by Ken Swenson and Mary L. Dickson

Common GROUND

The recent trend toward financing tenancies in common poses substantial challenges to lenders

When the Puente Hills Mall in the City of Industry, California, sold for $148 million in 2003, the biggest surprise was not the price for the 1.2 million square foot mall but the nature of the buyer. In conjunction with a Southern California-based real estate investment and management firm, more than 30 private investors joined the buying pool as tenants in common, a form of real property ownership that until recently was used more by default than design. Once shunned by investors, this method of holding title to real property has found new life in the otherwise mundane rules of like-kind property exchanges, commonly known as Section 1031 exchanges. (This common name references the section of the Internal Revenue Code that permits tax-deferred exchanges.[1])

Of equal interest to those in the business of real estate, however, was that a commercial lender risked $92 million of loan funds to finance the purchase by this collection of tenants in common.[2] In fact, lenders should take notice of this growing trend. Some reports suggest that the number of firms that sponsor tenancy in common transactions has grown to nearly 100, and the size and quality of tenancy in common transactions now includes Class A office and high-end retail properties.[3]

Until recently, a survey of real estate bankers and lawyers would likely have reached the conclusion that no lender in its right mind would make a loan—particularly such a substantial loan—to a tenancy in common group. Conventional thinking and black letter law pointed to the principal tenet of this form of ownership—that a tenant in common holds a separate but undivided interest in real property—as evidence that loans to tenancies in common were too risky. A "separate but undivided" interest means that each tenant in common has a separate interest that may be sold, financed, willed, or otherwise encumbered or transferred without the consent or even knowledge of the other tenants in common. It also means that each tenant in common has an undivided right to use or possess the whole of the property. The principle of separate but undivided is difficult both conceptually and in practice, and resolving disputes among tenants in common often requires court action, such as partition or

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ouster, which can effectively tie up the property for years.

With these difficulties in mind, the problems of loaning money to a tenancy in common ownership group are readily apparent. A lender would need to have the signature of each tenant in common to the loan documents, or the lender would only be able to foreclose on the interests actually pledged and could find itself a tenant in common with others. The free transferability of tenancy in common interests would have to be controlled or the lender would soon lose track of who actually owns the property and what ability any of them have to repay the loan. Some effort also must be made to control bankruptcy risks posed by individual tenants in common filing separate actions, especially one after another in a manner that would effectively thwart any collection or foreclosure attempt. Disputes among the tenants in common would need a forum for resolution that did not tie up the property itself. With these issues, combined with a plethora of simple and readily available alternative forms of property ownership (such as partnerships, limited partnerships, limited liability companies, and real estate investment trusts or REITs), tenancies in common were disfavored by real estate lenders and their borrowers until only recently.

Revenue Procedure 2002-22

What would cause the real estate development and finance industries to take a fresh look at tenancies in common? As is often the case, the answer lies in a confluence of events. Soaring real estate values have priced many individuals out of the single ownership or small partnership market for commercial real estate. Ownership pools, on the other hand, provide investors opportunities to participate in real estate acquisitions that would not otherwise be attainable. This expands the stock of available real estate investments for individuals. Of course, such ownership pools are already available in the form of real estate investment trusts, limited partnerships, and other vehicles, so this factor alone, while important, does not explain the interest in tenancies in common.

The decisive factor that made tenancy in common ownership deals more attractive was Internal Revenue Service Revenue Procedure 2002-22, which suggests that interests in tenancies in common may be exchanged under the Internal Revenue Code Section 1031 exchange rules for real estate that is not held in joint ownership.[4] Investors have for years enjoyed the benefits of tax-deferred Section 1031 exchanges, but the exchange rules—which permit exchanges of real or personal property for other property of a like kind—do not permit title to real property to be exchanged for interests in legal entities that own real property.[5] In other words, an acre in Azusa cannot be exchanged for a percentage of Pacoima Plaza partnership, even though the Pacoima Plaza partnership owns real estate and the values of the Azusa interest and the Pacoima interest may be identical.

