NATIONAL ASSOCIATION OF
REAL ESTATE INVESTMENT TRUSTS®

June 14, 2013

VIA E-MAIL
Michal.Stelmach@hmtreasury.gsi.gov.uk

Michal Stelmach
H.M. Treasury
100 Parliament Street
London, SW1A 2BQ
United Kingdom

Re: UK Real Estate Investment Trusts Discussion Paper

Dear Mr. Stelmach:

The National Association of Real Estate Investment Trusts® (NAREIT) greatly appreciates the opportunity to provide its comments in connection with the informal consultation dated March 20, 2013 (Consultation Paper) on including real estate investment trusts (REITs) as institutional investors for purposes of the U.K. REIT rules. NAREIT is supportive of H.M. Treasury's updating the U.K. regime, and recommends that, at the very least, a U.S. REIT be considered an "institutional investor" for purposes of the U.K. REIT rules.

NAREIT is the worldwide representative voice for 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 businesses throughout the world that own, operate, and finance income-producing real estate, as well as those firms and individuals who advise, study, and service those businesses.

As an initial point, NAREIT once again applauds the U.K. Government for its willingness to update and modify the U.K. REIT regime in order to encourage investment and stimulate the construction industry. We note that on July 14, 2004, May 7, 2005, and January 26, 2006, we submitted comments in connection with the development of the U.K. REIT regime, and we appreciate the opportunity to continue to provide our comments. Our comments today supplement the comments we submitted in a letter dated February 10, 2012 in connection with the Finance Bill 2012 (Draft Bill) in which we suggested that REITs be considered institutional investors under the U.K. REIT rules. Because our comments relate to both U.S. REITs and U.K. REITs, we refer to the respective country's REITs as either a "U.K. REIT" or "U.S. REIT" in the discussion below.

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EXECUTIVE SUMMARY

Under current law, a U.K. REIT may not be a "close company," as such term is defined. This requirement no doubt enables the REIT to have diverse ownership. Generally speaking, five or fewer persons may not control a U.K. REIT. As we understand the U.K. rules, current law does not typically "look through" widely held shareholders in determining whether a U.K. REIT is a close company. As a result, an entity owned by five or fewer entities would be considered a close company and could not qualify as a U.K. REIT. However, we understand that in July 2012, the U.K. law was modified to prevent a U.K. REIT from being treated as a close company merely because it has one or more "institutional investors." Further, the Consultation Paper solicits comments on including "REITs" in the definition of "institutional investor."

Because a U.S. REIT by definition may not be "closely held" (that is, five or fewer individuals may not control a U.S. REIT), we believe that a U.K. REIT's ownership by a U.S. REIT should not cause the U.K. REIT to be considered a close company. Accordingly, NAREIT recommends that the U.K. include a U.S. REIT in the list of institutional investors whose ownership in a U.K. REIT will not cause the U.K. REIT to be considered a close company.

DISCUSSION

I. U.K. REIT: Prohibition Against "Close Company" Status

A. Background

As we understand it, an entity may not qualify as a U.K. REIT if it is a "close company." This prohibition ensures that a U.K. REIT will have diverse ownership. Generally speaking, U.K law defines a U.K. REIT as a close company if it has five or fewer shareholders. Further, the general close company rules that permit a "look through" of certain widely held shareholders are not applicable to U.K. REITs.

In 2011, HM Revenue & Customs (HMRC) began an informal consultation with respect to possible changes to the U.K. REIT regime.[1] One area with respect to which HMRC sought comments was in connection with the introduction of a diverse ownership rule for institutional investors. Based on HMRC's posted feedback to this consultation project, "[s]takeholders were supportive of this measure on the basis that it will make investment easier for institutional investors, thereby enlarging the pool of potential investment in property. HM Treasury will take this reform forward." [2]

B. Draft Finance Bill 2012

In December 2011, HMRC released the Draft Bill, which proposed that ownership in a U.K. REIT by an "institutional investor" should not, by itself, cause the U.K. REIT to be a close

[1] http://www.hm-treasury.gov.uk/consult_reits_measures_questions.htm.
[2] http://www.hm-treasury.gov.uk/consult_reits_feedback.htm.

company. The term "institutional investor" would have been defined narrowly to include generally one or more of the following: a) an authorized unit trust; b) an open-ended investment company; c) a pension; a long-term insurance business; d) a sovereign entity; or, e) any "person" defined as an institutional investor in yet-to-be developed Treasury regulations. Under the proposal, a U.S. REIT thus would not have been considered an "institutional investor" unless the expected regulations included it as such. We understand that these proposals were enacted in July 2012.

