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NATIONAL ASSOCIATION OF
REAL ESTATE INVESTMENT TRUSTS®

October 4, 2011

Via email

Robert E. Feldman
Executive Secretary
Attention: Comments
Federal Deposit Insurance Corporation
550 17th Street, NW
Washington, DC 20429

Re: Interim Rule regarding the "Transfer and Redesignation of Certain Regulations Involving State Savings Associations Pursuant to the Dodd-Frank Wall Street Reform and Consumer Protection Act of 2010" – RIN 364-AD82

Dear Mr. Feldman:

This comment letter is in response to the above interim rule (the "Interim Rule")[1] in which the Federal Deposit Insurance Corporation (FDIC) reissues and redesignates certain regulations related to State savings associations that have been transferred to it from the Office of Thrift Supervision (OTS) under Title III of the Dodd-Frank Wall Street Reform and Consumer Protection Act of 2010. NAREIT appreciates the opportunity to comment on this Interim Rule, and, in particular, the rules governing the reporting of loans to real estate investment trusts on financial statements contained in §390.384.

NAREIT, the National Association of Real Estate Investment Trusts, is the worldwide representative voice for real estate investment trusts (REITs) and publicly traded real estate companies with an interest in U.S. real estate and capital markets. NAREIT's members are REITs and other real estate businesses throughout the world that own, operate and finance commercial and residential real estate. NAREIT's REIT members play an important role in helping to provide liquidity and transparency to the real estate market. Our members operating as Equity REITs own, lease and most often operate real estate, and thus are consumers of real estate debt finance. Our members operating as Mortgage REITs finance housing and commercial real estate, by originating mortgages or by purchasing whole loans or mortgage backed securities in the secondary market. Together, NAREIT's members provide perspective as market participants on both sides of the real estate finance

[1] 76 Fed. Reg. 47652 (Aug. 5, 2011).

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equation – *i.e.*, both as borrowers and as lenders – who are equally interested in an effective, efficient and stable market for real estate finance.

As described in more detail below, just as with other companies in the real estate industry, each REIT is unique in its specific approach to the business of real estate investment – and there is a wide diversity of companies currently operating as REITs. While these companies have all elected to comply with the U.S. tax rules governing REITs, we do not believe that, for purpose of this rule, a common tax election is sufficient to uniformly account for all loans to REITs in the same manner.

Background on REITs

In 1960, Congress passed, and President Dwight D. Eisenhower signed into law, the Cigar Excise Tax Act, which contained within it the initial Federal tax legislation authorizing REITs. As the legislative history of the initial REIT rules states, the primary intention of Congress in authorizing the use of REITs with respect to real estate investment and ownership was to provide a means "whereby small investors can secure advantages normally available only to those with large resources."[2] What Congress understood then and has endorsed through support for, and amendment of, the REIT rules for over 50 years is that, without such a regime for real estate investment, it would be far more challenging to make these three key benefits of real estate investment available to individual investors from all walks of life: 1) regular income; 2) capital preservation and appreciation; and, 3) portfolio-level as well as asset-class level diversification.

The REIT rules achieve this goal by requiring a REIT to be widely held; to focus principally on long-term real estate investment; and, to regularly generate and distribute to its shareholders real estate-related taxable income. Simply put, a regular corporation or business trust that elects with the IRS to be taxed as a REIT must maintain the bulk of its assets in qualifying real estate assets (at least 75% of all assets)[3]; must receive most of its income from some combination of rent from real property, interest from mortgages secured by real property and gains from the sale of real property (collectively amounting to at least 75% of all income)[4]; and must distribute at least 90% of its taxable income each year to its shareholders.[5] By complying with these and other related rules, a REIT is permitted to deduct the dividends it pays to its shareholders from its corporate tax bill.

The corporate tax regime followed by a REIT effectively results in a single level of tax that is paid by shareholders when they receive dividends from a REIT. Although REITs are not pass-through entities and are not permitted to pass-through losses or credits generally to their shareholders, the single level of tax is comparable to the situation faced by the vast majority of real estate owners and real estate borrowers who own and finance real estate through general and limited partnerships, limited liability companies, S corporations, etc.

