NATIONAL ASSOCIATION OF
REAL ESTATE INVESTMENT TRUSTS®

January 31, 2005

**VIA E-MAIL**

Mr. Jonathan G. Katz
Secretary
Securities and Exchange Commission
450 Fifth Street, NW
Washington, DC 20549-0609

Re: Proposed Rule on Securities Offering Reform (File No. S7-38-04)

Dear Mr. Katz:

The National Association of Real Estate Investment Trusts® (NAREIT) welcomes this opportunity to respond to the request for comments from the Securities and Exchange Commission (SEC or Commission) on the proposal contained in File No. S7-38-04 dated November 3, 2004 (Proposal). NAREIT is the national trade association for real estate investment trusts (REITs) and other publicly traded real estate companies. Members include REITs and other businesses that own, operate and finance income-producing real estate, as well as those firms and individuals who advise, study and service those businesses.

NAREIT commends the SEC's efforts to continue to promulgate high-quality rules and requirements that intend to modernize the securities offering process and that provide more timely information to investors. Overall, we support the requirements in the Proposal. However, we would like to clarify certain aspects in two broad areas: 1) the definition of well-known seasoned issuers; and, 2) shelf registrations.

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**Definition of Well-Known Seasoned Issuers**

The most sweeping amendments contained in the Proposal apply to those issuers who qualify as "well-known seasoned issuers" (WKSIs) as defined in Section II A of the Proposal. As proposed, a WKSI is defined as either an issuer with a minimum of $700 million market capitalization held by non-affiliates or an entity that has issued $1 billion aggregate amount of debt securities in registered offerings during the past three years. A majority-owned subsidiary of a WKSI may also be considered a WKSI in connection with the offer and sale of its own securities if:

1) the majority-owned subsidiary meets the conditions for eligibility as a WKSI;
2) a parent is a WKSI and fully and unconditionally guarantees the majority-owned subsidiaries debt;
3) the majority-owned subsidiary guarantees the obligations of (i) its parent or (ii) another majority-owned subsidiary when there is a full and unconditional guarantee of the same obligation by a parent that is a WKSI and the obligations are non-convertible; or
4) the majority-owned subsidiary's non-convertible obligations are fully and unconditionally guaranteed by another majority-owned subsidiary that is itself a WKSI.

The Proposal notes that the most far-reaching amendments are reserved for issuers that have a reporting history under the Exchange Act and are presumptively the most widely followed in the market. These issuers are deemed WKSIs. The Proposal states that "high level of analyst coverage, institutional ownership and trading volumes are useful indicators of the scrutiny that an issuer receives from the market, but no one statistic can fully capture the extent to which an issuer is well-followed by the market."

We applaud the Commission's proposals with respect to such seasoned issuers and feel that they make sense in the current marketplace. However, we want to focus specifically on the requirements for WKSIs, which are ***debt-only issuers***. The Proposal explains that the selection of the threshold at $1 billion aggregate in registered offerings of debt over the prior three years was based on the following statistics: between 1997 and 2003 these issuers accounted for 23 percent of all public debt issuers, issued 72 percent of all debt securities and all had investment grade ratings. We agree that these are the right parameters. However, we respectfully submit that the $1 billion requirement may exclude from the ranks of WKSIs debt-only issuers, which should be included in light of the criteria for WKSIs articulated by the Proposal. In addition to the $700 million market capitalization held by non-affiliates or an entity that has issued $1 billion aggregate amount of debt securities in registered offerings during the past three years criterion for a WKSI, we propose a third criterion:

- The issuer must have $250 million of investment grade debt securities currently outstanding.

We feel that this criterion will satisfy the intent of the Proposal for the following reasons. First, we believe that an investment grade rating by one of the three primary rating agencies (Moody's, Standard & Poor's or Fitch IBCA) is so important as a proxy for significant analyst coverage, institutional ownership and trading volumes that it should specifically be included as the basis for an alternative test of WKSI status for debt-only issuers. That would be consistent with the Eligibility Requirements for Use of Form S-3 (see: "Transaction Requirements - *Primary Offerings of Non-convertible Investment Grade Securities"*).

