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September 12, 2016

NASAA Legal Department
Mark Stewart, Counsel
NASAA
750 First Street, NE, Suite 1140
Washington, DC 20002

RE: Request for Public Comment Regarding a Proposed Amendment to the NASAA Statement of Policy Regarding Real Estate Investment Trusts

Dear Ladies and Gentlemen:

In my role as a Finance Professor at The George Washington University, I spend the majority of my time conducting research on investment performance and portfolio management. A central focus of my research is the role of conflicts of interest in the financial industry and their impact on investment performance. I have conducted significant amounts of research on investment products, such as non-traded Real Estate Investment Trusts, that are primarily marketed to unsophisticated retail investors.

I applaud NASAA for proposing concentration limits on investments in non-traded REITs. My own original research supports the interpretation that due to their high upfront fees and conflicts of interests from ongoing business engagements with parties affiliated with the sponsors, investors would have amassed much more wealth had they invested in publicly traded REITs as opposed to non-traded REITs. Thus, I applaud any steps to limit investor holdings of non-traded REITs in their current form.

With specific regard to non-traded REITs, I encourage NASAA to consider that the corporate governance recommendations set forth in the guidelines are unlikely to ameliorate the deleterious impact that conflicts of interest have on investment performance (specifically the provisions in II.B. set forth for the election of Trustees). Typically, non-traded REIT shares are owned by a dispersed group of primarily retail investors. Both of these attributes make non-traded REIT investors unlikely to participate actively in shareholder governance activities. Smaller investors tend to lack the financial incentives a large shareholder would have to perform these costly monitoring functions. Less sophisticated investors are unlikely to correctly assess the impact of proposals on future operating and investment performance. In fact, among non-traded REITs, third-party proxy services are typically employed to solicit the votes of these dispersed, unsophisticated investors in order to steer corporate votes in the preferred direction. Further, due to the non-traded status of these shares, it is impossible for investors to “vote with their feet” or for an activist investor to amass a block of shares sufficiently large to affect corporate governance. In short, due to the lack of liquidity and the fact that investors in non-traded REITs

tend to be small and dispersed, corporate governance through shareholder participation is unlikely to be effective at imposing discipline on the board of directors or management. Among non-traded REITs, I believe the most effective channel for corporate governance would be to encourage a few large and sophisticated investors to take ownership positions significantly large in size so as to incentivize their monitoring.

I would like to highlight two specific areas in the Statement of Policy Regarding Real Estate Investment Trusts (“NASAA Guidelines”) where Sponsor’s conflicts of interest are not being adequately disciplined by existing regulation and market forces.

- Sponsors are ignoring the Roll-up protections in I.B.23 of the NASAA Guidelines with impunity. In 2012 and 2013, at least eleven non-traded REITs “corrected” away these protections when the REITs’ capital raise period end and before a roll-up transaction after including such language in Registration Statements. The important protections were promised investors as they bought shares. Once investors were trapped in these illiquid REITs, American Realty Capital and Cole Credit unilaterally deleted the protections and subsequently caused the non-traded REITs to enter into abusive roll-up transactions.
- Also, provisions of the NASAA Guidelines II.F dealing with the Advisory Contract appear to be flouted by the 20-year advisory contract some ARC-controlled non-traded REITs entered into with the Sponsor owned advisor. II.F.2 reads “Each contract for the services of an ADVISOR entered into by the TRUSTEES shall have a term of no more than one year,” and II.F.3 reads “Each advisory contract shall be terminable by a majority of the INDEPENDENT TRUSTEES, or the ADVISOR on sixty (60) days written notice without cause or penalty. ...”

I also encourage NASAA to apply concentration limits to the broader class of direct participation programs. As noted in the concentration limit proposal background, non-traded REITs are one example of a broader class of products referred to as direct participation programs (“DPPs”). Other types of DPPs, including interests in oil and gas drilling partnerships, non-traded business development corporations, and equipment leasing programs, share common features as non-traded REITs.

Thank you for your consideration.

Sincerely,



Brian J. Henderson
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The George Washington University