or lender. Among other requirements, a REIT must distribute 90% of its taxable income each year to its shareholders and satisfy rigorous asset and income tests that effectively require that REITs primarily invest in qualifying real estate assets and primarily derive their income from such assets.

As SEC-registered public companies, PNLRs must make regular SEC filings, including quarterly and annual financial reports, which are publicly available through the SEC's EDGAR database. Interests in PNLRs are public offerings, exchanged primarily through broker-dealers registered with and regulated by the SEC, the Financial Industry Regulatory Association (FINRA) in addition to state securities regulatory authorities.

As discussed below in detail, there are two distinct PNLR organizational models. The distinction between these two models—which is nowhere acknowledged in the Proposal—underlies the Council's concerns.

## **The Proposal is Premised on an Outdated View of the PNLR Sector**

The PNLR Council is concerned that the Proposal appears to be based, in significant part, on an inaccurate, anachronistic impression of the PNLR sector and PNLR products. Many of the issues that NASAA highlights to justify the Proposal are largely, if not completely, ameliorated with respect to the NAV PNLRs that are now being offered to investors.

Some background here may be helpful. Until the last decade, the predominant model of a PNLR was the so-called Lifecycle PNLRs, which were designed to be limited-life products that undergo a lifecycle of fundraising followed by a liquidity event (e.g., a sale, merger, or listing on an exchange), disclosed in their offering prospectus. Under FINRA rules, which became effective in 2016, Lifecycle PNLRs generally provide their first independent appraisal-based NAV at a maximum of two years and 150 days after their fundraising escrow break, and at least annually thereafter.<sup>6</sup>

In the last decade, PNLRs have evolved—indeed, have been transformed—into very different financial products. Known as Net Asset Value (NAV) PNLRs, these newer PNLRs offer investors exposure to real estate with greater liquidity, transparency, enhanced governance, and independent expert valuations. Today's NAV PNLRs are distinct from Lifecycle PNLRs in many ways that are relevant to assessing the Proposal. NAV PNLRs are sponsored by global institutional asset managers with proven track records, such as Blackstone, Starwood, JLL, Apollo, and others. These sponsors have designed these NAV PNLRs to provide responsible investment options for investors.

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<sup>6</sup> See FINRA Regulatory Notice 15-02 (Jan. 2015) available at [https://www.finra.org/sites/default/files/notice\\_doc\\_file\\_ref/Notice\\_Regulatory\\_15-02.pdf](https://www.finra.org/sites/default/files/notice_doc_file_ref/Notice_Regulatory_15-02.pdf).

Today's NAV PNLRs typically have lower and more transparent fee structures than Lifecycle PNLRs. They are organized similarly to institutional funds, charging a management fee and a performance-based fee. Moreover, many NAV PNLRs have greatly reduced or eliminated front-end fees, depending upon the share class. For example, there are no up-front or ongoing fees for I class shares (the largest share class for many NAV PNLRs), and the T share class may pay up to a 3.5% up-front sales charge and an ongoing service fee with a cap for only a few years. Fees retained by the dealer manager have also been eliminated, or greatly reduced. Other fee categories, including servicing fees, have also been eliminated or greatly reduced.

NAV PNLRs establish their NAVs through a rigorous valuation process, typically undertaken by an independent third-party valuation adviser. The valuation process generally includes annual third-party appraisals of each property, conducted in accordance with the Uniform Standards of Professional Appraisal Practice, or similar industry standards, which are then reviewed by the independent valuation adviser for reasonableness as part of the process of developing the PNLR's NAV. This independent appraisal and valuation process is subject to the oversight of the NAV PNLR's board of directors, including a majority of the independent directors, and the resulting valuations are reported in the PNLR's periodic reports to the SEC.

