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CC:FIP:B02 – PLR-116139-04
Date: December 28, 2004

Legend:

Taxpayer =

Date 1 =

Subsidiary =

Corporation =

Year 1 =

Agreement =

a =

b =

c =

Dear :

This is in reply to a letter dated March 12, 2004, and subsequent correspondence, requesting certain rulings on behalf of Taxpayer. The requested rulings concern the treatment of a warehouse line of credit under section 856 of the Internal Revenue Code. You have withdrawn your ruling requests pertaining to taxable mortgage and real estate mortgage investment conduit issues that may be presented under the facts of this case.

Facts:

Taxpayer is a domestic corporation that initially elected to be treated as a real estate investment trust for its tax year ended on Date 1. Taxpayer's stock is publicly traded on a national exchange. Taxpayer's principal activity is to acquire and hold mortgage loans secured by mortgages or deeds of trust and mortgage backed securities for the production of interest income.

Subsidiary is a wholly-owned subsidiary of Taxpayer. Taxpayer and Subsidiary have jointly elected to treat Subsidiary as a taxable REIT subsidiary (TRS) of Taxpayer within the meaning of section 856(l). The principal activity of Subsidiary is to hold stock of one or more lower-tier subsidiaries. Subsidiary owns all of the stock of Corporation.

Corporation is a domestic corporation organized in Year 1. Corporation is engaged in the business of originating, purchasing, pooling, holding, selling, securitizing and servicing mortgage loans and selling securities in pools of mortgages. Substantially all of the mortgage loans held by Taxpayer were acquired from Corporation. Corporation continues to service those mortgages. Additionally, all pools of securitized mortgage loans owned by Taxpayer were originated by Corporation, which sold the mortgage securities to Taxpayer. The mortgage pools are generally securitized into mortgage backed securities through the use of a REMIC or, to a lesser extent, through a trust. The mortgages included in the pools consist of both fixed rate loans and adjustable rate loans.

When Corporation originates and acquires mortgage loans to include in a pool to be securitized, it obtains short-term financing from several sources, including from Taxpayer. The method of financing used is commonly referred to as "warehouse financing." In general, a warehouse lender takes a security interest in the mortgage pool. The lender's security interest is perfected by possession of the mortgage loans through an agent under Article 9 of the Uniform Commercial Code. Under the current security arrangement, Corporation treats Taxpayer as in possession of the mortgage loans that are the collateral on the warehouse line of credit. Corporation generally remits payments due Taxpayer on the warehouse line of credit directly to Taxpayer and remits the difference, if any, to its own account. The warehouse line of credit bears interest indexed to the same objective index factor as the mortgages assigned as collateral security. Also, the terms of the warehouse line of credit are comparable to that charged by unrelated lenders under similar conditions.

Taxpayer has not been treating the loans it makes to Corporation on its existing warehouse line of credit as real estate assets. Taxpayer now proposes to restructure the warehouse line of credit. In support of the restructured warehouse line of credit, Taxpayer has submitted a model agreement, the Agreement, and a model promissory note. Pursuant to the Agreement, Taxpayer proposes to structure the warehouse line of credit as an assignment of the mortgage loans from Corporation to Taxpayer on a nonrecourse basis. Taxpayer will collect the payments due on the mortgages either directly or through Corporation (acting as Taxpayer's agent), and credit to Corporation any monies in excess of the amount due on the warehouse line of credit.

The Agreement provides that loans made by Taxpayer shall be evidenced by a promissory note from Corporation and shall be nonrecourse to Corporation. The Agreement provides, in relevant part, that upon a request for borrowing, Corporation, as borrower, and Taxpayer, as lender, will confirm the face amount of the mortgages that Corporation will endorse to Taxpayer as collateral security for the loan (the "Committed Mortgages"). Corporation will grant Taxpayer a security interest in the Committed Mortgages and will endorse the Committed Mortgages on a nonrecourse basis and deliver them to Taxpayer. Corporation will notify the person servicing each Committed Mortgage to collect payments on the Committed Mortgage on behalf of Taxpayer and credit all net collections to Taxpayer. Taxpayer will reconvey or cause the servicer to reconvey the Committed Mortgages to Corporation upon repayment in full of the applicable loan, including all principal, accrued interest, and any other applicable charge.

