Department of the Treasury
Washington, DC 20224

Person To Contact:
, ID No.
Telephone Number:

Refer Reply To:
CC:FIP:B01
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Date:
November 15, 2011

Legend:

Taxpayer	=
State	=
A	=
B	=
C	=
D	=
Index	=
Sponsor	=

Dear

This responds to the letter dated May 26, 2011. Taxpayer requests that the Internal Revenue Service rule that a Transaction (as described below) will be treated as a real estate asset under sections 856(c)(4) and 856(c)(5)(B) of the Internal Revenue Code of 1986, as amended (the “Code”). Additionally, Taxpayer requests a ruling that gross income realized by Taxpayer from payments made under a Transaction will generate income that is treated as gain from the sale or other disposition of real property (including interests in real property and interests in mortgages on real property) which is not property described in section 1221(a)(1) within the meaning of section 856(c)(3)(C).

Facts

Taxpayer is a limited partnership organized in State and is classified as a partnership for federal income tax purposes. Taxpayer reports its income under the accrual method of accounting and its tax year ends December 31.

Taxpayer and Sponsor intend to engage in a roll-up transaction whereby a corporation or trust ("Newco") will be formed that will elect and qualify as a real estate investment trust ("REIT") for federal income tax purposes. Taxpayer will serve as the operating partnership and will originate and own Transactions, which will be the only assets it owns other than property specifically permitted under section 856.

Taxpayer invests in the potential long-term growth of residential real estate through Transactions. Taxpayer is capitalized through capital contributions from investors and such capital contributions are used to fund and originate Transactions.

Taxpayer offers the Transaction to residential Property owners ("Homeowners") between the ages of A and B. Transactions are designed as an alternative to traditional mortgage loans. Under a Transaction, participating Homeowners are paid an upfront payment ("Upfront Payment") and in exchange grant to Taxpayer the right (the "Participation Right") to participate in the future growth in the value of the underlying property ("Property"). Taxpayer is unable to definitively determine the full income effect of the transaction until a future event ("Trigger Event").

The Transaction begins with the submission of an application by an interested Homeowner. Upon receipt of an application, Taxpayer performs a review and underwrites the proposed transaction. Based upon factors such as the value of the Property ("Initial Property Value"), existing mortgage loans on the Property, location and other underwriting criteria, Taxpayer either approves or declines the Transaction. Because a Transaction is an asset-based transaction, the underwriting process is keenly focused on the value of the Property. If the application is approved, Taxpayer issues a proposed offer sheet that lists the Upfront Payment available to the Homeowner. Upfront Payment amounts are a percentage of the Initial Property Value. Each Upfront Payment has a corresponding Appreciation Participation Rate. "Appreciation Participation Rate" is the rate at which Taxpayer and the Homeowner participate in the appreciation, if any, of the Property. Appreciation Participation Rates range in value depending on the Upfront Payment paid to the Homeowner. Homeowners select the Upfront Payment they desire, as well as the corresponding Appreciation Participation Rate they are comfortable providing to Taxpayer. The amount paid to a Homeowner for an Upfront Payment is not required to be repaid, except in the event a Trigger Event terminates a Transaction within D years.

Trigger Events under the Transaction are: (i) an uncured breach by the Homeowner of the Participation Right Agreement (e.g. default on the primary mortgage loan, or failure to maintain insurance or pay utilities, taxes, etc.,); (ii) the sale/transfer of the Property, including a transfer that results from the death of the Homeowner; or (iii) C years from the origination of the Participation Right (or sooner based upon states' rules against perpetuity laws). Upon a Trigger Event, Taxpayer is entitled to exercise its rights under the Participation Right Agreement and receive a cash settlement amount of: (i) the Early Termination Charge (as defined below) if the Participation Right Agreement is terminated by a Trigger Event within the first D years; or, (ii) its share of appreciation, if any, based upon the Appreciation Participate Rate (the "Settlement Amount").

Transactions are intended to be long-term transactions. It is anticipated the majority of the Transactions will mature (or become exercisable) at a period of greater than D years. In the event a Trigger Event terminates a Transaction within the first D years from its origination, an Early Termination Charge applies. Under a Transaction, the "Early Termination Charge" equals the greater of: (i) the amount paid by Taxpayer to originate the Participation Right, which equals the Upfront Payment plus its origination cost (collectively, the "Participation Right Cost"), plus interest on the Participation Right Cost at an annual compounding rate of D percent or, (ii) Taxpayer's share of appreciation at the time of termination.

Appreciation under a Transaction is measured by the Index that covers the metropolitan area in which the Property is located. At the time the Transaction is originated, the value of the Index is used as the "Beginning Index Value." At the end of the Transaction, the value of the Index at that time establishes the "Ending Index Value." If the Ending Index Value is greater than the Beginning Index Value, the percentage increase is used to calculate the appreciation of the Property.

The Index is used to measure appreciation (as opposed to an appraisal) due to efficiency, transparency and fairness concerns. Using the Index, for example, prevents a potential dispute concerning accuracy and the added expense of additional back-end appraisals. In addition, in the event the Homeowner improves the Property and the improvement results in an increase in value to the Property, Taxpayer is entitled to only the amount owed as determined by the Index regardless of the increased value from the improvements. Finally, the Index adds an element of objectivity and transparency for the Homeowner participating in a Transaction.