NAV PNLRs offer a meaningful degree of liquidity to their shareholders by continuously offering and repurchasing a set amount of their shares pursuant to repurchase programs, which are disclosed in their prospectuses and other SEC filings.<sup>7</sup> Repurchase programs typically remain open indefinitely, unless modified or suspended by the NAV PNLR's board. Pursuant to these programs, which typically set forth the repurchase calendar, NAV PNLRs may repurchase shares daily, monthly or quarterly at a price disclosed in advance based solely upon the NAV of the underlying assets and liabilities, as determined by the process described above.

Significantly, NAV PNLRs also offer greater liquidity to investors than Lifecycle PNLRs.<sup>8</sup> Although redemption programs vary among NAV PNLRs, generally investors can redeem shares in an aggregate amount of up to 2% of NAV per month, not to exceed 5% of NAV per quarter and 20% of aggregate NAV per year. On average, this represents roughly a four-fold increase from the amount of liquidity previously offered by Lifecycle PNLRs. Even during the beginning of the economic downturn caused by the COVID pandemic in the spring of 2020, investors in NAV PNLRs sponsored by institutional asset managers were able to redeem shares through these repurchase plans.<sup>9</sup>

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<sup>7</sup> Moreover, NAV PNLRs fully disclose not only the terms and conditions of their redemption programs, but also all risks, however remote, that redemptions may not be available to all investors during a particular time frame, stating in prospectuses and periodic filings with the SEC that "shares should be considered as having only limited liquidity and at times may be illiquid." See, e.g., Blackstone Real Estate Income Trust (BREIT) 2021 annual report, available at <https://www.breit.com/wp-content/uploads/sites/23/2022/03/2021-breit-annual-report.pdf?v=1649796970>. See also, Starwood Real Estate Income Trust, Inc., 2021 annual report available at [https://www.starwoodnav.reit/wp-content/uploads/2022/03/SREIT\\_2021-10k-FINAL.pdf](https://www.starwoodnav.reit/wp-content/uploads/2022/03/SREIT_2021-10k-FINAL.pdf).

<sup>8</sup> It should be noted, however, that some Lifecycle PNLRs also have limited redemption programs and that there are some trading platforms for Lifecycle PNLR shares. See, e.g., Realto, available at <https://realto.ai/>.

<sup>9</sup> NASAA asserts that the redemption programs for three NAV PNLRs "were either suspended during the pandemic or amended in that timeframe to restrict investor withdrawals." Proposal at 7. Nareit is only aware of two small NAV PNLRs, one in the hotel sector (which

Importantly, PNLRs (like their listed counterparts) incorporate many features that make them a suitable investment for a variety of investors. PNLRs help investors build diversified portfolios, because their investment returns reflect the performance of income-producing real estate, which typically has been only moderately correlated with the returns of other assets over long investment horizons. PNLRs typically pay meaningful dividends, due to the IRS REIT distribution requirements described above. PNLRs also provide investors with an investment option that has the potential to provide long-term capital appreciation. Because rents and leases have, over time, tended to be responsive to inflation, PNLRs may also offer investors the potential for some protection from inflation risks.

## **The Proposal's Sweeping Concentration Limits are Misguided, Unworkable and Unnecessary**

The Proposal would impose a concentration limit applicable to an investor's aggregate investment in a particular PNLR, its affiliates, other PNLRs and other direct participation programs of 10% of an investor's liquid net worth, defined as cash, cash equivalents, and marketable securities. The Proposal, by design, includes no exemption for Accredited Investors, as defined under the federal securities laws<sup>10</sup>, meaning that individuals who are classified by the SEC as qualified to invest in complex and/or sophisticated types of securities would not be exempt from these limits. Additionally, the Proposal's concentration limit would operate as a minimum limit on investment for many PNLRs. Under the Proposal, sponsors would be obligated to propose a concentration limit particular to their own PNLRs and state securities administrators would be required to consider whether to accept a sponsor's limit, or adjust it, based upon long list of factors, e.g., "the REIT's use of leverage," "balloon payment financing," "potential variances in cash distributions," "prior performance," or "any other relevant factors."<sup>11</sup> Moreover, broker-dealers and advisers often do not have complete information about their clients' liquid assets, which many investors exclude from fee-based accounts. For these reasons, this 10% limit could actually restrict investor holdings in PNLRs to even less than 10% of their liquid net worth, as applied.

