KBS | Capital Markets Group

February 28, 2014

Elizabeth M. Murphy
Secretary
Securities and Exchange Commission
100 F Street, NE
Washington, DC 20549-1090

RE: File No. SR-FINRA-2014-006, Proposed Rule Change Relating to Per Share Estimated Valuations for Unlisted DPPs and REITs

Dear Ms. Murphy:

KBS Capital Advisors LLC is the advisor of five public unlisted REITs, with an additional KBS-sponsored program currently in registration. To date, KBS-sponsored programs have raised over $4.9 billion in equity capital and have acquired real estate and real-estate-related assets for over $8.9 billion. We support FINRA's efforts to ensure the reliability of per share estimated values for unlisted REITs included on customer account statements. However, as described further below, we believe that certain aspects of the proposed rule should be revised prior to adoption and that FINRA should delay its implementation to give sufficient time to the industry to prepare for the rule change.

<u>Adjusting Account Statement Values for Certain Distributions</u>

FINRA has proposed that the "net investment" account statement value be adjusted by an amount deemed to represent distributions in excess of GAAP net income before depreciation and amortization or depletion deductions. We believe this is the wrong metric to use for an adjustment of account statement values for the following reasons.

First, the metric is unsuitable when depreciation and amortization are not related to real estate. The proposed rule covers all direct participation programs, which include equipment leasing and oil and gas programs. Depreciation for such programs is more likely to reflect a true decline in share value than for a real estate company.

Second, utilizing this metric means that acquisition expenses that are paid in connection with purchasing real estate, which is an investing activity and which is almost always funded from offering proceeds or financing proceeds, will reduce the portfolio operating income against which distributions will be measured during the investing phase of the REIT. We are not arguing that these acquisition expenses are not real expenses incurred by the REIT. However, these expenses are not operating in nature and should be adjusted out for purposes of measuring whether certain distributions cause share values to fall below net investment amounts. Like asset management fees, acquisition expenses contribute to a return on investment. And like the proposed treatment of asset management fees (see FN 20 of proposal release), acquisition expenses should not trigger a decline in account statement values. Otherwise, share values will be mistakenly perceived as declining with each acquisition. In reality, the opposite is true. Failure to make investments would result in declining share values.

Third, if acquisition expenses are not adjusted out of the metric, investors will see a non-GAAP measure (net operating income before depreciation and amortization ("NIBDA")) that is seen as a distribution coverage measure and that fluctuates wildly based on the volume of investments during each quarter. Once the REIT completes its investment phase, the non-GAAP measure will immediately stabilize. This fluctuation will be very confusing to many investors and will result in a measure that does not help investors understand the distribution coverage trend that the REIT's operations are generating.

Fourth, NIBDA would be a new non-GAAP measure that would be disclosed in SEC filings resulting in likely three non-GAAP measures in unlisted REIT financials – FFO, MFFO and NIBDA. This will unnecessarily complicate REIT reports to shareholders.

Fifth, if account statements must be reduced to account for certain distributions, FFO and MFFO are already used by unlisted REITs and are better metrics for this purpose.

- FFO already adds back depreciation and amortization. It also calls for several other appropriate adjustments, the most significant of which are adjusting out gains and losses on real estate sales (which are not operating items and do not affect the operating income available to pay distributions).

- MFFO starts with FFO and then adjusts for two major items as well as a few other minor things. The first major item is the acquisition expenses noted above, which is appropriate for this purpose. The second is to eliminate non-cash rental items, mostly comprised of straight-lined rent (the difference between rents received in cash and rents recognized for GAAP purposes) and above- and below-market rent (assets and liabilities recorded as part of purchase accounting that result in rental revenue being grossed up or down as these amounts are amortized into rental revenue when no cash will ever actually be paid or received related to such revenue), which is also a good adjustment when the metric is being compared to distributions to determine an excess or shortfall in coverage because rents not received in cash are not available to pay a distribution. This focus on cash with respect to operations is appropriate. See page 8 of the proposal release, where FINRA justifies the adjustment for depreciation, amortization and depletion expenses because they "are not expenditures and do not impact the issuer's cash reserves."

