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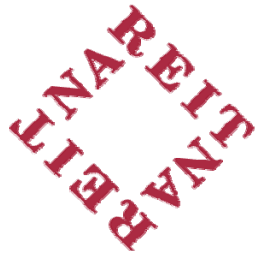
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**NATIONAL ASSOCIATION OF  
REAL ESTATE INVESTMENT TRUSTS®**

September 5, 2008

VIA E-MAIL

Ms. Florence E. Harmon  
Acting Secretary  
Securities and Exchange Commission  
100 F Street, NE  
Washington, DC 20549-1090

Re: *Securities Ratings*  
File No. S7-18-08  
Release No. 33-8940

Dear Ms. Harmon:

This letter is submitted in response to the solicitation of comments by the Securities and Exchange Commission (Commission) with respect to its proposed rulemaking (Proposal) published in *Security Ratings*, Release No. 33-8940 (File No. S7-18-08; July 1, 2008) (Proposing Release).

The National Association of Real Estate Investment Trusts® (NAREIT) is the worldwide representative voice for real estate investment trusts (REITs) and publicly traded real estate companies with an interest in U.S. real estate and capital markets. Members are REITs and other businesses throughout the world that own, operate and finance income-producing real estate, as well as those firms and individuals who advise, study and service these businesses. NAREIT welcomes the opportunity to respond to the Proposal and is submitting its comments below.

**Executive Summary**

While it is fully aware of the important reasons for the Proposal, NAREIT believes that the unintended consequences of the Proposal would create serious roadblocks to REITs' continued access to public debt capital markets. In summary, NAREIT believes that the vast majority of REITs that have a class of equity securities registered under the Securities Exchange Act of 1934 (1934 Act) would in practice be precluded from accessing public debt capital markets in an efficient manner through use by their operating partnership (OP) subsidiaries of the short-form shelf registration process under the Securities Act of 1933. This



preclusion would result from: 1) barring issuers of investment-grade debt securities from being able to use Form S-3 unless they satisfy the new proposed eligibility standard for debt-only issuers set forth in the Proposal; and 2) a variety of legal, financial and tax constraints applicable to REITs that limit severely the ability of REIT OP subsidiaries to qualify for use of Form S-3 under other existing eligibility standards or under the new proposed eligibility standard for debt-only issuers set forth in the Proposal. The limitation on REITs' access to debt capital markets could, in turn, result in a variety of other undesirable effects on financial and real estate market activities at a time when these effects are likely to be particularly harmful, given the current reduced availability of credit.

With these considerations in mind, NAREIT respectfully requests that the Commission consider and adopt several changes to the Proposal to provide continued access to Form S-3 by REITs and their OP subsidiaries. In the following sections of this letter, we: 1) describe the typical REIT/OP structure; 2) analyze the problems created by the Proposal in its current form; 3) explain why these problems arise; and 4) suggest how the Commission could modify the existing proposal to avoid foreclosing REITs' access to debt capital markets via Form S-3.

Please be assured that NAREIT does not question the Commission's policy decision to reduce undue reliance on ratings assigned to debt securities and to improve the level of analysis underlying investment decisions with respect to debt securities in general.<sup>1</sup> Neither does NAREIT question the Commission's goal of limiting Form S-3 eligibility to those issuers that have wide following in the marketplace, as evidenced by their filings under the 1934 Act being broadly followed and scrutinized by investors and other market participants. The problem NAREIT wishes to highlight for the Commission's consideration is that for OPs, as public issuers of debt securities only that will rarely meet the transaction requirement of General Instruction I.B.1. to Form S-3 (\$75 million public equity float), replacing the current transaction requirement of Form S-3 General Instruction I.B.2. (investment grade non-convertible debt securities) with a new requirement that the issuer have offered over \$1 billion of non-convertible debt securities for cash in registered offerings over the prior three years is too restrictive in light of, as well as unnecessary to accomplish, the Commission's stated policy objectives.

