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**NATIONAL ASSOCIATION OF  
REAL ESTATE INVESTMENT TRUSTS®**

July 9, 2009

**HAND DELIVERED**

The Honorable Michael Mundaca  
Deputy Assistant Secretary (International Tax Affairs)  
U.S. Department of the Treasury  
1500 Pennsylvania Avenue, N.W.  
Room 3045  
Washington, D.C. 20220

The Honorable Douglas H. Shulman  
Commissioner  
Internal Revenue Service  
1111 Constitution Avenue, N.W.  
Room 3000  
Washington, D.C. 20224

Re: Elective Stock Dividends/Extension and Amplification of Rev. Proc. 2009-15

Gentlemen:

The National Association of Real Estate Investment Trusts® (NAREIT) requests a two-year extension and amplification of Rev. Proc. 2009-15, 2009-4 I.R.B. 356, *amplifying and superseding* Rev. Proc. 2008-68, 2008-52 I.R.B. 1373 (together, the Guidance), which formalized the conclusions reflected in several private letter rulings concerning elective stock dividends by real estate investment trusts (REITs) when shareholders have the ability to elect to receive either cash or stock subject to a cap on the aggregate amount of cash that the REIT will distribute.

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.



The Honorable Michael Mundaca  
The Honorable Douglas H. Shulman  
July 9, 2009  
Page 2

This submission supplements NAREIT's letter dated May 28, 2009 regarding the Treasury Department's and the IRS' 2009-2010 Guidance Priority List. Please note that the issues raised in this submission represent NAREIT's foremost regulatory priority.

NAREIT very much appreciates the past issuance of the Guidance by the IRS and Treasury Department in response to the current financial crisis and ongoing recession that engender a highly constrained credit market and an extremely illiquid property market. In addition to a two-year extension of the Guidance, we also urge that the Guidance should be clarified to: 1) specify that such elective dividends are not preferential merely because they are calculated by reference to a multi-day trading period; and, 2) apply with equal force to non-listed REITs.

NAREIT additionally requests that extended Guidance should be written to indicate that: 1) the IRS will not apply the "disguised sale" rules of section 707(a)(2)(B)<sup>1</sup> to elective stock dividends distributed by those publicly traded REITs that own and operate their properties through limited operating partnerships<sup>2</sup> (OPs) in which limited partners are entitled to distributions equal to those made by the REIT to its shareholders; and, 2) an OP that receives REIT stock from its REIT general partner for purposes of making such a distribution obtains a fair market value basis in the stock so that limited partners who receive REIT stock from the OP will have a fair market value basis in the stock. Absent this policy, almost two-thirds of publicly traded REITs could face potential tax consequences sufficiently adverse as to discourage them from distributing an elective stock dividend under the Guidance or any extension thereof, thereby thwarting its policy goal of capital conservation.

We note that the trade association for the mutual fund industry, the Investment Company Institute, requested a one-year extension of the Guidance in its letter to the Treasury Department and IRS dated May 28, 2009. However, NAREIT believes that the magnitude of the credit crisis in combination with the security the elective dividend procedure will provide to REITs so that they can meet mandatory distribution requirements strongly support a two-year extension. Of course, because the market views REITs as income generators, there will be continuous private sector pressure on REITs to maximize their cash distributions consistent with prudent business judgment. As a result, it is expected that REITs will use the elective stock dividend procedure with substantial caution and only when truly necessary to conserve needed capital.

Extension and amplification of such Guidance is consistent with the Administration's other initiatives to resuscitate the credit markets and the economy, such as its efforts to partly address the credit crisis affecting the commercial real estate industry through the Term Asset-Backed Securities Loan Facility.

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<sup>1</sup> Unless otherwise provided, all section references are to the Internal Revenue Code of 1986, as amended.

<sup>2</sup> Including limited liability companies or other entities treated as partnerships for federal income tax purposes.



## DISCUSSION

### I. Ongoing Liquidity and Credit Crunch Continues to Limit Flexibility

In order for a company to maintain its qualification as a REIT, among other requirements, it must distribute at least 90% of its taxable income annually (the 90% Test).<sup>3</sup> To the extent that a REIT distributes its income, it generally may claim a dividends paid deduction (DPD) for the dividend distributed.<sup>4</sup> This rule requires a distribution of a significant amount of a REIT's cash flow in order to avoid adverse tax consequences.

In the midst of the severe credit crisis underway and the clearly contracting economy, distribution of taxable income solely in cash may be a burden at odds with long-term shareholder interests for some companies. Notably, there is no minimum distribution test applicable to non-REIT C corporations (other than mutual funds) to avoid adverse tax consequences should they wish to retain additional capital for corporate purposes such as paying down debt obligations.

The ongoing freeze in the credit markets has made it difficult to refinance real estate debt even with respect to properties that are performing well. Current data continue to indicate that the credit markets have not improved since the end of 2008. For example, approximately \$400 billion of commercial real estate debt is expected to mature in 2009, and another \$800 billion is expected to mature in 2010 and 2011. Publicly traded equity REITs have maintained a conservative leverage ratio (total debt divided by total market capitalization): 43% at the end of 2007 and 56% as of May 31, 2009, with the increase primarily due to declines in share price as a result of market turmoil. Two of the most common sources of financing, the commercial mortgage backed securities (CMBS) market and commercial banks, are currently not in a position to effectively provide necessary financing in the coming years. As an example, there have been no issuances of CMBS since the first half of 2008.

Furthermore, the most recent Federal Reserve data on Form H-8 (dated July 2, 2009) provide additional evidence of the continued contraction of bank debt. This data indicate that commercial banks had \$1,736.6 billion outstanding in commercial real estate loans as of December 2008, and that amount had declined to \$1,710.8 billion as of June 24, 2009.<sup>5</sup> In addition, a Treasury study dated June 15, 2009 of the top 21 participants in the U.S. Treasury's Capital Purchase Program shows a 20% decrease in renewals of commercial real estate (CRE) loans and a 23% decrease in new CRE loan commitments as of April 2009 compared to March 2009.<sup>6</sup> The study states: "Finally, nearly all respondents indicated that they are actively reducing their exposure to CRE loans, as banks expect CRE loan delinquencies to increase over the coming year."

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<sup>3</sup> Section 857(a)(1).

<sup>4</sup> To the extent a REIT retains taxable income above the 90% distribution requirement, it is subject to the usual corporate-level tax.

<sup>5</sup> <http://www.federalreserve.gov/releases/h8/Current/h8.pdf>.

<sup>6</sup> <http://financialstability.gov/docs/surveys/SnapshotAnalysisApril2009.pdf>.



As an additional example, a credit ratings agency stated in a report dated June 23, 2009: “Fitch Ratings believes the maintenance of sufficient liquidity represents the primary credit risk to U.S. equity REITs despite recent opportunistic actions to reduce financial pressures.” Please see Exhibit A for more data regarding the expected maturities of commercial real estate debt over the next several years.

## **II. Rev. Proc. 2009-15**

Issued in response to the most serious financial crisis since the Great Depression, Rev. Proc. 2008-68, and later, Rev. Proc. 2009-15, temporarily formalized the conclusions in a number of private letter rulings involving elective stock dividends, so that the entire distribution would be treated as a dividend.<sup>7</sup> Pursuant to the Guidance, effective for all distributions declared on or after January 1, 2008, a dividend paid by a listed REIT partly in stock as well as in cash qualifies for the DPD. The Guidance allows listed REITs to utilize a 10% minimum cash floor offer to shareholders for dividends declared with respect to taxable years ending on or before December 31, 2009.

Rev. Proc. 2009-15 does not specify the exact formula for determining the number and value of the shares to be received by any shareholder. Instead, it requires that “[t]he calculation of the number and value of shares to be received by any shareholder will be determined, as close as practicable to the payment date, based upon a formula utilizing market prices that is designed to equate in value the number of shares to be received with the amount of money that could be received instead.”

The REITs that have used the Guidance<sup>8</sup> have been able to conserve capital during an extremely challenging and difficult environment in the debt finance marketplace and for the economy as a whole. Additionally, the mere existence of the Guidance provides a measure of security to the market with respect to REITs.

## **III. Distribution of Elective Stock Dividends by REITs with OPs: Potential Tax Uncertainty**

### **A. Background: Umbrella Partnership REITs (UPREITs)**

A REIT in the UPREIT structure (itself, the UPREIT) typically owns a general partnership and limited partnership interest in an OP that owns and operates all of the REIT’s properties.<sup>9</sup> The

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<sup>7</sup> See PLRs 20085202, 20085002, 200832009, 200817031, 200618009, 200615024, 200406031, 200348020, and 200122001. Since the issuance of Rev. Proc. 2008-68, the IRS has issued the following PLRs as well: 200906040, 200915032, and 200917020.

<sup>8</sup> For a list of the REITs that have made elective stock dividends in 2009, see <http://www.reit.com/IndustryDataPerformance/ElectiveStockDividends/tabid/453/Default.aspx>.

<sup>9</sup> Typically, the REIT holds a majority interest (in many cases, over 90%) in the OP. Because the REIT’s distribution of an elective stock dividend typically results in the issuance of additional REIT shares, the REIT must acquire additional OP units. Another OP structure used less often is known as the “DownREIT” structure. This structure is similar to an UPREIT except that the REIT typically owns only one or more (but not all) of its properties



OP's limited partners are entitled to receive distributions from the OP equivalent to those distributions to which REIT shareholders are entitled, and at some point, are entitled to exchange on a one-to-one ratio their OP units for REIT stock or the value of such stock in cash, at the election of the REIT or OP (depending how the OP was established). As of May 31, 2009, approximately two-thirds of all publicly traded REITs (by market capitalization) were in the UPREIT format.

Exhibit B lists the 134 publicly traded REITs (without names) and their respective OP interests as of June 30, 2009. In the vast majority of cases, the REIT's interest in its OP exceeds two-thirds.

