NATIONAL ASSOCIATION OF
REAL ESTATE INVESTMENT TRUSTS®

November 7, 2011

Ms. Elizabeth M. Murphy
Secretary
Securities and Exchange Commission
100 F Street, NW
Washington, DC 20549-1090

Re: Companies Engaged in the Business of Acquiring Mortgages and Mortgage-Related Instruments, Release No. IC-29778; File No. S7-34-11

Dear Ms. Murphy:

This comment letter is submitted by the National Association of Real Estate Investment Trusts (NAREIT) in response to Release No. IC-29778 (Aug. 31, 2011) (the Concept Release) in which the Securities and Exchange Commission (the Commission) announced that the Commission and its staff (Staff) are reviewing interpretive issues under the Investment Company Act of 1940 (1940 Act) relating to the status of issuers relying on the exclusion found in Section 3(c)(5)(C) of the 1940 Act, and solicits information about, among other things, the issuers relying on that exclusion and how the exclusion is interpreted by, and affects investors in, such companies. In particular, the Concept Release solicits comment on the types of assets (Qualifying Interests) that the exclusion permits an issuer to hold.

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 commercial and residential real estate. NAREIT's members play an important role in providing diversification, dividends, liquidity and transparency to investors through their businesses which operate in all facets of the real estate economy in the U.S.

Today, publicly traded mortgage REITs perform an integral 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 also through originating mortgages and mortgage-related loans. As of October 31, 2011, there were 29 publicly traded mortgage REITs that comprise the FTSE NAREIT All REITs Index with a combined equity market capitalization of $43 billion.

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The importance of publicly traded mortgage REITs to the housing and real estate credit markets has increased in recent years, and will only grow as the housing market and the real estate economy continue to evolve. Further, when the Federal Reserve moves to unwind its non-traditional position in mortgages and when the government-sponsored enterprises move to reduce or eliminate their ownership of mortgages, market observers expect publicly traded mortgage REITs to become an increasingly important component of housing-related finance.

Over time, investors have been well served by publicly traded REITs, typically earning total returns built on dividends and the potential for capital appreciation. Moreover, investor returns on mortgage REITs generally, as measured by the FTSE NAREIT Mortgage REIT Index, have been competitive with investor returns in broad stock indexes. Given the track record and these developments, actors in the housing market and the commercial real estate economy in particular, and in the overall economy in general, look to the publicly traded mortgage REIT industry and its business model to grow and innovate.

NAREIT's Mortgage REIT Council (Council) has discussed the issues and questions raised in the Concept Release. The Council is comprised of both residential and commercial mortgage REITs, and the mission of the Council is to advise NAREIT's leadership on matters of interest to mortgage REITs, in part through the input of the Council's Residential and Commercial Committees.

Our Mortgage REIT Council wishes to underline an essential fact: publicly traded REITs are extensively regulated, in a manner not dissimilar from issuers registered under the 1940 Act. Both public REITs and registered investment companies offer their securities through registration statements filed with the Commission under the Securities Act of 1933, and both types of issuers provide their investors with shareholder reports required under the Securities Exchange Act of 1934. These shareholder reports contain financial statements complying with the Commission's accounting regulations, audited by independent auditors. These reports, further, must meet the requirements of the Sarbanes-Oxley Act. Publicly traded mortgage REITs also comply with the corporate governance rules of the exchanges on which they list; these rules impose independence requirements on the boards and audit committees in a manner comparable to that imposed on investment company boards and audit committees under the 1940 Act. Our Council believes that the regulatory differences between publicly traded mortgage REITs and registered investment companies are not significant enough to justify unnecessary and unfounded disruption. A summary of these various requirements which was previously provided to Staff is attached as Appendix A.

Also, our Mortgage REIT Council wants to emphasize that the exclusion provided by Section 3(c)(5)(C), which has been in place since the 1940 Act was first enacted, is straight-forward and by its own terms very broad. Given the plain language of the exclusion, publicly traded REITs have been organized, have registered and listed their securities and have operated successfully by relying on the self-operative nature of the exclusion over the last 50 years. When ambiguity around the Section 3(c)(5)(C) exclusion was perceived, the issuance of no-action letters by the Staff through the years, applying the exclusion to particular types of real estate instruments under specific facts-and-circumstances, has worked reasonably well. Our Council strongly suggests that, at a minimum, the status quo created by the various no-action letters issued to date should be maintained and affirmed.

The majority view expressed by the mortgage REITs on NAREIT's Mortgage REIT Council is attached as Appendix B. It supports a principles-based approach that would extend the existing framework of the exclusion in Section 3(c)(5)(C). These comments were developed under the auspices of the Residential Committee of NAREIT's Mortgage REIT Council and they are unanimously supported by the members of that Committee. Appendix B embraces this principles-based approach and contains the details of how it would provide guidance and clarity as to what constitutes a Qualifying Interest under the exclusion. Notably, this view supports the development of an interpretive release.

The Commercial Committee of the Mortgage REIT Council developed an alternative view that is expressed in Appendix C and is supported by a majority of that Committee. It is also grounded in principles, but it does recommend adoption of a rule, rather than an interpretive release, to delineate the full breadth of what constitutes a Qualifying Interest under the exclusion. This approach sets forth the attributes of various interests in real estate in definitional form consistent with the statutory exclusion in place as well as with past regulatory practice. It is also meant to address the growing array of commercial and residential mortgage instruments available in the market.

In reviewing the Appendices B and C, it is important to keep in mind that Residential Mortgage REITs and Commercial Mortgage REITs focus on different parts of the real estate market, and sometimes hold different types of instruments evidencing interests in real estate. Residential Mortgage REITs tend to concentrate more on holding interests in real estate through agency-backed mortgages, *i.e.*, with Fannie Mae, Freddie Mac or Ginnie Mae guarantees, as well as through non-agency mortgages to help finance the single-family housing market; and Commercial Mortgage REITs tend to concentrate on holding interests in real estate which are often risk-tranched and subordinate to help finance the commercial real estate industry.

NAREIT and its Mortgage REIT Council look forward to continuing to work with the Commission and the Staff on the issues raised by the Concept Release. The Concept Release examines an important industry at a critical moment, and we look forward to working with the Staff and the Commission as they balance issues of investor protection and industry guidance and clarification.

Please feel free to contact me with further questions.

Respectfully submitted,

Steven A. Wechsler
President and CEO

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ASSOCIATION
OF
REAL ESTATE
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REITS:
BUILDING
DIVIDENDS
AND
DIVERSIFICATION®

September 30, 2010

Andrew J. Donohue, Director
Division of Investment Management
U.S. Securities and Exchange Commission
100 F Street, NE
Washington, DC 20549

Dear Mr. Donohue:

In connection with your request, we have attached to this letter the following materials summarizing the regulatory scheme applicable to real estate investment trusts specializing in mortgage finance ("mortgage REITs"):

- a chart describing the body of the laws and regulations applicable to mortgage REIT operations and activities (the "Chart"),
- an exhibit to the Chart listing the statutes that specifically address mortgage REITs or which involve a substantial consideration of mortgage REITs by Congress ("Exhibit 1"), and
- an exhibit highlighting certain key sources of guidance governing the preparation and presentation of mortgage REIT financial statements, including releases by the Financial Accounting Standards Board and the staff of the Securities and Exchange Commission ("Exhibit 2").

Please do not hesitate to contact us with any questions regarding mortgage REITs, the information in the attached exhibits, or the REIT industry in general.

On behalf of NAREIT and its members, we appreciate your interest in and involvement with REIT issues arising under the securities laws, and we wish you the best in your future endeavors.

Respectfully Submitted.

Tony M. Edwards
Executive Vice President & General Counsel

THE BODY OF LAW, REGULATION AND REQUIREMENTS GOVERNING THE OPERATIONS AND ACTIVITIES OF REITS

Public real estate investment trusts (or "**REITs**") are operating companies active in the real estate industry that are subject to a complex body of laws, regulations, exchange rules, accounting pronouncements and market-driven best practices. In the following chart, we outline some of the key statutes, regulatory provisions, rules, pronouncements and practices that govern the operations and activities of REITs. Many of the provisions discussed are applicable to all public operating companies, and are not specific to REITs. Certain provisions, however, such as the REIT requirements under the Internal Revenue Code of 1986, as amended (the "**Code**"), apply specifically to REITs. Congress has specifically adopted statutes relating to REITs or with REITs in mind, a non-exhaustive list of which is attached as Exhibit 1. Though it has adopted a number of REIT related statutes, Congress has never suggested that the regulation of REITs under the Investment Company Act of 1940, as amended (the "**1940 Act**"), should be modified, including in the Dodd-Frank Wall Street Reform and Consumer Protection Act, signed into law on July 21, 2010 (the "**Dodd-Frank Act**").

Applicable Law or Regulation[1]	**Description**
SARBANES-OXLEY ACT (incorporated into 934 Act (as defined below)	**As a public company registered under the Securities Exchange Act of 1934, as amended (the "1934 Act"), a REIT generally is subject to the provisions adopted in the Sarbanes-Oxley Act of 2002, signed into law on July 30, 2002 ("SOX").**[2]
- Code of Ethics	In implementing SOX, the Securities and Exchange Commission ("**SEC**") has adopted rules requiring a public company to disclose whether it has adopted a code of ethics for its Chief Executive Officer ("**CEO**"), Chief Financial Officer ("**CFO**"), Chief Administrative Officer ("**CAO**"), controller and other persons performing similar functions and, if not, the reasons why it has not (the "**Code of Ethics**"). A Code of Ethics is a set of written standards reasonably designed to deter wrongdoing and to promote: • Honest and ethical conduct, including ethical handling of conflicts of interest,

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1 In this chart we are not addressing proposed Regulation AB. Regulation AB, the Dodd-Frank Act and potential rules and regulations stemming therefrom could significantly affect REITs and could impose a variety of additional requirements and restrictions upon or indirectly affect their operation and activities. We have also not included provisions suggested by the North American Securities Administrators Association (or "NASAA") in its "Statement of Policy Regarding Real Estate Investment Trusts," dated May 7, 2007.

2 Pub. L. No. 107-204; 116 Stat. 745 (July 30, 2002).

	• Full, fair, accurate, timely and understandable disclosure in SEC reports and public communications, • Compliance with applicable law, • Prompt internal reporting of violations, and • Accountability for compliance with the Code of Ethics.
- Disclosure Controls (Section 404 of SOX; Rule 13a-15)	Companies with securities registered under Section 12 of 1934 Act (such as public REITs) must maintain disclosure controls and procedures with respect to financial information. Disclosure controls and procedures mean controls and other procedures designed to ensure that information required to be disclosed in filings or reports under the 1934 Act are recorded, processed, summarized and reported within the required time periods, including controls and procedures to ensure that information required to be disclosed by an issuer in the reports that it files or submits under the 1934 Act is accumulated and communicated to the issuer's management, including its principal executive and principal financial officers, or persons performing similar functions, to allow timely decisions regarding required disclosure (collectively, "**Disclosure Controls and Procedures**").
- Quarterly Evaluation of Disclosure Controls and Procedures	Each quarter, management must evaluate, with the participation of the principal executive and financial officers, or persons performing similar functions, the effectiveness of the REIT's Disclosure Controls and Procedures.
- Internal Control Over Financial Reporting (Section 404 of SOX; Rule 13a-15)	Companies that file Form 10-Ks and 10-Qs (such as public REITs) must adopt "internal controls over financial reporting" ("**Internal Controls**") which means a process designed by, or under the supervision of, the REIT's principal executive and principal financial officers, or persons performing similar functions, and effected by the company's board, management and other personnel, to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles, including policies and procedures that: • Pertain to the maintenance of records that in reasonable detail accurately and fairly reflect the transactions and dispositions of the assets of the REIT; • Provide reasonable assurance that transactions are recorded as necessary to permit preparation of financial statements in accordance with generally accepted accounting principles, and that receipts and expenditures of the issuer are being made only in accordance with authorizations of management and directors of the REIT; and • Provide reasonable assurance regarding prevention or timely detection of unauthorized acquisition,

	use or disposition of the REIT's assets that could have a material effect on the financial statements.
- Quarterly Evaluation of Internal Control changes	Each quarter, management must evaluate, with the participation of the principal executive and financial officers any change in the REIT's Internal Controls that occurred during a fiscal quarter that has materially affected, or is reasonably likely to materially affect, the company's Internal Controls
- Internal Control Report (Section 404 of SOX; Rule 13a-15)	Each year, management must complete and provide as an exhibit to the Form 10-K a report of management on the REIT's Internal Controls (the "**Internal Control Report**") that contains: • A statement of management's responsibility for establishing and maintaining adequate Internal Controls for the registrant; • A statement identifying the framework used by management to evaluate the effectiveness of the company's Internal Controls as required by paragraph; • Management's assessment of the effectiveness of the registrant's Internal Controls as of the end of the registrant's most recent fiscal year, including a statement as to whether or not its Internal Controls are effective, including disclosure of any material weakness in the company's Internal Controls identified by management. Management is not permitted to conclude that the company's Internal Controls are effective if one or more material weaknesses are identified; and • A statement that the registered public accounting firm that audited the financial statements included in the Form 10-K has issued an attestation report on the company's Internal Controls.
- Internal Control Attestation	A REIT's auditor must attest to management's assessment of the effectiveness of the company's Internal Controls in the Internal Control Report (the "**Internal Control Attestation**"). The Public Company Accounting Oversight Board ("**PCAOB**") has adopted Auditing Standard No. 5 to provide guidance to auditors in conducting an integrated audit of the financial statements of a company and management's assessment of Internal Controls.[3]
- Section 906 Certification	Periodic reports (such as the Form 10-Q and Form 10-K) containing financial statements filed with the SEC must be accompanied by a certification by the REIT's CEO and CFO (the "**Section 906 Certification**"), stating that (i) the periodic report fully complies with the requirements the 1934 Act and (ii) the information in the report "fairly presents, in all material respects, the financial condition and results of operations of the issuer." Knowingly or willfully filing an incorrect Section 906 Certification is a criminal offense punishable by a large fine and/or imprisonment.

[3] Available at http://pcaobus.org/Standards/Auditing/Pages/Auditing_Standard_5.aspx.

	SOX provides a form of certification that must be used for the Section 906 Certification.
- Section 302 Certification	In filing a 10-Q or 10-K, the CEO and CFO of a REIT must certify that the financial statements filed with the SEC fairly present, in all material respects, the operations and financial condition of the company, and must attest to the adequacy of the company’s Disclosure Controls and Internal Controls.
- Prohibitions on Loans to Insiders (Section 402 of SOX)	Prohibits loans by a public company to its directors or executive officers, subject to very narrow exemptions for certain types of loans made in the course of the company’s business.
- Whistleblower protection	SOX protects employees of public companies (and, after the Dodd-Frank Act, certain of public companies’ subsidiaries and affiliates) against retaliation for providing information to supervisors, government agencies or Congress regarding violations of securities laws or antifraud laws.
- Audit Committee Requirements (SOX Section 301, SEC Rule 10A-3)	Prohibits national securities exchanges from listing securities of companies that do not comply with certain requirements relating to the company’s audit committee.
- Independence	Subject to certain exceptions, each member of the audit committee must be independent, meaning it may not: • Accept, directly or indirectly, any consulting, advisory or other compensatory fee from the company or its subsidiaries (other than board and committee fees), or • Be an “affiliated person” of the company or its subsidiaries (as defined in Rule 10A-3)
- Responsibility for external audit	Audit committee must be directly responsible for the appointment, compensation, retention and oversight of the work of auditors engaged (including resolution of disagreements between management and the auditor regarding financial reporting) for the purpose of preparing or issuing an audit report or performing other audit, review or attest services for the company, and each auditor must report directly to the audit committee
- Complaint process	Audit committee must establish procedures for: • The receipt, retention, and treatment of complaints received by the company regarding accounting, internal accounting controls, or auditing matters; and • The confidential, anonymous submission by employees of the company of concerns regarding questionable accounting or auditing matters
- Advisers	Audit committee must have the authority to engage independent counsel and other advisers, as it determines necessary to carry out its duties.

- Funding	SOX requires companies provide adequate funding to audit committee for hiring of auditor(s) and adviser(s), and for administrative costs
- Financial expert	Company must disclose on Form 10-K whether its audit committee has at least one “audit committee financial expert” meeting certain criteria, and, if not, why it does not have such an expert on its audit committee
NASDAQ GLOBAL MARKET (“NASDAQ”) LISTING REQUIREMENTS	**A REIT that is listed on NASDAQ must meet a number of requirements relating to, among other things, market capitalization, number of beneficial owners, share price and governance issues.**
- Initial Listing Requirements	In order to be listed on NASDAQ, a REIT must certain shareholder number, liquidity, pre-tax earnings, share price and market maker requirements.
- Ongoing Listing Requirements	In order to remain listed on NASDAQ, a REIT must continuously satisfy certain share price, liquidity and earnings requirements.
- Governance Requirements	A REIT listed on NASDAQ must meet the following governance requirements.
- Independent Directors (Rule 5605(b)(1)	A REIT must have a majority of independent directors. Even if a director is independent under NASDAQ rules, the REIT’s board must determine that there is no other relationship between a purportedly independent director and the company that would preclude that director from acting as an independent director.
- Meetings of Independent Directors (Rule 5605(b)(2))	At least twice a year, a REIT must hold a meeting of independent directors that is attended only by independent directors. This meeting can be held in conjunction with a meeting of directors generally.
- Compensation Committee (Rule 5605(d))	A committee of independent directors must set the compensation of chief executive officer and other executive officers.
- Nominating Committee (Rule 5605(e))	A committee of independent directors must be responsible for nominating director candidates for the REIT’s board
- Audit Committee (Rule 5605(c))	A NASDAQ listed REIT is required to have an audit committee consisting solely of independent directors who have the requisite financial experience and expertise. The audit committee must comply with the requirements of SOX and, particularly, Rule 10A-3.
- Other Requirements	
- Annual Meeting (Rule 5620(a))	A NASDAQ listed REIT is required to hold an annual meeting no more than one year after the end of its fiscal year
- Quorum (Rule 5620(c))	A quorum of shares for purposes of any meeting must mean not less than 33 1/3% of outstanding shares of voting stock
- Voting Rights (Rule 5640)	The voting rights of existing shareholders cannot be disparately reduced or restricted through any corporate action

	or issuance
- Conflict of interest review (Rule 5630)	A NASDAQ listed REIT must conduct a review of all related party transactions for potential conflict of interest situations. The review must be conducted by the audit committee or another independent body of the board
- Shareholder approval of security issuances (Rule 5635)	A NASDAQ listed REIT must obtain shareholder approval of certain securities issuances, including: (i) an issuance that will result in a change of control, (ii) private placements where the issuance (and shares sold by insiders and affiliates) equals 20% or more of the pre-transaction outstanding shares and where the issuance is made at a price less than the greater of book and market value, (iii) issuances related to equity compensation, and (iv) shares issued pursuant to an acquisition where the issuance equals 20% or more of the pre-transaction outstanding shares, or 5% or more of the pre-transaction outstanding shares when a related party has a 5% or greater interest in the acquisition target
- Code of Conduct (Rule 5610)	A NASDAQ listed REIT must adopt a code of conduct applicable to all officers, directors and employees. The code of conduct must satisfy the requirements of a code of ethics under SOX.
NYSE LISTING REQUIREMENTS	**A REIT that is listed on NYSE must meet a number of requirements relating to, among other things, market capitalization, number of beneficial owners, share price and governance issues. These requirements are similar to those applicable to NASDAQ listed REITs.**
- Initial Listing Requirements	In order to be listed on NYSE, a REIT must certain shareholder number, liquidity, pre-tax earnings, share price and market maker requirements.
- Ongoing Listing Requirements	In order to remain listed on NYSE, a REIT must continuously satisfy certain share price, liquidity and earnings requirements.
- Governance Requirements (Section 303A of the NYSE Rules)	A REIT listed on NYSE must meet the following governance requirements.
- Independent Directors	A NYSE listed REIT must have a majority of independent directors. Even if a director is independent under NYSE rules, the REIT's board must determine that there is no other relationship between a purportedly independent director and the company that would preclude that director from acting as an independent director.
- Meetings of Independent Directors	At least once a year, a REIT must hold a regularly scheduled meeting of independent directors that is attended only by independent directors.
- Compensation Committee	A committee of independent directors must set the compensation of chief executive officer and other executive officers
- Nominating/Corporate Governance Committee	A committee of independent directors must be responsible for nominating director candidates for the REIT's board and for developing and recommending corporate governance principles applicable to the REIT

- Audit Committee	An NYSE listed REIT is required to have an audit committee with at least three members consisting solely of independent directors who have the requisite financial experience and expertise. The audit committee must comply with the requirements of SOX and, particularly, Rule 10A-3.
- Internal Audit Function	An NYSE listed REIT must develop an internal audit function to provide management and the audit committee with an assessment of risk management and systems of internal control
- Corporate governance guidelines	An NYSE listed REIT must adopt and disclose corporate governance guidelines. These may include guidelines on topics including director qualifications and responsibilities, responsibilities of key board committees, director compensation, director orientation and continuing education, management succession planning, and a policy for evaluation of the board's or its committees' performance.
- Code of Business Conduct	An NYSE listed REIT must adopt and disclose a code of business conduct applicable to directors, officers and employees addressing conflicts of interest, corporate opportunities, confidentiality, fair dealing, protection and proper use of assets, compliance with laws rules and regulations and reporting of any illegal or unethical behavior. The code should constitute a code of ethics under SOX. The REIT must disclose any waivers to provisions of the code for directors and executive officers.
- Annual CEO Certification	The CEO of an NYSE listed REIT must certify each year that he or she is not aware of any violation by the REIT of the NYSE governance requirements.
SECURITIES ACT OF 1933 (THE "1933 ACT")	**Many REITs publicly offer their shares and, therefore, are subject to a number of requirements under the 1933 Act, including the registration requirements of Section 5, strict liability for misstatements in a registration statement set forth in Section 11, and the anti-fraud provision of Section 17. The staff of the Division of Corporation Finance makes a detailed review of each IPO registration statement on Form S-11 and regularly refers filings to the Division of Investment Management. The staff also may review and comment upon other registration forms.**
- Section 5: Registration of securities on Form S-11	In conducting a public offering of its shares, an entity electing to operate as a REIT must register the offer and sale of its shares to the public under the 1933 Act, using Form S-11. Form S-11 is divided into Part 1 (the prospectus provided to investors) and Part 2 (filed with the SEC and available through EDGAR but not provided directly to investors as part of the prospectus).

- Part 1 of Form S-11 (prospectus)[4]	Requires a REIT to provide a wide range of information about the company and the offering, including, among other things:
	
	• <u>Summary</u>. An introductory plain English summary of the information presented by the issuer in the full Form S-11 (Item 3), including:
	  ○ name, address and telephone number of general partner and names of persons making investment decisions
	  ○ if distributions are an investment objective, the estimated maximum time between closing and first distribution
	  ○ properties to be purchased or statement that properties have not been identified
	  ○ depreciation method to be used
	  ○ maximum leverage as a whole and on individual properties, if different
	
	• <u>Risk factors</u>. A discussion of specific risks applicable to the REIT and the offering, including tax risks, with cross references to additional discussion, when applicable
	
	• <u>Basic disclosures regarding the REIT and its personnel</u>
	  ○ *Basic information and terms of governing instruments*. Basic identifying information, state and form of organization, term of REIT, a description of provisions of governing instrument dealing with annual or other meetings of security holders, and, if the REIT was organized within 5 years, the name of all promoters and any positions or offices with the issuer held by such promoters (Item 11)
	  ○ *Directors and Executive Officers*. Information regarding each director, executive officer and certain significant employees, including, among other things, each such person's name, age, principal occupation and employment for the last five years and any familial relationship between that person and any other director or executive officer ("**Biographical Information**").
	
	• <u>Disclosures regarding REIT operation and activities</u>
	  ○ *Investment policies*. A description of the principles and procedures the issuer will employ in the

[4] In addition to the items listed on the Form S-11, additional guidance about the types of information required on the Form is set forth in the SEC's *Industry Guide No. 5: Preparation of registration statements relating to interests in real estate limited partnerships*, available at http://www.sec.gov/about/forms/secforms.htm.

acquisition of assets, including policies regarding the following types of investments, whether the policy may be changed without a vote of security holders, the percentage of assets that may be invested in any one type of investment, any leverage used, and any limitations on concentration in a single issuer:

- Investments in real estate or interests in real estate
- Investments in real estate mortgages
- Investments in persons primarily engaged in real estate activities
- Investments in other securities (Item 13)

- *Certain other policies*. A description of the REIT's policies regarding, and a discussion regarding the extent to which an issuer anticipates engaging in or has in the past three years engaged in, the following types of transactions:

  - Issuing senior securities
  - Borrowing money
  - Making loans to other persons
  - Investing in securities of other issuers for purpose of exerting control
  - Underwriting securities of other issuers
  - Engaging in the purchaser and sale of investments
  - Offering securities in exchange for property
  - Repurchasing or reacquiring the issuer's own shares or other securities
  - Making annual or other reports to security holders (Item 12)

- *Descriptions of real estate*. Description of any materially important real estate properties currently held by the REIT or intended to be acquired by or leased to the REIT or its subsidiaries, along with additional information about the real estate holding and the REIT's plan for its use (Item 14)

- *Operating data regarding holdings*. Certain information regarding materially important improved property held by the REIT, including, among other things, occupancy rate, principle provisions of tenant leases, average effective annual rent for last five years, and information regarding expiration of leases (Item 15)

- *Management and Custody of Investments*. Description of arrangements made or proposed to be made regarding management of the REIT's real estate assets or the purchase, sale and servicing of mortgages for the issuer, and information regarding investment advisory services or services related to the foregoing performed for the REIT by affiliated persons (Item 24)

- *Tax treatment of issuer and security holders*. Description of the material aspects of the REIT's tax treatment under federal tax law and tax treatment of the REIT’s investors with respect to distributions, among other things (Item 16)

- *Executive compensation*. A description of the compensation of the REIT’s key executives and directors; description must include all types of compensation (such as pension benefits, incentive plans, awards of stock or other securities, etc.) as well as an analysis of the plans under which such compensation packages or benefits were awarded (Item 22) (“**Executive Compensation Disclosures**”)

- <u>Financial Disclosures</u>

  - *Selected Financial Data*. In comparative columnar form, selected financial information (“**Selected Financial Data**”) for each of the last five fiscal years of the REIT (or for the life of the registrant and its predecessors, if less), and any additional fiscal years necessary to keep the information from being misleading (Item 9). Selected Financial Data includes, as applicable:

    - net sales or operating revenues; income (loss) from continuing operations; income (loss) from continuing operations per common share; total assets; long-term obligations and redeemable preferred stock (including long-term debt, capital leases, and redeemable preferred stock; and cash dividends declared per common share
    - Any additional information that would enhance an understanding of and highlight trends in the REIT’s financial condition and results of operations
    - A brief description of factors that materially affect the comparability of the information reflected in selected financial data (such as accounting changes, business combinations or dispositions of business operations)
    - A discussion any material that might cause the data presented not to be indicative of the issuer’s future financial condition or results of operations

  - *MD&A*. A discussion of the REIT’s financial condition, changes in financial condition and results of operations, including its liquidity, capital resources, results of operations, off-balance sheet arrangements, certain contractual obligations (in tabular form) and other information that the registrant believes to be necessary to an understanding of its financial condition, changes in financial condition and results of operations (Item 10) (“**MD&A Disclosure**”). This MD&A Disclosure can relate to the REIT as a whole or, where the issuer deems appropriate for an understanding of its business, relevant, reportable segments or other subdivisions of the REIT

- <u>Disclosures regarding the offering</u>

  - *Description of Securities*. A description of the securities being offered and the material terms applicable to the securities, which vary depending on whether the REIT is offering debt or equity

(Item 18)

- *Offering price*. A discussion of the how the offering price was determined and the factors influencing the price (Item 4)

- *Plan of distribution*. A discussion of the plan of distribution (Item 7), including:

  - The terms of agreements with underwriter(s) (including the compensation of the underwriters) and a discussion of certain aspects of the relationship between the REIT, its affiliates and the underwriter(s)
  - any distribution of securities offered other than through the underwriter(s) and certain terms regarding and details of such other distributions

- *Use of proceeds*. A description of the intended use of the proceeds of the offering or, if the REIT has no current specific plan for the proceeds, the principal reasons for the offering (Item 8)

- *Past experience and performance of sponsor*. A narrative summary of the track record or prior performance of programs sponsored by the sponsor and certain of its affiliates, as well as certain information in tabular form.

- *Fees, costs and compensation*. A tabular summary showing estimates of public offering expenses (both organizational and sales), amount available for investment, non-recurring initial investment fees, prepaid items and financing fees, cash down payments, reserves and acquisitions fees, and maximum and minimum proceeds of the offering. The table must show an itemized description of all compensation, fees, profits and other benefits (including reimbursement) that the general partner/sponsor or its affiliates will earn or receive in connection with the offering or operation of the REIT.

- *Dilution*. A discussion of any dilution investors will suffer as a result of insiders' pre-offering holdings purchased at a lower price (Item 5), including a comparison of the public contribution under the proposed public offering and the effective cash contribution of insiders

- *Selling shareholders*. If the offering includes secondary sales by current security holders, information about those security holders, their relationship with the company, and a description of their holdings both pre- and post- offering (Item 6)

- Disclosures regarding conflicts and policies addressing conflicts (where not addressed elsewhere)

  - *Holdings of insiders*. A description of the securities of the issue held by certain large investors and management

- *Related Person Transactions*. Information regarding:
    - any transaction, since the beginning of the REIT's last fiscal year, or any currently proposed transaction, in which the REIT was or is to be a participant and the amount involved exceeds $ 120,000, and in which any related person had or will have a direct or indirect material interest (a "**Related Person Transaction**")
    - policies and procedures for the review, approval, or ratification of any Related Person Transaction (Item 23)
- *Policies regarding insiders' activities*. A description of any provisions of the REIT's constituent documents or a description of any other policies limiting any director, officer, security holder or affiliate, or any other person in his, her or its ability to:
    - Have any direct or indirect pecuniary interest in investments to be acquired or disposed of by the REIT or its subsidiaries or in any transaction to which the REIT or any of its subsidiaries is a party, or
    - Engage for their own account in business activities of the types conducted or to be conducted by the REIT and its subsidiaries (Item 25)
- *Disclosure and Discussion of Conflicts of Interest*. A description of each potential transaction which could result in a conflict between the interests of investors and those of the manager/sponsor and its affiliates, and the proposed method of dealing with the conflict
- *Limitation of liability*. A description of the principal provisions of the governing instruments or any contract or arrangement with respect to limitations on the liability of REIT affiliated persons or any directors, officers or employees
- *Indemnification*. A description of any indemnification of REIT affiliated persons or any directors, officers or employees

- *Quantitative and Qualitative Market Risk Factors*. An analysis of quantitative and qualitative market risk and its affect on the REIT ("**Market Risk Factors**"); these Market Risk Factors are intended to clarify the REIT's exposures to market risk associated with activities in derivative financial instruments, other financial instruments, and derivative commodity instruments. Market risks includes interest rate risk, foreign currency exchange rate risk, commodity price risk, and other relevant market rate or price risks (*e.g.*, equity price risk) (Item 30)

	Certain information in the Part 1 of the Form S-11 may be incorporated by reference from an issuer's Form 10-K or other reports filed pursuant to Section 13(a) or 15(d) of the 1934 Act, subject to certain conditions. As discussed below, the Form S-11 and Form 10-K request overlapping information by referencing specific sections of Regulation S-K that describe the types of information required.

<table>
<tr>
<td>- Part 2 of Form S-11</td>
<td>This portion of the S-11 is not part of the prospectus, but is filed with the SEC and available on the EDGAR system. Part 2 of the S-11 requires a REIT to provide the following information and documents:

Information on recent sales. Name of person or class of persons to whom securities have been sold (and the consideration paid by such person(s)) within the past six months or are to be sold by the issuer or any selling shareholder at a price different from that offered to the public in the offering
Indemnification. A statement regarding the general effect of any statute, charter provisions, by-laws, contract or other arrangements under which any controlling persons, director or officer of the REIT is insured or indemnified by the REIT
Exhibits. A wide range of items must be filed as exhibits to Part 2 of Form S-11 including, to the extent applicable:

underwriting agreement
plan of acquisition, reorganization, arrangement, liquidation or succession (if applicable)
articles of incorporation or trust agreement
current by-laws (if applicable)
all instruments defining the rights of holders of the equity or debt securities being registered
opinion of counsel as to the legality of the securities being registered (stating whether, when sold, the securities, if equity securities, will be legally issued, fully paid and non-assessable, and, if debt securities, whether they will be binding obligations of the registrant
opinion of counsel on tax treatment as a REIT
any voting trust agreement
“material contacts” meaning, with exceptions, (i) every contract not made in the ordinary course of business which is material to the REIT and is to be performed in whole or in part at or after the filing of the registration statement or was entered into not more than two years before such filing and (ii) certain management agreements and compensation plans
a statement setting forth in reasonable detail the computation of per share earnings
a statement setting forth in reasonable detail the computation of any ratio of earnings to fixed charges, any ratio of earnings to combined fixed charges and preferred stock dividends or any other ratios which appear in the registration statement
the REIT’s annual report to security holders for its last fiscal year, its Form 10-Q and Form 10-QSB (if specifically incorporated by reference in the prospectus) or its quarterly report to security holders, if all or a portion thereof is incorporated by reference in the filing
if applicable, a letter from the independent accountant which acknowledges awareness of the use in a registration statement of a report on unaudited interim financial information
filed or which is not filed with the SEC or which the REIT otherwise wishes to include

</td>
</tr>
</table>

	○ if applicable, a letter from the registrant's former independent accountant regarding its concurrence or disagreement with the statements made by the registrant in the current report concerning the resignation or dismissal as the registrant's principal accountant ○ a list of all the REIT's subsidiaries (subject to exceptions) and the jurisdiction of formation of each ○ any consents of experts and counsel ○ a copy of the relevant power of attorney to the extent any name is signed to the registration statement or report pursuant to a power of attorney ○ any document incorporated by reference in the Form S-11 that is not otherwise required to be filed by Item 601 of Regulation S-K
- Private Rights of Action	A REIT is subject to liability for material misstatements and omissions in its registration statement under (among other provisions) Sections 11 and 12 of the 1933 Act, and Section 10(b) of the 1934 Act.
- Section 17	A REIT also is subject to the anti-fraud provisions of Section 17 of the 1933 Act, which the SEC may enforce (but for which no private right of action exists); the SEC need only show negligence, rather than scienter, in connection with an action under Section 17.
1934 ACT (excluding the portions of SOX discussed above)	**Most public REITs are required to register under the 1934 Act as a result of completing a public offering. As a result, REITs are subject to a wide array of disclosure obligations, reporting requirements and substantive restrictions under the 1934 Act.**
- Registration Requirement: Form 8-A or Form 10	REITs which are publicly traded, as opposed to private investment vehicles, generally must register under the 1934 Act by filing either Form 8-A or Form 10 with the SEC.
- Independent Auditor Requirement (Rule 10A) / PCAOB registration requirement (SOX)	The auditor to a public company, including public REITs, must be independent (as defined in Rule 2-1 under Regulation S-X). SOX also requires auditors to public companies to be registered with and subject to inspection by the PCAOB.
- Reporting Requirements	As a company registered under the 1934 Act, a REIT is subject to periodic and other ongoing reporting requirements under the 1934 Act. These reports are the subject of review and comment on a period basis by the staff of the Division of Corporation Finance.
- Annual Form 10-K (Section 13 or 15(d))	A REIT registered under Section 12 of the 1934 Act must file with the SEC an annual filing on Form 10-K which is made available to the public through the EDGAR system. The Form 10-K must be filed after the end of each fiscal year. The required deadline for filing a Form 10-K after the end of a fiscal year depends upon the "filer" status of the reporting company. Form 10-K is broken into four parts and requires the following information, among other things:

Part 1

- *Risk Factors*. The REIT must provide the same types of risk factors required under Form S-11, described above (both Form S-11 and Form 10-K reference the same provision of Regulation S-K in describing the required risk factors) (Item 1A)

- *Unresolved Comments*. Certain REITs (based on what type of "filer" the REIT is under the 1934 Act) that have received comments from the staff regarding their periodic or current reports must disclose any unresolved comments in the Form 10-K that it believes are material and discuss the substance of the comment (Item 1B)

- *Legal Proceedings*. A REIT must disclose and describe any material pending legal proceedings, other than ordinary routine litigation incidental to the business of the REIT, to which the REIT or any of its subsidiaries is a party or of which any of their property is the subject. The description must include the name of the court or agency in which the proceedings are pending, the date instituted, the principal parties thereto, a description of the factual basis alleged to underlie the proceeding and the relief sought. A REIT must include similar information as to any such proceedings known to be contemplated by governmental authorities (Item 3)

Part 2

- *Market Information*. A REIT must disclose and discuss information about the market for its securities, the number of holders of each class of its securities, the frequency and amount of any dividends the REIT has declared, performance of the REIT's securities, and information about securities available for issuance under equity compensation plans (Item 5)

- *Use of Proceeds*. A REIT must include a discussion on its use of proceeds from the REIT's public offerings, including an update on any ongoing or terminated offerings and a discussion of how the net proceeds have been applied.

- *Selected Financial Data*. A REIT must disclose in the Form 10-K the same Selected Financial Data that was required under the Form S-11 (both Form S-11 and Form 10-K reference the same provision of Regulation S-K in describing the required Selected Financial Data) (Item 6)

- *MD&A*. A REIT must include in its Form 10-K the MD&A discussion described above and included in the Form S-11 (Item 7)

- *Market Risk Factors*. A REIT must include in its Form 10-K the same type of Market Risk Factors as are described above in connection with the Form S-11 (both Form S-11 and Form 10-K reference the same provision of Regulation S-K in describing the required Market Risk Factors) (Item 7A)

- *Financial Statements*. *Interim Financial statements*. A REIT must provide financial statements in prepared in accordance with Regulation S-X (Item 8)

- *Change in accountants*. In the event a REIT changes its accountants, it must disclose material disagreements with the accountant regarding any matter of accounting principles or practices, financial statement disclosure, or auditing scope or procedure and whether the new accountant dealt with the matter differently than the previous accountant apparently would have concluded was required (Item 9)

- *Effectiveness of disclosure controls and procedures*. A REIT must disclose the conclusions of the REIT's principal executive and principal financial officers, or persons performing similar functions, regarding the effectiveness of the REIT's Disclosure Controls, adopted pursuant to SOX (as defined below), as of the end of the period covered by the report, based on the evaluation of these controls and procedures required by SOX (Item 9A)

- *Report on internal controls over financial reporting*. A REIT must provide the Internal Control Report required by SOX (discussed below) and the Internal Control Attestation from the company's independent public accountant, as well as a description of any change in the REIT's Internal Controls (as defined below) that occurred during the REIT's fourth fiscal quarter that has materially affected, or is reasonably likely to materially affect, the REIT's Internal Controls (Item 9A)

- *8-K Information*. The REIT must disclose any facts or information that would be required to be disclosed in a Form 8-K (discussed below) during the fourth quarter of the fiscal year covered by the Form 10-K (Item 9B)

<u>Part 3</u>

- *Directors, Executive Officers and Corporate Governance*.

    - Biographical Information. A REIT must disclose Biographical Information (as defined above) about its officers, directors and key employees (in certain cases)

    - Section 16(a) Information. A REIT must disclose failures of its Covered Persons (as defined below in connection with Section 16 reporting) to file a Form 3, 4 or 5

    - Code of Ethics. A REIT must disclose whether it has adopted a Code of Ethics (as defined below in the SOX discussion) and, if not, why it has not adopted a Code of Ethics (Item 10)

	• *Executive Compensation*. A REIT must provide the same Executive Compensation Disclosures as required under the Form S-11, discussed above (both Form S-11 and Form 10-K reference the same provision of Regulation S-K in describing the required Executive Compensation Disclosures) (Item 11)
	
	• *Ownership by Insiders and Related Matters*. A REIT must provide:
	
	  ○ Information regarding the holdings of company securities by large beneficial owners, directors and management, and
	
	  ○ The main features of any equity compensation plan adopted without the approval of shareholders, as well as information, in table form, regarding (i) the number of securities to be issued upon the exercise of outstanding options, warrants and rights, (ii) the weighted-average exercise price of the outstanding options, warrants and rights; and, (iii) other than securities to be issued upon the exercise of the outstanding options, warrants and rights, the number of securities remaining available for future issuance under the plan (Item 12)
	
	• *Related Person Transactions and Director Independence*. A REIT must:
	
	  ○ Disclose any Related Person Transactions (as defined above) since the beginning of the previous fiscal year, as well as policies and procedures for the review, approval, or ratification of any Related Person Transaction, and
	
	  ○ Name all directors that are independent under standards governing independence generally and that are members of a committee or sub-committee and are independent under the relevant standard for such sub-unit of the board (such as the audit committee; see SOX discussion below)
	
	• *Accountant and Audit Information*. A REIT must provide extensive information about its relationship with and fees paid to its accountant, as well as policies for monitoring that relationship.
	
	• *Exhibits*. The REIT must provide a range of exhibits to each Form 10-K (or must incorporate those exhibits by reference with a cross reference, if permitted), as set forth in Item 601 of Regulation S-K.

- Quarterly Form 10-Qs (Section 13 or 15(d))	Quarterly 10-Q must be filed within 45 days from the end of the relevant calendar quarter, or 40 days in the case or large accelerated filers and accelerated filers. The Form 10-Q is divided into two parts, and generally requires the following types of information: <u>Part 1</u> • *Interim Financial statements*. A REIT must provide interim financial statements in prepared in

accordance with Rule 10-01 of Regulation S-X (Item 1)

- *MD&A Disclosure*. A REIT must include in its Form 10-Q the MD&A discussion described above and included in the Form S-11 and Form 10-Q (Item 2)

- *Market Risk Factors*. A REIT must include in its Form 10-Q the same type of Market Risk Factors as are described above in connection with the Form S-11 and Form 10-K (Form S-11, Form 10-K and Form 10-Q reference the same provision of Regulation S-K in describing the required Market Risk Factors) (Item 3)

- *Effectiveness of disclosure controls and procedures*. A REIT must disclose the conclusions of the REIT's principal executive and principal financial officers, or persons performing similar functions, regarding the effectiveness of the REIT's Disclosure Controls, adopted pursuant to SOX, as of the end of the period covered by the report, based on the evaluation of these controls and procedures required by SOX (Item 4)

<u>Part 2</u>

- *Legal Proceedings*. A REIT must disclose and describe any material pending legal proceedings, other than ordinary routine litigation incidental to the business of the REIT, to which the REIT or any of its subsidiaries is a party or of which any of their property is the subject. The description must include the name of the court or agency in which the proceedings are pending, the date instituted, the principal parties thereto, a description of the factual basis alleged to underlie the proceeding and the relief sought. A REIT must include similar information as to any such proceedings known to be contemplated by governmental authorities (Item 1)

- *Risk Factors*. The REIT must provide any updates to the risk factors applicable to the REIT since disclosure of risk factors in its previous Form 10-K. (Item 1A)

- *Securities offerings*. The REIT must provide information regarding any securities sold or repurchased during the quarter to which the Form 10-Q corresponds.

- *Defaults and Changes in Dividends*. The REIT must discuss and provide information regarding any material default in the payment of principal, interest, a sinking or purchase fund installment, or any other material default not cured within 30 days, with respect to any indebtedness of the REIT or any of its significant subsidiaries exceeding 5% of the total assets of the REIT and its consolidated subsidiaries. The REIT must also discuss and provide information regarding any material arrearage in the payment of dividends that has occurred or any other material delinquency not cured within 30 days with respect to any class of preferred stock of the REIT which is registered or which ranks prior to any class of registered

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<tr><td></td><td>securities, or with respect to any class of preferred stock of any significant subsidiary of the REIT.

• 8-K Information. The REIT must disclose any facts or information that would be required to be disclosed in a Form 8-K (discussed below) during the fourth quarter of the fiscal year covered by the Form 10-K (Item 9B)

• Exhibits. The REIT must provide a range of exhibits to each Form 10-Q (or must incorporate those exhibits by reference with a cross reference, if permitted), as set forth in Item 601 of Regulation S-K.</td></tr>
<tr><td>- Form 8-K (Section 13 or 15(d))</td><td>Form 8-K is used to report important current events. The Form 8-K provides that an obligation to file the Form is triggered by the following events, though as noted in Section 8 of the Form, a REIT may choose to file a Form 8-K for other events that it believes are sufficiently significant (the list below is broken down by topic in accordance with the divisions in the Form 8-K):

• Section 1 -- Registrant's Business and Operations
○ Item 1.01 Entry into a Material Definitive Agreement
○ Item 1.02 Termination of a Material Definitive Agreement
○ Item 1.03 Bankruptcy or Receivership

• Section 2 -- Financial Information
○ Item 2.01 Completion of Acquisition or Disposition of Assets
○ Item 2.02 Results of Operations and Financial Condition
○ Item 2.03 Creation of a Direct Financial Obligation or an Obligation under an Off-Balance Sheet Arrangement of a Registrant
○ Item 2.04 Triggering Events That Accelerate or Increase a Direct Financial Obligation or an Obligation under an Off-Balance Sheet Arrangement
○ Item 2.05 Costs Associated with Exit or Disposal Activities
○ Item 2.06 Material Impairments

• Section 3 -- Securities and Trading Markets
○ Item 3.01 Notice of Delisting or Failure to Satisfy a Continued Listing Rule or Standard; Transfer of Listing
○ Item 3.02 Unregistered Sales of Equity Securities
○ Item 3.03 Material Modification to Rights of Security Holders

• Section 4 -- Matters Related to Accountants and Financial Statements
○ Item 4.01 Changes in Registrant's Certifying Accountant
○ Item 4.02 Non-Reliance on Previously Issued Financial Statements or a Related Audit Report or Completed Interim Review</td></tr>
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Section 5 -- Corporate Governance and Management

Item 5.01 Changes in Control of Registrant
Item 5.02 Departure of Directors or Certain Officers; Election of Directors; Appointment of Certain Officers
Item 5.03 Amendments to Articles of Incorporation or Bylaws; Change in Fiscal Year
Item 5.04 Temporary Suspension of Trading Under Registrant's Employee Benefit Plans
Item 5.05 Amendment to Registrant's Code of Ethics, or Waiver of a Provision of the Code of Ethics
Item 5.06 Change in Shell Company Status

Section 6 -- Asset-Backed Securities

Item 6.01 ABS Informational and Computational Materials
Item 6.02 Change of Servicer or Trustee
Item 6.03 Change in Credit Enhancement or Other External Support
Item 6.04 Failure to Make a Required Distribution
Item 6.05 Securities Act Updating Disclosure

Section 7 -- Regulation FD

Item 7.01 Regulation FD Disclosure

Section 8 -- Other Events

Item 8.01 Other Events (The registrant can use this Item to report events that are not specifically called for by Form 8-K, that the registrant considers to be of importance to security holders.)