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[2] *See* H.R. Rep. No. 2020, 86th Cong., 2d Sess. 3-4 (1960), 1960-2 C.B. 819.
[3] *See* Section 856(c)(4)(A) of the Internal Revenue Code of 1986, as amended ("I.R.C.").
[4] *See* I.R.C. § 856(c)(3).
[5] *See* I.R.C. § 857(a)(1)(A).

Over the course of the past five decades, the U.S. REIT industry, *i.e.*, the REIT sector of the real estate economy in the U.S., has grown substantially. For the 2008 tax year 1,679 companies in the U.S. (including publicly traded companies operating as REITs, private companies operating as REITs, and companies operating as REITs that offer their securities to the public but are not listed on an established stock exchange) filed tax returns as REITs.[6]

At the end of 2010, 273 REITs were registered in the U.S. with the SEC, and 176 of these REITs were listed on established U.S. stock exchanges (predominantly on the NYSE). Approximately 90% of these stock exchange-listed companies (by equity market capitalization) are known as "Equity" REITs that primarily invest directly in real property and that derive their income primarily from rental income paid to them by others. In effect, these publicly traded Equity REITs are real estate companies that own, operate and lease out real property to others. The remaining 10% of the publicly traded REITs are known as "Mortgage" REITs, *i.e.*, real estate finance companies, which derive most of their income from mortgage-related interest generated through loans tied to the single-family housing market or to the commercial real estate market.

At the end of 2010, U.S. Equity REITs registered with the SEC owned more than 29,000 properties in all 50 states, with a book value of about $500 billion. These investments are estimated to comprise approximately 10-15% of investment-grade commercial real estate in the United States, and they include all property types, including retail, office, multifamily, health care, lodging, industrial, self storage and timber. Each of these companies operates in its own manner, but the main thing they have in common is that they have all elected to comply with the U.S. tax rules governing REITs.

The Federal Government's North American Industry Classification System (NAICS) Illustrates the Diversity of Businesses Taxed as REITs

The diversity of businesses electing to be taxed as REITs is reflected by the 2007 revision of the North American Industry Classification System (NAICS). NAICS was established in 1997 as a classification system to facilitate data collection and analysis by various government agencies of individual businesses conducting the same economic activities. Like its predecessor, the Standard Industrial Classification (SIC) system, NAICS was intended to group together "business establishments" based on their primary activity. However, when initially created in 1997, and even still after it was first revised in 2002, NAICS improperly classified business establishments that elected to be taxed as REITs.

Originally, NAICS included all REITs – whether they were primarily owners and lessors of property or primarily engaged in owning or originating loans – in National Industry 525930 (Real Estate Investment Trusts) under Industry Sector 52 (Finance and Insurance). This original classification of REITs was apparently made based on a perception that REITs engage in uniform business based on a special status as "trusts." This perception was rendered compeletely inaccurate after Congress made changes in the Tax Reform Act of 1986 that allowed REITs to be self-managed and self-advised. Today, REITs undertake a range of economic activities, and most publicly traded REITs today are organized as corporations – not trusts – under state law.

[6] *See* Internal Revenue Service Statistics of Income-2008 Corporate Income Tax Returns at page 9.

In 2005, the U.S. Economic Classification Policy Committee (ECPC), with oversight from the White House Office of Management and Budget (OMB), undertook a review of the 2002 NAICS codes.[7] After hearing concerns from stakeholders including NAREIT, and in consultation with additional agencies, including the Federal Reserve Board and the Internal Revenue Service, the ECPC and OMB recognized that it would be appropriate to change the classification of REITs to reflect the diversity within the REIT sector.