#### B. UPREITs and Elective Stock Dividends

The UPREIT structure is designed so that when the REIT makes any distribution to its shareholders, the other limited partners in the OP are entitled to receive an equivalent proportionate distribution. This distribution policy is preserved by the UPREIT's retention of the same number of OP units as the number of REIT shares outstanding. As a result of these mechanics, an UPREIT that plans an elective stock dividend typically will need to ensure that the limited partners of its OP receive a combination of REIT stock and cash in the same proportions received by the REIT shareholders. If the limited partners receive just cash and additional OP units, they will be disadvantaged as a practical matter, because typically the amount of cash received will be insufficient to pay their federal tax liability on the income allocated to them. Furthermore, if they dispose of the OP units issued to them in the distribution to raise funds to pay this tax liability — and there may well be transfer restrictions that would limit or prevent such dispositions — they will generate taxable income in excess of that faced by UPREIT shareholders.<sup>10</sup>

From a business and equity standpoint, an UPREIT distributing an elective stock dividend under the Guidance would want to distribute cash and REIT stock to the OP limited partners in the same proportions as to REIT shareholders. However, unless the OP were to borrow money or use its constrained capital to acquire such REIT stock on the open market, a concern has been raised about a possible IRS assertion that the OP's acquisition of the REIT stock from the REIT (through a capital contribution or purchase from the REIT) could be viewed as a "disguised sale" of partnership interests from the OP's limited partners to the REIT. Obviously, such a result would have sufficiently adverse consequences for the OP's limited partners that UPREITs would feel pressured not to use the Guidance or to distribute 100% cash or to use precious capital to

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through one or more OPs. Like the limited partners in an UPREIT, DownREIT limited partners similarly are entitled to receive OP distributions based on the distributions made by the REIT to its shareholders.

<sup>10</sup> The limited partners will not receive a stepped up basis in the OP units and will recognize additional gain if they sell these newly received units because the partnership basis rules treat partners as having a single blended basis in all of their partnership interests, and do not separately track basis to units acquired at different times and for different consideration. *See* Rev. Rul. 84-53, 1984-1 C.B. 159 ("Consistent with the provisions of Subchapter K of the Code, a partner has a single basis in a partnership interest . . .").



acquire REIT stock on the open market despite the Guidance's policy to encourage capital conservation.

The transaction could be considered a "disguised sale" under section 707(a)(2)(B) because the REIT's partnership interest in the OP will increase — albeit by a nominal or *de minimis* amount — and the limited partners' interests will decrease, again by a nominal or *de minimis* amount. For example, if the REIT owns 60% of the OP and pays a 9% annual dividend (90% in stock and 10% in cash), the REIT's percentage interest in the partnership will go up by less than 3% a year as the REIT would be getting 60% of the additional units distributed by the OP anyway, and the only shift will be with respect to the 3.24% the limited partners would have received if they had received units instead of REIT stock.<sup>11</sup> If the transaction is a disguised sale, limited partners would be forced to recognize gain based on the value of the REIT stock received less their adjusted basis in the portion of the partnership interest treated as sold (as compared to utilizing a limited partner's adjusted basis in its entire partnership interest if the transaction is treated as a partnership distribution). In addition, UPREIT OP agreements may contain transfer restrictions designed to make sure the OP does not become a publicly traded partnership (PTP). As a result of this potentially adverse tax treatment and PTP transfer restrictions, UPREITs may be disinclined to use the elective stock dividend procedure notwithstanding their need to conserve capital.

From a policy perspective, if there is continued uncertainty about the application of the disguised sales rules to distributions of REIT stock by OPs in connection with elective stock dividends, there will be pressure on REITs in the UPREIT format not to utilize the provisions of the Guidance. Because the REIT is the general partner of the partnership, it has fiduciary obligations to the limited partners as well as to the REIT shareholders, and has to take account of the limited partners' interests in deciding whether to utilize an elective stock dividend in the first instance.

In order to provide the limited partners with a distribution equivalent to that the distribution paid to the REIT shareholders, the OP will want to distribute the same combination of REIT stock and cash to the limited partners as the REIT distributes to its shareholders. However, unless it borrows and/or uses its own capital to acquire the REIT stock on the open market, it faces the possibility that the IRS could treat the limited partners as having made a disguised sale of a portion of their partnership interests to the REIT.<sup>12</sup> Borrowing or using capital to acquire REIT stock would diminish the capital of the partnerships at a time and in an economic climate in which capital is critical to the REIT industry's ability to cope with the economic crisis. The Guidance helps solve this critical problem for non-UPREITs but since most public REITs are

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<sup>11</sup> For example, if an OP with 1,000 units outstanding, 600 owned by the REIT and 400 owned by the limited partners, distributes 81 units (90% of .09% of 1,000), pro rata to its partners, the REIT will own 648.6 out of 1,081 post distribution, or 60%. If, instead, the REIT contributes 32.4 shares of stock for distribution to the limited partners, and receives all 81 units, the REIT will own 681 out of 1,081 units, or 60%. If, instead, the REIT contributes 32.4 shares of stock for distribution to the limited partners, and receives all 81 units, the REIT will own 681 out of 1,081 units, or just under 63%. This represents a shift of only 3% a year, or .75% for each quarterly dividend.

<sup>12</sup> Some have even suggested that open market purchases could be subject to the disguised sale rules.



UPREITs, published guidance that favorably addresses this issue is critical to the full realization of the Guidance's goals. Another alternative of having the OP distribute 100% cash to the limited partners would favor the limited partners over the REIT shareholders and similarly would be contrary to the policy of capital conservation.

Additionally, there are technical arguments confirming that the transaction ought not to be treated as a disguised sale. Under section 707(a)(2)(B), a transaction is not treated as a partnership transaction if there is a transfer of money or other property by a partner to a partnership, there is a related transfer of money or other property by the partnership to another partner, and the transfers, when viewed together, are properly characterized as a sale of a partnership interest. Instead, the transaction is treated either as a sale of a partnership interest, or as a partial sale and a partial partnership contribution.<sup>13</sup>

Section 707(a)(2)(B) is to be applied “[u]nder regulations prescribed by the Secretary,”<sup>14</sup> and while regulations for the disguised sale of property to and by a partnership were published in 1992,<sup>15</sup> regulations for the disguised sale of a partnership interest have not been enacted. The Service and the Treasury Department have noted, however, that regulations for the disguised sale of a partnership interest should be “narrower” than the existing regulations for the disguised sale of property, because many more transactions may potentially be subject to the regulations for the disguised sale of a partnership interest.<sup>16</sup>

Proposed regulations for the disguised sale of a partnership interest were issued in 2004,<sup>17</sup> but were subsequently withdrawn.<sup>18</sup> The now-withdrawn proposed regulations were to apply to transactions with respect to which “all transfers considered part of a sale” occur on or after the date the regulations are published as final regulations.<sup>19</sup> For transactions prior to that date, a determination of disguised sale treatment is to be made based on the statutory language and the guidance provided in the legislative history of section 707(a)(2)(B).<sup>20</sup> Similarly, the notice of withdrawal of the proposed regulations indicates that “[u]ntil new guidance is issued, any determination of whether transfers between a partner or partners and a partnership is a transfer of a partnership interest will be based on the statutory language, guidance provided in legislative history, and case law.”<sup>21</sup>

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<sup>13</sup> Staff of the Joint Committee on Taxation, General Explanation of the Revenue Provisions of the Deficit Reduction Act of 1984 (JCS-41-84), at 231 (1984) (the Joint Committee Report); H.R. Rep. No. 861, 98<sup>th</sup> Cong., 2d Sess. 861 (1984) (the Conference Report); S. Rep. No. 169, volume 1, 98<sup>th</sup> Cong., 2d Sess. 230 (1984) (the Senate Report); H.R. Rep. No. 432, part 2, 98<sup>th</sup> Cong., 2d Sess. 1220 (1984) (the House Report).

<sup>14</sup> Section 707(a)(2)(B).

<sup>15</sup> T.D. 8439, 1992-2 C.B. 126 (September 30, 1992).

<sup>16</sup> Section 707 Regarding Disguised Sales, Generally, 2004-2 C.B. 1009, 1010 (published in the Federal Register on November 26, 2004).

<sup>17</sup> *Id.* at 1009.

<sup>18</sup> Withdrawal of Notice of Proposed Rulemaking, 74 Fed. Reg. 3508, 3509 (January 21, 2009) (“The Treasury Department and the IRS ... have decided to withdraw the proposed regulations.”).

<sup>19</sup> Section 707 Regarding Disguised Sales, Generally, 2004-2 C.B. at 1014 (cited in note 16).

<sup>20</sup> *Id.* at 1014-15.

<sup>21</sup> Withdrawal of Notice of Proposed Rulemaking, 74 Fed. Reg. at 3509 (cited in note 18).



If the proposed regulations applied to this transaction, there would generally not be a disguised sale because proposed Treas. Reg. § 1.707-7 provided an exception for operating cash flow distributions, defined by cross-reference to Treas. Reg. § 1.707-4 (relating to disguised sales of property to a partnership). Inasmuch as the distributions in question are intended to permit the REIT to pay sufficient dividends to satisfy the REIT requirements, it is likely that they would fit any exception for operating cash flow distributions that is likely to be included in regulations implementing rules for disguised sales of partnership interests. In this regard, it is important to remember that the question of a disguised sale arises only if one partner makes a contribution for partnership interests, and another partner receives a distribution, and even in that context the proposed regulations had provided for an exception for operating cash flow distributions.

The legislative history of section 707(a)(2) indicates that, in enacting section 707(a)(2)(B), Congress was concerned that taxpayers could defer or avoid tax on sales of property, including partnership interests, by characterizing sales as contributions of money or other property, followed or preceded by a related partnership distribution.<sup>22</sup> Factors indicating the existence of a disguised sale include closeness in time of the contribution and the distribution, and apparent tax motivation.<sup>23</sup> At the same time, congressional reports noted that Congress was not concerned with “non-abusive transactions that accurately reflect the various economic contributions of the partners.”<sup>24</sup>

NAREIT believes the proposed transaction does not implicate the concerns that motivated Congress to enact section 707(a)(2)(B). In particular, the parties to the proposed transaction do not intend to effectuate the economic equivalent of a sale of a partnership interest even though the REIT’s interest in capital and profits of the OP will be increased nominally. Instead, the REIT is merely contributing its stock to the OP (or the OP is buying the stock from the REIT, with the REIT using the cash to buy additional OP units) to enable the OP to make the distribution and each limited partner is merely receiving its pro-rata distribution from the OP in the form of REIT stock. The OP’s intention is to make distributions to the limited partners that are equivalent in value and form to distributions made by the REIT with respect to its stock. The most effective and direct way to accomplish this objective is for the OP to distribute REIT stock to the extent the REIT distributes its stock.

Furthermore, it also seems anomalous for limited partners to be treated worse when they are distributed stock under an application of the disguised sale rules than if the limited partners had simply received cash in respect of the shares of partnership income, but that is what will happen if the disguised sale rules are applied to treat the limited partners as if they had additional gain on the sale of low basis partnership interests (that simply correspond to the partnership income already allocated) and taxable to the limited partners. It is unlikely this was what Congress was concerned with in the disguised sale context, especially as is noted above; any shift of

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<sup>22</sup> Joint Committee Report, at 226 (cited in note 13); Conference Report, at 860 (cited in note 13); Senate Report, at 225 (cited in note 13); House Report, at 1218 (cited in note 13).

<sup>23</sup> Joint Committee Report, at 232 (cited in note 13).

