November 7, 2011

U.S. Securities and Exchange Commission
Attn: Ms. Elizabeth M. Murphy, Secretary
100 F Street, N.E.,
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

Commissioners of the Securities and Exchange Commission:

The undersigned trade associations appreciate this opportunity to jointly comment on the Release No. IC-29778, Companies Engaged in the Business of Acquiring Mortgages and Mortgage-Related Instruments (the Concept Release)[1] issued by the U.S. Securities and Exchange Commission (SEC, or the Commission). Each organization represents various participants in the residential and commercial real estate market, and each welcomes the SEC's review of current practices related to the interpretation of the statutory exception contained in section 3(c)(5)(C) of the Investment Company Act of 1940 for pools engaged in real estate finance, such as mortgage real estate investment trusts (mortgage REITs).

The Investment Company Act of the 1940 Exempts from Registration Pools Engaged in Real Estate Finance

The Investment Company Act of 1940 (the 1940 Act) was one of the four primary legislative responses to the market failures that led to the Great Depression. By establishing rules governing regulated investment companies (or mutual funds), which pool capital from individual investors for the purpose of investing in stocks, bonds, and other corporate securities, the 1940 Act created an opportunity for small investors to diversify their assets through well-regulated entities.

Congress also recognized that while this regulatory regime was appropriate to govern funds making investments in certain securities, exemptions were needed for entities making certain other investments, such as investing in real estate and in providing financing for small businesses and real estate. One of the statutory exemptions included in the 1940 Act has been critically important to the liquidity of the real estate market. Specifically, section 3(c)(5)(C) exempts:

> "Any person who … is primarily engaged in…(C) purchasing or otherwise acquiring mortgages and other liens on and interests in real estate."

The mortgage market has evolved since 1940, and so has the SEC's interpretation of the 3(c)(5)(C) exemption. Through SEC staff no-action letters issued in the decades since Congress passed the 1940 Act, this statutory exemption has been understood by the market to include fee

[1] 76 Fed. Reg. 55300 (Sept. 7, 2011)

interests in real estate; loans or liens that are fully secured by real estate; and assets that are the functional equivalent of an actual interest in real estate or a loan or lien fully secured by real estate, such as whole-pool agency mortgage backed securities and certain commercial real estate "B-Notes."

Regulation of Mortgage REITs

In 1960, Congress passed, and President Dwight D. Eisenhower signed into law, the Cigar Excise Tax Extension Act, which contained within it the initial Federal tax legislation authorizing real estate investment trusts (REITs). Congress created REITs to provide a means "whereby small investors can secure advantages normally available only to those with large resources" with respect to real estate investment and ownership.

In the United States, while most REITs (those known as equity REITs) are primarily invested in real property and derive their income primarily from rental income paid to them by others, a strong and growing number of REITs (those known as mortgage REITs), operate as real estate finance companies that derive most of their income from mortgage-related interest generated through loans tied to the single-family housing or the commercial real estate markets.

Public Mortgage REITs have not been considered investment companies because they rely on the 3(c)(5)(C) exemption Congress included in the 1940 Act. However, mortgage REITs must comply with a number of statutory and regulatory requirements that provide robust investor protections. For example, the REIT tax rules require that they primarily invest in real estate holdings for the long term and that they do not act as dealers. Public mortgage REITs must meet registration requirements according to Securities Act of 1933; comply with periodic reporting, public disclosure, and other requirements of the Securities Exchange Act of 1934; and fulfill reporting, audit and certification requirements of the Sarbanes Oxley Act. Finally, mortgage REITs listed on the NYSE, NASDAQ or another exchange must meet listing requirements related to independence for their board and audit committees, among other things.

This mosaic of regulatory requirements rivals, and in some cases surpasses, the regulatory regime governing mutual funds and other investment companies. The primary consequence of the exemption from registration as investment companies is that mortgage REITs are not limited in their use of leverage. Real estate finance, by its very nature, is a leveraged undertaking. In the case of mortgage REITs, the use of moderate and appropriate leverage increases their ability to provide liquidity to the real estate finance market both by allowing them to expand their portfolio of interests in real estate that qualify for the statutory exemption under 3(c)(5)(C), and by enhancing the returns they provide to their investors, thereby bringing more private capital to this market.

In fact, perhaps nothing better underscores the value and effectiveness of the investor protections provided by the current regulatory regime, as well as importance of the continued ability of participants in this sector to prudently employ leverage, as the fact that the FTSE NAREIT mortgage REIT index has provided competitive returns to investors compared to other broad stock indexes, such as the S+P 500, Russell 2000, NASDAQ Composite and Dow Jones Industrial Average, over the 1-, 3-, and 10-year investment horizons.

