REISA™
REAL ESTATE INVESTMENT SECURITIES ASSOCIATION

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VIA email: rule-comments@sec.gov

U.S. Securities and Exchange Commission
100 F Street NE
Washington, DC 20549
Attention: Elizabeth M. Murphy

Re: *File No. SR-FINRA 2014-006*

Dear Ms. Murphy:

The Real Estate Investment Securities Association ("**REISA**") is a trade association serving the real estate securities industry including all professionals active in offering, managing and distributing non-traded REITs, real estate partnerships, tenant-in-common interests (TICs), Delaware statutory trust interests (DSTs), real estate income and development funds, oil and gas interests, natural resources and alternative energy investments.

REISA works to maintain the integrity and reputation of the industry by promoting the highest ethical standards to its members and provide education, networking opportunities and resources. REISA connects members directly to key industry experts through intimate forums providing timely trends and education and helping create a diversified portfolio for their clients. The association was founded in 2003 and has over 800 members who are key decision makers that represent over 30,000 professionals throughout the nation including:

- Sponsors and managers of real estate and related offerings
- Broker-dealers
- Securities licensed registered representatives
- Registered investment advisers (RIAs)
- Investment adviser representatives (IARs)
- Accountants
- Attorneys
- Mortgage brokers
- Institutional lenders
- Qualified intermediaries
- Real estate agents
- Real estate brokers

On February 12, 2014, the Financial Industry Regulatory Authority, Inc. ("**FINRA**") proposed amendments to NASD Rule 2340 – Customer Account Statements to amend the provisions relating to the inclusion of per share estimated values for publicly registered DPP and REIT securities on customer account statements, as well as modify the requirements applicable to FINRA members' participation in public offerings of DPP and REIT securities under FINRA Rule 2310 (the "**Proposed Amendments**"). The Proposed Amendments were filed in the Federal Register on February 19, 2014. The Proposed Amendments are an additional revision to both Regulatory Notice 11-44 (September 29, 2011) ("**NTM 11-44**") and Regulatory Notice 12-14 (March 7, 2012) ("**NTM 12-14**"), on which REISA previously commented.

REISA believes in the importance of protecting the investing public while balancing the need for businesses and sponsors of quality real estate investment and other alternative investment products, along with the FINRA members who sell these products, to be able to efficiently raise capital without an overly burdensome regulatory scheme.

REISA joins FINRA in its focus on investor protection and transparency relating to non-listed REITs and other types of DPPs. REISA also understands FINRA's Corporate Financing Department's push for action to ensure enhanced transparency and accountability. However, it is important to also recognize that these investment programs have a unique place in the market for real estate securities and the investors attracted to these products are looking for real estate or other alternative products as an asset class in an illiquid, long-term investment. There are multiple disclosures in the offering documents for these programs that reference the long-term, illiquid nature of the DPPs and REITs and their portfolios, the types of investors who should and should not be investing their money in these types of programs, and the arbitrary nature of the offering price.

REISA has the following comments and observations relating to the Proposed Amendments to NASD Rule 2340 regarding Customer Account Statements.

Net Investment Methodology. Following the break of escrow and for a period of up to two years thereafter, an estimated value that follows this methodology would be presumed reliable and could be included in the customer account statement for general securities members. The "net investment" would be based upon the amount available for investment as disclosed in the "Estimated Use of Proceeds" section of the prospectus for the offering. This amount would deduct not only the selling commissions but also the organizational and offering expenses disclosed in the prospectus. In addition, this per share estimated value would also deduct the portion, if any, of cumulative distributions per share that exceeded Generally Accepted Accounting Principles ("**GAAP**") net income per share for the period, after adding back depreciation and amortization or depletion expenses.

1. The organization and offering expenses set forth in the "Estimated Use of Proceeds" section are just that – estimates. There is no current requirement to update that disclosure during the offering period to include actual expenses incurred. In addition, the table only provides two data points – the minimum offering amount (which has been achieved at the time the disclosure mandated by the Proposed Amendments would be required) and the maximum offering amount (which may not be achieved in the short term, if ever and perhaps not in the two year period contained in the "net investment" methodology). Thus, at any given point in time during the offering period, the calculation of the deduction for organization and offering expenses merely takes the estimated percentage contained in the "Estimated Use of Proceeds" table and deducts that from the gross offering price as a measure of value. Deducting such estimates in calculating a value (a) does not accurately reflect the organization and offering expenses actually incurred, (b) does not provide investors with accurate information regarding the organization and offering expenses of the program; (c) takes the entirety of the organization and offering expenses as a deduction upfront; and (d) could cause issuers to underestimate those expenses given their use in calculating the "net investment" amount to be provided on the customer account statement.