Revenue Procedure 2002-22 opens the door to a form of group ownership—tenancies in common—that can be exchanged either for tenancy in common interests in other real estate or directly for fee ownership of real estate. In theory, this opens up potentially vast markets of exchange alternatives for individual investors. The investor not only gets the benefit of participating in a substantial project but also can defer the gain on both the initial exchange into the project and on any subsequent exchange out of the project.

Exchangeable Tenancy in Common Interests

The revenue procedure sets forth 15 criteria as a minimum standard to be considered for tax-deferred exchange treatment.[6] These criteria are important for the promoters and investors of tenancy in common projects and are equally important for lenders providing credit risk and legal review of tenancy in common loan proposals. While lenders and their counsel are advised to be familiar with all 15 criteria, several are noteworthy because they form the essential framework of an exchangeable tenancy in common:

- Coowners must retain the right to approve: the hiring of any property manager and the terms of any new, renewed, or extended management contract; the sale or other disposition of the real property; any lease or release of all or a portion of the property; and the creation or modification of any lien on the real property. Approval of these matters by coowners must be unanimous.[7]
- Coowners must retain the rights to transfer, partition, or encumber their interest in the property. However, the revenue procedure provides certain qualifications that limit these rights.[8]
- Revenue from a sale of the property, after payment of any blanket liens, must be distributed to coowners.[9]
- Coowners must share in all revenues from and expenses of the property in proportion to their ownership interest. Coowners, sponsors (those who put the group together), and managers may not loan money to other coowners for expenses unless the loan is recourse to the borrowing coowner and is for a period not exceeding 31 days.[10]
- Coowners may not undertake activities with respect to the property other than those customarily performed in connection with the maintenance and repair of rental real property.[11]
- Leasing arrangements must be based on rents that reflect the fair market value for the use of the property; this is important for projects utilizing a master lease structure.[12]
- Amounts paid to a sponsor must reflect the fair market value of the coownership interests sold or acquired and may not be based on income or profits derived from the property.[13]

Failure to follow these criteria would not necessarily be fatal to obtaining a favorable tax ruling, but adhering to these criteria is expected to provide a safe harbor to members of a tenancy in common group seeking to exchange their interests for real property and, as a consequence, to lenders seeking to finance the tenancy in common group. These rules differ in some material ways from standard REIT, partnership, or LLC terms, so care and thought must be given to reviewing tenancy in common formation documents as a precursor to providing debt financing.

Tenancy in Common Formation

Determining the form of, and creating the documentation for, tenancy in common ownership has been something of a growth industry for many lawyers, accountants, and real estate professionals. The requirements of the revenue procedure do not in all cases compare neatly with the traditional allocation of rights, powers, and obligations between general partners and limited partners, REIT managers and REIT investors, or limited liability company managing members and general members. However, the revenue procedure criteria establish the framework within which the tenancy in common group formation and documentation must operate, and so the typical tenancy in common operating structures represent a not-so-subtle attempt to retain as many control and revenue-generating features as possible from traditional ownership structures and graft them onto the minimally necessary base of revenue procedure criteria.

From the perspective of the professional real estate manager, developer, and investor, tenancy in common groups are a way to raise equity capital. Thus, such groups generally are put together by a promoter—a person or group of people who are full-time real estate professionals with a resume of owned, managed, and developed projects. The promoter will identify an acquisition property and may actually enter into a purchase contract and commence diligence at the same time it offers tenancy in common interests to private investors via private placement offering materials. If the requisite number of investors is reached (a number determined by the promoter and specified in the offering materials but not exceeding 35, per the revenue procedure),[14] then the purchase contract is assigned to the tenancy in common group.

The promoter and its affiliated entities wear many hats in this process. Typically, the promoter forms a special purpose entity that acts as one of the coowners in the tenancy in common. The number of interests sold depends in large part on the promoter's individual goals—such as raising a small amount of additional capital versus fully divesting itself of ownership and seeking only the fee income that derives from the promoter's other roles.