Because the MFFO non-GAAP measure is already in use and approved for inclusion in SEC filings as a measure to address the sustainability of distributions and is superior to the metric proposed by

FINRA for the reasons noted above, it is the best metric to use to adjust account statement values on account of certain distributions if such an adjustment is deemed necessary.

Adjusting Account Statement Values for Organization Expenses

FINRA has proposed that the "net investment" account statement value be based on the "amount available for investment" percentage in the "Estimated Use of Proceeds" section of the offering prospectus. FINRA should clarify that the percentage in the "Estimated Use of Proceeds" section should be based on the maximum number of shares to be sold in the offering. This clarification is necessary because Industry Guide 5, which is applicable to unlisted REIT offerings, requires that the "Estimated Use of Proceeds" table also include a column assuming the minimum amount of proceeds raised. Given the large size of unlisted REIT offerings relative to the minimum amount needed to break escrow, using the minimum number would grossly overstate the burden of organization expenses on share values. We also note that Rule 415(a)(2) under the Securities Act of 1933 only allows an issuer to register on a shelf registration statement an amount that the issuer reasonably expects to raise within the first two years of the effective date of the registration statement.

Account Statement Value Reliability

The proposed rule states that a broker-dealer may provide a per share estimated value of an unlisted REIT share on an account statement but only if (i) the value has been developed in a manner "reasonably designed to ensure that it is reliable" and (ii) the broker-dealer "has no reason to believe that the per share estimated value is unreliable." This standard could be interpreted to impose a duty on a broker-dealer to assess the reasonableness of a valuation used on an account statement. FINRA should revise the proposed rule to make it clear that no broker-dealer has a duty to take any steps to assess the reasonableness of any valuations published by the issuer if the issuer was contractually obligated to comply with the requirements of proposed FINRA Rule 2310(b)(5)(B)(ii) (including a requirement of material assistance of a third-party valuation expert, disclosure of the method by which the estimated value was development and the delivery of an opinion from the valuation expert to the sponsor of the REIT regarding the scope and methodology of its review and the basis for the per share estimated value). Although not necessary, we would not object if FINRA Rule 2340 required a broker-dealer to refrain from including a per share estimated value on an account statement if the member has knowledge that the value was inaccurate as of the date of the valuation or is no longer accurate as a result of a material change in the operations or assets of the program or trust, which we believe is consistent with the standard applicable to broker-dealers under current FINRA Rule 2340.) Without this needed clarification of a broker-dealer's obligations, broker-dealers may determine to minimize their risk by simply showing "not priced" on an account statement. This could create tremendous investor confusion. We suspect that there would be other unforeseen and adverse consequences created by such a potentially significant change in account statements. Moreover, if broker-dealers are burdened to

KBS Capital Markets Group
660 Newport Center Drive, Suite 1200 • Newport Beach, CA 92660
TEL 949.717.6200 • FAX 949.717.6201

make a reasonableness assessment potentially years after their diligence for the offering is complete, this will increase the costs of raising capital, which hurts investors and unlisted REITs alike. We trust that FINRA does not intend for these additional burdens on broker-dealers with respect to account statement valuations and respectfully submit that FINRA should clarify that the new rule does not add to broker-dealer obligations with respect to assessing share values on account statements.

Implementation Date

We recommend that implementation of the final rule be delayed until at least 18 months after its final adoption. Programs that have already commenced their offerings should be given time to raise capital under the current regulatory regime. Otherwise, these programs will be at a significant disadvantage to newly created programs that will have time to adjust their offering structures to be competitive under the amended rules. Moreover, these adjustments will take time to create and implement. These adjustments may include the issuance of multiple classes of stock, the payment of trail commissions, the creation and capitalization of other entities used to monetize trail commissions, changes in fees and reimbursements payable to sponsors, changes in distribution policies, changes in investment strategies that are more conducive to covering distributions (such as core real estate programs instead of value-add real estate programs like KBS Strategic Opportunity REIT, Inc.), reprogramming automated account statement pricing systems, preparing sales materials and implementing new compliance procedures. An 18-month implementation date would give sponsors sufficient time to structure offerings that can be successful under the new rules and would not unfairly penalize those programs already raising capital under existing rules.

We appreciate your consideration of our views.

Sincerely,

Michael Crimmins
Chief Executive Officer/Managing Director
949.717.6215