The PNLR Council strongly objects to this proposed concentration limit, believing it to be unjustified and punitive. NASAA offers only a vague rationale for this limit, asserting that the concentration provision is necessary to "limit investor risk...particularly the liquidity risk inherent in this product."<sup>12</sup> Again NASAA's focus on assumed risks to investor liquidity posed by PNLRs seems blind to the investor redemption features intrinsic to NAV PNLRs, which, per the discussion above, typically offer greater liquidity to their shareholders than

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was particularly hard hit by the downturn), that modified their repurchase programs in this time frame. Each of these small NAV PNLRs disclosed in their prospectuses that their share repurchase program could be suspended during periods of market volatility. Both reinstated their programs within months. No NAV PNLR sponsored by a large institutional investor suspended or otherwise modified its repurchase program in a manner adverse to investors during this period. Nareit also notes that during this unprecedented period of market instability, many large public companies suspended their dividend or share buy-back programs.

<sup>10</sup> See, Accredited Investor Definition, 17 CFR § 230.501(a) - Definitions and terms used in Regulation D.

<sup>11</sup> Proposal, proposed revisions, section III.D.

<sup>12</sup> Proposal at 3.

Lifecycle REITs by continuously offering and repurchasing some of their shares pursuant to repurchase programs.

NASAA presents no data, or other analysis, to establish a link between an investor concentration limit of this nature and any measurable reductions in investor risk, or enhancements to investor liquidity. NASAA notes that “at least 20 different jurisdictions have imposed a concentration limit of some form on this product.” However, NASAA fails to disclose that the Proposal’s concentration would be more restrictive than the concentration limits of each of these 20 states. Regardless, NASAA does not attempt to evaluate, or compare the efficacy of any of these existing 20 state concentration limits (they vary in their requirements), or to study and compare investor protections and outcomes in these 20 states with some limits with those in the 30 U.S. states that have no concentration limits. Nor does NASAA acknowledge that the SEC rules intended to protect investors from complex products qualify investors on the basis of their net worth, net income or professional qualifications, rather than solely on the basis of their liquid assets.<sup>13</sup>

Nor has NASAA established what, if any, incremental risk reduction would be achieved by this concentration provision beyond the protections provided by existing federal securities laws. As SEC registered securities, PNLR shares are subject to Exchange Act rules, including the liability provisions under Section 11 of the Securities Act. SEC and FINRA rules currently require that broker-dealers and investment adviser consider the portfolio concentration and liquidity needs of each investor, and the SEC and FINRA require that regulated broker-dealers and advisers scrupulously supervise recommendations to senior investors.

We also note that as a practical matter, the proposed concentration limits appear to be close to unworkable. As drafted, it is unclear if an investor’s liquidity must be measured, for purposes of assessing concentration, at the time a PNLR is recommended, or at the time of sale, or, alternatively, if the NASAA concentration limit is intended to be a dynamic measurement, requiring brokers and advisers to continuously monitor their customers’ liquidity. Equally unclear is whether this limit would apply to customer portfolios that already include PNLRs and similar products, and whether existing PNLR sponsors would be required to amend their organizing documents to incorporate this concentration limit for shares that have already been issued.

Finally, we note that NASAA has not established, but rather has only assumed, that benefits would accrue from these concentration limits. But NASAA has not in any way addressed the costs associated with this standard, against which any benefit must be evaluated. The PNLR Council believes the costs of this concentration limit proposal would be considerable, not simply for PNLR sponsors and broker-dealers and advisers, but also for investors, who would be arbitrarily denied investment options that may be suitable for their investment objectives. Absent any persuasive data or analysis measuring the risk reduction benefits to investors and any acknowledgement of the costs, the PNLR Council strongly opposes NASAA’s proposed concentration limits for PNLRs.

