



November 11, 2011

Ms. Marcia E. Asquith  
Office of the Corporate Secretary  
Financial Industry Regulatory Authority  
1735 K Street, NW  
Washington, DC 20006-1506

NATIONAL  
ASSOCIATION  
OF  
REAL ESTATE  
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**Re: FINRA Regulatory Notice 11-44: FINRA Requests Comment on Proposed Amendments to NASD Rule 2340 to Address Values of Unlisted Direct Participation Programs and Real Estate Investment Trusts in Customer Account Statements**

Dear Ms. Asquith,

This letter is in response to FINRA Regulatory Notice 11-44 (the Proposed Amendment) in which FINRA requests comment on proposed changes to NASD Rule 2340 (Customer Account Statements) with respect to how per share estimated values of unlisted Direct Participation Programs (DPPs) and unlisted Real Estate Investment Trusts (REITs) are reported on customer account statements.

NAREIT, the National Association of Real Estate Investment Trusts, is the worldwide representative voice for real estate investment trusts (REITs) and publicly traded 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 commercial and residential real estate.

Our members identified as Equity REITs own, lease and often operate all types of real estate, while our members identified as Mortgage REITs finance housing and commercial real estate by originating mortgages or by purchasing whole loans or mortgage backed securities in the secondary market.

In addition, REITs in the U.S. may be public companies whose securities are registered with the SEC and listed on an established stock exchange (so-called, Listed REITs); public companies whose securities are registered with the SEC, but which are not listed on an established stock exchange (so-called, Public Non-Listed REITs (PNLRs)); or private companies.

As of June 30, 2011, 225 REITs were "public" through registration with the SEC, 159 of which are Listed REITs (predominantly listed on the NYSE) and 66 of which are PNLRs. Equity REITs own over 30,000 properties in all 50 states, with a value of approximately \$700 billion, with about \$80 billion of that



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amount attributable to PNLRs. These investments are estimated to comprise approximately 10-15% of investment-grade commercial real estate in the United States, and they include all property types, including retail, office, multifamily, health care, lodging, industrial, self storage and timber.

Given the nature of FINRA Regulatory Notice 11-44, this letter and its attachment are focused solely on PNLRs, which participate at NAREIT through its Public Non-Listed REIT Council, consisting of all 37 NAREIT PNLR corporate members (the PNLR Council). The mission of the PNLR Council is to advise NAREIT's Executive Board on matters of interest and importance to PNLRs.

The PNLR Council, led by its Executive Committee representing leading sponsors of PNLRs, has carefully reviewed the Proposed Amendment. As a result, it developed the attached comment letter for submission to and consideration by FINRA. In short, as reflected in the attached letter, the position of PNLR Council with respect to the Proposed Amendment is as follows:

#### **Close of Initial Offering Period and Appraised Value**

The PNLR Council supports limiting the period during which a per share estimated value based on the net offering price may be included on a Customer Account Statement to the Initial Offering Period, as proposed by FINRA.

#### **Presenting Per Share Net Offering Price, Net of Certain Organization and Offering Expenses**

The PNLR Council supports publication of the net offering price on the Customer Account Statement during the Initial Offering Period (when the program is acquiring assets and firms are selling shares at a stable value on a best-efforts basis); it supports the deduction of certain organization and offering expenses (O&O Expenses) characterized by FINRA as underwriting compensation (pursuant to FINRA Regulatory Notice 08-35) as proposed by FINRA; and it does not support the deduction of certain O&O Expenses characterized by FINRA as issuer expenses or due diligence expenses (pursuant to FINRA Regulatory Notice 08-35) which it contends are expenses intrinsically connected to the customer's investment in the REIT.

In addition, given the fact that the per share amount on the Customer Account Statement during the Initial Offering Period reflects a per share net offering price rather than a per share estimated value, the PNLR Council recommends to FINRA that the Customer Account Statement label the amount determined, after deduction of underwriting compensation, to be the per share net offering price. The PNLR Council supports disclosure of such expenses to the customer through the investor confirmation statement.