Section 9 -- Financial Statements and Exhibits

Item 9.01 Financial Statements and Exhibits

Form 8-Ks relating to events described in Sections 1-6 or Section 9 must be filed within four days of the event.</td></tr>
<tr><td>- Section 16</td><td>Because a REIT is registered under Section 12 of the 1934 Act, each officer, director and beneficial owner of more than 10% of any class of the REIT’s securities (a “Covered Person”) is subject to the filing requirements and substantive restrictions on short-swing trading profits of Section 16.</td></tr>
<tr><td>- Forms 3, 4 and 5 (Section 16(a))</td><td>Forms 3, 4 and 5 are filed pursuant to Section 16(a) of the 1934 Act and set forth a Covered Persons ownership of REIT securities (or, as described below, derivatives for which REIT securities serve as the underlier). The forms are publicly available, and an issuer is required to disclose in its Form 10-K and annual proxy statement the names of any Covered Persons who fail to timely submit Forms 3, 4 or 5.</td></tr>
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	<u>Form 3</u> A Covered Person must file a Form 3 at the time the REIT's registration statement under the 1934 Act becomes effective or within 10 days of the date the Covered Person becomes a Covered Person. In connection with equity securities of a REIT, the Form 3 requires a Covered Person to provide: the title of the equity securities the Covered Person owns, the amount of such securities, whether the Covered Person's ownership of the equity security is direct or indirect and, if indirect, the form of the indirect ownership. In connection with derivatives for which REIT securities are the underlying security, a Covered Person must provide, as applicable, the exercise date and expiration date of the derivative, the title and amount of the underlying REIT security, the conversion or exercise price of the REIT security, whether the Covered Person's ownership of the derivative security is direct or indirect and, if indirect, the form of the indirect ownership. <u>Form 4</u> A Covered Person must file a Form 4, updating its ownership information, before the end of the second business day following any transaction which causes its previously reported ownership to change. <u>Form 5</u> A Covered Person must file Form 5, setting out its ownership interest in the REIT's equity securities or in derivatives based on such securities, on an annual basis, no later than 45 days after the end of the REIT's fiscal year.
- Short swing profit restrictions (Section 16(b))	Under Section 16(b) of the 1934 Act, any profits resulting from a Covered Person's combination of purchases and sales or sales and purchases of the REIT's stock (or derivatives, as described above) must be turned over to the REIT. The method of calculating when profit or loss has occurred, as well as the amount of profit and loss, is complex. This rule is a prophylactic measure intended to prevent the misuse of inside information.
- Prohibition on Covered Person short sales (Section 16(c))	Section 16(c) of the 1934 Act prohibits Covered Persons from shorting REIT securities, even if the Covered Person owns the REIT securities and is shorting "against the box."
- Section 10(b) anti-fraud provision (and the rules thereunder)	A REIT is subject to the anti-fraud provisions of Section 10(b) and the rules thereunder.
- Proxy Rules (Section 14 and the rules thereunder)	As a company registered under the 1934 Act, a REIT is subject to the rules governing the solicitation of proxies and the requirements applicable to proxy solicitation materials.
- Proxy Solicitation Materials	A company subject to the proxy rules cannot solicit a proxy from investors unless it includes a proxy statement containing the information in Schedule 14A. Among other things, Schedule 14A requires a proxy statement to include the following information, where applicable:

	• *Revocation*. Whether or not the person giving the proxy has the power to revoke it (Item 2) • *Dissenter's rights*. The rights of appraisal or similar rights of dissenters with respect to any matter to be acted upon and indicate any statutory procedure required to be followed by dissenting security holders in order to perfect such rights (Item 3) • *Source and interest*. Information about the persons making the solicitation and their interest in the proposed vote, action or transaction for which the proxy is sought (Items 4 and 5) • *Information about directors*. If the proxy relates to the election of directors, certain information about the proposed directors and their proposed compensation (Item 7) • *Information about accountant*. If the proxy relates to the selection, approval or ratification of the company's independent public account, information describing the registrant's relationship with its independent public accountant (Item 9) • *Compensation plans*. If the proxy relates to actions to be taken with respect to any plan pursuant to which cash or noncash compensation may be paid or distributed, information about the features of the plan, the eligible officers and employees, the basis of participation and whether and how the plan can be amended without shareholder approval (Item 10) • *Exchange or Modification*. If the proxy relates to the modification or exchange of a company's securities, information about the proposed modification or exchange as well as financial statements and financial information (Items 11-13) • *Merger or Acquisition*. If the proxy relates to a proposed merger or acquisition, significant information equivalent to what would be required on a registration statement under Form S-4, among other things (Item 14) • *Acquisition or Disposition of Property*. If the proxy relates to a significant acquisition or disposition of property, a description of the general character and location of the property, the nature and amount of consideration to be paid or received by the company or any subsidiary, an outline of the facts bearing upon the question of the fairness of the consideration, the name and address of the transferor or transferee and the nature of any material relationship of such person to the company or any affiliate of the company, and an outline of the material features of the contract or transaction (Item 15) • *Restatement*. If the proxy relates to the restatement of any asset, capital, or surplus account of the registrant, information regarding the nature of the restatement and the date as of which it is to be effective,

	the reasons for the restatement and for the selection of the particular effective date, the name and amount of each account (including any reserve accounts) affected by the restatement and the effect of the restatement, and to the extent practicable, a statement of whether and the extent, if any, to which, the restatement will alter the amount available for distribution to the holders of securities (Item 16) • *Amendments*. If the proxy relates to an amendment of the company's charter, bylaws or other documents as to which information is not required above, information regarding the reasons for and the general effect of the amendments (Item 19) • *Voting procedures*. Information about the vote required to approve the proposed action and the method of counting votes (Item 21)
- Pre-filing of Proxy Materials	Any proxy solicitation materials must be filed with the SEC at least 10 calendar days prior to dissemination of the materials, unless the solicitation relates solely to certain routine matters such as election of directors or approval or certification of accountants.
- Filing of Proxy Materials	A definitive proxy statement, form of proxy and all other soliciting materials, in the same form as the materials sent to security holders, must be filed with the SEC no later than the date they are first sent or given to security holders.
- Anti-fraud Provisions of Proxy Rules (Section 14(e) and Rule 14a-9)	REITs are subject to the anti-fraud provisions of Section 14(e) and Rule 14a-9 in conducting a proxy solicitation.
- Section 13(d) and (g)	Investors in public REITs are subject to the reporting obligations of Sections 13(d) and (g) under the 1934 Act if such an investor acquires sufficient ownership to trigger the reporting obligations. Of course, like all market participants, a REIT is also subject to Section 13(d) and (g) reporting requirements if the REIT acquires a sufficient interest in a public company, such as another REIT, though certain asset limitations under the Code applicable to REITs limits a REIT's ability to make such investments (See the 25% Asset Test and related requirements, below).
- Tender Offer Rules	As public companies, REIT investors are given the protections of the rules governing both third party and issuer tender offers.
- Regulation FD	Public REITs are subject to the selective disclosure regime of Regulation FD. Thus, whenever a REIT, or any person acting on its behalf, discloses any material nonpublic information regarding the REIT or its securities to any Reg FD Covered Person (as defined below), the REIT must make public disclosure of that information: • Simultaneously, in the case of an intentional disclosure (meaning the person making the disclosure either knows, or is reckless in not knowing, that the information he or she is communicating is both material and

	nonpublic); and • Promptly, in the case of a non-intentional disclosure. "**Reg FD Covered Person**" means, generally, • a broker or dealer, or a person associated with a broker or dealer as defined in the 1934 Act • an investment adviser, an institutional investment manager required to file a Form 13F with the SEC for the most recent quarter ended prior to the date of the disclosure, or a person associated with either of the foregoing • an investment company or entity that would be an investment company but for Section 3(c)(1) or Section 3(c)(7) of the 1940 Act, or an affiliated person of either of the foregoing • a holder of the REIT's securities, under circumstances in which it is reasonably foreseeable that the person will purchase or sell the REIT's securities on the basis of the information.
INTERNAL REVENUE CODE	**An entity that meets the requirements for taxation as a REIT is entitled to a deduction for dividends paid to its shareholders. As a result, a REIT generally distributes annually to shareholders an amount equal to 100% of its taxable income.**
- General requirements	For an entity to be treated as a REIT under the Code: • it must be managed by one or more trustees or directors • the beneficial ownership of the entity must be evidenced by transferable shares or transferable certificates of beneficial interest • it must otherwise be taxable as a corporation (but for its election to be taxed as a REIT) • it cannot be a financial institution referred to in Section 582(c)(5) of the Code (such as a bank, mutual savings bank, building and loan association or other savings institution) or an insurance company • the beneficial ownership of the entity must be held by 100 or more persons for all years after the first taxable year for which a REIT election is made • it must not be "closely held" for all years after the first taxable year for which a REIT election is

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• it must meet two annual gross income tests and two quarterly asset tests, and

• it must satisfy a dividend distribution requirement.

The “closely held” requirement, the asset and income tests and the dividend distribution requirements are discussed below.</td></tr>
<tr><td>- Closely Held Requirement (Section 856(h)(1)(B) of the Code)</td><td>Generally, five or fewer individuals cannot own more than 50% of a REIT’s shares during the last half of the REIT’s taxable year. For purposes of this requirement, attribution rules generally apply under which shares held by a corporation, trust, or partnership are deemed to be owned proportionately by the shareholders, beneficiaries, or partners, as applicable.</td></tr>
<tr><td>- Two income tests (Sections 856(c)(2) and (3) of the Code)</td><td>The two annual gross income tests are a 75% test (the “75% Income Test”) and a 95% test (the “95% Income Test”).

<u>The 75% Income Test</u>

At least 75% of a REIT’s gross income during a year (excluding income from “prohibited transactions” as defined below and income from qualified REIT hedging transactions) must come from real estate related sources, such as, among other things:

• rents from real property

• interests on obligations secured by mortgages on real property or on interests in real property, including interest on certain types of mortgage-backed securities

• gains from sale or disposition of real property, including interests in real property or interests in mortgages on real property, other than in a prohibited transaction

• dividends or distributions from shares of other REITs

• abatements and refunds of taxes on real property

• amounts received or accrued for entering into agreements to make loans secured b mortgages or to purchase or lease real property (such as commitment fees)

“Prohibited transaction” means the sale of property held by the REIT primarily for sale to customers in the</td></tr>
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	ordinary course of business. A 100% income tax is applied to net income from prohibited transactions. The 95% Income Test At least 95% of a REIT's gross income during a year must be derived from items that qualify under the 75% Income Test or from dividends or interest from any source, which need not be related to real estate activities.
- Two Asset Tests (Section 856(c)(4) of the Code)	The two quarterly asset tests are a 75% test (the "**75% Asset Test**") and a 25% test (the "**25% Asset Test**"). . The 75% Asset Test On the last day of each calendar quarter of a REIT's taxable year, at least 75% of its assets must constitute "real estate assets," cash and cash items (including receivables arising in the ordinary course of the REIT's business) and government securities. "**Real estate assets**" generally means real property, including interests in real property and interests in mortgages on real property, interests in other REITs and REMICs and property (which need not be a real estate asset) attributable to the temporary investment of new capital. 25% Asset Test On the last day of each calendar quarter of a REIT's taxable year no more than 25% of the value of the REIT's total assets can be represented by securities other than government securities and securities, such as certain types of mortgage-backed securities, which are treated as real estate assets. Shares of stock in wholly owned "qualified REIT subsidiaries" are not treated as securities; a qualified REIT subsidiary is ignored as an entity separate from the parent REIT. Also, (i) no more than 25% of the value of a REIT's total assets can constitute securities issued by one or more taxable REIT subsidiaries; and, except in the case of a taxable REIT subsidiary or a qualified REIT subsidiary, (ii)(A) the securities of a single issuer cannot represent more than 5% of the value of a REIT's total assets, (B) a REIT cannot own more than 10% of the outstanding voting securities of any one issuer , and (C)other than in the case of certain straight debt securities, a REIT cannot own more than 10% of the total value of the outstanding securities of any one issuer..
- Dividend Distribution Requirements (Section 857(a)(1))	To maintain its status as a REIT under the Code, a REIT's deduction for dividends paid must equal at least (1) the sum of (a) 90% of the real estate investment trust's taxable income for the taxable year (determined without deducting for dividends paid and excluding any net capital gain) and (b) 90% of the excess of the net income from foreclosed property over the tax imposed on that income, minus (2) any "excess noncash income" (as defined in the Code). A failure to meet the distribution requirement for a taxable year will cause the REIT to be taxed as a C corporation for that year.
MARYLAND CORPORATE LAW	**Many REITs are organized as Maryland corporations. Maryland was one of the first states to adopt a statute specifically addressing REITs. State requirements impose fiduciary and other duties upon directors**

	and officers of REITs.
- Adherence to Charter and Bylaws	Maryland's corporations law gives its corporations significantly flexibility to organize its internal affairs and adopt guidelines and limitations on virtually any subject, including the corporation's permitted businesses, conditions for issuing securities, voting rights and procedures (e.g., quorum requirements, provisions requiring a vote, etc.), elections and powers of directors and officers, indemnification and limitation of liability of officers and directors (absent required indemnification) as well as conditions thereon. A Maryland corporation must adhere to the provisions of its charter and by-laws, which are filed with the State and are publicly available, along with amendments thereto. These organizational documents are also made publicly available as part of a REIT's 1934 Act filings.
- Standard of Care	As a fiduciary, officers and directors of a corporation are subject to a standard of care in carrying out corporate affairs. An officer or director must perform his or her duties in good faith, in the manner the director reasonably believes to be in the corporations best interests, and with the care that an "ordinarily prudent person in a like position would use under similar circumstances."[5] In applying the "prudent person" standard, courts use a "gross negligence" standard.[6] A director's fiduciary duty and standard of care change and become more complex in the context of a proposed merger or business combination.
- Directors' Limits on Reliance on Others	Directors are entitled to rely on material prepared by opinions, reports or statements prepared by officers or employees of the corporation who the director "reasonably believes to be reliable and competent in the matters presented" or a committee of the board who the director believes "merit[s] confidence."[7] Reliance by a director is not considered in good faith, however, if he or she has knowledge that would cause reliance to be unwarranted.[8]
- Corporate Opportunity	A Maryland corporation's directors, officers and majority stockholders cannot divert for their own purposes opportunities that rightly belong to the corporation. The corporate opportunity doctrine stems from directors', officers' and, to some extent, majority stockholders' duties to the corporation, and is the subject of a great deal of

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5 *See* Maryland Code Ann., Corporations & Associations § 4-405.1(a).

6 *See, e.g., NAACP v. Golding*, 679 A.2d 554 (Md. 1996); *Parish v. Md. & Va. Milk Producers Association*, 242 A.2d 512 (Md. 1968).

7 *See* Maryland Code Ann., Corporations & Associations § 4-405.1(b)(1)(i) and (ii).

8 *See* Maryland Code Ann., Corporations & Associations § 4-405.1(b)(2).

	judicial interpretation and gloss.
- Interested Director Transactions	A contract between the corporation and a director or the corporation and any entity in which a director has a financial interest or for which the director serves also serves as a director must be approved (i) by the disinterested directors or a committee of such directors or (ii) by stockholders. In any event, the contract must be "fair and reasonable to the corporation."[9]
- Shareholders' Right to Bring a Derivative Suit	Subject to certain case law imposed procedural requirements and making certain showings, a shareholder may bring an action against officers, directors or third parties on behalf of the corporation.
- Limits on Exculpation and Indemnification	Maryland law imposes limits on a corporation's statutory obligation and ability to indemnify directors, officers and employees under certain circumstances[10] and circumscribes the extent to which the liability of such persons can be limited.
MARKET-DRIVEN CONSTRAINTS AND PRACTICES	**Although not mandated by law or regulation, market practices, including pressures stemming from competition, shareholders and directors, create certain industry standard practices for REITs.**
- Custody	Most REITs maintain their assets with large, established financial institutions in order to minimize counterparty risk.
- Affiliated transactions	In addition to state and federal provisions imposing substantive and disclosure obligations in the context of affiliated transactions, investors, directors and competitive pressure impose limits on accepted transactions between a REIT and its affiliates, limiting self-dealing in the REIT industry.
VALUATION AND ACCOUNTING STANDARDS	**REITs registered under the 1934 Act are required to prepare and disseminated audited financial statements prepared in accordance with generally accepted accounting principles ("GAAP"), as described above. Even REITs which are not registered under the 1934 Act generally prepare and provide to investors audited financial statements prepared in accordance with GAAP. In preparing GAAP compliant financial statements, REITs must comply with the many sources of GAAP, including standards issued by the Financial Accounting Standards Board ("FASB") and, in the case of companies registered under the 1934 Act, SEC guidance and regulations governing the preparation of financial statements and accounting.** **A few of these SEC and FASB standards are described below. A more complete list, though not exhaustive, is attached as Exhibit 2.**

9 *See* Maryland Code Ann., Corporations & Associations § 4-419(a).

10 See Maryland Code Ann., Corporations & Associations § 4-418.

- Financial Accounting Standard 157 ("**FAS 157**") – "Determination of Fair Value"	In preparing financial statements in accordance with GAAP, REITs, like all companies seeking a GAAP-compliant audit, must ascertain a "fair value" for various assets and instruments. FAS 157 applies to other Financial Accounting Standards that require a fair value measurement, subject to certain limitations. FAS 157 defines fair value, establishes a framework for measuring fair value in GAAP and requires disclosures about fair value measurements. Generally, FAS 157 defines "fair value" as "the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date." FAS 157 describes the meaning of the terms used in this general definition and the assumptions and determinations that must be made in applying the definition.
- Financial Accounting Standards 166 ("**FAS 166**") – "Accounting for Transfers of Financial Assets"	Securitization is an important part of the real estate industry; because REITs are significant participants in the real estate industry, the accounting pronouncements governing securitization are important to the operation and activities of REITs. FAS 166 was adopted by FASB in June 2009, and amended previous guidance provided in FAS 140. FAS 166 significantly affects the way in which originators account for transfers in securitizations by imposes requirements on when the transfer of an interest in a special purpose vehicle can truly be treated as a sale, and, therefore, affects the accounting for securitized mortgage loans generally. FAS 166 eliminated (1) the exceptions for qualifying special-purpose entities from the consolidation guidance of FASB Interpretation No. 46, as amended ("**FIN 46(R)**"), which many banks used frequently in securitizations, and (2) the provisions of FAS 140 that permitted sale accounting for certain mortgage securitizations when a transferor has not surrendered control over the transferred financial assets.
- Financial Accounting Standards 167 ("**FAS 167**") – "Accounting for Transfers of Financial Assets"	FAS 167, which amends FIN 46(R), also has a significant effect on accounting in the context of securitizations. FAS 167 changes how an enterprise determines when an entity that is insufficiently capitalized or is not controlled through voting, or similar rights, should be consolidated. FAS 167 requires an enterprise to assess on an ongoing basis whether its interest in another entity makes that entity a "variable interest entity," such that the enterprise must include in its financial statements the assets, liabilities and activities of the entity. FAS 167 amends FIN 46(R) in a number of important ways with significant affects on originators of securitizations, special purpose vehicles and holders of interests in special purpose vehicles used for securitization.

<u>EXHIBIT 1</u>

STATUTES ADDRESSING OR RELATING TO REITS

Statute	Description
Investment Company Act of 1940 (the "<u>1940 Act</u>")	Section 3(c)(5)(C) of the 1940 Act provided the exemption from investment company statutes that REITs rely upon in operating without registration under the 1940 Act.
Real Estate Investment Trust Act of 1960 (the "<u>1960 Act</u>")	The 1960 Act created the REIT structure.
A bill to amend the Tariff Schedules of the United States to permit the importation of upholstery regulators, upholsterer's regulating needles, and upholsterer's pins free of duty (the "<u>1974 Provisions</u>")	The 1974 Provisions amended the REIT qualification rules such that (1) a REIT's receipt of income from foreclosure property and (2) the acquisition of real property upon foreclosure would not result in loss of REIT status. Instead of disqualification, the 1974 Provisions require a REIT acquiring real property upon foreclosure to pay corporate income tax on income received from foreclosure property and permit the REIT to elect a two-year grace period to liquidate the foreclosure property without being disqualified for holding property for sale to customers in the ordinary course of business.
The Tax Reform Act of 1976 (the "<u>1976 Act</u>")	The 1976 Act revised the 1960 Act to (1) provide a REIT the ability to make a "deficiency dividend" distribution to avoid disqualification for not distributing 90% of its annual income in instances where the REIT acted in good faith to satisfy the distribution requirements but failed to do so because of an audit adjustment, (2) impose an excise tax on a REIT for failure to distribute at least 75% of its real estate investment trust taxable income by the close of its taxable year, (3) replace the prohibition against a REIT holding property (other than foreclosure property) for sale to customers in the ordinary course of business with a tax of 100% on the net income from the sale or disposition of such property (the "prohibited transactions" tax), and (4) impose a 100% tax on net income attributable to the amount by which a REIT fails to meet the income source tests in lieu of disqualification.
The Revenue Act of 1978 (the "<u>1978 Act</u>")	The 1978 Act created a safe-harbor such that the prohibited transactions tax on property held primarily for sale by a REIT would not apply to the sale of property where the following conditions are satisfied: (1) the property has been held by the REIT for at least four years, (2) the total expenditures made by the REIT during the four-year period prior to sale do not exceed 20 percent of the net selling price of the property, (3) the REIT does not sell more than five properties during the taxable year, and (4) if the property is land or improvements not acquired through foreclosure, the property is held by the REIT for rent for a period of at least four years.
Secondary Mortgage Market Enhancement Act of 1984 ("<u>SMMEA</u>")	SMMEA sought to reduce regulatory barriers preventing private companies from issuing mortgage backed securities. SMMEA added a definition of "mortgage related securities" to the Securities and Exchange Act of 1934 and granted such securities special treatment under several provisions of the federal and state securities laws. In adopting SMMEA, Congress noted the SEC's exemptive authority under Section 6(c) of the

	1940 Act and stated that it expected the SEC to use that power to encourage a vigorous private secondary mortgage market.
Tax Reform Act of 1986 (the "1986 Act")	The 1986 Act curtailed use of REITs as tax shelters but removed certain restrictions on direct management and operation of properties by REITs as originally set forth in the 1960 Act. The 1986 Act revised the REIT asset requirement rules to permit REITs to hold assets in a wholly owned subsidiary ("qualified REIT subsidiary" or "QRS") such that a REIT and its QRS are treated as a single taxpayer (i.e., the separate corporate status of the QRS is ignored). The 1986 Act also, among other things, modified the prohibited transactions rules to increase the number of properties that could be sold within the safe harbor from four to seven and increase the amount of expenditures that a REIT may make within the four-year period prior to sale from 20 percent to 30 percent of the net selling price of the property.
Technical and Miscellaneous Revenue Act of 1988 (the "1988 Act")	The 1988 Act provided rules governing the treatment of interest rate swap or cap agreements (i.e., agreements which protect the REIT from interest rate fluctuations on variable debt incurred to acquire or carry real property) held by REITs. Such agreements are treated as securities for purposes of the three-percent test and payments under them qualify for the 95-percent income test. The 1988 Act also, among other things, provided that dividends declared in October, November, or December and made payable to shareholders of record in such a month are deemed to have been paid by the REIT and received by its shareholders on December 31 of such year, so long as the dividends are actually paid during January of the following year.
Revenue Reconciliation Act of 1993 (the "1993 Act")	The 1993 Act modified how beneficial owners of a REIT's shares are counted in determining whether a REIT meets the requirement that no more than 50% of a REIT's shares may be held by five or fewer beneficial owners. The 1993 Act permitted certain beneficiaries of pension plan participants to be counted as investors, rather than the pension plan itself, making REITs better able to take large institutional investments without the risk of violating the "five or fewer" rule.
REIT Simplification Act, passed as part of the Taxpayer Relief Act of 1997 (the "1997 Provisions")	The 1997 Provisions, among other things, (1) create a de minimis exception to prior law so that a REIT's rental income is not disqualified if it performs nominal, although impermissible, services for a tenant, (2) mirror corresponding mutual fund rules governing taxation of retained capital gains by passing through a credit to shareholders for capital gains taxes paid at the REIT level, (3) repeal the 30% gross income test (in conformity with the repeal of the analogous "short-short" test for mutual funds), (4) simplify property foreclosure rules, (5) update the current REIT hedging rule to include income from all hedges of REIT liabilities, (6) create a safe harbor to the shared appreciation mortgage rules that does not penalize a REIT lender for the borrower's bankruptcy, and (7) codify an IRS ruling position by allowing QRS status for a wholly-owned subsidiary even if the subsidiary previously had been owned by a non-REIT.
REIT Modernization Act (signed into law as part of the Ticket to Work and Work Incentives Improvement Act of 1999 (the "1999 Act"))	The 1999 Act, among other things, (1) allowed REITs to own up to 100% of the securities of a taxable REIT subsidiary (a "TRS"), subject to limitations, including limitations on the value of TRS compared to a REIT's total assets, (2) lowered the distribution requirement of REITs from 95% to 90%, which had been the requirement applicable between 1960 and 1980, (3) permitted REITs to hire a manager to operate nursing

	homes and other healthcare facilities without a lease for a certain period of time until it can secure a new lease, and (4) made certain technical changes to how a company calculates pre-REIT earnings that it must distribute to investors after electing REIT status or merging with a C Corporation.
Jobs and Growth Tax Relief Reconciliation Act of 2003 (the "2003 Act")	The 2003 Act lowered the tax rates applicable to certain corporate dividends, although REIT distributions generally do not qualify for the reduced rate under the 2003 Act.
REIT Improvement Act (signed into law as part of the American Jobs Creation Act of 2004 (the "2004 Act"))	The 2004 Act, among other things, (1) adopted retroactive changes to the Internal Revenue Code of 1986, as amended (the "Code"), to better allow REITs to make certain loans in the ordinary course of business without risking the loss of a company's REIT status, (2) clarified certain rules intended to prevent a REIT from inappropriately shifting income out of its TRS to the REIT, (3) modifies certain safe harbors under which a REIT may shift income or deductions between the REIT and its TRS, (4) modified the rules governing treatment of REIT hedging income in computing the 95% gross income test, (5) in certain cases imposes monetary penalties for failure to qualify as a REIT for a given period rather than loss of REIT status (amending the "death trap" provisions applicable to REIT status), (6) modifies the treatment of foreign investors in a REIT, and (7) provides for certain deductions and contains other provisions not specifically addressed at REITs, but which affect REITs.
Tax Increase Prevention and Reconciliation Act of 2005 (the "2005 Act")	The 2005 Act modified the treatment of distributions made by REITs and RICs (as defined in the tax code) attributable to foreign investment in real property (or FIRPTA) rules.
Housing and Economic Recovery Act of 2008 (which contained all but one of the titles of the proposed REIT Investment Diversification and Empowerment Act of 2007) (the "2008 Act")	The 2008 Act's REIT-related provisions include: (1) reducing the holding period under the prohibited transaction safe harbor test from four years to two years, (2) changing the measurement of the 10% of sales permitted under the safe harbor test from current tax basis to either tax basis or fair market value (at the REIT's annual option), (3) increasing the size ceiling for TRS from 20 percent to 25 percent of assets, (4) permitting health care REITs to use TRS in the same manner as hotel REITs, (5) excluding most real estate-related foreign currency gains from the computation of the REIT income tests; and, (6) providing the Treasury Department with clear authority to rule on whether a variety of items qualify under the REIT gross income tests.

<u>EXHIBIT 2</u>

GUIDANCE AFFECTING PREPARATION AND PRESENTATION OF REIT FINANCIAL STATEMENTS

REITs, as public companies, are required to include audited financial statements, prepared in accordance with generally accepted accounting principles ("**GAAP**"), in various annual and periodic disclosures. In preparing and presenting such GAAP-compliant disclosures, REITs are subject to a significant amount of guidance that must be taken into account. This chart lists certain sources of guidance governing REITs' preparation and presentation of financial statements and financial information.

Guidance	Description
STANDARDS OF THE FINANCIAL ACCOUNTING STANDARDS BOARD ("<u>FASB</u>")	FASB Standards are a core component of GAAP and serve a key basis for the presentation and preparation of all GAAP-complaint financial statements and materials. A large number FASB Standards and Interpretations apply to the presentation of REITs' financial statements; some of those FASB Standards are listed below.
- FAS 13	Governs accounting for leases (amended by FAS Nos. 22, 23, 27, 28, 29, 91 and 98)
- FAS 22	Modifies FAS 13 in accounting for provisions of lease agreements resulting from refundings of tax-exempt debt
- FAS 23	Modifies FAS 13; deals with inception of leases
- FAS 27	Modifies FAS 13; relates to classification of renewals or extensions of existing sales-type or direct financing leases
- FAS 28	Modifies FAS 13; relates to accounting for sales with leasebacks
- FAS 29	Modifies FAS 13; deals with contingent rental payments
- FAS 47	Governs accounting for long-term obligations
- FAS 65	Governs accounting for certain mortgage banking activities that may apply to REITs (amended by FAS Nos. 91, and 134)
- FAS 66	Governs accounting for sales of real estate (amended in part by FAS 98 and 152)
- FAS 67	Governs accounting for costs and initial rental operations of real estate projects
- FAS 91	Governs accounting for nonrefundable fees and costs associated with originating or acquiring loans and initial direct costs of leases (amended by FAS No. 98)
- FAS 95	Governs presentation of statement of cash flows (amended by FAS Nos. 102 and 104)
- FAS 98	Modifies certain previous guidance relating to accounting for sale-leaseback transactions involving real estate, sales-type leases of real

	estate, the definition of the lease term, and initial direct costs of direct financing leases
- FAS 102	Amends previous guidance on statement of cash flows by providing certain exemptions and governing classification of cash flows from certain securities acquired for resale
- FAS 104	Amends previous guidance on statement of cash flows by providing for net reporting of certain cash receipts and cash payments and governing classification of cash Flows from hedging transactions
- FAS 134	Governs accounting for mortgage-backed securities retained after the securitization of mortgage loans held for sale by a mortgage banking enterprise
- FAS 140	Governs accounting for transfers and servicing of financial assets (including mortgage servicing) and extinguishments of liabilities
- FAS 152	Governs accounting for real estate time-sharing transactions (amending certain previous guidance)
- FAS 157	Governs fair value measurements
- FAS 166	Governs manner of accounting for certain transfers of financial assets (e.g., when a sale a true sale)
- FAS 167	Amends certain previous guidance on when entities must be consolidated with those of another entity (affects securitizations)
- FAS 168	Provides a hierarchy of FASB guidance
FASB INTERPRETATIONS	FASB publishes interpretive guidance that affects GAAP compliance by modifying or interpreting FASB Standards. Certain of those interpretations are described briefly below.
REGULATION S-X	Regulation S-X sets forth the form and content of and requirements for financial statements required to be filed as a part of registration statements under the Securities Act of 1933, as amended (the "1933 Act"), registration statements under section 12 of the Securities and Exchange Act of 1934, as amended (the "Exchange Act"), annual or other reports under Sections 13 and 15(d) and proxy and information statements under Section 14 of the Exchange Act. Because REITs generally register the offer and sale of shares under the 1933 Act and are registered under the Exchange Act, REITs are subject to Regulation S-X.
STAFF ACCOUNTING BULLETINS	Staff Accounting Bulletins ("SABs") reflect the Securities and Exchange Commission ("SEC") staff's views regarding accounting-related disclosure practices. They represent interpretations and policies followed by the Division of Corporation Finance and the Office of the Chief Accountant in administering the disclosure requirements of the federal securities laws. In preparing disclosure materials and financial statements under the 1933 Act and 1934 Act, REITs must take into account SABs.
STAFF COMPLIANCE& DISCLOSURE INTERPRETATIONS ("C&DIS")	Certain SEC staff C&DIs affect the preparation and presentation of financial statements, particularly those issued by the Division of

	Corporation Finance, including, without limitation, the C&DI regarding Non-GAAP Financial Measures and those regarding disclosures on specific forms and schedules under the 1933 Act and 1934 Act.
NAREIT BEST PRACTICES	NAREIT, the primary trade association for REITs, publishes certain best practices regarding the calculation and presentation of supplemental financial disclosures, mainly dealing with funds from operations (often abbreviated as "FFO").
INDUSTRY AND ANALYST REQUIREMENTS	The demands of the market and REIT analysts often require REITs to provide additional, supplemental financial information and calculations, in addition to that required in GAAP financial statements or forms and disclosures REITs are required to file or make, respectively, under the federal securities laws.

APPENDIX B

November 7, 2011

Submitted by e-mail to rule-comments@sec.gov

Elizabeth M. Murphy
Secretary
Securities and Exchange Commission
100 F Street, NE
Washington, DC 20549-1090

Re: Companies Engaged in the Business of Acquiring Mortgages and Mortgage-Related Instruments, Release No. IC-29778, File No. S7-34-11 ("**Section 3(c)(5)(C) Concept Release**"), and Treatment of Asset-Backed Issuers under the Investment Company Act, Release No. IC-29779, File No. S7-35-11("**Rule 3a-7 Release**")

Dear Ms. Murphy:

The Residential Committee of the NAREIT Mortgage REIT Council (the "**Committee**") appreciates the opportunity to provide these comments to the Securities and Exchange Commission (the "**Commission**" or the "**SEC**") on the Section 3(c)(5)(C) Concept Release and the Rule 3a-7 Release, and to thereby continue the several-year dialogue we have had with members of the Staff of the Division of Investment Management (the "**Division**") on many of the issues and questions raised in those Releases.

This letter ("**Letter**") generally represents the views of the community of publicly traded residential mortgage real estate investment trusts ("**REITs**"), and represents the views of a number of publicly traded commercial mortgage REITs. This Letter has been prepared with the assistance and input of many of those REITS. These REITs originate, finance and acquire residential and commercial mortgages, and other liens on and interests in real estate. Publicly traded mortgage REITs generally are listed on the New York Stock Exchange ("**NYSE**"), Nasdaq or other major stock exchanges in the United States, and are subject to significant existing regulation under the Federal securities laws, the Sarbanes-Oxley Act of 2002, the Federal tax laws, and stock exchange listing requirements.

I. INTRODUCTION AND SUMMARY

A. The Interest of Publicly-Traded Mortgage REITs in the Concept Releases

Publicly-traded mortgage REITs have been in existence, in basically their current form, for over 45 years.[1] During that time, virtually every publicly-traded mortgage REIT, or a significant subsidiary of that REIT, has relied on the Section 3(c)(5)(C) exception. We believe that the broad exception provided by Section 3(c)(5)(C) has been a tremendous regulatory success story: it has (among other things) permitted the publicly traded mortgage REIT market to develop and expand alongside the mortgage and real estate markets, to create and participate in new and innovative real estate and mortgage financing products, and to provide investors with a reliable investment opportunity that traditionally combines significant dividend yields with the potential for capital appreciation.

Publicly-traded mortgage REITs play a vibrant and vital role in the mortgage and real estate markets primarily by funding mortgage and mortgage-related loans, and by providing liquidity and financing for commercial and residential real estate lenders through their purchases and financings of mortgages and mortgage-related instruments, and to a lesser extent by directly originating mortgages and mortgage-related loans. As of August 31, 2011, the NAREIT Mortgage REIT index contained 29 publicly-traded mortgage REITs (17 residential and 12 commercial), with a combined market capitalization of $45 billion.[2] Similarly, as of June 30, 2011, the Bloomberg Mortgage REIT Index contained 33 publicly-traded mortgage REITs, with a combined market capitalization of $41 billion, holding approximately $292 billion in mortgages and mortgage-related instruments.[3] Since 2000, publicly-traded mortgage REITs have raised in excess of $52 billion in 235 public initial and follow-on offerings; virtually all of this money has been used to finance and provide liquidity to the real estate and mortgage markets.[4]

Moreover, publicly-traded mortgage REITs have been able to continue to raise capital and provide financing and liquidity to the mortgage markets even following the recent real estate

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[1] See NAREIT, REIT Industry Timeline, *available at* http://www.reit.com/timeline/timeline.php. In 1960, Congress enacted legislation establishing the special tax treatment applicable to certain REITs; the conditions that REITs have had to satisfy in order to be eligible for this tax treatment have to a significant extent since then defined the structure and investment and other activities of REITs. The first mortgage REIT began trading on the NYSE in 1965. Id.

[2] NAREIT, REITwatch (Oct. 2011), *available at* http://returns.reit.com/reitwatch/rw1110.pdf.

[3] Source: Searches on Bloomberg, and review of the REITs' public filings (market capitalization information as of September 30, 2011, and asset information as of June 30, 2011). Exhibit 1 contains a list of the 33 residential and commercial mortgage REITs that comprise the Bloomberg Mortgage REIT Index, along with information about their market capitalization and total assets.

[4] Source: Searches on Dealogic and Factset databases, through Sept. 30, 2011.

downturn. Since 2008, there have been 12 initial public offerings ("**IPOs**") for mortgage REITs, which have raised $3.15 billion.[5] During that same period, there have been 76 secondary mortgage REIT public offerings, which have raised over $27.6 billion.[6] In short, following the worst real estate downturn since the Great Depression, publicly-traded mortgage REITs have raised over $30 billion in 88 separate public offerings, which they have been able to use to originate, acquire and finance residential and commercial mortgages.[7]

As a result, the capital formation facilitated by publicly-traded mortgage REITs are an important component of the stabilization of the United States real estate markets. These REITs have proven to be highly safe and efficient vehicles for raising private-sector capital and investing that capital in the residential and commercial mortgage and real estate markets.[8] Entities such as mortgage REITs that can direct private capital into the mortgage markets are expected to be critical to the mortgage markets at a time when other traditional holders of mortgages, like the Federal Reserve, Treasury Department and government-sponsored-enterprises ("**GSEs**") – such as the Federal National Mortgage Association ("**FNMA**") and the Federal Home Loan Mortgage Corporation ("**Freddie Mac**") – reduce or eliminate their support of the secondary mortgage markets.[9] Notably, the suggestions in the Section 3(c)(5)(C) Concept Release that perhaps mortgage REITs should not be able to continue to participate in these markets – including through their continued purchase of agency whole pool securities and certain other mortgage-backed securities ("**MBS**") – could have a significant and adverse effect not only

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5 See Exhibit 2. These mortgage REIT IPOs have generated an average total return of approximately 29%, while both non-REIT IPOs and the S&P 500 have, during that same period, generated a total return of approximately 3% and 16%, respectively. Id.

6 See Exhibit 3. These mortgage REIT secondary offerings have yielded an average total return of approximately 18%, while non-REIT secondary offerings during the same period yielded a total return of approximately 12% (again as compared to the approximately 10% return of the S&P 500 during that period). Id.

7 See Exhibit 4. Since 2008, mortgage REIT initial and secondary public offerings have yielded an average total return of approximately 17%, while non-REIT initial and secondary offerings during the same period have yielded a total return of approximately 12%.

8 Indeed, in 1960, one of the reasons Congress enacted special tax rules for REITs, similar to the tax rules for registered funds, was to encourage a significant flow of capital into the real estate markets during a real estate downturn:

> [I]t is also desirable to remove taxation to the extent possible as a factor in determining the relative size of investments in stocks and securities on one hand, and real estate equities and mortgages on the other. This is particularly important at the present time because of the shortage of private capital and mortgage money for individual homes, apartment houses, office buildings, factories and hotels.

Real Estate Investment Trusts, House Report 86-2020 (June 28, 1960), at 4.

9 See SEC vs. Mortgage REITs: What It Means, JP Morgan Securities (Sept. 9, 2011).

on REITs and their investors, but also on the MBS market as a whole, and the underlying real estate markets that MBS finance.

As another example of the importance of publicly traded mortgage REITs to the recovery of the United States real estate and mortgage markets, during the first half of 2011, the Federal Reserve, the Treasury and GSEs have together reduced their MBS holdings by approximately $215 billion.[10] During that same period, mortgage REITs have been net purchasers of approximately $80 billion of MBS (approximately $70 billion of which was agency MBS).[11] Moreover, as previously mentioned, since 2008, publicly traded mortgage REITs have raised over $30 billion in capital; assuming a debt-to-equity leverage ratio of 5:1, publicly-traded mortgage REITs have been able to commit approximately $180 billion of new capital to the mortgage markets.

In addition to their importance to the mortgage and real estate markets, publicly-traded mortgage REITS provide investors with access to an asset class that historically has yielded attractive risk-adjusted dividend returns along with the opportunity for appreciation in share prices. For example, from 2000 through September 30, 2011, publicly-traded mortgage REITs have generated cumulative total returns (dividends plus price appreciation) of 123%, as compared to cumulative total returns during the same period for the S&P 500 of -4%. Most of the return from mortgage REITs has come from dividend income.[12]

As demonstrated by a number of comment letters the Commission already has received from individual investors, this income-based return has made publicly-traded mortgage REITs an attractive investment option to a wide variety of individual (and institutional) investors.

As discussed in section II.C of this Letter, publicly-traded mortgage REITS already are subject to significant regulations that, to a large extent, address many of the same investor protection concerns addressed by the provisions of the Investment Company Act of 1940, as amended (the "**1940 Act**").[13] Publicly traded mortgage REITs also have been largely free of significant Commission enforcement concerns.

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[10] Id. at 2.

[11] Id.

[12] See Exhibits 5 and 6. Exhibit 5 also demonstrates that since 2000 publicly-traded mortgage REITs have outperformed a range of different yield benchmarks and S&P 500 subsectors. Exhibit 6 shows that the strong relative performance of mortgage REITs has continued during the challenging market environment of 2011.

[13] In addition, Appendix A contains a "White Paper" that NAREIT previously submitted to the Division, which also lists a number of important regulatory provisions to which publicly-traded mortgage REITs already are subject.

It is from this context that we submit our comments. We begin by noting that Section 3(c)(5)(C) was written broadly. It excepts from registration and regulation under the 1940 Act companies and funds that "purchase or otherwise acquire" qualifying interests in real estate – there is no requirement, for example, that the company originate or service those interests. It treats as qualifying interests in real estate "mortgages and other liens on" real estate, as well as "other . . . interests in real estate."[14] Publicly-traded mortgage REITs are and hold themselves out to be primarily engaged in the business of purchasing or otherwise acquiring mortgages, other liens on real estate, and other interests in real estate. In many cases, they also originate or directly finance mortgage loans. In short, they appear to engage in precisely the type of real estate investment activities that Section 3(c)(5)(C) was intended to exclude from 1940 Act regulation. This conclusion is demonstrated empirically by the fact that publicly traded mortgage REITs have relied on Section 3(c)(5)(C) for over half a century (that is, since 1960, when Congress enacted the legislation providing REITs with their specific tax treatment).

Publicly traded mortgage REITs also are active participants in creating, purchasing interests in, and managing mortgage-related securitization vehicles, including many that rely on Rule 3a-7 under the 1940 Act. These vehicles have been critically important in permitting publicly-traded mortgage REITs and others to efficiently provide financing and liquidity to the real estate markets. For example, the amount of mortgage debt outstanding totals about $13.5 trillion, while U.S. banks have about $12.6 trillion in total assets.[15] There simply is not enough capacity in our banking system to hold the outstanding mortgage debt, and as a result about $7.6 trillion is held in securitizations – $5.6 trillion of which is in agency mortgage-backed

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[14] As a result, it is simply incorrect to suggest – as it sometimes is suggested – that the Section 3(c)(5)(C) exception was intended to apply to the "mortgage banking industry," at least if that term is intended to suggest companies that originate and service mortgage loans. See, e.g., Exclusion From the Definition of Investment Company for Certain Structured Financings, Investment Company Act Release No. 18736 (May 29, 1992), 57 Fed. Reg. 23980, at n. 6 and accompanying text (proposing Rule 3a-7) (Section 3(c)(5)(C) "originally was intended to exclude issuers engaged in the . . . mortgage banking industries"); Division of Investment Management, Securities and Exchange Commission, Protecting Investors: A Half Century of Investment Company Regulation, at 100 ("Protecting Investors Study") (Section 3(c)(5)(C) "was intended to except mortgage bankers that originated, serviced, and sold mortgages"). The Division has acknowledged that, in any event, it has permitted companies other than mortgage bankers that originate, service and sell mortgages to rely on Section 3(c)(5)(C), "[b]ased on the broad language" of that provision. See Protecting Investors Study, at 100. Notably, the Senate and House Reports accompanying the original 1940 Act, which sometimes are cited in support of the "mortgage banking" purpose of Section 3(c)(5)(C), provide only that Section 3(c) of the 1940 Act excepts, among other things, "companies dealing in mortgages," with no mention of mortgage bankers, or mortgage originations or servicing. See Senate Report 76-1775 (June 6, 1940), at 13; House Report 76-2639 (June 18, 1940), at 12.

[15] See Board of Governors of the Federal Reserve System, Flow of Funds (Sept. 16, 2011), *available at* http://www.federalreserve.gov/econresdata/releases/mortoutstand/current.htm; Board of Governors of the Federal Reserve System, Assets and Liabilities of Commercial Banks in the United States (Oct. 28, 2011), *available at* http://www.federalreserve.gov/releases/h8/current.

securities and the balance of which is in private label mortgage-backed securities, commercial mortgage-backed securities ("**CMBS**") and home-equity securitizations.[16] The banking and mortgage finance systems need effective long-term holders of MBS and other mortgage-related instruments, such as publicly traded mortgage REITs.