Second, linking WKSI eligibility to a minimum amount of debt offered in registered offerings over three years, as opposed to a minimum amount of debt securities outstanding, would unduly penalize debt-only issuers who may possess all the "qualitative" attributes of a WKSI, but simply have not had such debt maturities or capital needs in the recent past as to require them to offer new debt securities over $1 billion. Adding to the "minimum amount issued over three years" standard a "minimum amount of investment grade debt currently outstanding" threshold would make the requirement more consistent with the $700 million common equity current float requirement.

Third, we believe that $250 million of debt provides a significant market for trading; moreover, we believe that this threshold, when coupled with an express investment grade rating requirement, would be as appropriate as the higher, issuance-linked threshold without a minimum rating requirement put forward in the Proposal. We submit that the compelling statistics cited in the Proposal would be equally compelling when related to this amended test, which would not unduly expand the universe of debt-only issuers eligible as WKSIs.

Separately, and by way of additional commentary on the suggested modifications to the Proposal discussed above, we wish to explain why the alternative set forth in the Proposal for majority-owned subsidiaries of a WKSI does not adequately address the prevalent corporate structure of most publicly traded REITs; for this reason, the proposed revision to the debt-only WKSI requirement discussed above is even more important for the REIT industry. It is important to note that we are not requesting special rules regarding WKSI status for affiliates of REITs, but rather proposing a general standard for all debt-only WKSIs that also addresses the peculiar needs, among others, of majority-owned affiliates of REITs.

The prevalent corporate structure of publicly traded REITs is the so-called "umbrella partnership REIT" or "UPREIT" structure, where a listed REIT (either a business corporation or a business trust) controls as general partner an operating partnership (OP) through which the REIT indirectly owns its properties and conducts its business. Usually, the REIT owns a majority of the equity of the OP; even when that is not the case, however, the REIT has full control of the OP under the terms of the partnership agreement, and the OP is managed by the Board of Directors of the REIT for the benefit both of REIT shareholders and OP minority partners. In the typical UPREIT structure, the OP, not the REIT, issues debt securities. Rating agencies require that the OP be the primary obligor on, and the issuer of, the debt because otherwise the portion of the cash flow from the underlying assets and business attributable to the minority interest in the OP that the REIT does not own would not be available to service the debt. While upstream guarantees by the OP of debt issued by the REIT might alleviate this problem, they present enforceability/equitable subordination and other legal issues. Debt issued by the OP is also by definition one step closer to the actual real estate properties, and thus alleviates "structural subordination" concerns from a general credit underwriting point of view. The REIT typically does not guarantee debt issued by the OP, principally in order to afford the minority partners tax basis proportionate to their equity stake in the OP, as well as other financing opportunities peculiar to the real estate business in an UPREIT structure.

Given the typical UPREIT structure, the debt-only issuer requirements for WKSI status set forth in the Proposal may create an anomalous situation where the REIT is a WKSI, but its OP subsidiary is not. That would happen if the OP itself has not issued over $1 billion of securities in the last three years, and the REIT does not fully and unconditionally guarantee the OP's debt. The dissimilar treatment makes no practical sense. As noted in the Proposal, the purpose of classifying an entity as a WKSI is to identify those entities that have a well demonstrated market following. Because of the UPREIT structure, an understanding of the financial condition of an OP is necessary to understand the financial condition of the REIT. This is because essentially all of the cash flow of a REIT is received through distributions made by the subsidiary OP. We recognize that the REIT and the OP are separate issuers and distinct legal entities with differing ownership. However, because the REIT in an UPREIT structure conducts its business through the OP, sophisticated institutional and retail investors, members of the financial press, and buy-side and sell-side analysts need the same access to the OP as with the REIT.

If the REIT qualifies as a WKSI, and has the required market following, it would be impractical and counterproductive for its OP subsidiary not to qualify as a WKSI. We are not proposing that the full and unconditional guarantee requirement be relaxed. Given that most OPs that issue publicly traded unsecured debt securities have an investment grade rating, we believe that our proposed additional WKSI test for debt-only issuers discussed above would alone minimize the likelihood of this anomalous result. In addition, we respectfully propose that the term "majority-owned subsidiary" in the Proposal be clarified to include controlled, consolidated subsidiaries like the OP in an UPREIT structure, regardless of the percentage of the equity owned by the REIT parent, so long as the REIT itself qualifies as a WKSI.

