Separating the Wheat from the Chaff

A Guide to Analyzing Tenant in Common (TIC) Investments

by Garrett Farmer

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TICs offer a compelling investment opportunity to 1031 exchange investors - deferral of the capital gain tax and the ability to acquire institutional-grade real estate assets that provide stable quarterly income without active property management. According to Omni Brokerage, a national TIC broker/dealer based in Salt Lake City, UT, in 2001 there were 10 national TIC sponsors that raised $167 million. In 2005, it is estimated that over 60 TIC sponsors will raise more than $4 billion. These numbers offer strong evidence that the TIC industry is growing at an unprecedented pace. There are new sponsors entering the marketplace daily, so it is important for real estate investors and their advisors to carefully analyze TIC offerings before making an investment decision.

What are the key due diligence items that investors and their advisors need to consider?

Deciding Upon a Sponsor:

Without question, a Sponsor's reputation is the primary characteristic that investors need to analyze when deciding upon a TIC sponsor. At a minimum, the Sponsor should have an independent due diligence review done on its management team and TIC structure. Another factor to consider is whether or not the Sponsor stays in the property as an equity owner. This is important because, as an equity owner alongside the other TIC investors, the sponsor has a vested interest in the long-term performance of the asset. Retaining an equity position is an indication of the sponsor's commitment to the overall performance of the property. Other factors to consider include the ongoing property management and asset management fees. Are the fees market rate? Or, is the Sponsor charging higher than market fees to generate additional profit to the company?

Two TIC sponsors nationwide have secured Private Letter Rulings from the IRS. Such rulings ensure that the IRS has reviewed and affirmed that the Sponsor's structure is in compliance with the IRS regulations related to Section 1031 of the tax code. A Private Letter Ruling provides investors with specific guidance from the IRS related to the TIC investment's compliance with the like-kind exchange rules.

Analysis of the Property:

As with any real estate investment, a significant amount of due diligence should be conducted by the investor and their advisors before deciding upon a property. At a minimum, a TIC sponsor should provide each investor with the following due diligence items related to the property:

- Title Commitment
- Survey
- Rent Roll
- Phase 1 Environmental Report
- Market Study
- Leases
- Property Condition Report
- Tax Opinion Letter

Another important factor to consider is who handles the property level management. Some sponsors manage the property and collect a fee, while other sponsors outsource management in order to match the best manager with the appropriate property and ensure the property management fees are maintained at market rates.

Given the influx of new TIC sponsors into the marketplace, investors who understand the important questions to ask will be empowered with the information they need to make smart, informed decisions on their TIC investments.

Garrett Farmer is Vice President of Investments for The Geneva Organization and is responsible for soliciting, analyzing and procuring investment opportunities.