14 March 2011

Mr. Joseph E. Price
Senior Vice President
Corporate Financing/Advertising Regulation

C/O Marcia E. Asquith
Office of the Corporate Secretary
FINRA
1735 K Street, NW
Washington, DC 20006-1506

Dear Mr. Price:

I have had a securities license for thirty five years and have served as a real estate sponsor since 1982 for Reg D's with assets from New York to Florida to Utah.

I want to thank you for your efforts in drafting 11-04. I support what you are trying to do. When a level playing field is created among sponsors, it is good for both sponsors and investors. With a level playing field the public develops greater comfort and offerings are easier to sell. That being said I must share with you that 11-04 does not work as drafted. I would like to use this letter to:

1) Share with you why I believe 11-04 does not work
2) Recommend improvements to the goals of 11-04

Why 11-04 Does Not Work

As I start my comments on this topic I want to clarify how I am reading 11-04. My understanding is that "15 percent of money raised is used to pay for offering costs and compensation."

If a sponsor offers a portfolio of Las Vegas REO single family homes where the banks are offering 100% financing on a $10 million portfolio, the sponsor may raise only $550,000 and not be compliant with 11-04. The uses would be $50,000 to the BD community and $500,000 to the sponsor. In this extreme example, zero would be used for "business purposes described in the offering document," and yet the sponsor is receiving only 5% of the offering's capitalization. As I read 11-04, the fees heretofore that were determined by capitalization are now determined by equity. The same is true of every HUD or USDA RD (formally Farmers Home Administration or FmHA) offering except the leverage would not be quite as extreme as these agencies offer 95% financing.

A second view of 11-04 that gives me pause is in the example below. Suppose that as a sponsor I contract with four builders from four states to syndicate four FmHA RD rural apartment complexes. The motive to create the offering is the upfront fee. FmHA limits cash flow to $4,000 per million dollars of development. If I receive the $4,000 cash flow it is used to pay for the tax return prep. Under 11-04 the sources and uses of the offering would look as follows:

Development Cost	$4,000,000
FmHA RD Mortgage (95%)	3,800,000
11-04 Raise (offering purpose plus 15%)	230,000
Offering purpose (Equity @ 5% of $4,000,000)	200,000
Sponsor net proceeds	30,000
To BD community (10% of $230,000)	23,000
Sponsor Fee	7,000

No one will create a $4,000,000 four property offering for the expectation of receiving the $7,000 sponsor fee shown above.

The third item that gives me pause is a subject on which 11-04 is silent and FINRA may not be able to regulate. What happens in two tiered offerings? In the above example the four local developers/builders charge a fee. These fees do not go into the purpose of any offering. Is the sponsor responsible to be FINRA's policeman? What if one of the developers has his own BD and others do not?

The fourth item that gives me pause is that anyone can sell a Reg-D as issuer. If 11-04 disenfranchises the BD community then those four developers/builders will offer their own product without any oversight from FINRA or the states. Whose interests are then being served?

Overpriced offerings could become the norm and the press will cover the failed offerings and paint both of us with a brush that we don't want.

My Suggestion

Do not combine "selling compensation "and "compensation," bifurcate them. Define and set standards for each. Keep in mind that the amount of capitalization and the amount of equity have no necessary relationship.

Selling Compensation

A selling commission is always paid through the BD community. Those selling as issuer cannot pay a commission. FINRA should establish guidelines for selling commission and related expenses that are equitable.

Compensation

The "compensation" issue is much more difficult. Let's suppose there were three different Reg D's. One was 700 single family homes in Las Vegas, the second was ten FmHA RD apartment complexes in five states (all with controlled rent and cash flow) and the third was a single 400 unit market rate apartment building in Bethesda, MD. Each offering had a capitalization of $10 million. Should the sponsor be limited to the same fee? The time required putting each offering together and the risk for each offering is very different. While it would be nice to have a "one size fits all," it does not work here as it does in the "Selling Compensation" paragraph above. It is more equitable to cap the sponsor fee as a percentage of capitalization rather than equity. That being said, based on what the cap is, the regulations will drive sponsors to certain products, not the market. It is more difficult to buy one FmHA RD property than one market rate property in Bethesda. My suggestion then is that FINRA accept a

Prudent Man Rule. A $1.5 million fee on a single apartment building in Bethesda might be too much while a similar fee on 700 single family homes might be a bargain.

Where FINRA shines is in the disclosure business. I would nominate that FINRA consider the appropriateness of requiring the disclosure of sponsor fees whether from equity or from debt. I would also require that sponsors disclose markups or markdowns on assets owned less than 12 months as well as including any individual who owns more than 20% of the sponsor. I assume that FINRA's regulations are close to this already.

The three most important words in real estate are location, location and location. The three most important words in the securities business are disclosure, disclosure and disclosure.

As a closing thought, the opening paragraph in 11-04's Executive Summary states "…..business purpose identified in the offering document." There is no requirement for an offering document. If history serves me well, the first private offering was on the Empire State Building. The tax opinion was written by Sheldon Cohen who later became IRS Commissioner under LBJ and is still living in the Maryland suburbs of DC. No offering document was prepared for this offering.

I may be reached at (W) 703-528-8063 and (M) 703-989-6438. I would like to make whatever contribution to this important subject including meeting with you or your staff. I remain,

William J. Fahey
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