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### **Transition Period**

The PNLR Council notes that the Proposed Amendment does not address a transition period for implementation of the new rule. The PNLR Council strongly urges FINRA to include a transition rule with its final proposal to ensure that inappropriate disruption does not occur in the market, and so that unnecessary confusion is not created for broker-dealers or their customers.

NAREIT and its PNLR Council look forward to continuing to work with FINRA on the issues raised by the Proposed Amendment. The Proposed Amendment addresses an important part of the REIT community at a critical moment, and we look forward to working with FINRA as it ensures that it provides sound industry guidance and thoughtful investor protection.

Please feel free to contact me with further questions.

Respectfully submitted,

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

Steven A. Wechsler  
President & CEO



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**Re: FINRA Regulatory Notice to Members 11-44; Proposed Amendments to NASD Rule 2340 to Address Values of Unlisted Direct Participation Programs and Real Estate Investment Trusts (hereafter, together referred to as DPPs) in Customer Account Statements (the Proposed Amendment)**

Dear Ms. Asquith,

This comment letter regarding the Proposed Amendment is submitted on behalf of the Public Non-Listed Real Estate Investment Trust (PNLR) Council of the National Association of Real Estate Investment Trusts (NAREIT), and is signed by its members, each of whom represents an established sponsor in the PNLR industry. Together, the members of the PNLR Council and NAREIT play a vital role in helping to provide a substantial portion of the overall transaction volume for the alternative asset and real estate markets. As a part of NAREIT, PNLR sponsors and their products are a critical part of hundreds of thousands of investors' portfolio diversification and income strategies, and have distributed tens of billions of dollars to shareholders since their legal inception nearly thirty years ago. We thank you for the opportunity to provide our comments on this rule proposal prior to its submission to the SEC.

Regulatory Notice 11-44 seeks to modify NASD Rule 2340<sup>1</sup>, the Customer Account Statement Rule, in two specific areas we address in this comment letter:

- To allow for the use of a fixed net offering price only if published per share estimated values on investor statements deduct all organization and offering expenses (net value); and,
- To limit the use of a net value per share on an investor statement to the Initial Offering Period<sup>2</sup> of an investment offering program.

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<sup>1</sup> We understand that, as part of the rulebook consolidation process, FINRA has proposed new FINRA Rule 2231 to replace NASD Rule 2340, and that the Proposed Amendment would be effective within NASD Rule 2340 or new FINRA Rule 2231, depending upon the timing of SEC approval of the rule in its final form.

<sup>2</sup> The Initial Offering Period, defined in your notice and by Securities Act Rule 415 as lasting up to three years plus an additional 180 day carryover period.

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We commend FINRA for recognizing the Customer Account Statement Rule as a tool for providing new approaches to investor protection and disclosure, and we support the majority of both the elements of and analysis in your notice.

In particular, we understand that FINRA is concerned with the length of time that a fixed public offering price is reported on a customer account statement. Presently, throughout even a multiple-offering capital formation process for a DPP, the dollar amount an investor sees on a customer statement does not represent a book or net asset value of a share of stock in a DPP, nor is it indicative of the proceeds that an investor would receive if the entity was liquidated. Your proposal would require a calculated estimated valuation on customer account statements to be published much earlier, at the end of an Initial Offering Period. We fully support this proposal and feel this will do much to improve, and to assist investors in understanding, the ultimate value and relative performance of DPPs over time. We also affirm our view that the Initial Offering Period is a reasonable period of time during which a non-valuation based fixed offering price can be both appropriate and consistent with the nature of DPPs as long-term investment vehicles.

Regarding the customer account statement during the Initial Offering Period, we are concerned that your rule amendment, if adopted as proposed, would lead investors to conclude that the “value” of their investment during the Initial Offering Period is equal to the offering price less any organization and offering expenses. The term “net value” or any other value construct on an initial statement is subject to many interpretations as a concept, as there is no external value measure associated with an Initial Offering Period share price. Blending any concept of approximation to objective value with a fee grossed down approach during an initial offering results in a potential disconnect for the investor, combining a form of value analysis into an acknowledged time in a product life cycle where formal value analysis does not yet occur. Should FINRA require additional disclosure during the Initial Offering Period regarding up-front investor costs, we support not referring to any resultant price as a “value.”