The United States real estate finance and mortgage markets are large, complex, and evolving, and following perhaps the most severe downturn in the real estate markets and broader economy since the 1930s, those markets currently are in a fragile state of recovery. While the Committee supports the Commission's review of its regulations impacting these markets – indeed, we believe that the Commission can greatly benefit these markets and the broader economy by expanding the types of mortgage-related instruments that mortgage REITs can hold – we also respectfully caution the Commission to tread carefully and lightly when considering actions that could limit the ability of mortgage REITs and others to provide liquidity, financing and innovation to these markets.[17]

For example, before the Commission takes any action that could require many publicly traded mortgage REITs to register as investment companies or significantly reduce the types of mortgage-related instruments in which they can invest, we believe the Commission should carefully evaluate, among other things, the effects its actions would have on: the mortgage financing and real estate markets in general, as well as any resulting increased cost of capital to residential and commercial mortgage lenders and borrowers; innovation and competition in the mortgage finance area, to the extent the Commission's actions limit the types of investments mortgage REITs can make; and mortgage REIT investors, who might no longer have access to an investment class with the favorable attributes of mortgage REITs, and whose existing mortgage REIT investment might lose significant value. We also believe that the Commission should consider potential "ripple" effects from any such actions, including the potential to adversely affect housing prices, mortgage rates, interest rates, economic growth, tax revenues (at the Federal, state and local level), and jobs.[18]

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[16] See SIFMA, U.S. Mortgage-Related Outstanding.xls, *available at* http://www.sifma.org/research/statistics.aspx.

[17] See, e.g., Maria Aspan, SEC's REIT Review Could Chill Housing Market, Analysts Warn, www.americanbanker.com (Sept. 14, 2011); and SEC action threatens REIT demand for MBS, Barclays Capital, Sept. 20, 2011.

[18] See, e.g., Business Roundtable v. SEC, 647 F.3d 1114 (D.C. Cir. 2011) (overturning shareholder proxy rule amendments because the Commission did not sufficiently consider the costs of the rule, and overstated its benefits); American Equity Investment Life Insurance Company v. SEC, 613 F.3d 166 (D.C. Cir. 2010) (overturning a rule defining the term "annuity" because the Commission did not conduct a sufficiently thorough study on its impact on competition, efficiency and capital formation); Chamber of Commerce of the United States v. SEC, 412 F.3d 133 (D.C. Cir. 2005) (remanding for further consideration the Commission's mutual fund independent director rule, because the Commission did not adequately consider the costs to business).

We also urge the Commission to precisely identify what concerns or perceived abuses it is seeking to address – as we discuss in this Letter, we do not believe the concerns expressed in the Section 3(c)(5)(C) Concept Release were generally applicable to publicly-traded mortgage REITs – and then consider whether there are less burdensome ways to achieve the results it seeks than subjecting those REITs to the 1940 Act.[19] The 1940 Act is a far-reaching and imposing statute that would require a publicly-traded mortgage REIT to make many significant changes to its activities in order to comply with it; changes would include, among many others, disclosure and investor reporting regimes; capital structure limitations; limitations on issuing options and stock awards to officers and directors; debt and investment limitations; and limitations on the ability to engage in secondary public offerings. An issue that could be addressed by disclosure or other narrowly tailored means – for example, in public filings under the Securities Act of 1933 ("**1933 Act**") or the Securities Exchange Act of 1934 ("**1934 Act**") – should not serve as the basis for applying the full panoply of 1940 Act restrictions and requirements to publicly-traded mortgage REITs.[20]

We believe that the regulatory caution we are urging the Commission to exercise is particularly appropriate in the context of publicly-traded mortgage REITs. These REITs have relied on Section 3(c)(5)(C) for over 50 years and have been actively engaged in mortgage-related securitizations for more than 25 years, with scant evidence of abuse or investor protection concerns.[21] We also urge the Commission, before undertaking any action that could significantly limit the operations and activities of publicly-traded mortgage REITs, to consult and coordinate its activities with the various financial, housing and banking regulators that are (especially in the wake of the Dodd-Frank Wall Street Reform and Consumer Protection Act ("**Dodd-Frank Act**") considering the appropriate response to the troubled U.S. housing and commercial real estate markets.

A final note on the caution we believe the Commission should exercise as it focuses on issues relating to the real estate finance and mortgage markets: since the Commission issued the

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[19] See Section 2(c) of the 1940 Act (requiring the Commission to consider whether a rulemaking or other action will promote efficiency, competition, and capital formation).

[20] In the same vein, the Commission should be extremely cautious about imposing particular 1940 Act provisions on publicly-traded mortgage REITs – a so-called "1940 Act-lite" approach. The provisions of the 1940 Act are designed for investment companies, not REITs; they are designed to work together, not on a piecemeal basis; and they are designed to broadly address concerns applicable to registered funds, rather than being narrowly tailored to address specific concerns the Commission may have about publicly-traded mortgage REITs. We also respectfully question the Commission's authority to impose a 1940 Act-lite framework in the absence of Congressional authorization.

[21] See, e.g., Goldstein v. SEC, 451 F.3d 873 (D.C. Cir. 2006) (overturning a change to a long-standing definitional rule under the Investment Advisers Act, because the Commission did not adequately justify that its new definition was reasonable).

Section 3(c)(5)(C) Concept Release and the Rule 3a-7 Release, only one publicly-traded mortgage REIT has made a public offering. While it is always difficult to distinguish cause and effect from correlation, we believe that the Commission's Releases have added uncertainty into the markets, and have dampened the ability of mortgage REITs to access the capital markets.

B. Summary of Comments on the Section 3(c)(5)(C) Concept Release

As members of the Committee have discussed with the Division on several occasions over the past two years, we and our members – after many hours of discussion and analysis – have concluded that there does not appear to be a "bright line" that neatly separates all publicly-traded mortgage REITs from all registered closed-end funds that invest in mortgage-related securities.[22] A publicly-traded mortgage REIT and a closed-end fund may in fact purchase and hold many of the same types of mortgage-related instruments, such as agency whole pool certificates issued by GSEs, or certain interests in mortgage-backed securities and other mortgage-related securitizations. In many instances, however, this is less an indication that REITs are engaging in investment company activities; and much more an indication that some registered funds are now participating in the same types of investments as REITs. As Congress has stated:

> Although the companies enumerated in [Section 3(c)(5)(C)] have portfolios of securities in the form of . . . mortgages and other liens on and interests in real estate, they are excluded from the [1940 Act's] coverage because they do not come within the generally understood concept of a conventional investment company investing in stocks and bonds of corporate issuers.[23]

[22] Since 1970, Section 3(c)(5)(C) has not been available to an entity that issues redeemable securities, such as a mutual fund. Publicly-traded mortgage REITs that rely on Section 3(c)(5)(C), like publicly-traded closed-end funds, issue a fixed number of shares that trade on a stock exchange and are not redeemable. If a publicly-traded mortgage REIT were required to register under the 1940 Act, it would almost certainly register as a closed-end fund. As a result, the various references in the Section 3(c)(5)(C) Concept Release to mutual funds (including money market mutual funds) that invest in mortgage-related securities are of at most limited relevance when considering both Section 3(c)(5)(C) and publicly-traded mortgage REITs.

[23] Investment Company Act Amendments of 1970, House Report 91-1382 (Aug. 7, 1970), at 17.

The Commission has used very similar language to make precisely the same point.[24]

As registered fund managers have searched for new asset classes and investment strategies, some of them have – quite appropriately – found the real estate market to present attractive investment opportunities. But as these managers, on behalf of the closed-end funds they advise, have invested in agency whole pool certificates, interests in other mortgage-backed securitizations, and similar real estate instruments that are neither stocks nor bonds of corporate issuers, they arguably no longer "come within the generally understood concept of a conventional investment company." Instead, these closed-end funds are investing in the types of instruments currently used to finance mortgages and provide liquidity to the real estate markets. In short, these closed-end funds have come to look like REITs and other mortgage pools that rely on Section 3(c)(5)(C). A primary reason, therefore, that it is difficult to cleanly distinguish mortgage REITs from closed-end funds is because closed-end funds have broad latitude to invest in the same instruments as do mortgage REITs.

We believe that, as the Commission considers the application and interpretation of Section 3(c)(5)(C), the central question will be, as it has been for decades, what instruments are "**qualifying interests**" – that is, what instruments constitute "mortgages and other liens on and interests in real estate." It is important to emphasize again that the distinction does not turn – indeed it cannot turn – on whether a particular instrument is a security for purposes of the 1940 Act. If the instruments in which a REIT invested were not securities for purposes of the 1940 Act, there would be no need for the Section 3(c)(5)(C) exception. As both Congress and the Commission have stated, the distinguishing feature of companies that rely on Section 3(c)(5)(C) is that they invest primarily in real estate-related securities, not that they invest in real estate-related instruments that are not securities.[25]

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[24] See Section 3(c)(5)(C) Concept Release, at 15-16; Report of the Securities and Exchange Commission on the Public Policy Implications of Investment Company Growth, House Report 89-1046 (Dec. 2, 1966) (the "**PPI Report**"), at 328 (Although companies relying on Section 3(c)(5)(C) are engaged in "acquiring mortgages and other interests in real estate – thus acquiring investment securities, such activities are generally understood not to be within the concept of a conventional investment company which invests in stocks and bonds of corporate issuers.").

[25] We urge the Commission, however, to clarify that whether a particular mortgage-related instrument is a security, for purposes of the 1940 Act or any other provision of the Federal securities laws, is a fact-specific and often difficult question. See, e.g., Reves v. Ernst & Young, 494 U.S. 56 (1990) (whether notes are securities for purposes of the 1933 and 1934 Acts depends on the application of a family resemblance test). We are aware of the Commission's view that the definition of security in the 1940 Act may be broader than the definition of security in the 1933 and 1934 Acts, despite the fact that those Acts use almost identical language to define the term "security." To our knowledge, however, the Commission has not identified the criteria it believes should be used for determining when an instrument (such as, perhaps, certain mortgage-related instruments) may be a security for purposes of the 1940 Act even though it is not a security for purposes of the 1933 and 1934 Acts; the Commission should consider doing so.

To date, determining whether a particular instrument is a qualifying interest has typically been done through the no-action letter process. As part of that process, the Division has developed at least four general principles to help determine when an instrument is a qualifying interest, and has determined that a number of instruments are in fact qualifying interests. We believe the Commission should issue an interpretive release in which it reaffirms the validity of these existing no-action positions, discusses the considerations for additional principles that could be applied to determine that particular instruments are qualifying interests, and specifically determines that several instruments are qualifying interests.

Specifically, the Committee strongly urges the Commission to issue an interpretive release in which it:

1. Reaffirms the four existing principles developed in the Division's no-action letters for determining whether a particular instrument is a qualifying interest, and expands and modernizes these principles as suggested in this Letter:

(a) An instrument (such as fee interests, and second mortgages and leaseholds secured by real property) is a qualifying interest if it represents an actual interest in real estate, or is a loan or lien fully secured by real estate (the "**Actual Interest Principle**");[26]

(b) An interest in a MBS or similar instrument, such an agency whole pool certificate, is a qualifying interest if it provides the holder with at least the same economic experience as the holder would have had if it directly held all of the underlying mortgages (the "**Economic Equivalence Principle**");[27]

(c) An instrument, such as a tier 1 real estate mezzanine loan and certain interests in a MBS in which the holder has the right to direct foreclosure of the underlying mortgages, is a qualifying interest if it can be viewed as the functional equivalent of, and provide the holder with the same economic experience as, an interest in real estate or a loan or lien fully secured by real estate (the "**Functional Equivalence Principle**");[28] and

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[26] See, e.g., Section 3(c)(5)(C) Concept Release, at 18 and note 49; Protecting Investors Study, at 72.

[27] See, e.g., Section 3(c)(5)(C) Concept Release, at 19; Protecting Investors Study, at 72. A whole pool certificate is a certificate "that represents the entire ownership interest in a particular pool of mortgage loans." Id. at 72, n.267. An agency whole pool certificate is a whole pool certificate that is issued or guaranteed by a GSE.

[28] See, e.g., Section 3(c)(5)(C) Concept Release, at 18; Capital Trust, Inc., SEC Staff No-Action Letter (May 24, 2007) ("Capital Trust, Inc. I")(Tier 1 real estate mezzanine loans are qualifying interests); FBC Conduit Trust I, SEC Staff No-Action Letter (Oct. 6, 1987) (certificates of participation in a pool of whole mortgage loans were qualifying interests when, among other things, the holder had the right to direct foreclosure). A tier 1 real estate mezzanine loan is a loan to a special purpose bankruptcy remote entity that holds all of the ownership interests in another special purpose entity, which in turn owns the commercial real estate being financed. These loans are junior to the

(d) An interest, such as a B Note, is a qualifying interest if it has attributes that, when taken together, allow the instrument to be classified as an interest in real estate or in a real estate related loan, rather than an interest in a company that is engaged in a real estate business, even though the holder may not have unilateral foreclosure rights (the "**Loan Participation Principle**").[29]

2. Encourages the Division to work with the publicly-traded mortgage REIT industry and others to develop additional principles for determining whether particular instruments are qualifying interests, especially as the mortgage financing markets continue to evolve;

3. Reaffirms that all of the instruments that the Division has previously determined to be qualifying interests continue to be qualifying interests – and specifically that agency whole pool certificates and certain interests in CMBS continue to be qualifying interests;

4. Specifically determines that several mortgage–related instruments are qualifying interests. These instruments, and the reasons they should be deemed to be qualifying interests, are discussed in section III.B of this Letter;

5. Encourages the Division to continue to work with the REIT industry and others to determine what additional instruments should be deemed to be qualifying interests;[30] and

6. Clarifies several statements in the Section 3(c)(5)(C) Concept Release, as discussed in this Letter.

C. Comments on the Rule 3a-7 Release

While the principal focus of our comments in this Letter is on the Section 3(c)(5)(C) Concept Release, we have three comments on the Rule 3a-7 Release that are closely related to

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senior position of the mortgage holder, and have effectively replaced second mortgages in the commercial real estate financing industry. Capital Trust, Inc. I.

29 See, e.g., Section 3(c)(5)(C) Concept Release, at 19, and n.53; Capital Trust, Inc., SEC Staff No-Action Letter (Feb. 3, 2009) ("Capital Trust, Inc. II"). A B Note is part of a so-called A/B financing, in which a commercial mortgage loan is divided into a senior interest, called the A Note, and a junior interest, called a B Note. The B Note holder does not have unilateral foreclosure rights. Capital Trust, Inc. II.

30 We also urge the Commission to work with the Division and the mortgage REIT industry to streamline the current system for obtaining no-action relief addressing whether a particular instrument is a qualifying interest. To obtain such a no-action letter will likely take many months, and perhaps well in excess of a year. The cost can be hundreds of thousands of dollars. We are happy to work with the Commission and the Division to make the process more efficient, and we encourage the Commission to devote more resources to this area.

other topics covered in this Letter. First, we urge the Commission to refrain from making significant discretionary changes to Rule 3a-7 at this time. We understand that, pursuant to the Dodd-Frank Act, the Commission is required to review the provisions in Rule 3a-7 that involve the use of rating agencies.[31] We believe that any changes the Commission proposes and eventually adopts relating to Rule 3a-7 should be narrowly tailored to respond to the Congressional concerns with the use of and reliance on rating agencies.

We believe that the Commission should not at this time make broader changes to Rule 3a-7. Among other reasons, the Commission recently made significant revisions to the disclosure and other rules applicable to securitizations in Regulation AB, which were in large part intended to address investor protection and other concerns similar to those identified in the Rule 3a-7 Release.[32] The Commission also has proposed additional rules and requested comments related to securitizations that would, among other things, address certain conflicts of interest, require additional asset-level disclosure and revise the rules relating to asset-backed shelf registrations.[33] In addition, pursuant to requirements in the Dodd-Frank Act, and in response to ongoing changes in the mortgage and real estate finance markets, important aspects of the structure of many mortgage and mortgage-related securitizations may change in the near future – most notably, sponsors of securitizations generally will be required to retain a portion of the credit risk associated with the assets underlying the securitization.[34] Before considering and perhaps making significant changes to Rule 3a-7 (other than the Congressionally mandated changes), the Commission should permit the structured finance market to implement the changes it already has made in Regulation AB (and perhaps will make in connection with related pending rule proposals), and should evaluate the need for and nature of any changes to Rule 3a-7 after the credit risk retention rules are implemented and effective, and the market has determined how securitizations should be structured so as to both comply with the new rules and be commercially viable and attractive.

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[31] Section 939A of the Dodd-Frank Act, Pub. L. No. 111-203, 124 Stat. 1376 (2010).

[32] Disclosure for Asset-Based Securitizations Required by Section 943 of the Dodd-Frank Wall Street Reform and Consumer Protection Act, Release 33-9175 (Jan. 20, 2011).

[33] See Prohibition Against Conflicts of Interest in Certain Securitizations, Release 34-65355 (Sept. 19, 2011) (proposing Rule 127B under the 1933 Act to prevent certain material conflicts of interest in securitizations); Re-Proposal of Shelf Eligibility Conditions for Asset-Backed Securities and Other Additional Requests for Comment, Release 33-9244 (July 26, 2011) (revising and re-proposing rules relating to shelf registration for securitizations, and requesting comment on proposed disclosures regarding asset-level information about pool assets).

[34] In general, the sponsor of a securitization will be responsible for retaining at least 5% of the credit risk associated with the assets in a securitization. See, e.g., Section 15G of the 1934 Act (requiring the Commission and various financial and housing regulators to proposed joint regulations regarding credit risk retention in securitizations); Credit Risk Retention, 76 Fed. Reg. 24090 (April 29, 2011) (proposing credit risk-retention rules).

Second, the Rule 3a-7 Release requests comment on whether it is appropriate for the Commission to seek from Congress a statutory amendment to Section 3(c)(5)(C) that would preclude asset-backed issuers from relying on that Section.[35] We strongly urge the Commission not to seek such a statutory modification. The Rule 3a-7 Release cites to no significant regulatory concerns that have arisen from securitizations that rely on Section 3(c)(5)(C), and we are not aware of any. More generally, if an actively managed company that primarily invests in and holds qualifying interests is excepted under Section 3(c)(5)(C), it is difficult to understand why a fairly passive company – such as a securitization vehicle – that primarily holds qualifying interests should be subject to additional regulation.

Third, the Rule 3a-7 Release requests a series of comments as to whether the voting interests in a securitization vehicle relying on Rule 3a-7 should always be "investment securities," as defined in Section 3(a)(2) of the 1940 Act, even if a company owns 50% or more of those interests.[36] If these interests are always investment securities, a company that holds a significant portion of its total assets in these interests might be deemed to be an investment company under Section 3(a)(1)(C) of the 1940 Act, unless another exception or exemption was available.

We strongly urge the Commission to not pursue this and similar proposals. We are not aware of any significant regulatory concerns associated with companies that hold a substantial portion of their assets in the form of voting securities of securitization vehicles, especially when those companies own a majority of the voting interests of the securitization vehicles. We also are concerned that a proposal to treat these voting interests as investment securities might unintentionally impede the securitization market. Some companies relying on Section 3(a)(1)(C) might be limited in the number or volume of securitization vehicles they could create (especially once the credit risk-retention rules are implemented and these companies are forced to retain at least a portion of the securitization), if these companies were required to treat their voting interests in the securitization vehicles as investment securities regardless of how much of those interests they retain. Such a proposal would also make it more difficult for many companies to purchase a majority stake in the voting interests of an existing securitization vehicle, which could unintentionally dampen the liquidity in the securitization markets.

Once again, because of the complexity of the securitization markets, and the fragility of the recovery of the real estate finance and mortgage markets, we urge the Commission to tread carefully and lightly as it considers any proposals that would limit Rule 3a-7 – a rule that by all measures has appeared to have worked exceedingly well for two decades. We also urge the Commission, before taking any actions that would limit the reach and flexibility of Rule 3a-7, to

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[35] Rule 3a-7 Release, at 46-47.

[36] Rule 3a-7 Release, at 41-42.

consult and coordinate with various other financial, housing and banking regulators that are working towards implementation of Title IX Subtitle D of the Dodd-Frank Act.

II. PUBLICLY-TRADED MORTGAGE REITS SHOULD NOT BE REQUIRED TO REGISTER AS INVESTMENT COMPANIES UNDER THE 1940 ACT

We do not believe anything in the Section 3(c)(5)(C) Concept Release suggests that the Commission is considering requiring publicly-traded mortgage REITs to register as investment companies, and we strongly support not subjecting publicly-traded mortgage REITs to regulation as investment companies.[37]

A. The Commission Should Not Impose New Restrictions on Mortgage REITs That Would Have the Effect of Requiring Them to Either Register Under the 1940 Act or Divest Significant Portions of Their Portfolios

We are concerned, however, that rulemaking or other actions consistent with some of the thoughts expressed in the Section 3(c)(5)(C) Concept Release – such as restricting the ability of publicly-traded mortgage REITs to continue to treat as qualifying interests a variety of mortgage-related instruments such as agency whole pool certificates and certain controlling interests in CMBS – could in effect result in many or most publicly-traded mortgage REITs having to either register as investment companies or dramatically divest certain of their mortgage and related holdings (essentially, a "register or divest" requirement).

Either of these results would have a devastating impact on the publicly-traded mortgage REIT industry. As discussed in section II.C of this Letter, publicly-traded mortgage REITs simply cannot comply with many of the requirements of the 1940 Act. It also is unlikely that those REITs could both change their activities to comply with the 1940 Act's requirements and continue to be successful. This conclusion is, in fact, strongly supported by data in footnote 3 of the Section 3(c)(5)(C) Concept Release. As discussed earlier, if a publicly-traded mortgage REIT were required to register as an investment company, it would likely register as a closed-end fund. Footnote 3 of the Release observes that as of June 30, 2011, there were 11 closed-end funds that invested significantly in the same types of mortgage-related instruments as publicly-traded mortgage REITs, and that these funds had total assets of $1.8 billion. These holdings are less than 1% of the assets of the 33 publicly-traded mortgage REITs that comprise the

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[37] The chief executive of Ireland's National Asset Management Agency, which was formed to assist Irish banks liquidate real-estate assets, has stated that Ireland should introduce mortgage REITs to help banks and the National Asset Management Agency offload loans made during the property boom. Neil Callahan, Ireland Needs Mortgage REITs to Help Cut Leverage, NAMA's McDonagh Says, Bloomberg.com (Oct. 26, 2011). It would be ironic if the Commission undertook steps to reduce capital formation of mortgage REITs while other countries encouraged capital formation by mortgage REITs.

Bloomberg Mortgage REIT Index. Closed-end funds that mimic REIT investments have not enjoyed anywhere near the broad investor acceptance and success that publicly-traded mortgage REITs have achieved.

The clear market distinction between mortgage REITs and registered closed-end funds is further demonstrated by the enormous disparity in their recent fund raising activities. For example, since 2000 there have been 235 public offerings by mortgage REITs that have raised in excess of $52 billion, while 8 public offerings by registered closed-end funds have raised slightly more than $1.2 billion. It also is worth noting that during this time, the cumulative total return to investors in mortgage REITs was 123%, as compared to the cumulative 19% return to investors in registered closed-end funds that held a majority of their assets in mortgage-related instruments.[38]

Requiring publicly-traded mortgage REITs to divest or greatly reduce their holdings of agency whole pool certificates and controlling interests in CMBS also would have devastating effects on those REITs. Almost two decades ago, the Division began issuing no-action letters that permit mortgage REITs to treat these instruments as qualifying interests.[39] In long-standing reliance on those letters, many publicly-traded residential mortgage REITs now hold a large portion of their mortgage instruments in the form of agency whole pool certificates, and many publicly-traded commercial mortgage REITs hold large portions of their mortgage instruments in the form of controlling interests in CMBS and other securitization vehicles. From the REITs' standpoint, purchasing and holding these types of instruments are consistent with their mortgage finance and banking business, are economically advantageous, and assist the REITs in complying with their tax and 1940 Act requirements. If these instruments no longer were treated as qualifying interests for publicly-traded mortgage REITs under Section 3(c)(5)(C), many of those REITs would be required to divest large portions of their existing portfolios, and would need to dramatically alter their long-standing business focus and operations.

Requiring publicly-traded mortgage REITs to register or divest also would greatly limit the ability of these REITs to provide financing and liquidity to the mortgage and real estate markets, to the great detriment of those markets (see section I.A of this Letter). It would greatly and unfairly alter the nature of the mortgage REIT investments fondly held by a large number of U.S. investors. It would fundamentally change the competitive landscape in favor of registered closed-end funds and against publicly-traded mortgage REITs, even though the REITs have

38 See Exhibit 7.

39 See, e.g., Investors GNMA Trust, Inc., SEC Staff No-Action Letter (Jul. 22, 1983) (GNMA mortgage pass-through certificates are qualifying interests); Premier Mortgage Corporation, SEC Staff No-Action Letter (Feb. 10, 1983) (notes backed by mortgages were qualifying interests when the noteholder's income was derived from the underlying mortgages, and the noteholder had the right to direct foreclosure).

clearly been far better received by the market, and have provided significantly enhanced dividends and total returns to investors. As also discussed in section I.A of this Letter, the 1940 Act directs the Commission to carefully weigh the economic and competitive implications of these likely results against the perceived benefits, and recent court decisions emphasize some of the difficulties in making these types of assessments.[40] Moreover, as we discuss immediately below, there do not appear to be any significant reasons that support any additional 1940 Act restrictions on mortgage REITs, much less a draconian "register or divest" requirement.

Imposing a "register or divest" requirement on publicly-traded mortgage REITS also could amount to the Commission in effect rewriting Section 3(c)(5)(C), in a way that courts have recently cautioned is beyond the Commission's authority.[41]

B. There Are No Compelling Reasons to Impose a "Register or Divest" Requirement on Publicly-Traded Mortgage REITs

The Section 3(c)(5)(C) Concept Release raises four principal "issues" that perhaps could be used to attempt to support Commission or Division actions that would require publicly-traded mortgage REITs to "register or divest": (i) the possibility that there is uncertainty about the reach and interpretation of Section 3(c)(5)(C); (ii) the concern that some publicly-traded mortgage REITs use more leverage than registered funds; (iii) the fact that some publicly-traded mortgage REITs share some characteristics with some registered investment companies; and (iv) the fact that some private funds (not publicly-traded REITs) that invested in mortgage-related instruments were the subject of SEC enforcement actions, and that a REIT executive and some related entities purchased more than 5% of a non-REIT public company without filing a Schedule 13D. We discuss each of these immediately below, and explain why they do not justify imposing a "register or divest" requirement on publicly-traded mortgage REITs.

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40 In addition, requiring mortgage REITs to register or divest likely would significantly reduce the amount of dividends that REITs would be able to pay, which – in addition to the obvious adverse effect on REIT investors – would have an adverse effect on Federal and state tax revenues. For example, since 2008, mortgage REITs have paid over $11 billion in dividends (through the second quarter of 2011). (Source: Searches on FactSet and SNL Financial databases.) At the top marginal tax rate, these dividends would have resulted in approximately $6 billion in Federal, state and local ordinary income tax revenues, and $6 billion in disposable income (with incremental sales tax on any consumption). In addition, if publicly-traded mortgage REITs limited their leverage to the same leverage as is employed by registered closed-end funds that invest principally in real estate related instruments, REITs could, we estimate, be forced to reduce their dividends by about 80%, with a similar effect on tax revenues.

41 See, e.g., Goldstein v. SEC, 451 F.3d 873 (D.C. Cir. 2006).

1. Uncertainty About the Scope of Section 3(c)(5)(C).

The Section 3(c)(5)(C) Concept Release requests comment about whether there is uncertainty or differing views about the availability of the Section 3(c)(5)(C) exception.[42] We have a number of observations about this request for comment:

- There is uncertainty and differing views about virtually every provision in Section 3 of the 1940 Act, including the determination of whether a company is an investment company under Section 3(a), and the scope of the various exceptions in each of the provisions of Sections 3(b) and 3(c). There also is uncertainty and differing views about many other provisions of the 1940 Act, including (for example) the application of the affiliated transaction provisions of Section 17 and the senior security and leverage restrictions of Section 18. Counsel for companies routinely advise companies on the interpretation of the 1940 Act, as well as all the other Federal securities laws – and in truth virtually all laws. The fact that there is uncertainty or varying interpretations of the scope of a law or regulation is unremarkable; the remarkable thing usually would be if, in an industry as complex and dynamic as the mortgage REIT industry, there were no uncertainty or varying interpretations;

- In general, however, the publicly-traded mortgage REIT industry has demonstrated a consistent understanding of the scope of the Section 3(c)(5)(C) exception. These REITs, along with their counsel, underwriters, accountants and others, are well aware of the existing no-action and interpretive letters addressing whether certain instruments are qualifying interests. They also generally are aware of additional guidance provided by the Division, which frequently is provided in connection with the Division's review of a REIT's registration statement or other Commission filing, and generally results in appropriate disclosure in the registration statement or other filing;

- As we have discussed, the principal uncertainty regarding the Section 3(c)(5)(C) exception is whether particular mortgage-related instruments are qualifying interests for purposes of that Section. As we also have discussed, we strongly urge the Commission to issue an interpretive release reaffirming the existing Division no-action letters on what constitutes a qualifying interest, declaring that the instruments discussed in section II.B of this Letter also are qualifying

[42] Section 3(c)(5)(C) Concept Release, 17 Fed. Reg. 55,300, 55,301, 55,306 (Sept. 7, 2011) ("It appears that some types of mortgage-related pools might interpret the exclusion provided by Section 3(c)(5)(C) in a broad manner, while others might interpret the exclusion too narrowly, suggesting that there may be confusion among some mortgage-related pools about when the exclusion applies.").

interests, and directing the Division to continue working with the REIT industry and others to determine whether additional mortgage-related instruments are qualifying interests; and

- Any uncertainty or differing views about whether particular mortgage-related instruments are qualifying interests suggests only that the Division should work with the publicly-traded mortgage REITs to clarify those issues, and not that the Commission should impose additional regulations on REITs or withdraw prior interpretations on which those REITs currently rely.

2. The Use of Leverage by REITs Does Not Support Imposing 1940 Act Regulation.

The Section 3(c)(5)(C) Concept Release notes that "most mortgage-related pools use leverage to magnify their returns,"[43] that publicly-traded mortgage REITs on average have "a debt-to-equity ratio of nearly five to one," and that "the debt-to-equity ratio of closed-end investment companies that use borrowings was generally less than one quarter to one."[44] The Release later suggests a concern "that some mortgage-related pools . . . may raise the potential for [abuse], such as . . . extensive leveraging."[45] The sole example provided for this concern was the example of an offshore vehicle, not a mortgage REIT, that held mortgage-backed securities with a 32:1 leverage ratio; when the mortgage-backed securities lost value, the fund could not service its debts, and its lenders seized its assets.[46]

- The fact that registered closed-end funds have a lower debt-to-equity ratio than non-investment companies – and many other public companies – is not surprising. Section 18 of the 1940 Act imposes significant limitations on the ability of

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[43] Section 3(c)(5)(C) Concept Release, at 8 (footnote omitted).

[44] Id. at 9 (footnotes omitted).

[45] Id. at 13 (footnote omitted).

[46] Id. at 13 n.35 (citing Nathan Vardi, High-Profile Investor Sues Carlyle Group, Forbes.com (July 13, 2009)). Carlyle Capital Corporation Limited was an investment vehicle domiciled in Guernsey, Channel Islands, which held its assets held in a Cayman Islands subsidiary, and which was listed on the Amsterdam exchange. The fund was managed by the private equity firm Carlyle Group, and had the ability to invest in private funds managed by Carlyle Group. See PriceWaterhouse Coopers, Independent Auditors' Report and Consolidated Financial Statements: Carlyle Capital Corporation Limited and Subsidiaries, Dec. 31, 2006 and Mar. 31, 2007 (http://www.carlylecapitalcorp.com/Financial%20Documents/2007/item952.pdf). Its class A holders, all Carlyle Group partners, owned 15% of the fund. "Carlyle Capital Winding Down, Says There'll be No Money Left for Holders," Marketwatch.com (March 17, 2008). Carlyle Capital Corporation Limited did not resemble a publicly-traded mortgage REIT in structure, ownership, domicile, listing, investment guidelines, corporate governance, disclosure or regulatory oversight.

registered investment companies to borrow or otherwise incur debt. Publicly-traded mortgage REITs, like other non-investment companies, are not subject to these limitations. And the fact that many REITs have leverage ratios that exceed those permitted by Section 18 is not evidence that they should be subject to the Section 18 leverage limits; just the opposite, it is a stark example of how imposing the restrictions of the 1940 Act on publicly-traded mortgage REITs would cause REITs to have to dramatically alter their successful business models.[47] Indeed, by passing the many exceptions in Section 3(c) of the 1940 Act – which in addition to real estate companies also excepts from 1940 Act registration and regulation entities such as banks, insurance companies, brokerage firms, certain lending companies, pension plans, charitable plans, oil and gas funds, and private funds – Congress intended to permit these companies to (among other things) exceed the leverage limitations that are applicable to registered investment companies.

- There is no suggestion in the Concept Release, and we do not believe, that any publicly-traded mortgage REIT has had dire financial consequences primarily as a result of the excessive use of leverage – even during the recent severe downturn in the mortgage markets. The Release does suggest that an offshore vehicle, which reportedly had more than six times more leverage than the average publicly-traded mortgage REIT, did have dire financial consequences.[48] Even in that case, there is no suggestion that anyone acted illegally – just that the fund investors lost their money. This is, of course, a possibility for all equity investors in companies that become insolvent, regardless of whether the insolvency was caused by leverage issues, business issues, competition, or any other reason. In any event, the unfortunate demise of this offshore vehicle seems to have little to do with the analysis of how Section 3(c)(5)(C) should apply to publicly-traded mortgage REITs.

- Publicly-traded mortgage REITs already are subject to significant *de facto* limitations on their use of leverage. First, many publicly-traded mortgage REITs have investment guidelines with explicit leverage limitations. The boards of

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[47] The approximately 5 to 1 debt-to-equity ratio of publicly-traded mortgage REITs is actually well within the norm for lending companies that are not investment companies. For example, the 5 to 1 debt-to-equity ratio is well within the BASEL III capital guidelines. See The Bank for International Settlements Basel Committee on Banking Supervision, *available at* http://www.bis.org/press/p100912b.pdf. In addition, banks in the United States currently have a debt-to-equity ratio of approximately 8 to 1. Federal Deposit Insurance Corporation, Statistics at a Glance, June 30, 2011, http://www.fdic.gov/bank/statistical/stats/2011jun/industry.html.

[48] See Section 3(c)(5)(C) Concept Release, at 13 n.35 (discussing Carlyle Capital Corporation Limited, an offshore fund).

directors of these REITs approve their investment guidelines, including their use of leverage. Second, publicly-traded mortgage REITs typically disclose the amounts and effects of significant leverage, and the associated risks, in their public filings. Third, the "5 to 1" leverage number is somewhat misleading, especially when comparing the leverage of REITs to the maximum amount of leverage closed-end funds may incur under Section 18 of the 1940 Act. Many REIT borrowings – such as repurchase agreements and certain secured borrowing facilities – are fully collateralized in a way that would cause those borrowings to not be treated as leverage by a closed-end fund under Section 18.[49] Other REIT leverage, such as borrowing against mortgage-related assets by securitizing those assets while retaining a portion of the securitized structure, is effectively non-recourse leverage; that is, the debt holders can look for payment only to the assets held by the securitization vehicle, not to the other assets of the REIT. These types of leverage facilities and structures are significantly less risky to a REIT and its equity holders than, for example, borrowing facilities that broadly have a security or other interest in all of the REIT's assets.

Nonetheless, if the Commission believes that the debt-to-equity ratio of REITs is of concern, the most direct way of addressing that issue would be to require uniform and prominent disclosure about leverage by publicly-traded mortgage REITs in their 1933 Act and 1934 Act filings. Indeed, as part of the Commission's review of registration statements of and other public filings by REITs, the Commission's Staff already frequently requests this disclosure. In considering such a disclosure requirement, however, the Commission should consider whether and why it believes the use of leverage by REITs requires more stringent disclosure rules than the disclosure rules applicable to the use of leverage by other types of companies. The Commission might also want to consider whether registered closed-end funds that invest primarily in real estate related assets should be required to disclose the amount of leverage they use, the limits on their use of leverage, and the effects those leverage limitations may have on their returns (perhaps as compared to REITs).

3. Similarities Between REITs and Some Investment Companies Do Not Justify 1940 Act Regulation.

The Section 3(c)(5)(C) Concept Release lists five examples of characteristics common to some mortgage-related pools and registered investment companies: (i) pooling of assets and professional asset management; (ii) internal or external management arrangements;

[49] See Securities Trading Practices of Registered Investment Companies, Release No. IC-10666, 44 Fed. Reg. 25128, 25131-32 (1979) (Section 18 leverage limitations are not implicated when an investment company "covers" a senior security by establishing and maintaining certain segregated accounts).

(iii) asset-based and, in some cases, performance-based fees paid to external managers; (iv) some mortgage-related pools invest in the same types of assets as some registered and unregistered private funds; and (v) some mortgage-related pools may be perceived by investors and the media as being investment vehicles.

Before addressing each of these characteristics, it will be helpful to make several general observations. First, as previously discussed, of course companies that expressly are excepted from the 1940 Act will share some characteristics of registered investment companies – if they did not share some characteristics, there would be no need to except them. The point of Section 3(c)(5)(C), and the other exceptions in Section 3(c), is precisely to except from 1940 Act regulation a number of companies that have some or many characteristics of registered funds, but that should nonetheless not be regulated as investment companies. The fact that publicly-traded mortgage REITs that rely on Section 3(c)(5)(C) have some characteristics in common with registered funds therefore cannot be a basis for significantly narrowing the existing interpretations of Section 3(c)(5)(C), or for regulating those REITs as investment companies.

Second, each of the common characteristics listed in the Concept Release appears to have largely been in place for the entire 50-plus year history of mortgage REITs, and these common characteristics have never before been viewed by Congress or the Commission as a basis for calling into question the ability of some mortgage REITs to rely on the Section 3(c)(5)(C) exception. There is no apparent reason why the Commission's view should now change.

Indeed, in the 1960 House Report accompanying the legislation that established the special tax provisions for REITs, which are closely modeled on the special tax provisions for registered funds, Congress indicated that it was precisely the similarities between REITs and registered funds that justified providing REITs with this special tax treatment:

> [T]he equality of the tax treatment between the beneficiaries of real estate investment trusts and the shareholders of regulated investment companies is desirable since in both cases the methods of investment constitute pooling arrangements whereby small investors can secure advantages normally available only to those with larger resources. These advantages include the spreading of the risk of loss by the greater diversification of investment which can be secured through the pooling arrangements; the opportunities to secure the benefits of expert investment counsel; and the

> means of collectively financing projects which the investors could not undertake singly.[50]

In enacting the 1940 Act, and 20 years later in enacting the REIT tax provisions, Congress was fully aware of the similarities between mortgage pools such as REITs and registered funds – in many instances the very same similarities the Concept Release identifies – and saw no reason to subject mortgage pools to 1940 Act regulation.[51]

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50 Real Estate Investment Trusts, House Report 86-2020 (June 28, 1960), at 3-4. Soon after the enactment of the REIT tax provisions, the Commission issued a brief release discussing the treatment of REITs under the Federal securities laws. See Statement on Real Estate Investment Trusts, 1940 Act Release No. 3140 (Nov. 18, 1960). In that release, the Commission indicated that many types of REITs would not be subject to 1940 Act registration, when it stated that "no question would be raised [under Section 3(c)(5)(C), which was then Section 3(c)(6)(C)] where a real estate investment trust invested exclusively in fee interests in real estate or mortgages or liens secured by real estate." Id. at 2. The Commission's 1940 Act concern was with REITs that "invested to a substantial extent in other real estate investment trusts (as is permitted by the [legislation]) or in companies engaged in the real estate business or in other securities that may not qualify for this exception." Publicly-traded mortgage REITs do not invest to a substantial extent – and in most cases at all – in other REITs or companies engaged in a real estate business, and have at most limited investments in securities that are not real estate related securities.

51 As part of the Investment Company Act Amendments of 1970, Congress made the only substantive change to Section 3(c)(5) since the enactment of the 1940 Act: it prohibited companies that issue redeemable securities from relying on Section 3(c)(5). This change followed the recommendation of the Commission in the Report of the Securities and Exchange Commission on the Public Policy Implications of Investment Company Growth, House Report 89-2337 (Dec. 2, 1966) (the "PPI Report"), at 238-239. The basis for this change was the Commission's concern that companies holding notes, commercial paper or real estate mortgages were attempting to capitalize on the popularity of mutual funds by offering redeemable securities to a group of "unsophisticated investors," while relying on the exception in Section 3(c)(5) (which was then Section 3(c)(6)). Id. at 238. This chapter in the history of Section 3(c)(5) is instructive for several reasons. First, in the past, when the Commission has believed that a significant limitation should be imposed under that Section, it asked Congress to amend the statute, rather than seeking to limit the statute by rulemaking or interpretation. See, e.g., Goldstein v. SEC, 451 F.3d 873, 881 (D.C. Cir. 2006) ("An agency construction of a statute cannot survive judicial review if a contested regulation reflects an action that exceeds the agency's authority."); American Bankers Association v. SEC, 804 F.2d 739, 752 (D.C. Cir. 1986) (overturning a rule in part because the Commission cannot issue regulations counter to Congressional intent). Second, the 1970 amendment again shows that Congress is and has been well aware that a REIT shares many characteristics with registered funds. Congress' response, however, was only to prohibit REITs from issuing redeemable securities that could cause them to be confused with mutual funds; Congress did not choose to impose limitations on the mortgage and other investments of REITs. Third, as discussed in section II.C of and Appendix 1 to this Letter, the significant regulatory regime to which publicly-traded mortgage REITs are now subject greatly reduces the types of investor protection concerns that motivated the Commission to recommend and Congress to enact the change to Section 3(c)(5) in 1970.

We now turn to a brief discussion of each of the specific common characteristics identified in the Concept Release:

(a) *Pooling of assets and professional asset management*. Virtually every company "pools" investors' money, and this pooling does not cause a company to be an investment company. Shareholders in a car manufacturer do not, for example, own particular cars that drive off the assembly line, particular welding machines on a factory floor, or particular desks and chairs of the corporate offices. Instead, investors' money is pooled by the company to engage in its business activities. In a publicly-traded mortgage REIT, investors' funds are pooled to originate, finance and purchase mortgages and mortgage-related instruments.

In addition, as discussed in section I.A of this Letter, publicly-traded mortgage REITs and other mortgage pools have relied on Section 3(c)(5)(C) since the 1960s. For that entire time they have pooled investors' money. Indeed, as discussed earlier, when Congress enacted the special REIT tax provisions in 1960, one of the justifications for providing special tax treatment to REITs was to encourage the popularity of REITs among investors because of the benefits REIT investors obtained from pooling their resources under expert managers. It is difficult to see, then, why the fact that REITs continue to pool investors' money is of any particular relevance to the Commission's current consideration of Section 3(c)(5)(C).

(b) *Internal or external management arrangements*. Every company must be internally or externally managed; there are no other choices. Most operating companies – including 19 of the 33 mortgage REITs in the Bloomberg Mortgage REIT Index – are internally managed, and most investment companies are externally managed (although there are exceptions to both of these statements). But whether a company is internally or externally managed is not relevant to the determination of whether the company is an investment company: Section 3(a) of the 1940 Act defines an investment company primarily on the basis of its securities holdings and securities investment activities (and in one case on the type of instruments it issues); its management structure is never mentioned. Moreover, we are not aware of any reason to believe that internally or externally managed mortgage REITs routinely outperform (or underperform) the other. In any event, we believe that the optimal management structure of a REIT is a question that the market is uniquely qualified to determine.

(c) *Asset- and performance-based fees*. Those publicly-traded mortgage REITs that have external managers must compensate those managers in some fashion, and asset- and equity-based fees seem to be a successful way of aligning the interests of external REIT managers as well as external fund managers. But just as external management arrangements are irrelevant under Section 3(a) of the 1940 Act in determining whether a company is an investment company, Section 3(a) also does not look to the method by which an external manager is compensated when determining whether a company is an investment company. Notably, registered funds generally are prohibited from receiving most types of performance fees, and the fact that some externally managed REITs pay their managers a performance fee probably further distinguishes those REITs from registered funds, and in any event is another example of how 1940 Act regulation is incompatible with the business models and practices of many publicly-traded mortgage REITs.

(d) *Common Assets*. The Concept Release focuses on the fact that some publicly-traded mortgage REITs, and some registered funds, acquire "agency" securities – that is, mortgage-related securities backed by a GSE. As discussed earlier, this fact in many respects is more an indication that certain registered closed-end funds are behaving like REITs, and less an indication that REITs are behaving like closed-end funds. In this regard, holding agency securities is a way of financing the mortgages underlying the security; it is not a method of investing in stock and debt of corporate issuers.

In addition, one reason many residential (and some commercial) mortgage REITs acquire these securities – and especially in "agency whole pool" securities – is precisely because for over two decades, the Division has taken the position that agency whole pool securities are qualifying interests for purposes of Section 3(c)(5)(C). It would be an extremely odd result for the Division to first approve of mortgage REITs treating agency whole pool securities as qualifying interests for purposes of the investment company exception in Section 3(c)(5)(C), and then say that because REITs hold these assets, they are investment companies that should not be able to rely on the Section 3(c)(5)(C) exception.

Moreover, given the actual and perceived safety of agency securities – which have the explicit or implied backing of the United States government – it seems odd for the Commission to have particular regulatory or investor protection concerns over mortgage REITs that hold those securities. Also, Section 3(a)(1)(C) of the 1940 Act generally permits a company to hold an unlimited amount of Government securities, including agency securities, without thereby being deemed to be an investment company. There is little reason for the 1940 Act to permit other companies to avoid 1940 Act regulation by holding Government securities, but to require REITs to be regulated as investment companies because they hold Government securities.

(e) *Investor Perception*. The Concept Release states that some mortgage-related pools are perceived by investors and the media as investment vehicles and not as companies engaged in the mortgage banking business. Notably, this concern stands in stark contrast to the many comment letters the Commission is receiving from individual investors about this Release, which generally show that those investors fully understand what a REIT is and do not want the Commission to regulate REITs under the 1940 Act. Moreover, while the Release cites only three news articles for this proposition, there are hundreds or thousands of articles, blogs and other writings about mortgage REITs every year that make no such suggestion; the very small number of writings identified in the Concept Release therefore are unlikely to cause significant investor confusion.