<sup>24</sup> Joint Committee Report, at 231 (cited in note 13). *See also* Senate Report, at 230 (cited in note 13); House Report, at 1220 (cited in note 13).



partnerships interest from the OP's limited partners to the REIT is likely to be nominal or *de minimis*.<sup>25</sup>

#### IV. Requests

##### A. Two-Year Extension of the Guidance

The ongoing disequilibrium in the credit markets has made it extremely challenging for REITs as well as other real estate owners to refinance debt, thereby increasing the importance of conserving cash from both operations and asset sales to repay debt. Accordingly, many REITs would prefer to use an elective stock dividend structure such as that described above as a means to satisfy the 90% Test and to distribute capital gain income, thereby permitting them to husband cash for use in managing their balance sheets in the midst of the pervasive credit crisis.

As a result of the foregoing, NAREIT respectfully requests a two-year extension of Rev. Proc. 2009-15 to apply to distributions declared with respect to a taxable year ending on or before December 31, 2011.

##### B. Conclusion That Elective Stock Dividend under the Guidance is Non-Preferential if Two-Week Pricing Formula Used

Additionally, it would be extremely helpful if the IRS and the Treasury Department also concluded (both for the existing Guidance and any extended guidance) that an elective stock dividend issued pursuant to Rev. Proc. 2009-15 (as extended) would not be considered a "preferential" dividend under section 562(c) so long as the calculation of the number and value of shares to be received by any shareholder is determined by a pre-agreed upon formula using up to at least a two-week multi-day pricing average. Treas. Reg. § 20.2031-1(b) defines "fair market value" as "the price at which the property would change hands between a willing buyer and a willing seller, neither being under any compulsion to buy or to sell and both having reasonable knowledge of relevant facts." This regulation indicates that a formula to determine the number and value of REIT shares to be distributed that is agreed upon in advance can be just as indicative of fair market value as an exactly set number of REIT shares that similarly is agreed upon in advance.

As a result, this formula should be viewed, in the words of the Guidance, as a formula that utilizes market prices "designed to equate in value the number of shares to be received with the amount of money that could be received instead." Furthermore, the fact that there may be an increase or decrease in the REIT's trading price once the number of REIT shares is determined pursuant to this pre-agreed formula should be irrelevant to the determination of whether the elective stock dividend is preferential.<sup>26</sup>

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<sup>25</sup> NAREIT understands if the Treasury and IRS would want to limit this policy to a specific *de minimis* shift of partnership interests.

<sup>26</sup> Indeed, the fact that there may be other contemporaneous sales at different prices does not distract from the fair market price set by reference to a multi-day trading period. There are many trades at different prices each day of a



Again, NAREIT very much appreciates the Treasury Department's and IRS' release of the Guidance. Because the formula for determining the number and value of shares of REIT stock to be distributed is somewhat open-ended, we understand that a number of REITs are pursuing further private guidance concerning valuation with the IRS. As a means of reducing the use of IRS resources in connection with this determination, it would be helpful for any extension of the Guidance to include at least a minimum number of days, *e.g.*, two weeks, which could be used as the basis for a formula based upon multi day trading.

C. The Guidance Should Apply to Non-listed REITs

We understand that the Guidance was limited to listed REITs primarily because the government had concerns about how the 10% cash minimum would be applied to REIT stock that was not readily valued by reference to an established securities market. As stated in our original submission dated October 31, 2008, NAREIT believes that the principles behind the many private letter rulings issued in past years, and as formalized by the Guidance, apply with equal force to non-listed REITs. As with other applications of tax laws to specific facts, non-listed REITs will need to be comfortable in applying the Guidance to sustain their valuation conclusions if later questioned upon audit. However, NAREIT sees no reason why non-listed REITs should be precluded from benefiting from the Guidance since the tax rules apply with equal force to listed and non-listed REITs and non-listed REITs face the same liquidity challenges as listed REITs.

D. Disguised Sales Rule Should Not Apply to UPREITs During Effective Period of the Guidance, As It May Be Extended

NAREIT also requests that the IRS and Treasury Department issue guidance under which the government affirms that it will not apply the "disguised sale" rules of section 707(a)(2)(B) to elective stock dividends distributed by those publicly traded REITs that own and operate their properties through the UPREIT structure<sup>27</sup> and that an OP which receives REIT stock from its REIT, whether purchased by the OP from the REIT for cash (which the REIT reinvests in OP units), or contributed by the REIT for OP units obtains a fair market value basis in the stock so that the other limited partners who receive REIT stock from the OP will have a fair market value basis in the stock. This conclusion is consistent with both the spirit of Treas. Reg. § 1.1032-3, and to section 704(c)(1)(B)(iii) (although under section 1032 the REIT will not actually recognize gain on the stock). Under this conclusion, the limited partners also would receive a stepped-up basis in the REIT stock they obtain from the OP as part of an elective stock dividend.

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publicly traded stock, without concern that each trade sets a fair market value price between the particular buyer and seller. In other words, there is no absolute fair market price. *See* Rev. Proc. 75-468, 1975-2 C.B. 115 (because a redemption premium in excess of 10% arose solely as a result of market conditions and was not bargained for or intended by the parties, it was a reasonable redemption premium within the meaning of section 305(c) and Treas. Reg. § 1.305-5(b)). *See generally* Treas. Reg. § 1.368-2 (fluctuations in market value have no effect on whether "continuity of interest" exists in the context of a tax-free reorganization under Section 368 if certain conditions are met).

<sup>27</sup> NAREIT also requests that this policy apply with equal force to REITs owning properties through DownREIT partnerships.



The Honorable Michael Mundaca  
The Honorable Douglas H. Shulman  
July 9, 2009  
Page 11

Please contact Tony Edwards, NAREIT's Executive Vice President & General Counsel, at [tedwards@nareit.com](mailto:tedwards@nareit.com) or Dara Bernstein, NAREIT's Senior Tax Counsel, at [dbernstein@nareit.com](mailto:dbernstein@nareit.com) to further discuss these issues.

Respectfully submitted,



Steven A. Wechsler  
President & CEO

Enclosures (2)

Exhibit A: PowerPoint Presentation Concerning the Credit Crisis for Commercial Real Estate  
Exhibit B: List of Publicly Traded REITs and Ownership Interests in Operating Partnerships

cc: Clarissa C. Potter, Esq.  
Eric A. San Juan, Esq.  
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Jeffrey Van Hove, Esq.  
Michael S. Novey, Esq.  
William D. Alexander, Esq.  
Stephen R. Larson, Esq.



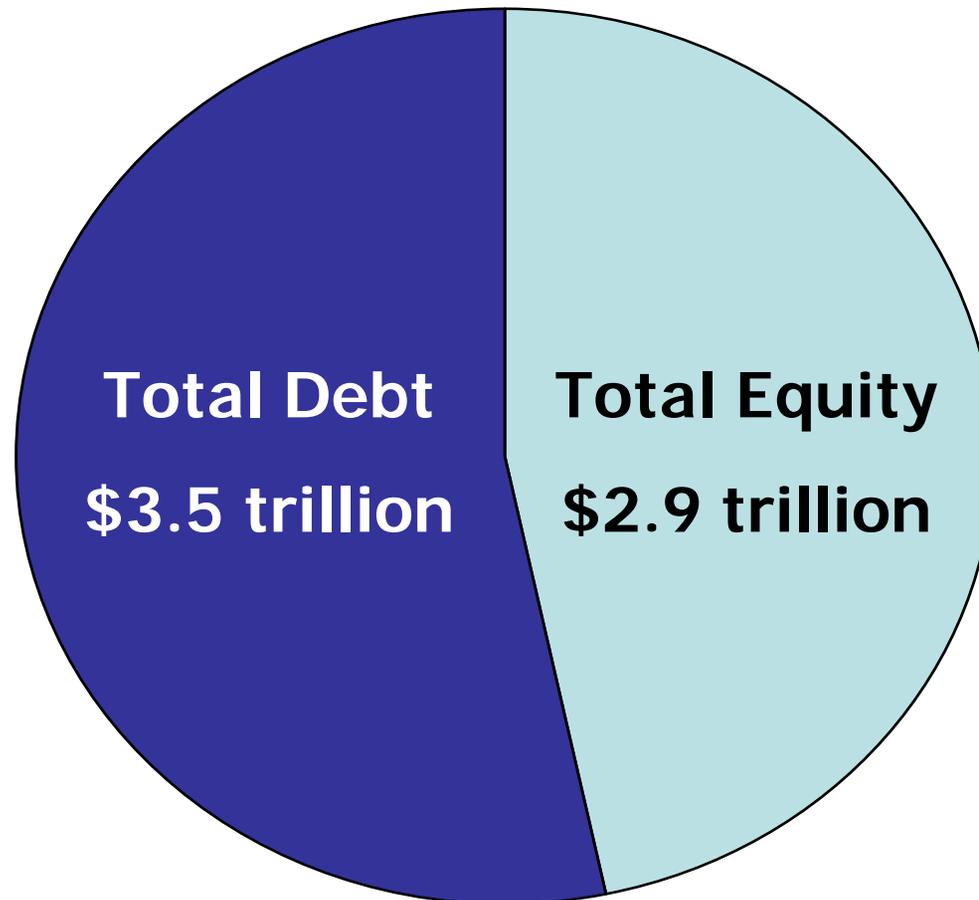
# The Credit Crisis in Commercial Real Estate

# Summary

- Commercial real estate accounts for a meaningful 6% of GDP
- Commercial real estate entered the recession reasonably well balanced
- However, approximately \$400 billion of CRE debt matures in 2009, and another \$800 billion matures in 2010 and 2011
- According to S&P, another \$800 billion of corporate debt matures on 2009
- Two largest sources of CRE debt have been banks and CMBS
- Banks are not lending, and the CMBS market is closed
- Bid-ask spreads remain large, and assets cannot be sold
- Performing loans must be refinanced to avoid asset price deflation
- AAA-rated debt requires Treasury support to establish price discovery