In conclusion, under the amendments we suggest to the Proposal, a debt-only issuer which is a consolidated OP subsidiary of a REIT with less than $700 million of common equity float, would itself be a WKSI, even absent a downstream guarantee by the REIT, so long as it had, or will have upon completion of the offering (based on the pre-offering "provisional" rating: 1) an investment grade rating; and, 2) at least $250 million of publicly-traded debt securities outstanding. This treatment of subsidiaries such as UPREITs seems particularly appropriate in light of the fact that under the Proposal, any majority-owned subsidiary of a WKSI, regardless of the amount of debt it has issued, its debt rating or the amount of control wielded by the minority owner(s), would be a WKSI automatically so long as its parent company guarantees the debt. That construct unduly penalizes UPREITs because upstream and downstream guarantees are not common in the REIT industry and, despite the REIT's full control over the OP, occasionally the REIT owns less than a majority of the equity of the OP. At the same time, we believe that other industries may equally benefit from these revised requirements for WKSI status and we are not advocating special relief limited to the REIT industry. Conversely, we are putting forward a proposal that lends itself to general application.

**Shelf Registrations**

In the typical UPREIT structure, when a partnership or individual (each, a Contributor) desires to liquidate his or her investment, the Contributor has the right to redeem his or her units in the OP for cash in an amount equal to the fair market value of a similar number of shares of the REIT's common stock. In order to provide a REIT with flexibility in managing its cash flow and capital needs, most REITs reserve the right at the REIT's election (acting as general partner of the OP) to pay for redeemed OP units with shares of common stock of the REIT in lieu of cash. Because the redemption of units by a Contributor (whether for cash or stock) immediately results in the Contributor incurring the tax consequences that were deferred at the UPREIT's formation (or subsequent contribution of properties to the UPREIT), if the consideration paid by the REIT for the units is common stock of the REIT, then the Contributor often immediately resells all or a portion of the common stock in order to satisfy his or her tax liability.

The desire of an UPREIT unitholder to immediately resell REIT common stock that may be acquired upon the redemption of OP units in order to offset tax liability creates unique consequences for unitholders in light of the holding periods required by Rule 144, since the issuance of units to Contributors is typically achieved through private placement transactions to accredited investors that are exempt from registration pursuant to Section 4(2) of the Securities Act of 1933, as amended (the Securities Act). Although the Staff in the Division of Corporate Finance's interpretations of Rule 144(d)(3) generally provide for the tacking of holding periods in certain circumstances involving the exchange of securities, members of the REIT securities bar are aware that the Staff takes the view that holders of UPREIT operating partnership units cannot tack the holding period of their units onto the holding period of common stock issued as payment for redeemed units for Rule 144 purposes. This limitation requires public UPREITs to register the REIT common stock that it may reserve for issuance to Contributors as payment for redeemed OP units in lieu of cash, which, as a practical matter, is essential because, absent registration, unitholders would not be able to afford to start a new waiting period under Rule 144, given that significant taxes are immediately due upon the redemption of the units.[1]

Under current Staff interpretations, UPREITs can register common stock that may be issued as payment for redeemed units by filing a registration statement within a narrow four-week window around the one-year anniversary of the issue date of the units (when such units become redeemable). In the alternative, such registration can be accomplished by filing an evergreen

[1] Initial registration under the Securities Act of the shares of common stock that may be reserved by a REIT for payment of UPREIT units is not possible because of the integration issues surrounding the Staff's interpretation of the roll-up transaction rules under Items 901 through 915 of Regulation S-K. (The Staff took the position in the early 1990s in connection with a number of REIT/UPREIT formation transactions that immediate registration of the units and underlying REIT shares reserved by the REIT as payment for such units at the REIT's election would cause the private formation transactions to be integrated with the simultaneous REIT initial public offering. This would then have made the private placement exemption from the roll-up rules unavailable. Compliance with the roll-up rules was deemed time and cost prohibitive.)

resale shelf registration statement on Form S-3. The former option can be cumbersome, does not always provide relief from Rule 144 compliance for unitholders who are also affiliates (as is often the case), and, because of the narrow window of time during which the registration statement must be filed, is a perilous trap to the unwary. In addition, it may not be possible if the UPREIT is not 8-K compliant under Rule 3-14 of Regulation S-X or has a material development pending at the relevant time. Consequently, many UPREITs elect to file evergreen resale shelf registration statements pursuant to Rule 415 in order to provide for the public resale of common stock that a REIT may elect to issue as payment for redeemed units in lieu of cash.