The promoter also may act as transaction adviser to investors and may manage the tenancy in common affairs. Entities affiliated with the promoter also may serve as the property manager, the leasing agent, the broker on a sale of the property, and the loan broker. Many tenancy in common arrangements involve a promoter-affiliated entity actually leasing the entirety of the property from the tenants in common and then managing and subleasing the property as a master tenant. In each case in which the promoter or a promoter-affiliated entity acts in a different capacity with respect to the property, the promoter or its affiliate charges a fee.

The most important document in this ownership structure is the tenancy in common (TIC) agreement. This document defines the rights and obligations among the tenants in common and includes most of the provisions that may create or defeat compliance with the criteria of Revenue Procedure 2002-22. Even though the tenancy in common is not (and may not be under tax law) an organized group that holds itself out as a single entity, it is important to have a well-drafted TIC agreement that serves many of the purposes that a partnership agreement or limited liability company operating agreement would serve. For these reasons, lenders must include the TIC agreement in their underwriting and legal review.

The Lender Watch List

Tenancy in common arrangements still rely on debt financing for the bulk of acquisition or development capital. Therefore, in order for tenancies in common to work, they must be financeable. This means lenders must have some certainty that the expected sources of repayment (property operations, equity growth, individual obligors or guarantors) will be continuously available, and that possession of the collateral (rents, accounts, and property), if necessary, will not unexpectedly be hindered.

The issues to be addressed by lenders should echo familiar themes. The foregoing discussions of the law of tenancies in common, the revenue procedure, and the structure of tenancy in common groups have already shaped to a large degree the analysis of lender review by identifying the areas of primary concern. In fact, the areas of concern to promoters, investors, and managers generally are also of concern to lenders, although their views of satisfactory resolution may differ.

Every loan is different; the guidance here can only be generic. Moreover, the issues raised here are in addition to, and not in lieu of, normal lending credit and legal issues, such as the quality and value of the collateral and the borrower, and the normal and customary loan covenants and lender protections. Special issues are nevertheless presented by loaning to a tenancy in common group. Most of these special issues are addressed in the TIC agreement, although some arise in other contexts.

When financing a tenancy in common group, lenders should pay special attention to at the least the following issues.

Nature and identity of coowners. The nature of the tenancy in common as a form of property ownership means that a loan to a tenancy in common group is really a loan to every individual in that group, each of whom is (or should be under the loan documents) jointly and severally liable for repayment. This has numerous ramifications.

First, every coowner should sign every document. This differs from other forms of property ownership. A coowner is permitted under the revenue procedure to give a power of attorney to another coowner to sign documents, but lenders are advised not to rely on powers of attorney for such important obligations as loan agreements, promissory notes, and pledges of real property collateral. Also, any document that contains representations and warranties should not be signed by power of attorney, or it becomes difficult to allocate liability for breach of the representations and warranties.

Second, lenders will probably want each coowner to be a single purpose, bankruptcy remote entity, such as a single-member limited liability company.[15] The use of special purpose entities by the tenants in common is designed to minimize the impact of the bankruptcy of a single coowner.

Third, lenders must consider whether their loans to tenancy in common members will be recourse or nonrecourse. Even if they are nonrecourse, the customary carve-out guaranties for so-called bad boy acts,[16] or springing guaranties,[17] are recommended. Similarly, for recourse loans, lenders must consider whether personal guaranties will be required and from which owners.

Fourth, because each coowner is pledging its interest in the underlying property to secure the obligations of every other coowner, each coowner should give waivers of the suretyship protections under California law.[18]

Finally, the customer identification requirements passed as part of the USA PATRIOT Act[19] will apply to each individual coowner, since each coowner is a separate borrower and since maintaining vigilance with respect to all the coowner borrowers supports the antiterrorism and anti-money laundering goals of that act.

