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A User's Guide to LTIP Units: A Special Form of Equity Compensation for UPREITs

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In the universe of equity compensation, an "LTIP" is a commonly used term that invokes a "long term incentive program," which is any form of award of cash or shares paid or issued in order to attract, retain and incentivize management and better align their interests with shareholders generally. For umbrella partnership real estate investment trusts, known as "UPREITs," however, "LTIP Units" have come to refer to awards of a special class of limited partnership interest that take advantage of the relatively unique structure of an UPREIT: a REIT that is taxable as a corporation that holds all of its assets through an operating company subsidiary immediately below the REIT, known as its "operating partnership," that is taxable as a partnership.[1]

LTIP Units are similar in many ways to other equity compensation awards granted by REITs and other public companies to their directors, officers, employees and other service providers that are subject to time and/or performance vesting conditions and payable in shares of the company's common stock (or an amount of cash determined based on the value of such shares). Unlike these other awards, however, LTIP Units are structured as "profits interests" for tax purposes and therefore generally carry two fundamental benefits and one fundamental risk:

- if properly structured, there is no taxable event when an LTIP Unit is issued or when it vests; and
- when the taxable event does occur and the holder of vested LTIP Units receives shares of common stock of the REIT, or "common shares," or the cash equivalent, the long-term capital gains rate generally applies; *however*
- the holder of vested LTIP Units cannot receive common shares or the cash equivalent unless the fair market value of the operating partnership's assets (most commonly measured by reference to the trading price of common shares) has appreciated sufficiently since the LTIP Unit was issued.

In this article, we discuss how LTIP Unit programs are structured and implemented, as well as a variety of related design and drafting considerations.

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[1] While LTIP Units are most commonly used by UPREITs, they can also be used in so-called "Up-C" structures (i.e., corporations that are not REITs that hold their operating assets through an entity taxed as a partnership).

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