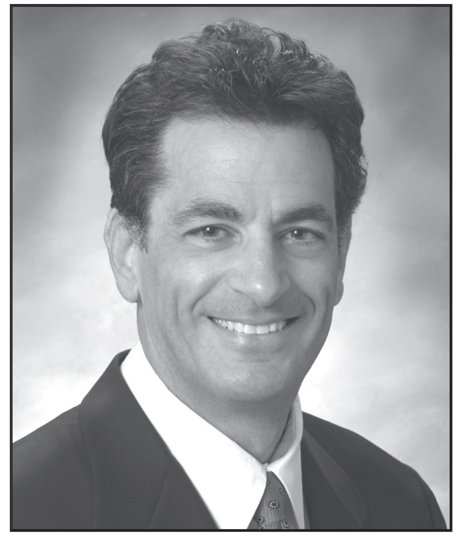
The Delaware Series LLC



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Mr. Lerman of San Rafael, California is a real estate lawyer whose practice includes forming entities, including Delaware Series LLCs, He is the Managing Partner of Lerman & Lerman. He's also co-chair of the State Bar Real Estate Litigation Section and former co-chair of the Marin County Bar Association Real Estate Section. He is former general counsel for two real estate syndication companies with nationwide holdings. Mr. Lerman has been practicing law for 25 years. He has published articles nationwide and is a sought-after speaker.

The booming real estate market and the correlating increase in real estate investors holding multiple properties have presented a problem: how to find a simple, effective and cost-effective way to protect your assets when you own multiple properties. You could drop those properties into one limited liability company (the most popular entity of choice for real estate investors). However, lenders don't usually like that and the liabilities of one property could wipe out your equity in one or more of your other properties. You could set up multiple LLCs—one for each property—but that gets prohibitively expensive. Frustrated by the flaws in these two solutions, many investors simply give up and resign themselves to holding title to their properties in their own names, fully exposing their personal assets to potential lawsuits.

Enter the Delaware Series LLC. Simply put, the Series LLC is the most exciting development in real estate ownership and asset protection since the LLC itself. An innovative concept created by statute nine years ago, but just recently getting more attention (Iowa and Oklahoma recently enacted Series statutes and other states are considering it), the Series LLC is essentially a single "umbrella" entity that has the ability to partition its assets and liabilities among various sub-LLCs or series.

"The structure is similar to a parent corporation with subsidiaries..."

Each sub-LLC may have different assets, economic structures, members, membership rights and managers. The profits, losses and liabilities of each sub-LLC are legally separate from the other sub-LLCs. More specifically, the debts, liabilities and obligations incurred with respect to a Sub-LLC are enforceable against that sub-LLC only and not against the main LLC or any other sub-LLC. The structure is similar to a parent corporation with subsidiaries, only without the expense, the formalities and the heavy double-taxation.

The main benefits of the Series LLC are profound:

• It enables investors to place multiple assets in a single LLC

• It compartmentalizes the liabilities associated with each of those assets, essentially creating a firewall between each sub-LLC

• It eliminates the administrative burden of forming multiple LLCs

• It eliminates the expense of forming multiple LLCs

"...holders of as few as three properties can still save thousands..."

How much expense can it save? Lots. Assume you have an investor who owns ten properties, all located in California. Assume further that none of the properties has annual gross revenues of more than \$250,000, but at least half will sell for more than \$250,000 (this is, after all, California). The investor could either form ten separate LLCs or one Series LLC. When you take into consideration filing fees (for Articles of Organization, Statements of Information, filing service and counter fees), legal fees to set up each entity, accounting fees (ten separate federal and state tax returns), California's annual \$800 franchise tax, and California's gross receipts fee, it totals approximately \$70,000.

Compare that with the filing, legal, accounting and related fees and costs associated with setting up one Delaware Series LLC with ten separate sub-LLCs, which total only about \$16,000, for a *total savings in the first year alone of \$54,000*! Hold those same properties for at least three years and the *savings soar to over \$100,000*! Do you need to own ten properties before this tool makes sense? Absolutely not. On these same assumptions, holders of as few as three properties can still save thousands of dollars employing this strategy.

Other benefits include the ease of adding or dissolving sub-LLC to the umbrella entity, the fact that you should be able to do 1031 transfers between sub-LLCs, and you may be able to avoid Proposition 13 reassessment on such transfers.

Like LLCs in general, the Delaware Series LLC is not without certain risks. For example, no court has yet ruled upon its validity. By the same token, no court has indicated they are not valid. However, most legal commentators and practitioners believe that a validly formed Delaware Series LLC that qualifies to do business in the state in which the property is located should be respected by the courts.

"...no, you don't have to go to Delaware..."

Just as with regular LLCs, it is critical to set up the Series LLC correctly and follow certain rules in operating it. For that, investors should consult a competent real estate lawyer who has specific experience in Delaware Series LLCs. And, no, you don't have to go to Delaware to find that attorney. California counsel can form Delaware Series LLCs, if they have the requisite expertise.