Mortgage REITs Can Continue to Help Address the Real Estate Policy Challenges Facing the U.S. Economy

Whether primarily invested in commercial or residential real estate debt instruments, mortgage REITs have been an important source of capital in the real estate finance market, particularly during the current post-crisis period. Investors have recognized this – since 2008, mortgage REITs have raised more than $30 billion from the public markets and 12 new mortgage REITs have completed initial public offerings. As policymakers consider significant reforms to the housing finance system, including the bipartisan consensus that more must be done to attract additional private capital into the housing finance system, and as our economy continues to work through the challenges facing commercial real estate, they should view mortgage REITs to be part of the solution.

For example, at a time when the Federal Reserve, Treasury Department, and the GSEs have been net sellers of MBS to the tune of $215 billion, and when demand has softened among other traditional MBS investors such as domestic banks and overseas investors, residential mortgage REITs have provided critically important liquidity to MBS markets. Since 2010 they have purchased $130 billion in MBS, including $80 billion purchased MBS in first half of 2011.

Similarly, commercial mortgage REITs have played an important role in commercial real estate finance. For example, in the first half of 2011, as commercial banks and thrifts have decreased their outstanding commercial mortgage holdings at by almost $20 billion, commercial mortgage REITs have expanded their holdings by $2.5 billion. Additionally, commercial mortgage REITs have been and will continue to be a critical source of subordinated debt, which will be incredibly important as property owners and their lenders face a wave of over $1.4 trillion of loans that mature and must be refinanced according to stricter underwriting standards and during a period of reduced property values.

The SEC Concept Release Provides an Opportunity to Bring Additional Well-Regulated Private Capital to Bear on These Policy Challenges

While it is clearly appropriate for the SEC to undertake a review of policy that has evolved over the course of 71 years, it is important that this process does not lead to the narrowing of the SEC's interpretation of the statutory exemption Congress created for real estate interests in the Investment Company Act of 1940 and how it applies to mortgage REITs.

If mortgage REITs were to be regulated as mutual funds, their ability to provide liquidity and financing to the commercial and residential real estate markets would be dramatically undermined, just when that liquidity is needed most. It would also run counter to the bipartisan view that more private capital is needed to shore up these markets. And, given the robust regulatory regime currently governing public mortgage REITs, any dramatic change to their regulation would provide insufficient investor protection benefits to warrant such an action.

If anything, the Commission should be considering ways to flesh out its current interpretation of and approach to the 3(c)(5)(C) statutory exemption, to provide greater certainty for market participants, such as public mortgage REITs, to continue to bring private capital inflows into the real estate finance markets in a well-regulated and efficient way. Furthermore, the Commission should ensure that any action it takes in the short-term allows it to remain flexible as the real estate finance market continues to evolve – whether as the result of organic market forces, or as the result off more fundamental reforms that have been, or will be, enacted by Congress. Such changes may result from policy changes related to the implementation of rules required by the Dodd-Frank Act related to credit risk retention and the establishment of qualified residential mortgages and commercial real estate loans; the potential enactment of fundamental reforms to the Government Sponsored Enterprises and the housing finance market; or even targeted policy changes that may be made by the FHFA, Fannie Mae or Freddie Mac, such as the tranching of the securities issued by the GSEs to allow for private investors to assume the credit risk of these mortgage pools.

Conclusion

In the final analysis, and particularly with regard to mortgage REITs, the undersigned trade associations are united in the view that, as the Commission considers the questions it has raised in the Concept Release, it should take no action that would undermine current market practices; it should provide greater certainty for market participants that the current interpretation of the 3(c)(5)(C) statutory exemption remains valid; and it should maintain its ability to adapt its interpretation of the 3(c)(5)(C) statutory exemption as the real estate finance market evolves. If you have any questions related to this comment letter, please do not hesitate to contact Chip Rodgers of The Real Estate Roundtable at 202-639-8400 or crodgers@rer.org

Respectfully submitted,

Appraisal Institute
American Resort Development Association
CCIM Institute
CRE Finance Council
Institute of Real Estate Management
Mortgage Bankers Association
NAIOP, the Commercial Real Estate Development Association
National Apartment Association
National Association of Real Estate Investment Trusts
National Association of Realtors
National Multi Housing Council
Society of Industrial and Office Realtors
The Real Estate Roundtable