

Evaluating “Tenants In Common” Offerings: Important Questions to Ask

by Anne Baber, Investment Real Estate Broker

Tenants In Common investments (TIC’s) coupled with the 1031 tax deferred exchange have exploded in popularity within the last few years. This is due in part to the increased demand from aging baby boomers entering retirement. By using the Tenants In Common investments coupled with the 1031 Exchange as a retirement vehicle, investors are deferring their capital gains liability while maintaining an attractive income stream. This allows investors to keep Uncle Sam’s dollars working for them during their retirement years.

Like any investment vehicle that enjoys rapid growth, TIC’s raise fears of trouble down the road. As with any investment, one should try to minimize risk and exposure by careful study of all the facts and financial analysis provided by the sponsor. If investors do not closely examine and complete a sufficient amount of due diligence on these offerings, the investor might pay too much and the real estate will not perform. To help in an evaluation of a particular TIC property, you might consider asking the following questions.

How long has the TIC sponsor been in business?

With the increased demand for TIC investments, it follows that more companies have entered the TIC arena. Make sure that the sponsor is “seasoned” and has been in business for at least 10 years.

Does the sponsor have a solid track record with respect to their TIC properties?

Ask for list of TIC projects for the past several years. What was the average annual percentage cash flow? What was the overall return upon sale? What is their average holding period?

Does the sponsor have a legal opinion for the TIC offering?

There are three standard legal opinions given for TIC offerings reflecting the potential compliance with IRC Sec 1031. These are usually given by independent attorneys who specialize in tax and securities law. Below are the three opinions:

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|------------------------|--|
| • More likely than not | Less strong opinion |
| • Should | Stronger opinion |
| • Will | Strongest opinion, but rarely if ever given
(no one will give a 100% will opinion with respect to the IRS)! |

Investors have a higher comfort level with their investment knowing that their 1031 exchange is in compliance with IRS regulations.

Should I select the investment solely on the cash flow?

No! Cash flow projections are just that....projections. While the income stream is important to most investors, the following should be considered:

- What has the distribution history been for the sponsor? Have they consistently met or exceeded projections?
- Has the sponsor ever reduced or missed distributions?
- Does the sponsor pay monthly or quarterly?

Cash flow, while important, should simply be only one variable in the overall evaluation process.

How does the sponsor make their money?

We all recognize (or should) that the sponsor is not a non-profit organization. That said, it is important that you understand how the sponsor is compensated. Under the guidelines of IRS Revenue Procedure 2002-22, the sponsor organizations are not allowed to share in the distributions. The manner in which a sponsor pays itself and a list of the fees and charges to the investor should be clearly outlined in the offering memorandum. One should closely examine these fees and charges to make sure that they are fair and not excessive.

What are the Sponsors resources to close TIC transaction in a timely manner?

It is important to have a certain comfort level when identifying a TIC, that the sponsor has the resources and game plan in place to close the transaction even if some of the other investors drop. Is there a bridge loan in place to be used if needed? What is the history of the sponsor company's closings? The risk of not closing in a timely manner is not to be ignored.

Summary

Tenants In Common investments coupled with the 1031 tax deferred exchange can be a powerful tool when structuring a retirement/exit strategy. The importance of the investors through due diligence and independent analysis by one's tax advisor cannot be understated. A TIC investment is much like a marriage – "know who you are going to bed with"!

Anne Baber is a real estate broker with the Apartment Owners Association, Commercial Brokerage Division and has 20+ years experience in apartment house brokerage. She can be reached at (818) 235-1135 or anne@aoausa.com.