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<sup>13</sup> See, Accredited Investor Definition, *supra* note 9.



## **Structuring the Concentration Limit to Restrict Affiliate Investments Exacerbates the Problems**

The PNLR Council is particularly concerned with the provision of the Proposal that would limit PNLR investors to holding no more than 10% of a PNLR “issuer, its affiliates, and other non-traded direct participation programs.” NASAA states that it chose to structure the concentration limit this way “... based on the observation that liquidity is restricted in all programs; high fees and expenses conflicts, and [that] lack of historical operations also predominate these offerings.”<sup>14</sup>The Council believes that this “observation” is unfounded, and fails to account for the quality, scale and sophistication of today’s PNLR sponsors and their offerings. Today’s NAV PNLR sponsors, many of which are experienced global asset managers, do not fit this observation. Moreover, they generally feature a range of product offerings, with a variety of liquidity profiles.

The Proposal’s broad definition of an affiliate in the proposed concentration limit could also extend to publicly traded securities of a sponsor company, private placements and securities registered under the 1940 Act, or other funds and programs that invest in assets other than real estate. As such, the Proposal would limit a PNLR investor from opportunities to diversify its investments by investing in a sponsor’s listed shares, or in funds or other products that may focus on sectors other than real estate, which would exhibit risk and return profiles that are not closely correlated with PNLR investments. These products could offer many investors opportunities for greater diversification and investor protections.

Moreover, many financial products offered by NAV PNLR sponsors, or their affiliates, are expressly exempt from state regulation. These may include private placements, exchange traded securities or funds, and 1940 Act registered, closed-end funds, including interval funds. We are concerned that this broad affiliate definition creates confusion. Is NASAA intending to assert authority to regulate or limit these exempt products that are subject to federal regulation?

We are also concerned that NASAA’s failure to acknowledge that today’s NAV PNLR sponsors are larger institutional-quality asset managers that offer investors a range of product types would lead to the anomalous result of providing a competitive advantage to smaller, less well capitalized sponsors that have fewer product offerings. Hampering the ability of experienced, well capitalized institutional sponsors with proven track records from offering a broad range of products to PNLR investors would likely increase costs for investors. Larger, more sophisticated sponsors with multiple PNLRs and other products and can achieve certain economies of scale which can result in reduced expenses relative to smaller sponsors of fewer products. The concentration limit would work to favor sponsors that potentially do not have the economies of scale to result in lower expenses for investors. Investors’ interests would not be well served by this initiative.

NASAA has not demonstrated any benefit to expanding the concentration limit to include affiliates. Nor has it addressed the costs of this proposed change, which are considerable and have not been fully considered. If

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<sup>14</sup> Proposal, at 7-8.

the concentration limit applicable to affiliates is adopted in this form, investors would surely find that there are fewer experienced, institutional sponsors, offering fewer products, thereby limiting their investment opportunities, including opportunities to reduce portfolio risk and costs.

For the reasons described above, the PNLR Council strongly opposes NASAA's proposed concentration limit for PNLRs. The Council also opposes this "affiliate" feature of the proposed concentration limit, which we believe is discriminatory and does not operate in the best interests of investors.

## **Raising the Gross Income and Net Worth Requirements for PNLRs is Unjustified**

The Proposal would also increase investor gross income/net worth requirements and index them to inflation on a backward-looking basis to 2007. Because PNLR shares are SEC registered securities and subject to all applicable rules and liabilities of SEC registered securities, the Council has long questioned the utility of these state requirements with respect to PNLRs and their value in enhancing investor protection. Raising these income and net worth limits would compound this anomaly.

NASAA appears to offer no justification for increasing these limits, other than the fact that they have not been increased since 2007. Absent any data, or analysis, demonstrating any benefit that would accrue from raising these limits, the Council questions the value of doing so. Again, making this change would not be costless. Aside from the administrative burdens on sponsors, broker-dealers and advisers, this change would further operate to restrict the investment options of many investors. Moreover, it would do so for no demonstrated benefit. For these reasons, the Council opposes this aspect of the Proposal.

