



Real Estate Investment
Securities Association (REISA)

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Submitted via e-mail

Mr. Gerald J. Laporte
Chief, Office of Small Business Policy
Division of Corporation Finance
U.S. Securities and Exchange Commission
100 F Street, N.E.
Room 3650
Washington, D.C. 20549-3628

Re: SEC Small Business Forum, November 18, 2010

Dear Mr. Laporte:

The Real Estate Investment Securities Association (REISA) appreciates the opportunity to participate in the SEC Small Business Forum on the implications for Small Business Capital Formation. REISA is a trade organization serving the real estate securities industry. This includes all professionals active in offering, managing and distributing non-traded REITs, real estate partnerships, tenant-in-common interests (TIC), Delaware statutory trust interests (DSTs), real estate income and development funds, oil and gas interests, natural resources and alternative energy investments. The association was founded in 2003 and was renamed from the Tenant-In-Common Association (TICA) to REISA in 2009. REISA has over 500 members who are key decision makers that represent over 18,000 professionals throughout the nation including:

- Sponsors and Managers of Real Estate Offerings
- Broker-Dealers
- Securities Licensed Registered Representatives
- Registered Investment Advisers (RIAs)
- Accountants
- Attorneys
- Mortgage brokers
- Institutional lenders
- Qualified intermediaries

- Real estate agents
- Real estate brokers

REISA's volunteer committees serve to keep the association current and ensure members have input in initiatives implemented. REISA committees include:

- Capital Markets
- Due Diligence & Compliance
- Education & Marketing
- Ethics & Standards
- Legislative & Regulatory

REISA has followed with great interest the various rule and study proposals contained in the Dodd-Frank Wall Street Reform and Consumer Protection Act of 2010 (the "Dodd-Frank Act"). REISA would like to outline particular provisions of the Dodd-Frank Act, as well as other policies proposed, that would materially affect the business of REISA's members as well as stifling small business capital formation.

Study and Rulemaking Regarding Obligations of Brokers, Dealers and Investment Advisers (Section 913 of the Dodd-Frank Act):

Under the Investment Advisers Act of 1940 (the "Advisers Act"), investment advisers currently work under a fiduciary duty, which requires them to act solely in their clients' best interest when offering personalized investment advice. The Advisers Act specifically exempts broker-dealers from this language. Broker-dealers instead operate under a "suitability standard," which requires them to only recommend products that are "suitable" for their customers.

Broker-dealers are subject to FINRA regulation and the FINRA rules provide specific guidance regarding a determination whether or not an investor is suitable for a particular transaction. Specifically, broker-dealers are required to determine, on the basis of information obtained from the client, concerning the client's age, investment objectives, other investments, financial situation and needs, and any other information known to the broker-dealer that the client is in a financial position appropriate to enable the client to realize to a significant extent the benefits of the investment as described, including the tax benefits to the extent they are a significant aspect of the investment; the client has a fair market net worth sufficient to sustain the risks inherent in the investment in the amount proposed, including complete loss, and lack of liquidity of, of such investment; and the investment is suitable in type and amount for the client. This guidance allows a broker-dealer to have a certain level of certainty when dealing with its customers.

In addition, FINRA has been actively policing the actions of broker-dealers under Regulation D to protect against possible misconduct with private placements. A recent regulatory notice issued in April 2010 (FINRA Regulatory Notice 10-22) reminded brokers-dealers of their duty under federal law to conduct a reasonable investigation of private placement issuers and their products prior to selling securities to their customers.

The Dodd-Frank Act acknowledged that certain broker-dealer activities will not be deemed to violate the applicable standard of care, such as receipt of commissions or other standard forms of compensation, selling only proprietary or a limited range of products, and the ability to consent to material conflicts of interest so long as they are adequately disclosed. In addition, broker-dealers would not be subject to continuing duties of care or loyalty after providing personalized investment advice. REISA believes that these activities, which are closely aligned with the current activities of many of its broker-dealer members, are more properly conducted under a suitability standard rather than an absolute fiduciary standard.

REISA believes that the dual system of regulating financial advisory services provided to customers as it has been in place for the past 70 years continues to be the most beneficial system for investors and their financial well-being. The suitability standard for broker dealers has functioned well over the years in protecting investors' interests without opening brokers up to broad new areas of litigation. Broker-dealers provide a key service to investors in effecting sales of securities that are not easily duplicated on a fee for service basis or in an ongoing comprehensive financial advisory role.

Applying a fiduciary standard to brokers would be a regulatory overreach that would reduce small business capital formation and reduce or eliminate a large portion of REISA's members' traditional day-to-day business. Because private placements under Regulation D would likely be considered "illiquid" investments under a fiduciary standard of care, small businesses and real estate investments packaged as Regulation D offerings could be eliminated from the alternatives that could be recommended by REISA member broker-dealers to their clients, who are sophisticated, accredited investors.

