TIC-TAC-No!
the TIC Market Today

Michael K. Houge, CCIM, SIOR, is the founder of Chief Real Estate Company in Minneapolis, Minnesota. He has more than 22 years experience in project leasing and investment sales and is a specialist in the sale of net-leased investment properties and tenants-in-common (TIC) transactions. He is a frequent speaker on Investment Sales, Marketing, the Net-Lease Industry and TIC investment.

By Michael Houge, CCIM, SIOR

The Tenant-in-Common (TIC) business is in serious trouble. Major sponsors, such as DBSI and Sunwest Management, are filing for bankruptcy protection, leaving thousands of investors out in the cold and without a sponsor. Meanwhile, other TIC syndicators are being acquired by stronger competitors, foreclosures abound, and formerly attractive financing has all but disappeared.

Why? What has led to the seeming demise of a popular upstart industry that boasted more than $8 billion in investments in 2006? To answer that question, we have to examine the history of the TIC syndication business.

Prior to 2002, TIC syndicates were being formed and there was TIC investing, but only at an estimated clip of $100-$150 million annually and only with a few sponsors or syndicators willing to forge ahead using the TIC structure to satisfy 1031 Tax Deferred Exchanges. Most TICs were structured among families and acquaintances to allow for multiple owners, with added flexibility both for exit strategies and to assure parity in property-level decision making.

In March of 2002, the IRS lit a fuse by issuing a Revenue Procedure Ruling, which provided clarity and favorable capital gains tax treatment for TICs purchased to use Section 1031 Tax Deferred Exchanges. With the issue of this ruling, which provided a road map for tax-efficient structuring TIC investment, an industry was born. Accountants, asset managers, attorneys, brokers, broker-dealers, developers, institutional lenders, investors, mortgage brokers, qualified intermediaries, registered representatives, sponsors, syndicators, title companies, and other related professionals came out of the woodwork to structure, offer, sell, lend on, and manage properties of every type imaginable to appease a seemingly never-satisfied appetite for properties available for 1031 exchange investors.

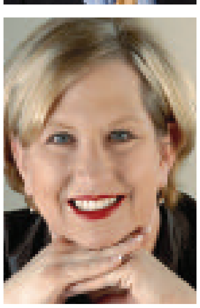
In 2003, the Tenant-in-Common Association (TICA) was formed to self-police its members, many of whom come from the preceding list of professionals. TICA has more than 600 members, many of whom are sponsors. TICA drafted and issued a very detailed list of

"Best Practices" to help maintain a high degree of integrity and ethical activity within the industry. For the most part, it worked. Most insiders thought the TIC industry would continue to grow and flourish, claiming a "sweet spot" among 1031 replacement properties.

It may have done so, since most 1031 tax deferred exchange investors must invest in properties encumbered with debt (along with their equity), and TIC properties have been offered usually with available debt. But when the capital crisis hit, available debt dried up for all commercial properties, including TICs—especially TICs. The conduit or CMBS lenders were toast, and these arguably made more than 90 percent of the TIC loans. The lenders left standing, primarily insurance companies and banks, became very selective when making loans. The cream rises to the top, so new TIC deals, which involved multiple owners from disparate backgrounds, locations, experience, and financial strength, ended up at the bottom of the piles of loan applications, with the other "brain damaged" deals. Now back to today, or better yet, tomorrow.

"only the best TIC deals will make it to the market."

Where Is the TIC Industry Heading?



To help answer this question, I interviewed two captains of the TIC business, **Duane Lund** and **Renee Brown**. Lund is founder and CEO of The Geneva Organization, one of the premier TIC sponsors in the nation. Geneva, based in Minneapolis, has completed more than $650 million in TIC investments and continues to grow and thrive, despite overall industry woes.

Brown is with Minneapolis-based Wildwood Wealth Management, an investment advisor specializing in TIC offerings, and (as of this writing and pending board approval), she is the President–Elect of TICA.

Both Lund and Brown see significant changes for the TIC business. Lund emphasizes a difference between the TIC and the 1031 industry. He does not think the 1031 market is going away in fact, he says, "It should increase." He grounds this belief in investor demographics. "There will be a maturation of entrepreneurial real estate ownership," he says, and many of those owners "will wish they'd sold their properties in the last run-up, and they will want (or need) to monetize their portfolio. The properties will have a low basis for tax purposes," Lund says, "so 1031s will be a very attractive capital gains tax deferral strategy." He sees the TIC business as a byproduct.

