April 21, 2022

Ms. Vanessa A. Countryman
Secretary, U.S. Securities and Exchange Commission
100 F Street, N.E.
Washington, D.C. 205499–1090

[Submitted via email to rule-comments@sec.gov]

Re: SEC Release No. IA-5955; Securities File No. S7-03-22 (February 9, 2022).
Private Fund Advisers

Dear Ms. Countryman:

The Real Estate Board of New York (REBNY) is pleased to provide comments to the Securities and Exchange Commission (SEC) on its proposal to impose new rules under the Investment Advisers Act of 1940 concerning private fund advisers. REBNY is New York City's leading real estate trade association representing commercial, residential, and institutional property owners, builders, managers, investors, brokers, salespeople, and other organizations and individuals active in New York City real estate.

The proposed regulation would significantly disrupt the operations of real estate private equity investment advisers and the funds they advise. Those funds – which take risks for the sophisticated investors that make economic choices to invest in them – and their investments are important to efficiently and effectively allocating capital in the industry that has fostered investment in real estate that supports good jobs and bolsters state and local tax coffers. If adopted, the proposals would add substantial cost to this industry, disrupting practices and hampering investments without providing clear benefits to investors or the public.

To that end, REBNY offers the following specific comments on the proposal.

1. Real estate private equity provides substantial benefits to the economy and investors

Real estate investment funds take risks for investors that choose to participate in those funds. Those investments have been instrumental to the success and growth of the real estate sector, creating improved buildings, billions of dollars in returns for pension funds and other investors, and good jobs for building service and construction workers. For this reason, interest in real estate private equity from sophisticated investors continues to grow as these investments deliver strong returns.

A strong vibrant real estate private equity sector is important to directing capital to efficient uses. This reality was borne out in recent years when, in the midst of a pandemic and economic downturn, the investment from this sector supported jobs and delivered returns for many investors, including public pension funds. Specifically in New York City, the companies supported by these investments play a critical role in local economic development, including for unionized building service workers, construction workers, and the local economy that supports those workers and building occupants. Real estate private equity investments also provide vital support to State and City budgets, where real estate transaction and property taxes account for a substantial share of tax collections.

2. The proposed rule does not establish that it would provide substantial benefits to investors or the public

The proposed rule, if adopted, would establish significant new requirements on real estate private equity advisers and funds. For the reasons articulated below, the proposal fails to explain how it would provide benefits to investors or the public necessary to warrant its promulgation.

As important context, the overwhelming majority of investors in private funds are sophisticated investors. Those "qualified investors" are presumed to be able to evaluate and understand the risks of their investments. Given their size and sophistication, combined with their increasing appetite for investment in real estate private equity, it is not clear why those investors require additional protections.

Further, many of the investors that would "benefit" from the proposal are already protected by other requirements. For instance, smaller investors often invest through a "chaperone" such as a pension plan, ERISA plan, or fund of funds. In addition, any person that exercises discretionary authority over an ERISA plan is subject to a fiduciary duty, while State pension plan trustees and administrators are subject to heightened investor protection regimes.

These considerations are particularly important in light of the Commission's obligations to establish the need for this action. In issuing a proposed regulation, the Commission is required to consider the impact the rule will have on efficiency, competition, and capital formation. Doing so necessitates an understanding of the current state of the marketplace, a requirement which in this case the Commission has failed to satisfy, as the proposal states that the Commission is not aware of the "extent to which advisers currently provide information that would be required to be provided under the proposed rule to investors." Without such information, the Commission is unable to evaluate the impact of the proposal or justify the need for such sweeping changes.

3. The proposal has substantial costs that far exceed any potential benefits

The proposal would impose significant new costs on the industry, disrupting business practices that are important to the efficient allocation of capital. In doing so, the proposal would likely hinder the ability of small and new firms to compete, consolidating the market and cutting down competition. Further, such costs combined with fewer market participants would create challenges for investors' ability to generate desired returns. These concerns are detailed with greater specificity below.

A. The proposal will inhibit the ability of sophisticated investors to seek out appropriate risks and achieve their desired returns

The proposal would generally prohibit investment advisers and investors from agreeing to limit an adviser's liability, a prohibition that ultimately hurts investors even more than it hurts advisers. Investors may agree to limit the liability of private fund advisers so that advisers will not pass up valuable opportunities out of fear of potential litigation. In seeking to prohibit such arrangements, the proposal would eliminate an incentive structure that many investors have found to drive efficient investment strategies.

The proposed prohibition will also result in increased investor costs. This is the case because private fund advisers would need to charge large, fixed management fees (with sufficient cushion built in for any unexpected developments) to offset the litigation liability that they are no longer able to limit contractually and to cover the compliance and regulatory costs. As a result, investors would potentially pay more compared to the current model.

The consequences of these changes could be substantial. For instance, the proposal could limit the ability of institutional investors, including state and local pension funds, to generate the returns they need to meet their current and future obligations. Unfortunately, many state local pension plans across the country are facing financial challenges. Investments in alternative funds like real estate private equity are one of the few ways those plans can meet their return targets and fund their benefits. Given that the investment activity that can generate those returns is inherently risky, advisers to the funds that need to pursue those returns should not be punished for making good faith judgments even if, as is inevitable, some do not produce the desired performance results.

B. The proposals will add costs that are particularly harmful to smaller and new firms

If adopted, the proposed reporting requirements, including ongoing monitoring to ensure such reporting guidelines are properly followed, will be very costly. However, investment advisers already provide extensive reporting to investors, and advisers to private funds have tailored that reporting over time to meet the specific needs of particular fund investors such that many sponsors have invested substantial sums of money to build out proprietary reporting templates and systems. The new requirements will require sponsors to modify or expand their reporting systems at significant cost to comply.

These Proposal's extensive reporting requirements would be particularly challenging for smaller firms or newer entrants to the market and will add cost to funds. As a result of those additional costs, smaller fund sponsors that lack the back-office infrastructure needed to efficiently comply with the proposed reporting requirements may be driven out of the market. In addition, the new reporting burdens would also create a barrier to entry for startup advisers to real estate private funds, including minority and women-owned businesses that are currently underrepresented in the asset management industry and could otherwise be expected to make up a greater percentage of new entrants to the market. As such, the proposal could well have the undesirable effect of fostering industry consolidation, which does not generally favor investors.

C. The proposal would completely disrupt existing fund operations

The proposed changes are unworkable for existing funds. Real estate private equity funds have a lifespan of over ten years. As a result, funds that exist today are in different stages of their investment strategies. If the rules applied to existing funds, the investor agreements would need to be renegotiated—an enormously costly, massively disruptive endeavor. Moreover, the mandatory renegotiations would disadvantage funds at different lifecycle stages, which would arbitrarily harm some investors and advisers more than others simply because of the timing of the rules.

In conclusion, advisers to real estate private funds bring expertise that provides immense value to an investor's portfolio, which is why sophisticated investors continue to engage with this industry. Investors and advisers to private real estate funds have established a practice that allocates economic considerations and risks between sophisticated parties through contractual negotiations that reflect and satisfy the commercial value proposition for all parties. In jeopardizing those arrangements, the proposal risks upending this important economic driver without providing benefits to investors.

Thank you for the opportunity to comment on this important issue.

Sincerely,

James Whelan
President