Triple-net vs. Tenancy in Common (TICs) Investments

Real estate investors involved in 1031 Tax Deferred Exchanges, seeking single tenant, net-leased properties are facing the daunting reality of lower returns coupled with less opportunity. With the advent of the IRS Revenue Procedure 2002-22, a new property type is emerging; the Tenants or Tenancy in Common (TIC) investment.

The Tenancy in Common investment structure has basically been "blessed" by the IRS as an approved investment type for those seeking replacement properties in a Section 1031 Tax Deferred Exchange, in effect creating a whole new investment opportunity class.

I will attempt to compare and contrast single tenant net-leased real estate (triple-net properties) with Tenancy in Common (TIC) offerings.

The working definitions of the triple-net property and a Tenancy in Common (TIC) investment are as follows:

Triple-Net Leased property:

This property has all of the expenses "netted out" and paid by the tenant. The true "triple-net" property has no property management or involvement by the owner and all expenses including real estate taxes, insurance, CAM and utilities are paid directly by the tenant.

Tenants in Common (TIC) Investment:

The property ownership structure is a fractionalized, undivided interest including up to 35 investors (the limit allowed by the IRS). Most TICs however will have less. As a syndication, the property will have a sponsor who acts as the asset manager, and often as the property manager.

Triple-net properties are very attractive to average and astute investors alike, for the following reasons:

1. **Little or no property management**.
   These properties are very passive in nature, and except for variations in the definition of "net", triple-net properties require very little, if any, involvement by the investor. This is a key characteristic to the unsophisticated buyer seeking a real estate investment, with little or no management experience. Both investor types often seek properties that can afford easier lifestyles and are better for preparing for estate transitions. The triple-net property serves both goals.

2. **Simple "rent roll."**
   Both savvy and unsophisticated investors appreciate the simplicity of the single tenant long term net-lease, especially in the last days of a 1031 Tax Deferred Exchange. The predictability of the rent roll combined with the strict time constraints of a 1031 make the net-lease investment the path of least resistance. The investor does not have to be as concerned with potential vacancies, tenant improvement allocations and other factors often underwritten in multi-tenant or multi-family properties. A net-lease is easier to get his/her arms around.

3. **Quality real estate-reasonable returns.**
   Many net-leased properties are leased long-term to national and creditworthy tenants. The failure rate of investment grade companies is very low. An investor in a triple-net, credit investment property can expect reasonable returns with very low risk of default.

Tenants in Common (TIC) properties are emerging as another investment opportunity because they offer some of the same attributes of the net-lease with the added potential for upside.

TICs are attractive for the following reasons:

1. **Little or no property management.**
   Tenants in Common investments are usually offered with professional asset and property management services as part of the package.

2. **Bigger opportunities.**
   An investor with $50,000 can, by investing alongside other investors through a TIC structure, participate in properties that would normally not be reachable. This investor can invest into a property valued at $7,000,000 assuming 35 equity investors each invest $50,000 into a 25/75 debt to value ratio. Normally this investor can only leverage up to a property value of $200,000. Generally, the $7,000,000 property is significantly superior in tenant quality, fundamental real estate factors, and potential for upside and market attractiveness. Using the same argument, the $5,000,000 equity investor can (theoretically) leverage into a trophy property or portfolio if part of a TIC of up to $700,000,000!

3. **Asset Diversification.**
   By investing in either a mix of fee simple equities or TICs, an investor can diversify his/her real estate portfolio. The buyer can invest in differing property types (industrial, office, retail, multi-family, etc.) into varying geographical and demographical locations, into separate and distinct

industries, and ultimately, into properties with various risk/reward profiles. Long-term this can be a very sound strategy.

Triple-Net Downside

In a triple-net property, it is rare to find an investment with all of the value components perceived as perfect. The value components are:

1. **The Tenant.**
   The credit, competitive edge, net-worth, financial history, future prospects, reputation and name recognition of the tenant all impact triple-net property value.

2. **The Lease.**
   The lease form, the degree of "net" or landlord responsibility, NOI increases, lease term and other conditions can significantly impact property value.

3. **The Real Estate.**
   Demographics, geographies, visibility, ingress/egress, building specialization vs. generic functionality and overall estimate of future and residual values all drive property value.

Any perceived problems in any of the aforementioned will influence investor appetite. These factors combined with the single tenant nature of a triple-net property are considered in any risk assessment. Most investors are concerned about the "all eggs in one basket" attribute of the net-leased property. The impact of supply and demand, availability and cost of financing and skyrocketing development costs are also considerations.

TIC Downside

A TIC property (by definition) involves other decision makers. This makes for less (perceived) liquidity and nimbleness in reacting to market forces.

Sponsorship poses another layer of risk. If the sponsor and or its property manager(s) or leasing agent(s) are not qualified or competent, a quality TIC investment can suffer.

A TIC investment has all of the other inherent risks associated with commercial real estate those considering this type of property should do their homework before investing.

Both triple-net and TIC investments have potential for good or bad results. An investor facing the prospect of either property type should consider the fundamentals associate with investing, obtain quality advice and proceed cautiously.