# Commercial Real Estate Debt and Equity

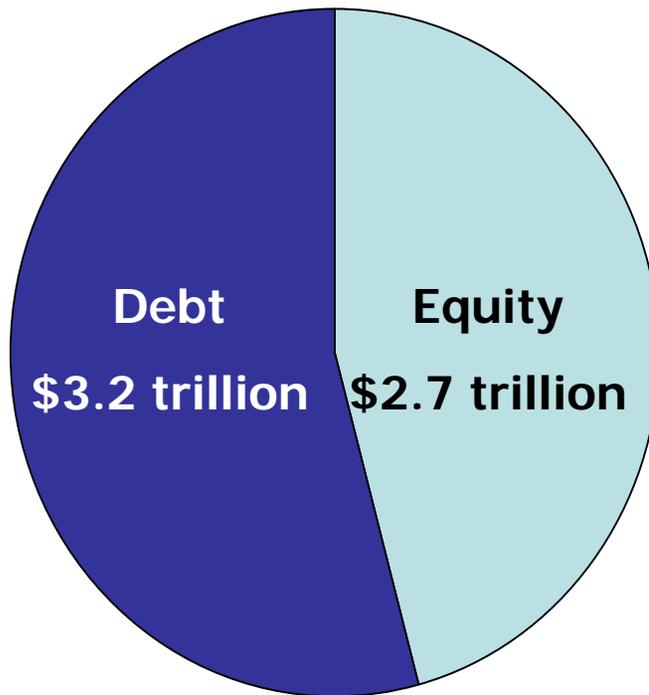
Investment-grade, income-producing real estate  
\$6.4 trillion as of December 2008



# Commercial Real Estate Debt and Equity

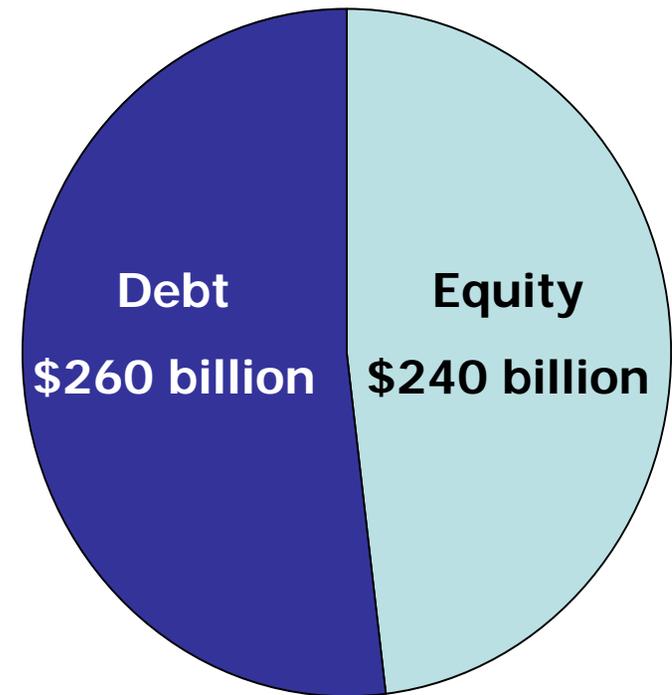
## Public and Private Ownership as of December 2008

### Private Ownership



**\$5.9 trillion**

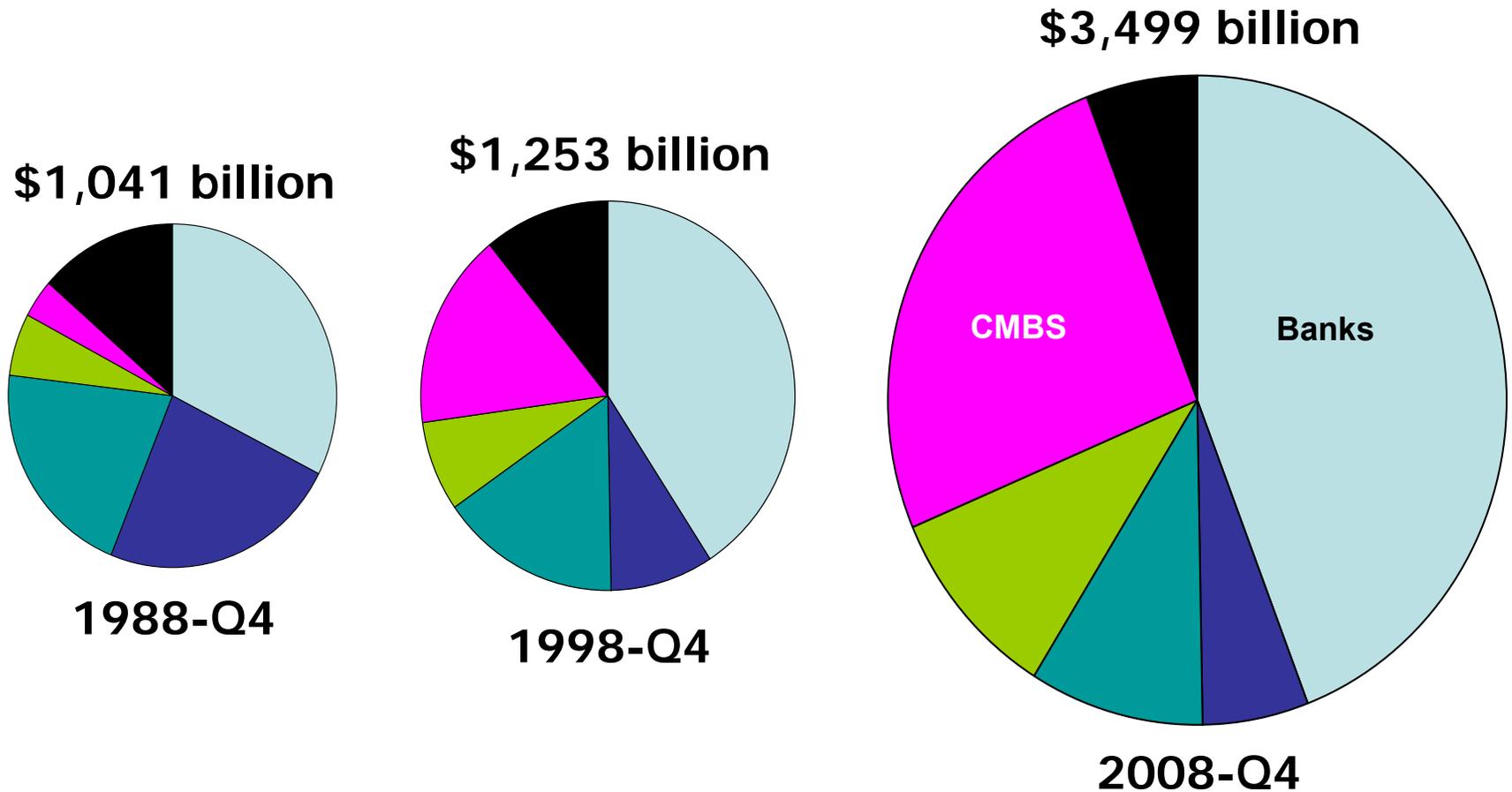
### Public Ownership



**\$0.5 trillion**

# Commercial Mortgage Debt Outstanding

## By source of funds



Source: Federal Reserve Flow of Funds Accounts of the United States



# Publicly Traded Real Estate Equity (REITs)

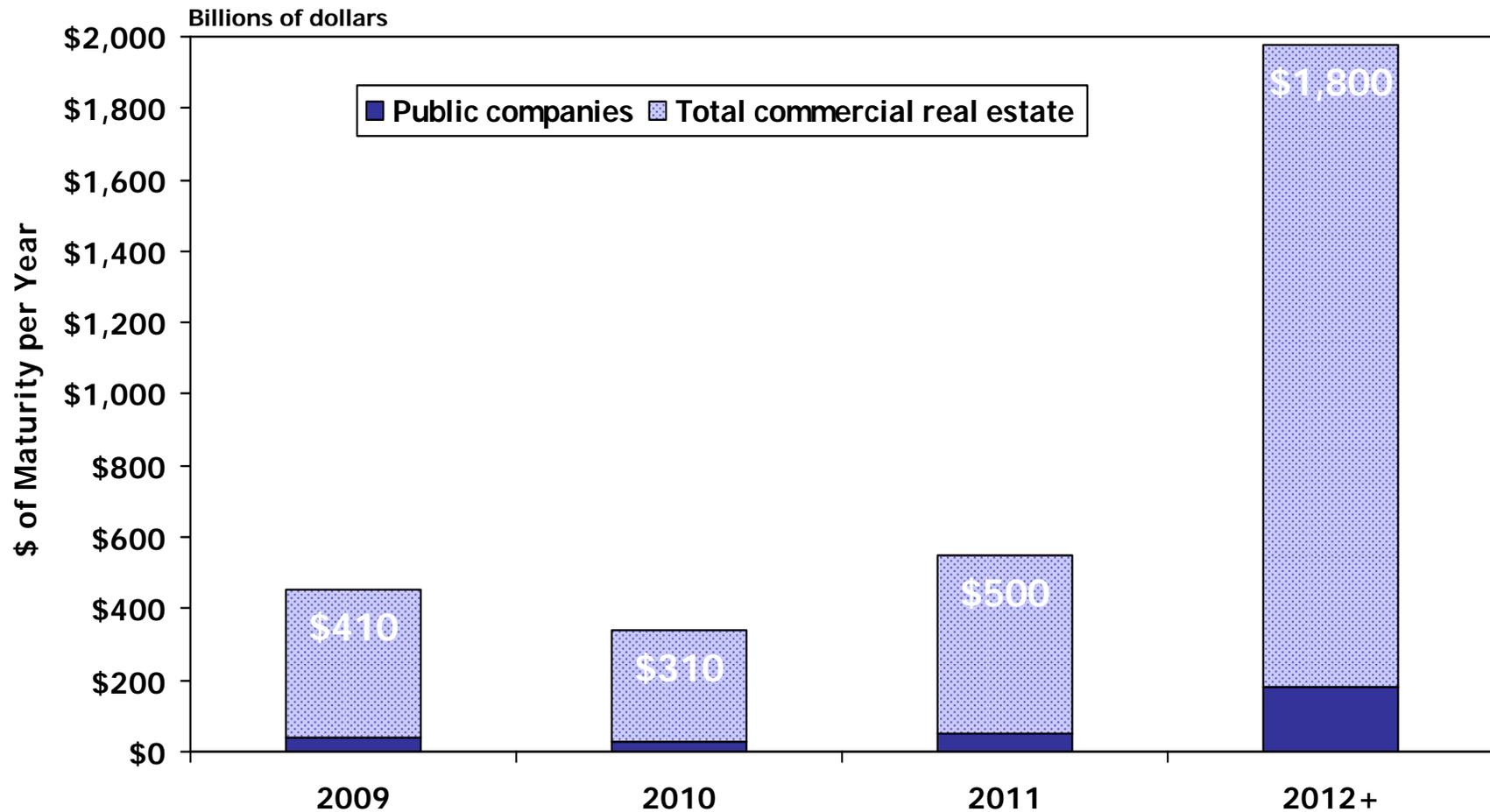
## A window on commercial real estate equity finance