## **The Proposal's Restrictions on Use of PNLR Proceeds is Unwarranted**

The Proposal would add a new prohibition against "using gross offering proceeds as an investment objective or strategy to make distributions."<sup>15</sup> As an initial matter, the Council does not understand this provision of the Proposal, as drafted, because its meaning is not entirely clear. To the extent that the provision is intended to restrict PNLRs from ever paying distributions from offering proceeds, the Council strongly objects to this provision.

The Council also questions why NASAA has raised this issue at this time, because it appears that the concerns animating this proposed restriction on use of proceeds relate to historical practices of older Lifecycle PNLRs. The NAV PNLRs raising capital today publish their net asset value on a daily, or monthly, basis. Any distribution issued by a NAV PNLR that is paid from sources other than cash flow from operations would result in a reduction in NAV. The regular publication of NAV allows transparency into the value of the PNLR's shares. This transparency makes NASAA's proposal unnecessary because a NAV PNLR that overpays distributions will report reductions in NAV over time.

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<sup>15</sup> Proposal, p. 1.

Moreover, NASAA also takes no account of 2013 SEC staff guidance on this very topic, which, is relevant here.<sup>16</sup> Under this guidance, the SEC does not object to a PNLN paying distributions in excess of cash flow from operations, provided that its prospectus includes disclosure regarding the sources of the cash used to cover the shortfall, such as offering proceeds or debt, as well as appropriate risk factor disclosure. The SEC guidance further requires PNLNs to disclose to the SEC, on a quarterly basis, the source or sources used to fund distributions. This required quarterly disclosure provides on-going transparency into the sources of distributions.

Because the SEC requires that PNLNs disclose this information each quarter, PNLN investors, and those that advise them, have access to historical information regarding the sources used to fund distributions prior to making an investment decision. This required disclosure also enables broker-dealers and analysts to perform comprehensive due diligence, including a review of the PNLN's historical distribution coverage, when evaluating PNLNs as possible investments for their clients. Most broker-dealers monitor distribution coverage on an on-going basis because failure to demonstrate full coverage, or progress toward full future coverage, may violate sales agreements with some sponsors.

Most PNLNs are chartered in Maryland, where Maryland law permits the use of proceeds for distribution, conditioned upon approval of the board of directors, which has a fiduciary obligation to both the PNLN and its stockholders. It is a fundamental fiduciary responsibility of the board of a Maryland REIT to make determinations on how to fund distributions, through offering proceeds or otherwise. Maryland law also imposes equity and balance sheet solvency tests on REITs that further address any concerns about the overpayment of distributions. These statutory tests obligate a Maryland PNLN board to determine that subsequent to any distribution, the PNLN will remain able to pay its debts as they become due and that its assets will exceed its liabilities.<sup>17</sup>

The Council is concerned that in proposing this restriction, NASAA appears to have ignored recent developments in the PNLN sector and relevant existing state and federal regulation that address these very issues. NASAA has also offered no persuasive rationale for restricting sources of distributions in this manner, notwithstanding this explicit SEC guidance. For this reason, the Council opposes this provision of the Proposal.

## **The Proposal's Additional Conduct Standards are Unwarranted**

The Proposal would add a new conduct standard definition applicable to persons selling, recommending, or providing investment advice concerning shares PNLNs. Although NASAA suggests that the new conduct standard is intended to update its Guidelines by formally incorporating the SEC's 2019 Regulation Best Interest

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<sup>16</sup> 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/corpin/guidance/cfguidance-topic6.htm> ("SEC Disclosure Guidance: Topic No. 6").

<sup>17</sup> Maryland General Corporation Law (MGCL) § 2-311(a)(2).

