NATIONAL ASSOCIATION OF REAL ESTATE INVESTMENT TRUSTS®

REITS: BUILDING DIVIDENDS AND DIVERSIFICATION®

April 20, 2017

Submitted electronically to ***submissions@banking.senate.gov***

The Honorable Michael D. Crapo
Chairman
Senate Committee on Banking,
Housing and Urban Affairs
534 Dirksen Senate Office Building
Washington, D.C. 20510

The Honorable Sherrod Brown
Ranking Member
Senate Committee on Banking,
Housing and Urban Affairs
534 Dirksen Senate Office Building
Washington, D.C. 20510

RE: Request for Proposals to Foster Economic Growth

Dear Chairman Crapo and Ranking Member Brown,

The National Association of Real Estate Investment Trusts (NAREIT) 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 residential and commercial real estate. NAREIT's Mortgage REIT (MREIT) Council ("MREIT Council" or "Council"), which includes both residential and commercial MREITs, advises NAREIT's leadership on MREIT matters.

On behalf of NAREIT, I am happy to transmit this Comment from NAREIT's MREIT Council responding to your request for proposals to assist the Committee move forward on a bipartisan basis in the 115th Congress to promote growth and to improve the economic well-being of all Americans. The Council's Comment, which addresses the Committee's housing finance agenda, focuses the need to expand the role of private capital and the potential of MREITs to contribute to this effort.

Today, publicly traded MREITs play an important role in the real estate capital markets by providing financing and liquidity through funding mortgage and mortgage related loans for residential and commercial borrowers and by acquiring mortgages and mortgage-related loans. As of March 31, 2017, there are 25 stock exchange-listed residential MREITs with a cumulative equity market capitalization of $45.9 billion and 13 stock exchange-listed commercial Mortgage REITs with a cumulative equity market capitalization of $15.1 billion.

Residential MREITs stand today as one of the very few significant sources of private permanent capital dedicated to the single family housing sector, contributing to housing affordability by originating mortgage loans, purchasing mortgage-backed securities, and providing first loss capital for new private label securitizations. Moreover, they are well-poised to expand their support of the

U.S. Housing sector, particularly if certain limitations placed upon MREITs today, described in the attached Comment, can be addressed.

NAREIT and its Mortgage REIT Council members stand ready to assist the Members and staff of the Senate Banking Committee as they move forward with the critical task of modernizing housing finance.

Please feel free to contact me with further questions.

Respectfully submitted,

Steven A. Wechsler President and CEO

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RE: Request for Proposals to Foster Economic Growth

Dear Chairman Crapo and Ranking Member Brown,

Thank you for the opportunity to provide comments to the Senate Banking Committee (the Committee) regarding ways that the Committee can move forward in the 115th Congress to create jobs and grow the economy. We commend the Senate Banking Committee's bipartisan leadership on housing finance policy matters and for its recent efforts in exploring ways to return private capital to the housing finance sector. We share the perspective of many Committee members that private capital can beneficially and prudently play a much larger role in the U.S. housing finance market. Our comments below focus on this objective and the ability of mortgage REITs (MREITs) to contribute to that goal.

The National Association of Real Estate Investment Trusts (NAREIT) 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 residential and commercial real estate.

NAREIT's MREIT Council (MREIT Council or the Council), which includes both residential and commercial MREITs, advises NAREIT's leadership on MREIT matters. Residential MREITs serve the U.S. housing market by funding the acquisition and financing of mortgages and mortgage-related instruments and by purchasing mortgages and mortgage-related loans. By using private capital to invest in residential mortgages and mortgage backed securities (RMBS), MREITs help provide liquidity and credit to home mortgage markets. Commercial MREITs provide financing for commercial real estate, including, importantly, multi-family housing. They invest in commercial mortgages and commercial real estate loans, CMBS, mezzanine loans, subordinated securities or construction loans and participate in loan securitizations.

Residential MREITs, together with many commercial MREITs, currently play a highly consequential role in the single-family and multi-family mortgage arenas and have, to date, financed mortgage loans for 2.5 million homebuyers. The success of MREITs today reflects years of developed expertise in the fundamentals of real estate debt markets: expertise combining rigorous research, valuation, data collection, underwriting and technical analytics, together with a deep understanding of the fiscal, legal and regulatory frameworks within which RMBS and CMBS markets operate. As such, MREITs are well positioned to expand their role in the post-financial crisis restructuring of the U.S. housing finance market.

