

April 14, 2020

The Honorable David J. Kautter
Assistant Secretary of Tax Policy
U.S. Department of Treasury

The Honorable Michael J. Desmond
Chief Counsel
Internal Revenue Service

Krishna P. Vallabhaneni
Tax Legislative Counsel, Office of Tax Policy
U.S. Department of Treasury

RE: Emergency Relief for Delaware Statutory Trusts Owning Real Property

Dear Mr. Kautter, Mr. Desmond and Ms. Vallabhaneni:

The Institute for Portfolio Alternatives (“IPA”) writes to support a letter submitted today by the law firms Baker McKenzie and DLA Piper (“Letter”) with respect to the Delaware statutory trust real estate investment industry. The IPA has an immediate interest in the emergency request as many of our members structure DST investments for property and business owners.

For over 30 years the IPA has raised awareness of portfolio diversifying investment (PDI) products among stakeholders and market participants, including investment professionals, policymakers and the investing public. We support increased access to investment strategies with low correlation to the equity markets: lifecycle real estate investment trusts (Lifecycle REITs), net asset value REITs (NAV REITs), business development companies (BDCs), interval funds and direct participation programs including DST investments (DPPs). Through advocacy and industry-leading education, the IPA is committed to ensuring that all investors have access to real assets and the opportunity to effectively diversify their investment portfolios.¹

As discussed in the Letter, DSTs are at a distinct disadvantage with respect to their ability to adjust to the current economic climate. In order to allow DSTs the ability to protect the investments of the beneficial owners, we ask that DST be allowed the right to undertake on a temporary basis actions relating to lease modification, loan modification and acceptance of additional capital contributions that

¹ IPA member firms support individual investor access to a wide variety of asset classes with low correlation to the traded markets and historically available only to institutional investors. These investment products have been held in the accounts of more than 3 million individual investors. With over \$135 billion in capital investments, they remain a critical component of an effectively balanced investment portfolio and serve an essential capital formation function for national, state and local economies.

are otherwise prohibited under Revenue Ruling 2004-86.² Each of those actions is addressed in the Letter, as is an alternative request to allow DSTs the ability to spring to an entity taxed as a partnership (e.g., limited liability company), which would be able to take the required actions. We ask that this relief begin immediately and extend through October 31, 2020 so that DSTs can protect the investment of their beneficial interest owners.

We appreciate your consideration of this request during this challenging time. If the IPA may be of any assistance, please do not hesitate to contact me or Anya Coverman, IPA's Senior Vice President, Government Affairs and General Counsel, at (202) 548-7190.

Sincerely,



Anthony Chereso
President & CEO, Institute for Portfolio Alternatives

² Similar relief was provided to investment trusts that own mortgages in Rev. Proc. 2020-26.



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Re: Emergency Relief for Delaware Statutory Trusts Owning Real Property

Dear Mr. Kautter, Mr. Desmond and Ms. Vallabhaneni:

With respect to the Delaware statutory trust real estate investment industry, we are requesting the Internal Revenue Service (the "Service") provide emergency relief to certain Delaware statutory trusts ("DSTs") that own real property. It is estimated that over the last 5 years, more than \$22 Billion of real estate has been acquired by DSTs and the interests in these DSTs have been syndicated to individual investors.¹ The typical investor in a DST acquires approximately \$150,000 to \$200,000 per investment and the DST interests are typically acquired as part of a Code Section 1031 deferred exchange. Many DST investors are retired, over 60 years old and rely on the income from their DST investment. In recent years, most of the DSTs in the syndicated DSTs industry have acquired multifamily rental properties.

In 2004, the Service issued Revenue Ruling 2004-86 (the "Revenue Ruling") which applied the investment trust requirements to DSTs which acquired real estate. The Revenue Ruling required that the DST remain a passive owner of real estate that was not able to vary the investment of the beneficial holders of the DST. Among the restrictions applicable to a DST, the DST is not permitted to (i) re-lease the real property owned by the DST except in the event of the bankruptcy or insolvency of the tenant, (ii) modify the terms of existing debt obtained by the DST or (iii) accept additional capital contributions. So long as the DST is treated as an investment trust for federal income tax purposes, the beneficial interests in the DST qualify as replacement property for purposes of Code Section 1031.

Given the unprecedented economic crisis facing the United States resulting from the COVID-19 pandemic, many of the properties owned by DSTs are facing an operational crisis. While the challenges facing DST property owners are no different than those faced by other owners, DSTs are at a distinct disadvantage

¹ Mountain Dell Consulting.



