estate equity. Weak performance in the REIT sector in 1998 and 1999 slowed the growth of REITs, however, and in some cases fostered a consolidation of the market. While the source of debt and equity in the future remains unknown, having both public and private sources of capital should enhance the availability of debt and equity for real estate development in the future.

Ownership Structures for Industrial Development Ventures

Real estate ventures can be owned by an individual—a person or a firm—or a group. The ability to bring a real estate venture to profitable reality in harmony with the business and investment goals of its entrepreneurs and investors depends in good part on choosing the right ownership structure. Each form of ownership carries its own legal and tax consequences. The form of ownership most appropriate for a particular venture depends on several factors, such as the developer's or investor's objectives, market conditions, type of industrial development contemplated, and sources of debt and equity capital. Figure 3-4 summarizes key features of the major forms of ownership.

Industrial developers commonly raise capital for a specific project by entering a joint venture with an institution, such as a pension fund, a life insurance company, or a wealthy individual or family. Such a joint venture is not a form of ownership per se, and it may take any legal form the participants desire. In the past, such joint ventures were usually organized as limited partnerships, where the institutional investor provided most, if not all, of the capital, while the developer contributed development and management expertise. In recent years, limited liability corporations (LLCs) have become the preferred form of ownership structure. Through the terms and conditions set forth in the ownership agreement, the parties share in the project's operating cash flow, appreciation, and investment risk. In recent years, some institutional partners have been reluctant to share the ownership benefits with the developer, preferring instead to hire the developer for a fee and retain 100 percent ownership of the completed development.

Individual Direct Ownership

Direct ownership of real estate by an individual person or firm is the simplest form of ownership. It offers no partners or associates to deal with and no organizational requirements beyond one's own to satisfy. But this simplicity also entails some disadvantages. Without the protection of a separate tax entity, the direct owner of a property is liable for all the debts and liabilities associated with the property. In addition, a direct owner can encounter difficulties in obtaining debt financing for the project, as the entity's viability relies solely on one person. Direct ownership can also complicate planning for the succession of the property to another owner or owners.

Personal Liability	Income Tax Treatment	Transfer of Ownership	Dissolution
Unlimited	Single	Simple and inexpensive	Excellent
Unlimited	Single	Potentially difficult	Potentially difficult
Unlimited	Single	Poor	Fairly simple
Limited for limited partnership; unlimited for general partner	Single	Poor for general partner; fair for limited partner	May be time-consuming and tie up invested capital
Limited	Double	Superior	Simple process but needs shareholders' approval
Limited	Single	Impeded by ceiling on number of shareholders	Simple process but needs shareholders' approval
Limited	Modified single	Superior	Complex
Limited	Single	Superior	Simple process but needs members' approval

The DFW Trade Center is a joint venture between the developer and a foreign investor. The $100 million project consists of ten industrial buildings on more than 180 acres (73 ha) in northwest Dallas, Texas.

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Direct ownership generally is appropriate only for small industrial developments. For most industrial developments, the large capital requirements and the need for sharing risks make direct ownership unworkable.

Partnerships

In legal terms, a partnership is an unincorporated association of two or more persons or entities. People often refer to a partnership as a joint venture or syndication when many limited partners are involved. During the last 20 years, the partnership has been the real estate industry's preferred organizational form. It gained notoriety as the vehicle that was used to finance the commercial real estate building boom that essentially was ended by the Tax Reform Act of 1986. That act introduced limitations on the use of passive losses in tax calculations to curb what was viewed as abusive sheltering of non–real estate income with paper losses from the depreciation of real estate.

A partnership is a reporting vehicle. It is not a taxable entity; that is, partnerships are not considered a separate entity for tax purposes. Therefore, all income and appreciation flow through to the investors, and the entity is not taxed. Partnerships report items of gross income and deductions from income, and the partners include their share of these items on their individual income tax returns. Among ownership entities, only partnerships have the flexibility to make special allocations of income, gain, loss, deductions, or tax credits to their partners. Partnerships have no limits on the number of partners they can include or on the tax status or nationality of their partners. A foreign individual, corporation, or trust may be a partner in a U.S. partnership.