NAREIT also respectfully submits that, considering all operating companies that are debt-only issuers as a group (*i.e.*, excluding special purpose vehicles created primarily for the purpose of issuing structured securities and issuers of asset-backed securities), the Proposal would have a disproportionately negative impact on REITs. It appears to NAREIT that one of the key purposes of the Proposal relative to Form S-3 eligibility is to address the recent turmoil in the debt capital markets, primarily insofar as investment grade debt issued by special purpose vehicles fueled excessive growth in some sectors of the market and led to investment losses in what were considered relatively low-risk securities. NAREIT respectfully requests that the Commission take into consideration that REITs and their OP subsidiaries are stable, well-capitalized, moderately leveraged, long-term owners and operators of investment real estate, not highly

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<sup>1</sup> The Proposing Release states on page 4 that "the Commission is considering whether the inclusion of requirements related to securities ratings in its rules and forms has, in effect, placed an 'official seal of approval' on ratings that could adversely affect the quality of due diligence and investment analysis. The Commission believes that today's proposals could reduce undue reliance on ratings and result in improvements in the analysis that underlies investment decisions."



leveraged special purpose vehicles created to issue structured financial securities. Yet, if the Proposal is adopted in its present form, REITs and their OP subsidiaries would see their ability to access the debt capital markets most efficiently through take-down debt offerings from effective Form S-3 shelf registration statements severely constrained precisely at a time when they (and real estate markets) need that access the most. Moreover, the probable effect of denying most REIT OPs the ability to issue debt in registered offerings using Form S-3 would be to direct more of these offerings to the unregistered markets, contrary to the Commission's long term goal of increasing the attractiveness of registered offerings by reducing the time needed to access public markets and making short-form registration available to a greater number of issuers.

## **I. Introduction to the Legal and Financial Structure of REITs**

In order to understand the impact of the Proposal, it is helpful to describe the typical legal and financial structure of publicly traded REITs. The prevalent corporate structure of these REITs is the so-called "umbrella partnership REIT" or "UPREIT" structure, in which a REIT (organized either as a business corporation or a business trust) is the general partner of an OP. The REIT indirectly owns its properties and conducts substantially all of its business through the OP. In almost all cases, the REIT owns a majority of the equity of the OP (OP units) and, whether or not that is the case, the REIT has full control of the OP as general partner under the terms of the partnership agreement. OP units are usually exchangeable for common shares of the REIT, subject to some conditions, making common shares of the REIT and OP units effectively economic equivalents. The OP, through the REIT's general partnership interest in the OP, is managed by the Board of Directors of the REIT for the benefit both of REIT shareholders and OP minority partners. In the great majority of cases, and in all cases with which NAREIT is concerned for purposes of this letter, the REIT's common equity securities are listed on a national securities exchange. However, the OP units are not and, for reasons summarized below, cannot be exchange-listed.

In most cases, UPREITs borrow at the OP level, rather than at the REIT level. These borrowings are comprised of both publicly issued debt securities, including debt securities of the OP exchangeable for common equity of the REIT, and private and quasi-private debt financings, such as secured and unsecured bank debt and financing provided by other institutional investors to fund acquisition and development activities. Creditors, as well as rating agencies, generally require that the OP be the primary obligor on the debt, and therefore be the issuer of the debt securities. This requirement ensures that, although the OP is only partially owned by the REIT, 100% of the cash flow from the operating assets of the whole enterprise is available to satisfy the claims of the holders of the debt securities. If the REIT were to issue the debt securities itself, the portion of the cash flow from the underlying assets that is attributable to the minority equity interests in the OP not owned by the REIT would not be available to service the debt. For the same reason, incurring debt obligations at the REIT level would interfere with preserving the pro rata liability of minority partners of the OP and undermine the effective economic equivalency of REIT shares and OP units.

In addition, OP debt securities are structurally one step closer to the actual revenue-producing real estate assets to which creditors ultimately look for repayment. Being creditors at the OP level alleviates "structural subordination" concerns from a general credit underwriting point of



view. Structural subordination arises in a parent-subsidary organizational structure regardless of whether the subsidiary is wholly or partially owned. Creditors of the parent whose claims for principal and interest should, as a business matter, rank *pari passu* with claims of creditors of a subsidiary for principal and interest do not actually rank on a parity basis with those claims because the subsidiary's creditors can exercise their remedies against the subsidiary and its assets, while the parent company's creditors cannot and thus are effectively "equity" *vis-à-vis* the subsidiary's creditors. In the UPREIT context, banks and institutional real estate lenders typically require the OP to be their borrower. If debt securities were to be issued in capital markets transactions by the REIT, rather the OP, those securities would be structurally junior to bank and similar debt.

While upstream guaranties by the OP of debt securities issued by the REIT might alleviate some of these concerns, they often present difficult enforceability/equitable subordination and other legal issues. A REIT typically does not guarantee debt issued by the OP, principally in order to afford the minority OP partners who contribute properties to the OP a tax basis proportionate to their equity interests in the OP. The fact that REITs generally do not guarantee subsidiary indebtedness is an integral part of the UPREIT structure that supports the operating and growth strategies of the REIT's real estate business as a whole. This structure is unlike many other parent/subsidiary relationships, where downstream guaranties are more common. Although downstream guaranties by the REIT of debt securities issued by the OP might be thought to reduce some of the adverse effects of the Proposal on REITs, in practice these guaranties will pose a variety of practical, legal and tax issues that would make general use of them problematic. NAREIT believes that effectively requiring downstream guaranties by the REIT as a condition to use of Form S-3 by the OP, as the Proposal would effectively do, is both unnecessary in light of the corporate relationship between the REIT and the OP and detrimental to REITs' ability to take full advantage of the UPREIT structure.