- 93 companies listed on the NYSE
- 72% investment grade by equity market capitalization
- \$500 billion of property owned as of December 31, 2008
- Current leverage ratio of 56% compared with 43% at the end of 2007
- Fixed charge ratio of 2.5 at 2009:Q1 compared with 2.7 at 2007:Q4
- \$17.7 billion of dividends paid to shareholders in 2008
- Average daily trading volume of \$4 billion to \$5 billion
- Share prices lead measured property valuations by 5-6 quarters
  - Share prices peaked early in 2007 and may have bottomed early in 2009

# Commercial Real Estate Debt Maturities

## Including secured and unsecured debt

### Debt Maturities by Year



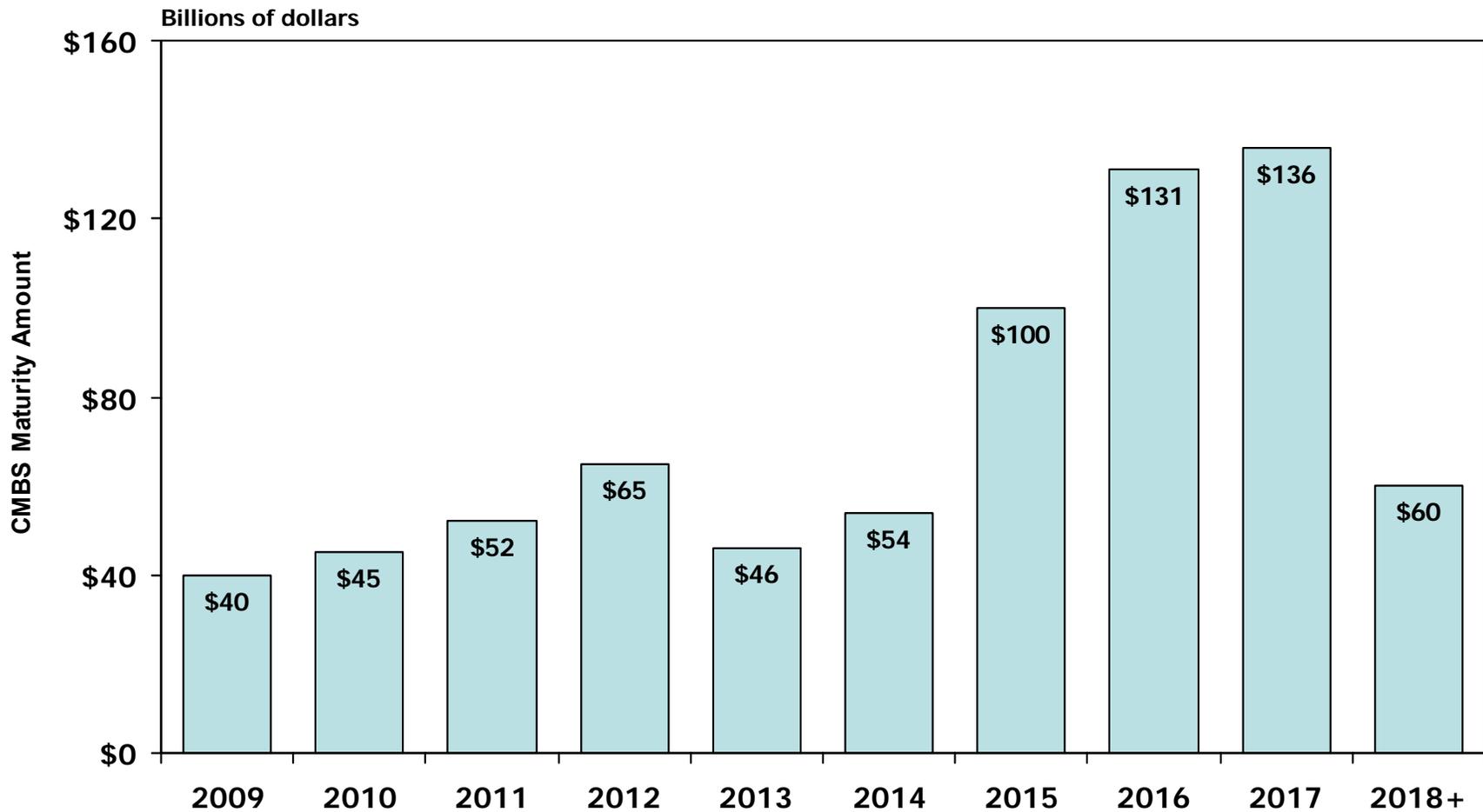
Sources: Goldman Sachs and REIT filings

# Publicly Traded Real Estate Debt (CMBS)

## A window on commercial real estate debt finance

### Annual maturity schedule

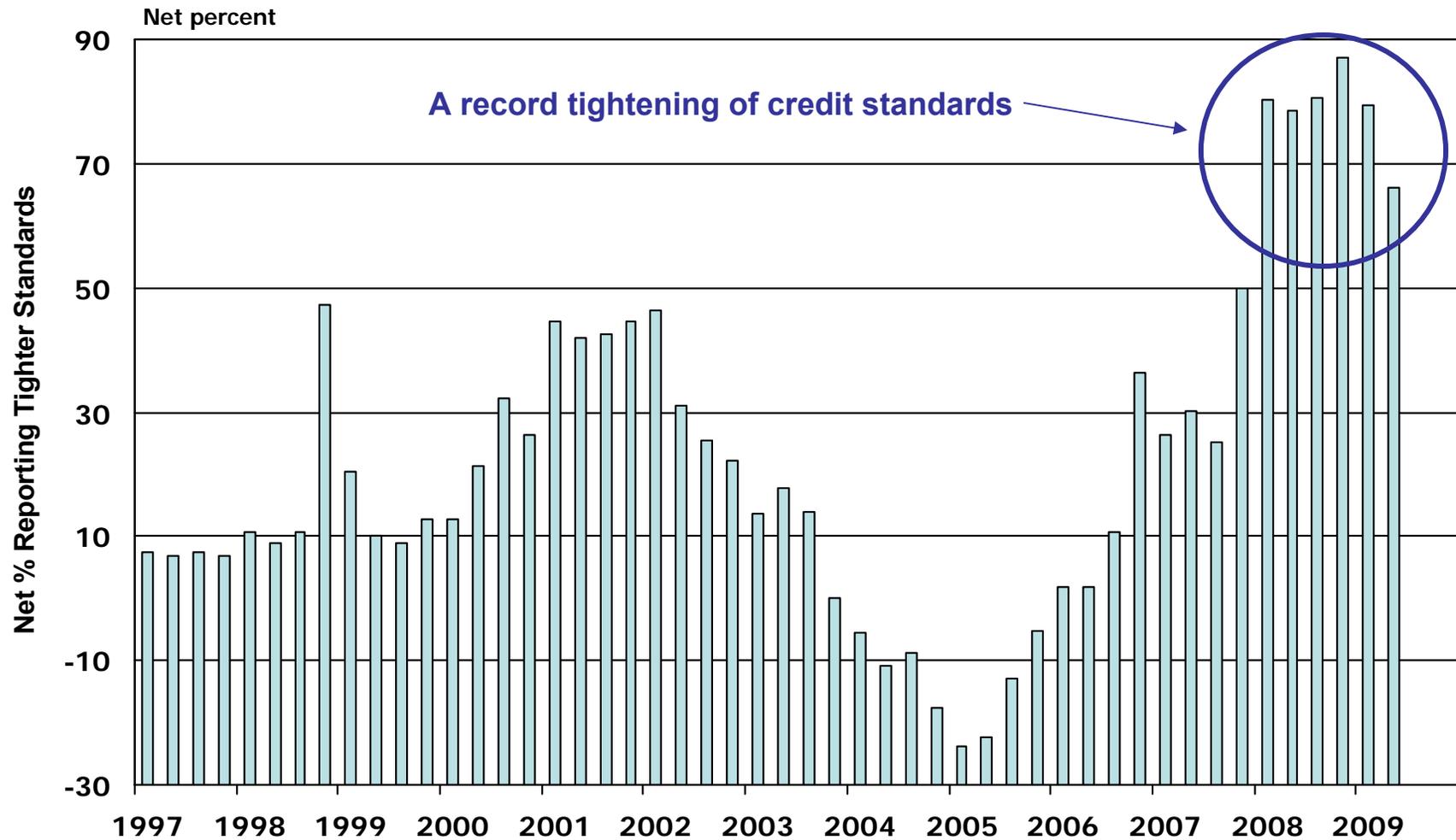
Overall U.S. CMBS Maturities by Year



Sources: Goldman Sachs and Trepp

# Commercial Real Estate Loans at Banks

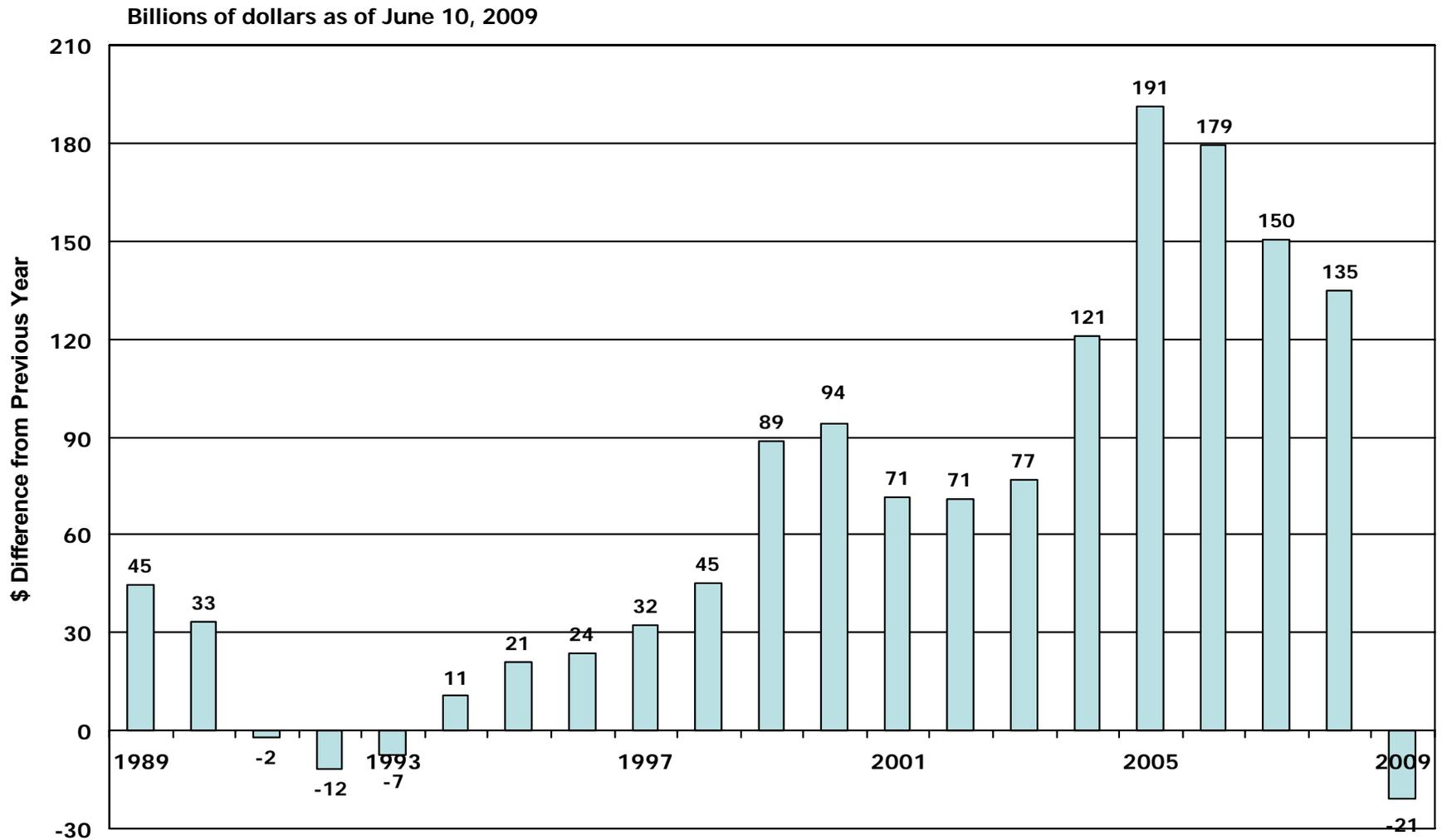
## CRE credit standards: 1997:Q1 – 2009:Q2



