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

[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.

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 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

[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."

existing guidance. In Part III, we address other questions raised by the SEC in the ANPR Release that apply to CMRs.

I.
BACKGROUND

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

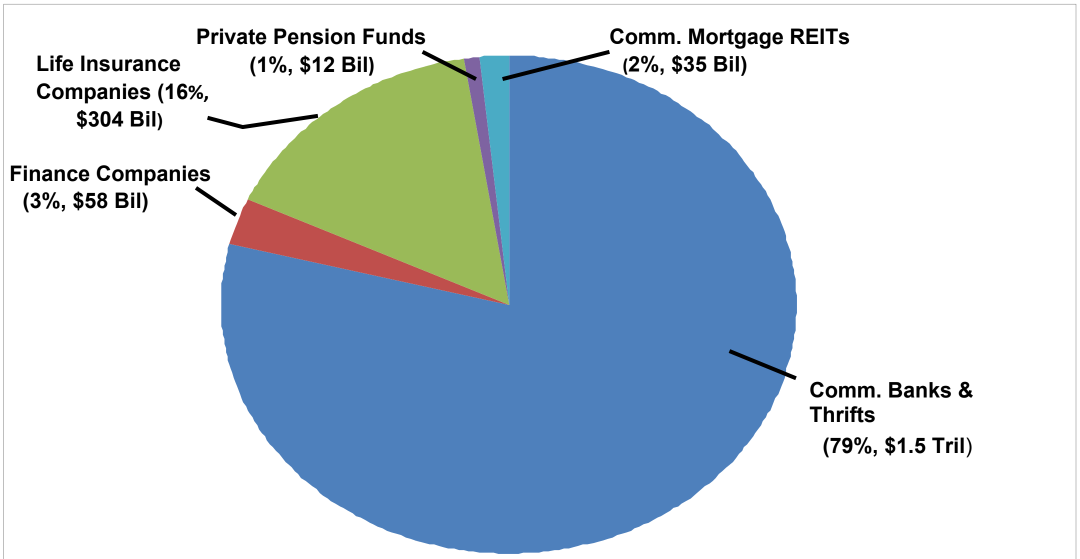
CMRs serve as an integral source of capital in the commercial mortgage finance market. CMRs' financing activities include the origination and acquisition of all financing products available in the commercial mortgage market, including commercial mortgage loans, participations in commercial mortgage loans, 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

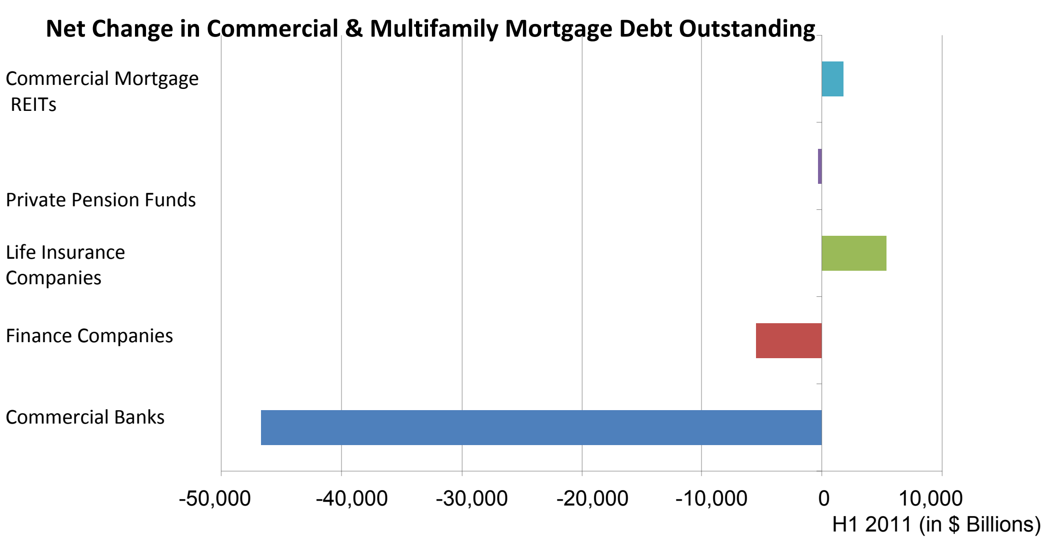
Source: NAREIT, Bloomberg LP, RAIT Financial Trust; Market cap as of 10/11/11; Assets under management as of 6/30/11

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.