Most blueprints for mortgage market reform call for a significantly reduced role for Fannie Mae and Freddie Mac. Refinancing the mortgage loans and RMBS currently owned by the GSEs and funding new mortgage originations for a growing pool of future homebuyers will require enormous sources of additional private capital. Most large residential and commercial MREITs are listed on the NYSE or NASDAQ[1] and have the ability to efficiently raise private capital for single family and multi-family housing without relying on either federal guarantees or insured deposits. Mortgage REITs raised $84.8 billion in total equity offerings between 2005 and June 2016.

MREITs stand today as one of the very few significant wholly private sources of permanent capital dedicated to the single family housing sector, contributing to housing affordability by financing mortgage loans, purchasing RMBS and providing first loss capital for new private label securitizations. These activities not only finance homes, but also create a broad spectrum of jobs. However MREITs are currently constrained in their ability to support the U.S. housing finance sector in two important respects:

- MREITs are currently ineligible to become (and in a few instances, to remain) members of the Federal Home Loan Banks (“FHLBs”), following the implementation of the Federal Housing Finance Agency’s (“FHFA”) 2016 rule altering FHLB membership criteria (the FHFA FHLB Membership Rule).[2] FHLB funding enables MREITs to diversify their funding sources and expand their support for the U.S. housing sector. Housing focused MREITs are fully aligned with the mission of the FHLB system, contributing high quality housing-focused capital and strength to the system.

- MREITs are restricted in their ability to participate in GSE Credit Risk Transfer (CRT) securities issuance pursuant to the Securities and Exchange Commission (SEC) staff’s current interpretation of certain provisions of the Investment Company Act of 1940, which determine real estate investments and are under the jurisdiction of the Senate Banking

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[1] As of March 31, 2017, there were 25 listed residential MREITs with a cumulative equity market capitalization of $45.9 billion and 13 listed commercial Mortgage REITs with a cumulative equity market capitalization of $15.1 billion.
[2] Members of Federal Home Loan Banks, 81 Fed. Reg. 3246 (Jan. 20, 2016).

> Committee; and pursuant to provisions of the Internal Revenue Code of 1986, which are not under the jurisdiction of the Senate Banking Committee.[3] For this reason, REITs make up only 2% of the CRT investor base, despite their larger participation in agency and non-agency MBS markets.[4]

Below is a brief description of each of these regulatory constraints.

FHLB Membership

FHLB funding has the potential to enable MREITs to diversify their funding sources and deepen liquidity in the secondary market, which translates into a stronger housing sector and more jobs across the country. MREIT membership, in turn, benefits the FHLB system by bringing housing-based capital and additional strength to the system. The recent positive experience of MREIT membership in the FHLBs of Chicago, Cincinnati, Des Moines, Indianapolis, Topeka and others strongly supports this case.

Since 2012, more than 30 MREITs had become members in FHLBs through wholly-owned captive insurance subsidiaries, all of which were subject to state insurance regulation and oversight. However, the recent FHFA FHLB membership Rule eliminated the eligibility of these types of insurance members, thereby terminating the FHLB membership of all MREIT-owned insurance entities as of February 18, 2017.[5]

NAREIT's MREIT Council opposed the FHFA FHLB membership rule from the beginning and submitted a comment to the FHFA opposing the proposal and highlighting the strong mission alignment between MREITs and the FHLB system. Residential MREITs (as well as many commercial MREITs) are real estate finance businesses created and operated *for the very purpose of funding residential real estate*. MREITs have deployed FHLB advances to support the purchase of mortgage loans and securities that have funded millions of single and multi-family homes, which is an activity that is entirely consistent with the mission of the FHLBs "to provide reliable liquidity to member institutions to support housing finance and community investment."[6]

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[3] To maintain their REIT status, MREITs (like all REITs) must satisfy certain rules set forth under the Internal Revenue Code of 1986, as amended, including rules that i) require that at least 75% of the value of a REIT's total assets be represented by real estate assets, cash and cash items and government securities (so-called "qualifying assets); and, ii) require that no less than 75% of a REIT's income be derived from such qualifying assets. Currently, it is believed that most CRT securities do not meet the definition of a "real estate asset" for purposes of the 75% test because they do not generally represent interests in real property or mortgages under the strict definition**.**
[4] See, http://www.fhfa.gov/AboutUs/Reports/ReportDocuments/CRT-Overview-8-21-2015.pdf, at 14.
[5] The grandfathering provisions of the final FHFA FHLB membership rule permitted a very limited number of captive insurance members of the FHLBs, including four MREIT captives, to retain their membership for five years.
[6] *See*, The Council of Federal Home Loan Banks http://www.fhlbanks.com/fhlbanks--mission.html. *See also* 81 Fed. Reg. at 3246 ("The Banks are . . . organized . . . to serve the public interest by enhancing the availability of

