



# The Real Estate Roundtable

## Real Estate Capital Formation

### Capital and Credit

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## Summary

In 2023, the Securities and Exchange Commission (SEC) proposed changes to require SEC-registered investment advisers to put all their clients' assets, including all digital assets like Bitcoin and certain physical assets like real estate, with "qualified custodians." The proposal would also require a written agreement between custodians and advisers, expand the "surprise examination" requirements, and enhance recordkeeping rules. These rules were originally designed for digital assets. "Reasonable" safeguarding requirements is ambiguous as applied to real estate. Furthermore, the SEC's release contains an inaccuracy regarding the way deeds evidencing ownership of real estate are recorded.

RER sees no policy reason to impose the proposed rule on real estate and has advocated for an exception for real estate.

## Key Takeaways

- Due to a variety of factors, real estate cannot readily be stolen, making the rule seem irrelevant to this asset class.
- In addition to the proposed Custody Rule, the SEC has a number of proposed rulemaking measures that could have a chilling effect on real estate capital markets, further impair liquidity, and be a "death by a thousand cuts" for commercial real estate.
- Capital formation is vital when credit markets tighten to restructure maturing debt.

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## Background

### SEC Proposal

- On Feb. 15, 2023, the SEC proposed *Safeguarding Advisory Client Assets*, which would significantly expand the requirements of the Custody Rule to maintain client assets with a qualified custodian for certain physical assets such as real estate.
- The SEC's release indicates that deeds evidencing ownership of real estate can be held at a qualified custodian—this is not accurate.
  - Deeds are recorded with a government authority. Land and buildings cannot be physically absconded.
  - Lenders and other interested parties have an interest in ensuring no misappropriation of real estate.
- Fortunately, on June 5, 2024, the U.S. Fifth Circuit Court of Appeals issued an opinion that vacated the SEC Private Fund Adviser Rules, holding that the SEC exceeded its statutory authority in adopting the rule. Specifically, the court held that the "promulgation of the [Rule] was unauthorized... no part of it can stand."
- The SEC previously considered expanding its Safeguarding Rule to include physical assets like real estate under the prior administration but faced significant industry pushback, with groups like RER urging its exclusion due to existing protections.
- The initial proposal aimed to broaden the rule's application beyond traditional privately offered securities but was met with concerns that it would create compliance burdens, raise costs for clients, and inadequately address the unique nature of real estate assets.
- As of October 2023, there was active discussion to exclude real estate from the final rule, though the outcome of the proposal remains uncertain.
- With the change of administration, SEC Chair Gary Gensler has been replaced by SEC veteran Paul Atkins. Under Atkins' leadership, it is likely that the Commission may either withdraw the proposed rule altogether or grant an exception for real estate.



## Recommendations

**Grant an Exemption for Real Estate:** RER believes that the SEC's policy reasons for imposing the rule on real estate seem irrelevant.

- Real estate cannot readily be stolen. As stated above, lenders and others have an interest in ensuring no misappropriation of real estate.
- Title insurance protects real estate investors against covered title defects, such as a previous owner's debt, liens, and other claims of ownership. It's an insurance policy that protects against past problems, whereas other insurances usually deal with future risks. Titles are recorded in the name of the acquiring entity by a government entity.
- Different jurisdictions present even more challenges. Different laws for titles exist between not only states but also countries. The rule applies to registered investment advisors regardless of where the asset is located.
- RER has submitted a comment letter to the SEC and met with senior staff from the investment management division, requesting an exception for real estate.