In addition, the process of moving the Initial Offering Period customer account statement toward a new form of pricing and fee disclosure, if adopted as presently proposed, will pose significant implementation challenges including capital account, yield calculation and discounted share pricing issues. This occurs because the proposed rule alters the baseline for these calculations from \$10 to the grossed down number “net value.” We feel an investor can be led to better understand the price they pay for a share, as well as related selling commissions and fees, if there is disclosure clarifying these fees relative to a “net offering price” placed on the ultimate investor statement. This may require additional fee transparency, but it does not require a value construct. Using this approach, individual issuers can continue to determine their own public offering price per share. For example, an issuer could opt to establish a fixed public offering price resulting, after removal of underwriting fees,

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in net proceeds per share of \$10, which it would deem its net offering price. Investor confirmations could then show fees paid on top of this net offering price in disclosure that is clear, while investor capital accounts and the Initial Offering Period statement price per share could remain at \$10. We feel this can be a preferable and easier-to-implement alternative to the existing FINRA statement proposal.

Regarding implementation, we strongly encourage FINRA to affect its ultimate rule proposal through an expansive transitional process that allows currently effective DPP programs to retain their existing customer statement models. We are concerned that, absent some form of staged rollout, a marketplace with multiple inconsistent pricing mechanisms will create investor confusion and hurt DPP's ability to raise capital. We also feel an appropriate time is needed after the rule is finalized, but prior to its adoption, to allow FINRA member firms to prepare their customers for the effect of the new rule and to allow new DPP programs to incorporate new pricing methodologies into their structures.

In further consideration of implementation of a new rule, we request that FINRA complete a full and reasoned assessment, with industry input, of the potential costs and capital formation impacts associated with placing the proposed "net value" on an initial offering period customer statement. We also are unclear as to how your proposal applies to private offerings, or to public non-traded business development companies.

Finally, we note you propose a pricing mechanism during an initial offering that recognizes and removes three distinct categories of issuer organization and offering expenses: issuer expenses that are reimbursed or paid for with offering proceeds; due diligence expenses; and underwriting compensation (commissions and all other compensation paid to a FINRA member in connection with a sale). Requiring the removal of organization and offering expenses beyond those included in the FINRA definition of underwriting from the initial offering customer statement price diverges the statement pricing mechanism of DPPs from that accepted by FINRA for other securities. These other categories of fees are not fixed costs like underwriting, and they are ultimately paid in total or in part using funds generated by an issuer's operations, and not at the point of sale. We suggest that disclosure at the time of purchase of underwriting charges alone is more practical and appropriate. Other non-underwriting issuer organization and offering costs vary widely as a percentage of capital raise over time, rendering the act of fixing and marking them down in a share price at the initial time of investment arbitrary and often impossible to calculate until the end of an offering.

The DPP industry and FINRA members selling DPP shares have operated under the current pricing and customer account statement model for many years. We welcome this comment period as an opportunity to now enhance the DPP industry and the process of investment in alternative and real estate assets. We are also committed to

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working with FINRA to make sure the future is free from unintended consequences and focused on constructive engagement in the regulatory process. Thank you for your consideration of these important matters.

Respectfully Submitted,

Executive Committee  
NAREIT PNL Council

Chair:  
Daniel L. Goodwin, CEO  
Inland Real Estate Group

Charles N. Hazen, President & CEO  
Hines REIT and Hines Global REIT

Robert S. Aisner, President & CEO  
Behringer Harvard Holdings

Nicholas S. Schorsch, Chairman & CEO  
American Realty Capital

Marc Nemer, CEO  
Cole Real Estate Investments

Thomas K. Sittima, CEO  
CNL Financial Group

Charles J. Schreiber, CEO  
KBS Realty Advisors