Legislation

During the 114th Congress, NAREIT's MREIT Council supported various legislative efforts to enable MREITs to become members of the FHLBs, including two bills in 2015 (H.R. 3808) and (S. 1484) that would have blocked implementation of the final FHFA/FHLB Membership Rule.

Recommendation

Congress should enact legislation to enable residential and other housing focused MREITs to become members of the FHLBs, directly or indirectly through their wholly-owned captive insurance subsidiaries, because they are primarily engaged in housing finance activities consistent with the historic mission of the FHLBs.

MREIT Participation in CRT Securities

The Investment Company Act of 1940 ('40 Act)

Section 3(c)(5)(C) of the '40 Act exempts from regulation as an investment company any company that i) "is not engaged in the business of issuing redeemable securities, face-amount certificates of the installment type or periodic payment plan certificates"; and, ii) is "primarily engaged in the business of purchasing or otherwise acquiring mortgages and other liens on and interests in real estate." Since the 1980s, SEC staff have generally held that a company is "primarily engaged" when at least 55% of the value of its assets are held in so called "qualifying interests" in real estate and the remaining 45% consist primarily of "real estate-type interests." This interpretation is set forth in a series of "no-action" letters issued by the staff of the SEC's Division of Investment Management.[7] SEC staff guidance further provides that "qualifying interests" in real estate consist of loans or liens fully secured by real estate or actual interests in real estate or assets that can be viewed as the functional and economic equivalent of such loans or liens or interests in real estate.

Under this framework, most Agency CRT securities issued to date have not been viewed as "qualifying interests" and some not as "real-estate type interests," due to their technical structure as derivatives or debt obligations of the GSEs with principal payments determined by the credit performance of a reference pool.

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residential housing finance and community lending credit."); Federal Home Loan Bank of Atlanta, Annual Report on Form 10-K (March 9, 2017) ("The primary function of the Bank is to provide readily available, competitively priced funding to its member institutions. The Bank serves the public by providing its member institutions with a source of liquidity, thereby enhancing the availability of credit for residential mortgages and targeted community developments.").

[7] *See, e.g.,* Securities and Exchange Commission, Salomon Brothers Inc., No-Action Letter (June 17, 1985); Securities and Exchange Commission, Nottingham Realty Securities, Inc., No-Action Letter (April 19, 1984).

Legislation

During the 114th Congress, NAREIT 's MREIT Council supported two House bills— the *Taxpayer Protections and Market Access for Mortgage Finance Act* (H.R. 6487) and the *Moving Housing Forward Act* (H.R. 6500), which might serve as a starting point for future legislative language.

Recommendation

Congress should enact legislation to ensure that CRTs are treated as "real estate assets" for purposes of Section 3(c)(5)(C) of the *'40 Act* and for purposes of the Internal Revenue Code with respect to REITs.

Conclusion

NAREIT's MREIT Council appreciates this opportunity to assist the Senate Banking Committee in the development of a bipartisan housing policy agenda for the 115th Congress. We believe that MREITs have enormous potential to prudently expand their support for the U.S. housing sector, particularly if certain regulatory matters can be addressed. We look forward to working with you and other Members of the Committee as you embark on the important mission of reforming U.S. housing finance.

We hope you will look to NAREIT and the members of NAREIT's MREIT Council as resources as you move forward. Please do not hesitate to contact us, or Steve Wechsler, NAREIT's President & CEO (swechsler@nareit.com or (202) 739-9406), or Victoria Rostow, SVP, Policy & Regulatory Affairs (vrostow@nareit.com or (202) 739-9431).

Respectfully submitted,

Executive Committee
NAREIT Mortgage REIT Council

Chairman William S. Gorin
CEO, MFA Financial, Inc.

Vice Chair: Kevin E. Grant
President & CEO, CYS Investments, Inc.