In addition, mortgage REITs as an asset class are covered by many sell-side equity analysts, who perform and publish rigorous analyses of REITs and their holdings, performance, operations, and other important metrics. These analysts, and presumably those who read their reports, have no trouble differentiating between publicly-traded mortgage REITs and closed-end mutual funds (which, if they are covered by the sell-side, have their own research effort).[52] By contrast, analyses of closed-end funds, such as those on Morningstar.com and Lipper, typically do not list or mention mortgage REITs. In short, there does not appear to any actual investor confusion between mortgage REITs and the few registered closed-end funds that principally invest in mortgage-related securities.

Moreover, this "investor perception" argument is seemingly irrelevant to a consideration of whether the 1940 Act should apply to a company that is, and that holds itself out to be, a mortgage REIT. Investor perception can be relevant in determining that a company is not an investment company: the Seventh Circuit, for example, held that a company that otherwise meets the definition of an investment company may in some cases still not be an investment company if, among other things, investors and the markets do not view the company as primarily engaged in an investment business.[53] But neither Section 3(a) of the 1940 Act, nor any court decision of which we are aware, permits the Commission to treat as an investment company a company that is not engaged in an investment company business, and that does not hold itself out as an investment company, simply because some segment of the market views that company as an investment vehicle.

Also, as previously discussed, both Congress and the Commission have recognized that the distinction between mortgage REITs that rely on Section 3(c)(5)(C) and investment companies is not that one invests in securities and the other does not; it is that mortgage REITs primarily finance and acquire a particular type of securities – that is, mortgage-related securities. The fact that some investors may view REITs as investment vehicles is therefore neither surprising, nor particularly relevant, to the Commission's current consideration of Section 3(c)(5)(C).

[52] For examples of mortgage REIT coverage, see: "Residential Mortgage REITs 3Q11 Preview," Keefe Bruyette & Woods, October 9, 2011; "Compelling Opportunity to Buy MREITs for Cheap," Barclays Capital, October 6, 2011; "REITS out of favor as European debt concerns ease," Bank of America Merrill Lynch, September 30, 2011. Closed-end fund research often is produced by different analysts, such as Morningstar and Lipper.

[53] See SEC v. National Presto Industries, Inc., 486 F.3d 315 (7th Cir. 2007).

Finally, if investor perception or confusion issues are of potential concern to the Commission, an easy and direct way of addressing those concerns is to require mortgage REITs to prominently and uniformly disclose in their registration statements and public filings that they are not regulated as investment companies, and require registered closed-end funds that invest significantly in mortgage-related instruments to prominently and uniformly disclose that they are not REITs.

4. No Significant REIT Regulatory Concerns.

The Section 3(c)(5)(C) Concept Release expresses concern that some mortgage-related pools may raise the potential for the same types of abuses as unregulated investment companies, including deliberate misevaluation of assets, extensive leveraging and overreaching by insiders.[54]

- Notably, these concerns could be expressed about almost any type of company, and do little to suggest that the application of the 1940 Act is warranted. For example, imagine three hypothetical companies: a manufacturing company that makes widgets, a distribution company that sells the widgets, and a company that supplies the raw materials used to produce the widgets. Each of those companies could, as easily as a mortgage-related company, intentionally misvalue assets, engage in extensive leveraging, and engage in overreaching by insiders. None of these concerns suggest that the appropriate response is to regulate manufacturers, distributors and suppliers as investment companies, and these concerns also do not suggest any basis for regulating mortgage-related companies as investment companies.

- None of the Commission enforcement actions cited in the Concept Release – with one exception – involved a publicly-traded mortgage REIT. Rather, the actions appeared to involve private mortgage pools. As discussed in section II.C of this Letter, publicly-traded mortgage REITs are subject to significant regulation and oversight, and the fact that after more than 50 years of operations these REITs have been subject to so few regulatory actions by the Commission strongly suggests that the current regulatory scheme applicable to them is sufficiently guarding against the concerns identified in the Release.

- The one action cited in the Concept Release that had even a tangential relationship to a publicly-traded REIT involved the failure of an executive of a REIT and some related entities to file a Schedule 13D, as a group, in connection

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54 Section 3(c)(5)(C) Concept Release, at 55,303-304, notes 34-37.

with an investment in a non-REIT company. This action is cited for the concern that REIT insiders may engage in "overreaching." We respectfully suggest that the failure of an officer of a company to appropriately identify himself as part of a Section 13(d) group is hardly the type of "overreaching" to which the 1940 Act is addressed, and that this citation does nothing to support the suggestion that publicly-traded mortgage REITs might appropriately be regulated as investment companies.

C. Publicly-Traded Mortgage REITs Already Are Subject to Significant and Effective Regulation

Publicly-traded mortgage REITS already are subject to a significant and effective regulatory regime, which offsets the need for additional regulation such as that under the 1940 Act. Appendix A contains the White Paper that NAREIT submitted to the Division last year, which has a more comprehensive list of the regulatory provisions to which publicly-traded mortgage REITs are subject. Among the principal regulatory schemes applicable to publicly-traded mortgage REITs are the following:

- The registration provisions of the Securities Act of 1933. The Commission has designated a unique registration form – Form S-11 – for use by REITs. This form is tailored specifically for REITs, and the substance and format of the required disclosure reflects the unique characteristics of REITs. Form N-2, the registration form used by closed-end funds (and presumably the registration form that would be used by a REIT or a similar entity that was newly required to register under the 1940 Act), is not geared toward REITs, and the use of that form likely would result in the public receiving less, and less useful, information than is currently provided on Form S-11.

- The periodic reporting, public disclosure, and other requirements mandated by Section 12(g) of the Securities Exchange Act of 1934. For example, publicly traded mortgage REITS prepare, file and disseminate annual reports on Form 10-K, quarterly reports on Form 10-Q, and current reports on Form 8-K; their officers, directors, and 10% shareholders are subject to the reporting and short swing profit provisions of Section 16; and their large shareholders are subject to the reporting requirements of Section 13(d) and (g).

- The substantive, reporting, audit and certification requirements of the Sarbanes-Oxley Act ("**SOX**"). The Chief Executive Officer ("**CEO**") and Chief Financial Officer ("**CFO**") of a publicly traded REIT must provide certifications under SOX with each periodic report, including quarterly and annual filings, containing financial statements that are filed with the Commission. These certifications assert that the periodic report fully complies with the requirements of section 13(a) or 15(d) of the 1934 Act and that the CEO and CFO have reviewed the reports, take responsibility for such reports and that the reports contain no untrue or misleading information, among other things. Furthermore, REITs are subject to the SOX provisions requiring an independent audit committee and requiring the audit committee to have an audit committee financial expert who meets certain qualifications. The REIT must disclose if there is a Code of Ethics in place for its officers and directors, and if there is not, it must disclose why. REITs also must institute internal controls and procedures with regard to financial information to ensure that the information required to be disclosed is recorded, processed, summarized and reported in the relevant time period. In addition the REIT must include in each year's annual report an internal control report that describes management responsibilities and contains an assessment by management of the effectiveness of such internal controls; accelerated filers also must include an auditor attestation.

- The listing requirements of the NYSE, Nasdaq or other exchanges, which include appointing independent board and audit committee members as well as meeting market capitalization requirements. The listing requirements of the NYSE, Nasdaq or other exchanges, include independent board, audit committee and similar requirements. For example, both the NYSE and Nasdaq require a majority of the REITs' board of directors to be independent. REITs must establish independent audit committees, consisting of all independent board members who are financially literate, and at least one member who has accounting or related financial management expertise. The boards also must have compensation and nominating/corporate governance committees. Additionally, REITs must adopt corporate governance guidelines, a code of business conduct and ethics, and for the NYSE the CEO must certify annually that he or she knows of no violations of NYSE listing requirements.

- The required levels of real estate holdings, real estate income, required levels of diversification of ownership, and other requirements imposed by Section 856 of the Internal Revenue Code. REITs must meet two income requirements under the Internal Revenue Code. First, at least 75% of the REIT's gross income must be derived from rents from real property, interest from loans secured by real property or interests in real property, gain from sale of investment real property, REIT dividends, income from foreclosure property and other specified sources. Second, at least 95% of the REIT's gross income must be from the sources specified in the 75% test, plus income from interest, dividends, and gains from the sale of stock or securities. Furthermore, quarterly, REITs must ensure (1) that at least 75% of the value of the REIT's total assets consists of "real estate assets," cash and cash items and government securities; (2) that not more than 25% of the value of the REIT's assets are securities of a taxable REIT subsidiary; and (3) that not more than 25% of the value of the REIT's total assets consists of securities that are: (a) an amount that is in value greater than 5% of the value of the REIT's assets; (b) more than 10% of the voting power of the issuer; and (c) more than 10% of the value of the issuer's securities.

As a result, publicly-traded mortgage REITs already are subject to significant regulations that protect their investors and appropriately limit their risk taking and business ventures. This regulatory approach has been successful for over 50 years, and there is no apparent reason to significantly alter that approach now.

D. <u>Publicly-Traded Mortgage REITs Cannot Operate Under the Requirements of the 1940 Act</u>

Publicly-traded mortgage REITs would have significant difficulties in operating under the 1940 Act, including under the following provisions:

- <u>Section 17 restrictions on affiliated entity transactions</u>. Section 17(a) of the 1940 Act generally prohibits an affiliated person or second-tier affiliate of a registered investment company from knowingly selling securities or other property to the investment company. An affiliated person is broadly defined to include, among others, entities that own 5% or more of another company's voting securities. Among other potential Section 17(a) issues, REITs may purchase mortgage-related instruments from, or sometimes sell instruments to, a wide variety of investment and commercial banks, and others in the mortgage and finance businesses. It would be extremely difficult and burdensome for a publicly traded mortgage REIT to make sure that, each time it engaged in such a transaction, the other party was not directly or indirectly a 5% shareholder, and that no other person was a 5% shareholder of both the REIT and the other party. There also is no obvious problem involving publicly-traded mortgage REITs that the imposition of such a rule would solve.

  Similarly, Section 17(d) of the 1940 Act prohibits an affiliated person or second-tier affiliate of a registered investment company from jointly participating in or effecting any transaction. Among other potential Section 17(d) issues, some REITs may have affiliates that service their loans or jointly hold mortgages with them. Business ventures between or involving these affiliates could be a prohibited joint transaction under Section 17(d). And because, as discussed above, publicly-traded mortgage REITs may have significant difficulty in identifying certain affiliated persons and second-tier affiliates, subjecting them to Section 17(d) would create significant compliance costs and potential uncertainty about the legality of their transactions. Again, we are unaware of any concerns involving publicly-traded mortgage REITs that would be addressed by imposing the restrictions of Section 17(d) on them.

Moreover, as discussed above, publicly-traded mortgage REITs are subject to significant regulatory requirements – including disclosure, independent directors, independent audit, and SOX and other requirements – that provide significant protections against overreaching by insiders of publicly-traded mortgage REITs.

- <u>Section 18 leverage limitations</u>. Section 18 imposes significant restrictions on the ability of a registered fund to borrow money, issue debt and preferred stock, and issue stock options, restricted stock and similar securities. Many publicly-traded mortgage REITs – like many public operating companies – have capital structures that do not comply with Section 18. As previously discussed, many mortgage REITs also use leverage in excess of the Section 18 leverage limitations, which often are critical to their investment strategies. We are unaware of significant issues stemming from the use of leverage by publicly-traded mortgage REITs that would be solved by imposing Section 18 leverage restrictions. In addition, the independent director and disclosure regimes (among others) already applicable to publicly traded mortgage REITs act as significant checks on their use of leverage.

- <u>Section 12(d)(1) anti-pyramiding provisions</u>. Section 12(d)(1) places a 3% limitation on the interests that one investment company can own in another. Notably, many registered funds invest in publicly-traded mortgage REITs. If REITs became subject to Section 12(d)(1), however, many registered funds would be significantly limited in their current investment strategies. It is not clear why this would be a favorable result.

- <u>Section 23 limitations on distributions of fund shares</u>. Section 23 generally prohibits a registered closed-end fund from selling shares at a price below net asset value per share. Virtually all publicly-traded mortgage REITs, however – like most publicly-traded companies – do not, and are not required to, calculate their net asset value or net asset value per share (especially in a manner that would comply with the 1940 Act). Instead, their shares are traded on exchanges at the price the market sets for them. Imposing the restrictions of Section 23(b) on publicly-traded mortgage REITs would require them to calculate a net asset value per share, and would have the effect of artificially preventing a REIT from

> selling shares when that net asset value per share happened to exceed the market price of the REIT's shares. This would serve absolutely no purpose. The market already is very effective at deciding whether to provide capital to a mortgage REIT, and under what terms, and the market has never found a net-asset-value-per-share calculation to be relevant to this determination. There is, therefore, no reason for the Commission to impose it.

III. THE COMMISSION SHOULD ISSUE AN INTERPRETIVE RELEASE REAFFIRMING CURRENT INTERPRETATIONS ON WHAT CONSTITUTES A QUALIFYING INTEREST

The Section 3(c)(5)(C) Concept Release requests comment on various possible regulatory actions the Commission might take to clarify or provide additional guidance under Section 3(c)(5)(C).[55] As previously discussed, the Committee believes that the Commission should issue an interpretive or similar release that: (i) reaffirms the four existing principles that the Division has developed for determining whether a particular instrument is a qualifying interest, and expands and modernizes these principles as suggested in this Letter; (ii) encourages the Division to work with the publicly-traded mortgage REIT industry and others to develop additional principles for determining whether a particular instrument is a qualifying interest, especially as the mortgage financing markets continue to evolve;[56] (iii) reaffirms that all of the instruments the Division previously has determined to be qualifying interests continue to be qualifying interests, including agency whole pool certificates and certain interests in CMBS; (iv) specifically determines that the mortgage-related instruments discussed in this Letter are qualifying interests; (v) encourages the Division to work with the REIT industry and others to determine what additional instruments should be deemed to be qualifying interests; and (vi) clarifies several statements in the Section 3(c)(5)(C) Concept Release, as discussed in this Letter.

A. Introduction

Section 3(c)(5)(C) excepts 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";

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[55] Section 3(c)(5)(C) Concept Release, at 22-26.

[56] The commercial and residential mortgage finance market has evolved over the 70 years since the 1940 Act was enacted, and the interpretation of Section 3(c)(5)(C) has evolved with it. The market will continue to evolve, and the interpretation of Section 3(c)(5)(C) should continue to evolve with it. For example, the market currently may be developing a financing structure in which a first-loss piece of an agency whole pool certificate is sold to investors. There may be questions about when and whether different parts of this structure are "qualifying interests," depending upon if and how this structure develops. See, e.g., Alan Zibel, Plan Floated to Spread Risk in Mortgage Bonds, Wall Street Journal (Oct. 14, 2011).

(iii) in "purchasing or otherwise acquiring mortgages and other liens on and interests in real estate." These three clauses provide a basic framework for interpreting the statute.

There are few interpretive issues surrounding the first part of the test – publicly-traded mortgage REITs do not issue redeemable securities, face-amount certificates of the installment type, or periodic payment plan certificates.

There also have been few interpretive issues – at least for the last two decades – over whether a publicly-traded mortgage REIT is "primarily engaged" in a real estate business. Since at least 1988, the Division has stated that a company is "primarily engaged" in a real estate business within the meaning of Section 3(c)(5)(C) if (i) at least 55% of the value of its assets are held in qualifying interests and (ii) at least 80% of the value of its assets are held in qualifying interests and real estate related assets.[57] Notably, Section 3 of the 1940 Act uses the term "primarily engaged" or "engaged primarily" at least 8 times,[58] including in Sections 3(c)(5)(A) and (B), and in every provision other than Section 3(c)(5)(C), those terms are defined by reference to whether a company holds at least 55% of its assets in a particular class of assets, and derives at least 55% of its income from those assets. Section 3(c)(5)(C) is the only instance in which the Division has imposed a different test (i.e., the 55%/80% asset test).

The Committee supports maintaining the current 55%/80% test under Section 3(c)(5)(C). That test appears to have been developed to permit REITs and other entities to have certainty as to whether they comply with the exception based on their assets mix, which is within their control, and not to be subject to the uncertainty that a downturn in the real estate market could cause them to fail to derive at least 55% of their income from qualifying interests for an appreciable period of time – something largely outside of their control. The addition of the 25% test to the standard 55% asset test has generally been understood as a "trade off" for REITs and similar entities not having to examine their income when determining their primary engagement. The Committee believes that this test is appropriate for determining the primary engagement of a company, and should be retained.

The Committee also believes, however, that a REIT or other entity should be able to rely on the traditional 55% asset/55% income test. In this regard, if a REIT invests at least 55% of the total value of its assets in qualifying interests, and derives at least 55% of its income from those investments, it should also be deemed to comply with Section 3(c)(5)(C), regardless of whether it also meets the 55%/80% test. This would bring Section 3(c)(5)(C) into line with all

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[57] See, e.g., NAB Asset Corp., SEC Staff No-Action Letter (Jun. 20, 1991); Metropolitan Realty Corp., Inc., SEC Staff No-Action Letter (Nov. 15, 1989); United Bankers, Inc., SEC Staff No-Action Letter (Mar. 23, 1988).

[58] See Sections 3(a)(1)(A), 3(b)(1), 3(b)(2), 3(c)(2), 3(c)(5)(A), 3(c)(5)(B), 3(c)(5)(C) and 3(c)(6) under the 1940 Act. The term "engaged primarily" also is used in Rule 3a-2 under the 1940 Act.

other Commission interpretations of the term "primarily engaged," and should therefore be a well-known and accepted measure of determining a company's primary engagement.[59] To be clear, we believe that REITs should be able to rely on either the 55%/80% asset test or the 55% asset/55% income test.

Significantly, the Concept Release is imprecise in its description of the 55%/80% test. The Release states that the Division, in interpreting the "primarily engaged" requirement under Section 3(c)(5)(C), "generally has focused on whether at least 55% of the issuer's assets will consist of mortgages and other liens on and interests in real estate . . . and the remaining 45% of the issuer's assets will consist primarily of real estate-type interests."[60] That is not the test.[61] The current 55%/80% test focuses only on whether at least 80% of the issuer's assets are real estate related, not on whether 100% of the issuer's assets are real estate related. We respectfully request that the Commission correct or clarify this imprecise statement.

The Committee also believes that the Commission should clarify that, under both "primarily engaged" tests, a publicly-traded mortgage REIT is able to "ignore" – or subtract from both the numerator and the denominator – cash, Government securities (other than Government securities that are qualifying interests or real estate related assets), and shares of registered money market mutual funds. This is consistent with the treatment of these cash items under Section 3(a)(1)(C) of and Rule 3a-1 under the 1940 Act, and would give REITs and others relying on Section 3(c)(5)(C) certainty that they would not be out of technical compliance with the statute due to holding cash received from, for example, the sale of assets, receipt of income, or the proceeds of a public or private offering.

By far the most prevalent interpretive issues under Section 3(c)(5)(C) have been and remain whether particular mortgage instruments are qualifying interests, and the principles for

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[59] This also would correct a current anomaly under Section 3(c)(5). Sections 3(c)(5)(A) and (B) except companies that are primarily engaged in making and acquiring certain loans and notes. The Division typically has employed the standard 55% asset/55% income test for determining whether a company is primarily engaged in a Section 3(c)(5)(A) or (B) business. Section 3(c)(5) also expressly permits a company to rely on that exception if it is primarily engaged in one or more of the activities listed in paragraphs (A), (B) and (C). Because the Division has employed different tests for primary engagement under paragraphs (A) and (B) than it has under paragraph (C), there are difficult interpretive issues presented under Section 3(c)(5) when a company holds both loans and mortgage-related securities. Permitting companies to use the 55% asset/55% income test for determining primary engagement under paragraph (C) would greatly help in reducing these interpretive issues.

[60] See Section 3(c)(5)(C) Concept Release, at 17. We note that the no-action letters cited in footnote 48 of the Concept Release, as well as a parenthetical description to one of those citations, specifically acknowledge the 55%/80% test, but the textual discussion associated with footnote 48 makes no reference to this test.

[61] Prior to 1988, several no-action letters generally described the test in the way the Release did. See, e.g., Bear Stearns & Co., Inc., SEC Staff No-Action Letter (Oct. 3, 1986); Prudential-Bache Securities, Inc., SEC Staff No-Action Letter (Aug. 19, 1985).

making this determination, and these should, in our view, be the main focus of the Commission's proposed interpretive release.

B. The Commission Should Reaffirm and Expand Existing No-Action Guidance

Each of the four principles developed in the Division's no-action letters for determining whether a particular instrument is a qualifying interest is appropriate, and the Commission should issue a statement, in an interpretive release or otherwise, re-affirming these principles, and expanding them, as discussed below. The Commission also should make it clear that additional principles may need to be developed, or that the existing principles may need to be expanded, in order to reflect developments in the real estate and mortgage-finance markets.

1. The Actual Interest Principle

Under this principle, an interest is a qualifying interest if it represents an actual interest in real estate, or is a loan or other lien fully secured by real estate. Examples of qualifying interests under this principle include fee interests, and second mortgages and leaseholds secured by real property. This principle, as it has been applied, clearly meets the statutory language of Section 3(c)(5)(C).

The Commission also should expand this principle. Nothing in Section 3(c)(5)(C) requires the mortgage or other lien on or interest in real estate to be fully secured by real estate. No doubt, at some point the value of the real estate securing a mortgage, loan or other interest (collectively, a "**Loan**") is so small in relation to the value of the Loan as to raise doubts as to whether the Loan is sufficiently real estate related to be deemed a qualifying interest. But if real estate that secures or otherwise backs a Loan has a value of at least 80% of the amount of the Loan, that Loan should be deemed to be a qualifying interest. The 80% figure derives from the Division's 80% test under Section 3(c)(5)(C) – if a company is deemed to be primarily engaged in real estate activities if at least 80% of its assets are appropriately real estate related, then it seems that a Loan should be deemed to be primarily a real estate Loan if at least 80% of its value is secured or backed by real estate.

We also recommend that the Commission clarify this principle in two additional ways. First, the Commission should clarify that if a Loan is fully secured by real estate at the time the Loan is made, the Loan continues to be treated as a qualifying interest even if the purchaser buys the Loan at a time when the value of the real estate has decreased and no longer is sufficient to fully secure the Loan. Such "underwater" Loans are no less interests in real estate than they were when the real estate value was higher. The price of the Loan almost certainly will be adjusted to reflect the impaired quality of the real estate that is the collateral for the Loan, and the Loan therefore is still fully a lien or interest in real estate. And, the possibly increased risk of default on such a Loan means that the holder of the Loan is more likely to foreclose on the Loan and take direct ownership of the real estate that was the collateral for the Loan – making this type of underwater Loan potentially "closer to the underlying real estate" than a similar Loan that remained fully secured by real estate.

Second, the Commission should clarify that a Loan that is fully secured by real estate at the time it is made is a qualifying interest, even if that Loan also is collateralized by non-real estate assets, as long as the real estate is the principal asset securing the Loan. For example, if a Loan is fully secured by commercial property owned by a business, and further secured by all or a portion of the cash flow of that business, the Loan should be deemed to be a qualifying asset as long as the value of the real estate is the principal asset securing the Loan (e.g., the value of the real estate is at least 80% of the value of the total collateral at the time the Loan is made).

2. The Economic Equivalence Principle

Under this principle, an interest in a MBS or similar instrument is a qualifying interest if it provides the holder with at least the same economic experience as the holder would have had if it directly held all of the underlying mortgages. An example of a qualifying interest under this principle is an agency whole pool certificate.

The Commission should retain this principle. If a particular instrument gives a mortgage REIT at least the same economic experience as if the REIT held the mortgages directly, there is no reasonable basis for treating the REIT as an investment company because it holds that instrument. At worst, the REIT is in precisely the same situation as if it held the mortgages directly, in which case Congress already has established in Section 3(c)(5)(C) that there is no reason to subject the REIT to the 1940 Act. If the instrument gives the REIT an even better experience than if it held the mortgages directly – as is the case in an agency whole pool certificate, in which the relevant GSE takes the risk of default or late payment on the underlying mortgages – then logically there should be even less need for 1940 Act protection, not more.[62]

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[62] As noted in the Section 3(c)(5)(C) Concept Release, the Commission previously requested comment on whether agency whole pool certificates should continue to be qualifying interests, in the1992 release proposing Rule 3a-7. See Section 3(c)(5)(C) Concept Release, at 24, n.58. As the Commission noted in the Concept Release:

> Commenters strongly urged the staff not to withdraw its position, arguing that agency whole pool certificates are interests in real estate because certificate holders receive payment streams that reflect payments on the underlying mortgages. Commenters also argued that withdrawal of the position could result in some REITs and mortgage bankers that held these instruments becoming subject to the Investment Company Act. In response to commenters' concerns at that time, the staff ultimately decided not to withdraw its position.

Nothing in the almost 20 years since then has lessened the validity of the commenters' concerns, or the appropriateness of the Division's decision to continue treating agency whole pool certificates as qualifying interests.

In addition, as discussed earlier, publicly-traded mortgage REITs have been permitted to hold agency whole pool certificates for over two decades, and are now significant holders of these instruments. Requiring publicly-traded mortgage REITs to divest those holdings, or be forced to register as investment companies, would be grossly unfair to those REITs and their shareholders. It also could have a devastating effect on the market for MBS – especially in the near future, when mortgage REITs likely will be relied on to provide private capital to that market as the GSEs reduce their role in that market.

We also urge the Commission to apply this principle to agency partial pool certificates, and to treat those certificates as qualifying interests. In fact, there are two different types of certificates that the markets refer to as agency partial pool certificates. First, an agency partial pool certificate can be a "pass through" certificate that, like an agency whole pool certificate, represents an undivided beneficial ownership interest in a distinct pool of mortgage loans, and provides the certificate holder with its pro rata portion of principal and interest paid on the underlying mortgages.[63] Such a certificate is conceptually identical to an agency whole pool certificate, but there are two or more certificate holders.

This type of agency partial pool certificate is at least the economic equivalent of owning an interest in the underlying mortgages. The certificate holder gets at least the same pro rata portion of the cash flows from the underlying mortgages as the certificate holder would receive if it directly held the same pro rata interest in each of the underlying mortgages. As a result, the Commission should clarify that this type of agency partial pool certificate is a qualifying interest.

Second, an agency partial pool certificate can be a "tranched" certificate issued by a GSE that again represents an undivided beneficial ownership interest in a pool of mortgage loans. As with agency whole pool certificates, the GSE guarantees that the certificate holders will receive all of the money they would have received had the underlying mortgages paid in full and on time. Unlike an agency whole pool certificate, in a tranched agency partial pool structure, there are several different certificates and certificate holders, and each certificate may be entitled to a specified portion of the underlying mortgage payments – for example, tranches may be designed to have different priorities to cash flows from the underlying mortgages, to have different average lives, or to receive principal-only payments or interest-only payments.

Regardless of which tranche of payments the certificate holder is entitled to, those payments are based directly on cash flows from the underlying mortgages. As a result, the certificate holder has an interest in the real estate underlying those mortgages, and the certificate

[63] Pursuant to the GSE guaranty, the GSE may be required to supplement the amounts paid to the certificate holders. Those payments also are paid to certificate holders on a pro rata basis.

holder has the additional certainty of payment that comes from the GSE guaranty. Accordingly, we request that the Commission confirm that tranched agency partial pool certificates also are interests in real estate, and thus qualifying interests.

We are aware that the Division previously has taken the position that agency partial pool certificates – apparently referring to tranched agency partial pool certificates – are not qualifying interests.[64] In the Protecting Investors Study, the Division stated its basis for this view:

> The rationale is that an investor in partial pool certificates obtains greater diversification and is subject to different prepayment risk than an investor who purchases the underlying mortgages directly. An investment in partial pool certificates is viewed as being more like an investment in the securities of an issuer, rather than an investment in the underlying mortgages.[65]

The suggestion that an investor in an agency partial pool certificate "obtains greater diversification" than an investor in an agency whole pool certificate is, we submit, both wrong and irrelevant. In both cases, the certificate holders have an interest in the stream of payments from all of the underlying mortgages, so there is no greater diversification from an agency partial pool certificate than from an agency whole pool certificate. Moreover, the diversification argument seems irrelevant under Section 3(c)(5)(C). That Section does not prevent a mortgage REIT from having a diversified portfolio of mortgage-related instruments – in fact, the REIT provisions of the Internal Revenue Code ("**Code**") require this – so the fact that a REIT receives some diversification from an agency partial pool certificate seems in no way inconsistent with Section 3(c)(5)(C). The important fact is that the payments to the certificate holder derive exclusively from cash flow generated by the underlying mortgages (and the related GSE guaranty), and that the certificate therefore is an interest in the real estate underlying those mortgages.

The possibility that a holder of an agency partial pool certificate may be subject to different prepayment risks than the holder of an agency whole pool certificate supports, rather than argues against, treating agency partial pool certificates as qualifying interests. The fact that the holder of an agency partial pool certificate is or can be subject to a prepayment risk demonstrates that the certificate is directly tied to the performance of the underlying mortgages, and thus should be a qualifying interest. The possibility that agency whole pool and agency

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[64] See, e.g., Protecting Investors Study, at 73; Nottingham Realty Securities, Inc., SEC Staff No-Action Letter (Apr. 19, 1984).

[65] Protecting Investors Study, at 73.

partial pool certificate holders may be subject to different prepayment risks is perhaps a pricing or valuation issue; it is not an argument for concluding that one certificate is an interest in the underlying mortgages and the other certificate is not.

Finally, holding a partial pool certificate bears no more resemblance to an investment in an issuer of securities than does holding a whole pool certificate. In each case, the certificate holder's return is tied directly to the performance of the underlying mortgages (as guaranteed by the relevant GSE), and nothing else. In both cases, the underlying pool holds mortgages, and makes payments solely from the cash flow from those mortgages. It does not engage in other business activities or derive income from other business activities. In both cases, the certificate holder has an interest in the mortgages, and in turn, in the underlying real estate.

3. The Functional Equivalence Principle

Under this principle, an instrument is a qualifying interest if it can be viewed as the functional equivalent of, and provides the holder with the same economic experience as, an interest in real estate or a loan or lien fully secured by real estate. Examples of a qualifying interest under this principle are tier 1 real estate mezzanine loans and certain interests in an MBS in which the holder has the right to direct foreclosure of the underlying mortgages.

(a) The Commission Should Retain the Functional Equivalence Principle

The Commission should retain this position. This principle in effect recognizes that in the hands of a mortgage REIT, mortgages and mortgage-related instruments are assets, and mortgage REITs are permitted to borrow money and use those mortgage assets as collateral for the loan. In a simpler time, a mortgage REIT might have kept the mortgages on its balance sheet, and borrowed money from a bank by pledging the mortgages as collateral. For commercial, tax and regulatory reasons, today's financing structures are more complex. In an MBS structure, for example, the mortgage REIT may sell mortgages to a special purpose entity; that entity will issue debt securities backed by the payment stream of the mortgages held by that entity, while the REIT will be entitled to any payments received after the debt holders are fully paid. Such a situation is economically and functionally identical to the straight balance sheet borrowing arrangement, and the Division has appropriately recognized that a REIT may treat such an interest in an MBS as a qualifying interest.[66]

[66] See, e.g., Capital Trust, Inc. I, SEC Staff No-Action Letter (May 24, 2007) (Tier 1 real estate mezzanine loan with ongoing control rights, right to foreclose, and collateralization is functionally equivalent to a second mortgage and so is a qualifying interest); Premier Mortgage Corp., SEC Staff No-Action Letter (Mar. 14, 1983) (mortgage-backed security with ownership of a whole pool interest and foreclosure rights is a qualifying interest).

This principle is equally true with respect to tier 1 real estate mezzanine loans, which as discussed in section I.B of this Letter, are the functional and economic equivalent of second mortgage loans of commercial property.

We note that the Section 3(c)(5)(C) Concept Release requests "comment on whether a company whose primary business consists of investing in CMBS, or any other type of mortgage-backed security, is the type of entity that Congress intended to be encompassed by the exclusion provided by Section 3(c)(5)(C)."[67] We urge the Commission to affirm that such a company is entitled to rely on Section 3(c)(5)(C). Such a company is, in effect, borrowing against all or a significant portion of its mortgage assets. Nothing in Section 3(c)(5)(C) limits an entity from borrowing against all or a significant part of its mortgage assets, and there is no basis for concluding that the economically and functionally identical activity – borrowing through an MBS structure – should be treated any differently under Section 3(c)(5)(C).

(b) Historical Support for Treating MBS as Qualifying Interests

In fact, a review of the mortgage finance instruments that had been in wide use in the United States shortly before the enactment of the 1940 Act strongly supports the conclusion that Congress was aware at that time of instruments that were much like today's MBS structures, and took no steps to exclude those instruments from the scope of Section 3(c)(5)(C). The 1920s witnessed a speculative commercial real estate boom that was unmatched until the mid-2000s.[68] Among the various methods used to finance that development were bonds that: were issued to the public by underwriters known as real estate bond houses; were collateralized or backed by real property; and "directed and divided cash flows from one or a group of commercial properties through an intermediary to a group of public investors."[69] Interest rates varied between 4 and 7%, and terms ranged from 2 to 47 years.[70]

The amount of these securities that were issued was staggering. In 1936, a well-regarded study of the size of the public real estate securities markets in the 1920s:

> [E]stimated the total issuance to have exceeded $4.1 billion across 1090 individual issues between 1919 and 1931. Between 1919 and

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[67] Section 3(c)(5)(C) Concept Release, at 24-25.

[68] William N. Goetzmann and Frank Newman, Securitization in the 1920's, National Bureau of Economic Research, Working paper 15650 (January 2010), at 3 ("Securitization in the 1920's").

[69] Securitization in the 1920's, at 4 -5; Kenneth A. Snowden, The Anatomy of a Residential Mortgage Crisis: A Look Back to the 1930s, National Bureau of Economic Research, Working Paper 16244 (July 2010), at 12-13 ("Anatomy of a Residential Mortgage Crisis").

[70] Securitization in the 1920's, at 5.

> 1925, total yearly issuance grew from $57.7 million to $695.8 million, or nearly 1,106%. Real estate security issuance notably surpassed railroad bond issuance in the years 1924, 1925 and 1928 and represented nearly 23% of total public corporate debt issuance at the peak of the market in 1925. [71]

The collapse of that market was equally dramatic: by 1934, real estate bond issuance accounted for just 0.14% of all corporate debt issuances;[72] by 1935, 80% of all outstanding real estate bonds were in default; and in 1935, following complaints about real estate bond houses by their bondholders, Congress conducted an investigation into real estate bondholders' reorganizations and considered securities law and bankruptcy legislation in response.[73]

A precursor to residential MBS also existed during the 1920s. Entities called mortgage guarantee companies issued so-called "guaranteed mortgage participation certificates," which were a form of mortgage pass-through securities that "represented pools of residential mortgage cash flows from geographically diversified baskets of cities and towns across the United States."[74] The mortgage guarantee companies also issued mortgage insurance.[75] In 1933, state regulators began responding to concerns with mortgage guarantee companies – in that year alone, New York State's Department of Insurance seized 18 mortgage guarantee companies for liquidation; these companies had sold $1 billion of insured whole mortgage loans, and $800 million of participation certificates held by more than 200,000 investors.[76]

Also notable were financial institutions known as Building & Loan Associations ("**B&Ls**"). "The typical B&L was a small, local and undiversified mutual fund into which members contributed weekly or monthly dues; the pooled dues were then lent to members who chose to purchase new or existing homes."[77] By the end of the 1920s, B&Ls "wrote more mortgage debt on one-to-four-family homes each year than life insurance companies,

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71 Securitization in the 1920's, at 8 (relying on a 1936 study performed by Ernest Johnson).

72 Securitization in the 1920's, at 18.

73 Anatomy of a Residential Mortgage Crisis, at 19.

74 Securitization in the 1920's, at 5; Anatomy of a Residential Mortgage Crisis, at 11-12.

75 Anatomy of a Residential Mortgage Crisis, at 11.

76 Anatomy of a Residential Mortgage Crisis, at 18.

77 Anatomy of a Residential Mortgage Crisis, at 8.

commercial banks and mutual savings banks combined . . . ."[78] By 1941, more than 50% of the 12,000 B&Ls that were operating in 1929 had failed.[79]

In 1940, when Section 3(c)(5)(C) was enacted, Congress had to be aware of securities such as commercial real estate backed bond and guaranteed mortgage participation certificates, and Congress had to be aware of real estate related financial entities such as real estate bond houses, mortgage guarantee companies and B&Ls. Had Congress intended for Section 3(c)(5)(C) to not apply to these types of securities, or to these types of financial institutions, it is reasonable to expect that Congress would have drafted Section 3(c)(5)(C) to specifically exclude them. Congress did not. It would have been reasonable to expect Congress to have discussed in the legislative history to the 1940 Act that these types of securities and entities were subject to the 1940 Act. Congress did not. The most logical conclusion – indeed, we submit, the only logical conclusion – for these omissions is that Congress intended that these types of securities could be qualifying interests, and that these types of entities could rely on Section 3(c)(5)(C). Indeed, as discussed in section I.B of this Letter, Congress drew a distinction between companies generally investing in stocks and bonds of corporate issuers, which are investment companies, and companies generally investing in securities that represent interests in real estate, which are not investment companies.

A corollary of this historical analysis is that the recent real estate market downturn and related concerns should not serve as the basis for now narrowing the reach of Section 3(c)(5)(C). That provision was enacted following another major downturn in the real estate markets, and Congress determined then that it was inappropriate to respond to that downturn by attempting to regulate important parts of the mortgage and real estate finance markets under the 1940 Act. It is, we submit, equally inappropriate now.

(c) Expansion of MBS Securities Deemed to be Qualifying Interests

We also urge the Commission to apply the Functional Equivalence Principle more broadly, and to permit a publicly-traded mortgage REIT to treat as a qualifying interest a class of securities of an MBS that gives the REIT the right and power to direct foreclosure, even when the REIT owns less than 100% of that class of securities. For example, if the holder of 51% of a class of securities in an MBS has the ability to direct foreclosure of the underlying mortgages, the holder of that 51% interest will be in a functionally equivalent position to holding the underlying mortgages directly, and will have an economic experience that is the same as holding the underlying mortgages while financing 49% of their cost. Indeed, requiring a publicly-traded mortgage REIT to hold the entire class of the securities harms

[78] Anatomy of a Residential Mortgage Crisis, at 10 (internal citations omitted).

[79] Anatomy of a Residential Mortgage Crisis, at 17.

investor protection – it causes the REIT to have to devote additional money to the same class of securities without gaining any additional foreclosure or other rights, thereby causing the REIT to become more concentrated and less diversified, to the potential detriment of its shareholders.

In addition, the Commission should clarify that if a publicly-traded mortgage REIT holds securities in an MBS that gives it the ability to direct foreclosure, the REIT should be able to treat as qualifying interests any other securities of that MBS that it holds. The Division has indicated that only "contiguous" pieces of an MBS can be treated as qualifying interests. So, for example, if a REIT owns the equity and lowest debt tranche of an MBS, other investors own the next tier of debt, and the REIT owns the senior debt tranche, the Division currently takes the position that the equity and lowest debt tranche are qualifying interests, but the senior debt tranche is not.

This position makes no sense. If the REIT owns the equity of an MBS and has the ability to direct foreclosure, the REIT is in the same functional and economic situation as if it held the underlying mortgages directly. The fact that it chooses to own contiguous or non-contiguous pieces of the MBS' debt structure simply reflects the REIT's view of the most advantageous method of financing the mortgages. By way of direct analogy, if the REIT held the mortgages directly on its balance sheet, it might negotiate with one or more lenders to borrow money, and post as collateral for those loans various portions of the income streams expected to be generated from those mortgages. Of course, the cost and terms of the financing would vary depending upon which income streams were posted as collateral. But regardless of the way the income streams were carved out, the REIT would still own the mortgages and treat them as qualifying interests. The fact that the REIT does precisely the same thing through an MBS structure in which it owns the equity, and ends up holding non-contiguous pieces of that structure, should in no way affect its ability to treat all the securities issued by that MBS as qualifying interests.

4. The Loan Participation Principle

Under this principle, an interest is a qualifying interest if it has attributes that, when taken together, allow the instrument to be classified as an interest in real estate or in a real estate related loan, rather than an interest in a company that is engaged in a real estate business, even though the holder may not have unilateral foreclosure rights. An example of a qualifying interest under this principle is a B Note.[80]

[80] The Division recently called into question a well-reasoned and long-standing position, dating back over a quarter of a century, that participation interests in loans that are secured by real property and carry the right to direct foreclosure are qualifying interests. The Division has suggested that other attributes must also be considered. See Section 3(c)(5)(C) Concept Release, at 19, n.53; Capital Trust, Inc. II. We respectfully but strongly urge the

The Commission should retain and expand this principle. This principle in effect recognizes that Section 3(c)(5)(C) does not require a lien on or other interest in real estate to be the exclusive lien on or interest in that real estate. This principle also recognizes that Section 3(c)(5)(C) does not require a lien or other interest in real estate to carry the right to direct foreclosure. So, for example, a non-exclusive lien or interest can be a qualifying interest if, for example, the holder has significant functional rights with respect to the underlying real estate (even if the holder does not have the right to direct foreclosure), and has significant economic rights that derive from the underlying real estate.[81] In such a case, it is appropriate to treat the interest as a qualifying interest.

5. Additional Principles

We also urge the Commission to make it clear that the Division and the REIT industry may develop other principles, or expand the existing principles, as the real estate and mortgage finance markets develop. As we have discussed in this section, the Division has developed a number of flexible principles to help determine whether a particular instrument is a qualifying interest, and has done so in response to continuing market and other developments in the mortgage markets. These developments will continue, and as we have discussed, may accelerate in the foreseeable future. We believe it is of critical importance that any statement by the Commission stresses that the existing principles are not exclusive or unchangeable. As the mortgage and real estate finance markets develop, the principles the Division and the industry use to analyze them must continue to develop as well, and this should be able to happen without requiring a Commission order or interpretive release.

For example, as discussed in section I.C of this Letter, the Commission and other financial and housing regulators are in the process of adopting credit retention rules that will require the sponsors of many MBS structures to retain a portion of those structures. Depending upon the final shape of those rules, and the market's reaction to them, it may not be possible in many cases for publicly-traded mortgage REITs to own 100% of any tranche of an MBS. As we discussed above, we do not believe this should be required under the Division's current Functional Equivalence Principle, and we have asked the Commission to state that it agrees with us. The likely issues mortgage REITs will face once the credit retention rules are adopted are an excellent example of the need for the Commission and the Division to flexibly interpret the term "qualifying interest" as the mortgage, MBS and related markets continue to develop.

Commission to direct the Division to reaffirm the continuing validity of this long-standing position, regardless of whether the participation interests have "other attributes." A participation interest that is secured by real estate and that provides the holder the ability to direct foreclosure is an interest in the underlying real estate, regardless of what other attributes that participation interest may have.

81 Cf. Capital Trust, Inc. II.

Finally, we urge the Commission to strongly consider greatly expanding the types of instruments that it will view as qualifying interests. The language of Section 3(c)(5)(C) is very broad – it includes, in addition to mortgages and liens on real estate, "other . . . interests in real estate." As we have previously noted, the "other interests in real estate phrase is not limited to interests that provide the right to control foreclosure; it is not limited to interests that are functionally equivalent to mortgages; it is not, in fact, limited in any way except that it must be an interest in real estate. A fair reading of this provision might go so far, for example, as to include any tranche of an MBS, regardless of how much of that tranche a REIT held, as long as the tranche received its returns from the cash flow of the underlying mortgages.

We are fully aware that this reading of the statute is far broader than the Division's current interpretation of Section 3(c)(5)(C). But we do think it is fair to point out, as the Commission considers the proper interpretation of Section 3(c)(5)(C), that the Division's current interpretations of that Section are quite narrow given the Section's broad language; we therefore believe that the Division's interpretations should be viewed as a floor, not a ceiling. Indeed, as we have suggested in a number of instances in this Letter, we believe the definition of qualifying interest should be broadened, not narrowed, and we respectfully suggest that the real question for the Commission is not whether that definition should be broadened, but by how much.

*   *   *   *   *

On behalf of the Committee and its publicly-traded mortgage REIT members, thank you for considering our comments, and we look forward to continuing to work with you and the Division on the issues discussed in this Letter.

Exhibit 1

	Mortgage REITs			
	Company Name	Ticker	Mkt Cap ($mm)	Total Assets ($mm)
1	Annaly Capital Management Inc	NLY	$16,116	$100,557
2	American Capital Agency Corp	AGNC	4,838	43,637
3	Chimera Investment Corp	CIM	2,845	10,089
4	MFA Financial Inc	MFA	2,500	11,927
5	Hatteras Financial Corp	HTS	1,892	17,028
6	Invesco Mortgage Capital Inc	IVR	1,630	12,527
7	Starwood Property Trust Inc	STWD	1,603	2,649
8	Two Harbors Investment Corp	TWO	1,241	6,008
9	CYS Investments Inc	CYS	999	9,311
10	Capstead Mortgage Corp	CMO	974	11,820
11	Redwood Trust Inc	RWT	879	5,165
12	Anworth Mortgage Asset Corp	ANH	898	8,552
13	CreXus Investment Corp	CXS	680	970
14	Walter Investment Management Corp	WAC	634	2,073
15	iStar Financial Inc	SFI	537	8,291
16	ARMOUR Residential REIT Inc	ARR	515	5,530
17	PennyMac Mortgage Investment Trust	PMT	442	883
18	Colony Financial Inc	CLNY	425	660
19	Newcastle Investment Corp	NCT	414	3,687
20	Resource Capital Corp	RSO	372	1,972
21	Dynex Capital Inc	DX	325	2,657
22	NorthStar Realty Finance Corp	NRF	317	5,431
23	Apollo Commercial Real Estate Finance	ARI	271	896
24	RAIT Financial Trust	RAS	130	3,008
25	Gramercy Capital Corp	GKK	159	5,279
26	BRT Realty Trust	BRT	88	188
27	Arbor Realty Trust	ABR	96	1,764
28	PMC Commercial Trust	PCC	82	253
29	New York Mortgage Trust Inc	NYMT	78	456
30	Capital Trust Inc	CT	50	2,365
31	Origen Financial Inc	ORGN	36	699
32	Veslin Realty Mortgage II Inc	VRTB	16	112
33	IMPAC Mortgage Holdings Inc	IMH	15	5,807
		Total	$42,098	$292,249

Note: Market Cap as of September 30, 2011. Assets as of June 30, 2011.
Source: Company Filings and Bloomberg

<u>Exhibit 2</u>

New Equity Issue Volume and Performance - IPOs

Gross proceeds in millions

Time Period	IPOs – Mtg REITs: # of deals	Mtg REITs: Amount Raised ($mm)	Mtg REITs: Total Return (%)	IPOs – Other: # of deals	Other: Amount Raised ($mm)	Other: Total Return (%)	Mtg REIT as % of Total	S&P 500 Total Return
2008	2	$476	+102%	29	$28,779	+27%	1.7%	
2009	7	$2,204	+5%	41	$15,239	+21%	14.5%	
2010	N/A	N/A	N/A	110	$37,748	+4%	N/A	
2011 YTD	3	$470	(3%)	83	$27,202	(11%)	1.7%	
Total / Average	**12**	**$3,150**	**+34%**	**263**	**$108,968**	**+10%**	**2.9%**	**(10%)**

Source: Dealogic, Factset, as of 09/16/11.
Note: IPOs since 2008. Total return % includes price appreciation and cash dividends.
Average return represents the mean of the average annual returns.