Leasing requirements. One of the most unrealistic requirements of the revenue procedure is that all tenants in common approve all leases. A long term, single tenant building may be the easiest scenario for a tenancy in common group, but even single tenant leases may require amendments or adjustments after they are signed. Will it be possible to obtain the agreement and the signature of each tenant in common to such an amendment?

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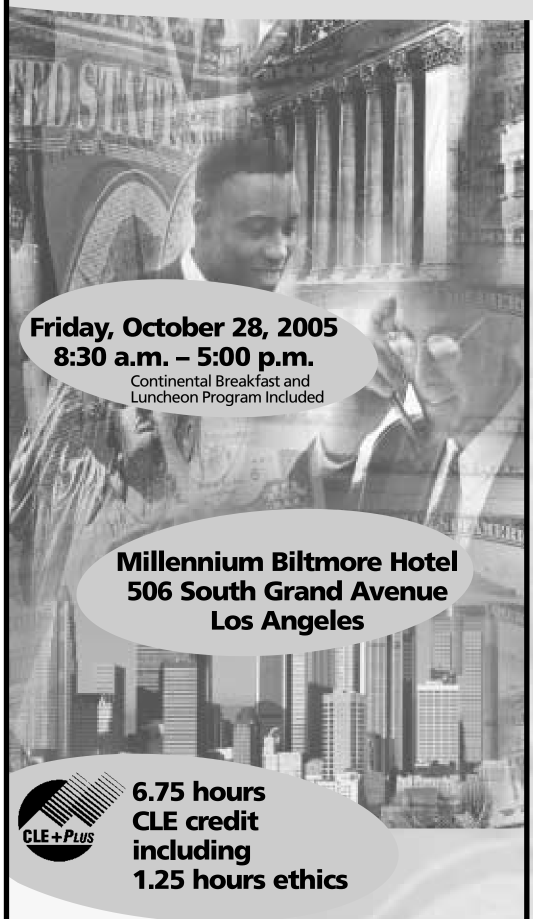

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tiple tenant spaces—including office, retail, and multifamily properties—are often leased by professional property managers who have been delegated the authority to sign tenants using a form lease. However, not every tenant is willing to sign the standard form lease, and owners need to address departures from the form.

One way to address the problem of unanimity is by using the master lease structure, which separates the ownership from the day-to-day leasing activities. The terms of the master lease are fixed at the time of the investment and, with luck, no changes will be necessary during its term. This also puts the risk (and benefit) of market rent fluctuations on the master lessee and flattens the risk curve for the tenants in common and the lender. Many lenders are familiar with the master lease structure and are comfortable with it so long as the master lease is subordinated to the lender's deed of trust and the master tenant gives to the lender a leasehold mortgage or an assignment of the property leases and rents.

Another way to address the unanimity problem is through the inclusion of buy-out provisions in the TIC agreement.

Partition and ouster. Under the laws of most states, including California, a tenant in common may end the tenancy in common by bringing an action for partition—that is, using judicial process to divide the otherwise indivisible right to possess and occupy the property by forcing a sale of the property and distribution of the proceeds.[20] Unless one coowner or a third party purchases all coownership interests, partition is the only method to end a tenancy in common. Of course, it merely ends the relationship by eliminating the underlying property, so it is something of a draconian measure. Obviously, a lender who has financed a tenancy in common does not want the loan transaction unwound because one or more coowners become dissatisfied and seek partition. For this reason, lenders providing financing to a tenancy in common group should require that the TIC agreement include a waiver of the right to partition. Waiver of partition appears to be permissible under California law.[21] Lenders should not rely on clauses in the TIC agreement that purport to create a "deemed" waiver in the event a lender were to require waiver as a condition to financing. Also, as with any other waiver in California, the waiver should be unambiguous as to the right being waived.