2. In addition, the cost of performing adequate due diligence is included in the organization and offering expenses and therefore is required to be deducted from the gross offering price to get to the "net investment" to be disclosed on customer account statements. In light of such deduction, issuers may become reluctant to reimburse FINRA members for due diligence expenses and, as a result, FINRA members may (1) be required to either pay their own due diligence expenses, (2) cut back on the due diligence they perform on these DPPs and REITs or (3) stop selling DPPs and REITs because they cannot meet their due diligence obligations. In any of these scenarios, by requiring issuer organization and offering expenses to be deducted in calculating the per share value of a DPP or REIT, FINRA is discouraging the very behavior it has been trying to encourage when it lifted the cap on due diligence expense reimbursements.

3. In calculating the "net investment" amount, the Proposed Amendments also include another adjustment – this time for cumulative cash distributions in excess of GAAP net income after adding back depreciation and amortization or depletion expenses. This additional adjustment (a) will lead to more investor and FINRA member confusion and (b) treats non-traded REIT and DPP securities differently than any other type of public securities. This type of adjustment harkens back to the early days of FFO in REITs and has more capacity to confuse than to provide any kind of accurate "value" that is useful to an investor. Different product types will look to add back other types of "non-recurring" expenses and different issuers will calculate these "add backs" differently. The disclosure contained in the periodic reports of REIT and DPP issuers already contains significant disclosure regarding the source of distributions and the risks attendant thereto. Requiring customer account statements to include such an adjustment as an indication of estimated per share value will serve only to create additional confusion and still not achieve the transparency and clarity that FINRA is seeking for these alternative investments.

4. In addition, it remains unclear what the long-term effect deducting cumulative "over-distributions" will have on investors who invest during different times in the offering. The investor who invested on day one of the offering and the investor who invested in the 18th month of the offering will have very different outcomes based upon the calculation of value under the "net investment" methodology. It is unclear whether this advances transparency and clarity or muddies the waters even more.

5. While the calculation of the "net investment" amount takes into account many deductions from the gross offering price, it does not take into account the effects of leverage on the amount of investment a DPP or REIT can make. Therefore, the net proceeds available for investment only reflect the proceeds of the offering available for investment but do not account for the leverage used by DPPs or REITs to make actual

investments. An increase in investments due to leverage utilized would increase the value of the DPP or REIT and thus the estimated value per share but would not be included under the "net investment" methodology. Using only the proceeds from the offering with the various deductions contained in the Proposed Amendments does not provide the investor an accurate snapshot of the value of its investment.

6. Another concern with respect to the "net investment" methodology is the ability of those who prey upon DPP and REIT investors by making mini-tender offers to use the arbitrary values to their advantage and to the disadvantage of the investors who purchased the securities for investment purposes but see the values being reduced dramatically in the short term with little or no understanding as to why. REISA believes there will be significant potential for abuse by those who are in the business of making mini-tender offers at the expense of the very investors FINRA is trying to protect.

Independent Valuation Methodology. This methodology can be used by issuers at any time and requires that a third-party valuation expert determine, or provide material assistance in the process of determining, the valuation. The issuer's first periodic report filed following the second anniversary of breaking escrow must include (a) the value as determined by the third-party valuation expert, (b) an explanation of the method by which that value was determined, (c) the date of the valuation and (d) the identity of the third-party valuation expert used. In addition, the general partner or sponsor must agree to have the valuation conducted at least once every two years in accordance with a methodology that conforms to standard industry practice and such valuation must be accompanied by a written opinion to the general partner or sponsor explaining the scope of the review, the methodology and the basis for the value provided. While REISA generally believes that an independent valuation methodology provides benefits to investors, the Proposed Amendments should be revised to take into consideration the following concerns.

1. The independent valuation methodology requires that the valuation be conducted at least once every two years in accordance with a methodology that conforms to "standard industry practice." How is standard industry practice defined for purposes of the Proposed Amendments? Who gets to determine what is "standard industry practice" and what is not? It is difficult to adhere to a standard that is not contained in the Proposed Amendments and is not otherwise defined in the rules of the SEC or FINRA.

