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CAPITAL MANAGEMENT

To Whom It May Concern:

I am writing in response to the SEC's request for comment on investment companies engaged in the business of acquiring mortgages and mortgage-related instruments (mortgage REITs). I understand that the SEC wishes to protect investors' interests. However, I believe the SEC's resources would be better spent on another topic.

Mortgage REITs do not try to hide the fact that they invest in mortgages instead of real estate properties. If an investor were to look at a mortgage REIT company's website and read the 'About Us' section, the investor would find that they invest in mortgages and mortgage pools instead of real estate properties. If the SEC wants to make it extremely clear to all potential investors that the company is a mortgage REIT, one simple solution would be to make it a requirement that, to qualify as a REIT, 'Mortgage REIT' has to be in the name, or something to that affect.

If the concern is that an investor does not know what mortgage REITs invest in, then it is due to a lack of due diligence on the investor's part. Take for example agency mortgage REITs. A majority of their 10-Qs clearly state what types of mortgages, swaps and repos they have in a clear, understandable format. There are a few mortgage REITs that go so in-depth that they state how much exposure they have with their various counterparties. I personally find it easier to read and understand the 10-Qs of agency mortgage REITs than some 10-Qs from banks.

I believe the likelihood that these mortgage REITs will be the next thing to cause a financial crisis is extremely small. Mortgage REITs use leverage and invest in mortgages and mortgage-related pools, similar to banks and saving and loan companies. However, the mortgage REITs did not need help during 2008, which was one of the most difficult times for mortgage-related products. Mortgage REITs' use of leverage is not extremely high. Mortgage REITs are less than 10x levered, whereas other investment vehicles, such as hedge funds, can be 20x to 30x levered.

A greater concern is that mortgage originators do not invest in the mortgages they originate. Instead, they make money by flipping the mortgages as quickly as possible and collecting fees. Most mortgage REITs buy their mortgages from banks and other mortgage originators. There are some mortgage REITs that are starting to originate mortgages and, while I understand that this may be a concern for the SEC, one of the primary reasons mortgage REITs are doing this is to have better control on what they are investing in. The mortgage REITs' goal is not to flip the mortgages, but rather invest in the mortgages themselves and hold them on their books.

If the SEC were to find it necessary to put a leverage cap on mortgage REITs, then I suggest the leverage cap be different for different types of mortgage REITs. Take agency mortgage REITs as an example once again. They invest solely in agency mortgage pools. These pools are backed by the government. Mortgage pools that are backed by the government should not cause the same type of cascading drops in value as the subprime mortgage crisis did in 2008, as there is no non-government credit risk. These agency mortgage REITs should be able to have a higher leverage cap than mortgage REITs that invest solely in subprime mortgages. I also believe, if there is a leverage cap, that it should be higher than where the average mortgage REIT's leverage currently is. If the average agency mortgage REIT's leverage is 8.5x, then I believe the

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maximum leverage should be around 11x or 12x. Also, if the average subprime mortgage REIT's leverage is 4.5x, then I believe the maximum leverage should be around 8x or 9x. This allows the mortgage REITs to continue to provide the yields they currently carry while giving them flexibility if the environment changes. At the same time leverage caps would insure that there won't be a rogue mortgage REIT that has an excessive amount of leverage.

I understand it is easy to confuse mortgage REITs with 1940 Act companies. Both mortgage REITs and 1940 Act companies are basically pools of investor money that invest in an asset class at the manager's discretion. However, if an investor were to do proper/appropriate research into these mortgage REITs before purchasing, the investor would easily find that mortgage REITs carry more than the 1.5x leverage that is allowable for 1940 Act companies. In addition, if an investor invests in a REIT, they should already understand that the mortgage REIT has to distribute at least 90% of its income to qualify as a REIT. Also, they should know at least 75% of the income earned by the REIT has to be income from rent or mortgage interest per IRS guidelines.

Given these requirements, REITs behave differently than 1940 Act companies. For example, mortgage REIT companies generally have a long term buy and hold strategy, while1940 Act companies may invest in real estate-related securities. Also, mortgage REITs often utilize more hedging strategies than 1940 Act companies while focusing more directly on income versus asset appreciation. These characteristics mitigate some of the risks of taking on additional leverage.

To grasp a clearer picture of this, let's create a hypothetical situation. Two investment companies that invest in mortgages start in the beginning of 2009. One of the investment companies is set up as a REIT while the other is set up as a closed end fund, a type of 1940 Act company. Both companies buy mortgages in the beginning of 2009. Let's assume that mortgage values have gone up largely in 2009 and 2010. In 2011, the closed end fund could sell its mortgage pool to realize gains and invest in a different set of mortgages with completely different characteristics. However, the REIT could not do this because, if it did, it would realize a large gain that would be greater than 25% of its gross income. So, while the closed end fund could completely change its position, the REIT could not. The REIT has to have a longer time frame and be more concerned with income and risk management, while the closed end fund can make more volatile investments to realize gains.

Using the hypothetical above, say the manager of the close end fund was bullish on mortgages, so the manager took on leverage to increase exposure. Due to the 1940 Act, the manager can only take on up to 1.5x leverage. In 2011, the manager decides to take gains because the manager is not as bullish on the initial mortgage pools as they were in 2009 and 2010 due to their large price appreciation. The mortgage REIT would have taken on leverage not because the manager was bullish on mortgages, but because the manager believes that the assets acquired would yield more than the cost of borrowing and will continue to yield more than the mortgage REIT's cost of borrowing. In 2011 the mortgage REIT also has a large unrealized gain on the mortgages. But the mortgage REIT won't sell the underlying asset to realize all the gain like the closed end fund can. The mortgage REIT will still hold on to the majority of the mortgages because the mortgage REIT is more concerned with income, not realizing the gain on the mortgages.

If the SEC were to change mortgage REIT regulations drastically there could be undesired ancillary effects. If the SEC were to choose to put a leverage cap on mortgage REITs at the same level as the 1940 Act companies, it would force most of the mortgage REITs to de-lever by selling assets. This would cause a large supply of mortgages to flow into the market with fewer buyers than before, putting downward pressure on mortgage-related products' prices. These mortgage REITs also represent a large amount of the demand for mortgage products. So, forcing de-leveraging would cause the doubly negative effect of reducing potential mortgage buyers while also increasing supply. As a result of these negative changes in supply/demand characteristics, borrowing rates for home buyers seeking mortgages would rise. This would materially reduce the demand for housing within the United States. The poor condition of the housing market may be the single biggest drag on an incredibly challenged United States economy that faces minimal GDP growth, little inflation, and remarkably high and sustained unemployment.

I would also like to bring up the point that many of the comments posted on the SEC website on this topic are common American investors who live off the income streams derived from mortgage REITs. It appears these investors have done their research on these mortgage REITs. Any SEC action could greatly hurt their retirement portfolio and standard of living.

I would like to thank the SEC for doing its best to protect investors. However, I believe drastically changing the regulations on mortgage REITs will provide minimal additional protection to investors, while coming at great cost. An example solution to increasing investor protection could be to periodically check that mortgage REITs are properly disclosing the risks involved with investing in them. The SEC could use new hires, whose knowledge is similar to an average investor's, to act as if they were potential investors in these mortgage REITs. They could look at the mortgage REITs' websites and call the mortgage REITs to ask questions. This process could give the SEC a personal and upfront viewpoint as a check to see if the mortgage REITs are properly disclosing their risks. This could help in leading the SEC to take precise actions to protect investors.

For full disclosure, I do work at an investment firm that has clients who invest in agency mortgage REITs. As an investor, I see great risk-adjusted benefits in investing in these products for our clients.

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