Will Obeid,
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Delivering Risk Adjusted Returns to TIC Investors

~ Will Obeid

Over the last few years TIC sponsors have structured most of their programs to acquire stabilized properties that will provide a relatively steady cash yield to investors. As TICs grow in popularity and more sponsors enter the market, the complexion of TIC programs has begun to vary to include value-add deals in the market.

There are two factors driving value-add deals. The first is the desire for higher cash-on-cash yields by TIC investors willing to understand and accept a higher risk investment. Theoretically, the sponsor will have paid a below market price for an asset that has problems they believe can be fixed or managed. This lower purchase price should be passed on to TIC investors and result in above average yields. The additional yield is the risk premium that is required by investors for taking on additional risk. An example of this might be a grocery-anchored shopping center with a dark anchor that is still paying rent through the remaining term of the lease. The obvious value-add objective is to replace the dark anchor at the same or higher rent with a new tenant. In this example, investors should earn an above average return for taking the risk that the property manager may not be able to find another tenant to replace the dark anchor.

The second factor is the challenging acquisition environment that sponsors are in; there is simply too much capital chasing too few deals. Sponsors compete with other institutional sources of capital such as pension funds, REITs, and insurance companies. This forces buyers, including TIC sponsors, to look at deals that may have significant vacancy, or other property management issues that need to be addressed immediately upon acquisition. The danger of course is if the sponsor, and / or the TIC investors, pay full price for a flawed asset. An example of this would be a building that is 30% vacant with average cash-on-cash yields of 7%. Where is the risk premium? It doesn't exist. In this case, the sponsor either didn't make a good buy, or failed to pass the savings on to the investors' acquisition price.

With the wide variety of TIC deals in the market, it is critical for sponsors, broker dealers, and representatives to look closely at a risk adjusted return analysis for each deal coming to market. This analysis basically asks, "Does the risk that an investor is being asked to bear for this investment correlate to the current and overall return of the project?" As this industry matures, more sophisticated techniques will be used to measure risk adjusted returns for all TIC deals. Property risks in TIC value-add programs should not necessarily be feared or avoided. However, risks should be understood, measured, and managed to deliver appropriate risk adjusted returns to TIC investors.

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