



## Bucking the TIC Trend

By Michelle Napoli

**THE TENANT-IN-COMMON** investment business has grown dramatically in just a few short years and, consequently, so have many of its key players. A case in point is SCI Real Estate Investments LLC. A year-and-a-half ago, the Los Angeles-based company had about 35 employees operating out of a single office. Today, it has 100 staffers and contractors in more than 25 branches across the US, and its TIC property portfolio, worth in excess of \$1 billion, keeps growing.

Notably, the company has achieved that growth while bucking the most pro-

nounced trend within the TIC 1031-exchange industry: SCI is among a small minority of sponsors that does not structure its investment offerings as securities. Rather, SCI is selling its product purely as real estate—a point, say company executives, that puts them in good stead with commercial brokers.

“I’m trying to position SCI to be the most real estate brokerage-friendly sponsor out there,” says company founder and president Marc Paul. “How can a potential TIC investor really analyze his options if he’s not dealing with a commercial real estate broker?”

“Approximately 95% of all real estate exchangers go into a sole-ownership deal and only a real estate broker can show those properties,” he adds. “I think it’s important to investors to have the services of a commercial real estate broker to show them both sole-ownership properties and the TIC alternative so they can make an informed decision.”

The key difference between the company’s real estate-only platform and that of the securitized majority has to do with a sponsor’s ongoing involvement in a property once it is sold to the TICs, SCI executives stress. Most sponsors remain

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SCI Real Estate Investments LLC has amassed a tenant-in-common property portfolio worth in excess of \$1 billion. Leading the company are (from left) chief executive officer Douglas E. Johnston Jr., founder and president Marc Paul and chief operating officer Andrew Van Tuyle.

# SCI Real Estate Investments LLC

heavily involved in the asset's day-to-day management once the interests are sold to the investors. Thus, the investors' expectation of a return is reliant on the sponsor's efforts, qualifying the investment product as a security under a definition that still stands from a decades-old US Supreme Court case.

While SCI remains a co-investor in each of its deals, it does not carry out asset or property management responsibilities. The property is controlled by the investment group and its third-party service providers. "SCI exits all asset management, property management, leasing and control functions the moment the TICs come into deeded fee title, which is completely different than a securitized model," explains Paul.

The distinctions are important, since legally, only securities licensees can be

To back up its beliefs and offer a certain comfort level to investors and real estate professionals alike, SCI says it has invested heavily in legal opinions that support its non-securitized platform. Since making the announcement late last year, company executives have declined to name the attorneys that provided the opinions, only stating that they were among the largest law firms that advise on tenant-in-common deals. SCI cites the opinions as chief among the reasons for its confidence in its business model.

The SCI business process was developed "with at least two major law firms," says SCI's CEO, Douglas E. Johnston Jr. "We believe, and our law firms agree, that we have developed and perfected a model that correctly allows us to distribute TIC interests as purely real estate and not as securities."

company in 1994 to invest in earthquake-damaged properties throughout the Los Angeles area. When the IRS issued RevProc 2002-22 in 2002, which spawned what one might consider the modern TIC era, the duo decided the TIC business would make for a natural extension of its previous experience in syndications.

During 2005, SCI acquired approximately \$500 million worth of properties, representing about \$200 million of investors' equity. Earlier this year, company executives stated that they expected to purchase at least \$1 billion of properties during the 2006 calendar year alone. Paul now anticipates closing on some \$750 million in deals this year. Given the competitive market and rising interest rates, SCI is not alone in revising its projections downward. "It isn't a lack

## While most tenant-in-common offerings are structured as securities, SCI's product focuses on the real estate

paid a commission for selling securities products. Likewise, receiving compensation for selling real estate in most states requires a real estate license. Given the dual nature of some TIC products, both can come into play depending on the specifics of the transaction. The topic is a complex one with many legal twists and turns, as well as different points of view and interpretations. Thus far, there has been a lack of explicit guidance from either state or federal regulatory officials.

SCI executives state they have never disagreed with the notion that most sponsors are correctly structuring and selling their TIC investments as securities, though they do note that some on the securities side of the business may be ignoring state real estate licensing requirements. When it comes to any real estate-versus-securities discussion, Paul wants to make sure a picture of the different business models is not painted with broad-brush strokes. It is possible, he says, for a TIC product to be structured in a way that it does not constitute a security.

Paul adds: "We have spent a tremendous amount of time, energy, legal expense and networking to make sure that our program truly qualifies as a real estate-only platform. We're very comfortable that it does."