(Reg BI) into the framework,<sup>18</sup> the many references in the NASAA Proposal's release to NASAA's recent, highly critical report on Reg BI (NASAA Reg BI report)<sup>19</sup> suggests that these proposed changes are actually intended to impose additional, incremental regulation on broker-dealers and investment advisers with respect to PNLRs, beyond the requirements of Reg BI.

Nareit and the PNLR Council supported the SEC proposal that formed the basis of Reg BI and submitted comments<sup>20</sup> to the SEC supporting the proposal's principles-based approach, which requires broker-dealers "to act in the best interest of the retail consumer at the time a recommendation is made to an investor...". Nareit and the PNLR Council continues to support Reg BI and its goals. Further, because the PNLR Council shared the concerns expressed by other groups about the NASAA Reg BI Report, Nareit joined the Institute for Portfolio Alternatives (IPA), the Securities Industry and Financial Markets Association (SIFMA), the U.S. Chamber of Commerce and several other organizations in commissioning an analysis of the NASAA Reg BI report<sup>21</sup>, which identified issues regarding the report's objectivity and methodology.

The Council does not believe that the NASAA Reg BI report provides persuasive support that Reg BI inadequately protects the best interests of PNLR investors. The Council also agrees with concerns that have been raised by others in comments submitted on the Proposal, suggesting that there would be many practical difficulties with implementing this conduct standard for PNLR sponsors, broker-dealers and advisers, if it was adopted. For these reasons, the Council is not persuaded that additional conduct regulation targeting PNLRs, layered on top of Reg BI, is warranted to protect PNLR investors and opposes this proposed revision.

## Conclusion

The PNLR Council opposes the Proposal for the reasons set forth above. The PNLR Council is troubled that the Proposal appears to be premised on an outdated understanding of the PNLR sector, a perspective that fails to take into account the ascendance of NAV PNLRs over the last decade. Many of the proposed revisions set forth in the Proposal, including the proposed concentration limits, net worth and gross income requirements and the restrictions on sources of distributions, appear to take aim at PNLR products that are no longer being offered by PNLR sponsors to investors. The Council also disagrees with NASAA's conclusion that Reg BI is deficient in protecting PNLR investors and that additional conducts standards are warranted. For these reasons, the PNLR Council urges NASAA to withdraw the Proposal from consideration.

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<sup>18</sup> Regulation Best Interest, 84 FR 33318 (Sept.10, 2019).

<sup>19</sup> NASAA Reg BI Phase IIA Report (Nov. 2021), available at [https://www.nasaa.org/wp-content/uploads/2021/11/NASAA-Reg-BI-Phase-II-A-Report-November-2021\\_FINAL.pdf](https://www.nasaa.org/wp-content/uploads/2021/11/NASAA-Reg-BI-Phase-II-A-Report-November-2021_FINAL.pdf)

<sup>20</sup> Nareit, Nareit PNLR Council Comment to the Securities and Exchange Commission Regulation Best Interest (Aug. 6, 2018) available at <https://www.sec.gov/comments/s7-07-18/s70718-4171495-172202.pdf>.

<sup>21</sup> Analysis Of North American Securities Administrators Association's (NASAA) Reg BI Surveys Prepared by Greenwald Research (Feb. 2022), available at <https://greenwaldresearch.com/wp-content/uploads/2022/02/Analysis-of-NASAA-Surveys-on-Reg-BI-Greenwald-Research-2.22.pdf>.



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The Council would be happy to discuss these comments with NASAA. If you would like to discuss this submission further, please contact Victoria Rostow, Nareit's Senior Vice President, Regulatory Affairs & Deputy General Counsel at [vrostow@nareit.com](mailto:vrostow@nareit.com) or (202) 739-9431.

Respectfully submitted,

A handwritten signature in black ink, appearing to read "C. Allan Swaringen". The signature is fluid and cursive, with a long horizontal stroke at the end.

C. Allan Swaringen  
Chair, Nareit Public Non-Listed REIT Council  
President & CEO  
JLL Income Property Trust, Inc.