General Partnerships. In a general partnership, all the partners share the risks, rewards, and management of the venture. Any and all partners are liable (jointly and severally) for all the debts and obligations of the business. For this reason, wealthy individuals and money partners do not typically enter into general partnerships for real estate ventures, preferring the protection of limited liability provided by limited partnerships or limited liability companies.

Limited Partnerships. A limited partnership must include at least one general partner and one limited partner, with the general partner (or partners) liable for the partnership's debts and other obligations and the limited partner (or partners) bearing no liability beyond its contributed capital. Participation by limited partners in the day-to-day management of the partnership is not allowed, and if it occurs, the limited partners risk loss of their limited liability status.

Limited partnerships are historically the most widely used form of ownership for industrial properties. The attraction lies in their ability to allocate income (without double taxation) or losses to the limited partners without conferring liability on those partners. Not only does a limited partnership avoid double taxation: the income received by partners retains its nature as ordinary or capital gains income. For industrial developments, the most common type of limited partnership involves a corporate entity established by the developer, which acts as the general partner and manager, and investors who are limited partners.

Limited Liability Companies

Limited liability companies—relative newcomers to the scene—combine the advantages of a nontaxable entity, limited liability for investors, and no restrictions on investors' participation in the management of the enterprise. Virtually every state has adopted legislation that allows business organizations to be formed as LLCs.

In general, the members and managers of an LLC are not personally liable for the LLC's debts and obligations, regardless of the degree to which they participate in its management. A member's liability is limited to the amount of capital contributed. Accordingly, creditors may not recover any part of a claim from a member's personal assets if the LLC's assets are insufficient to satisfy it.

The advantages of LLCs—flexibility in allocation of income and loss, flow-through tax benefits, limited liability, and owners' participation in management—make this form of ownership increasingly attractive for industrial development and investment.

C Corporations

A corporation is an organization separate and apart from its owners, a legal entity created under authority of the state. A corporation's scope of activity is limited by its charter. Corporations pay income tax on their earnings before distribution to equity investors. Generally, corporations are solely responsible for their debts. They operate under the authority of a board of directors elected by the shareholders, and they continue in existence unaffected by any transfer of ownership or by the death, retirement, or bankruptcy of their shareholders. C corporations can have any number of shareholders—including only one —of any type or nationality.

For industrial development projects, the corporate form of ownership presents some tax disadvantages. Corporate earnings that are distributed to the shareholders in the form of dividends are taxed twice—once as corporate earnings and again as the shareholder's income. This tax characteristic makes the transfer of an industrial project's cash flow to investors problematic.

In addition, if a venture under a corporate form incurs losses in its early years, its owners receive no immediate tax benefit (unless the corporation elects to be taxed as an S corporation, as explained in the next section). Such losses can offset corporate earnings only in the future. Unlike some other forms of ownership, C corporations do not allow losses to be used to offset other of the stockholders' current income.

The ability of many corporations to elect to be S corporations or REITs makes the establishment of a C corporation to hold or operate real estate a poor choice.

S Corporations

In some situations, corporations can elect to be taxed as small business corporations (called "S" corporations after the relevant subchapter in the tax code). Like partnerships, S corporations are pass-through entities, meaning that income (or loss) is passed through to the investors without the entity's being taxed. Thus, S corporations do not pay tax as an entity on income that is distributed to shareholders.

The growing acceptance of LLCs has come at the expense of S corporations, which are used much less frequently than they once were. An electing S corporation must meet a number of varied restrictions and eligibility requirements to retain its qualified S status: no more than 75 shareholders; no corporate shareholders; no foreign shareholders; no special allocations of income, loss, and cash distributions; and only one class of stock.

Courtesy DeRevere and Associates

An 85,000-square-foot (7,900-m²) R&D building in Cypress, California.