Source: Federal Reserve Board Senior Loan Officer Opinion Survey on Bank Lending Practices (April 2009)

# Commercial Real Estate Loans at Banks

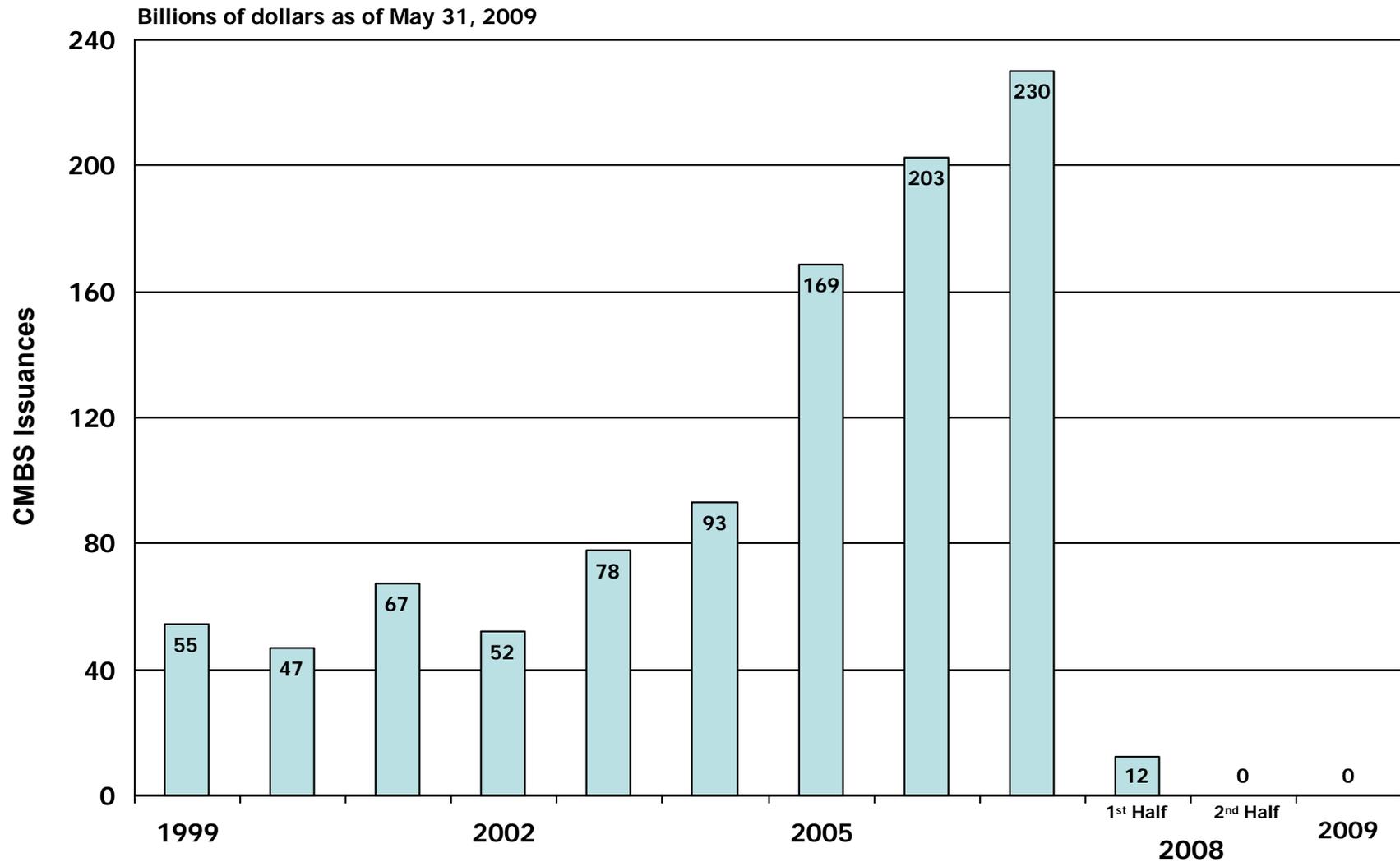
## CRE lending volume: 1989 - 2009



Source: Federal Reserve Board

# Securitized Commercial Real Estate Loans

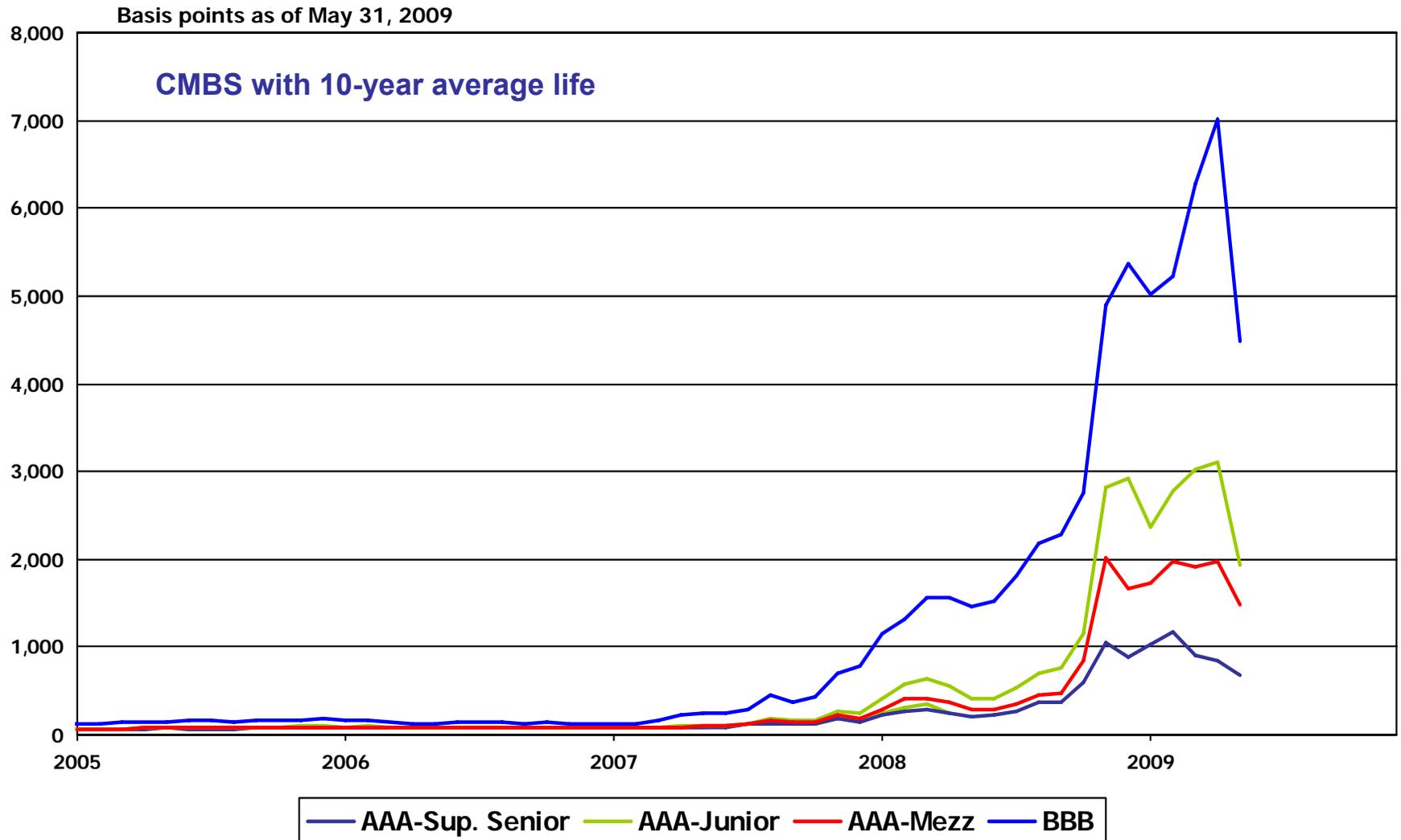
## CMBS issuance volume: 1999 - 2009



Source: Commercial Mortgage Securities Association

# CMBS Credit Spreads

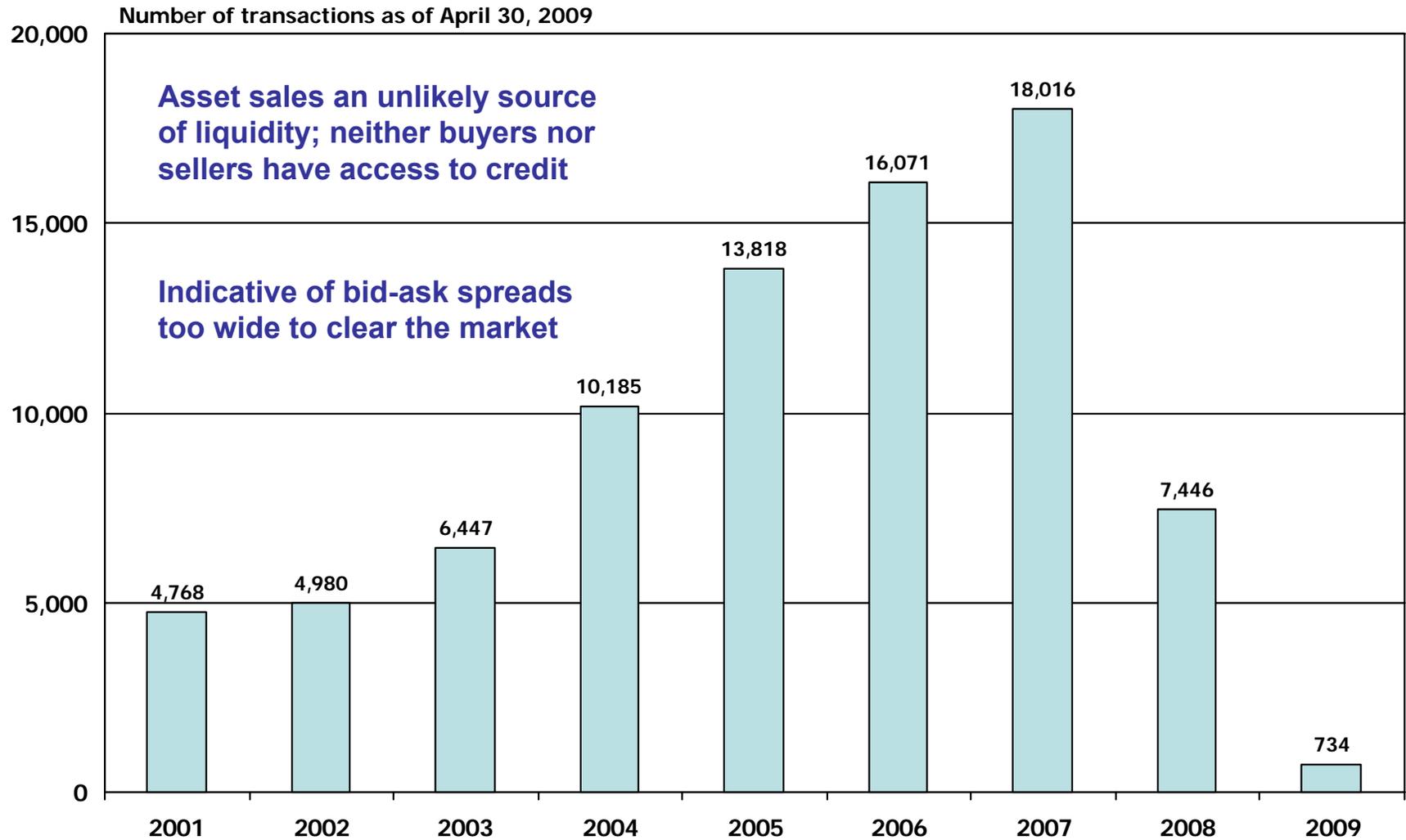
## CMBS yield less 10-year Treasury yield