Ouster occurs when a coowner is excluded from possession by one or more other coowners who are in possession.[22] The coowner who has been ousted may bring an action to eject the dispossessing owners, or for damages, either one of which could adversely affect the function of a tenancy in common group. The California statutes specifically provide that ouster "does not apply to the extent the [co-owner] out of possession is not entitled to possession," and further refers to the supremacy of any "written instrument that indicates the possessory rights or remedies" of coowners.[23] A lender providing financing to tenants in common should require that the TIC agreement provide that none of the coowners has a right to possession of the underlying property, and that each waives its right to claim an ouster.

Transfer of interests. The appeal of tenancy in common groups to private investors is the ability to freely exchange their interests. Here, the interests of lenders and investors diverge widely. Lenders will review the credit risk of a loan to a tenancy in common group in part by determining the creditworthiness of the individual investors. This is true even though the loan may be nonrecourse; while lenders may not be able to recover directly from individual borrowers, lenders look for assurance that individual borrowers at least have the ability to make necessary payments and deficit contributions.

As a result, a lender will not, and should not, permit transfer of tenancy in common interests without the lender's review and approval of the proposed transferee, the terms of the transfer, an assumption by the transferee of the loan obligations, and an amendment to the TIC agreement adding the transferee. Fortunately for lenders, even though the revenue procedure requires that coowners maintain free transferability of their interests, the revenue procedure also states that "restrictions on the right to transfer…that are required by a lender and that are consistent with customary commercial lending practices are not prohibited."[24]

Involuntary transfers and transfers by operation of law, such as transfers by will or transfers as part of marital dissolution, create a practical issue for lenders. Current lending practice is that each such transfer is a default, and lenders reserve the ability to permit exceptions in the loan documents or to waive the default on a case-by-case basis. Lenders may find this a hard sell to sophisticated promoters arranging loans for tenancy in common groups made up largely of wealthy individual investors who will be concerned with the conduct of their individual affairs and that an entire investment could be lost as a result of an inadvertent, "no-fault" transfer. Also, too many waivers during the loan term could lead to modification of the loan terms unless the lender takes care to provide appropriate nonwaiver letters in each instance.

One solution is that coowners may each have a right of first refusal to purchase the interest of a transferring coowner, although this may be difficult to implement when the transfer is for estate planning purposes, is pursuant to a will, or part of a marital dissolution. There is not a right or wrong answer on this issue, and the solution will depend to a large degree on the strengths of relationship, collateral, and the market for the loan product in question.

Management decisions. As with leasing, the revenue procedure requires that certain other important decisions affecting the property require unanimous approval of the coowners, including hiring a manager, selling or disposing of the property, and the creation or modification of a lien on the whole of the property.[25] Most day-to-day operational decisions respecting the property require the approval of only 50 percent of the coowners, and most of those decisions, like property management, may be delegated to a professional property manager approved unanimously by the coowners.[26]

For management of the issues and relationships affecting the tenancy in common group, the TIC agreement should designate a single coowner as the contact for the lender (and for other contract parties, such as the property manager) for such things as delivery of notices and other day-to-day questions. Lenders may insist that a promoter-affiliated entity retain at least 50 percent of the interest in a tenancy in common group, assuring that no deadlock will occur over lesser management issues. Unfortunately, the revenue procedure proscribes the use of global powers of attorney (meaning that decision-making authority cannot be broadly delegated), although powers of attorney may be given to allow execution of specific documents relative to decisions already made.[27] Thus, powers of attorney are not the answer to management deadlock, and lenders should watch for misuse of them.

For the more important property decisions, TIC agreements should take a page from partnerships and limited liability companies. Lenders should require TIC agreements to include provisions to break a deadlock, such as buy-sell options allowing the interests of holdout coowners to be purchased by other coowners. Lenders should pay close attention to the terms of such buyouts. They must be structured as "call" options rather than "put" options.[28] In other words, the TIC agreement should be drafted so that if an action requiring unanimous vote falls short, those voting against are deemed to have offered their interests to the coowners or promoter, rather than the other coowners or promoter having an option to require those voting against to sell their shares. Additionally, the sales price must be fair market value, meaning the fair market value of the total property multiplied by the selling coowner's percentage interest in the property.[29] This will require an appraisal of the total property, and a lender should consider requiring copies of the appraisal to be delivered concurrently to the lender.

