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## An Up-TIC in Realty Swaps

By Joe Gose

SOARING PROPERTY VALUES AND AGING baby boomers have combined to produce another kind of boom: an investment that carries a big tax break and potentially fat returns for longtime owners of apartment houses and other income-producing real estate. The investment is called a TIC, which stands for tenants-in-common, a hardly novel form of joint asset ownership, but one that has flourished in real estate in the past four years.

The TIC structure, which allows individuals to own a property with several other investors, exploded in popularity in 2002, when the Internal Revenue Service ruled that TIC shares could qualify as 1031 Tax-Deferred Exchanges, a reference to Section 1031 of the federal tax code. Before the ruling, fewer than 10 TIC sponsors had raised \$157 million in equity to fund some \$700 million in property acquisitions. Last year, 46 sponsors raised \$1.8 billion in equity to finance \$4.5 billion in real estate, according to Omni Brokerage, a TIC consultant based in South Jordan, Utah. And the total value of such holdings could run as high as \$9 billion, since deals by dozens of small sponsors fly under industry trackers' radar.

The IRS ruling came at an opportune time. Now nearing retirement, baby boomers who over the years have funneled savings into investment real estate are selling properties. Capital-gains taxes can be deferred under Section 1031 if the proceeds go toward the purchase of other income properties (owner-occupied housing doesn't count) within a specified period (the seller of an old property must choose the new property within 45 days and close on the purchase by 180 days). Under the IRS ruling, TIC-sponsored real estate qualifies. TIC investors re-

ceive monthly distributions that now typically reflect annual yields of 6.5% to 7.5%.

In California, the roughly 40-mile stretch of El Camino Real on the San Francisco peninsula from Burlingame to San Jose illustrates the lucrative potential of TICs. Says Kevin Fitzgerald, chairman of Napa, Calif.-based U.S. Advisor, a TIC sponsor: "Seventy five percent of the properties that line that boulevard are held by investors who are logical candidates for TICs."

Before the IRS ruling, a small 1031 investor, acting alone, might trade out of a property such as a four-unit apartment and into a mini-mart. By joining with other investors in a TIC, the seller gains muscle to compete with institutions for bigger and better properties.

This past spring, for example, Los Angeles-based SCI Real Estate Investments, a TIC sponsor, paid \$44 million for the 130,000-square-foot Casa Paloma Shopping Center in Chandler, Ariz. In February, TIC sponsor Meridian Realty Investments of Boston paid \$66 million for One Cleveland Center, a 543,000-square-foot, 31-story Class A office building in Cleveland.

About all that keeps TICs from even larger deals are rules limiting the structures to 35 investors. Some sponsors, however, are investing in properties alongside TICs to enable TIC participation in bigger investments. Additionally, last year the IRS ruled that TICs could be structured as Delaware statutory trusts, which would allow larger rosters. U.S. Advisor completed the first such transaction late last year when it bought a 280-unit apartment complex in Durham, N.C., for \$23.9 million. Few other sponsors have followed suit because to be eligible a

property typically must be occupied by a single tenant under a net lease. U.S. Advisor structures its trust deals by entering into master lease agreements with its TICs.

Like any investment vehicle that enjoys rapid growth, TICs raise fears of trouble down the road. "Even though they've grown rapidly and continue to grow, the future of TICs is really an open question until a few get into trouble and are tested," says William Pollert, president of New York-based Capital Lease Funding. Because TIC investors must rush to swap properties to meet tax-code deadlines, sponsors risk overpaying. "There's a real danger if investors don't do a very good amount of due diligence on these deals that they'll pay too much, and the real estate won't perform," says Gary Beynon, chief executive officer of Omni Brokerage.

Most sponsors consider TIC shares securities under federal law, requiring that sponsors provide private-placement memorandums for each building and that shares be sold by licensed securities dealers. But some sponsors argue that not all TIC shares are securities, and sell shares through real-estate brokers. The Securities and Exchange Commission hasn't proposed any definitive guidelines on TICs, though the National Association of Securities Dealers has told members the shares "generally are securities for purposes of federal securities laws and NASD rules." Says Cary Losson, president of 1031 Exchange Options in Walnut Creek, Calif., a consultant to TIC investors: "It's absolute insanity to offer these to the general public and not structure them as a security." ■

JOE GOSE is a Kansas City-based free-lance writer who reports frequently on real estate.