Corporation's books will reflect that the Committed Mortgages belong to Taxpayer. Corporation will enforce any defaulted mortgage in Taxpayer's name. Taxpayer will take permanent possession of the mortgages upon a default by Corporation. It is represented that the aggregate amount of the Committed Mortgages will exceed the amount advanced to Corporation on the warehouse line of credit. The Committed Mortgages will have an outstanding aggregate principal balance that is at least a percent greater than the outstanding balance of principal and accrued interest on the warehouse line of credit. Furthermore, the real property securing the Committed Mortgages has and will have a fair market value equal to or greater than the amount of the balance on the warehouse line of credit.

The Committed Mortgages will generally have stated terms of twenty years. The weighted average maturity of the mortgages is from a to b years. The average term of the advances on the warehouse line of credit is c days.

Law and Analysis:

To qualify as a REIT, an entity must derive at least 75 percent of its gross income from sources listed in section 856(c)(3). Among the sources of income that qualify under section 856(c)(3) is interest on obligations secured by mortgages on real property or on interests in real property.

Section 856(c)(4)(A) provides that at the close of each quarter of the taxable year at least 75 percent of a REIT's total assets must be represented by real estate assets, cash and cash items (including receivables), and Government securities. Section 856(c)(4)(B) provides, in relevant part, that at the end of each quarter of a taxable year, not more than 25 percent of the value of a REIT's total assets may be represented by securities; not more than five percent of the REIT's total assets may be represented by securities of any one issuer; and a REIT may not hold securities possessing more than 10 percent of the total voting power or value of the outstanding securities of a single issuer.

Section 856(c)(5)(B) 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 1.856-3(d) of the Income Tax Regulations provides that local law definitions are not controlling for purposes of determining the meaning of the term "real property" as used in section 856 and the regulations thereunder. Section 1.856-3(e) provides that the term "securities" does not include "real estate assets" as defined in section 856.

Rev. Rul. 80-280, 1980-2 C.B. 207, concerns a REIT that made loans to commercial real estate developers (the "developer loans"). The developer loans were nonrecourse except for the security of commercial mortgages made to third party owners of real property that were assigned to the REIT by the developers as collateral. The balances of the developer loans would never exceed 80 percent of the unpaid balance of the assigned mortgages. To perfect its security interest in the assigned mortgages, the REIT took custody of them. As holder of the assigned mortgages, the REIT was able to enforce payment in its own name if an original mortgagor defaulted. The REIT collected all amounts due from the original mortgagors. From these amounts, the REIT retained the interest due on the developer loans and remitted the balance to the developers.

Rev. Rul. 80-280 holds that the developer loans (commonly referred to as hypothecation loans) qualify as real estate assets under section 856, and the interest on the developer loans qualifies as "interest on obligations secured by mortgages on real property".

The loans from Taxpayer to Corporation in this case are generally analogous to those made by the REIT to developers in Rev. Rul. 80-280. The loans will be made to Corporation on a nonrecourse basis and the fair market value of the real property securing the Committed Mortgages is and will continue to be greater than the balance due on the warehouse line of credit. Additionally, any default on a Committed Mortgage held as collateral will be enforced by Corporation in Taxpayer's name.

Accordingly, based on the information submitted and representations made, we conclude that if the value of the real property securing the Committed Mortgages continues to exceed the principal amount due on the warehouse line of credit secured by the Committed Mortgages, interest paid on the warehouse line of credit will qualify as interest on obligations secured by mortgages on real property or on interests in real property within the meaning of section 856(c)(3)(B). Consequently, the warehouse line of credit constitutes a real estate asset within the meaning of section 856(c)(5)(A) and thus is not a security for purposes of the REIT asset tests under section 856(c)(4).

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 Taxpayer will otherwise qualify as a REIT under part II of subchapter M of Chapter 1 of the Code.

This ruling is directed only to the taxpayer who requested it. Section 6110(k)(3) provides that it may not be used or cited as precedent. In accordance with the Power of Attorney on file with this office, a copy of this letter is being sent to your authorized representative.

Sincerely yours,

David Silber
David Silber
Senior Technician Reviewer, Branch 2
Office of Associate Chief Counsel
(Financial Institutions & Products)

Enclosures:
Copy of this letter
Copy for section 6110 purposes