## **II. REIT OPs Have Limited Eligibility for Form S-3**

Eligibility to use Form S-3 depends on an interplay of the registrant and transaction requirements in the General Instructions to Form S-3. Many REITs whose common equity securities are listed on a national securities exchange not only satisfy the registrant requirements of General Instruction I.A., but also satisfy the transaction requirements for primary offerings without limitation as to amount in General Instruction I.B.1. The largest REITs are also "well known seasoned issuers" (WKSIs) under Commission rules. However, their subsidiary OPs can only use Form S-3 pursuant to the eligibility standard for offerings of investment grade rated non-convertible debt securities that the Proposal would effectively eliminate. As discussed above, OPs in practice need to be able to issue debt securities in the public capital markets. Access to Form S-3 is therefore extremely important because it enables a REIT, through its OP, to use the shelf registration process to access the debt capital markets efficiently, both from a timing/process perspective and from a cost perspective. Preserving the eligibility of OPs to access to Form S-3 is of vital importance to REITs, which rely on frequent issuances of publicly traded debt securities to fund their operations and growth.

OPs satisfy neither the registrant requirements of General Instruction I.A. nor the transaction requirements for primary offerings of securities generally under General Instruction I.B.1. OPs



do not have a class of equity securities registered under the 1934 Act that is listed for trading on a national securities exchange and therefore cannot meet the \$75 million public float requirement, which is based on trading prices as reported by an exchange. The unlisted status of OP equity securities results in part from the adverse effects of becoming publicly traded partnerships (and therefore taxed as corporations) under the Internal Revenue Code. OPs cannot satisfy the transaction requirements for “limited primary offerings” under General Instruction I.B.6. because OP units are not listed for trading on any exchange. Further, even in the case of secondary sales, OPs cannot satisfy the transaction requirements of General Instruction I.B.3. to cover secondary sales (resales) of securities sold in unregistered private offerings because General Instruction I.B.3. requires that securities of the same class must be listed and registered on a national securities exchange. Finally, only the largest REIT OPs, which NAREIT believes to be very limited in number, could qualify as WKSIs by having issued more than \$1 billion of non-convertible debt in registered offerings over the most recent three years.

Therefore, to be able to launch and price a public offering of debt securities on short notice using Form S-3, with the speed and efficiency necessary to take advantage of favorable market conditions, REITs and their OPs have generally relied on one of two approaches, both of which are based on the issuance of non-convertible investment grade debt securities. Neither of these approaches would be possible if the Proposal were adopted in its current form.

First, many OPs have issued investment grade non-convertible debt securities under Form S-3 General Instruction I.B.2. (*Primary Offerings of Non-convertible Investment Grade Securities*). To qualify to issue non-convertible investment grade debt securities under Form S-3, these OPs have chosen to register a class of equity securities under the 1934 Act on a voluntary basis by filing a Form 10 registration statement. This permits an OP to use Form S-3 and the shelf registration process of Rule 415 to register debt securities for issuance “off the shelf” as soon as it obtains an investment grade rating. Under the Proposal, it would no longer be possible for OPs to qualify to issue investment grade non-convertible debt securities under General Instruction I.B.2.

As an alternative, other OPs have issued debt securities in registered offerings, including shelf registrations, under General Instruction I.C.2. to Form S-3 as majority-owned subsidiaries of REITs that were transaction-eligible for use of Form S-3. However, General Instruction I.C.2. incorporates the investment grade non-convertible debt requirement currently found in General Instruction I.B.2. As a result, this eligibility to use Form S-3, like the direct eligibility described in the preceding paragraph, would no longer be available if the Proposal were adopted in its current form.

OPs also issue debt securities in unregistered offerings (generally private placements structured to take advantage of the Rule 144A resale exemption). This structure allows for speed comparable to a shelf “takedown” when marketing an offering, but carries trading restrictions associated with privately issued securities. Registered public offerings of debt securities do not face the same drawbacks, and the easy public access to the documentation for registered offerings through the EDGAR system also increases the level of transparency in the market and promotes broader research and market coverage.























**ANNEX 1**

