

TIC: The Convergence Of Real Estate And Capital Markets

The tenant-in-common structure is a great example of how the real estate industry continues to evolve.

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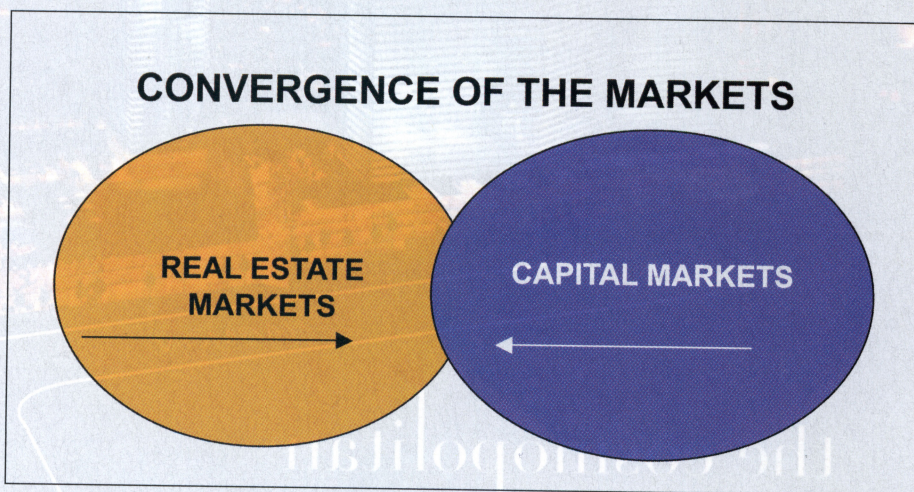
The real estate and capital markets continue to converge. As a result, the evolution of securitized and syndicated real estate investment vehicles will continue. The tenant-in-common (TIC) industry is a great example of this evolution. With the growing demand for passive income investment opportunities (by an aging baby boomer population) and difficulty of finding acceptable replacement properties by exchangers, the TIC market continues to witness a growing inflow of equity. This article provides an overview of the TIC market and key considerations for investors.

WHAT IS A TIC?

A Tenant in Common (TIC) allows the investor to own an undivided fractional interest in an entire property and share in its portion of the net income, tax shelters, and property value. In addition, each investor receives a separate deed and title insurance for their percentage interest in the property and has the same rights as a single owner. Real estate professionals should be aware of the key participants in the TIC area [see chart 1].

TIC MARKET

The TIC market came about in the mid 1990s with isolated transactions that struggled to gain acceptance. During this time, the uncertainty with ten-



ant-in-common structures meeting compliance with IRS 1031 rules, kept companies from getting fully involved. With the issuance of IRS Revenue Procedure 2002-22 in March 2002, TIC programs gained popularity, as the IRS provided 15 guidelines for TICs to avoid being construed as partnerships. This was a breakthrough for the industry and the TIC program exponentially grew with the total equity raised in 2004 representing a 2,387 percent increase over what was raised in 2002. It has basically doubled for each of the last 4 years. Approximately \$792 million was raised in the fourth quarter of 2004 alone. The number of sponsors grew from nine in 2001 to 40-plus in 2004. Refer to the growth charts for an illustrative snapshot of the growth.

The demand for the TIC structure comes mostly from baby boomers that own highly appreciated real estate and also desire to switch from active to passive ownership and management. These boomers are looking to keep the appreciation they have in their real estate by doing a 1031 exchange while turning over to professional real estate companies, the acquisition and management responsibilities of the investment. Additional demand comes from non-exchange driven investors that are seeking: diversification, passive management, current cash flow with less emphasis on property appreciation.

TIC BENEFITS

A TIC can be an attractive alternative structure for many investors. It is a pre-packaged product available with

Chart I.

Real Estate Comparable	TIC Participant	Description
Seller	Sponsor	The entity that structures the TIC program, acquires, manages and sells the TIC properties. They remain active during the ownership and operations of the property. The top sponsors raised approx 50% of the market.
Broker	Broker/Dealer	The entity that performs due diligence on the TIC property and offering and raises the equity for TIC sponsors. Based on estimates, there are approximately 100 active broker dealers but an estimated 10 firms raise the majority of the equity.
Agent	Registered Representative	The professionals who promote TIC offerings to qualified investors as solutions for 1031 replacement properties. They are licensed with Broker Dealers who are members of the NASD (National Association of Securities Dealers). Based on estimates there are 60 reps that represent 80% of all the activity.

all the features of institutional real estate including, non-recourse financing, complete property due diligence, tax opinion, and PPM (private offering memorandum) as a security with full and complete disclosure of risks. It is important to understand that it does put more emphasis on income than appreciation, but total return remains critical to investor's ultimate decision. Key benefits include:

- Simplicity by relinquishing property management issues to professionals, resulting in a coupon clipper and mailbox management investment;
- Regular cash flow distributions, partially tax sheltered via depreciation and interest deduction write-offs;
- Participation in property value at time of sale;
- Minimum equity requirements to invest in high quality and institutional properties allowing for diversifica-

tion by property type, geography, and tenant mix;

- A ready inventory of TIC properties allows individuals to identify properties within the 45-day identification period, acquire within the 180 days, or have a "back-up" property in case their preferred real estate falls through; and
- Because TIC opportunities are often "packaged" with management and financing in place, TICs often offer su-