Exhibit 3

New Equity Issue Volume and Performance – Add-Ons

Gross proceeds in millions

Time Period	Add-Ons						Mtg REIT as % of Total	S&P 500 Total Return
	Mtg REITs			Other				
	# of deals	Amount Raised ($mm)	Total Return (%)	# of deals	Amount Raised ($mm)	Total Return (%)		
2008	11	$4,186	+12%	225	$147,614	+6%	2.8%	
2009	11	$2,850	+50%	493	$193,955	+42%	1.5%	
2010	25	$5,921	+12%	427	$122,512	+10%	4.8%	
2011 YTD	29	$14,717	(1%)	276	$87,894	(11%)	16.7%	
Total / Average	**76**	**$27,674**	**+18%**	**1,421**	**$551,975**	**+12%**	**5.0%**	**(10%)**

Source: Dealogic, Factset, as of 09/16/11.
Note: Follow-ons since 2008. Total return % includes price appreciation and cash dividends.
Average return represents the mean of the average annual returns.

Exhibit 4

Gross proceeds in millions

Time Period	All Equity Offerings: Mtg REITs: # of deals	Mtg REITs: Amount Raised ($mm)	Mtg REITs: Total Return (%)	Other: # of deals	Other: Amount Raised ($mm)	Other: Total Return (%)	Mtg REIT as % of Total	S&P 500 Total Return
2008	13	$4,662	+26%	254	$176,393	+8%	2.6%	
2009	18	$5,055	+32%	534	$209,194	+41%	2.4%	
2010	25	$5,921	+12%	537	$160,260	+9%	3.7%	
2011 YTD	32	$15,187	(1%)	359	$115,096	(11%)	13.2%	
Total / Average	**88**	**$30,825**	**+17%**	**1,684**	**$660,942**	**+12%**	**4.7%**	**(10%)**

Source: Dealogic, Factset, as of 09/16/11.

Note: IPOs and follow-ons since 2008. Total return % includes price appreciation and cash dividends.
Average return represents the mean of the average annual returns.

Exhibit 5

Total Returns Since 2000

The Broader Market

	Price Appreciation	Dividends	Total Return
Bloomberg REIT Mortgage Index	**(55%)**	**178%**	**123%**
S&P 500	(23%)	19%	(4%)

Mortgage REITs vs. the Traditional Yield Benchmarks

	Price Appreciation	Dividends	Total Return
Utility Index	65%	101%	166%
Bloomberg REIT Mortgage Index	**(55%)**	**178%**	**123%**
NCREIF Property Index(1)	36%	0%	36%
MSCI US REIT Index(2)	(15%)	28%	12%
KBW Bank Index	(54%)	18%	(36%)
S&P Financials	(51%)	15%	(35%)

Mortgage REITs vs. the S&P 500 subsectors

	Price Appreciation	Dividends	Total Return
S&P Energy	108%	56%	164%
Bloomberg REIT Mortgage Index	**(55%)**	**178%**	**123%**
S&P Consumer Staples	47%	49%	96%
S&P Utilities	20%	68%	88%
S&P Materials	15%	37%	52%
S&P Healthcare	13%	25%	37%
S&P Industrials	(8%)	25%	17%
S&P Consumer Discretionary	(8%)	14%	6%
S&P Financials	(51%)	15%	(35%)
S&P Telecom	(62%)	21%	(41%)
S&P Info Tech	(53%)	4%	(50%)

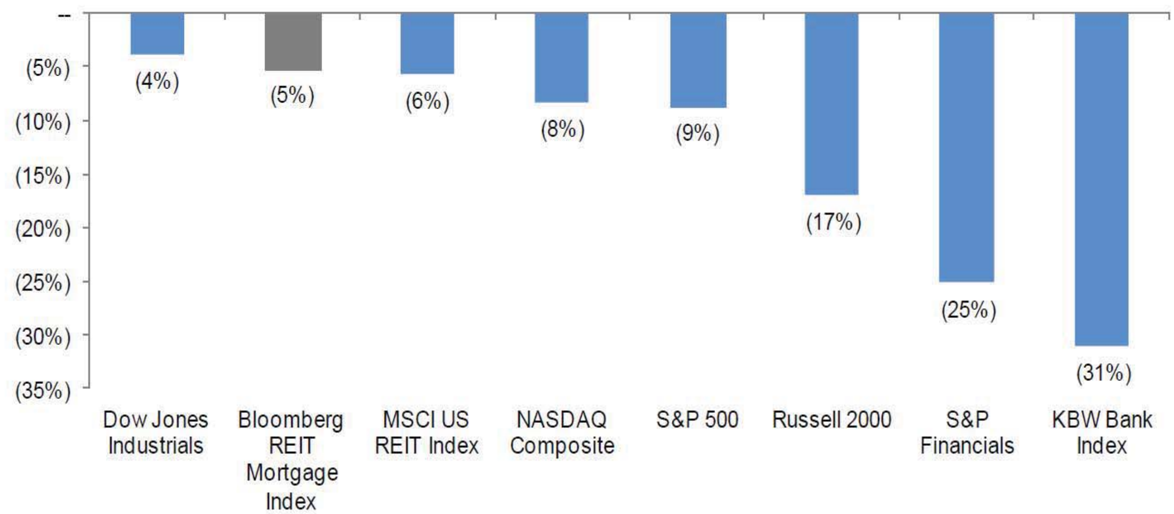
Source: Bloomberg, weekly, December 31, 1999 through September 30, 2011.

(1) NCREIF Property Index a quarterly total rate of return measure of investment performance of a large pool of individual commercial real estate properties acquired in the private market. Latest data as of June 30, 2011.

(2) MSCI US REIT Index performance data begins June 17, 2005.

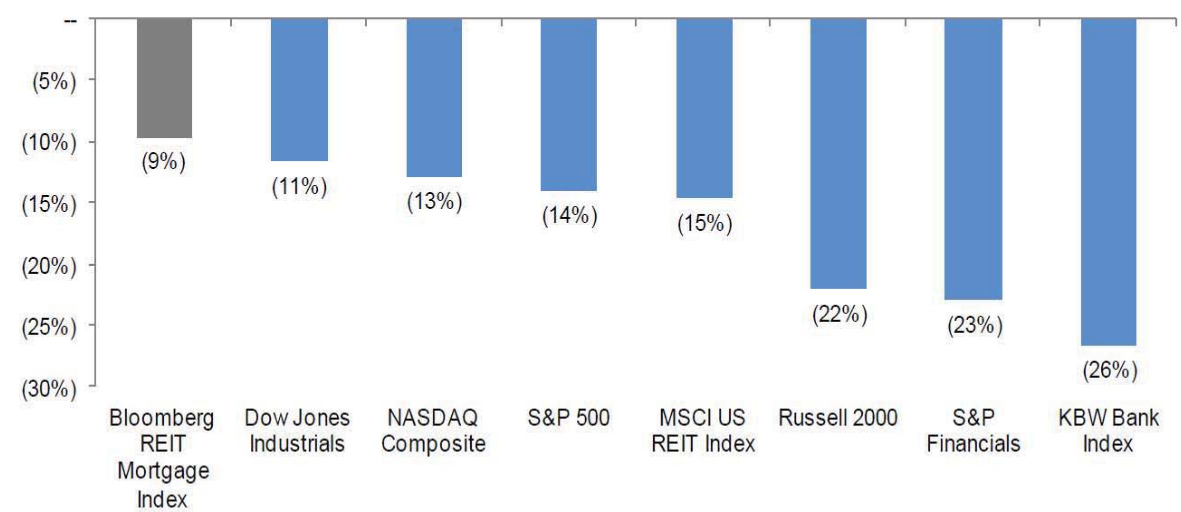
Exhibit 6

2011 YTD



Note: Data as of 9/30/2011.
Source: Bloomberg

Q3 2011



Note: Data as of 9/30/2011.
Source: Bloomberg

Exhibit 7

Comparison of Mortgage REITs and Closed-End Funds since 2000

	Capital Raised		Market Cap[1]	Total Return of Sector[2]
	$mm	# of deals	$mm	
mREITs	$52,805	240	$41,783	123%
Closed-End Funds[3]	$1,455	8	$1,228	19%

Source: Dealogic, Factset, as of 09/30/11.

(1) Market capitalization of mREITs shown as market capitalization of the Bloomberg REIT Mortgage Index.

(2) Total Return of the Bloomberg Mortgage REIT Index since 2000. Total return includes price appreciation and cash dividends. Closed-End Funds includes funds that became public since 2000.

(3) Includes CEF IPOs classified by Morningstar as Mortgage funds or which hold >50% of current assets in mortgage related products.

APPENDIX C

November 7, 2011

Ms. Elizabeth M. Murphy, Secretary
U.S. Securities and Exchange Commission
100 F Street, N.E.
Washington, D.C. 20549-1090

Re: File No. S7-34-11: Section 3(c)(5)(C) Concept Release (IC Rel. No. 29778)
File No. S7-35-11: Rule 3a-7 Advanced Notice of Proposed Rulemaking (IC Rel. No. 29779)

Dear Ms. Murphy:

We are writing in response to the request of the Securities and Exchange Commission ("Commission" or "SEC") in Investment Company Act Release No. 29778 (August 31, 2011), 76 FR 55300 (Sept. 7, 2011) (the "Concept Release"), seeking comments on questions concerning the interpretation of Section 3(c)(5)(C) of the Investment Company Act of 1940, as amended (the "Investment Company Act), and in Investment Company Act Release No. 29779 (August 31, 2011), 76 FR 55308 (Sept. 7, 2011) (the "ANPR Release"), providing advanced notice of proposed rulemaking on Rule 3a-7 under the Investment Company Act and soliciting comments on the operation of this rule. We are all publicly traded companies that operate as real estate investment trusts ("REITs") and are members of the National Association of Real Estate Investment Trusts ("NAREIT"). We represent the majority views of the Commercial Mortgage REIT Committee of NAREIT's Mortgage REIT Council.[1] We each have an investment objective and set of investment policies to invest principally in commercial real estate mortgages and related assets of the types described below (such entities, "commercial mortgage REITs" or "CMRs"). In managing our respective businesses, we all rely on the statutory exclusion provided in Section 3(c)(5)(C), which excludes with broad language market participants that purchase or acquire both "mortgages and other liens on . . . real estate" and "other . . . interests in real estate," as well as on the safe harbor provisions of Rule 3a-7 under the Investment Company Act.

We appreciate the opportunity to comment on these matters and commend the Commission for undertaking this effort to provide clarity, consistency and regulatory certainty with respect to Section 3(c)(5)(C) as it pursues the rulemaking required to update certain provisions of Rule 3a-7. As we discuss in this comment letter, we believe the Commission should codify certain existing staff guidance and adopt a principles-based definition of "qualifying asset" that will enable commercial mortgage REITs to determine with reasonable certainty for purposes of Section 3(c)(5)(C) the appropriate treatment of commercial real estate mortgage loans and related instruments that are prevalent in the market today or that may be introduced in the future as the commercial mortgage finance market continues to evolve and innovate. We believe such action would serve the interests of issuers and investors alike and facilitate a more efficient administration of the statutory exclusion by the Commission and its staff. We also believe that in proposing amendments to Rule 3a-7, the Commission should preserve the ability of CMRs for

[1] This letter represents the views of the following NAREIT members: Arbor Realty Trust, Inc.; Capital Trust, Inc.; Colony Financial, Inc.; Gramercy Capital Corp.; NorthStar Realty Finance Corp.; RAIT Financial Trust; Resource Capital Corp.; and Starwood Property Trust, Inc.

purposes of Section 3(a)(1)(C) of the Investment Company Act to treat their interests in majority-owned structured finance vehicles that are relying on Rule 3a-7 as non-investment securities, and allow these vehicles to continue to rely alternatively on Section 3(c)(5)(C).

We have divided this comment letter into three parts because we believe that organizing our comments in this manner allows us to address effectively the many questions concerning commercial mortgage REITs raised in the Concept Release and the ANPR Release, as well as to highlight the steps that the Commission may undertake to accomplish the various goals identified in the Concept Release.[2] Part I provides background information on the commercial mortgage industry, the role played by CMRs as sophisticated participants in the commercial mortgage market in the United States, and the unique ability of CMRs to successfully form capital in order to provide financing to the commercial real estate industry in the United States. Part I also provides background information on the evolution of the commercial mortgage market and the products that are prevalent in the market today. In Part I we also discuss the operations of CMRs and distinguish them from the investment activities of registered investment companies that invest primarily in real estate type interests. Part II addresses the Commission's request for industry input on the interpretation of the Section 3(c)(5)(C) exclusion.[3] In this section, we recommend that the Commission codify with minor modifications the staff's existing Section 3(c)(5)(C) percentage test and embrace a principles-based definition of "qualifying asset" for purposes of this test that we believe allows for the past and future evolution of the commercial real estate finance industry. The proposed definition not only addresses industry concerns, but also is predicated upon the two operating principles centered on "control" and the "same investment or economic experience" that the staff has articulated in existing guidance. In Part III, we address other questions raised by the SEC in the ANPR Release that apply to CMRs.

[2] In the Concept Release, the Commission stated that it was requesting data and other information from the public about mortgage-related pools and soliciting views about the application of Section 3(c)(5)(C) to accomplish four specific goals: (1) to be consistent with the Congressional intent underlying the exclusion from regulation under the Investment Company Act provided by Section 3(c)(5)(C); (2) to ensure that the exclusion is administered in a manner that is consistent with the purposes and policies underlying the Investment Company Act, the public interest, and the protection of investors; (3) to provide greater clarity, consistency and regulatory certainty in this area; and (4) to facilitate capital formation. *See* Concept Release, circa text accompanying n. 9.

[3] While our objective in this part of the letter, among other things, is to address the Commission's questions whether companies that are engaged in the real estate and mortgage banking business are different from traditional investment companies, we believe that given the broad language of Section 3(c)(5)(C), the Commission should appropriately interpret that section expansively to include various forms of market participants that are primarily engaged in "purchasing or otherwise acquiring mortgages and other liens on and interests in real estate."

I.
BACKGROUND

A. The Commercial Mortgage Finance Market and CMRs' Role as Capital Providers

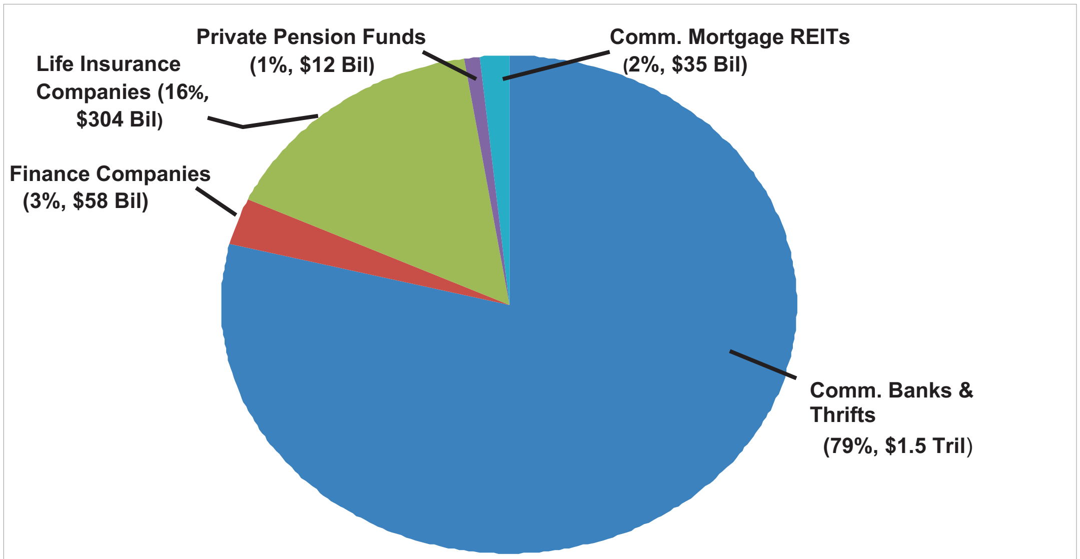
CMRs serve as an integral source of capital in the commercial mortgage finance market. CMRs' financing activities include the origination and acquisition of all financing products available in the commercial mortgage market, including commercial mortgage loans, participations in commercial mortgage loans, mezzanine loans, and various securitized products, such as commercial mortgage-backed securities ("CMBS"). As of September 30, 2011, there were approximately 13 public CMRs with an aggregate market capitalization of $5.3 billion and assets under management of $39.2 billion. We represent a majority of the public CMR market as demonstrated in the table below.

Commercial Mortgage REITs

#	Company Name	Ticker Symbol	Equity Market Cap (in $mill)	Assets under Management (in $mill)
1	Starwood Property Trust Inc.	STWD	1,643.4	2,649.0
2	Crexus Investment Corp.	CXS	694.2	969.9
3	iStar Financial Inc.	SFI	561.9	8,291.4
4	Newcastle Investment Corp.	NCT	438.8	3,686.8
5	Colony Financial Inc.	CLNY	436.0	660.2
6	Resource Capital Corp.	RSO	370.7	1,972.4
7	Northstar Realty Finance Corp.	NRF	315.7	7,281.2
8	Apollo Commercial Real Estate Finance Inc.	ARI	266.9	895.5
9	Gramercy Capital Corp.	GKK	159.6	5,430.0
10	RAIT Financial Trust	RAS	142.6	3,007.7
11	Arbor Realty Trust Inc.	ABR	84.5	1,763.6
12	PMC Commercial Trust	PCC	82.7	252.8
13	Capital Trust Inc.	CT	50.1	2,365.4
		Totals	$5,331.8	$39,225.9

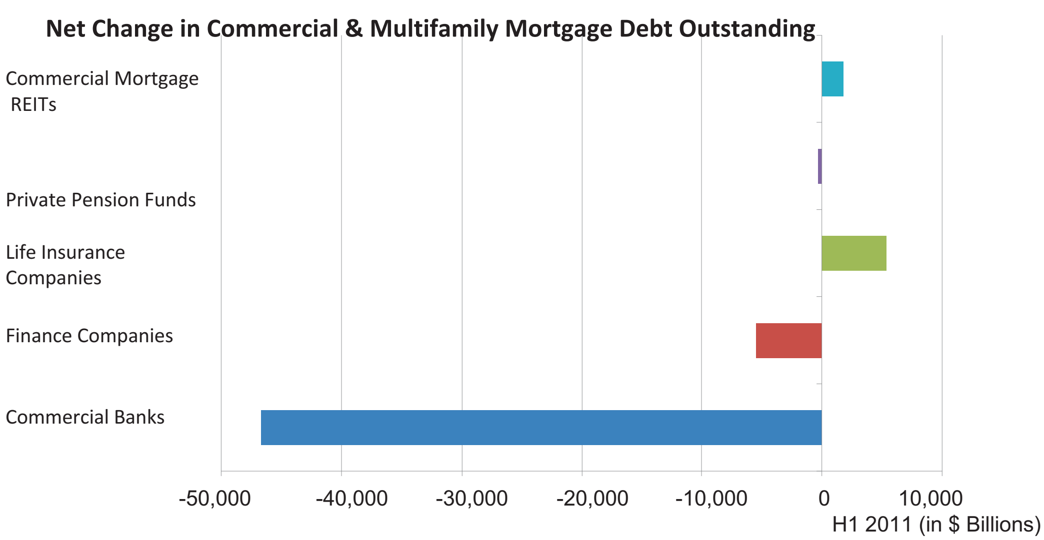
Source: NAREIT, Bloomberg LP, RAIT Financial Trust; Market cap as of 10/11/11; Assets under management as of 6/30/11

As shown in the diagram below, the commercial mortgage finance market is large and diverse and includes as participants commercial banks and thrifts, private pension funds, life insurance companies and finance companies, as well as commercial mortgage REITs.



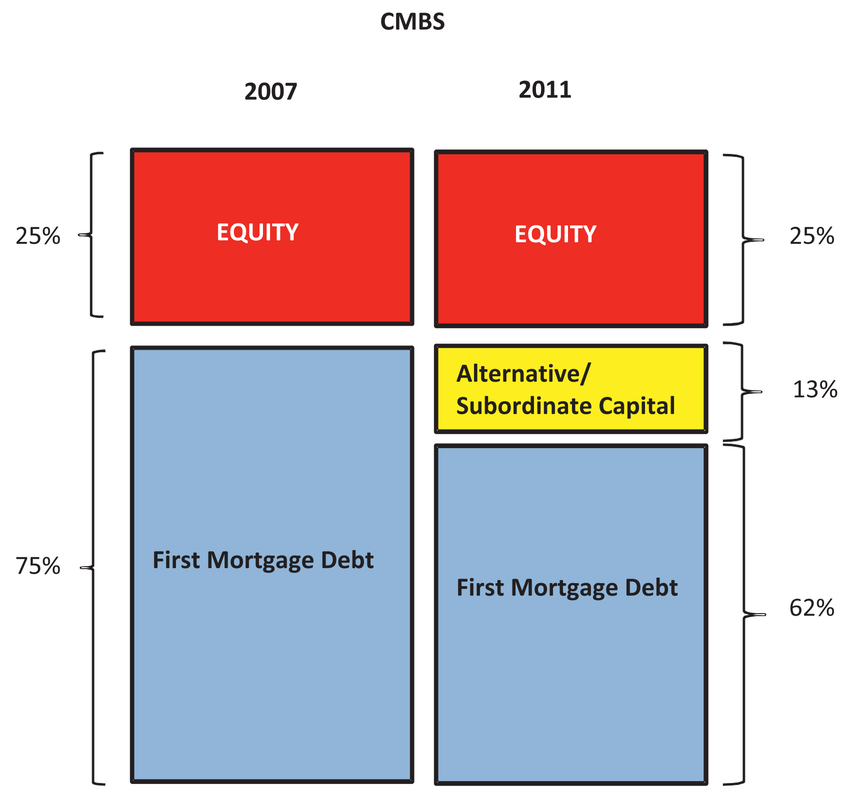
Source: Federal Reserve, Mortgage Bankers Association and RAIT Financial Trust

Commercial banks and thrifts are the largest providers of commercial mortgage finance by a significant margin. In recent years, however, these participants have significantly reduced their new loan originations. As shown in the diagram below, outstanding commercial mortgage holdings at commercial banks and thrifts decreased by almost $47 billion in the first half of 2011 alone. Commercial mortgage REITs and life insurance companies, on the other hand, have expanded their holdings by $1.7 billion and $5.3 billion, respectively. We expect CMRs to continue to grow their presence in the market.



Source: Federal Reserve, Mortgage Bankers Association, and RAIT Financial Trust

While commercial mortgage REITs' role in the market as mortgage finance providers is expanding, we believe the Commission should also consider the significance of the capital that many CMRs provide to finance commercial real estate properties. We believe the relative amount of capital provided by CMRs belies the important role played by them in the market, a role that has recently taken on greater significance as traditional first mortgage lenders have pulled back from the market. Using the current market for commercial mortgage-backed securities as a proxy for the overall commercial mortgage market, borrower loan-to-value ratios have decreased from the mid-70% range as of 2007 to approximately 62% as of mid-2011. As depicted below, this decrease has resulted in a significant equity gap that commercial real estate owners will need to fill in order for the commercial real estate industry to refinance itself over time.

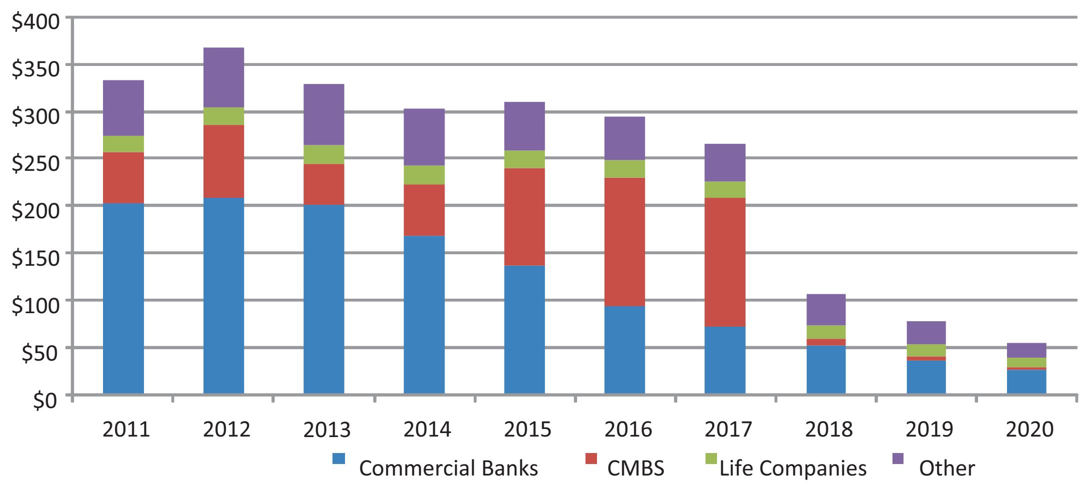


Source: RAIT Financial Trust

As sophisticated participants, CMRs have historically served as a critical source of this needed "gap" capital. CMRs are generally positioned to provide this capital given that they have developed the credit underwriting skills and structuring expertise, as well as asset management capabilities, that allow them to underwrite the risks associated with the capital described above. While the amount of capital supplied through these customized solutions may represent just 10% to 15% of the property's capital structure, without it, property owners would need to obtain additional equity funding which may not be available on economically viable terms, or at all. As traditional commercial mortgage lenders continue to retrench, there will be an increasing need for capital providers such as CMRs who can underwrite and invest in mezzanine or similar subordinated debt instruments to bridge the gap between available equity and senior mortgage financing. Any disruption in the ability of CMRs to provide this essential financing can be expected to have a negative effect on an already troubled commercial real estate industry and the ability of property owners to satisfy their future capital formation needs.

The table below depicts existing commercial real estate debt maturities estimated over the next decade. The commercial real estate sector faces the daunting task of refinancing over $1.5 trillion of debt that is expected to mature through 2015, and approximately $2.4 trillion by 2021. We expect commercial mortgage REITs, as sophisticated market participants with the proven ability to raise capital in these challenging markets, to play a vital role in developing solutions to meet this demand for refinancing.

Commercial Real Estate Estimated Debt Maturity Schedule



Sources: Foresight Analytics, SNL, Intex, Trepp, Morgan Stanley, RAIT Financial Trust

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B. <u>The Business of CMRs</u>

1. <u>Product Types</u>

The commercial mortgage finance market has evolved substantially since the enactment of the Investment Company Act in 1940. What had originally been a relatively simple mortgage market has evolved through the application of risk tranching. Risk tranching has allowed for a more efficient delivery of capital to the market as well as enabling finance companies to originate and acquire only the portion of the capital structure that meets their risk and return profiles. Risk tranching is evident in the direct financing of properties and portfolios through mortgage participations and subordinate financings such as mezzanine loans and preferred equity. The market has also embraced securitization, with the cash flows from individual or pools of mortgages being packaged and sold as tranched securities. All of these products are financings in the current market and have become prevalent, displacing in large part traditional direct whole mortgage loan origination and acquisition. We describe below the principal commercial real estate mortgage loan and related products that CMRs originate or acquire to varying degrees consistent with their investment objectives and policies.

a. Whole Commercial Mortgage Loans

CMRs may originate or acquire whole commercial mortgage loans. A whole commercial mortgage loan is an undivided mortgage loan fully secured by a first lien on commercial real property. As the sole owner of a whole commercial mortgage loan, a CMR has all of the rights as lender and can exercise all remedies, including the right to foreclose on the underlying real property both before and after default on the mortgage loan.

b. Participations in Commercial Mortgage Loans

CMRs may also originate or acquire participations in commercial mortgage loans or sell participations in such loans and retain a portion, particularly in cases in which a CMR has originated a loan. A common form of participation originated or acquired by CMRs is the B Note, representing a junior participation in the tranching of a commercial mortgage loan.[4] The holder of the A Note, representing the senior participation, and the B Note holder share a single borrower and both participations are secured by the same mortgage lien.

Because of its first loss position, the B Note holder retains various rights typically processed by a commercial mortgage lender, which it may exercise directly or through an operating advisor, an independent third party. The B Note holder's rights may include: (i) the right to give pre-default approvals on matters such as property-level budgets, leasing of the property, material alterations to the property, property manager changes, modifications/amendments to loan documents, waivers, or transfers; (ii) the right to give post-default approvals on matters such as loan document modifications/amendments (the "workout"), removal of the property manager, commencing and prosecuting a loan foreclosure, and approval of a plan of reorganization; (iii) the right to purchase the specially serviced A Note at par plus accrued interest (in some cases without prepayment premium and default interest); and (iv) the right to cure monetary and non-monetary defaults under the A Note.

A CMR may also retain the A Note, particularly in cases in which it has originated the related commercial mortgage loan, and sell the other participations in this loan. The A Note is fully secured by a mortgage lien on real property. The A Note holder, as the senior lender, holds legal title to the mortgage loan and is listed as the lender of record with the appropriate governmental authority. The A Note holder is in contractual privity with the borrower and is able to pursue remedies for collection directly against the borrower in the event of the borrower's default on the commercial mortgage loan. Because the A Note holder typically originates a commercial mortgage loan that has been divided into the A/B participation structure, the A Note holder generally is fully engaged in the lending process, including assessing the creditworthiness of the borrower and making the decision whether to lend. The A Note holder retains non-default servicing rights with respect to the mortgage loan and, therefore, directly or indirectly, continues to be involved in servicing the loan. The A Note holder thus has all of the rights it would retain as the lender of a whole mortgage loan except that, for as long as the B Note has value as demonstrated by an appraisal, the A Note holder cedes the right to foreclose on the underlying property to the B Note holder.

In addition to the A Note and the B Note, a commercial mortgage loan may be divided into one or more other intermediate participations (*i.e.*, participations between the A Note serving as the most senior participation, and the B Note as the most junior).

A commercial mortgage loan may also be divided into *pari passu* participations, rather than the senior/junior participation structure. Under this structure, holders of participations in a commercial mortgage loan have equal rights with respect to matters relating to the collection of principal and interest and the allocation of loss. However, the right to exercise approval rights and to pursue remedies in case of a defaulted loan typically requires the consent of the participant(s) representing a majority interest in the loan.

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[4] In certain commercial mortgage loan participation structures, there may be additional participations that are subordinate to the B Note and there may be different terms used to describe the various participations. For purposes of this letter, we are using the A/B participation nomenclature to describe the commercial mortgage loan participations discussed in this letter, the term "B Note" to describe the most junior participation in the participation structure, and the term "A Note" to describe the most senior participation in the structure.

c. Mezzanine Loans

CMRs may originate or acquire mezzanine loans, a financing alternative that was developed by the market to provide financing in addition to traditional first mortgage loans. A mezzanine loan is a separate loan that is subordinate to a first mortgage loan on commercial real property but senior to the owner's equity in the property. It is typically secured by a pledge of all of the equity interests in a special purpose limited partnership or limited liability company that owns the underlying real property. The mezzanine lender obtains a first priority perfected security interest in this collateral. If the mezzanine borrower (i.e., the special purpose limited partnership or limited liability company that owns the property owning entity) were to default on the mezzanine loan, the mezzanine lender has the right to foreclose on the collateral, become the owner of the mezzanine borrower and, accordingly, become the owner and operator of the underlying real property.

A CMR, as a mezzanine lender, obtains important rights through an intercreditor agreement it enters into with the first mortgage lender, as well as under the terms and conditions of the mezzanine loan agreements. These rights may include: (i) the right, pre-default, to approve actions relating to budget, leasing of the property, material alterations on the property, property manager changes, modifications/alterations of loan documents, waivers or transfers; (ii) the right, post-default, to approve actions relating to loan document modifications/amendments (the "workout"), removal of the property manager, commencing and prosecuting a foreclosure of the mezzanine loan, and approval of any plan of reorganization; (iii) the right to purchase the specially serviced senior mortgage loan (represented by both the A Note and B Note when the first mortgage loan is divided through a participation) at par plus accrued interest (in some cases, without prepayment premium and default interest); and (iv) the right to cure monetary and non-monetary defaults under the first mortgage loan.

CMRs may originate or acquire junior or senior mezzanine loans. These are separate loans that are issued in connection with the financing of commercial real property. Each mezzanine loan is separate and distinct with its own collateral and set of loan documents. Under this structure, the limited partnership or limited liability company that is the sole owner of the property-owning entity (the "senior mezzanine borrower") obtains a mezzanine loan ("senior mezzanine loan") from a mezzanine lender ("senior mezzanine lender") that is secured by a first priority perfected security interest in all of the ownership interests in the property-owning entity. In addition, the limited partnership or limited liability company that successively owns all of the ownership interests in the senior mezzanine borrower ("junior mezzanine borrower") obtains a separate mezzanine loan ("junior mezzanine loan") from a separate mezzanine lender ("junior mezzanine lender").[5]

Under this arrangement, the first mortgage lender, the senior mezzanine lender and the junior mezzanine lender all enter into an intercreditor agreement to establish the relative priority of rights among the three lenders. The senior mezzanine lender, among other rights, obtains cure rights and purchase rights relative to any possible default on the first mortgage loan. Similarly, the junior mezzanine lender, among other rights, obtains cure rights and purchase rights relative to any possible default on both the senior mezzanine loan and the first mortgage loan, with the priority being given to the junior mezzanine lender because it holds the first loss position with respect to the first mortgage loan cure and purchase rights. With respect to foreclosure in these circumstances, all three lenders have the right to foreclose on their respective collateral in the event of an uncured default on their instrument.

[5] On occasion, this can involve more than three levels of mezzanine debt.

d. Mezzanine Loan Participations

CMRs may also originate or acquire mezzanine loan participations. These are participations in a mezzanine loan that has been divided into a senior mezzanine loan participation and one or more junior mezzanine loan participations in the same way that a first mortgage loan may be divided into a senior loan participation and one or more junior participations. Under these arrangements, pursuant to the terms of a participation or other intercreditor agreement, the holder of the most junior mezzanine loan participation (*i.e.,* the first loss holder) is given control rights over the servicing of the entire mezzanine loan, including the right to foreclose, similar to the rights obtained by a B Note holder in the case of a first mortgage loan participation.

e. Preferred Equity

As an alternative to a mezzanine loan, a CMR may originate or acquire a preferred equity interest in a property owning entity that owns commercial real property. Under this arrangement, the CMR obtains a preferred return in the property owning entity and the right to replace the property owning company's management in certain circumstances. In such cases, the common members of the property owning entity lose their voting rights, dividends, and right to the distribution of any profit.

f. Commercial Mortgage Backed Securities

A CMR may acquire commercial mortgage backed securities ("CMBS"), which are securities issued by a special purpose vehicle that owns one or more commercial real estate mortgage loans. The securities issued by the special purpose vehicle are tranched and represent different priorities on the cash flow generated from the underlying mortgage loan collateral. These securities are generally rated with classes from AAA down to as low as B and an unrated class, NR.

The typical CMBS arrangement is governed by a pooling and servicing agreement. Under this agreement, the single holder or majority-holder[6] of the first loss or most junior class of securities (*i.e.,* the class that is the first to bear losses in case of default on the underlying loans or the class with the lowest payment priority) generally is designated as the "controlling" or "directing" class holder and given various rights associated with its first loss position that are substantially the same as the rights associated with a B Note investment. The pooling and servicing agreement provides for such controlling class rights, including the right to control the exercise of foreclosure, to shift to the next more senior junior class. This shift occurs when the underlying collateral declines in value, thereby eliminating or substantially reducing the potential recovery available to the original controlling class holder. Every class in a CMBS issuance has the ultimate ability to become the controlling class and the holder of a majority interest in a class controls the rights afforded to that class.

g. Real Property Ownership

A CMR may hold on its books commercial real property, such as offices, warehouse/distribution properties, industrial and retail properties, and hotels. In some cases, these properties are acquired as a direct investment. Some of these properties are acquired and net leased to corporate and other tenants. In these arrangements, the tenants are required to pay, in addition to rent, some or all of the property expenses that would normally be paid by the property owner, such as real estate taxes, insurance, maintenance, repairs, utilities and other expenses. In other cases, properties may have been acquired

[6] In some cases, there may be more than one holder of the first loss class of securities. In such case, the holder of the majority of the outstanding certificates of this class becomes the "controlling class holder."

through the foreclosure process, a development that, consistent with their extensive underwriting, CMRs anticipate and are prepared to hold and manage properties acquired in this manner.

2. The Product Origination and Acquisition Process

CMRs are active providers of capital to borrowers in the real estate markets. In originating or acquiring loan products, we apply extensive credit underwriting procedures, as further described below, and are operationally prepared for the possibility of foreclosing on the commercial properties that collateralize our mortgage-related products. As such, we have developed the infrastructure necessary to ensure that we are in a position to carry out competently and manage our loan origination or acquisition decision-making and asset management activities. The typical CMR is served by knowledgeable professionals (whether employed directly or accessed from the professional staff of its external investment manager) who have the experience necessary to perform the loan origination, credit underwriting and asset management functions that are important to its active product origination and acquisition strategies.

Before a loan is originated or acquired, a CMR performs a significant amount of due diligence. A CMR's procedures typically include hands-on analysis of the property collateralizing the underlying mortgage loan, market analysis, tenant analysis, financial analysis, visits to the property site, borrower background checks, and lease and contract review, all of which culminate in the production of a detailed underwriting file that provides a basis for its decision whether to finance the particular project. In addition, once an instrument is originated or acquired, a CMR undertakes various ongoing asset management activities with respect to maintaining the asset, including typically loan servicing, lease approvals, budget review and approvals, financial reviews, and borrower consultations. In the event of non-performance of a commercial mortgage loan, the asset management staff will workout the loan and exercise the remedies afforded the lender, including the right to foreclose and take title to the underlying commercial property. CMRs must, therefore, commit substantial resources to the development and maintenance of their underwriting and asset management infrastructure. CMRs must either directly or through their external manager recruit, compensate and retain the professional staff with the qualifications to carry out these activities, and must invest in the proprietary analytical and surveillance systems that are central to supporting the proper underwriting and monitoring of their assets.

C. Financing CMR Assets

CMRs often finance their commercial mortgage loan originations or acquisitions of commercial mortgage related products. Such financing may be obtained through the issuance of debt securities and borrowings under credit facilities, term loans and warehouse lines. Some CMRs also finance their portfolios in the securitization market through the use of collateralized debt obligations ("CDOs") which provide long-term, non-recourse and match-funded financing. Under this financing method, a CMR transfers assets (principally qualifying assets and real estate-related assets) to a wholly owned special purpose entity ("SPE") set up to issue the CDO debt obligations in the form of notes collateralized by the SPE's assets.[7]

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[7] The SPE issues the rated and unrated notes in tranches to various investors. The CMR (or an affiliate) typically serves as the collateral manager responsible for the ongoing asset management of the collateral, and retains all of the beneficial ownership interests in the SPE (*i.e.,* the common shares representing nominal ownership of common equity in the SPE, and the preferred shares) and interests in the unrated tranches. In some cases, the common shares may be donated to a charitable institution or held by a nominal third party. Although the donation of these shares may raise questions whether a CDO could be treated as a majority-owned or wholly owned subsidiary of the CMR, as the CDO originator, for purposes of the exclusions provided under the Investment Company Act, the CMR's retention of the preferred shares and interests in the unrated tranches generally is enough to establish the subsidiary status of the CDO structure for these purposes. As an accounting matter, the debt obligations and the collateral assets transferred to the SPE are generally consolidated on the CMR's balance sheet. As the owner of the first loss risk in the CDO arrangement, the CMR acquires certain control rights. Depending on the structure of the CDO arrangement and the terms of the related collateral management agreement, the assets serving as collateral

CDO financings are consistent with a CMR's business objective because the CMR remains actively involved over the entire life of the assets that serve as collateral for the CDOs.

D. The Regulation of CMRs

We are all publicly traded REITs whose securities are listed for trading on a national securities exchange. As listed companies, we are subject to a comprehensive body of laws, regulations, securities exchange rules, accounting pronouncements and market-driven best practices. For example, we are required to file periodic and other reports with the Commission in accordance with the requirements of the Securities Exchange Act of 1934, as amended (the "Exchange Act") and the rules thereunder and, as a consequence, operate with a substantial degree of ongoing transparency into our operations. As public companies, we are also subject to an array of substantive corporate governance requirements that are imposed by applicable securities exchange listing rules, the Sarbanes Oxley Act of 2002 and, more recently, the Dodd–Frank Wall Street Reform and Consumer Protection Act (the "Dodd-Frank Act").[8] Among other things, we are required to have a board of directors comprised of a majority of independent directors, maintain independent audit, compensation and corporate governance committees, and adopt and administer codes of conduct governing compliance, related-person transactions and other conflicts of interest matters. The financial statements we file and disseminate to our investors are audited by registered public accounting firms overseen by the Public Company Accounting Oversight Board.[9]

In September 2010, the members of a task force organized by NAREIT to consider questions concerning the interpretation of Section 3(c)(5)(C) submitted a white paper to the Commission staff detailing the regulatory scheme that currently applies to the operations of public REITs, including CMRs. The white paper demonstrated that the various regulations that currently apply to public REITs address many of the key aspects of RIC operations that are regulated under the Investment Company Act, including corporate governance, affiliated transactions, disclosures provided to shareholders, periodic reporting to the Commission and to shareholders and custody of company assets. Because of its relevance to certain questions raised in the Concept Release concerning the regulation of public REITs, we have attached that white paper to this comment letter for the Commission's convenience. *See* Exhibit A.

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may be managed to varying degrees. A CDO arrangement may be structured to provide for a static pool of assets held in an SPE as collateral for the CDO notes, with substitution of collateral assets being permitted only to replace at risk assets. In this arrangement, the SPE functions much like a structured financing issuer of the type contemplated in Rule 3a-7 under the Investment Company Act. On the other hand, a CDO arrangement may be structured to provide for more active management of the assets held as collateral for the CDO notes, so that the collateral manager has more flexibility under the terms of the collateral management agreement to buy and sell assets held as collateral or replace them if they mature. The SPE, in such case, is less of a structured financing issuer of the type contemplated by Rule 3a-7 and generally must rely on another exclusion from regulation as an investment company (*e.g.,* Section 3(c)(7), Section 3(c)(1) or Section 3(c)(5)(C)).

[8] For example, to implement the requirements of the Dodd-Frank Act, the Commission has adopted rules regarding the issuance of asset-backed securities, including CDOs (such as rules regarding asset-backed securities' issuers' responsibilities to conduct and disclose a review of the assets underlying those securities and to make certain disclosures about those reviews – Securities Act Release No. 9176 (Jan. 20, 2011)), and has proposed various rules affecting these issuers, such as the proposed new rule to implement Section 621 of the Dodd-Frank Act that would prohibit certain persons that create and distribute an asset-backed security (including a CDO backed by a mortgage loan) from engaging in certain transactions that may give rise to a material conflict of interest within one year after the date of the first closing of the sale of the asset-backed security. *See* Exchange Act Release No. 65355 (Sept. 19, 20111). The Commission has also adopted and proposed rules relating to corporate governance and disclosure provided by SEC-regulated issuers (such as the new requirements relating to shareholder approval of executive compensation and "golden parachute" compensation adopted pursuant to new Section 14A of the Exchange Act). *See* Exchange Act Release No. 63768 (Jan. 25, 2011).

[9] Unlisted CMRs are also subject to many of the same requirements as listed CMRs, and are subject to other regulations imposed by the Financial Industry Regulatory Authority and state "blue sky" laws.

E. Comparison of CMRs' and RICs' Structure and Operations

The Commission has requested that commenters address the similarities and differences between companies that rely on the statutory exclusion provided by Section 3(c)(5)(C) and registered investment companies ("RICs"), and in connection therewith describe any key operational or structural characteristics that serve to distinguish such companies from RICs. We believe the description provided above of the commercial mortgage industry and CMRs' role in this industry, the nature of their products and the manner in which they originate or acquire their products reveals that there are fundamental differences in the structure and operations of CMRs and RICs.

First, although CMRs and certain RICs do invest to a limited extent in similar mortgage related instruments, [10] their products lines and the process of originating or acquiring new assets are generally very different. One may typically find on the balance sheet of a CMR sizable holdings of assets of the types listed above, including (depending on the investment objectives and policies of the particular CMR) whole commercial mortgage loans, mezzanine loans, commercial mortgage loan participations, real property (including REO property), CMBS and similar real estate asset types. All of these asset types require the application of stringent credit underwriting procedures in the process of originating or acquiring them so as to mitigate the risk of default and potential adverse effects on a CMR's financial condition.[11] As indicated above, a CMR, whether in originating new loan products or in acquiring existing loans, performs extensive due diligence and other credit underwriting procedures that culminate in the production of a detailed underwriting file serving as the basis for its decision whether to originate or acquire the particular commercial mortgage related product. In addition, once an asset is originated or acquired, it must be maintained. To successfully perform these various operations, as we noted, a CMR or its manager must be staffed with experienced and knowledgeable staff, and a CMR must incur the expenditures necessary to ensure that it has the systems and other infrastructure to perform these operations successfully. These various aspects of a CMR's structure and operations are consistent with their public statements that they are engaged in the business of providing financing to borrowers in the commercial real estate markets, not investing in the manner of RICs, pension plans and other similar institutions.