Subordination. Lenders should think about subordination in three areas. First, the TIC agreement may be recorded, as is permitted under the revenue procedure,[30] and would generally be an interest in the collateral preceding the lenders' security interest. Therefore, lenders will need to require that the TIC agreement be subordinated to the lien of a deed of trust or mortgage to prevent the terms of the TIC agreement from being a cloud on title postforeclosure. Second, in a tenancy in common group, the promoter or coowners may loan funds to other coowners, either as part of an up front arrangement to pay transaction or other costs or to advance funds on behalf of a coowner who is not contributing its fair share. A lender should require that the TIC agreement provide that such loans are subordinate to the lender's loan, that such loans require the lender's consent, and that any lien that may attach to the lender's collateral as a result of the coowner borrower's failure to repay the loan will be junior to the lender's lien. A similar provision should appear in the loan documents. Third, if the tenancy in common structure includes a master lease, the master lease should be subordinated to the lender's lien on the fee.

Fees. Promoters of tenancy in common groups and the promoters' affiliates generally wear numerous hats and collect fees associated with each. While some of these fees are not equity returns that can rationally and easily be subordinated to the lender's repayment, they still constitute payments to insiders that should be watched and regulated. Lenders should be sure such payments are at arm's-length rates. In fact, a market rate requirement is built into the revenue procedure.[31]

Moreover, lenders may seek loan document provisions that prohibit or defer payment of such fees if the loan is not paid timely or if the property fails to maintain specified standards (loan-to-value, debt service coverage, occupancy percentage, average lease rate, and so on). After all, it makes no sense from the lender's perspective for the principal-promoter to be receiving a return if the lender is not being paid. This may be more appropriate for some fees than for others. For example, if a promoter-affiliated entity is the working property manager (that is, has not subcontracted the actual management responsibilities), then payment for those services may be fair, as such expenses would be incurred by a third party if the affiliated entity had not undertaken management. On the other hand, many TIC agreements or related documents provide that the promoter or an affiliated entity will receive a loan finder's fee in connection with a loan made by the lender, or will receive a fee associated with its management of the tenancy in common group (as opposed to the property itself). Subordination, deferral, or a set aside account for such fees may make sense. Likewise, any fees that are being paid to a promoter-affiliated entity for property management or for leasing or sale brokerage where the same services have been subcontracted to third parties should also be considered for subordination, deferral, or set aside.

Obligations of the promoter/manager. A lender's actual borrowers in a tenancy in common group are the coowners, not the promoter (except to the extent the promoter is also a coowner). Since the promoter holds the cards at the outset of the tenancy in common relationship—for example, drafting all the agreements the coowners will sign—it is possible that the coowners will be asked to indemnify the promoter or promoter-affiliated entities from certain losses the promoter or promoter-affiliated entities may suffer as a result of the overall transaction (investment losses, hazardous substance response costs, or litigation losses, for example). So long as this indemnity does not run to the benefit of a promoter-affiliated entity that is also a coowner—since coowners must share equally in profits, losses, and debt—nothing in the revenue procedure prevents such an indemnity.[32] However, the larger the indemnity obligation, the more it will hurt the ability of the coowners to satisfy that obligation and satisfy lenders' debt. Therefore, lenders should remove, limit, cap, condition, or subordinate such indemnity obligations.

Revenues. For a tenancy in common property ownership to qualify for tax-deferred exchange treatment, coowners may engage only in customary activities "performed in connection with the maintenance and repair of rental real property."[33] Lenders should review the activities that the tenancy in common group will be undertaking to avoid the transaction being disqualified for tax deferral on exchange, an action that could diminish repayment prospects by limiting the liquidity of the tenancy in common interests. There is no bright-line test for what activities the IRS will consider customary. For example, it probably is not customary for a mall owner to also operate one or more restaurants in the mall, even though that does happen from time to time. If the mall is to be owned by a tenancy in common group, the restaurant operations should be divested. However, it may be perfectly plausible that customary activities include operating a gift wrapping service, kiddie rides, holiday activities (Santa, Easter Bunny), or a carousel.

