

Is a Slice of the Tenant-In-Common Pie Still Sweet?

by Robert A. Horning, Sheryl Onopchenko, and Linda Bak

It's prudent to scrutinize the Tenant-In-Common (TIC) industry's rapid growth. Will sound investment principles nurture TICs long into the future; or will its meteoric rise fizzle?

The industry experienced exponential growth after March 2002 when the IRS issued Revenue Procedure 2002-22 providing guidelines stating when an undivided fractional interest would be treated as real estate for tax purposes. The distinction between real estate and business is critical because properly structured TICs qualify for exchange treatment (Internal Revenue Code Section 1031), whereas a partnership interest would not.

TICs are popular investment vehicles because they meet the needs of both 1031 exchange investors and those simply wishing to invest capital. TICs allow investors to keep equity in real estate while eliminating time-consuming management headaches. When the thrill of investment property ownership diminishes and the "three T's"—tenants, toilets, and trash—take over, Tenant-In-Common may be your next move.

Tenant-In-Commons offer:

- Institutional-quality properties
- Passive management
- Renewed tax deductions
- Less liability and mortgage risk
- Potential for higher net cash flow
- Retention of direct property ownership in your interest
- Rights to transfer your interest like a sole ownership property
- Portfolio diversification

It's natural to expect a slowdown after a period of intense growth. Although many sponsors and broker/dealers have experienced less activity, we're continuing to see large amounts of equity pouring into the TIC industry. At the close of the third quarter of 2006, close to \$1 billion in equity was raised. This represents the fifth consecutive quarter in which equity nearly reached or exceeded \$1 billion according to OMNI Brokerage, which tracks industry statistics by surveying 68 active sponsors. Clearly investors are still enamored with TICs.

In the early years there were relatively few offerings on the market. Deals were closing so quickly that investors had little time to conduct thorough due diligence. Today we benefit from greater choice. Although fluctuations in syndication times still exist, now investors typically enjoy more time to compare and contrast various sponsors and offerings.

"Location, location, location" remains paramount when selecting viable investment real estate. Sponsors are keenly attuned to changing market conditions. In coastal regions that face dramatic cyclical price changes, many sponsors wait for the market to correct and prices to level off before syndicating an offer. During boom cycles, good properties may be found in non-coastal markets typically insulated from major price variances, where economic growth remains steady or shows moderate upward shifts. When sponsors

take advantage of all phases of the market cycle, investors benefit from increased geographic diversification.

We're also seeing a greater selection of asset classes. Although interest remains high in core properties—multi-family residential, office, retail, and industrial—investors can expand into energy, hospitality, assisted living, land deals, golf courses, and even automobile dealerships.

Past performance is the leading benchmark for sponsor evaluation. As the industry matures, more properties will come full cycle. Actual performance should be compared to sponsor forecasts. Some TICs are bound to underperform. It's important to watch how sponsors handle underperforming assets. Transparent communications, coupled with a sound strategic plan, may allow sponsors and investors to collectively solve issues and ultimately bring the asset back to its stated performance objectives.

TICs are a blend of managing risks inherent with real estate while meeting investor expectations for cash flow. TICs may be speculative in nature and require a high level of due diligence. If you're an accredited investor—have either one million dollars in net worth or have earned \$200,000 per year for the past two consecutive years, or \$300,000 per year if filing a joint tax return—and are looking for a long-term, generally illiquid asset, TICs may be appropriate for you. Although cash flows and returns are not guaranteed, and early sales of individual shares may only be possible at a significant discount, we think a well-balanced portfolio that includes TICs is still a pretty sweet slice of pie.

Risk Disclosure: All investment strategies have risks. Past performance and/or forward statements are never an assurance of future results. Only a sponsor's Private Placement Memorandum or Prospectus is controlling.

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