

March 11, 2004

Ms. Barbara Z. Sweeney
NASD
Office of the Corporate Secretary
1735 K Street, N.W.
Washington, DC 20006-1500

Re: **NASD Notice to Members 04-07**
Proposed Amendments to NASD Conduct Rules 2710 and 2810

Hines

Dear Ms. Sweeney:

The following comments are offered in response to NASD Notice to Members 04-07, which described several proposed amendments to NASD Conduct Rules 2710 and 2810 (collectively referred to herein as the "Conduct Rules").

Proposed Amendments Prohibiting Payment of Commissions on Reinvested Dividends

1. **Significant Distinctions Exist Between Non-Liquid REITs and Mutual Funds.**

The stated policy reasons underlying the NASD's proposal to amend the Conduct Rules to prohibit the payment of commissions for investments made with reinvested dividends are the same as the reasons stated in its Notice to Members 97-48, which proposed substantially identical amendments to the rules governing the sale and distribution of investment company shares and variable insurance products. In NASD Notice to Members 97-48, the NASD proposed, among other amendments, that the Investment Company Rule be modified to prohibit sales loads on reinvested dividends because "these charges will typically cause an investor to pay a charge twice on the same assets, and could exceed the appropriate sales charge limits." In so stating, the NASD provided the example of "an investor who invests in a load fund at a time when a portion of the fund's net asset value includes undistributed income or capital gains will pay a charge based, in part, on the undisclosed earnings. When those earnings are distributed and reinvested, the investor will pay a second charge on those assets." Thus, the amendment to the Investment Company Rule was designed to "ensure that investors are not subject to the imposition of these duplicative loads."

Likewise, in the recently issued Notice to Members 04-07, the NASD states the following as a justification for the proposed amendment prohibiting the payment of commissions on investments made with reinvested dividends in REITs, DPPs and closed-end funds:

In April 2000, NASD amended the Investment Company Rule to prohibit members from offering or selling shares of an investment company if it has a front-end or deferred sales charge imposed on shares purchased through the reinvestment of dividends. Loads on reinvested dividends may be opaque or confusing to investors and in certain circumstances, may cause an investor to pay a charge twice on the same assets. For example, an investor who pays a load at a time of purchase based on a net asset value that includes undistributed income or capital gains may pay a second charge on the same assets when those earnings are distributed and reinvested.

This premise, that the purchase price paid by investors in REITs reflects an appreciated "net asset value," which includes undistributed income or capital gains, is incorrect with respect to substantially all publicly registered, non-traded REITs. Thus, the fear that an investor may "pay a charge twice" on the same assets does not provide justification for this proposed amendment.

We agree that, in the open-end mutual fund arena, the per share purchase price can fluctuate significantly based on a fund's value which can often reflect imbedded capital gains. Thus, when an investment is made, the per share price paid by an investor may well reflect an imbedded gain then existing in the fund. In contrast, however, publicly registered, non-traded REITs are generally offered and sold to the public at fixed per share prices. To our knowledge, except for one limited instance, no publicly registered, non-traded REITs have repriced their offerings based upon their net asset values and, thus, the per share prices have not included imbedded capital gains.

In further contrast to mutual funds, the amount of the dividends distributed to investors in REITs are based almost entirely on the amount of actual cash the specific program generates from its real estate operations. Although it may be true that distributions from such products often include a return of capital component (at least for tax purposes), the return of capital portion of such distributions is the direct result of permitted depreciation taken on the underlying real estate assets, as opposed to economic appreciation of the properties. While the payment of sales loads on capital gain distributions in the mutual fund area, when coupled with a situation where an investor has already paid a sales commission on the value of imbedded capital gains within the fund, may well be viewed as paying "a second charge on the same assets," the same is simply not true for REITs, where dividends and cash flow distributions are based almost exclusively on operating cash flow generated by the real estate assets owned by the program.

2. The Payment of Commissions For Sales Made by Reinvested Dividends is Fully Disclosed in the Prospectus.

Notice to Members 04-07 also provides that “[l]oads on reinvested dividends may be opaque or confusing to investors. . .” Although this may or may not be true for mutual funds, it is not true for investments in publicly registered, non-traded REITs.

The amount of all commissions payable on sales of these investments, including commissions paid on shares purchased through dividend reinvestment programs, are fully disclosed in the prospectuses issued for these programs. These disclosures are scrutinized by both the SEC and the NASD for clarity and adequacy of disclosure as a condition of issuing a “no objection” letter and the ability to be declared effective by the SEC. It is difficult to conceive of how an investor who reviews such disclosures could make a legitimate claim of confusion. Thus, the possibility of investor confusion does not seem to us to provide justification for the proposed amendment.

3. The Proposed Amendment Would Actually Encourage the Sales Practice Abuse that it is Intended to Prevent.

We believe that you should consider whether the proposed amendment would actually encourage sales practice abuses that the NASD is intending to prevent. The NASD’s underlying policy reason for making this proposal is to ensure that registered representatives do not place and keep their clients in unsuitable REIT and DPP investments, for the sole purpose of earning commissions on reinvested dividends. In fact, however, if the payment of commissions on reinvested dividends is prohibited, registered representatives will be motivated to move their clients’ funds into investments which would pay them current commissions, regardless of whether the REIT or DPP investment is in fact more suitable for the client. For policy reasons, the NASD should not prescribe a rule that would promote redemptions in otherwise suitable investments, particularly with respect to real estate investments which are inherently long-term, illiquid investments.

For the reasons set forth above, we believe that commissions on reinvested dividends should not be prohibited. If, however, the decision is in fact made to prohibit such commissions altogether, we believe that serious consideration should be given to whether it is appropriate to provide for some type of continuing servicing fee to be paid to registered representatives to compensate them for the legitimate and valuable ongoing services they provide to investors throughout the term of their investment.

Proposed Amendment Regarding the Location of Training and Education Meetings

We concur that the interpretation of an “appropriate location” for a bona fide training and education meeting should be expanded to include a location at which a significant DPP or REIT asset is located. Indeed, a registered representative who is working to discharge his or her ongoing responsibility to monitor the real estate portfolio of an investment program would undoubtedly find it more valuable to review in person a significant portfolio asset, than to attend a meeting at a location that offers nothing more than proximity to the sponsor’s home office.

Proposed Amendment Relating to the Allocation of Dual Employee Compensation to Organization and Offering Expenses

We applaud the NASD’s effort to apply objective criteria to the often difficult and time consuming assessment of whether the compensation of NASD registered employees, who perform work for both an issuer and an affiliated dealer/manager, should be allocated as underwriting compensation or issuer organization and offering expenses.

We appreciate the opportunity to make comments regarding the proposed rule amendments and would be pleased to answer any questions that you have regarding the comments set forth in this letter.

Sincerely yours,



Leslie B. Jallans
Director of Compliance
Hines Real Estate Securities, Inc.
Member of the NASD