

## Talking TICs

By examining the industry's past and present, an industry insider predicts a strong future.  
By C. Grant Conness

**W**hile the current economy is causing the tenancy-in-common industry to face some adversity and growing pains, there is still hope for the sector's future. Based on past and current factors, many investors and industry watchers believe that in time TICs will return to the forefront of the commercial real estate industry.

### TICs Take Hold

The TIC industry began in the mid-1990s in Southern California, when what may be the first-known TIC investment property transaction took place on behalf of 1031 exchange investors. In 2002, following years of uncertainty in tax and legal qualifications, the Internal Revenue Service issued Revenue Procedure 2002-22, which provided official guidance for TICs to qualify under section 1031 of the Internal Revenue Code. By March 2002, about a dozen real estate sponsor firms had taken advantage of this niche, which permitted up to 35 small to midsize investors to take title to potentially institutional-quality and professionally managed properties. By virtue of their size and stature, these types of assets TIC investors began to target were much more attractive than typical 1031 exchange properties.

In the early years, property sizes and asset classes ranged from \$20 million shopping centers to trophy office towers priced upwards of \$180 million. The TIC concept permitted investors with as little as \$500,000 to \$1 million of equity to invest and purchase a percentage of ownership into a series of substantial buildings previously reserved for pension plans, insurance companies, and real estate investment trusts.

At the end of 2002, the total equity raised from these dozen or so sponsor firms was approximately \$360 million. As the commercial real estate industry heated up, TIC investments became more publicized, especially on the West Coast. Equity was raised at unprecedented figures as properties literally were fully subscribed within hours. The equity stimulating this market nearly doubled on an annual basis every year from 2002 until fourth-quarter 2007, according to Omni Research and Consulting.

### TICs Today

In today's market, TICs certainly are experiencing the same pain as the rest of commercial real estate. In August 2007, when the credit crunch struck the U.S., the cheap interest rates and creative financing structures that fueled the debt components of just about every major TIC transaction suddenly were gone.

Due to the lack of liquidity in the market, several lenders halted financing altogether, while others were forced to charge spreads upwards of 500 basis points over the 10-year treasury on commercial mortgage-backed securities loans. Also gone were the days of 70 percent to 90 percent loan-to value and interest-only financing. Lenders were forced to tighten their underwriting standards, and with the CMBS market no longer an option, the more prominent sponsors were forced to seek out alternative financing through insurance companies, government agencies, and bank lenders.

Another issue currently confronting TICs is its limited distribution channels. While some large broker-dealers have begun to take a look at TICs, most TIC deals have been conducted through the independent broker-dealer community. Therefore, in terms of present growth, clients of broker-dealers and registered reps currently engaged in the TIC business are the main sources of equity being placed.

Many TIC sponsors have been permanently sidelined or forced out of the industry because they underestimated the longevity and commitment of continued investor-client relations. Others have merged, consolidated, or been acquired by other sponsors with more funding to weather the storm.

For TIC investors, the credit crunch has slowed the pipeline as properties are taking much longer to sell due to the increased inventory on the market and the current financing woes. This turmoil has had a substantial effect on the amount of equity available to the TIC market, reports *The Insurance Journal*.

However, on a positive note, several seasoned sponsor firms have experienced great success in selling properties acquired a few years ago on behalf of TIC investors.

Deals that went full cycle last year were one of the driving components of 2007's total equity raised, as many of these investors continued on with the sponsors and 1031 exchanges into another TIC investment, according to *Insurance Journal*.

The ability for TIC investments to compete with institutional buyers and sellers seems to be very attractive to the average investor and continues to be a driving force behind TICs' growth. The trend of deals going full cycle should continue to propel the industry during the current economic downturn as many institutional buyers on the backside of these TIC transactions consistently continue to acquire quality real estate.

### TICs in the Future

While the industry faces some obstacles, the future outlook remains positive. One optimistic factor has to do with the demographics driving the demand for TIC investments, Omni reports. Over the past seven years, seniors and baby boomers collectively have funneled more than \$12.5 billion into TIC investments. These two market segments make up more than 112 million U.S. investors. In addition, demand should escalate during the next 35 years as some \$40 trillion in multigenerational wealth transfers when more boomers retire, *Insurance Journal* notes.

Another growth prospect consists of the emergence of a secondary market for TIC investments. Though TICs are illiquid investments like other forms of real estate, several companies have begun to develop a much-anticipated secondary market. TIC investors are now, in a limited manner, granted the ability to gain access to previously offered TIC properties that investors are seeking to sell. Not without its limitations, this concept should gain more steam as TICs become a more publicized and mainstream industry.

Additional trends helping to move the industry forward have to do with the size of future TIC transactions and the fact that sponsors are being forced back to more-traditional lending practices. In the future, sponsors should see stricter standards as far as leverage requirements and interest-only and nonrecourse financing capabilities. These stringent lending conditions, combined with the amount of time it takes a sponsor to complete an equity raise on a TIC transaction should limit the amount of mega deals produced.

The industry should continue to experience a movement toward deal sizes in the \$15 million to \$50 million price range. These pricing parameters seem to give sponsors the comfort and confidence that they can close a transaction in a timely manner, limiting the unknown risk and expenses of prolonged carrying costs.

The main factor indicating a positive future for TICs is the National Association of Realtors exemption request to the Securities and Exchange Commission. If granted, it would permit commercial real estate professionals to obtain a referral or advisory fee for their part in referring or advising a client on a securitized TIC transaction.

Furthermore, the influential support of NAR alone would be an excellent dynamic to further sustain the longevity and future of the TIC industry.

Although the TIC industry faces adversity in today's challenging economy, its future appears quite hopeful. If the past is any indication of future performance, the TIC industry should have no problem continuing to develop and navigate its path to a more mainstream and widely accepted national platform.

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