Source: Morgan Stanley

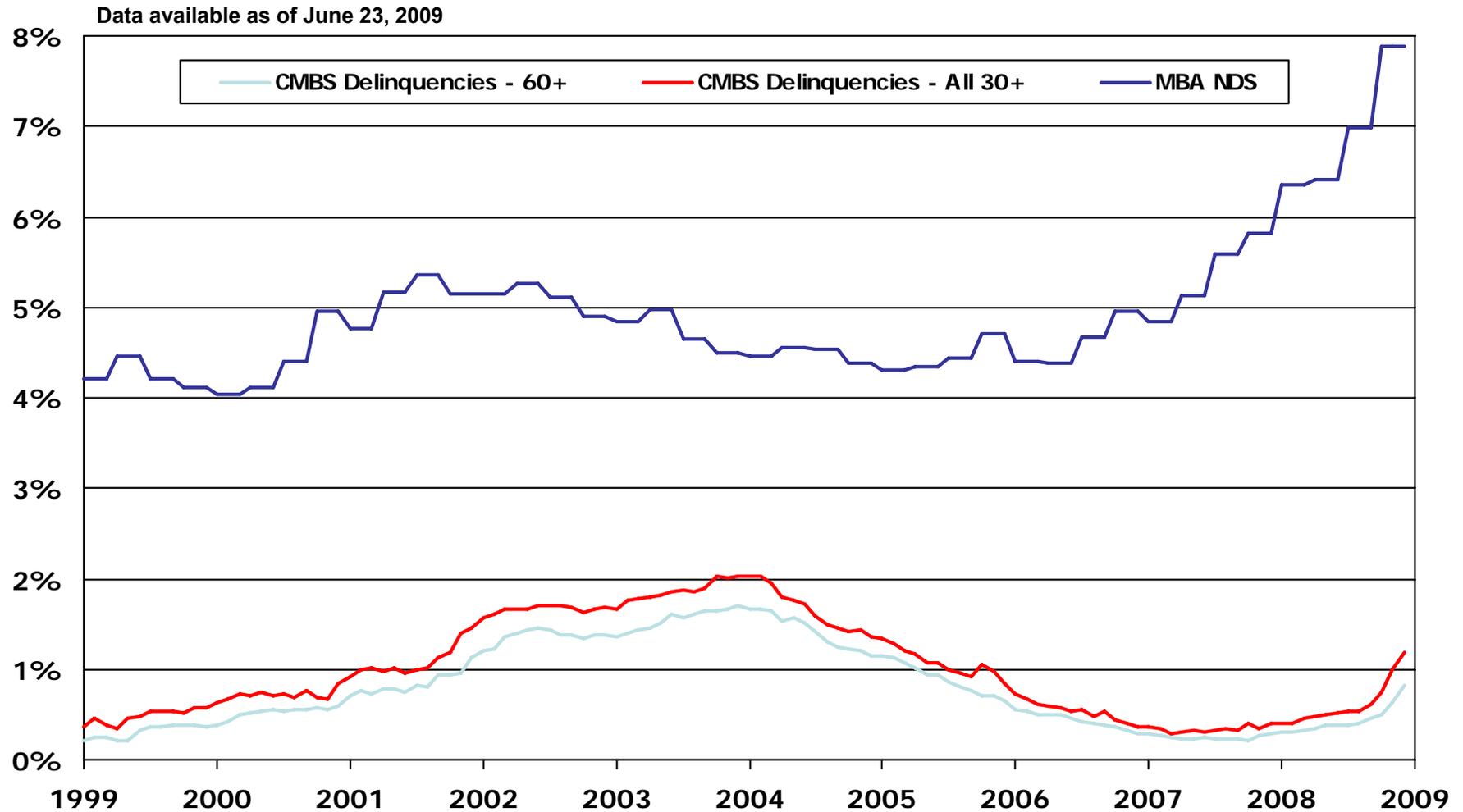
# Commercial Real Estate Transactions

## Transaction volume: 2001 – 2009



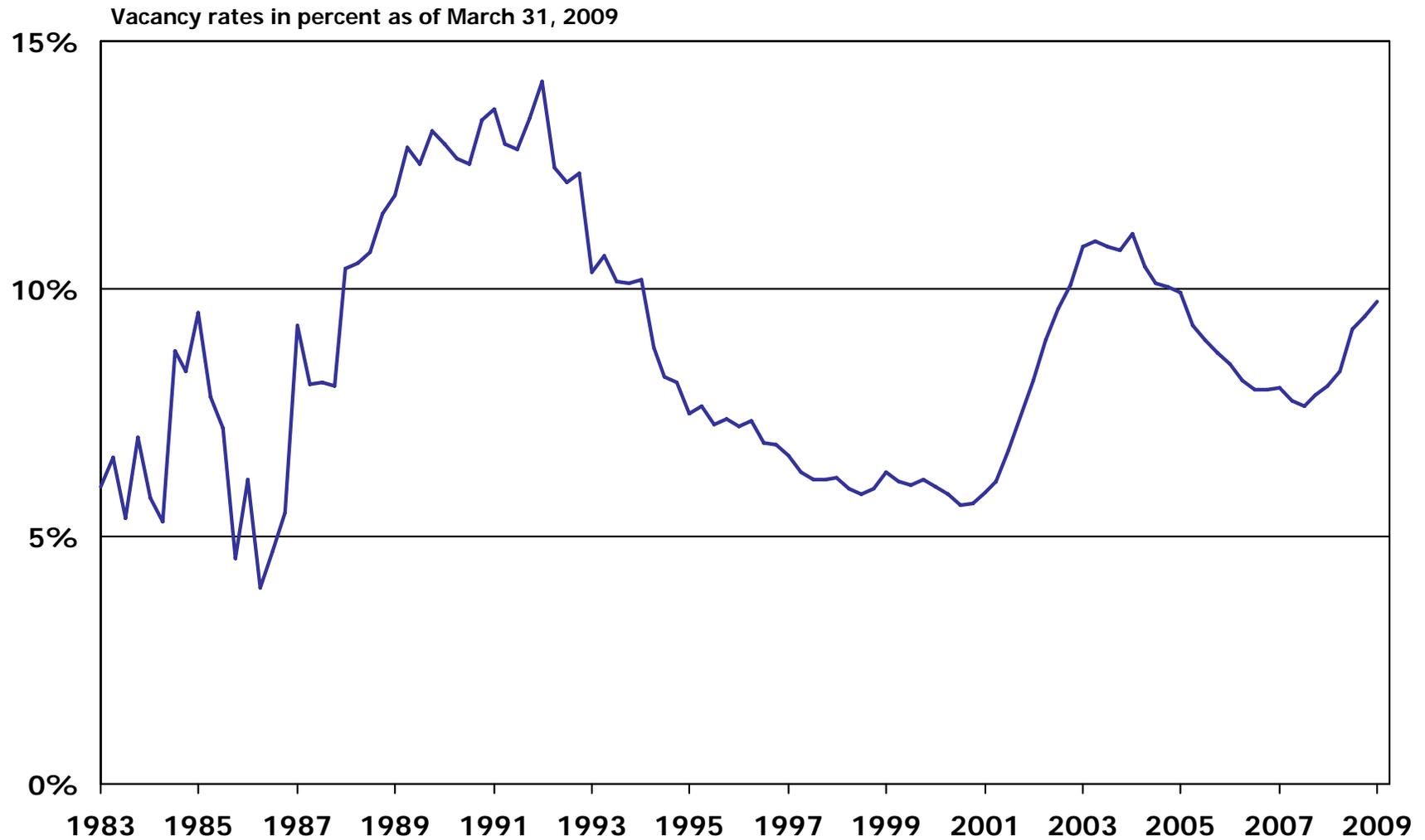
Source: Real Capital Analytics

# CMBS and Residential Mortgage Delinquencies 1999 – 2008:Q4



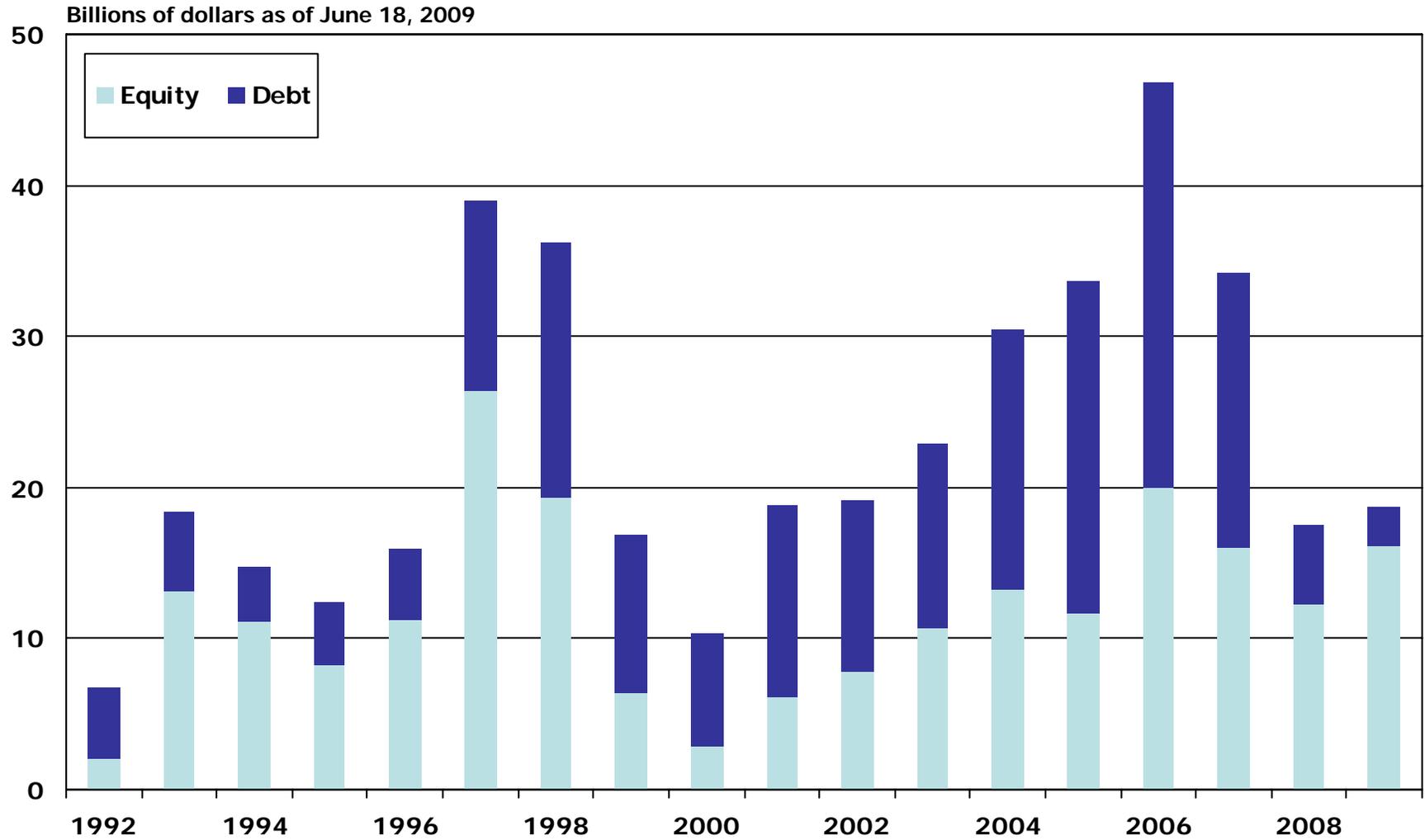
Sources: Trepp LLC, CMSA, MBA

# Nationwide Core Property Vacancy Rates 1983:Q1 – 2009:Q1



Source: NCREIF

# Securities Offerings by Public Companies



Sources: NAREIT® and SNL Financial

**Exhibit B:**  
**List of Publicly Traded REITs and Ownership Interests in Operating Partnerships**

ID	Equity Mkt Cap (\$M)	Implied Mkt Cap (\$M)	REIT's Interest in OP
<b>REITs with OP</b>			
N45	1,243.2	1,244.5	99.9%
N73	708.3	709.3	99.9%
N102	3,564.0	3,574.5	99.7%
N34	660.3	662.3	99.7%
N23	146.9	147.4	99.7%
N50	196.2	197.2	99.5%
N14	98.8	99.3	99.5%
N71	4,238.6	4,258.9	99.5%
N99	668.9	672.3	99.5%
N110	2,851.2	2,867.8	99.4%
N49	3,095.2	3,114.9	99.4%
N118	85.5	86.6	98.7%
N19	1,273.5	1,293.0	98.5%
N1	532.2	540.8	98.4%
N87	2,719.5	2,768.1	98.2%
N6	1,199.6	1,221.9	98.2%
N133	1,827.2	1,861.4	98.2%
N117	526.7	536.9	98.1%
N65	5,560.7	5,693.9	97.7%
N5	2,499.6	2,561.0	97.6%
N58	5,869.1	6,018.5	97.5%
N52	286.9	295.0	97.3%
N116	1,759.1	1,812.6	97.0%
N38	2,034.6	2,099.0	96.9%
N18	660.1	681.1	96.9%
N16	955.3	988.3	96.7%
N42	132.8	138.1	96.2%
N124	1,655.1	1,722.0	96.1%
N75	2,285.1	2,378.6	96.1%
N21	1,961.1	2,046.9	95.8%
N27	228.0	238.4	95.6%
N48	642.1	674.1	95.2%
N74	418.9	441.0	95.0%
N70	704.4	741.8	95.0%
N95	222.0	234.2	94.8%
N121	34.1	36.1	94.4%
N46	6,639.8	7,036.2	94.4%
N62	1,436.9	1,528.9	94.0%
N2	135.1	145.6	92.8%
N36	2,714.4	2,926.8	92.7%
N130	8,311.2	8,963.0	92.7%
N56	103.9	112.2	92.7%
N11	1,104.2	1,192.5	92.6%
N83	1,023.1	1,110.3	92.1%
N128	173.7	189.0	91.9%
N47	1,824.5	1,991.3	91.6%
N31	1,531.3	1,697.5	90.2%
N119	258.1	289.0	89.3%
N51	178.0	200.9	88.6%
N72	191.8	217.9	88.0%
N79	50.3	57.3	87.8%
N77	1,321.9	1,519.3	87.0%
N112	8.1	9.3	87.0%
N106	166.4	192.7	86.4%

**Exhibit B:**  
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ID	Equity Mkt Cap (\$M)	Implied Mkt Cap (\$M)	REIT's Interest in OP
N17	5,837.3	6,797.8	85.9%
N61	132.3	156.2	84.7%
N30	378.2	447.0	84.6%
N33	778.6	920.5	84.6%
N78	1,896.0	2,252.7	84.2%