Specifically, as the OMB directed in its final rule that adopted the 2007 NAICS codes proposed by ECPC, "NAICS 525390, Real Estate Investment Trusts, will be deleted from the classification and portions will be reclassified as follows: (1) Equity REITs will be classified in the Real Estate Subsector in NAICS Industry Group 5311, Lessors of Real Estate, under individual national industries based on the content of the portfolio of real estate operated by a particular REIT; and (2) Mortgage REITs will remain classified in the Finance Sector but will be moved from NAICS 525930 to NAICS 525990, Other Financial Vehicles."[8]

Specific Mention of REITs in the Reporting Requirements for Loans Under §390.384 is Inappropriate and Unnecessary

The Appendix to §390.384 contained in the Interim Rule specifies the how line items should be presented on the financial disclosures included by State savings associations included as part of certain securities filings. With regard to loans, the Appendix requires that the disclosures must state the amount of loans in four distinct categories: "(i) real estate mortgages; (ii) real estate construction; (iii) installment; and (iv) commercial, financial, and agricultural."[9]

For the most part, the definition of these categories is straightforward and reasonable. The real estate mortgage category generally includes loans secured by developed income property and/or personal residences. The real estate construction category generally includes loans secured by property and which finance construction or land development projects. The installment category generally includes common consumer loans that are payable in monthly installments. The fourth category generally includes any loan that is not included in the previous three categories, such as commercial, financial and, agricultural loans.

However, the description of the fourth category of loans in the Appendix specifically states that loans to certain business entities should automatically be included. These entities are "real estate investment trusts, mortgage companies, banks and other financial institutions." As described above, the businesses that operate as REITs are diverse, with the primary unifying characteristic among them being their election to be taxed as REITs. Furthermore, the vast majority of companies currently operating as REITs have little in common with mortgage companies or banks, and, as recognized by NAICS, equity REITs are not financial institutions. Therefore, it is

[7] *See* 70 Fed. Reg. 12390 (Mar. 11, 2005).
[8] *See* 71 Fed. Reg. 28532 (Mar. 16, 2006)
[9] *See* Interim Rule at Appendix to § 390-384—Financial Statement Presentation. (I)(8)(c). 76 Fed. Reg. 47734 (Aug. 5, 2011).

inappropriate and unnecessary to include a broad industry identified exclusively by a tax election among this list of entities that are otherwise identified by their business activities.

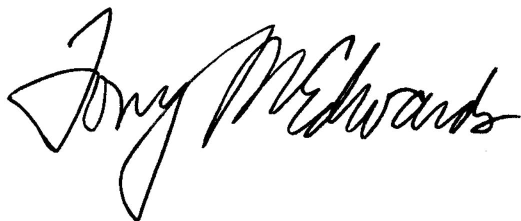
Furthermore, the Appendix states that this fourth category of loans includes "all loans not included in another category."[10] This instruction, on its own, implies that secured real estate mortgage loans and secured construction real estate construction loans should not be included. The provision also specifically instructs the State savings associations, "Do not include loans secured primarily by developed real estate,"[11] in this fourth category.

Many REITs, like other owners of developed real estate access mortgage loans secured by property, and like other developers of real estate access construction loans secured by property.[12] Therefore, the instruction to not include these types of loans secured by property stands in direct tension with the instruction in the same provision to include "loans to real estate investment trusts" in this catch-all category. This tension could result in inaccurate reporting by the State savings associations regulated by this rule. Additionally, this tension further underscores that it is inappropriate and unnecessary to treat all loans to REITs as being "commercial, financial or agricultural loans" based on the tax election made by – rather than the business activities of – the borrower.

Conclusion

As the Agency completes this current rulemaking, and in the context of any further consideration of substantive amendments or modifications to the reissued and redesignated regulations, we respectfully request that the FDIC delete the reference to "real estate investment trusts" from the Appendix to §390.384. Such a deletion would eliminate the arbitrary and unfounded distinction with regard to REITs and ensure that the State savings agencies regulated by these rules will accurately reflect the nature of their loans in their financial statements.

Respectfully submitted,



Tony M. Edwards
Executive Vice President & General Counsel

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[10] *See* Interim Rule at Appendix to § 390-384—Financial Statement Presentation. (I)(8)(c)(iv). 76 Fed. Reg. 47734 (Aug. 5, 2011).
[11] *Id.*
[12] An analysis of company 10-K data (as reported by SNL Financial) shows that at the end of 2010 publicly-offered REITs had over $213 billion in secured debt outstanding, nearly $45 billion of which was funded through asset-backed securitizations.