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with respect to their ability to adjust to the current economic climate. In order to allow DSTs the ability to protect the investments of the beneficial owners, we ask the Service to allow DSTs the right to undertake on a temporary basis, certain actions otherwise prohibited under the Revenue Ruling. Similar relief was provided to investment trusts that own mortgages in Rev. Proc. 2020-26.

Modifying Leases

DSTs are structured in one of two ways. When the DST is acquiring a property that is subject to a long-term, net lease with a tenant (such as a single tenant retail property or corporate headquarter building), the DST will assume the lease with the third-party tenant. In other situations the DST will enter into a master lease arrangement with an affiliate of the DST sponsor. In this later case, the master tenant will sublease to the tenants.

In order to qualify as an investment trust, the DST is prohibited from renegotiating leases originally entered into by the DST except in the case of the tenant's bankruptcy or insolvency. Because of the COVID-19 crisis and stay-at-home orders issued by most states, many commercial tenants are suffering a significant reduction in cash flow, making it difficult for them to remain current on the payment of rent. A large number of DSTs that own commercial properties have received requests to modify the terms of the leases in order to remain viable. The problem is even more pronounced with respect to DSTs that own multifamily rental, senior housing or student housing properties which are master leased. Approximately 30% of multifamily residents in the United States did not timely make their April 2020 rental payments.² Many states have issued orders prohibiting landlords from evicting non-paying tenants. The master tenants are in a critical position; the income generated at the properties has decreased as a result of the stay-at-home orders, but the master tenant must still pay for property expenses and pay rent under the master lease in order to avoid defaults. Many of the master leases are anticipated to be in default.

We request that DSTs be permitted to modify the terms of their leases, whether with third party tenants or master tenants, to allow for a lease restructuring or reduction in rental payments.

Loan Modifications

It is estimated that DSTs have approximately \$11.5 billion of outstanding loans which is primarily agency and CMBS debt.³ Lenders have signaled that they are willing to work with borrowers to modify the terms of their debt in order to avoid a foreclosure crisis like which occurred in 2009. DSTs would like to take advantage of the modifications that are being made available to other similarly situated borrowers.

² National Multifamily Housing Council.

³ Mountain Dell Consulting.



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However, the Revenue Ruling provides that the DST may not renegotiate the terms of the debt used to acquire the property owned by the DST.

We request that DSTs be permitted to pursue loan modifications with respect to financing obtained by the DST.

Acceptance of Additional Capital Contributions

The Revenue Ruling indicates the DST may not exchange the property owned by the DST, purchase assets other than certain short-term investments or accept additional capital contributions (including money) to the DST. The inability of the DST to accept additional capital contributions makes the DST particularly vulnerable to abrupt changes in the economy which significantly reduce the cash flow generated at the property owned by the DST. The DST's only source of income is the rent under the leases at the property level (or if applicable the rent from the master tenant). If this income suddenly terminates, the DST is in danger of not having sufficient funds to pay its expenses, including debt service, property expenses, taxes and insurance and other capital expense items. While other property owners have the ability to support their real property by supplementing the ownership entity's capital, the DST is prohibited from accepting such additional capital from any source. In many cases, lenders will only consider modifications to a loan in the event additional capital is contributed by the borrower. The prohibition on accepting additional capital contributions may have the effect of prohibiting the DSTs from entering into loan modifications with their lenders which may be required as a result of the crisis.

We request that DSTs be permitted to accept additional capital contributions.

Alternative Request

If the Service is not able to waive the prohibitions described above, we request that the Service provide DSTs with the ability to spring to an entity taxed as a partnership (e.g., limited liability company) which would be able to take the required actions. So long as the property entity converts back to a DST within 6 months, we request that the DST be considered to be an investment trust going forward.

Timing

In order to allow DST property owners the ability to take the actions described above, we ask that the prohibitions on modifications of leases, modifications of loans and acceptance of new capital be suspended beginning immediately through October 31, 2020 so that DST can protect the investment of their beneficial interest owners.



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Thank you for your consideration of the above emergency request. We are available to discuss the above request in more detail and can be reached as follows:

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Sincerely,

A blue ink signature of Darryl Steinhouse, consisting of a stylized 'D' and 'S' followed by a horizontal line.

Darryl Steinhouse

A blue ink signature of Daniel Cullen, featuring a stylized 'D' and 'C' followed by a horizontal line.

Daniel Cullen

DS/DC:vpc