Bankruptcy. The last but far from the least of a lender's concerns in dealing with a tenancy in common group is bankruptcy. The automatic stay imposed upon creditors on the filing of a petition in bankruptcy court[34] will shield the filing coowner from the necessity of immediate performance under the TIC agreement or under the loan documents. If additional capital is required to sustain the property during this time, other coowners or the lender will need to make up the share of the filing coowner (although this should be done under the auspices of the bankruptcy court as a postpetition financing in order to gain some rights to repayment). If other coowners are unable to sustain the increased burden, they too may file for bankruptcy. Ultimately, a coowner in bankruptcy may seek to have the TIC agreement rejected as an executory contract.[35] Successful rejection would allow the filing coowner to invoke the rights of a tenant in common that had been waived in order to induce financing, such as partition. Moreover, attempts to prevent a bankruptcy filing or to require a filing coowner to sell to nonfiling coowners would not be enforceable.

The bankruptcy risks of tenancies in common is an area of contracts and law that will evolve as modern tenancy in common arrangements work through a full economic cycle and reach the bankruptcy courts, providing rulings that will produce refinements to TIC agreements and loan documents. For the short term, lenders should continue to look to single purpose, bankruptcy remote entities and to provisions that allow nonfiling tenants in common to purchase the interests of filing tenants in common. These methods will not prevent bankruptcy, but they are likely to make the bankruptcy easier and faster to manage (dismissal, conversion to liquidation, sale under the auspices of the court).

Limitations on Tenancies in Common

Tenancies in common are not the right choice for all real estate investors. The implementation of tenancies in common as a practical ownership vehicle and the reliability of the revenue procedure as a principal driver of renewed use of tenancies in common introduce at least four problems that ultimately may limit their popularity.

For one thing, the free exchangeability of tenancy in common interests is limited in reality by numerous factors, including the presently limited secondary market for tenancy in common interests, and the fact that most tenancy in common agreements often require that a selling or trading coowner first offer the interest to other coowners at market value.

Additionally, the revenue procedure is not a law or even an IRS ruling. Simply put, it is an invitation to taxpayers to request an IRS ruling on the taxability of a transaction or event, with the suggestion that if the transaction or event satisfies numerous criteria outlined in the revenue procedure, then the actual ruling may be favorable—but no promises are made.[36] Until an actual ruling is issued, promoters, investors, and financiers should tread with due caution. Most offering materials for tenancy in common interests highlight this risk.

Moreover, the safe harbor of the revenue procedure, to the extent it can be called that, is based on the same legal nature of tenancies in common that historically made them disfavored by real estate investors and lenders in the first place. The IRS notes in the revenue procedure that "[t]he central characteristic of a tenancy in common…is that each owner is deemed to own individually a physically undivided part of the entire parcel of property."[37] The revenue procedure takes every opportunity to give effect to this central theme. Thus, the very characteristic of tenancies in common that makes them appropriate for tax-deferred exchanges is what makes them a challenge for investment or financing.

Finally, failure to satisfy the revenue procedure's 15 criteria for deferred tax treatment could cause financial difficulties for individual owners that would lead them to default on their pro rata obligations, resulting in a risk of a domino effect. Failure to satisfy these criteria could also result in the tenancy in common group being treated as a partnership or other state law organization,[38] yet the group would not have complied with the organizational and tax rules governing such organizations and would therefore have state and federal compliance issues that could increase the risk of a loan default.

For the time being, tenancies in common and TIC agreements are the favorite innovation of the real estate investment and exchange world and are likely to stay respectably popular unless or until economic recession lowers real estate prices substantially or until adverse rulings eliminate their advantages. As the volume of transactions involving this form of ownership increases, so does the likelihood that a lender will be asked to loan to one. Lenders can and should combine the criteria of the revenue procedure with their traditional underwriting procedures and take advantage of these potentially good business and relationship opportunities. ■

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[1] I.R.C. §1031.