The typical RIC, by contrast, does not perform and is not equipped to perform the extensive credit underwriting procedures required for loan originations and acquisitions of the types held by CMRs, nor is it equipped to provide the asset management services to maintain these assets or to bring onto its books underlying real property in cases in which a loan has been the subject of a foreclosure proceeding. Consistent with its public statements concerning its activities as an investor in the capital markets, the typical RIC or its investment adviser[12] is staffed heavily with investment advisory personnel, traders, research personnel, and others that are more integrally involved in the process of providing advice about investing, reinvesting or trading in securities.

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10 Given the illiquid nature of many of these investments, RICs that may invest in these asset types would be classified as closed-end investment companies. We expect that there may few of these RICs. Because many more RICs are organized as open-end management investment companies that are restricted to holding no more than 15% of the value of their total assets in illiquid securities, we expect that there would be far fewer RICs that would invest to any significant extent in mortgage related instruments of the types originated and acquired by CMRs.

11 For those CMRs that originate and acquire subordinate products and, therefore, are exposed to first loss positions, the risk of loss is amplified in the event of an underlying default.

12 Substantially all RICs are managed by an external investment adviser, with the Vanguard family of funds being perhaps the only notable mutual fund family that uses an internalized management structure. By contrast, some CMRs are managed under an internalized structure, while there are others that use an external investment manager.

Second, an element that is common to many of the products originated and acquired by CMRs, as we discuss further below, is the ability of the CMR to obtain and exercise effective "control" over these products. We describe "control" in this sense in Section II below as the ability of a CMR to get to the "dirt" (*i.e.,* to claim ownership of the parcel of real property that serves as collateral for a commercial mortgage loan or other secured real estate loan) if the loan is not performing. Exercising this "control" feature is an important and necessary part of a CMR's operations. RICs, by contrast, typically do not invest to obtain control over an issuer of securities or assets of the types that CMRs originate and acquire. They generally are not positioned to invest in commercial mortgage loans and related instruments with the expectation of exercising the foreclosure and other rights associated with the instruments which CMRs typically hold and possibly acquiring the underlying real property for their portfolios. A RIC's typical response when a loan is perceived as non-performing is to seek to sell the loan, not to foreclose on the loan and become the owner of the underlying real property.

Third, given the nature of their structure and operations that are more in the nature of sophisticated, hands-on operating companies (and, thus, that are not investment companies), CMRs are comfortable utilizing leverage to meet their substantial operating costs relating mainly to the origination and acquisition of products and to enhance the returns provided to their common stockholders. A CMR's potential to leverage its assets is not unlimited. The amount of leverage a CMR may undertake is dictated by market conditions and the market's assessment of the company's financial condition and cash flows. A CMR, in this regard, is much like an operating company: it or its manager has sustainable operations to manage the risks associated with its leverage, and its ability to undertake leverage is subject to market restraints. By contrast, Section 18 of the Investment Company Act significantly restricts the ability of a RIC to leverage its assets, a prudent restriction in light of the nature of the investment programs of RICs.[13]

Finally, as we noted, CMRs publicly disclose in their filings made with the Commission and in their disclosure documents furnished to shareholders that they are engaged principally in the business of providing financing to borrowers in the commercial real estate market. They support these statements by describing in these filings and disclosure documents in much detail the nature of their business and operations substantially along the lines of the description provided above in this letter. The history of their operations described in these documents supports the *bona fide* nature of these public statements, and the activities of their officers, directors and employees (of the activities of the officers, directors and employees of the CMRs' manager) provide additional support. CMRs do not hold themselves out as registered investment companies entitled to the investor protections accorded by the Investment Company Act, and we are unaware of any empirical evidence that suggests that investors do not

[13] In fact, Congress imposed these restrictions on RICs when it enacted the Investment Company Act in 1940 because of significant losses incurred by investors in registered investment companies around the time of the Great Depression as a result of excessively overleveraging these companies' assets. RIC insiders established these companies as lightly capitalized entities, and proceeded to burden them with debt to enhance the returns that might be received by the RIC insiders who retained the common equity. These RICs failed under the weight of their own excessive debt when their investments failed. In its Memorandum to Chairman Levitt entitled "Mutual Funds and Derivative Instruments" (Sept. 26, 1994), the Division of Investment Management ("Division") explained the problem of leverage for RICs in the era preceding the enactment of the Investment Company Act: "One reason for limiting investment company leverage was to prevent the abuse of the purchasers of senior securities, which were sold to the public as low risk investments. Investment company assets during the 1920s and 1930s consisted mostly of common stocks that did not provide the stable asset values or steady income stream necessary to support these senior charges. Because the sponsors often kept all or most of the junior, voting securities for themselves, they could operate the company in their own interests. Senior securities tended to lead to speculative investment policies to the detriment of senior securityholders because the common stockholder/sponsors, who often had a relatively small investment risk in the fund, looked to the capital gains for profit. Multiple classes of senior securities and pyramiding frustrated senior securityholders' attempts to determine whether secure returns were likely." *See also* Galbraith, John Kenneth, *The Great Crash 1929*, pp. 45-65 (1988) (providing a similar explanation of investment company leverage in this era).

understand that the CMRs in which they invest are not subject to regulation under the Investment Company Act. Consistent with this position, CMRs disclose in their filings and in their disclosure documents that they are not registered as and, therefore, are not subject to regulation as investment companies. By contrast, RICs make it clear in their public filings and disclosure documents, consistent with Commission regulation, that they are registered as investment companies and subject to the requirements of the Investment Company Act.

In sum, through their respective activities in the capital markets, CMRs and RICs provide capital to discrete but complementary components of a commercial property capital structure. Each of these components represents important capital for the commercial real estate industry. Investors are presented with the choice of vehicle in which they wish to invest based on their assessment of CMRs' and RICs' respective investment strategies and their operating capabilities. We believe that CMRs operate with transparency and fully and fairly inform investors of their financing strategies and operating capabilities as well as of the risks associated with an investment in a CMR.

F. <u>Particular Concerns Raised by the Commission in the Concept Release</u>

In the Concept Release, the Commission expressed particular concern that some REITs may raise the potential for abuses of the types applicable to RICs, such as overreaching by insiders, deliberate misvaluation of company holdings, and extensive leveraging.[14] We believe that the extensive regulation that currently applies to public REITs, as described above and in Exhibit A to this letter, adequately addresses these areas of concern with respect to the operations of public REITs, including CMRs. We address below these concerns.

1. <u>Overreaching by Insiders</u>

The Commission noted that the Investment Company Act, among other things, contains protections, such as Section 17 and Section 10(f) of this Act, that seek to prevent investment companies from being organized, operated, managed, or having their portfolio securities selected in the interests of company insiders.[15] While public REITs are not subject to particular restrictions on affiliated transactions such as those contained in Section 17 and Section 10(f) of the Investment Company Act, they are subject to various regulations that seek to protect against overreaching by company insiders.

As noted in Exhibit A, as public companies registered under the Exchange Act, public REITs are subject to the provisions of the Sarbanes Oxley Act of 2002 ("SOX"). Pursuant to its authority in SOX, the Commission has adopted rules requiring a public company, such as a public REIT, to disclose whether it has adopted a code of ethics for its chief executive officer, chief financial officer, chief administrative officer, controller and other persons performing similar functions and, if not, the reasons why it has not done so. The code of ethics is a set of written standards reasonably designed to deter wrongdoing and to promote: (i) honest and ethical conduct, including ethical handling of conflicts of interest; (ii) full, fair, accurate, timely and understandable disclosure in SEC reports and public communications; (iii) compliance with applicable law; (iv) prompt internal reporting of violations; and (v) accountability for compliance with the code of ethics. In addition, Section 404 of SOX and Rule 13a-15 under the Exchange Act require companies, such as public REITs, that file Form 10-Ks and 10-Qs with the Commission, to adopt internal controls over financial reporting that, among other things, require the adoption of policies and procedures reasonably designed to provide reasonable assurance regarding the prevention or timely detection of unauthorized acquisition, use or disposition of REIT assets that could have a material effect on its financial statements. Further, Section 402 of SOX prohibits a public

14 *See* Concept Release, text accompanying n. 36.

15 *See* Concept Release, n. 32 and accompanying text.

company, such as a public REIT, from making loans to its directors or executive officers, subject to very narrow exemptions for certain types of loans made in the course of the company's business. SOX contains various other requirements that indirectly protect against overreaching by insiders.

Exhibit A also summarizes NYSE and NASDAQ requirements that, among other things, serve to protect against overreaching by insiders and apply to REITs that are listed for trading on these exchanges. A NASDAQ listed REIT must have a majority of independent directors and must satisfy various audit committee and other board requirements. In addition, a NASDAQ listed REIT must require that the audit committee or other independent body of the board conduct a review of all related party transactions for potential conflicts of interest. Further, a NASDAQ listed REIT must adopt a code of conduct applicable to officers, directors and employees of the REIT. This code must satisfy the requirements for a code of ethics under SOX. Similar requirements apply to a REIT listed for trading on the NYSE. Among other things, such a REIT must adopt and disclose a code of business conduct applicable to directors, officers and employees of the REIT and addressing conflicts of interest, corporate opportunities, confidentiality, fair dealing, protection and proper use of assets, compliance with laws, rules and regulations and reporting of any illegal or unethical behavior.

Exhibit A further summarizes the disclosure requirements applicable to public REITs in registering the offer and sale of their shares under the Securities Act of 1933, as amended (the "Securities Act") and in periodic reports filed with the Commission under the Exchange Act. In particular, Item 404 of Regulation S-K requires a REIT to disclose in forms filed under the Securities and Exchange Acts certain transactions or proposed transactions exceeding $120,000 in which the REIT was or is to be a participant and in which the related person had or will have a direct or indirect material interest. For this purpose, the term "related person" is defined very broadly to include a director or executive officer of the REIT, any immediate family member of a director or executive officer of the REIT, a security holder of the REIT covered by Rule 403(a) of Regulation S-K (generally, any person whom the REIT knows to be the beneficial owner of more than 5% of any class of its voting securities), and any immediate family member of this security holder. In addition, a GAAP-compliant set of financial statements must include disclosure of all related party transactions, whether or not material. The requirement to make these disclosures and the resultant transparency into their operations impose an additional discipline on REITs to ensure that they have these protections against related party transactions in place.

In addition to the foregoing, as described in Exhibit A, market practices, including pressures stemming from competition, shareholders and directors, create certain industry standard practices for REITs (even though not mandated by law or regulation). In this regard, most REITs maintain their assets with large, established financial institutions in order to minimize counterparty risk. In addition, investors, directors and competitive pressure impose limits on accepted transactions between a REIT and its affiliates, limiting self-dealing in the REIT industry.

2. <u>Deliberate Misvaluation of REIT Holdings</u>

The Commission noted that the Investment Company Act seeks to prevent RICs from employing unsound or misleading methods, or not receiving adequate independent scrutiny, when computing the asset value of their investments or their outstanding securities.[16] As described in Exhibit A, REITs that are registered under the Exchange Act are required to prepare and disseminate audited financial statements prepared in accordance with generally accepted accounting principles ("GAAP") and in doing so, must comply with the many sources of GAAP, including standards issued by the Financial Accounting Standards Board ("FASB"), as well as Commission guidance and regulations governing the preparation of financial

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16 *See* Concept Release, n. 30 and accompanying text.

statements and accounting. Even REITs that are not registered under the Exchange Act prepare and deliver to investors audited financial statements prepared in accordance with GAAP.

Exhibit A describes a few of the Commission and FASB standards and contains a more comprehensive list of applicable requirements. In preparing financial statements in accordance with GAAP, REITs (like other companies) seeking a GAAP-compliant audit, must ascertain a fair value for various financial assets and liabilities. Financial Accounting Standard 157 (Determination of Fair Value) defines fair value for this purpose, and establishes a framework for measuring fair value as well as requires disclosure of fair value measurements. Financial Accounting Standard 166 (Accounting for Transfers of Financial Assets) significantly affects the way in which originators account for transfers in securitizations by imposing requirements on when the transfer of an interest in a special purpose vehicle can be treated as a sale. It, therefore, affects the accounting for securitized mortgage loans generally. Financial Accounting Standard 167 (Accounting for Transfers of Financial Assets) requires an enterprise to assess on an ongoing basis whether its interest in another entity makes that entity a "variable interest entity," such that the enterprise must include in its financial statements the assets, liabilities and activities of the entity. It, therefore, has a significant effect on originators of securitizations, special purpose vehicles and holders of interests in special purpose vehicles used for securitization.

The valuation of a CMR's assets and liabilities has been an important area of focus for the CMR's independent auditors in recent years, particularly in light of the promulgation of the FASB standards referred to above. These auditors obtain further assurances about the value ascribed to a CMR's assets by performing procedures to validate the existence of these assets.

The foregoing, as well as the more comprehensive description and listing of other requirements set forth in Exhibit A, indicates that, for a public REIT, there is a spotlight on the manner in which it values its holdings for public reporting purposes. When these requirements are considered in the context of the financial reporting controls imposed by SOX (as well as in Commission rules), including disclosure controls and internal control over financial reporting imposed by Section 404 of SOX and Exchange Act Rule 13a-15, as further described in Exhibit A, we believe the likelihood of deliberate misvaluations of REIT holdings is remote.

3. Extensive Leverage

In the Concept Release, the Commission stated that the Investment Company Act seeks to prevent RICs from engaging in excessive borrowing and issuing excessive amounts of senior securities.[17] The Commission explained in that release that prior to 1940, some investment companies were highly leveraged through the issuance of senior securities in the form of debt or preferred stock, which often resulted in the companies being unable to meet their obligations to the holders of their senior securities, and that excessive leverage also greatly increased the speculative nature of the common stock of these companies. The Commission noted that Section 18 was enacted to limit the ability of RICs to engage in borrowing and to issue senior securities.

As we observed in an earlier section of this letter, although CMRs are not subject to limitations on leverage similar to the requirements of Section 18 of the Investment Company Act, CMRs are not investment companies and operate more like operating companies that are not subject to limits of this type. Like an operating company, a CMR or its manager has operations that go beyond a mere investment in securities. A review of a CMR's balance sheet, including the notes to the financials, bears this out. Therefore, there is more in the operations of a CMR than there is for a RIC to support the undertaking of leverage by a CMR. A CMR is not the lightly capitalized entity that, because of excessive

[17] *See* Concept Release, n. 31 and accompanying text.

leveraging of its assets, including leverage incurred by the pyramiding of investment companies, resulted in heavy losses to holders of this entity's debt in 1929.[18] A CMR is much better capitalized than the closed-end investment companies that existed around this period of history and is much better able to maintain its debt.

To our knowledge, except for statements made by the Commission in the Concept Release, no one considers the current level of leverage in the commercial mortgage REIT industry to be an area of material concern. In expressing this concern in the Concept Release, the Commission cited to one instance of an offshore fund investing in mortgage-backed securities (but which, to our knowledge, did not elect treatment as a REIT for purposes of federal tax law) that had lost value when the fund could not service its debts. The Commission noted that this fund reportedly had a 32:1 leverage ratio.[19] While we recognize that effective regulatory policy should not always be reactive (*i.e.,* the Commission should not wait for a disaster to occur before implementing effective regulations), we believe that there is nothing about the borrowing activities of commercial mortgage REITs to warrant the level of concern the Commission has expressed as a basis for reexamining the Section 3(c)(5)(C) exclusion. Any suggestion that it might be appropriate for the Commission to impose limits on a REIT's ability to borrow similar to the limits that currently apply to RICs under Section 18 of the Investment Company Act should be based on more evidence that REITs' existing borrowing activities present undue risks to investors. As we have indicated, CMRs (and other REITs) benefit immensely from being able to borrow, including through the structuring of CDOs, to finance the origination and acquisition of their assets. Any restriction on this ability, along the lines of the restrictions applicable to RICs, would have a significant effect on the business of REITs.

II.
PROPOSED CODIFICATION OF SECTION 3(C)(5)(C) PERCENTAGE TEST AND A PROPOSED DEFINITION OF "QUALIFYING ASSET"

CMRs generally agree that the current Section 3(c)(5)(C) percentage test developed by the Commission staff, requiring that at least 55% of the value of total assets of a CMR be "qualifying assets" and at least 80% be "real estate-related assets," has worked well. We have accordingly developed systems to assure compliance with this test, and have successively refined this process over the approximately twenty-six years since the test was first enunciated by the Commission staff in a no-action letter.[20] There is far less certainty, however, about the manner of categorizing products for purposes of this test. Because of the lack of Commission or staff guidance in this area, CMRs have had difficulty deciding which products should be treated as "qualifying assets" and which as "real estate-related assets." The difficulty is compounded by the fact that the commercial mortgage finance industry has been active in innovating products in the last several years, as discussed above, and, except for two no-action letters issued to Capital Trust, Inc. in 2007 and 2009, the Commission staff has not promulgated any guidance in this area

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[18] *See* supra n. 13.

[19] *See* Concept Release, n. 35.

[20] *See, e.g., Salomon Brothers Inc.,* SEC Staff No-Action Letter (June 17, 1985) (no-action assurance granted where at least 55% of the issuer's assets would be invested in mortgage bonds representing the entire outstanding issue of one or more issues of mortgage bonds, and the remaining 45% would be invested primarily in real estate-type interests). *See also Bear Stearns & Co. Inc.,* SEC Staff No-Action Letter (Oct. 3, 1986) (issuer would invest at least 55% of its assets in whole pool FNMA certificates and the remaining 45% primarily in real estate-type interests); *Citytrust,* SEC Staff No-Action Letter (Dec. 19, 1990) (staff statement that that an issuer is excepted under Section 3(c)(5)(C) if at least 55% of its assets consists of "mortgages and other liens on and interests in real estate" and the remaining 45% consists primarily of real estate-type interests, and that the issuer would meet the 45% test if at least 25% of its total assets were invested in real estate-type interests, subject to a reduction to the extent that it invests more than 55% of its total assets in assets meeting the 55% test).

since the early 1990's.[21] While other major commercial finance institutions have avoided Section 3(c)(5)(C) interpretive questions because they may rely alternatively on other exclusions from regulation as investment companies (for example, banks, thrifts and insurance companies may rely alternatively on the exclusion from the definition of investment company provided by Section 3(c)(3) of the Investment Company Act), CMRs have had to contend with the difficult interpretive questions raised under Section 3(c)(5)(C) in the face of such product innovation and in the absence of any alternative exclusion.

We believe that the Commission would achieve the various goals highlighted in the Concept Release if it were to (i) codify with minor modifications the staff's existing percentage test for the exclusion provided by Section 3(c)(5)(C), and (ii) adopt a definition of "qualifying asset" substantially along the lines of the definition we recommend below, which reflects the principles of "control" and "same investment or economic experience" we describe herein. In our view, the codification of the percentage test and adoption of the proposed "qualifying asset" definition would: (1) be consistent with the Congressional intent underlying the Section 3(c)(5)(C) exclusion; (2) ensure that the exclusion is administered in a manner that is consistent with the purposes and policies underlying the Investment Company Act, the public interest, and the protection of investors; (3) provide greater clarity, consistency and regulatory certainty for CMRs and other market participants in determining whether they qualify for the exclusion provided by Section 3(c)(5)(C); and (4) facilitate capital formation by permitting CMRs to continue to provide financing to borrowers in the commercial real estate markets without being hamstrung by questions about the permissible scope of their financing activities. Such action by the Commission would be consistent with the broad language contained in the statutory text of Section 3(c)(5)(C). CMRs would thus be able to determine with reasonable certainty the appropriate treatment of commercial real estate mortgage instruments that not only are prevalent in the market today, but also new products that may be introduced in the future as the commercial mortgage finance market continues to evolve. Adoption of this test and qualifying asset definition would serve the interests of both issuers and investors alike and facilitate a more efficient administration of the statutory exclusion by the Commission and its staff. This result would be preferable to continuing with the *status quo,* where staff no-action letters and other staff pronouncements inform CMRs as to how they should interpret the Section 3(c)(5)(C) exclusion but often leave CMRs with a degree of uncertainty and lead to inconsistency in the treatment of various assets.

A. <u>Proposed Codification of Section 3(c)(5)(C) Percentage Test</u>

We propose that the Commission codify with minor modification, either by rule or in an interpretive release, the staff's existing percentage test for determining when an issuer qualifies for the Section 3(c)(5)(C) exclusion, using language substantially along the lines of the following which we included in the document attached hereto as Exhibit B:[22]

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[21] As the Commission itself observed in the Concept Release, it has not specifically addressed the scope of Section 3(c)(5)(C) since 1960, when it issued a release discussing the applicability of the federal securities laws to REITs. *See* Concept Release, n. 42 and accompanying text, citing to *Real Estate Investment Trusts,* Investment Company Act Release No. 3140 (Nov. 18, 1960) (discussing Section 3(c)(6)(C), which was subsequently redesignated as Section 3(c)(5)(C)). Guidance on Section 3(c)(5)(C) since that time has been provided by the Commission staff through the no-action letter process.

[22] The test for Section 3(c)(5)(C) we propose, as well as the test for "Qualifying Assets", is intended to apply not just to commercial mortgage REITs which are the focus of this comment letter but to other REITs as well, including REITs that focus on investments that relate to residential mortgage loans and equity REITs (*i.e.,* REITs that focus on investing in equity interests in real property). We believe our proposed tests are expansive enough to cover all of these REITs.

1. An issuer is excluded from the definition of investment company pursuant to Section 3(c)(5)(C) of the Investment Company Act if the issuer is not engaged in the business of issuing redeemable securities, face-amount certificates of the installment type, or periodic payment plan certificates and, immediately after acquiring any security or other investment, at least 55% of the value of the issuer's total assets (excluding cash items other than Qualifying Cash) consists of Qualifying Assets and at least 80% of the value of the issuer's total assets (excluding cash items other than Qualifying Cash) consists of Qualifying Assets and Real Estate-Related Assets.[23]

For purposes of this test, the term "Qualifying Asset" would be defined in the manner discussed below. The term "Real Estate-Related Asset" would be defined to mean generally a beneficial ownership interest in a Qualifying Asset or in a company, pool of assets or class of securities of the type described in the definition of "Qualifying Asset" but which itself is not a Qualifying Asset. Similar to the definition of "investment company" in Section 3(a)(1)(C) of the Investment Company Act (and Rule 3a-1 thereunder), the value of an issuer's total assets would be adjusted to deduct "cash items,"[24] except for "Qualifying Cash," which we have defined to mean the net cash proceeds received on sale of a Qualifying Asset (or on the payoff or paydown of a Qualifying Asset) and which are held, pending distribution or reinvestment in other Qualifying Assets, for a maximum period of one year after receipt of the cash proceeds. We believe the exception for "Qualifying Cash" from the deduction for "cash items" would be appropriate if, as proposed, the Commission were to define "Qualifying Asset" to include a category for "Qualifying Cash." We have also proposed the addition of the words "immediately after acquiring any security or other investment" to the foregoing test of Section 3(c)(5)(C) to be consistent with the time for testing numerical limits provided in other sections of the Investment Company Act (such as Section 3(c)(1)).

Although we propose that the Commission codify with minor modifications the existing Section 3(c)(5)(C) percentage test, we recommend in the alternative that the Commission adopt a simpler test that contains only a 55% Qualifying Asset test without the possible need to maintain additional investments in real estate-related assets. We believe that a test of this type would be consistent with the single asset test applied to other provisions of the Investment Company Act, particularly Section 3(a)(1)(C) of the Investment Company Act, and would accomplish certain of the goals the Commission has stated in the Concept Release without compromising investor protection. The Commission staff, to our knowledge, has never fully explained its reasons for treating real estate assets, for purposes of the Section 3(c)(5)(C) exclusion, more restrictively than other asset types when interpreting other provisions of the Investment Company Act, and there is nothing about real estate assets that, in our view, justifies this more restrictive treatment. We emphasize, however, that because CMRs, like other mortgage REITs, have relied on the existing test for such an extended period of time (approximately twenty six years) and have established appropriate systems to comply with these requirements, we are proposing as a first alternative that the

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[23] The Commission has not raised any question in the Concept Release concerning the meaning of "redeemable securities" as referenced in Section 3(c)(5)(C), which is the other requirement that must be met in order to qualify for the Section 3(c)(5)(C) exclusion. Nevertheless, we believe that any guidance that the Commission might choose to provide on the meaning of this term as used in that section should clarify that partnership units in an operating partnership in a so-called umbrella partnership (UPREIT) structure are not "redeemable securities." An UPREIT structure is a legal structure in which a REIT serves as controlling general partner and majority limited partner of an operating partnership that holds real estate assets directly or indirectly. Over two-thirds of listed equity REITs use the UPREIT structure. In this structure, limited partners generally have the right to sell their securities in the operating partnership to the REIT general partner, which has the option of paying cash or REIT common stock as consideration for the sale. The Commission has accepted the UPREIT structure since the first public, exchange-listed UPREIT initial public offering was conducted in 1992.

[24] The term "cash item" would be interpreted in the same manner as it is interpreted for purposes of Section 3(a)(1)(C) and Rule 3a-1. *See* Investment Company Act Release No. 10937, n. 29 (Nov. 13, 1979) (proposing Rule 3a-1); *Willkie Farr & Gallagher,* SEC Staff No-Action Letter (Oct. 23, 2000).

Commission codify the existing percentage test and only secondarily consider our alternative to adopt a simple 55% Qualifying Asset only test.

B. Proposed Definition of "Qualifying Asset"

The text of Section 3(c)(5)(C), particularly given the paucity of legislative history, suggests that the exclusion for companies primarily engaged in real estate businesses can reasonably be read to have broad application for enterprises engaged in such businesses. When this provision was first enacted in 1940, the real estate industry operated in a relatively simple manner. Since that time, however, the real estate industry has evolved substantially and there has been significant innovation in the financial markets, with the introduction of financing techniques that more efficiently provide and intermediate the flow of capital necessary to acquire, own and operate real estate. Specifically, tranched interests in and divisible interests in mortgage loans through participation agreements, mezzanine loan structures and interests in securitization arrangements collateralized by pools of mortgage loans have become prevalent, displacing in large part traditional direct whole mortgage loan investing. The financial markets can be expected to continue to evolve and innovate, especially given the looming refinancing problem coming due in the next few years, as discussed above.

It is for these reasons that we propose the following principles-based definition of "Qualifying Assets" as one we believe will introduce clarity, consistency and certainty with respect to the treatment of existing and new assets alike for purposes of Section 3(c)(5)(C) without unduly impeding the critical flow of capital into the mortgage sector:

> ***2. An investment is a Qualifying Asset for purposes of Section 3(c)(5)(C) if, under the terms and conditions of the instrument governing this investment, the investor acquires:***
>
> ***(a) a beneficial ownership interest in real property (including ownership by fee simple or leasehold);***
>
> ***(b) a beneficial ownership interest in a company that is not an investment company as defined in Section 3(a)(1) of the Investment Company Act because it is primarily engaged in the business of owning, holding or investing in Qualifying Assets of the type described in paragraph 2(a) above or which is excluded from the definition of investment company pursuant to Section 3(c)(5)(C) of this Act, provided that (i) the investor's beneficial ownership interest in the company is a general partner interest, a joint venture interest or another interest that is not deemed to be a "security" as defined in Section 2(a)(36) of the Investment Company Act, and (ii) in determining the value of the investor's beneficial ownership interest in this company that shall be deemed to be a Qualifying Asset, the investor shall apportion the value of its beneficial ownership interest among Qualifying Assets, Real Estate-Related Assets and other assets, as applicable, based on the company's percentage ownership interest in these assets;***[25]

[25] The definition of Qualifying Asset we propose in paragraph 2(b) is generally consistent with the staff's no-action position in the following no-action letters: *NAB Asset Corporation,* SEC Staff No-Action Letter (June 20, 1991) (no-action assurance granted to permit a company seeking to rely on Section 3(c)(5)(C) to treat real estate loans and real estate held indirectly through wholly owned or majority-owned subsidiaries or through a general partnership as qualifying assets, real estate-related assets or other assets, and to value its interest in each loan or real estate held by the subsidiary based on the company's percentage ownership interest of the company in the subsidiary); *United States Property Investments, NV,* SEC Staff No-Action Letter (May 1, 1989) (no-action assurance granted to permit a company's wholly owned subsidiary to rely on Section 3(c)(5)(C) where the subsidiary proposed to invest, among other things, in joint ventures formed to make real estate mortgage loans that it proposed to treat as qualifying assets, and where the subsidiary retained the right, by itself, to foreclose on the mortgage securing the loan in the event of default); *MSA Realty Corporation,* SEC Staff No-Action Letter (March 19, 1984) (no-action assurance granted to

(c) a controlling beneficial ownership interest in a company that itself qualifies for the exclusion from the definition of investment company in Section 3(c)(5)(C) of the Investment Company Act, provided that in determining the value of such a Qualifying Asset, the investor shall apportion the value of its beneficial ownership interest among Qualifying Assets, Real Estate-Related Assets and other assets, as applicable, based on the company's percentage ownership interest in these assets;[26] [27]

(d) a controlling beneficial ownership interest in a pool substantially all of whose assets consists of Qualifying Assets as defined in paragraph 2(e) or agency mortgage-backed securities;

(e) a beneficial ownership interest in a loan to the extent such loan is secured by real property, or by all of the beneficial ownership interests in an entity substantially all of whose total assets consists of a direct or indirect beneficial ownership interest in real property, and which gives the investor the right, whether conditional or unconditional, to foreclose or direct foreclosure on the underlying collateral or otherwise to acquire beneficial ownership of this collateral, including in case of loan default;

(f) a controlling beneficial ownership interest in a class of securities issued with respect to a pool of assets that itself qualifies for the exclusion from the definition of investment company in Section 3(c)(5)(C) of the Investment Company Act, which class entitles its security holders to receive payments that depend primarily on the cash flows from these assets, and which gives the investor with respect to a particular asset in the pool the right, whether conditional or unconditional, to direct foreclosure on the underlying real property that secures the asset or otherwise to acquire beneficial ownership of the property in the event of a loan default, provided that in determining the value of the investor's controlling beneficial ownership interest in this class of securities that shall be deemed to be a Qualifying Asset, the investor shall apportion the value of its controlling beneficial ownership interest among Qualifying Assets, Real Estate-Related

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permit a corporation to rely on Section 3(c)(5)(C) where it proposed to invest, among other things, in equity interests in joint ventures that it proposed to treat as qualifying assets for purposes of this exclusion).

[26] We emphasize that the Qualifying Asset definitions we propose in paragraph 2(b) and 2(c) apply only with respect to a company's beneficial ownership interest in a subsidiary in cases in which the investing company is seeking to rely on the Section 3(c)(5)(C) exclusion. Many investing REITs that serve as holding companies for one or more majority-owned subsidiaries seeking to rely on Section 3(c)(5)(C) are not subject to registration under the Investment Company Act because they do not fall within the Section 3(a)(1)(C) definition of "investment company" since their interests in these subsidiaries, among other reasons, are not "investment securities." The proposed Qualifying Asset definitions in paragraphs 2(b) and 2(c) do not apply to these REITs that fall outside the definition of "investment company" for Section 3(a)(1)(C) purposes, and thus they would treat the interests in their Section 3(c)(5)(C) subsidiaries not as "investment securities" when calculating the value of such securities on an unconsolidated basis to determine whether they fall under the prescribed 40% ceiling.

[27] Because we recommend *pro rata* treatment under the Qualifying Asset definitions proposed in paragraphs 2(b) and 2(c), we believe that it would be inappropriate for purposes of these definitions to consolidate the financial information for a REIT that seeks to rely on Section 3(c)(5)(C) with the financial information for one or more majority owned or wholly owned subsidiaries that either do not fall within the Section 3(a)(1) definition of investment company or that are relying on the Section 3(c)(5)(C) exclusion from the definition of investment company. An investing REIT should determine the value of its Qualifying Assets in these subsidiaries for purposes of these definitions on an unconsolidated basis.

Assets and other assets, as applicable, held in the pool based on the pool's percentage ownership interest in these assets;[28] or

(g) Qualifying Cash.

For purposes of the foregoing definition of "Qualifying Asset," we propose the inclusion of the following section of the rule or interpretive release that would define terms used in the test of Section 3(c)(5)(C) and in defining "Qualifying Asset":

3. For purposes of the foregoing:

(a) An investor has a beneficial ownership interest in a company, a pool of assets, or class of securities if the investor, directly or indirectly through any contract, arrangement, understanding, relationship or otherwise has or shares (i) voting power, which includes the power to vote, or direct the voting of, such interest, and/or (ii) investment power, which includes the power to dispose, or to direct the disposition of, such interest.

(b) An investor has a controlling beneficial ownership in a company, a pool of assets, or class of securities referred to in paragraph 2(f) if the investor owns at least 50% of the outstanding voting securities issued by or with respect to this company, pool or class or is able by contract, arrangement, understanding, relationship or otherwise to exert a controlling influence over the material decisions relating to ownership of these assets including, in the case of Qualifying Assets described in paragraph 2(f) above, the right to direct foreclosure on the underlying property or other remedies in the event of loan default.

(c) An agency mortgage-backed security is a security interest issued with respect to a mortgage loan or a pool of mortgage loans that is issued or guaranteed by a U.S. Government agency or a U.S. Government sponsored enterprise such as Fannie Mae or Freddie Mac.

(d) A Real Estate-Related Asset is a beneficial ownership interest in a Qualifying Asset or in a company, pool of assets or class of securities of the type described in paragraphs 2(b), (c), (d) and (f) above, but which itself is not a Qualifying Asset.

(e) A loan is secured by real property to the extent the note is secured by a mortgage, deed of trust or deed to secure debt, or if it is a cooperative loan or a condominium loan. For this purpose, an installment sales contract related to manufactured housing is considered a loan secured by real estate.

(f) A right to direct foreclosure on underlying property or collateral is conditional if, under the terms and conditions governing a loan as described in paragraph

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28 Because we recommend pro rata treatment under the Qualifying Asset definitions proposed in paragraphs 2(b) and 2(c), we believe that it would be inappropriate for purposes of these definitions to consolidate the financial information for a REIT that seeks to rely on Section 3(c)(5)(C) with the financial information for one or more majority-owned or wholly owned subsidiaries that either do not fall within the Section 3(a)(1) definition of investment company or that are relying on the Section 3(c)(5)(C) exclusion from the definition of investment company. An investing REIT should determine the value of its Qualifying Assets in these subsidiaries for purposes of these definitions on an unconsolidated basis.

2(e) or the issuance of a class of securities as described in paragraph 2(f), the investor is able to exercise this right only (i) if the holder of a more subordinate interest in the loan or class of securities loses its ability to exercise this right, or (ii) with the approval of the holder of a more senior loan encumbering the underlying real property or a more senior interest in the loan or class of securities.

(g) Qualifying Cash are the net cash proceeds received on sale or the payoff or paydown of a Qualifying Asset and which are held, pending distribution or reinvestment in other Qualifying Assets, for a maximum period of one year after receipt.

Two principles underlie most of the instruments included in the foregoing proposed test of "Qualifying Asset": (1) the "control" principle, and (2) the "same investment or economic experience" principle. These principles, in our view, sufficiently distinguish the types of products that CMRs (and, more generally, REITs) hold from the types of investments that are typical for RICs. "Qualifying Cash," which we propose for inclusion in the definition of "Qualifying Asset," would not be based on either of these principles. Nevertheless, we propose its inclusion because it would be an acknowledgement that a CMR, in the ordinary course of business and fully consistent with its investment objectives and policies, will sell a Qualifying Asset from time to time, or receive cash from the payoff or paydown of a Qualifying Asset, and can be expected to hold the cash proceeds for temporary periods of time pending distribution or reinvestment in other Qualifying Assets.[29] Given the time needed to source, structure and underwrite its originations or acquisitions prudently, CMRs can be expected to hold these cash proceeds for some period of time. A CMR in these circumstances should not be "penalized" by being required to treat such cash proceeds as miscellaneous assets for purposes of the Section 3(c)(5)(C) test.

The "control" element is common to many of the types of products included within our proposed test of "Qualifying Asset" and, in our view, serves to distinguish these products from the types of investments RICs typically make. "Control" in this sense means the ability of a CMR (or other REIT) to "get to the dirt" with respect to a loan that it has originated or acquired – *i.e.*, to claim full ownership of (generally through exercise or control of exercise of the right to foreclose on) real property underlying a loan, whether conditional or unconditional, in case of loan default. The "control" element is present in the type of Qualifying Asset described in paragraph 2(a) (although a CMR may better be described as already owning the "dirt" under this paragraph, by virtue of its equity interest in real property),[30] in paragraph 2(b) (by virtue of the controlling influence the CMR exercises over the management and operations of the company that owns real property and other Qualifying Assets), in paragraph 2(c) (also by reason of the controlling influence the CMR exercises over the management and operations of the company that owns Qualifying Assets), in paragraph 2(d) (although treatment of this asset type as a Qualifying Asset is based also and more appropriately on the "same investment or economic experience" principle discussed below), in paragraph 2(e) (describing a CMR's beneficial ownership interest in a whole mortgage loan, a mortgage loan participation, a mezzanine loan, or a mezzanine loan participation and the CMR's ability to control, whether conditional or unconditional, the foreclosure process in case of loan default), and in paragraph 2(f) (describing a CMR's ability, as a majority owner of interests in the controlling class of a CMBS issuance, to control the foreclosure process over the underlying mortgage loans).

The "control" element may be demonstrated by the treatment of B Notes as Qualifying Assets, which we propose to treat as such in paragraph 2(e) above consistent with the no-action letter granted to *Capital*

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[29] A CMR also receives sizable amounts of cash when it refinances a CDO after the 5-year refinancing window that is typical for these structures. This cash also is held temporarily pending reinvestment in Qualifying Assets.

[30] As described above, a CMR may hold real estate-owned (REO) property acquired by direct investment or through the exercise of the foreclosure remedy when a commercial mortgage loan has gone into default.

Trust, Inc., SEC Staff No-Action Letter (Feb. 3, 2009). In that letter, the staff granted no-action assurance based on the argument that a B Note is a participation interest in a mortgage loan that is fully secured by real property, that the company holding the B Note has rights with respect to the administration and servicing of the mortgage loan, such as approval rights in connection with any material decisions pertaining to the administration and servicing of the loan, and that the company has effective control over the remedies relating to the enforcement of the mortgage loan, including ultimate control of the foreclosure process even though the company does not have the unilateral right to foreclose on the mortgage loan (or even though the special servicer is not required to act in the best interests of both the A Note holder and the B Note holder). On the question of effective "control," the staff noted particularly the representations that the company as B Note holder has the right to select the special servicer, that the company often appoints its wholly owned subsidiary to act as special servicer, that in the event the mortgage loan becomes non-performing, the company is able to pursue remedies it desires by advising, directing or approving the actions of the special servicer, and that the company, if dissatisfied with the action of the special servicer, could terminate and replace the special servicer at any time with or without cause, cure the default so that it no longer is a non-performing loan, or purchase the A Note at par plus accrued interest, thereby acquiring the entire mortgage loan.

Under paragraph 2(f) of our proposed "Qualifying Asset" definition, a controlling beneficial ownership interest in a class of CMBS held by a CMR would also be treated as a Qualifying Asset when the CMR, under the terms and conditions of the instrument governing the CMBS issuance, has the right (whether conditional or unconditional) to direct foreclosure on the underlying real property that secures the Qualifying Asset or otherwise to acquire beneficial ownership of this property in the event of a loan default. Treatment as a Qualifying Asset in such cases would be based on the presence of the "control" element, as evidenced by considerations substantially similar to those that the Commission staff has identified in the case of B Notes. To assure proper valuation, however, the CMR would determine the value of its Qualifying Asset in such cases by apportioning the value of its controlling beneficial ownership interest of the CMBS class among Qualifying Assets, Real Estate-Related Assets and other assets, as applicable, based on the CMBS pool's percentage ownership interest in these assets.

We recognize that under our proposed test, certain products would be treated as Qualifying Assets even though the CMR's ability to "get to the dirt" might be a bit attenuated. For example, we are proposing that certain beneficial ownership interests in mortgage loan participations or mezzanine loans be treated as Qualifying Assets even though the CMR's ability to foreclose on the underlying real property is "conditional," which we define to mean that a CMR is able to exercise the right of foreclosure only if the holder of a more subordinate interest in the loan loses its ability to exercise this right.[31] We believe this treatment is appropriate given the business objectives and investment policies of CMRs, the nature of their operations and their infrastructure, as described above. As noted, a CMR is structured to originate or acquire commercial mortgage loans which may include subordinate interests of the types described above and, in accordance with its business objectives and policies, is prepared to accept within its portfolio a loan that has become distressed or the underlying real property itself. A RIC, by contrast, generally is not prepared to accept such a loan or underlying real property in its portfolio, and holding these products within its portfolio to any meaningful extent generally would not be consistent with the

[31] We also define the term "conditional" to mean that a CMR is able to exercise the right of foreclosure with the approval of the holder of a more senior loan encumbering the underlying real property or a more senior position in the loan or class of securities. Such approval might be required, for example, by the holder of a first mortgage loan before the holder of a second mortgage loan secured by a mortgage on the same underlying real property may exercise the right of foreclosure. The Commission staff in the past has granted no-action assurance to treat a second mortgage loan as a Qualifying Asset in such cases. *See, e.g., The State Street Mortgage Co.,* SEC Staff No-Action Letter (July 17, 1986); *Prudential Mortgage Bankers & Investment Corp.,* SEC Staff No-Action Letter (Dec. 4, 1977).

recitation of its investment policies set forth in its registration statement.[32] It should not matter, therefore, if under the terms and conditions of an instrument governing a loan, a CMR is able to exercise the right of foreclosure only if the holder of a more subordinate interest in the loan loses its ability to exercise this right. A CMR should still be regarded as being able to get to the "dirt" for purposes of treating this product as a Qualifying Asset even though its ability to do so is contingent. A CMR that holds to some extent these asset types is every bit about the business of originating or acquiring commercial mortgage loan type assets, and there is little danger that such a CMR might be mistakenly viewed by the investing public as a company that is primarily engaged in the business of a RIC.

Similarly, we have proposed that certain controlling beneficial ownership interests in companies that qualify for the exclusion in Section 3(c)(5)(C) be treated as Qualifying Assets. For the reasons stated above, we believe such treatment is appropriate. We take this view even though the CMR's ability to "get to the dirt" derives indirectly from its ability to exert a controlling influence over the management and operations of the underlying Section 3(c)(5)(C) company that holds Qualifying Assets. To prevent the possibility of abuse in these circumstances, however, we have proposed that the value of a CMR's controlling beneficial ownership interest in an underlying Section 3(c)(5)(C) company be pro rated among the Qualifying Assets, Real Estate-Related Assets, and other assets of the underlying company based on the company's percentage ownership interest in these assets and valued accordingly.[33]

Under the Qualifying Asset test we propose, an A Note would be treated as a Qualifying Asset because the A note retains many of the features of a whole mortgage loan and the A note holder retains sufficient control over the related mortgage loan. The A Note is fully secured by a mortgage lien on real property. The A Note holder, as the senior lender, holds legal title to the mortgage loan and is listed as the lender of record with the appropriate governmental authority. The A Note holder is in contractual privity with the borrower and is able to pursue remedies for collection directly against the borrower in the event of the borrower's default on the commercial mortgage loan. Because the A Note holder typically originates a commercial mortgage loan that has been divided into the A/B participation structure, the A Note holder generally is fully engaged in the lending process, including checking the creditworthiness of the borrower and making the decision whether to lend. The A Note holder retains non-default servicing rights with respect to the mortgage loan and, therefore, directly or indirectly continues to be involved in servicing the loan. In these circumstances, the A Note has all of the indicia of a whole mortgage loan, except for control of the right to foreclose, which is retained by the B Note holder. Giving up this one right should not cause the A Note to become a Real Estate-Related Asset for 3(c)(5)(C) purposes, notwithstanding that the related B Note might be considered a Qualifying Asset for this purpose.

Our proposed definition of "Qualifying Asset" for certain asset types is based alternatively on the "same investment or economic experience" principle or jointly on the "control" and "same investment experience" principles. The investments described in paragraph 2(d) of our proposed definition of "Qualifying Asset" include "whole pool" investments that, based on a line of no-action letters granted by the Commission

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[32] Section 8(b) of the Investment Company Act requires a RIC to recite in its registration statement its policy with respect to the purchase and sale of real property, among other things.

[33] In paragraph 2(b) of the definition of "Qualifying Asset" above, we also propose that certain non-security beneficial ownership interests in a company that does not fall within the definition of "investment company" in Section 3(a)(1) of the Investment Company Act be treated as Qualifying Assets, provided that these non-security beneficial ownership interests are pro rated among the Qualifying Assets, Real Estate-Related Assets and other assets held by the underlying company. We emphasize that we are proposing this treatment only for a CMR or other REIT that seeks to rely on Section 3(c)(5)(C) of the Investment Company Act. As noted above, we are not proposing that pro rata treatment be applied with respect to a CMR's (or other REIT's) beneficial ownership interest in a Section 3(c)(5)(C) underlying company when the CMR (or other REIT) does not register as an investment company on the basis that it does not fall within the Section 3(a)(1) definition of investment company.

staff in the context of agency-backed securities[34] and a very few involving conventional loans,[35] have been treated as Qualifying Assets because a holder of these interests is considered to have the same investment experience as if the holder owned the underlying mortgage loans. We have also proposed in paragraph 2(d) that the Commission treat partial pool certificates, in cases in which the holder owns a controlling beneficial ownership interest in the related pool of mortgage loans, as Qualifying Assets based also on the “same investment experience” principle. Our reasoning is that taking such a controlling ownership interest in a pool of underlying mortgage loans is a type of investment that is particular to REITs and is not the type of investment in which RICs typically invest.

Under our proposal, a mezzanine loan would be treated as a Qualifying Asset based in part on the “control” principle and in part on the “same investment or economic experience” principle.[36] A CMR, as a mezzanine lender, obtains ongoing control rights over the management of the underlying property, such as rights relating to the approval of major leases, budget improvements, capital expenditures and the application of insurance proceeds or condemnation awards, as well as the right to replace the property manager in case of default on the loan. In addition, a CMR, as the mezzanine lender, has the right to foreclose on the collateral and, through its ownership of the property-owning entity, become the owner of the underlying real property, thus getting to the “dirt.” Treatment of a mezzanine loan as a Qualifying Asset is also supported by the “same investment experience” rationale because a CMR, as mezzanine lender, has the same investment or economic experience as a second mortgage lender, and the staff has granted no-action assurance to permit second mortgage loans to be treated as Qualifying Assets. This conclusion is based principally on the fact that the value of the collateral under both a mezzanine loan and a second mortgage loan is economically the same because the ownership interests in the property-owning entity have no economic value apart from the underlying real property (other than incidental assets related to the ownership of the property) since the property-owning entity is not permitted to engage in any business except the ownership of the real property.