Transactions are secured by a performance mortgage (or performance deed of trust, depending on state requirements) recorded against the subject Property's title. Additionally, Taxpayer records a memorandum of option on the Property's title to provide public notice of an interest in the Property. Each performance mortgage is a lien against the Property, and Taxpayer is the mortgagee, with all rights and privileges, under the mortgage. The performance mortgage is intended to secure the Homeowner's performance under the Transaction. No stated sum certain is listed in the performance mortgage due to the uncertainty of the Transaction.

As described above, Taxpayer makes an Upfront Payment to a Homeowner and in exchange receives the right to share in the potential future appreciation of the Property. Taxpayer records a performance mortgage against the Property to secure and provide notice of its interest in the Property. At the end of the Transaction, Taxpayer is entitled to either: (i) the Early Termination Charge (if applicable); or (ii) its share of appreciation, if any, which is gain from the sale or disposition of the Property secured by the mortgage. Appreciation is calculated using the Index described above. If the Transaction ends after D years from the date of its origination and there is no appreciation, Taxpayer is not entitled to any payment. In this case, the Homeowner keeps the Upfront Payment and Taxpayer suffers a loss on its investment in the Property.

Law and Analysis

Section 856(c)(5)(B) of the Code defines the term "real estate assets", in part, to mean real property (including interests in real property and interests in mortgages on real property) and shares (or transferable certificates of beneficial interest) in other REITs. Section 856(c)(5)(C) provides that the term "interests in real property" includes fee ownership and co-ownership of land or improvements thereon, leaseholds of land or improvements thereon, options to acquire land or improvements thereon, and options to acquire leaseholds of land or improvements thereon, but does not include mineral, oil, or gas royalty interests.

Section 856(c)(3) provides that, to qualify as a REIT for any taxable year under part II of subchapter M, an entity must derive at least 75 percent of its gross income (excluding gross income from prohibited transactions) from sources listed in section 856(c)(3), which also includes gain from the sale or other disposition of real property (including interests in real property and interests in mortgages on real property) which is not property described in section 1221(a)(1).

Section 1.856-3(b)(1) of the Income Tax Regulations (the "Regulations") provides that the term "real estate assets" means real property, interests in mortgages on real property (including interests in mortgages on leaseholds of land or other improvements thereon), and shares in other qualified REITs. Section 1.856-3(c) provides that "interests in real property" includes fee ownership and co-ownership of land or improvements thereon, leaseholds of land or improvements thereon, options to acquire land or improvements thereon, and options to acquire leaseholds of land or improvements thereon.

Under section 1.856-3(g) of the Regulations, a REIT that is a partner in a partnership is deemed to own its proportionate share of each of the assets of the partnership and to be entitled to the income of the partnership attributable to that share. For purposes of section 856, the interest of a partner in the partnership's assets is determined in accordance with the partner's capital interest in the partnership. The character of the various assets in the hands of the partnership and items of gross income of the partnership retain the same character in the hands of the partners for all purposes of section 856.

In the instant case, the Transaction is secured by a performance mortgage (or performance deed of trust) recorded against the subject Property's title. As described above, each performance mortgage is a lien against the Property with all rights and privileges under the mortgage. The Transaction arises through an agreement between Taxpayer and Homeowner with respect to real property. In addition to authorizing the Transaction, the Homeowner enters into the Participation Right Agreement and a performance mortgage (or performance deed of trust) for the benefit of Taxpayer in exchange for the Upfront Payment. The Participation Right Agreement and performance mortgage (or performance deed of trust) attach an interest on the real property securing the Participation Right. Accordingly, a Transaction is secured by an interest in the underlying real property. To the extent a Transaction is fully secured by real property, it qualifies as a real estate asset within the meaning of sections 856(c)(4) and 856(c)(5)(B). In addition, when a Transaction is terminated and the Taxpayer receives an Early Termination Charge or its share of appreciation of the Property, if any, such amount is gain from the sale or other disposition of real property (including interests in real property and interests in mortgages on real property) which is not property described in section 1221(a)(1) within the meaning of section 856(c)(3)(C).

Conclusion

Based on the facts as represented by Taxpayer, we rule that, to the extent a Transaction is fully secured by real property, it qualifies as a real estate asset within the meaning of sections 856(c)(4) and 856(c)(5)(B). In addition, we rule that gross income realized by Taxpayer under a Transaction constitutes gain from the sale or other disposition of real property (including interests in real property and interests in mortgages on real property) which is not property described in section 1221(a)(1) within the meaning of section 856(c)(3)(C).

Except as specifically ruled upon above, no opinion is expressed concerning any federal income tax consequences relating to the facts herein under any other provision of the Code. Specifically, we do not rule whether Newco otherwise will qualify as a REIT under part II of subchapter M of Chapter 1 of the Code.

This ruling is directed only to the taxpayer requesting it. Taxpayer and Newco should attach a copy of this ruling to each tax return to which it applies. Section 6110(k)(3) of the Code provides that it may not be used or cited as precedent.

Sincerely,

Thomas M. Preston
Thomas M. Preston
Senior Counsel, Branch 2
(Financial Institutions & Products)