[2] *See, e.g., Puente Hills Mall Changes Hands in $148 Million Tenant in Common Deal,* RETAIL TRAFFIC MAG., May 15, 2003, *available at* http://www.retailtrafficmag.com.

[3] Jessica Roe, *Uncommon Growth,* COMMERCIAL PROPERTY NEWS, Oct. 16, 2003.

[4] REV. PROC. 2002-22, Mar. 19, 2002.

[5] I.R.C. §1031.

[6] REV. PROC. 2002-22 §§6.01-6.15. For a discussion of these criteria, *see* Robert A. Briskin, *Fair Exchanges,* LOS ANGELES LAWYER, Sept. 2003, at 50.

[7] REV. PROC. 2002-22 §6.05.

[8] *Id.* §6.06.

[9] *Id.* §6.07.

[10] *Id.* §6.08.

[11] *Id.* §6.11.

[12] *Id.* §6.13. The fair market rent requirement is particularly important for master lease structures.

[13] *Id.* §6.15.

[14] *Id.* §6.02.

[15] For a discussion of single-purpose (or special-purpose), bankruptcy remote entities, *see* David B. Stratton, *Special-purpose Entities and Authority to File Bankruptcy,* AM. BANKR. INST. J., Mar. 2004, at 36. *See also* Adam B. Weissburg & John Matthew Trott, *Special Purpose Bankruptcy Remote Entities,* LOS ANGELES LAWYER, Jan. 2004, at 12, available at http://www.lacba.org/Files/LAL/Vol26No10/1477.pdf. Such single member entities generally will be disregarded for tax purposes, so an individual need not file separate returns or obtain a separate taxpayer identification number for the limited liability company.

[16] Bad boy acts typically include, at a minimum, fraud, waste, misappropriation or misapplication of rents or profits, failure to turn over insurance or condemnation proceeds as required, failure to apply or account for security deposits or prepaid rents, violation of hazardous substance covenants, and bankruptcy or similar filings.

[17] A springing guaranty comes into effect only if the primary borrower files for bankruptcy protection.

[18] CIV. CODE §§2787 *et seq.*

[19] *See* 31 U.S.C. §5318(I) (identification and verification of account holders); 31 C.F.R. §103.121 (2005) (customer identification programs).

[20] CODE CIV. PROC. §§872.010 *et seq.*

[21] *Id.* §872.710(b). *See also* 5 HARRY D. MILLER & MARVIN STARR, CALIFORNIA REAL ESTATE §12:21, at 49 (2000) ("The right to partition can be waived by an express or implied agreement between the cotenants.") *and* citations therein.

[22] CIV. CODE §843.

[23] *Id.*

[24] REV. PROC. 2002-22 §6.06.

[25] REV. PROC. 2002-22 §6.05.

[26] *Id.*

[27] *Id.* §§6.05, 6.12.

[28] *Id.* §6.10.

[29] *Id.*

[30] *Id.* §6.04 (The coowners may enter into a limited coownership agreement that may run with the land.).

[31] *Id.* §6.12.

[32] *Id.* §§6.08, 6.09.

[33] *Id.* §6.11.

[34] 11 U.S.C. §362.

[35] 11 U.S.C. §365.

[36] "The guidelines set forth in this revenue procedure are not intended to be substantive rules and are not to be used for audit purposes." REV. PROC. 2002-22 §3.

[37] *Id.* §2 (citing 7 RICHARD R. POWELL, POWELL ON REAL PROPERTY §§50.01-50.07 (2000)).

[38] *See, e.g.,* Bergford v. Commissioner, 12 F. 3d 166 (9th Cir. 1993) (coownership interests in computer equipment subject to a lease constituted a partnership in which the coowners could not sell, lease, or encumber their interests or the underlying property and in which the manager participated in the profits and losses of the venture).