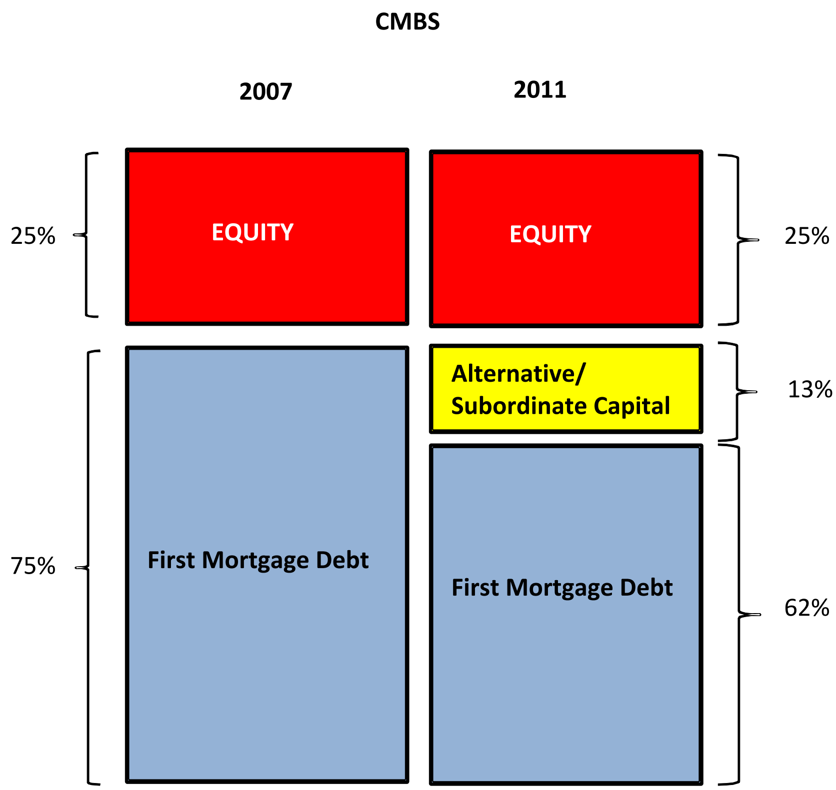
Source: Federal Reserve, Mortgage Bankers Association and RAIT Financial Trust

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.

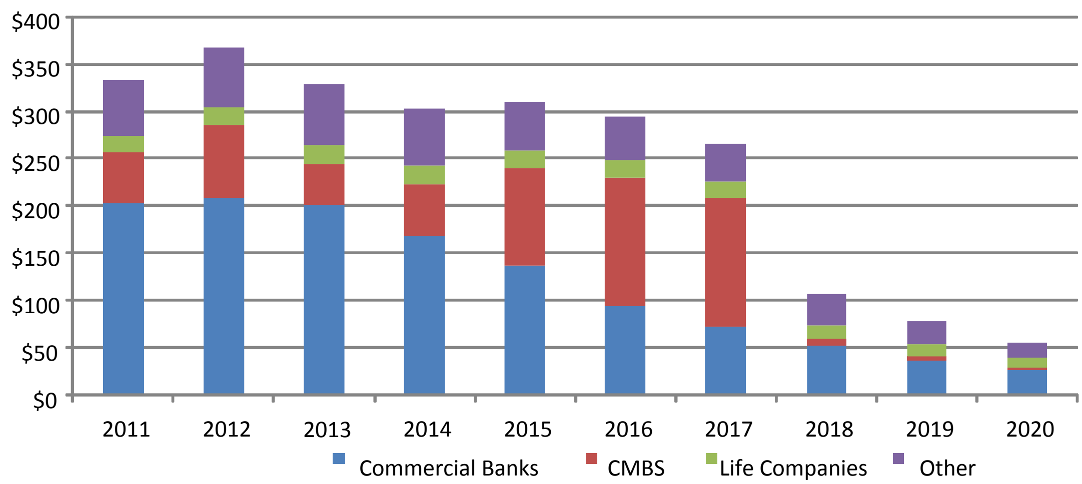


Source: RAIT Financial Trust

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

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[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]

[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. Particular Concerns Raised by the Commission in the Concept Release

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. Overreaching by Insiders

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

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

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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

[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. <u>Other Issues</u>

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

[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.*,

[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.

* * * * * * * * * * * * * * * *

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 INVESTMENT TRUSTS®

♦ ♦ ♦

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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- Compensation Committee (Rule 5605(d))	A committee of independent directors must set the compensation of chief executive officer and other executive officers.
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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	
- 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) • <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.

- Part 2 of Form S-11	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

	○ 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

	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 circumstances10 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.

<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.

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.