Under our proposal, other tiers of mezzanine loans (such as junior or senior mezzanine loans) would also be treated as Qualifying Assets based on the same reasoning as set forth above for tier 1 mezzanine loans. In our view, this reasoning applies equally well to other tiers of mezzanine loans.

C. Other Issues

As an alternative to Section 3(c)(5)(C) (and Section 3(a)(1)(C)),[37] Section 3(c)(6) of the Investment Company Act may be relied on by CMRs to be excluded from the definition of “investment company.” Reliance on Section 3(c)(6), however, has been difficult for CMRs (and other mortgage REITs) because of the lack of Commission or staff guidance on the requirements of this exclusion. We believe that the effort undertaken by the Commission by issuance of the Concept Release to examine various questions relating to the interpretation of Section 3(c)(5)(C) with a view to issuing meaningful guidance on these

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[34] *See, e.g., American Home Finance Corp.,* SEC Staff No-Action Letter (April 9, 1991).

[35] *See, e.g., Premier Mortgage Corp.,* SEC Staff No-Action Letter (March 14, 1983).

[36] In a letter granted to *Capital Trust, Inc.,* SEC Staff No-Action Letter (May 24, 2007), the Commission staff granted no-action assurance to permit tier 1 mezzanine loans (which the staff described as mezzanine loans made specifically and exclusively for the financing of real estate) to be treated as Qualifying Assets for purposes of Section 3(c)(5)(C) of the Investment Company Act. Under our proposal, other tiers of mezzanine loans would also be treated as Qualifying Assets.

[37] As noted, many CMRs are not registered under the Investment Company Act on the basis that they do not fall within the definition of investment company in Section 3(a)(1)(C) of this Act because no more than 40% of the value of their adjusted total assets on an unconsolidated basis consists of “investment securities.” For this purpose, a CMR treats its net equity and other interests in a majority-owned subsidiary that is relying on Section 3(c)(5)(C) as non-investment securities.

matters provides an opportune time for the Commission to examine as well questions concerning the interpretation of Section 3(c)(6).

One question that arises under Section 3(c)(6) is the meaning of "primarily engaged" for purposes of this exclusion. To our knowledge, neither the Commission nor its staff has provided any meaningful guidance on this matter. The Commission staff has indirectly addressed this question in at least one no-action letter, *Financial Trustco Capital Ltd.,* SEC Staff No-Action Letter (Aug. 14, 1985) ("*Financial Trustco*"). In that letter, the staff noted that it had previously concurred with the position taken in the context of its review of a registration statement that an issuer satisfied the "primarily engaged" requirement for relying on Section 3(c)(6) when it held approximately 69% of its total assets (consolidated with the assets and liabilities of its wholly owned subsidiary that was engaged primarily in the business of making real estate mortgage loans) in the form of mortgage loans and other interests in real estate. The staff declined to grant no-action assurance to the requesting issuer, however, because the issuer did not satisfy the 25% gross income test of Section 3(c)(6),[38] but the staff did not express disapproval with the issuer's position that it would continue to satisfy the asset test of Section 3(c)(6) if it invested the proceeds of its proposed public offering to acquire a majority ownership interest in one or more non-investment company businesses.

We believe that the Commission should take the interpretive position implied in the *Financial Trustco* letter on the meaning of "primarily engaged" for purposes of the Section 3(c)(6) exclusion: *i.e.,* that an issuer satisfies the "primarily engaged" test of Section 3(c)(6) if at least 55% of the value of its total assets consists of the following: (1) direct holdings of Qualifying Assets, as defined above (or other assets that would be considered qualifying interests for purposes of Section 3(c)(5)(A) or Section 3(c)(5)(B)); (2) interests in one or more majority-owned subsidiaries that are relying on the exclusion provided by Section 3(c)(3), Section 3(c)(4), or Section 3(c)(5)(A), (B) or (C); or (3) interests in majority-owned subsidiaries that do not fall within the definition of investment company in Section 3(a)(1)(C) or Section 3(a)(1)(A) of the Investment Company Act. Under this test, consistent with existing requirements and the text of Section 3(c)(6), an issuer must have assets of the type described in (2) to qualify for the Section 3(c)(6) exclusion.[39] The issuer may, however, hold in addition assets of the types described in (1) and (3). We believe such a test would be consistent with the requirements for determining "investment company" status in other provisions of the Investment Company Act and would provide much needed clarity to CMRs and other mortgage REITs in conducting their activities.

Another question that arises under Section 3(c)(6) is how to value investments in a Section 3(c)(5)(C) or other majority-owned subsidiary for purposes of the Section 3(c)(6) exclusion – whether consolidation treatment is appropriate in the case of Section 3(c)(5)(C) or other subsidiaries that are wholly owned by a CMR that seeks to rely on the Section 3(c)(6) exclusion.

In making the asset and income determinations of Rule 3a-1 under the Investment Company Act, the Commission permits an issuer to use the consolidated financial results of its wholly owned subsidiaries. We believe that the Commission should take a similar view with respect to the asset and income determinations of Section 3(c)(6) for wholly owned subsidiaries that are relying on the exclusions provided in Sections 3(c)(3), 3(c)(4), or 3(c)(5)(A), (B) or (C), or that are companies that do not fall within

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[38] The issuer in the *Financial Trustco* letter proposed to use the proceeds of a follow on offering to invest in majority-owned subsidiaries that were not investment companies but which were not companies relying on the Section 3(c)(5)(C) exclusion. The staff indicated that in order to meet the 25% gross income requirement of Section 3(c)(6), an issuer must derive more than 25% of its gross income from majority-owed businesses that are engaged in Sections 3(c)(3), (4) and (5) activities.

[39] The issuer must hold assets of this type because in order to satisfy the income requirement of Section 3(c)(6), the issuer must derive more than 25% of its gross income in its last fiscal year from majority-owned subsidiaries that are primarily engaged in Sections 3(c)(3), 3(c)(4) or 3(c)(5) activities.

the definition of investment company in Section 3(a)(1)(C) or Section 3(a)(1)(A). Consolidation treatment in such case would help an issuer determine whether it qualifies for the Section 3(c)(6) exclusion, particularly if the issuer conducts its business through wholly owned subsidiaries and prepares its GAAP-compliant financial statements on a consolidated basis. In addition, because these subsidiaries would be wholly owned, there should be little opportunity for an issuer to seek to circumvent the requirements of the Investment Company Act through the use of consolidated financial statements.[40]

III.
ANPR RELEASE

A. Reasons to Permit Asset-Backed Issuers to Continue to Rely on Section 3(c)(5)

In the ANPR Release, the Commission requested comments on whether Section 3(c)(5) should be amended to limit the ability of asset-backed issuers to rely on Section 3(c)(5). The Commission stated that asset-backed issuers that rely are Section 3(c)(5) and those that rely on Rule 3a-7 are subject to somewhat disparate treatment based solely on the type of assets held. The Commission reiterated a concern that issuers of mortgage-backed securities that relied on Section 3(c)(5) played a role in the current financial crisis.

The ANPR Release asks about structural or operational reasons why an asset-backed issuer may need to rely on Section 3(c)(5) rather than Rule 3a-7. A CMR may finance its mortgage holdings in a variety of ways, including through the transfer of these holdings to a subsidiary that issues commercial mortgage-backed securities ("CMBS"). An issuer of CMBS might be excluded under both Section 3(c)(5)(C) and Rule 3a-7.

There are good reasons for preserving the ability of asset-backed issuers to rely on the Section 3(c)(5)(C) exclusion. For example, given the current financial environment, commercial foreclosure properties and defaulted commercial loans are abundant. To the extent a CMR wishes to securitize distressed assets, the exclusion under Section 3(c)(5)(C) might be available, but the exclusion under Rule 3a-7 would not be. Rule 3a-7 requires that the security holders of the issuer receive payments that depend on the cash flow from eligible assets. The term "eligible assets" means financial assets that by their terms convert into cash within a finite time period. REO property, for instance, does not qualify as an eligible asset under Rule 3a-7. The securitization of these distressed assets could provide crucial capital to the distressed asset market. Preserving the availability of the Section 3(c)(5)(C) exclusion for these CMBS issuers will ensure the flow of capital necessary to help manage the country's mortgage default and foreclosure problems and the looming refinancing problem.

Another reason that CMBS issuers should be permitted to rely on Section 3(c)(5)(C) relates to the exclusions used by CMRs themselves. Many CMRs rely on Section 3(c)(5)(C) or Section 3(c)(6), holding most of their mortgage assets through subsidiaries, including subsidiaries that are CMBS issuers. If a CMBS issuer that owns commercial mortgage loans relies on Section 3(c)(5)(C), then the CMRs treat those investments as qualifying assets for purposes of their own Section 3(c)(5)(C) or Section 3(c)(6) exclusion. If a subsidiary is required to rely solely on Rule 3a-7, it is unclear whether the CMR's investment in that subsidiary is a qualifying asset.

The language of Section 3(c)(5)(C) sets out an asset-based exclusion. Eliminating the availability of Section 3(c)(5)(C) for CMBS issuers through rulemaking would introduce an operational test (*i.e.*,

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[40] *Cf.* Investment Company Act Release No. 11551 (Jan. 14, 1981) (adoption of Rule 3a-1), describing the efforts to circumvent the requirements of the Investment Company Act that might arise with respect to use of consolidation financial statements with majority-owned subsidiaries but recognizing that similar efforts are not likely to occur in the case of wholly owned subsidiaries.

necessity of qualification under Rule 3a-7 for an entity that qualifies for the Section 3(c)(5)(C) exclusion) where none was intended. The Commission cannot act to alter the asset-based nature of Section 3(c)(5)(C) absent new legislation from Congress. In any event, if asset-backed issuers were excluded from reliance on Section 3(c)(5)(C), these asset-backed issuers and companies that hold similar assets would be subject to somewhat disparate treatment based solely on how a particular company is structured.

B. Reasons to Continue to Treat Rule 3a-7 Subsidiaries as Non-Investment Companies for Section 3(a)(1)(C) Purposes

In the ANPR Release, the Commission requested comments on whether Rule 3a-7 should be modified so that a company's investments in majority-owned securitization vehicles that rely on Rule 3a-7 are deemed "investment securities," as defined in Section 3(a)(2) of the Investment Company Act, for purposes of determining that company's own status under Section 3(a)(1)(C) of this Act. The Commission is especially concerned that some companies may invest virtually all their assets in securities issued by Rule 3a-7 subsidiaries and still not meet the definition of investment company under Section 3(a)(1)(C). In the view of the Commission, such companies appear to be in the business of investing in securities.

As discussed above, many CMRs (including those that rely on Section 3(a)(1)(C)) securitize assets they originate or acquire in order to finance their non-investment company businesses. The assets are securitized through issuers that may hold a mix of qualifying and non-qualifying assets. Depending on the asset mix, Section 3(c)(5)(C) may be unavailable to these issuers. The risk retention rules proposed by the Dodd-Frank Act and other regulations would require CMRs to retain an interest in securitization issuers, a retained interest that in the case of Rule 3a-7 securitization issuers the Commission proposes to deem "investment securities." This result would be detrimental to many CMRs because a fundamental financing mechanism would at the very least become less attractive and possibly be eliminated altogether. This result would be particularly harsh for CMRs that are motivated to undertake these arrangements because of a need to obtain capital to originate and acquire new assets and not as a means possibly to circumvent the registration requirements of the Investment Company Act.

It seems that the Commission is mainly concerned with a discrete use of the Rule 3a-7 exclusion by a limited number of companies that invest primarily in Rule 3a-7 majority-owned subsidiaries with a view to avoid regulation under the Investment Company Act and that are concerned only secondarily with financing the acquisition of new assets. If true, it would be unwise to establish a blanket rule that states that investments in all Rule 3a-7 majority-owned subsidiaries are "investment securities," particularly when the Rule 3a-7 exclusion is widely used by CMRs to finance the acquisition of assets through securitization subsidiaries.

For the foregoing reasons, we do not believe any changes regarding the treatment of investments in Rule 3a-7 majority-owned subsidiaries would be wise. If the Commission decides, however, that some change is absolutely necessary to protect against potential abuses, we would suggest that the Commission set a limitation on the percentage of investments in Rule 3a-7 majority-owned subsidiaries that could be treated as non-investment securities. For example, the Commission could provide that an investment of 40% of a company's assets in Rule 3a-7 majority-owned subsidiaries would not constitute investment securities, but that any further investment in Rule 3a-7 majority-owned subsidiaries would presumptively be deemed to be investment securities. This presumption could be rebutted depending on the circumstances, such as the way in which the company originated or acquired the assets underlying the securitizations.

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We would be pleased to have the opportunity to discuss these matters further with you or with any member of the Commission staff. Please feel free to contact the undersigned at gjervis@capitaltrust.com or (212) 655-0247.

Sincerely,

By: ____________________
Name: Geoffrey G. Jervis
Title: Chief Financial Officer
Capital Trust, Inc.

cc: Mary L. Shapiro, Chairman
Elisse B. Walter, Commissioner
Luis A. Aguilar, Commissioner
Troy A. Paredes, Commissioner
Eileen Rominger, Director, Division of Investment Management

EXHIBIT A

NATIONAL
ASSOCIATION
OF
REAL ESTATE
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♦ ♦ ♦
REITs:
BUILDING
DIVIDENDS
AND
DIVERSIFICATION®

September 30, 2010

Andrew J. Donohue, Director
Division of Investment Management
U.S. Securities and Exchange Commission
100 F Street, NE
Washington, DC 20549

Dear Mr. Donohue:

In connection with your request, we have attached to this letter the following materials summarizing the regulatory scheme applicable to real estate investment trusts specializing in mortgage finance ("mortgage REITs"):

- a chart describing the body of the laws and regulations applicable to mortgage REIT operations and activities (the "Chart"),

- an exhibit to the Chart listing the statutes that specifically address mortgage REITs or which involve a substantial consideration of mortgage REITs by Congress ("Exhibit 1"), and

- an exhibit highlighting certain key sources of guidance governing the preparation and presentation of mortgage REIT financial statements, including releases by the Financial Accounting Standards Board and the staff of the Securities and Exchange Commission ("Exhibit 2").

Please do not hesitate to contact us with any questions regarding mortgage REITs, the information in the attached exhibits, or the REIT industry in general.

On behalf of NAREIT and its members, we appreciate your interest in and involvement with REIT issues arising under the securities laws, and we wish you the best in your future endeavors.

Respectfully Submitted,

Tony M Edwards

Tony M. Edwards
Executive Vice President & General Counsel

♦ ♦ ♦
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THE BODY OF LAW, REGULATION AND REQUIREMENTS GOVERNING THE OPERATIONS AND ACTIVITIES OF REITS

Public real estate investment trusts (or "**REITs**") are operating companies active in the real estate industry that are subject to a complex body of laws, regulations, exchange rules, accounting pronouncements and market-driven best practices. In the following chart, we outline some of the key statutes, regulatory provisions, rules, pronouncements and practices that govern the operations and activities of REITs. Many of the provisions discussed are applicable to all public operating companies, and are not specific to REITs. Certain provisions, however, such as the REIT requirements under the Internal Revenue Code of 1986, as amended (the "**Code**"), apply specifically to REITs. Congress has specifically adopted statutes relating to REITs or with REITs in mind, a non-exhaustive list of which is attached as Exhibit 1. Though it has adopted a number of REIT related statutes, Congress has never suggested that the regulation of REITs under the Investment Company Act of 1940, as amended (the "**1940 Act**"), should be modified, including in the Dodd-Frank Wall Street Reform and Consumer Protection Act, signed into law on July 21, 2010 (the "**Dodd-Frank Act**").

Applicable Law or Regulation[1]	**Description**
SARBANES-OXLEY ACT (incorporated into 934 Act (as defined below)	**As a public company registered under the Securities Exchange Act of 1934, as amended (the "1934 Act"), a REIT generally is subject to the provisions adopted in the Sarbanes-Oxley Act of 2002, signed into law on July 30, 2002 ("SOX").**[2]
- Code of Ethics	In implementing SOX, the Securities and Exchange Commission ("**SEC**") has adopted rules requiring a public company to disclose whether it has adopted a code of ethics for its Chief Executive Officer ("**CEO**"), Chief Financial Officer ("**CFO**"), Chief Administrative Officer ("**CAO**"), controller and other persons performing similar functions and, if not, the reasons why it has not (the "**Code of Ethics**"). A Code of Ethics is a set of written standards reasonably designed to deter wrongdoing and to promote: • Honest and ethical conduct, including ethical handling of conflicts of interest,

1 In this chart we are not addressing proposed Regulation AB. Regulation AB, the Dodd-Frank Act and potential rules and regulations stemming therefrom could significantly affect REITs and could impose a variety of additional requirements and restrictions upon or indirectly affect their operation and activities. We have also not included provisions suggested by the North American Securities Administrators Association (or "NASAA") in its "Statement of Policy Regarding Real Estate Investment Trusts," dated May 7, 2007.

2 Pub. L. No. 107-204; 116 Stat. 745 (July 30, 2002).

	• Full, fair, accurate, timely and understandable disclosure in SEC reports and public communications, • Compliance with applicable law, • Prompt internal reporting of violations, and • Accountability for compliance with the Code of Ethics.
- Disclosure Controls (Section 404 of SOX; Rule 13a-15)	Companies with securities registered under Section 12 of 1934 Act (such as public REITs) must maintain disclosure controls and procedures with respect to financial information. Disclosure controls and procedures mean controls and other procedures designed to ensure that information required to be disclosed in filings or reports under the 1934 Act are recorded, processed, summarized and reported within the required time periods, including controls and procedures to ensure that information required to be disclosed by an issuer in the reports that it files or submits under the 1934 Act is accumulated and communicated to the issuer's management, including its principal executive and principal financial officers, or persons performing similar functions, to allow timely decisions regarding required disclosure (collectively, "**Disclosure Controls and Procedures**").
- Quarterly Evaluation of Disclosure Controls and Procedures	Each quarter, management must evaluate, with the participation of the principal executive and financial officers, or persons performing similar functions, the effectiveness of the REIT's Disclosure Controls and Procedures.
- Internal Control Over Financial Reporting (Section 404 of SOX; Rule 13a-15)	Companies that file Form 10-Ks and 10-Qs (such as public REITs) must adopt "internal controls over financial reporting" ("**Internal Controls**") which means a process designed by, or under the supervision of, the REIT's principal executive and principal financial officers, or persons performing similar functions, and effected by the company's board, management and other personnel, to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles, including policies and procedures that: • Pertain to the maintenance of records that in reasonable detail accurately and fairly reflect the transactions and dispositions of the assets of the REIT; • Provide reasonable assurance that transactions are recorded as necessary to permit preparation of financial statements in accordance with generally accepted accounting principles, and that receipts and expenditures of the issuer are being made only in accordance with authorizations of management and directors of the REIT; and • Provide reasonable assurance regarding prevention or timely detection of unauthorized acquisition,

	use or disposition of the REIT's assets that could have a material effect on the financial statements.
- Quarterly Evaluation of Internal Control changes	Each quarter, management must evaluate, with the participation of the principal executive and financial officers any change in the REIT's Internal Controls that occurred during a fiscal quarter that has materially affected, or is reasonably likely to materially affect, the company's Internal Controls
- Internal Control Report (Section 404 of SOX; Rule 13a-15)	Each year, management must complete and provide as an exhibit to the Form 10-K a report of management on the REIT's Internal Controls (the "**Internal Control Report**") that contains: • A statement of management's responsibility for establishing and maintaining adequate Internal Controls for the registrant; • A statement identifying the framework used by management to evaluate the effectiveness of the company's Internal Controls as required by paragraph; • Management's assessment of the effectiveness of the registrant's Internal Controls as of the end of the registrant's most recent fiscal year, including a statement as to whether or not its Internal Controls are effective, including disclosure of any material weakness in the company's Internal Controls identified by management. Management is not permitted to conclude that the company's Internal Controls are effective if one or more material weaknesses are identified; and • A statement that the registered public accounting firm that audited the financial statements included in the Form 10-K has issued an attestation report on the company's Internal Controls.
- Internal Control Attestation	A REIT's auditor must attest to management's assessment of the effectiveness of the company's Internal Controls in the Internal Control Report (the "**Internal Control Attestation**"). The Public Company Accounting Oversight Board ("**PCAOB**") has adopted Auditing Standard No. 5 to provide guidance to auditors in conducting an integrated audit of the financial statements of a company and management's assessment of Internal Controls.[3]
- Section 906 Certification	Periodic reports (such as the Form 10-Q and Form 10-K) containing financial statements filed with the SEC must be accompanied by a certification by the REIT's CEO and CFO (the "**Section 906 Certification**"), stating that (i) the periodic report fully complies with the requirements the 1934 Act and (ii) the information in the report "fairly presents, in all material respects, the financial condition and results of operations of the issuer." Knowingly or willfully filing an incorrect Section 906 Certification is a criminal offense punishable by a large fine and/or imprisonment.

[3] Available at http://pcaobus.org/Standards/Auditing/Pages/Auditing_Standard_5.aspx.

	SOX provides a form of certification that must be used for the Section 906 Certification.
- Section 302 Certification	In filing a 10-Q or 10-K, the CEO and CFO of a REIT must certify that the financial statements filed with the SEC fairly present, in all material respects, the operations and financial condition of the company, and must attest to the adequacy of the company's Disclosure Controls and Internal Controls.
- Prohibitions on Loans to Insiders (Section 402 of SOX)	Prohibits loans by a public company to its directors or executive officers, subject to very narrow exemptions for certain types of loans made in the course of the company's business.
- Whistleblower protection	SOX protects employees of public companies (and, after the Dodd-Frank Act, certain of public companies' subsidiaries and affiliates) against retaliation for providing information to supervisors, government agencies or Congress regarding violations of securities laws or antifraud laws.
- Audit Committee Requirements (SOX Section 301, SEC Rule 10A-3)	Prohibits national securities exchanges from listing securities of companies that do not comply with certain requirements relating to the company's audit committee.
- Independence	Subject to certain exceptions, each member of the audit committee must be independent, meaning it may not: • Accept, directly or indirectly, any consulting, advisory or other compensatory fee from the company or its subsidiaries (other than board and committee fees), or • Be an "affiliated person" of the company or its subsidiaries (as defined in Rule 10A-3)
- Responsibility for external audit	Audit committee must be directly responsible for the appointment, compensation, retention and oversight of the work of auditors engaged (including resolution of disagreements between management and the auditor regarding financial reporting) for the purpose of preparing or issuing an audit report or performing other audit, review or attest services for the company, and each auditor must report directly to the audit committee
- Complaint process	Audit committee must establish procedures for: • The receipt, retention, and treatment of complaints received by the company regarding accounting, internal accounting controls, or auditing matters; and • The confidential, anonymous submission by employees of the company of concerns regarding questionable accounting or auditing matters
- Advisers	Audit committee must have the authority to engage independent counsel and other advisers, as it determines necessary to carry out its duties.

- Funding	SOX requires companies provide adequate funding to audit committee for hiring of auditor(s) and adviser(s), and for administrative costs
- Financial expert	Company must disclose on Form 10-K whether its audit committee has at least one "audit committee financial expert" meeting certain criteria, and, if not, why it does not have such an expert on its audit committee
NASDAQ GLOBAL MARKET ("NASDAQ") LISTING REQUIREMENTS	**A REIT that is listed on NASDAQ must meet a number of requirements relating to, among other things, market capitalization, number of beneficial owners, share price and governance issues.**
- Initial Listing Requirements	In order to be listed on NASDAQ, a REIT must certain shareholder number, liquidity, pre-tax earnings, share price and market maker requirements.
- Ongoing Listing Requirements	In order to remain listed on NASDAQ, a REIT must continuously satisfy certain share price, liquidity and earnings requirements.
- Governance Requirements	A REIT listed on NASDAQ must meet the following governance requirements.
- Independent Directors (Rule 5605(b)(1)	A REIT must have a majority of independent directors. Even if a director is independent under NASDAQ rules, the REIT's board must determine that there is no other relationship between a purportedly independent director and the company that would preclude that director from acting as an independent director.
- Meetings of Independent Directors (Rule 5605(b)(2))	At least twice a year, a REIT must hold a meeting of independent directors that is attended only by independent directors. This meeting can be held in conjunction with a meeting of directors generally.
- Compensation Committee (Rule 5605(d))	A committee of independent directors must set the compensation of chief executive officer and other executive officers.
- Nominating Committee (Rule 5605(e))	A committee of independent directors must be responsible for nominating director candidates for the REIT's board
- Audit Committee (Rule 5605(c))	A NASDAQ listed REIT is required to have an audit committee consisting solely of independent directors who have the requisite financial experience and expertise. The audit committee must comply with the requirements of SOX and, particularly, Rule 10A-3.
- Other Requirements	
- Annual Meeting (Rule 5620(a))	A NASDAQ listed REIT is required to hold an annual meeting no more than one year after the end of its fiscal year
- Quorum (Rule 5620(c))	A quorum of shares for purposes of any meeting must mean not less than 33 1/3% of outstanding shares of voting stock
- Voting Rights (Rule 5640)	The voting rights of existing shareholders cannot be disparately reduced or restricted through any corporate action

- Funding	SOX requires companies provide adequate funding to audit committee for hiring of auditor(s) and adviser(s), and for administrative costs
- Financial expert	Company must disclose on Form 10-K whether its audit committee has at least one "audit committee financial expert" meeting certain criteria, and, if not, why it does not have such an expert on its audit committee
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- Audit Committee (Rule 5605(c))	A NASDAQ listed REIT is required to have an audit committee consisting solely of independent directors who have the requisite financial experience and expertise. The audit committee must comply with the requirements of SOX and, particularly, Rule 10A-3.
- Other Requirements	
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- Quorum (Rule 5620(c))	A quorum of shares for purposes of any meeting must mean not less than 33 1/3% of outstanding shares of voting stock
- Voting Rights (Rule 5640)	The voting rights of existing shareholders cannot be disparately reduced or restricted through any corporate action

	or issuance
- Conflict of interest review (Rule 5630)	A NASDAQ listed REIT must conduct a review of all related party transactions for potential conflict of interest situations. The review must be conducted by the audit committee or another independent body of the board
- Shareholder approval of security issuances (Rule 5635)	A NASDAQ listed REIT must obtain shareholder approval of certain securities issuances, including: (i) an issuance that will result in a change of control, (ii) private placements where the issuance (and shares sold by insiders and affiliates) equals 20% or more of the pre-transaction outstanding shares and where the issuance is made at a price less than the greater of book and market value, (iii) issuances related to equity compensation, and (iv) shares issued pursuant to an acquisition where the issuance equals 20% or more of the pre-transaction outstanding shares, or 5% or more of the pre-transaction outstanding shares when a related party has a 5% or greater interest in the acquisition target
- Code of Conduct (Rule 5610)	A NASDAQ listed REIT must adopt a code of conduct applicable to all officers, directors and employees. The code of conduct must satisfy the requirements of a code of ethics under SOX.
NYSE LISTING REQUIREMENTS	**A REIT that is listed on NYSE must meet a number of requirements relating to, among other things, market capitalization, number of beneficial owners, share price and governance issues. These requirements are similar to those applicable to NASDAQ listed REITs.**
- Initial Listing Requirements	In order to be listed on NYSE, a REIT must certain shareholder number, liquidity, pre-tax earnings, share price and market maker requirements.
- Ongoing Listing Requirements	In order to remain listed on NYSE, a REIT must continuously satisfy certain share price, liquidity and earnings requirements.
- Governance Requirements (Section 303A of the NYSE Rules)	A REIT listed on NYSE must meet the following governance requirements.
- Independent Directors	A NYSE listed REIT must have a majority of independent directors. Even if a director is independent under NYSE rules, the REIT's board must determine that there is no other relationship between a purportedly independent director and the company that would preclude that director from acting as an independent director.
- Meetings of Independent Directors	At least once a year, a REIT must hold a regularly scheduled meeting of independent directors that is attended only by independent directors.
- Compensation Committee	A committee of independent directors must set the compensation of chief executive officer and other executive officers
- Nominating/Corporate Governance Committee	A committee of independent directors must be responsible for nominating director candidates for the REIT's board and for developing and recommending corporate governance principles applicable to the REIT

- Audit Committee	An NYSE listed REIT is required to have an audit committee with at least three members consisting solely of independent directors who have the requisite financial experience and expertise. The audit committee must comply with the requirements of SOX and, particularly, Rule 10A-3.
- Internal Audit Function	An NYSE listed REIT must develop an internal audit function to provide management and the audit committee with an assessment of risk management and systems of internal control
- Corporate governance guidelines	An NYSE listed REIT must adopt and disclose corporate governance guidelines. These may include guidelines on topics including director qualifications and responsibilities, responsibilities of key board committees, director compensation, director orientation and continuing education, management succession planning, and a policy for evaluation of the board's or its committees' performance.
- Code of Business Conduct	An NYSE listed REIT must adopt and disclose a code of business conduct applicable to directors, officers and employees addressing conflicts of interest, corporate opportunities, confidentiality, fair dealing, protection and proper use of assets, compliance with laws rules and regulations and reporting of any illegal or unethical behavior. The code should constitute a code of ethics under SOX. The REIT must disclose any waivers to provisions of the code for directors and executive officers.
- Annual CEO Certification	The CEO of an NYSE listed REIT must certify each year that he or she is not aware of any violation by the REIT of the NYSE governance requirements.
SECURITIES ACT OF 1933 (THE "1933 ACT")	**Many REITs publicly offer their shares and, therefore, are subject to a number of requirements under the 1933 Act, including the registration requirements of Section 5, strict liability for misstatements in a registration statement set forth in Section 11, and the anti-fraud provision of Section 17. The staff of the Division of Corporation Finance makes a detailed review of each IPO registration statement on Form S-11 and regularly refers filings to the Division of Investment Management. The staff also may review and comment upon other registration forms.**
- Section 5: Registration of securities on Form S-11	In conducting a public offering of its shares, an entity electing to operate as a REIT must register the offer and sale of its shares to the public under the 1933 Act, using Form S-11. Form S-11 is divided into Part 1 (the prospectus provided to investors) and Part 2 (filed with the SEC and available through EDGAR but not provided directly to investors as part of the prospectus).

<table>
<tr>
<td>- Part 1 of Form S-11 (prospectus)[4]</td>
<td>Requires a REIT to provide a wide range of information about the company and the offering, including, among other things:

<u>Summary</u>. An introductory plain English summary of the information presented by the issuer in the full Form S-11 (Item 3), including:

name, address and telephone number of general partner and names of persons making investment decisions
if distributions are an investment objective, the estimated maximum time between closing and first distribution
properties to be purchased or statement that properties have not been identified
depreciation method to be used
maximum leverage as a whole and on individual properties, if different

<u>Risk factors</u>. A discussion of specific risks applicable to the REIT and the offering, including tax risks, with cross references to additional discussion, when applicable
<u>Basic disclosures regarding the REIT and its personnel</u>

Basic information and terms of governing instruments. Basic identifying information, state and form of organization, term of REIT, a description of provisions of governing instrument dealing with annual or other meetings of security holders, and, if the REIT was organized within 5 years, the name of all promoters and any positions or offices with the issuer held by such promoters (Item 11)
Directors and Executive Officers. Information regarding each director, executive officer and certain significant employees, including, among other things, each such person's name, age, principal occupation and employment for the last five years and any familial relationship between that person and any other director or executive officer ("Biographical Information").

<u>Disclosures regarding REIT operation and activities</u>

Investment policies. A description of the principles and procedures the issuer will employ in the

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[4] In addition to the items listed on the Form S-11, additional guidance about the types of information required on the Form is set forth in the SEC's *Industry Guide No. 5: Preparation of registration statements relating to interests in real estate limited partnerships*, available at http://www.sec.gov/about/forms/secforms.htm.

acquisition of assets, including policies regarding the following types of investments, whether the policy may be changed without a vote of security holders, the percentage of assets that may be invested in any one type of investment, any leverage used, and any limitations on concentration in a single issuer:

  - Investments in real estate or interests in real estate
  - Investments in real estate mortgages
  - Investments in persons primarily engaged in real estate activities
  - Investments in other securities (Item 13)

- *Certain other policies*. A description of the REIT's policies regarding, and a discussion regarding the extent to which an issuer anticipates engaging in or has in the past three years engaged in, the following types of transactions:

  - Issuing senior securities
  - Borrowing money
  - Making loans to other persons
  - Investing in securities of other issuers for purpose of exerting control
  - Underwriting securities of other issuers
  - Engaging in the purchaser and sale of investments
  - Offering securities in exchange for property
  - Repurchasing or reacquiring the issuer's own shares or other securities
  - Making annual or other reports to security holders (Item 12)

- *Descriptions of real estate*. Description of any materially important real estate properties currently held by the REIT or intended to be acquired by or leased to the REIT or its subsidiaries, along with additional information about the real estate holding and the REIT's plan for its use (Item 14)

- *Operating data regarding holdings*. Certain information regarding materially important improved property held by the REIT, including, among other things, occupancy rate, principle provisions of tenant leases, average effective annual rent for last five years, and information regarding expiration of leases (Item 15)

- *Management and Custody of Investments*. Description of arrangements made or proposed to be made regarding management of the REIT's real estate assets or the purchase, sale and servicing of mortgages for the issuer, and information regarding investment advisory services or services related to the foregoing performed for the REIT by affiliated persons (Item 24)

- *Tax treatment of issuer and security holders*. Description of the material aspects of the REIT's

	tax treatment under federal tax law and tax treatment of the REIT's investors with respect to distributions, among other things (Item 16) • *Executive compensation*. A description of the compensation of the REIT's key executives and directors; description must include all types of compensation (such as pension benefits, incentive plans, awards of stock or other securities, etc.) as well as an analysis of the plans under which such compensation packages or benefits were awarded (Item 22) ("**Executive Compensation Disclosures**") • <u>Financial Disclosures</u> ○ *Selected Financial Data*. In comparative columnar form, selected financial information ("**Selected Financial Data**") for each of the last five fiscal years of the REIT (or for the life of the registrant and its predecessors, if less), and any additional fiscal years necessary to keep the information from being misleading (Item 9). Selected Financial Data includes, as applicable: ▪ net sales or operating revenues; income (loss) from continuing operations; income (loss) from continuing operations per common share; total assets; long-term obligations and redeemable preferred stock (including long-term debt, capital leases, and redeemable preferred stock; and cash dividends declared per common share ▪ Any additional information that would enhance an understanding of and highlight trends in the REIT's financial condition and results of operations ▪ A brief description of factors that materially affect the comparability of the information reflected in selected financial data (such as accounting changes, business combinations or dispositions of business operations) ▪ A discussion any material that might cause the data presented not to be indicative of the issuer's future financial condition or results of operations ○ *MD&A*. A discussion of the REIT's financial condition, changes in financial condition and results of operations, including its liquidity, capital resources, results of operations, off-balance sheet arrangements, certain contractual obligations (in tabular form) and other information that the registrant believes to be necessary to an understanding of its financial condition, changes in financial condition and results of operations (Item 10) ("**MD&A Disclosure**"). This MD&A Disclosure can relate to the REIT as a whole or, where the issuer deems appropriate for an understanding of its business, relevant, reportable segments or other subdivisions of the REIT • <u>Disclosures regarding the offering</u> ○ *Description of Securities*. A description of the securities being offered and the material terms applicable to the securities, which vary depending on whether the REIT is offering debt or equity

	(Item 18) ○ *Offering price*. A discussion of the how the offering price was determined and the factors influencing the price (Item 4) ○ *Plan of distribution*. A discussion of the plan of distribution (Item 7), including: ▪ The terms of agreements with underwriter(s) (including the compensation of the underwriters) and a discussion of certain aspects of the relationship between the REIT, its affiliates and the underwriter(s) ▪ any distribution of securities offered other than through the underwriter(s) and certain terms regarding and details of such other distributions ○ *Use of proceeds*. A description of the intended use of the proceeds of the offering or, if the REIT has no current specific plan for the proceeds, the principal reasons for the offering (Item 8) ○ *Past experience and performance of sponsor*. A narrative summary of the track record or prior performance of programs sponsored by the sponsor and certain of its affiliates, as well as certain information in tabular form. ○ *Fees, costs and compensation*. A tabular summary showing estimates of public offering expenses (both organizational and sales), amount available for investment, non-recurring initial investment fees, prepaid items and financing fees, cash down payments, reserves and acquisitions fees, and maximum and minimum proceeds of the offering. The table must show an itemized description of all compensation, fees, profits and other benefits (including reimbursement) that the general partner/sponsor or its affiliates will earn or receive in connection with the offering or operation of the REIT. ○ *Dilution*. A discussion of any dilution investors will suffer as a result of insiders' pre-offering holdings purchased at a lower price (Item 5), including a comparison of the public contribution under the proposed public offering and the effective cash contribution of insiders ○ *Selling shareholders*. If the offering includes secondary sales by current security holders, information about those security holders, their relationship with the company, and a description of their holdings both pre- and post- offering (Item 6) • <u>Disclosures regarding conflicts and policies addressing conflicts (where not addressed elsewhere)</u> ○ *Holdings of insiders*. A description of the securities of the issue held by certain large investors and

	management ○ *Related Person Transactions*. Information regarding: ▪ any transaction, since the beginning of the REIT's last fiscal year, or any currently proposed transaction, in which the REIT was or is to be a participant and the amount involved exceeds $ 120,000, and in which any related person had or will have a direct or indirect material interest (a "**Related Person Transaction**") ▪ policies and procedures for the review, approval, or ratification of any Related Person Transaction (Item 23) ○ *Policies regarding insiders' activities*. A description of any provisions of the REIT's constituent documents or a description of any other policies limiting any director, officer, security holder or affiliate, or any other person in his, her or its ability to: ▪ Have any direct or indirect pecuniary interest in investments to be acquired or disposed of by the REIT or its subsidiaries or in any transaction to which the REIT or any of its subsidiaries is a party, or ▪ Engage for their own account in business activities of the types conducted or to be conducted by the REIT and its subsidiaries (Item 25) ○ *Disclosure and Discussion of Conflicts of Interest*. A description of each potential transaction which could result in a conflict between the interests of investors and those of the manager/sponsor and its affiliates, and the proposed method of dealing with the conflict ○ *Limitation of liability*. A description of the principal provisions of the governing instruments or any contract or arrangement with respect to limitations on the liability of REIT affiliated persons or any directors, officers or employees ○ *Indemnification*. A description of any indemnification of REIT affiliated persons or any directors, officers or employees • *Quantitative and Qualitative Market Risk Factors*. An analysis of quantitative and qualitative market risk and its affect on the REIT ("**Market Risk Factors**"); these Market Risk Factors are intended to clarify the REIT's exposures to market risk associated with activities in derivative financial instruments, other financial instruments, and derivative commodity instruments. Market risks includes interest rate risk, foreign currency exchange rate risk, commodity price risk, and other relevant market rate or price risks (*e.g.*, equity price risk) (Item 30)

	Certain information in the Part 1 of the Form S-11 may be incorporated by reference from an issuer's Form 10-K or other reports filed pursuant to Section 13(a) or 15(d) of the 1934 Act, subject to certain conditions. As discussed below, the Form S-11 and Form 10-K request overlapping information by referencing specific sections of Regulation S-K that describe the types of information required.

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<tr>
<td>- Part 2 of Form S-11</td>
<td>This portion of the S-11 is not part of the prospectus, but is filed with the SEC and available on the EDGAR system. Part 2 of the S-11 requires a REIT to provide the following information and documents:

Information on recent sales. Name of person or class of persons to whom securities have been sold (and the consideration paid by such person(s)) within the past six months or are to be sold by the issuer or any selling shareholder at a price different from that offered to the public in the offering
Indemnification. A statement regarding the general effect of any statute, charter provisions, by-laws, contract or other arrangements under which any controlling persons, director or officer of the REIT is insured or indemnified by the REIT
Exhibits. A wide range of items must be filed as exhibits to Part 2 of Form S-11 including, to the extent applicable:

underwriting agreement
plan of acquisition, reorganization, arrangement, liquidation or succession (if applicable)
articles of incorporation or trust agreement
current by-laws (if applicable)
all instruments defining the rights of holders of the equity or debt securities being registered
opinion of counsel as to the legality of the securities being registered (stating whether, when sold, the securities, if equity securities, will be legally issued, fully paid and non-assessable, and, if debt securities, whether they will be binding obligations of the registrant
opinion of counsel on tax treatment as a REIT
any voting trust agreement
“material contacts” meaning, with exceptions, (i) every contract not made in the ordinary course of business which is material to the REIT and is to be performed in whole or in part at or after the filing of the registration statement or was entered into not more than two years before such filing and (ii) certain management agreements and compensation plans
a statement setting forth in reasonable detail the computation of per share earnings
a statement setting forth in reasonable detail the computation of any ratio of earnings to fixed charges, any ratio of earnings to combined fixed charges and preferred stock dividends or any other ratios which appear in the registration statement
the REIT’s annual report to security holders for its last fiscal year, its Form 10-Q and Form 10-QSB (if specifically incorporated by reference in the prospectus) or its quarterly report to security holders, if all or a portion thereof is incorporated by reference in the filing
if applicable, a letter from the independent accountant which acknowledges awareness of the use in a registration statement of a report on unaudited interim financial information
filed or which is not filed with the SEC or which the REIT otherwise wishes to include

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	○ if applicable, a letter from the registrant's former independent accountant regarding its concurrence or disagreement with the statements made by the registrant in the current report concerning the resignation or dismissal as the registrant's principal accountant ○ a list of all the REIT's subsidiaries (subject to exceptions) and the jurisdiction of formation of each ○ any consents of experts and counsel ○ a copy of the relevant power of attorney to the extent any name is signed to the registration statement or report pursuant to a power of attorney ○ any document incorporated by reference in the Form S-11 that is not otherwise required to be filed by Item 601 of Regulation S-K
- Private Rights of Action	A REIT is subject to liability for material misstatements and omissions in its registration statement under (among other provisions) Sections 11 and 12 of the 1933 Act, and Section 10(b) of the 1934 Act.
- Section 17	A REIT also is subject to the anti-fraud provisions of Section 17 of the 1933 Act, which the SEC may enforce (but for which no private right of action exists); the SEC need only show negligence, rather than scienter, in connection with an action under Section 17.
1934 ACT (excluding the portions of SOX discussed above)	**Most public REITs are required to register under the 1934 Act as a result of completing a public offering. As a result, REITs are subject to a wide array of disclosure obligations, reporting requirements and substantive restrictions under the 1934 Act.**
- Registration Requirement: Form 8-A or Form 10	REITs which are publicly traded, as opposed to private investment vehicles, generally must register under the 1934 Act by filing either Form 8-A or Form 10 with the SEC.
- Independent Auditor Requirement (Rule 10A) / PCAOB registration requirement (SOX)	The auditor to a public company, including public REITs, must be independent (as defined in Rule 2-1 under Regulation S-X). SOX also requires auditors to public companies to be registered with and subject to inspection by the PCAOB.
- Reporting Requirements	As a company registered under the 1934 Act, a REIT is subject to periodic and other ongoing reporting requirements under the 1934 Act. These reports are the subject of review and comment on a period basis by the staff of the Division of Corporation Finance.
- Annual Form 10-K (Section 13 or 15(d))	A REIT registered under Section 12 of the 1934 Act must file with the SEC an annual filing on Form 10-K which is made available to the public through the EDGAR system. The Form 10-K must be filed after the end of each fiscal year. The required deadline for filing a Form 10-K after the end of a fiscal year depends upon the "filer" status of the reporting company. Form 10-K is broken into four parts and requires the following information, among other things:

Part 1

- *Risk Factors*. The REIT must provide the same types of risk factors required under Form S-11, described above (both Form S-11 and Form 10-K reference the same provision of Regulation S-K in describing the required risk factors) (Item 1A)

- *Unresolved Comments*. Certain REITs (based on what type of "filer" the REIT is under the 1934 Act) that have received comments from the staff regarding their periodic or current reports must disclose any unresolved comments in the Form 10-K that it believes are material and discuss the substance of the comment (Item 1B)

- *Legal Proceedings*. A REIT must disclose and describe any material pending legal proceedings, other than ordinary routine litigation incidental to the business of the REIT, to which the REIT or any of its subsidiaries is a party or of which any of their property is the subject. The description must include the name of the court or agency in which the proceedings are pending, the date instituted, the principal parties thereto, a description of the factual basis alleged to underlie the proceeding and the relief sought. A REIT must include similar information as to any such proceedings known to be contemplated by governmental authorities (Item 3)

Part 2

- *Market Information*. A REIT must disclose and discuss information about the market for its securities, the number of holders of each class of its securities, the frequency and amount of any dividends the REIT has declared, performance of the REIT's securities, and information about securities available for issuance under equity compensation plans (Item 5)

- *Use of Proceeds*. A REIT must include a discussion on its use of proceeds from the REIT's public offerings, including an update on any ongoing or terminated offerings and a discussion of how the net proceeds have been applied.