	Risk	Considerations
Liquidity Risk	The ability to trade out of a TIC position as required – i.e. the liquidity of the investment.	While there is currently no active secondary market for TIC shares, TIC sellers do not appear to be having a problem selling their position. As the market grows, an active secondary market should be part of the evolution process.
Tax Risk	The risk that the TIC interest will be deemed a partnership and not a TIC interest.	A TIC structure should have a clean tax opinion issued by a reputable law firm to mitigate the tax risk.
Sponsor Risk	The risk that the sponsor is not qualified or will not effectively manage the property in the best interest of the investors	By working with a knowledgeable advisor an investor can determine the sponsor and property which best matches his risk profile and objectives. In addition, the NASD regulates the broker dealers and registered representatives providing a continual oversight of the TIC underwriting process..
Closing Risk	The risk that the sponsor will not be able to close on the purchase of the property / properties, putting the investors' 1031 exchange at risk.	Identifying sponsors that already control the property or properties and have financial resources to reduce the uncertainty of closing the transaction..
Real Estate Risk	The risk inherent in investing in real estate – market, property, tenant risk, etc.	Real estate investment has risks – these risks can be limited by performing a thorough due diligence on recognized sponsors that focus on acquiring quality assets on a risk / adjusted pricing basis.

perior efficiencies in the identification, acquisition, financing, closing, and operating stages of real estate ownership

TIC RISKS

While there are many potential benefits to a TIC, investors need to be aware of the potential risks. The most significant, if not controlled, is demand outpacing supply and driving the economics of the deals beyond what is supported by the asset's fundamentals. While this could resemble a repeat of the limited partnership era of the 1980s and '90s, there are major differences in the TIC structure — control is the biggest. TIC owners have a deeded fractionalized ownership, they control the destiny of this real estate, they vote on decisions, they hire and fire management, they decide to sell, they decide to refinance, and they can and do rely on professionals in the process. Basically, they are passive but involved owners by definition of co-ownership agreements.

There is significant investor demand for TICs and until recently, the demand has outstripped the supply of TICs. To limit the risk of a questionable TIC offering and better control the market, the broker-dealers are scrutinizing the TIC offerings through a thorough due diligence review before any TIC program is allowed to be sold. Due diligence is required by the Secu-

rities Regulators, and a key to keeping this hot market in check.

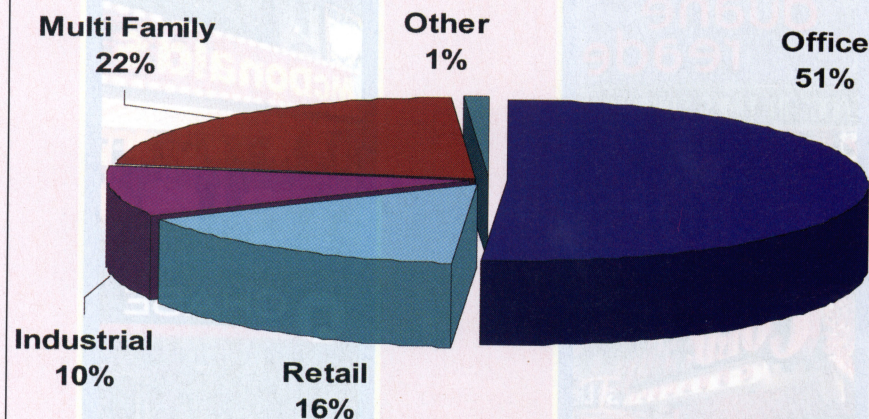
Given that TICs are considered securities, TIC investments are not purchased through traditional real estate agents but instead registered representatives that are licensed with the NASD (National Association of Securities Dealers). An investor should choose a qualified registered representative that can help them determine and review which TIC provides an appropriate match given the investor's risk profile.

CONCLUSION

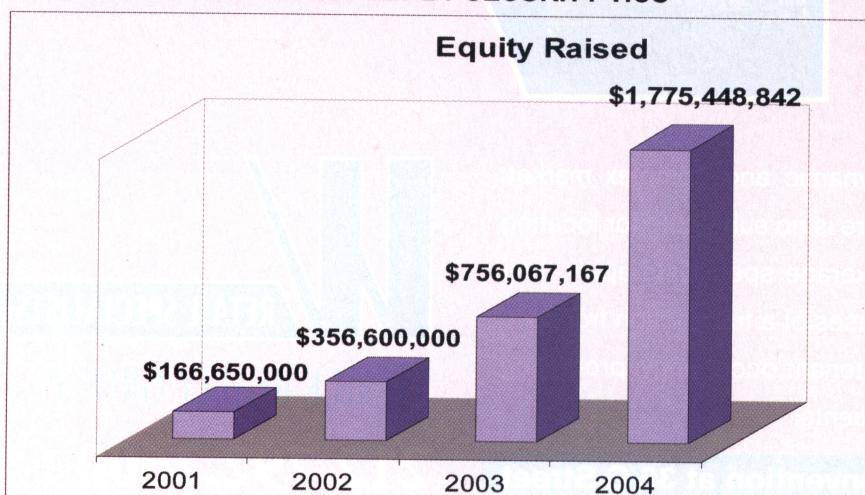
As the real estate and capital mar-

kets continue to converge, real estate investors should become aware of emerging securitized or syndicated investment alternatives that could be utilized in the absence of viable direct investment opportunities. As the investment community becomes more comfortable with these investment vehicles, they need to be aware of not only the options and benefits of TICs, but also the risks of each as they match possible TIC solutions to their own risk profile. **SCB**

DISTRIBUTION OF PROPERTY TYPES ACQUIRED BY TIC MARKET



EQUITY RAISED ANNUALLY BY SECURITY TICs



Gary Beynon is the chairman and CEO of OMNI Brokerage, a leading broker-dealer of 1031 tenant-in-common exchange properties. Gary Saykaly is a managing partner for NewBridge Retail Advisors that provides capital and transaction solutions to the shopping center industry: dispositions, acquisitions, JV structuring, equity placements and advisory services.