2. The Proposed Amendments require that the independent valuation be conducted at least once every two years. During that intervening two year period, the DPP or REIT may purchase multiple assets, may take an impairment charge on a significant asset in the portfolio and sell a number of assets. If an issuer is only required to conduct an independent valuation once every two years, the estimated per share value included on the customer account statements during the intervening two year period does not accurately reflect the value of the portfolio at any given period of time. During this interim period, how does the DPP or REIT present the estimated per share value in its periodic reports and how does a FINRA member show such estimated per share value on the customer account statements? If the DPP or REIT would be required to update its per share estimated value every quarter, every month or every time it bought an asset, sold an asset or took an impairment charge on one of its assets, the publicly registered, non-traded DPP or REIT will start to look very similar to its publicly traded DPP or REIT brethren with a regular "market price" being determined. This would fundamentally change the nature of the non-traded DPP and REIT product. In addition, the costs incurred to obtain these independent valuations would ultimately be paid by the investors.

3. Additionally, if the independent valuation expert is required to provide a written opinion to the general partner or sponsor explaining the scope of the review, the methodology and the basis for the value provided, does a DPP or REIT have to get the consent of the independent valuation expert in order to include the value in its periodic reports and post-effective amendments? If a consent is required, the DPP or REIT will be required to pay for such consent and those costs will ultimately borne by the investors.

4. If a DPP or REIT determines that it wants to either increase or decrease the estimated per share value six months after the latest valuation is performed by an independent valuation expert, does the DPP or REIT have to go out and get another independent valuation report and opinion? Under what circumstances can a DPP or REIT adjust the estimated per share value, either up or down, without having to incur the substantial costs of an independent valuation expert outside of the every two year period?

<u>"Not Priced Option" if a FINRA Member Has Reason to Believe it is Unreliable.</u>

1. In the situation above where there are material changes in the portfolio of an issuer during the two year period following an independent valuation, a FINRA member could determine that such estimated per share value was unreliable. In such event, the customer account statement could exclude any value for the DPP or REIT security, immediately causing investor confusion and concern. Would a FINRA member then require the issuer to perform a new independent valuation each and every time some material change in the portfolio were to occur? The cost of such valuations would be passed along to the investors, decreasing the value of their investment even further. As noted above, such a scenario would create a non-traded DPP or REIT that looks eerily similar to a publicly traded security that is priced by the market on a regular basis without any of the advantages of having a liquid security.

2. If the FINRA member believed that the per share estimated value is unreliable and therefore opted to not include a value on the customer account statement, the disclosure contained in the Proposed Amendments to the effect that (a) the securities are illiquid, (b) the current value of the security will be different from its purchase price and may be less than its purchase price and (c) if applicable, that the estimated per share value is not available does not, in our view, provide an investor with transparency and clarity regarding its investment. If a FINRA member opted into the "not priced option" would it be required to include a statement as to why it was not providing a value or its basis for determining that the value is unreliable? This non-priced option seems to create more potential confusion for FINRA members given that the two methodologies for calculating the estimated value per share are presumptively deemed reliable. The current required disclosure relating to the illiquid nature of the securities -- the securities are not listed on a national securities exchange, are generally illiquid and that, even if the investor were to be able to sell the securities, the price received may be less than the value contained on the statement -- do not appear to be useful to an investor in the situation where no price is provided on the customer account statement.

Implementation Period. REISA respectfully requests that FINRA include a longer transition period for implementing the Proposed Amendments. The proposed effective date of 180 days following the approval of the Proposed Amendments by the SEC is too short a time for those DPP and REIT programs currently in the market and those well along in the process to make the necessary revisions to the structure to enable these Proposed Amendments to be implemented. For example, in light of the Proposed Amendments issuers need to review the Estimated Use of Proceeds to take into account the potential additional costs of independent valuations as well as the adjustments to the gross offering price proposed. In addition, the impact of the "over-distributions" deduction will have significant implications for many of the current programs across the various types of DPP and REIT products, including oil and gas programs and equipment leasing that remain unknown at this time.

Conclusion

REISA remains committed to collectively working to improve the industry from the standpoint of transparency and valuation. REISA believes that while Proposed Amendments continue to have the right goals in mind, there are some issues with the Proposed Amendments that require some adjustments. REISA appreciates the opportunity to comment on the Proposed Amendments and looks forward to a continued dialogue with FINRA on these and other important issues for the protection of investors and the capital markets.

Sincerely,

Mark Kosanke

Mark Kosanke
President, Real Estate Investment Securities Association