The difficulty that UPREITs often encounter with evergreen resale shelf registration statements stems from the requirement that the selling security holders be identified in the registration statement prior to effectiveness or in a post-effective amendment to the registration statement, a requirement that is further complicated by the Staff's position that a prospectus supplement may not be used to provide information about selling security holders except in limited circumstances.[2]

The Proposal generally provides relief from the requirement to include the names of selling security holders in the registration statement or in a post-effective amendment. Specifically, the Proposal permits the identification of selling security holders in a prospectus supplement; provided, however, that: 1) the resale registration statement must identify the specific private transaction or transactions pursuant to which the securities were sold; and, 2) the private transaction must have been completed and the securities that were the subject of the registration statement must have been issued in the private transaction and be outstanding prior to the initial filing of the resale registration statement.

Evergreen registration statements filed by UPREITs can easily disclose the identity of the specific private transaction pursuant to which units are sold and can satisfy the requirement that the private placement of the units be completed. However, because of the significant tax consequences that accrue upon the redemption of units, the common stock that may be issued by a REIT as payment for redeemed UPREIT units in lieu of cash (which shares of common stock the REIT would register on an evergreen shelf registration statement) will rarely if ever be outstanding at the time the initial resale registration statement is filed and the time that updating of the names of selling security holders is required. The shares will generally be outstanding at the time any such shares of common stock are being resold to the public by a Contributor in order to facilitate payment of the taxes that have become due as a result of his redemption of units. As a result, under the proposed rules contained in the Proposal, an UPREIT would not be eligible to identify selling security holders in a prospectus supplement and instead would still be governed by the current regulatory scheme that requires the filing of a more cumbersome and

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[2] Footnote 270 of the Proposal states that "Currently, the staff in the Division of Corporation Finance requires all issuers registering securities for the benefit of selling security holders to include the names of selling security holders in the registration statement either prior to effectiveness or through a post-effective amendment to the registration statement, with limited exceptions for the identities of security holders owning a de minimis amount of the issuers securities (less than 1 percent) or receiving the securities as a result of a donative transfer."

costly post-effective amendment. We believe that this result is unwarranted and inconsistent with the objectives of simplifying the registration process contemplated by the Proposal and we ask that the Commission provide a specific exemption permitting UPREITs (or any corporate owned partnership that has the same structure as an UPREIT) to utilize a prospectus supplement in connection with identifying selling security holders under an evergreen shelf registration statement.

Existing restrictions applicable to primary and secondary distributions, particularly those involving public shells and private investment in public equity (PIPE) transactions, together with the compliance framework of Rule 144, are designed to: 1) provide investors with the information that they need to be able to make intelligent investment decisions; and, 2) to safeguard against the use of ostensible private purchasers or other transferees as conduits for the sale of securities to the public without registration. We recognize that the Staff has concerns about the efficacy of these safeguards in the case of PIPE and reverse merger transactions. We believe, however, that none of these potential abuses exist in the case of UPREIT units.

UPREIT units are bona fide long-term holdings of sophisticated accredited investor Contributors who are making long-term investments in real estate. The issuance of UPREIT units to these Contributors in private placements and the subsequent evergreen registration statements that cover the common stock that may be issued by the REIT as payment for redeemed units in lieu of cash do not implicate any of the Commission's concerns relating to PIPE and shell transactions, as UPREITs are clearly not a conduit to the sale of securities to the public without registration, as registration statements are on file in virtually all cases and UPREIT unitholders tend to be long-term holders. Therefore, we believe it is appropriate for the Commission to provide a specific exemption permitting UPREITs to utilize a prospectus supplement in connection with identifying selling security holders under an evergreen shelf registration statement.

NAREIT thanks the Commission for this opportunity to comment on the proposal. Please contact Tony Edwards, NAREIT's Senior Vice President and General Counsel, at (202) 739-9408 or myself at (202) 739-9432 if you would like to discuss our comments.

Respectfully submitted,

George Yungmann
Vice President, Financial Standards