N122	1,023.3	1,219.6	83.9%
N115	15,001.9	18,040.7	83.2%
N44	989.9	1,192.7	83.0%
N37	1,127.9	1,444.7	78.1%
N113	512.2	667.7	76.7%
N103	915.9	1,243.7	73.6%
N68	518.6	707.1	73.3%
N63	1,075.0	1,487.5	72.3%
N29	73.1	101.5	72.0%
N123	1,308.9	1,963.0	66.7%
N82	9.0	13.9	65.0%
N39	373.5	629.2	59.3%
N26	442.4	757.7	58.4%
N84	151.6	733.8	20.7%
N93	12.9	151.4	8.5%

**REITs without OP**

N12	39.2	39.2	100.0%
N105	80.3	80.3	100.0%
N92	65.9	65.9	100.0%
N22	35.6	35.6	100.0%
N9	83.1	83.1	100.0%
N127	242.5	242.5	100.0%
N25	125.0	125.0	100.0%
N120	421.1	421.1	100.0%
N126	380.1	380.1	100.0%
N90	209.1	209.1	100.0%
N66	1,081.2	1,081.2	100.0%
N59	968.8	968.8	100.0%
N41	847.8	847.8	100.0%
N67	579.0	579.0	100.0%
N24	701.2	701.2	100.0%
N57	901.8	901.8	100.0%
N100	1,025.9	1,025.9	100.0%
N81	1,394.1	1,394.1	100.0%
N108	2,238.6	2,238.6	100.0%
N3	1,371.8	1,371.8	100.0%
N4	1,408.3	1,408.3	100.0%
N85	149.4	149.4	100.0%
N132	1,267.9	1,267.9	100.0%
N54	449.7	449.7	100.0%
N7	285.1	285.1	100.0%
N8	7,507.3	7,507.3	100.0%
N20	42.0	42.0	100.0%
N32	473.2	473.2	100.0%
N35	701.8	701.8	100.0%
N40	99.3	99.3	100.0%
N43	667.8	667.8	100.0%
N53	891.7	891.7	100.0%
N96	16.2	16.2	100.0%

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**List of Publicly Traded REITs and Ownership Interests in Operating Partnerships**

<b>ID</b>	<b>Equity Mkt Cap (\$M)</b>	<b>Implied Mkt Cap (\$M)</b>	<b>REIT's Interest in OP</b>
N107	3,145.0	3,145.0	100.0%
N114	2,016.7	2,016.7	100.0%
N125	87.7	87.7	100.0%
N129	4,337.8	4,337.8	100.0%
N86	1,340.9	1,340.9	100.0%
N104	11,335.3	11,335.3	100.0%
N28	1,648.7	1,648.7	100.0%
N97	5,779.3	5,779.3	100.0%
N91	1,314.6	1,314.6	100.0%
N60	3,792.7	3,792.7	100.0%
N88	733.7	733.7	100.0%
N69	328.1	328.1	100.0%
N109	901.8	901.8	100.0%
N64	1,310.9	1,310.9	100.0%
N10	660.0	660.0	100.0%
N80	493.5	493.5	100.0%
N76	477.2	477.2	100.0%
N13	375.7	375.7	100.0%
N131	268.8	268.8	100.0%
N89	37.4	37.4	100.0%
N134	151.9	151.9	100.0%
N111	83.2	83.2	100.0%
N55	100.3	100.3	100.0%
N98	79.2	79.2	100.0%
N101	3.2	3.2	100.0%
N94	281.9	281.9	100.0%
N15	4,732.2	4,733.4	100.0%
<b>REITs with OP (74)</b>	<b>113,276.5</b>	<b>124,965.9</b>	
<b>REITs without OP (60)</b>	<b>72,569.6</b>	<b>72,570.8</b>	
<b>Totals (134)</b>	<b>185,846</b>	<b>197,536.7</b>	