II. Because U.S. REITs Must Have Diverse Ownership, NAREIT Recommends That H.M. Treasury Include U.S. REIT in the Definition of "Institutional Investor"

A. U.S. Law Requires U.S. REITs to Be Widely Held

As NAREIT has noted in its prior submissions, the U.S. Congress created the U.S. REIT structure as a way to enable investors from all walks of life to invest in professionally managed, income-producing real estate in much the same way that this type of investment was available to high net worth individuals and larger institutions.

Beginning with the second half of the second taxable year of the entity, a U.S. REIT must have at least 100 shareholders and may not be "closely held." Closely held is defined as when five or fewer individuals own more than 50% of the value of the entity's stock,[3] with a number of look through rules applying when determining ownership.[4] For example, in most cases these rules require looking through a pension fund to its beneficiaries or a corporation to its shareholders in order to determine the ultimate individual shareholders of the REIT.[5] Many REITs incorporate these legal limitations in their organizational documents as a means to insure that these limitations are satisfied.

As a result of these rules, U.S. REITs tend to be widely held, and many are publicly listed. In addition to listed REITs, companies with more than $10 million in assets whose securities are held by more than 2,000 owners must file annual and other periodic reports with the U.S. Securities and Exchange Commission (SEC). As a result of these rules, both listed REITs, and a number of non-listed U.S. REITs that do file periodic and annual reports with the SEC due to the size of their ownership base and investment portfolio (listed REITs and non-listed, SEC-registered REITs, together, SEC-registered REITs) must by definition be widely-held.

B. Treating U.S. REITs as Institutional Investors Could Attract More Capital and Investment Expertise to the U.K. Real Estate Market

As of March 28, 2013, the equity market capitalization of listed U.S. REITs was $667 billion. U.S. REITs invest in real estate assets both in the U.S. and throughout the world. As the tenant base of U.S. REITs expands throughout the U.K. and elsewhere, the ability of these U.S. REITs to make significant investments in U.K. REITs helps to provide these tenants with access to a

[3] Internal Revenue Code of 1986, as amended (I.R.C.) §§ 856(a)(6) and 856(h).
[4] *See* I.R.C. § 544.
[5] I.R.C. § 856(h)(3).

portfolio of high-quality assets in additional markets. By permitting larger investment by U.S. REITs in U.K. REITs, U.S. REITs will be able to leverage their skills in capital allocation, balance sheet management, and operating expertise. However, the current close company rules in the U.K. impede significant investments by U.S. REITs in U.K. REITs. Already U.S. REITs have invested in French REITs as an efficient way to deploy capital with management teams with local expertise. Based on information provided by some of our members, it is quite possible that U.S. REITs would like to follow the same approach with U.K. REITs.

In addition, some U.S. REITs acquire common or preferred stock in other U.S. REITs either as long-term investments or as a way to invest cash reserves before they are deployed into real estate investments. It is possible that U.S. REITs would make similar investments in U.K. REITs.

C. Because of Their Required Ownership Diversity, U.S. REITs Should Be Considered Institutional Investors in Determining Whether a U.K. REIT is a Close Company

Institutional investors are permitted to own shares in U.K. REITs without causing those REITs to be close companies presumably as a means to enlarging the pool of potential investment in property. The widely-held nature of U.S. REITs renders them comparable to an "institutional investor." Because U.S. REITs are required to have a wide ownership base in order to maintain their status as REITs, NAREIT recommends that H.M. Treasury consider U.S. REITs to be institutional investors with respect to the ownership rules applicable to U.K. REITs.

Accordingly, NAREIT recommends either that H.M. Treasury expand the list of categories describing "institutional investors" to include a U.S. REIT, or that the regulations to be promulgated expand the definition of "institutional investor" include a U.S. REIT. At the very least, NAREIT recommends that H.M. Treasury consider the term "institutional investor" as including SEC-registered U.S. REITs. This change would make a substantial amount of capital available to invest in the U.K. economy.

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Thank you again for the opportunity to submit these comments. We would look forward to discussing them in more detail if you believe it appropriate. Please contact me at (202) 739-9408 or tedwards@nareit.com or Dara Bernstein, NAREIT's Senior Tax Counsel, at (202) 739-9446 or dbernstein@nareit.com to discuss in more detail.

Respectfully submitted,

Tony M. Edwards
Executive Vice President and General Counsel