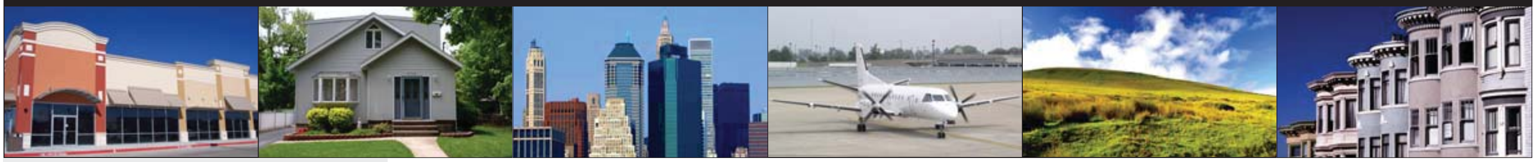
Fractional Ownership

"Delaware Statutory Trust (DST) versus TIC Ownership"



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Investors desiring the tax deferral benefits of §1031 exchanges coupled with the advantages of fractional ownership increasingly are seeking the popular alternatives of tenant-in-common ("TIC") or Delaware Statutory Trust ("DST") co-ownership. Recently, DSTs have been gaining in popularity for a number of reasons including the ability to secure financing more easily and attract more investors with lower minimum investment threshold amounts. Let's look at some of the attributes of DST fractional ownership and how DSTs differ from TIC ownership.

A Delaware Statutory Trust is a separate legal entity created as a trust under the laws of Delaware in which each owner has a "beneficial interest" in the DST for Federal income tax purposes and is treated as owning an undivided fractional interest in the property. In 2004, the IRS released Revenue Ruling 2004-86 which allows the use of a DST to acquire real estate where the beneficial interests in the trust will be treated as direct interests in replacement property for purposes of IRC §1031. Due to the restrictions for DST qualification, the best attributes for a DST are generally single-tenant occupancy, an investment-grade tenant with a long-term lease to avoid turnover costs and triple net lease terms which require the tenant to pay all property expenses. In order for a DST to quality for a §1031 exchange, the trustee may <u>not</u> have the power to do any of the following:

1. Accept contributions from either current or new investors after the offering is closed;
2. Renegotiate the terms of the existing loans, or borrow any new funds from a third party;
3. Sell real estate and use the proceeds to acquire new real estate;
4. Make other than minor repairs that are considered (a) normal repair and maintenance (b) minor non-structural improvements and (c) those required by law;
5. Invest cash held between the distribution dates other than in short-term government debt;
6. Retain cash, other than necessary reserves (all cash must be distributed on a current basis);
7. Enter into new leases or renegotiate the current lease.

A chief advantage of the DST structure is that the lender views the trust as only one borrower (rather than having up to 35 borrowers as in many TIC arrangements) which makes it easier and less expensive to obtain financing. In addition, since the investor's only right with respect to the DST is to receive distributions and they have no voting authority regarding the operation of the property, the "bad boy carve outs" are eliminated and the lender looks only to the sponsors for these carve outs from the non-recourse provisions of a note. Other differences between a DST structure and TIC structure are summarized below:

	DST STRUCTURE	**TIC STRUCTURE**
IRS Guidance	Rev. Rul. 2004-86	Rev. Proc. 2002-22
Maximum Number of Investors	No IRS imposed limitation	Up to 35
Ownership	Percentage of beneficial ownership in a DST that owns real property	Undivided tenant in common interest in real property
Investors Receive Property Deed	No	Yes
Investors Form Single Member LLC	No	Yes (generally)
Major Decision Approval	No voting rights	Equal voting rights and unanimous approval
Number of Borrowers	1 (the DST)	Up to 35 (the maximum number of investors)
Bankruptcy Remote	Yes	No/Yes (if using a single member LLC)