Additionally, if a fiduciary standard were to be applied to broker-dealers, broker-dealers would need to expand the coverage of their Errors and Omissions insurance policies to include fiduciary duties in Regulation D private placements. REISA's broker-dealer members tell us that they anticipate a significant insurance premium increase to cover a shift to a fiduciary standard from the current suitability standard. For those broker-dealers who sell only a small number of Regulation D private placements, REISA is concerned that those broker-dealers may elect to not approve any Regulation D offerings to avoid the expected significant insurance premium increase and heightened liability in Regulation D offerings. The elimination of additional broker-dealers selling private placements will further reduce the amount of equity being raised in the private markets and available to small businesses for capital formation.

Disqualifying Felons and Other "Bad Actors" from Regulation D Offerings (Section 926 of the Dodd-Frank Act):

REISA believes that those who defraud or deceive investors should not be allowed to participate in the private placement market. However, the language contained in Section 926 of the Dodd-Frank Act leaves much open to interpretation and may prohibit persons from participating in private placements that are not "bad actors" but merely violated a technical rule or was otherwise swept up in a minor violation. Some of the open questions that the SEC must resolve in its rulemaking under Section 926 of the Dodd-Frank Act include the following:

- Clearly identify the persons who would disqualify an issuer or broker-dealer from taking advantage of Regulation D for capital raising activities. For example, would “persons” subject to this disqualification include officers or directors or just owners, and if owners would it be 10%, 20% or more beneficial owners or would it include only “control persons.”
- Clearly define what is meant by a “final order” especially in a case where an order has been issued by a state regulator but such order is in the process of being challenged or otherwise appealed through judicial or administrative proceedings.
- Address the potential for misapplication of the standard of “any law or regulation that prohibits fraudulent, manipulative or deceptive conduct.” There are states where minor and technical violations of rules or regulations, such as recordkeeping requirements or filing notices, are deemed to be fraudulent conduct and would therefore disqualify issuers from making use of Rule 506 for acts that would not normally fit within the definition of fraudulent or deceptive acts.
- Preclude the adoption of rules that would deem minor rule violations as “fraudulent, manipulative or deceptive conduct” in order to reduce or eliminate the use of Rule 506 for offerings in their state.
- Provide a mechanism by which an issuer may request a waiver from disqualification “upon a showing of good cause,” particularly in light of the 10-year look back whereby a person may have entered into a settlement agreement with a state regulator prior to the enactment of the Dodd-Frank Act which would otherwise provide the basis for a disqualification now.

Adjusting the Accredited Investor Standard (Section 413 of the Dodd-Frank Act):

Section 413 of the Dodd-Frank Act modifies the accredited investor net worth test standard for individuals, effective immediately upon enactment to \$1 million, *excluding* the value of the investor’s primary residence. Although the dollar threshold for the net worth test was not increased, by excluding the value of an investor’s primary residence, the Dodd-Frank Act has effectively tightened the eligibility standards for individuals to meet the test for accredited investors. The SEC staff’s published guidance noted that when determining net worth for accredited investor purposes, the value of an individual’s primary residence, as well as the related amount of any mortgage or other indebtedness secured by such residence, must be excluded. In addition, the SEC staff indicated that, pending future SEC rulemaking as a result of the Dodd-Frank Act, any indebtedness secured by the residence in excess of the home’s value should be considered a liability and deducted from the investor’s net worth.

The exclusion of the primary residence from the calculation of net worth has caused substantial harm to REISA’s members, excluding potentially 1 out of every 2 investors in the Regulation D private offering market. In addition, given its immediate effect, it has had negative implications for ongoing private offerings whereby an investor who invested at the beginning of a continuing offering as an accredited investor may no longer be eligible to make an additional investment in the same offering after the passage of the Dodd-Frank Act’s immediate implementation of the revised accredited investor standard when the only change for an investor is the exclusion of the

value of the primary residence as part of the calculation of its net worth. These changes have eliminated millions of dollars in legitimate investor equity for private placements for REISA members, which in turn has the effect of impeding job creation and capital formation in this country without providing additional meaningful protection for investors.

Notwithstanding REISA's position above, REISA believes that if the value of the primary residence is to be excluded, then it should be excluded on both the asset and the liability side of the equation. The deduction of the mortgage debt in excess of the value of the primary residence makes what was intended to be a simple calculation a much more difficult and subjective calculation that has the potential to change on a daily basis, force investors to incur additional expenses to obtain a third party appraisal on their primary residence and determine the outstanding balance on their mortgage in order to determine whether or not there should be a deduction to their net worth. REISA believes that in order to best protect its members, the simpler the determination the better and that both the value and the mortgage debt should be excluded from the calculation.