In order to achieve those legal opinions, SCI had to make some adjustments to the way it structures its transactions, which Paul is reluctant to describe in detail, claiming that much of it is proprietary.

All of these efforts have led SCI to seek a patent for its business model. Johnston says he expects the patent application to be published later this year by the US Patent and Trademark Office. "It's a significant piece of work and it outlines the business process that we alone developed. It is different from any other process currently in the TIC market," he says.

While that product and business model has been developed over the past several years, SCI's start as a real estate investment firm dates back to before the rise of the tenants-in-common business. Paul and co-founder Robert Robotti started the

of equity, it's a lack of suitable TIC properties," he adds.

The company's acquisition activity continues to center on retail and multifamily assets. Its property type preferences are based on retail's "stability of cash flow and income stream, along with the potential for rent increases," says COO Andrew Van Tuyle. As for multifamily, the firm cites such attributes as well as the product type's "shorter lease terms, with which you also have a much greater potential for upside," he says.

Geographically, the firm looks at both real estate fundamentals and population/job growth stories, but other influences also play a factor, says Van Tuyle, who heads up the acquisitions team. For instance, while Florida was at one point a favored location for multifamily acquisitions, it has been roughly a year since SCI last bought apartment properties in the Sunshine State, largely because of the negative impact of the condo conversion craze on prices, he says. Markets in



SCI has begun buying in the student-housing sector. It recently offered investors the 292-unit Gateway at College Station, near Texas A&M University in College Station, TX.

which SCI has bought or may buy in the future include Albuquerque, the Carolinas, parts of Dallas, Pennsylvania and Phoenix.

SCI's sweet spot, says Van Tuyle, is properties with price tags between \$20 million and \$45 million. Among its more recent purchases was the Chino Towne Center, a 116,673-sf asset in Chino, CA that is anchored by a Gigante supermarket. The only transaction detail disclosed was the cap rate, at 6.24%. Also added to the portfolio was Brodick Hill Apartments, a 312-unit property in metro Atlanta for which the company paid about \$25.2 million.

SCI has also begun expanding within



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the multifamily sector to include student housing. It recently offered investors its first acquisition in the segment, which has become increasingly popular with institutional players in particular. The property, the 292-unit Gateway at College Station, is near Texas A&M University in College Station, TX.

SCI is in the process of negotiating the purchase of several other assets, says Van Tuyle. "We have been spending the better part of the year researching the industry," he adds. "Student housing deals tend to have a little higher yield than multifamily and our investors obviously like that."

Given that SCI is selling out its TIC interests, it appears that individual investors approve of the firm's choice of assets.

"They have good properties with creditworthy tenants," says Charles Lederman, president of Charles Lederman and Associates in Marina del Rey, CA, who has brokered his clients' investments in SCI vehicles. "They also get good financing terms for their purchases, and they're not overleveraged."

Cathy Scullin is an SVP at NAI Capital in Encino, CA who has invested

her own money in about 10 SCI deals during the past three years. "They've become one of the larger players in the market and, as a result, are able to look at more and higher-quality properties," she says. "I think if they were churning out offerings for nine or 10 properties a month, I'd be extremely concerned, because I don't think there are that many great properties out there. The fact that they're looking at a lot of buildings and narrowing it down to one or two makes me a little more comfortable that they're not compromising on the selection process."

Scullin says the fact that SCI remains a co-owner in the property gives her a sense of confidence. "If somebody's not willing to put their own money in the deal, I don't know if I want to put mine in, either," she adds.

So what's next for a company that last year was ranked the seventh largest private investor in US retail properties by Real Capital Analytics Inc. and number 319 on *Inc.* magazine's list of the country's 500 fastest-growing private companies? In addition to expanding its portfolio of TIC properties, SCI is considering the possibility of licensing its business model. "We have been approached by a couple of current and prospective sponsors about our willingness to license it," says Johnston. "We're open to it, and we've had discussions with more than one party." (SCI declined to name the interested sponsors.)

SCI also plans to keep promoting its real estate-only TIC business model through the brokerage community. The company recently announced a new program "to deepen our relationships with national brokerage firms by offering up TIC properties on an exclusive listing basis," says Johnston. "This is unique, and it's been extremely well received by the executive strata of national brokerage houses." Again, SCI declined to name participants in the program, though they did say announcements are forthcoming.

"We distribute our properties exclusively through licensed real estate professionals, and you'll see us clarifying that," remarks Paul. "We will not even be marketing to principals, to the TIC themselves. We feel that the people best qualified to assist TICs are licensed commercial professionals." ♦