Brown agrees, adding that the TIC structure or multiple ownership investment still makes sense, since "there will always be investors with $200,000 seeking institutional quality, passive real estate investments." The TIC or 1031 replacement properties going forward will be of much higher quality. Lund thinks there will be more and more focus on "blue-chip properties with predictable returns and less downside."

Quality is the key. Properties will be over-analyzed by everyone involved. Sponsors, fearing the same fate as DBSI and others, will pick from the best properties available, with the most predictable rent rolls, occupied by the very best tenants. They'll have to. Investors will remain fear-driven and will have many more offerings to pick from, so only the best TIC deals will make it to market. Lenders will be even more diligent in their review. For sponsors to be successful in getting their property syndications through a lender's committee review, they will almost need an act of God—especially if the sponsor is not a seasoned real estate pro. As Lund says, "This is a game for veterans, not amateurs."

Brown points out that, in spite of the current market conditions, there are approximately 76 TIC offerings on the market. "Gone is the sense of urgency," she says.

Many of the syndicators who were in the TIC game, were in it to raise money. When the capital markets collapsed, the money-raising game ended, along with their business.

The TIC Business Model

The business model for a money-raising enterprise is as different as night and day from business models of a real estate company—models that are designed to weather down cycles (a norm in the commercial real estate world) but just happened to offer TICs. Quality TIC sponsors are experienced in the day-to-day business of real estate ownership, asset management, or property management, leasing, and/or development—and they are usually involved in more than one of these activities. These syndicators "operate in the real estate business," Lund says, "They own, buy, manage, and build, and just happen to raise money too."

Lund and Brown agree that, going forward, the TIC structure, as we knew it, is probably dead. Lenders will not lend to entities with multiple owners if there is no "go-to guy" or general partner. But the IRS does not allow this for a TIC.

What Will Work?

The best structure currently allowed for syndicated 1031 investors is the Delaware Statuary Trust (DST). The DST was designed to provide one voice or one manager (trustee) the ability to make asset- and property-level decisions without needing the involvement of all of the 1031 (TIC) investors, some of whom could well be unavailable or unreachable.

Although the market is experiencing great problems resulting from lack of debt capital and other looming fundamental problems, it is and always will be cyclical. As SIOR professionals, we are able to offer professional services to the sponsors of the DSTs (TICs) and to the end investors. According to Lund, "There will still be significant investment from the bread-and-butter, weekend real estate investor, who sees significant value in hitching their wagons to real pros."