In addition, REISA disagrees with the recommendation by the North American Securities Administrators Association to add additional qualifications to the accredited investor test for "invested assets" if the investor must qualify for this test under all circumstances. REISA would support the concept of three Accredited Investor tests in which at least one qualification must be met: (1) net worth, (2) income or (3) invested assets. REISA believes that an "invested assets" test is duplicative because the broker-dealer suitability analysis and the investment adviser's fiduciary duty standard already requires investors to be rejected from qualifying to invest in a private placement if they do not meet the diversification/concentration and portfolio allocation tests particular to that investor's individual situation.

Carried Interest Tax Changes

A modification to the long-standing tax treatment accorded to "carried interest," or "profits interest," earned by partners in certain partnerships has been proposed. Under the proposal, carried interest would be taxed under ordinary income tax rates (the top ordinary tax rate is currently 35% but scheduled to rise to 39.6% next year) as opposed to the rate applicable to long term capital gains (currently 15% but set to rise to 20% next year).

REISA recommends that Congress reject efforts to raise capital gains taxes on the commercial real estate sector by treating the carried interest earned by partners in partnerships as ordinary income rather than long-term capital gains income. Taxing carried interest at the higher, ordinary income rates would harm the already weakened commercial real estate sector by further reducing transaction volume.

Commercial Real Estate Lending and Capital Markets Loosening

While the financial crisis has eased for many lenders and investors, it remains very much a growing disaster for the commercial real estate market, whose worst days may still be ahead. The central problem is that thousands of commercial real estate loans are set to mature in the next few years, meaning the debt will need to be refinanced – but there is still virtually no way to

refinance most of these loans. An average of \$300 billion a year in CRE loans will mature every year for the next decade, and there is a total of \$3.5 trillion of CRE debt currently outstanding.

The credit markets for commercial real estate are still largely frozen – with banks not lending on new transactions but only temporarily extending existing loans at maturity. This problem is compounded by economic factors such as low office rental rates, high retail vacancies and CMBS delinquencies, which have driven down commercial property values. The inability to refinance CRE debt could produce a wave of loan defaults, which would jeopardize U.S. economic recovery and inflict new damage upon recently healed financial markets

While REISA’s member investment companies would be particularly overwhelmed by a series of defaults, the effects would also be felt in the industries where real estate supports 9 million jobs – such as construction, planning, engineering, building management, landscaping, leasing, brokerage, mortgage lending, and accounting and legal services. By revenue, commercial real estate constitutes an estimated 13% of U.S. GDP. The commercial real estate crisis also affects all Americans whose pension funds invest directly or indirectly in \$160 billion of commercial real estate equity.

REISA continues to believe that Congress, the Obama Administration and federal financial regulators must act quickly to address the crisis in commercial real estate by implementing the following:

- The Treasury or financial regulators should establish a federally backed credit facility for originating new CRE loans, possibly by expanding the FDIC’s existing public-private investment fund program (the “PPIP Legacy Loans Program”) or through a new, privately funded guarantee program.
 - (1) One option would involve adapting the PPIP’s model (using private capital with leverage from the federal government) to fund a pipeline of new, solidly underwritten CRE loans instead of acquiring legacy loans. This would provide an important source of liquidity to the industry at the whole loan level.
 - (2) Another option would entail creating a new, federally chartered, privately funded guarantee facility for newly issued CMBS or whole loans. After an initial period of support from TARP and the Fed, the program would be self-funded by a fee charged to securities issuers, the same way the FDIC insures bank deposits. Such an entity would create an insurance pool to stand behind these securities, creating a stable secondary market into which banks can sell newly originated loans.
- Congress should encourage non-U.S. debt and equity investment in U.S. real estate by amending or repealing the outdated Foreign Investment in Real Property Tax Act (FIRPTA), which applies to equity investments. FIRPTA is the only major provision of U.S. tax law that subjects non-U.S. investors to taxation on capital gains realized from investment in U.S. assets. This law discourages foreign investment in U.S. real estate and drives non-U.S. investors to markets in Brazil, China and India.

- Congress and the Administration must continue to apply pressure upon banks and loan servicers to extend performing loans, based on cash-flow analysis. Members of Congress and the Obama Administration have been diligent this year about encouraging residential mortgage lenders and servicers to modify and extend the terms of at-risk loans as a way to avoid a wave of foreclosures, with several hearings exploring the issue. The same approach must be brought to the lenders and servicers that support commercial real estate, with lenders' risks acknowledged by focusing on performing loans.

REISA appreciates the opportunity to participate in the SEC Small Business Forum and looks forward to continuing the dialogue with respect to enhancing small business capital formation.

Sincerely,



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