- *Selected Financial Data*. A REIT must disclose in the Form 10-K the same Selected Financial Data that was required under the Form S-11 (both Form S-11 and Form 10-K reference the same provision of Regulation S-K in describing the required Selected Financial Data) (Item 6)

- *MD&A*. A REIT must include in its Form 10-K the MD&A discussion described above and included in the Form S-11 (Item 7)

- *Market Risk Factors*. A REIT must include in its Form 10-K the same type of Market Risk Factors as are described above in connection with the Form S-11 (both Form S-11 and Form 10-K reference the same provision of Regulation S-K in describing the required Market Risk Factors) (Item 7A)

- *Financial Statements. Interim Financial statements.* A REIT must provide financial statements in prepared in accordance with Regulation S-X (Item 8)

- *Change in accountants.* In the event a REIT changes its accountants, it must disclose material disagreements with the accountant regarding any matter of accounting principles or practices, financial statement disclosure, or auditing scope or procedure and whether the new accountant dealt with the matter differently than the previous accountant apparently would have concluded was required (Item 9)

- *Effectiveness of disclosure controls and procedures.* A REIT must disclose the conclusions of the REIT's principal executive and principal financial officers, or persons performing similar functions, regarding the effectiveness of the REIT's Disclosure Controls, adopted pursuant to SOX (as defined below), as of the end of the period covered by the report, based on the evaluation of these controls and procedures required by SOX (Item 9A)

- *Report on internal controls over financial reporting.* A REIT must provide the Internal Control Report required by SOX (discussed below) and the Internal Control Attestation from the company's independent public accountant, as well as a description of any change in the REIT's Internal Controls (as defined below) that occurred during the REIT's fourth fiscal quarter that has materially affected, or is reasonably likely to materially affect, the REIT's Internal Controls (Item 9A)

- *8-K Information.* The REIT must disclose any facts or information that would be required to be disclosed in a Form 8-K (discussed below) during the fourth quarter of the fiscal year covered by the Form 10-K (Item 9B)

<u>Part 3</u>

- *Directors, Executive Officers and Corporate Governance.*

    - Biographical Information. A REIT must disclose Biographical Information (as defined above) about its officers, directors and key employees (in certain cases)

    - Section 16(a) Information. A REIT must disclose failures of its Covered Persons (as defined below in connection with Section 16 reporting) to file a Form 3, 4 or 5

    - Code of Ethics. A REIT must disclose whether it has adopted a Code of Ethics (as defined below in the SOX discussion) and, if not, why it has not adopted a Code of Ethics (Item 10)

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Executive Compensation. A REIT must provide the same Executive Compensation Disclosures as required under the Form S-11, discussed above (both Form S-11 and Form 10-K reference the same provision of Regulation S-K in describing the required Executive Compensation Disclosures) (Item 11)
Ownership by Insiders and Related Matters. A REIT must provide:

Information regarding the holdings of company securities by large beneficial owners, directors and management, and
The main features of any equity compensation plan adopted without the approval of shareholders, as well as information, in table form, regarding (i) the number of securities to be issued upon the exercise of outstanding options, warrants and rights, (ii) the weighted-average exercise price of the outstanding options, warrants and rights; and, (iii) other than securities to be issued upon the exercise of the outstanding options, warrants and rights, the number of securities remaining available for future issuance under the plan (Item 12)

Related Person Transactions and Director Independence. A REIT must:

Disclose any Related Person Transactions (as defined above) since the beginning of the previous fiscal year, as well as policies and procedures for the review, approval, or ratification of any Related Person Transaction, and
Name all directors that are independent under standards governing independence generally and that are members of a committee or sub-committee and are independent under the relevant standard for such sub-unit of the board (such as the audit committee; see SOX discussion below)

Accountant and Audit Information. A REIT must provide extensive information about its relationship with and fees paid to its accountant, as well as policies for monitoring that relationship.
Exhibits. The REIT must provide a range of exhibits to each Form 10-K (or must incorporate those exhibits by reference with a cross reference, if permitted), as set forth in Item 601 of Regulation S-K.

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<tr>
<td>- Quarterly Form 10-Qs (Section 13 or 15(d))</td>
<td>
Quarterly 10-Q must be filed within 45 days from the end of the relevant calendar quarter, or 40 days in the case or large accelerated filers and accelerated filers. The Form 10-Q is divided into two parts, and generally requires the following types of information:

<u>Part 1</u>

Interim Financial statements. A REIT must provide interim financial statements in prepared in

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accordance with Rule 10-01 of Regulation S-X (Item 1)

- *MD&A Disclosure*. A REIT must include in its Form 10-Q the MD&A discussion described above and included in the Form S-11 and Form 10-Q (Item 2)

- *Market Risk Factors*. A REIT must include in its Form 10-Q the same type of Market Risk Factors as are described above in connection with the Form S-11 and Form 10-K (Form S-11, Form 10-K and Form 10-Q reference the same provision of Regulation S-K in describing the required Market Risk Factors) (Item 3)

- *Effectiveness of disclosure controls and procedures*. A REIT must disclose the conclusions of the REIT's principal executive and principal financial officers, or persons performing similar functions, regarding the effectiveness of the REIT's Disclosure Controls, adopted pursuant to SOX, as of the end of the period covered by the report, based on the evaluation of these controls and procedures required by SOX (Item 4)

Part 2

- *Legal Proceedings*. A REIT must disclose and describe any material pending legal proceedings, other than ordinary routine litigation incidental to the business of the REIT, to which the REIT or any of its subsidiaries is a party or of which any of their property is the subject. The description must include the name of the court or agency in which the proceedings are pending, the date instituted, the principal parties thereto, a description of the factual basis alleged to underlie the proceeding and the relief sought. A REIT must include similar information as to any such proceedings known to be contemplated by governmental authorities (Item 1)

- *Risk Factors*. The REIT must provide any updates to the risk factors applicable to the REIT since disclosure of risk factors in its previous Form 10-K. (Item 1A)

- *Securities offerings*. The REIT must provide information regarding any securities sold or repurchased during the quarter to which the Form 10-Q corresponds.

- *Defaults and Changes in Dividends*. The REIT must discuss and provide information regarding any material default in the payment of principal, interest, a sinking or purchase fund installment, or any other material default not cured within 30 days, with respect to any indebtedness of the REIT or any of its significant subsidiaries exceeding 5% of the total assets of the REIT and its consolidated subsidiaries. The REIT must also discuss and provide information regarding any material arrearage in the payment of dividends that has occurred or any other material delinquency not cured within 30 days with respect to any class of preferred stock of the REIT which is registered or which ranks prior to any class of registered

	securities, or with respect to any class of preferred stock of any significant subsidiary of the REIT. • *8-K Information*. The REIT must disclose any facts or information that would be required to be disclosed in a Form 8-K (discussed below) during the fourth quarter of the fiscal year covered by the Form 10-K (Item 9B) • *Exhibits*. The REIT must provide a range of exhibits to each Form 10-Q (or must incorporate those exhibits by reference with a cross reference, if permitted), as set forth in Item 601 of Regulation S-K.
- Form 8-K (Section 13 or 15(d))	Form 8-K is used to report important current events. The Form 8-K provides that an obligation to file the Form is triggered by the following events, though as noted in Section 8 of the Form, a REIT may choose to file a Form 8-K for other events that it believes are sufficiently significant (the list below is broken down by topic in accordance with the divisions in the Form 8-K): • *Section 1 -- Registrant's Business and Operations* 　○ Item 1.01 Entry into a Material Definitive Agreement 　○ Item 1.02 Termination of a Material Definitive Agreement 　○ Item 1.03 Bankruptcy or Receivership • *Section 2 -- Financial Information* 　○ Item 2.01 Completion of Acquisition or Disposition of Assets 　○ Item 2.02 Results of Operations and Financial Condition 　○ Item 2.03 Creation of a Direct Financial Obligation or an Obligation under an Off-Balance Sheet Arrangement of a Registrant 　○ Item 2.04 Triggering Events That Accelerate or Increase a Direct Financial Obligation or an Obligation under an Off-Balance Sheet Arrangement 　○ Item 2.05 Costs Associated with Exit or Disposal Activities 　○ Item 2.06 Material Impairments • *Section 3 -- Securities and Trading Markets* 　○ Item 3.01 Notice of Delisting or Failure to Satisfy a Continued Listing Rule or Standard; Transfer of Listing 　○ Item 3.02 Unregistered Sales of Equity Securities 　○ Item 3.03 Material Modification to Rights of Security Holders • *Section 4 -- Matters Related to Accountants and Financial Statements* 　○ Item 4.01 Changes in Registrant's Certifying Accountant 　○ Item 4.02 Non-Reliance on Previously Issued Financial Statements or a Related Audit Report or Completed Interim Review

	• *Section 5 -- Corporate Governance and Management*
	    ○ Item 5.01 Changes in Control of Registrant
	    ○ Item 5.02 Departure of Directors or Certain Officers; Election of Directors; Appointment of Certain Officers
	    ○ Item 5.03 Amendments to Articles of Incorporation or Bylaws; Change in Fiscal Year
	    ○ Item 5.04 Temporary Suspension of Trading Under Registrant's Employee Benefit Plans
	    ○ Item 5.05 Amendment to Registrant's Code of Ethics, or Waiver of a Provision of the Code of Ethics
	    ○ Item 5.06 Change in Shell Company Status
	
	• *Section 6 -- Asset-Backed Securities*
	    ○ Item 6.01 ABS Informational and Computational Materials
	    ○ Item 6.02 Change of Servicer or Trustee
	    ○ Item 6.03 Change in Credit Enhancement or Other External Support
	    ○ Item 6.04 Failure to Make a Required Distribution
	    ○ Item 6.05 Securities Act Updating Disclosure
	
	• *Section 7 -- Regulation FD*
	    ○ Item 7.01 Regulation FD Disclosure
	
	• *Section 8 -- Other Events*
	    ○ Item 8.01 Other Events (The registrant can use this Item to report events that are not specifically called for by Form 8-K, that the registrant considers to be of importance to security holders.)
	
	• *Section 9 -- Financial Statements and Exhibits*
	    ○ Item 9.01 Financial Statements and Exhibits
	
	Form 8-Ks relating to events described in Sections 1-6 or Section 9 must be filed within four days of the event.

- Section 16	Because a REIT is registered under Section 12 of the 1934 Act, each officer, director and beneficial owner of more than 10% of any class of the REIT's securities (a "**Covered Person**") is subject to the filing requirements and substantive restrictions on short-swing trading profits of Section 16.
- Forms 3, 4 and 5 (Section 16(a))	Forms 3, 4 and 5 are filed pursuant to Section 16(a) of the 1934 Act and set forth a Covered Persons ownership of REIT securities (or, as described below, derivatives for which REIT securities serve as the underlier). The forms are publicly available, and an issuer is required to disclose in its Form 10-K and annual proxy statement the names of any Covered Persons who fail to timely submit Forms 3, 4 or 5.

	<u>Form 3</u> A Covered Person must file a Form 3 at the time the REIT's registration statement under the 1934 Act becomes effective or within 10 days of the date the Covered Person becomes a Covered Person. In connection with equity securities of a REIT, the Form 3 requires a Covered Person to provide: the title of the equity securities the Covered Person owns, the amount of such securities, whether the Covered Person's ownership of the equity security is direct or indirect and, if indirect, the form of the indirect ownership. In connection with derivatives for which REIT securities are the underlying security, a Covered Person must provide, as applicable, the exercise date and expiration date of the derivative, the title and amount of the underlying REIT security, the conversion or exercise price of the REIT security, whether the Covered Person's ownership of the derivative security is direct or indirect and, if indirect, the form of the indirect ownership. <u>Form 4</u> A Covered Person must file a Form 4, updating its ownership information, before the end of the second business day following any transaction which causes its previously reported ownership to change. <u>Form 5</u> A Covered Person must file Form 5, setting out its ownership interest in the REIT's equity securities or in derivatives based on such securities, on an annual basis, no later than 45 days after the end of the REIT's fiscal year.
- Short swing profit restrictions (Section 16(b))	Under Section 16(b) of the 1934 Act, any profits resulting from a Covered Person's combination of purchases and sales or sales and purchases of the REIT's stock (or derivatives, as described above) must be turned over to the REIT. The method of calculating when profit or loss has occurred, as well as the amount of profit and loss, is complex. This rule is a prophylactic measure intended to prevent the misuse of inside information.
- Prohibition on Covered Person short sales (Section 16(c))	Section 16(c) of the 1934 Act prohibits Covered Persons from shorting REIT securities, even if the Covered Person owns the REIT securities and is shorting "against the box."
- Section 10(b) anti-fraud provision (and the rules thereunder)	A REIT is subject to the anti-fraud provisions of Section 10(b) and the rules thereunder.
- Proxy Rules (Section 14 and the rules thereunder)	As a company registered under the 1934 Act, a REIT is subject to the rules governing the solicitation of proxies and the requirements applicable to proxy solicitation materials.
- Proxy Solicitation Materials	A company subject to the proxy rules cannot solicit a proxy from investors unless it includes a proxy statement containing the information in Schedule 14A. Among other things, Schedule 14A requires a proxy statement to include the following information, where applicable:

	• *Revocation*. Whether or not the person giving the proxy has the power to revoke it (Item 2) • *Dissenter's rights*. The rights of appraisal or similar rights of dissenters with respect to any matter to be acted upon and indicate any statutory procedure required to be followed by dissenting security holders in order to perfect such rights (Item 3) • *Source and interest*. Information about the persons making the solicitation and their interest in the proposed vote, action or transaction for which the proxy is sought (Items 4 and 5) • *Information about directors*. If the proxy relates to the election of directors, certain information about the proposed directors and their proposed compensation (Item 7) • *Information about accountant*. If the proxy relates to the selection, approval or ratification of the company's independent public account, information describing the registrant's relationship with its independent public accountant (Item 9) • *Compensation plans*. If the proxy relates to actions to be taken with respect to any plan pursuant to which cash or noncash compensation may be paid or distributed, information about the features of the plan, the eligible officers and employees, the basis of participation and whether and how the plan can be amended without shareholder approval (Item 10) • *Exchange or Modification*. If the proxy relates to the modification or exchange of a company's securities, information about the proposed modification or exchange as well as financial statements and financial information (Items 11-13) • *Merger or Acquisition*. If the proxy relates to a proposed merger or acquisition, significant information equivalent to what would be required on a registration statement under Form S-4, among other things (Item 14) • *Acquisition or Disposition of Property*. If the proxy relates to a significant acquisition or disposition of property, a description of the general character and location of the property, the nature and amount of consideration to be paid or received by the company or any subsidiary, an outline of the facts bearing upon the question of the fairness of the consideration, the name and address of the transferor or transferee and the nature of any material relationship of such person to the company or any affiliate of the company, and an outline of the material features of the contract or transaction (Item 15) • *Restatement*. If the proxy relates to the restatement of any asset, capital, or surplus account of the registrant, information regarding the nature of the restatement and the date as of which it is to be effective,

	the reasons for the restatement and for the selection of the particular effective date, the name and amount of each account (including any reserve accounts) affected by the restatement and the effect of the restatement, and to the extent practicable, a statement of whether and the extent, if any, to which, the restatement will alter the amount available for distribution to the holders of securities (Item 16) • *Amendments*. If the proxy relates to an amendment of the company's charter, bylaws or other documents as to which information is not required above, information regarding the reasons for and the general effect of the amendments (Item 19) • *Voting procedures*. Information about the vote required to approve the proposed action and the method of counting votes (Item 21)
- Pre-filing of Proxy Materials	Any proxy solicitation materials must be filed with the SEC at least 10 calendar days prior to dissemination of the materials, unless the solicitation relates solely to certain routine matters such as election of directors or approval or certification of accountants.
- Filing of Proxy Materials	A definitive proxy statement, form of proxy and all other soliciting materials, in the same form as the materials sent to security holders, must be filed with the SEC no later than the date they are first sent or given to security holders.
- Anti-fraud Provisions of Proxy Rules (Section 14(e) and Rule 14a-9)	REITs are subject to the anti-fraud provisions of Section 14(e) and Rule 14a-9 in conducting a proxy solicitation.
- Section 13(d) and (g)	Investors in public REITs are subject to the reporting obligations of Sections 13(d) and (g) under the 1934 Act if such an investor acquires sufficient ownership to trigger the reporting obligations. Of course, like all market participants, a REIT is also subject to Section 13(d) and (g) reporting requirements if the REIT acquires a sufficient interest in a public company, such as another REIT, though certain asset limitations under the Code applicable to REITs limits a REIT's ability to make such investments (See the 25% Asset Test and related requirements, below).
- Tender Offer Rules	As public companies, REIT investors are given the protections of the rules governing both third party and issuer tender offers.
- Regulation FD	Public REITs are subject to the selective disclosure regime of Regulation FD. Thus, whenever a REIT, or any person acting on its behalf, discloses any material nonpublic information regarding the REIT or its securities to any Reg FD Covered Person (as defined below), the REIT must make public disclosure of that information: • Simultaneously, in the case of an intentional disclosure (meaning the person making the disclosure either knows, or is reckless in not knowing, that the information he or she is communicating is both material and

	nonpublic); and • Promptly, in the case of a non-intentional disclosure. "**Reg FD Covered Person**" means, generally, • a broker or dealer, or a person associated with a broker or dealer as defined in the 1934 Act • an investment adviser, an institutional investment manager required to file a Form 13F with the SEC for the most recent quarter ended prior to the date of the disclosure, or a person associated with either of the foregoing • an investment company or entity that would be an investment company but for Section 3(c)(1) or Section 3(c)(7) of the 1940 Act, or an affiliated person of either of the foregoing • a holder of the REIT's securities, under circumstances in which it is reasonably foreseeable that the person will purchase or sell the REIT's securities on the basis of the information.
INTERNAL REVENUE CODE	**An entity that meets the requirements for taxation as a REIT is entitled to a deduction for dividends paid to its shareholders. As a result, a REIT generally distributes annually to shareholders an amount equal to 100% of its taxable income.**
- General requirements	For an entity to be treated as a REIT under the Code: • it must be managed by one or more trustees or directors • the beneficial ownership of the entity must be evidenced by transferable shares or transferable certificates of beneficial interest • it must otherwise be taxable as a corporation (but for its election to be taxed as a REIT) • it cannot be a financial institution referred to in Section 582(c)(5) of the Code (such as a bank, mutual savings bank, building and loan association or other savings institution) or an insurance company • the beneficial ownership of the entity must be held by 100 or more persons for all years after the first taxable year for which a REIT election is made • it must not be "closely held" for all years after the first taxable year for which a REIT election is

	made • it must meet two annual gross income tests and two quarterly asset tests, and • it must satisfy a dividend distribution requirement. The "closely held" requirement, the asset and income tests and the dividend distribution requirements are discussed below.
- Closely Held Requirement (Section 856(h)(1)(B) of the Code)	Generally, five or fewer individuals cannot own more than 50% of a REIT's shares during the last half of the REIT's taxable year. For purposes of this requirement, attribution rules generally apply under which shares held by a corporation, trust, or partnership are deemed to be owned proportionately by the shareholders, beneficiaries, or partners, as applicable.
- Two income tests (Sections 856(c)(2) and (3) of the Code)	The two annual gross income tests are a 75% test (the "**75% Income Test**") and a 95% test (the "**95% Income Test**"). <u>The 75% Income Test</u> At least 75% of a REIT's gross income during a year (excluding income from "prohibited transactions" as defined below and income from qualified REIT hedging transactions) must come from real estate related sources, such as, among other things: • rents from real property • interests on obligations secured by mortgages on real property or on interests in real property, including interest on certain types of mortgage-backed securities • gains from sale or disposition of real property, including interests in real property or interests in mortgages on real property, other than in a prohibited transaction • dividends or distributions from shares of other REITs • abatements and refunds of taxes on real property • amounts received or accrued for entering into agreements to make loans secured b mortgages or to purchase or lease real property (such as commitment fees) "**Prohibited transaction**" means the sale of property held by the REIT primarily for sale to customers in the

	ordinary course of business. A 100% income tax is applied to net income from prohibited transactions. <u>The 95% Income Test</u> At least 95% of a REIT's gross income during a year must be derived from items that qualify under the 75% Income Test or from dividends or interest from any source, which need not be related to real estate activities.
- Two Asset Tests (Section 856(c)(4) of the Code)	The two quarterly asset tests are a 75% test (the "**75% Asset Test**") and a 25% test (the "**25% Asset Test**"). . <u>The 75% Asset Test</u> On the last day of each calendar quarter of a REIT's taxable year, at least 75% of its assets must constitute "real estate assets," cash and cash items (including receivables arising in the ordinary course of the REIT's business) and government securities. "**Real estate assets**" generally means real property, including interests in real property and interests in mortgages on real property, interests in other REITs and REMICs and property (which need not be a real estate asset) attributable to the temporary investment of new capital. <u>25% Asset Test</u> On the last day of each calendar quarter of a REIT's taxable year no more than 25% of the value of the REIT's total assets can be represented by securities other than government securities and securities, such as certain types of mortgage-backed securities, which are treated as real estate assets. Shares of stock in wholly owned "qualified REIT subsidiaries" are not treated as securities; a qualified REIT subsidiary is ignored as an entity separate from the parent REIT. Also, (i) no more than 25% of the value of a REIT's total assets can constitute securities issued by one or more taxable REIT subsidiaries; and, except in the case of a taxable REIT subsidiary or a qualified REIT subsidiary, (ii)(A) the securities of a single issuer cannot represent more than 5% of the value of a REIT's total assets, (B) a REIT cannot own more than 10% of the outstanding voting securities of any one issuer , and (C)other than in the case of certain straight debt securities, a REIT cannot own more than 10% of the total value of the outstanding securities of any one issuer..
- Dividend Distribution Requirements (Section 857(a)(1))	To maintain its status as a REIT under the Code, a REIT's deduction for dividends paid must equal at least (1) the sum of (a) 90% of the real estate investment trust's taxable income for the taxable year (determined without deducting for dividends paid and excluding any net capital gain) and (b) 90% of the excess of the net income from foreclosed property over the tax imposed on that income, minus (2) any "excess noncash income" (as defined in the Code). A failure to meet the distribution requirement for a taxable year will cause the REIT to be taxed as a C corporation for that year.
MARYLAND CORPORATE LAW	**Many REITs are organized as Maryland corporations. Maryland was one of the first states to adopt a statute specifically addressing REITs. State requirements impose fiduciary and other duties upon directors**

	and officers of REITs.
- Adherence to Charter and Bylaws	Maryland's corporations law gives its corporations significantly flexibility to organize its internal affairs and adopt guidelines and limitations on virtually any subject, including the corporation's permitted businesses, conditions for issuing securities, voting rights and procedures (e.g., quorum requirements, provisions requiring a vote, etc.), elections and powers of directors and officers, indemnification and limitation of liability of officers and directors (absent required indemnification) as well as conditions thereon. A Maryland corporation must adhere to the provisions of its charter and by-laws, which are filed with the State and are publicly available, along with amendments thereto. These organizational documents are also made publicly available as part of a REIT's 1934 Act filings.
- Standard of Care	As a fiduciary, officers and directors of a corporation are subject to a standard of care in carrying out corporate affairs. An officer or director must perform his or her duties in good faith, in the manner the director reasonably believes to be in the corporations best interests, and with the care that an "ordinarily prudent person in a like position would use under similar circumstances."[5] In applying the "prudent person" standard, courts use a "gross negligence" standard.[6] A director's fiduciary duty and standard of care change and become more complex in the context of a proposed merger or business combination.
- Directors' Limits on Reliance on Others	Directors are entitled to rely on material prepared by opinions, reports or statements prepared by officers or employees of the corporation who the director "reasonably believes to be reliable and competent in the matters presented" or a committee of the board who the director believes "merit[s] confidence."[7] Reliance by a director is not considered in good faith, however, if he or she has knowledge that would cause reliance to be unwarranted.[8]
- Corporate Opportunity	A Maryland corporation's directors, officers and majority stockholders cannot divert for their own purposes opportunities that rightly belong to the corporation. The corporate opportunity doctrine stems from directors', officers' and, to some extent, majority stockholders' duties to the corporation, and is the subject of a great deal of

5 *See* Maryland Code Ann., Corporations & Associations § 4-405.1(a).

6 *See, e.g., NAACP v. Golding*, 679 A.2d 554 (Md. 1996); *Parish v. Md. & Va. Milk Producers Association*, 242 A.2d 512 (Md. 1968).

7 *See* Maryland Code Ann., Corporations & Associations § 4-405.1(b)(1)(i) and (ii).

8 *See* Maryland Code Ann., Corporations & Associations § 4-405.1(b)(2).

	judicial interpretation and gloss.
- Interested Director Transactions	A contract between the corporation and a director or the corporation and any entity in which a director has a financial interest or for which the director serves also serves as a director must be approved (i) by the disinterested directors or a committee of such directors or (ii) by stockholders. In any event, the contract must be "fair and reasonable to the corporation."[9]
- Shareholders' Right to Bring a Derivative Suit	Subject to certain case law imposed procedural requirements and making certain showings, a shareholder may bring an action against officers, directors or third parties on behalf of the corporation.
- Limits on Exculpation and Indemnification	Maryland law imposes limits on a corporation's statutory obligation and ability to indemnify directors, officers and employees under certain circumstances[10] and circumscribes the extent to which the liability of such persons can be limited.
MARKET-DRIVEN CONSTRAINTS AND PRACTICES	**Although not mandated by law or regulation, market practices, including pressures stemming from competition, shareholders and directors, create certain industry standard practices for REITs.**
- Custody	Most REITs maintain their assets with large, established financial institutions in order to minimize counterparty risk.
- Affiliated transactions	In addition to state and federal provisions imposing substantive and disclosure obligations in the context of affiliated transactions, investors, directors and competitive pressure impose limits on accepted transactions between a REIT and its affiliates, limiting self-dealing in the REIT industry.
VALUATION AND ACCOUNTING STANDARDS	**REITs registered under the 1934 Act are required to prepare and disseminated audited financial statements prepared in accordance with generally accepted accounting principles ("GAAP"), as described above. Even REITs which are not registered under the 1934 Act generally prepare and provide to investors audited financial statements prepared in accordance with GAAP. In preparing GAAP compliant financial statements, REITs must comply with the many sources of GAAP, including standards issued by the Financial Accounting Standards Board ("FASB") and, in the case of companies registered under the 1934 Act, SEC guidance and regulations governing the preparation of financial statements and accounting.** **A few of these SEC and FASB standards are described below. A more complete list, though not exhaustive, is attached as <u>Exhibit 2</u>.**

[9] *See* Maryland Code Ann., Corporations & Associations § 4-419(a).

[10] See Maryland Code Ann., Corporations & Associations § 4-418.

- Financial Accounting Standard 157 ("**FAS 157**") – "Determination of Fair Value"	In preparing financial statements in accordance with GAAP, REITs, like all companies seeking a GAAP-compliant audit, must ascertain a "fair value" for various assets and instruments. FAS 157 applies to other Financial Accounting Standards that require a fair value measurement, subject to certain limitations. FAS 157 defines fair value, establishes a framework for measuring fair value in GAAP and requires disclosures about fair value measurements. Generally, FAS 157 defines "fair value" as "the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date." FAS 157 describes the meaning of the terms used in this general definition and the assumptions and determinations that must be made in applying the definition.
- Financial Accounting Standards 166 ("**FAS 166**") – "Accounting for Transfers of Financial Assets"	Securitization is an important part of the real estate industry; because REITs are significant participants in the real estate industry, the accounting pronouncements governing securitization are important to the operation and activities of REITs. FAS 166 was adopted by FASB in June 2009, and amended previous guidance provided in FAS 140. FAS 166 significantly affects the way in which originators account for transfers in securitizations by imposes requirements on when the transfer of an interest in a special purpose vehicle can truly be treated as a sale, and, therefore, affects the accounting for securitized mortgage loans generally. FAS 166 eliminated (1) the exceptions for qualifying special-purpose entities from the consolidation guidance of FASB Interpretation No. 46, as amended ("**FIN 46(R)**"), which many banks used frequently in securitizations, and (2) the provisions of FAS 140 that permitted sale accounting for certain mortgage securitizations when a transferor has not surrendered control over the transferred financial assets.
- Financial Accounting Standards 167 ("**FAS 167**") – "Accounting for Transfers of Financial Assets"	FAS 167, which amends FIN 46(R), also has a significant effect on accounting in the context of securitizations. FAS 167 changes how an enterprise determines when an entity that is insufficiently capitalized or is not controlled through voting, or similar rights, should be consolidated. FAS 167 requires an enterprise to assess on an ongoing basis whether its interest in another entity makes that entity a "variable interest entity," such that the enterprise must include in its financial statements the assets, liabilities and activities of the entity. FAS 167 amends FIN 46(R) in a number of important ways with significant affects on originators of securitizations, special purpose vehicles and holders of interests in special purpose vehicles used for securitization.

EXHIBIT 1

STATUTES ADDRESSING OR RELATING TO REITS

Statute	Description
Investment Company Act of 1940 (the "1940 Act")	Section 3(c)(5)(C) of the 1940 Act provided the exemption from investment company statutes that REITs rely upon in operating without registration under the 1940 Act.
Real Estate Investment Trust Act of 1960 (the "1960 Act")	The 1960 Act created the REIT structure.
A bill to amend the Tariff Schedules of the United States to permit the importation of upholstery regulators, upholsterer's regulating needles, and upholsterer's pins free of duty (the "1974 Provisions")	The 1974 Provisions amended the REIT qualification rules such that (1) a REIT's receipt of income from foreclosure property and (2) the acquisition of real property upon foreclosure would not result in loss of REIT status. Instead of disqualification, the 1974 Provisions require a REIT acquiring real property upon foreclosure to pay corporate income tax on income received from foreclosure property and permit the REIT to elect a two-year grace period to liquidate the foreclosure property without being disqualified for holding property for sale to customers in the ordinary course of business.
The Tax Reform Act of 1976 (the "1976 Act")	The 1976 Act revised the 1960 Act to (1) provide a REIT the ability to make a "deficiency dividend" distribution to avoid disqualification for not distributing 90% of its annual income in instances where the REIT acted in good faith to satisfy the distribution requirements but failed to do so because of an audit adjustment, (2) impose an excise tax on a REIT for failure to distribute at least 75% of its real estate investment trust taxable income by the close of its taxable year, (3) replace the prohibition against a REIT holding property (other than foreclosure property) for sale to customers in the ordinary course of business with a tax of 100% on the net income from the sale or disposition of such property (the "prohibited transactions" tax), and (4) impose a 100% tax on net income attributable to the amount by which a REIT fails to meet the income source tests in lieu of disqualification.
The Revenue Act of 1978 (the "1978 Act")	The 1978 Act created a safe-harbor such that the prohibited transactions tax on property held primarily for sale by a REIT would not apply to the sale of property where the following conditions are satisfied: (1) the property has been held by the REIT for at least four years, (2) the total expenditures made by the REIT during the four-year period prior to sale do not exceed 20 percent of the net selling price of the property, (3) the REIT does not sell more than five properties during the taxable year, and (4) if the property is land or improvements not acquired through foreclosure, the property is held by the REIT for rent for a period of at least four years.
Secondary Mortgage Market Enhancement Act of 1984 ("SMMEA")	SMMEA sought to reduce regulatory barriers preventing private companies from issuing mortgage backed securities. SMMEA added a definition of "mortgage related securities" to the Securities and Exchange Act of 1934 and granted such securities special treatment under several provisions of the federal and state securities laws. In adopting SMMEA, Congress noted the SEC's exemptive authority under Section 6(c) of the

	1940 Act and stated that it expected the SEC to use that power to encourage a vigorous private secondary mortgage market.
Tax Reform Act of 1986 (the "1986 Act")	The 1986 Act curtailed use of REITs as tax shelters but removed certain restrictions on direct management and operation of properties by REITs as originally set forth in the 1960 Act. The 1986 Act revised the REIT asset requirement rules to permit REITs to hold assets in a wholly owned subsidiary ("qualified REIT subsidiary" or "QRS") such that a REIT and its QRS are treated as a single taxpayer (i.e., the separate corporate status of the QRS is ignored). The 1986 Act also, among other things, modified the prohibited transactions rules to increase the number of properties that could be sold within the safe harbor from four to seven and increase the amount of expenditures that a REIT may make within the four-year period prior to sale from 20 percent to 30 percent of the net selling price of the property.
Technical and Miscellaneous Revenue Act of 1988 (the "1988 Act")	The 1988 Act provided rules governing the treatment of interest rate swap or cap agreements (i.e., agreements which protect the REIT from interest rate fluctuations on variable debt incurred to acquire or carry real property) held by REITs. Such agreements are treated as securities for purposes of the three-percent test and payments under them qualify for the 95-percent income test. The 1988 Act also, among other things, provided that dividends declared in October, November, or December and made payable to shareholders of record in such a month are deemed to have been paid by the REIT and received by its shareholders on December 31 of such year, so long as the dividends are actually paid during January of the following year.
Revenue Reconciliation Act of 1993 (the "1993 Act")	The 1993 Act modified how beneficial owners of a REIT's shares are counted in determining whether a REIT meets the requirement that no more than 50% of a REIT's shares may be held by five or fewer beneficial owners. The 1993 Act permitted certain beneficiaries of pension plan participants to be counted as investors, rather than the pension plan itself, making REITs better able to take large institutional investments without the risk of violating the "five or fewer" rule.
REIT Simplification Act, passed as part of the Taxpayer Relief Act of 1997 (the "1997 Provisions")	The 1997 Provisions, among other things, (1) create a de minimis exception to prior law so that a REIT's rental income is not disqualified if it performs nominal, although impermissible, services for a tenant, (2) mirror corresponding mutual fund rules governing taxation of retained capital gains by passing through a credit to shareholders for capital gains taxes paid at the REIT level, (3) repeal the 30% gross income test (in conformity with the repeal of the analogous "short-short" test for mutual funds), (4) simplify property foreclosure rules, (5) update the current REIT hedging rule to include income from all hedges of REIT liabilities, (6) create a safe harbor to the shared appreciation mortgage rules that does not penalize a REIT lender for the borrower's bankruptcy, and (7) codify an IRS ruling position by allowing QRS status for a wholly-owned subsidiary even if the subsidiary previously had been owned by a non-REIT.
REIT Modernization Act (signed into law as part of the Ticket to Work and Work Incentives Improvement Act of 1999 (the "1999 Act"))	The 1999 Act, among other things, (1) allowed REITs to own up to 100% of the securities of a taxable REIT subsidiary (a "TRS"), subject to limitations, including limitations on the value of TRS compared to a REIT's total assets, (2) lowered the distribution requirement of REITs from 95% to 90%, which had been the requirement applicable between 1960 and 1980, (3) permitted REITs to hire a manager to operate nursing

	homes and other healthcare facilities without a lease for a certain period of time until it can secure a new lease, and (4) made certain technical changes to how a company calculates pre-REIT earnings that it must distribute to investors after electing REIT status or merging with a C Corporation.
Jobs and Growth Tax Relief Reconciliation Act of 2003 (the "2003 Act")	The 2003 Act lowered the tax rates applicable to certain corporate dividends, although REIT distributions generally do not qualify for the reduced rate under the 2003 Act.
REIT Improvement Act (signed into law as part of the American Jobs Creation Act of 2004 (the "2004 Act"))	The 2004 Act, among other things, (1) adopted retroactive changes to the Internal Revenue Code of 1986, as amended (the "Code"), to better allow REITs to make certain loans in the ordinary course of business without risking the loss of a company's REIT status, (2) clarified certain rules intended to prevent a REIT from inappropriately shifting income out of its TRS to the REIT, (3) modifies certain safe harbors under which a REIT may shift income or deductions between the REIT and its TRS, (4) modified the rules governing treatment of REIT hedging income in computing the 95% gross income test, (5) in certain cases imposes monetary penalties for failure to qualify as a REIT for a given period rather than loss of REIT status (amending the "death trap" provisions applicable to REIT status), (6) modifies the treatment of foreign investors in a REIT, and (7) provides for certain deductions and contains other provisions not specifically addressed at REITs, but which affect REITs.
Tax Increase Prevention and Reconciliation Act of 2005 (the "2005 Act")	The 2005 Act modified the treatment of distributions made by REITs and RICs (as defined in the tax code) attributable to foreign investment in real property (or FIRPTA) rules.
Housing and Economic Recovery Act of 2008 (which contained all but one of the titles of the proposed REIT Investment Diversification and Empowerment Act of 2007) (the "2008 Act")	The 2008 Act's REIT-related provisions include: (1) reducing the holding period under the prohibited transaction safe harbor test from four years to two years, (2) changing the measurement of the 10% of sales permitted under the safe harbor test from current tax basis to either tax basis or fair market value (at the REIT's annual option), (3) increasing the size ceiling for TRS from 20 percent to 25 percent of assets, (4) permitting health care REITs to use TRS in the same manner as hotel REITs, (5) excluding most real estate-related foreign currency gains from the computation of the REIT income tests; and, (6) providing the Treasury Department with clear authority to rule on whether a variety of items qualify under the REIT gross income tests.

EXHIBIT 2

GUIDANCE AFFECTING PREPARATION AND PRESENTATION OF REIT FINANCIAL STATEMENTS

REITs, as public companies, are required to include audited financial statements, prepared in accordance with generally accepted accounting principles ("**GAAP**"), in various annual and periodic disclosures. In preparing and presenting such GAAP-compliant disclosures, REITs are subject to a significant amount of guidance that must be taken into account. This chart lists certain sources of guidance governing REITs' preparation and presentation of financial statements and financial information.

Guidance	Description
STANDARDS OF THE FINANCIAL ACCOUNTING STANDARDS BOARD ("FASB")	FASB Standards are a core component of GAAP and serve a key basis for the presentation and preparation of all GAAP-complaint financial statements and materials. A large number FASB Standards and Interpretations apply to the presentation of REITs' financial statements; some of those FASB Standards are listed below.
- FAS 13	Governs accounting for leases (amended by FAS Nos. 22, 23, 27, 28, 29, 91 and 98)
- FAS 22	Modifies FAS 13 in accounting for provisions of lease agreements resulting from refundings of tax-exempt debt
- FAS 23	Modifies FAS 13; deals with inception of leases
- FAS 27	Modifies FAS 13; relates to classification of renewals or extensions of existing sales-type or direct financing leases
- FAS 28	Modifies FAS 13; relates to accounting for sales with leasebacks
- FAS 29	Modifies FAS 13; deals with contingent rental payments
- FAS 47	Governs accounting for long-term obligations
- FAS 65	Governs accounting for certain mortgage banking activities that may apply to REITs (amended by FAS Nos. 91, and 134)
- FAS 66	Governs accounting for sales of real estate (amended in part by FAS 98 and 152)
- FAS 67	Governs accounting for costs and initial rental operations of real estate projects
- FAS 91	Governs accounting for nonrefundable fees and costs associated with originating or acquiring loans and initial direct costs of leases (amended by FAS No. 98)
- FAS 95	Governs presentation of statement of cash flows (amended by FAS Nos. 102 and 104)
- FAS 98	Modifies certain previous guidance relating to accounting for sale-leaseback transactions involving real estate, sales-type leases of real

	estate, the definition of the lease term, and initial direct costs of direct financing leases
- FAS 102	Amends previous guidance on statement of cash flows by providing certain exemptions and governing classification of cash flows from certain securities acquired for resale
- FAS 104	Amends previous guidance on statement of cash flows by providing for net reporting of certain cash receipts and cash payments and governing classification of cash Flows from hedging transactions
- FAS 134	Governs accounting for mortgage-backed securities retained after the securitization of mortgage loans held for sale by a mortgage banking enterprise
- FAS 140	Governs accounting for transfers and servicing of financial assets (including mortgage servicing) and extinguishments of liabilities
- FAS 152	Governs accounting for real estate time-sharing transactions (amending certain previous guidance)
- FAS 157	Governs fair value measurements
- FAS 166	Governs manner of accounting for certain transfers of financial assets (e.g., when a sale a true sale)
- FAS 167	Amends certain previous guidance on when entities must be consolidated with those of another entity (affects securitizations)
- FAS 168	Provides a hierarchy of FASB guidance
FASB INTERPRETATIONS	FASB publishes interpretive guidance that affects GAAP compliance by modifying or interpreting FASB Standards. Certain of those interpretations are described briefly below.
REGULATION S-X	Regulation S-X sets forth the form and content of and requirements for financial statements required to be filed as a part of registration statements under the Securities Act of 1933, as amended (the "1933 Act"), registration statements under section 12 of the Securities and Exchange Act of 1934, as amended (the "Exchange Act"), annual or other reports under Sections 13 and 15(d) and proxy and information statements under Section 14 of the Exchange Act. Because REITs generally register the offer and sale of shares under the 1933 Act and are registered under the Exchange Act, REITs are subject to Regulation S-X.
STAFF ACCOUNTING BULLETINS	Staff Accounting Bulletins ("SABs") reflect the Securities and Exchange Commission ("SEC") staff's views regarding accounting-related disclosure practices. They represent interpretations and policies followed by the Division of Corporation Finance and the Office of the Chief Accountant in administering the disclosure requirements of the federal securities laws. In preparing disclosure materials and financial statements under the 1933 Act and 1934 Act, REITs must take into account SABs.
STAFF COMPLIANCE& DISCLOSURE INTERPRETATIONS ("C&DIS")	Certain SEC staff C&DIs affect the preparation and presentation of financial statements, particularly those issued by the Division of

	Corporation Finance, including, without limitation, the C&DI regarding Non-GAAP Financial Measures and those regarding disclosures on specific forms and schedules under the 1933 Act and 1934 Act.
NAREIT BEST PRACTICES	NAREIT, the primary trade association for REITs, publishes certain best practices regarding the calculation and presentation of supplemental financial disclosures, mainly dealing with funds from operations (often abbreviated as "FFO").
INDUSTRY AND ANALYST REQUIREMENTS	The demands of the market and REIT analysts often require REITs to provide additional, supplemental financial information and calculations, in addition to that required in GAAP financial statements or forms and disclosures REITs are required to file or make, respectively, under the federal securities laws.

EXHIBIT B

Text of Proposed Rule or Interpretive Position For the Exclusion in Section 3(c)(5)(C) of the Investment Company Act

1. ***An issuer is excluded from the definition of investment company pursuant to Section 3(c)(5)(C) of the Investment Company Act if the issuer is not engaged in the business of issuing redeemable securities, face-amount certificates of the installment type, or periodic payment plan certificates and, immediately after acquiring any security or other investment, at least 55% of the value of the issuer's total assets (excluding cash items other than Qualifying Cash) consists of Qualifying Assets and at least 80% of the value of the issuer's total assets (excluding cash items other than Qualifying Cash) consists of Qualifying Assets and Real Estate-Related Assets.***

2. ***An investment is a Qualifying Asset for purposes of Section 3(c)(5)(C) if, under the terms and conditions of the instrument governing this investment, the investor acquires:***

(a) a beneficial ownership interest in real property (including ownership by fee simple or leasehold);

(b) a beneficial ownership interest in a company that is not an investment company as defined in Section 3(a)(1) of the Investment Company Act because it is primarily engaged in the business of owning, holding or investing in Qualifying Assets of the type described in paragraph 2(a) above or which is excluded from the definition of investment company pursuant to Section 3(c)(5)(C) of this Act, provided that (i) the investor's beneficial ownership interest in the company is a general partner interest, a joint venture interest or another interest that is not deemed to be a "security" as defined in Section 2(a)(36) of the Investment Company Act, and (ii) in determining the value of the investor's beneficial ownership interest in this company that shall be deemed to be a Qualifying Asset, the investor shall apportion the value of its beneficial ownership interest among Qualifying Assets, Real Estate-Related Assets and other assets, as applicable, based on the company's percentage ownership interest in these assets;

(c) a controlling beneficial ownership interest in a company that itself qualifies for the exclusion from the definition of investment company in Section 3(c)(5)(C) of the Investment Company Act, provided that in determining the value of such a Qualifying Asset, the investor shall apportion the value of its beneficial ownership interest among Qualifying Assets, Real Estate-Related Assets and other assets, as applicable, based on the company's percentage ownership interest in these assets;

(d) a controlling beneficial ownership interest in a pool substantially all of whose assets consists of Qualifying Assets as defined in paragraph 2(e) or agency mortgage-backed securities;

(e) a beneficial ownership interest in a loan to the extent such loan is secured by real property, or by all of the beneficial ownership interests in an entity substantially all of whose total assets consists of a direct or indirect beneficial ownership interest in real property, and which gives the investor the right, whether conditional or unconditional, to foreclose or direct foreclosure on the underlying collateral or otherwise to acquire beneficial ownership of this collateral, including in case of loan default;

(f) a controlling beneficial ownership interest in a class of securities issued with respect to a pool of assets that itself qualifies for the exclusion from the definition of investment company in Section 3(c)(5)(C) of the Investment Company Act, which class entitles its security holders to receive payments that depend primarily on the cash flows

from these assets, and which gives the investor with respect to a particular asset in the pool the right, whether conditional or unconditional, to direct foreclosure on the underlying real property that secures the asset or otherwise to acquire beneficial ownership of the property in the event of a loan default, provided that in determining the value of the investor's controlling beneficial ownership interest in this class of securities that shall be deemed to be a Qualifying Asset, the investor shall apportion the value of its controlling beneficial ownership interest among Qualifying Assets, Real Estate-Related Assets and other assets, as applicable, held in the pool based on the pool's percentage ownership interest in these assets; or

(g) Qualifying Cash.

3. *For purposes of the foregoing:*

(a) An investor has a beneficial ownership interest in a company, a pool of assets, or class of securities if the investor, directly or indirectly through any contract, arrangement, understanding, relationship or otherwise has or shares (i) voting power, which includes the power to vote, or direct the voting of, such interest, and/or (ii) investment power, which includes the power to dispose, or to direct the disposition of, such interest.

(b) An investor has a controlling beneficial ownership in a company, a pool of assets, or class of securities referred to in paragraph 2(f) if the investor owns at least 50% of the outstanding voting securities issued by or with respect to this company, pool or class or is able by contract, arrangement, understanding, relationship or otherwise to exert a controlling influence over the material decisions relating to ownership of these assets including, in the case of Qualifying Assets described in paragraph 2(f) above, the right to direct foreclosure on the underlying property or other remedies in the event of loan default.

(c) An agency mortgage-backed security is a security interest issued with respect to a mortgage loan or a pool of mortgage loans that is issued or guaranteed by a U.S. Government agency or a U.S. Government sponsored enterprise such as Fannie Mae or Freddie Mac.

(d) A Real Estate-Related Asset is a beneficial ownership interest in a Qualifying Asset or in a company, pool of assets or class of securities of the type described in paragraphs 2(b), (c), (d) and (f) above, but which itself is not a Qualifying Asset.

(e) A loan is secured by real property to the extent the note is secured by a mortgage, deed of trust or deed to secure debt, or if it is a cooperative loan or a condominium loan. For this purpose, an installment sales contract related to manufactured housing is considered a loan secured by real estate.

(f) A right to direct foreclosure on underlying property or collateral is conditional if, under the terms and conditions governing a loan as described in paragraph 2(e) or the issuance of a class of securities as described in paragraph 2(f), the investor is able to exercise this right only (i) if the holder of a more subordinate interest in the loan or class of securities loses its ability to exercise this right, or (ii) with the approval of the holder of a more senior loan encumbering the underlying real property or a more senior interest in the loan or class of securities.

(g) Qualifying Cash are the net cash proceeds received on sale or the payoff or paydown of a Qualifying Asset and which are held, pending distribution or reinvestment in other Qualifying Assets, for a maximum period of one year after receipt.