Statement of Ownership, Management, and Circulation

1. Publication Title- Professional Report a publication of the SOCIETY OF INDUSTRIAL AND OFFICE REALTORS. 2. Publication Number 0324-270 3. Filing date November 21, 2008 4. Issue Frequency-Quarterly 5. Number of Issues Published Annually- 4 6. Annual Subscription Price $35.00 members $45.00 nonmembers $55.00 Foreign addresses 7. Complete Mailing Address of Known Office of Publication (Not Printer) (Street, City, State, and ZIP+4) 1201 New York Ave., NW, Suite 350, Washington, DC 20005-6126 8. Complete Mailing Address of Headquarters or General Business Office of Publisher (Not Printer) 1201 New York Ave., NW, Suite 350, Washington, DC 20005-6126 9. Full Names and Complete Mailing Addresses of Publisher, Editor, and Managing Editor (Do not leave blank) Publisher (Name and complete mailing address) SOCIETY OF INDUSTRIAL AND OFFICE REALTORS 1201 New York Ave., NW, Suite 350, Washington, DC 20005-6126 Editor (Names and Complete mailing address) Richard Hollander SIOR 1201 New York Ave., NW, Suite 350, Washington, DC 20005-6126 Managing Editor (Names and Complete mailing address) Linda Nasvaderani SIOR 1201 New York Ave., NW, Suite 350, Washington, DC 20005-6126 10. Owner (Do not leave blank. If the publication is owned by a corporation, give the name and address of the corporation immediately followed by names and addresses of all stockholders owning or holding 1 percent or more of the total amount of stock. If owned by a corporation, give the names and addresses of the individual owners. If owned by a partnership or other unincorporated firm, give its name and address as well as those of each individual owner. If the publication is published by a nonprofit organization, give its name and address.) Full Name- SOCIETY OF INDUSTRIAL AND OFFICE REALTORS. Complete Mailing Address 1201 New York Ave., NW, Suite 350, Washington, DC 20005-6126 11. Known Bondholders, Mortgagees, and Other Security Holders owning or Holding 1 Percent or More of Total Amount of Bonds, Mortgages, or Other Securities. If none, Check box - None 12. Tax Status (For completion by nonprofit organizations authorized to mail at nonprofit rates) (Check one) The purpose, function and nonprofit status of this organization and the exempt status for federal income tax purposes: Has Not Changed During the Preceding 12 Months 13. Publication Title-*Professional Report* a publication of the SOCIETY OF INDUSTRIAL AND OFFICE REALTORS 14. Issue Date for Circulation Data Below 3rd Quarter 2008 15. Extent and Nature of Circulation-Average No. Copies each Issue During the Preceding 12 Months a. Total Number of Copies (Net Press Run) 4408 b. Paid and/or Requested Circulation (*By Mail and Outside the Mail*) b(1) Mailed Outside-County Paid Subscription Stated on PS Form 3541. (Include paid distribution above nominal rate, advertiser's proof copies and exchange copies) 3,063 b(2) Mailed In-County Subscriptions Stated on PS Form 3541 (Include advertisers proof and exchanged copies) 0 b(3) Paid Distribution Outside the Mail including Sales Through Dealers and Carriers, Street Vendors, Counter Sales, and Other Paid Distribution Outside USPS® 0 b(4) Paid Distribution by Other Classes of Mail Through USPS (E.G. First-Class Mail ®) 158 c. Total Paid Distribution [Sum of 15b. (1), (2), (3), and (4)] 3221 d. Free or Nominal Rate Distribution (By Mail and Outside the Mail) d(1) Free or Nominal Rate Outside-County Copies as Stated on PS Form 3541 393 d(2) Free or Nominal Rate In-County Copies Included on PS Form 3541 0 d(3) Free or Nominal Rate Copies Mailed at Other Classes Through USPS (e.g. First-Class Mail) 162 d(4) Total Free or Nominal Rate Distribution Outside the Mail (Carriers or other means) 480 e. Total Free or Nominal Rate Distribution (Sum of 15d. (1), (2), (3), and (4) 1035 f. Total Distribution (Sum of 15c. and 15e.) 4256 g. Copies not Distributed (See Instructions to Publishers #4 (page 3)) 152 h. Total (Sum of 15f. and 15e.) 4408 i Percent Paid (15c. divided by 15f. times 100) 76% 15. Extent and Nature of Circulation No. Copies of Single Issue Published Nearest to Filing Date a. Total Number of Copies (Net Press Run) 4750 b. Paid and/or Requested Circulation (*By Mail and Outside the Mail*) b(1) Mailed Outside-County Paid Subscription Stated on PS Form 3541. (Include paid distribution above nominal rate, advertiser's proof copies and exchange copies) 3,066 b(2) Mailed In-County Subscriptions Stated on PS Form 3541 (*Include advertisers proof and exchanged copies*) 0 b(3) Paid Distribution Outside the Mail including Sales Through Dealers and Carriers, Street Vendors, Counter Sales, and Other Paid Distribution Outside USPS® 0 b(4) Paid Distribution by Other Classes of Mail Through USPS (E.G. First-Class Mail ®) 158 c. Total Paid Distribution [Sum of 15b. (1), (2), (3), and (4)] 3224 d. Free or Nominal Rate Distribution (By Mail and Outside the Mail) d(1) Free or Nominal Rate Outside-County Copies as Stated on PS Form 3541 395 d(2) Free or Nominal Rate In-County Copies Included on PS Form 3541 0 d(3) Free or Nominal Rate Copies Mailed at Other Classes Through USPS (e.g. First-Class Mail) 200 d(4) Total Free or Nominal Rate Distribution Outside the Mail (Carriers or other means) 586 e. Total Free or Nominal Rate Distribution (Sum of 15d. (1), (2), (3), and (4) 1079 f. Total Distribution (Sum of 15c. and 15e.) 4403 g. Copies not Distributed (See Instructions to Publishers #4 (page 3)) 347 h. Total (Sum of 15f. and 15e.) 4708 i Percent Paid (15c. divided by 15f. times 100) 73% 16. Publication of Statement of Ownership Publication required. Will be printed in the 1st Quarter 2009 issue of this publication 17. Signature and Title of Editor, Publisher, Business Manager or Owner Linda Nasvaderani, Senior Director Date November 21, 2008. I certify that all information furnished on this form is true and complete to the best of my ability. I understand that anyone who furnishes false or misleading information on this form or who omits material or information requested on the form may be subject to criminal sanctions (including fines and imprisonment) and/or civil sanctions (including civil penalties). Failure to file or publish a statement of ownership many lead to suspension of Periodicals authorization. PS Form 3526, September 2006 (page 2 of 3)