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INSIDE REAL ESTATE

More Property Investors Join As Tenants-In-Common

Investment Vehicle Climbing

Boomers eyeing retirement can invest in big properties while deferring gains tax

BY JOE GOSE

FOR INVESTOR'S BUSINESS DAILY

Naming investment vehicles after bloodsucking parasites might seem like a bad idea. Not so in the case of TICs.

Short for tenants-in-common, TICs are an investment structure with tax advantages for small commercial real estate owners. They give investors a way to sell their assets and pool the proceeds with other investors to buy larger properties, all the while deferring capital gains taxes.

Though TICs aren't new, they drew little attention for more than a decade. But over the last few years, they've eaten up an ever-larger portion of real estate equity.

Since 2001, the amount of cash pouring into TICs has roughly doubled each year. It hit \$3.2 billion in 2005, according to Omni Brokerage, a TIC investor consultancy and research firm based in South Jordan, Utah. This year, Omni projects TICs will raise some \$5.5 billion.

"People certainly are getting more comfortable with the structure," said Richard Walter, president of retail property brokerage Faris Lee Investments in Irvine, Calif. "There's so much cash out there, and it's moving pretty fast."

Walter expects his company to broker about \$1 billion in TIC purchases and sales this year, about double last year's volume.

Converging Drivers

What's behind the growth? Baby boomers and the IRS.

Planning for retirement, boomers are selling properties they've owned for years and plowing the proceeds into TICs. Under a 2002 IRS ruling, such transactions qualify as Section 1031 exchanges, which defer taxes on the gains made from the initial sale as long as certain conditions are met. (See box.)

Other benefits of the structure? TIC investors generally get monthly distributions that reflect annual yields of 6.5% to 7.5%. And total returns — yields plus appreciation in the properties' value — often have topped 20% recently as TICs have sold off assets to take advantage of rising demand for real estate.

Most TIC investors are taking those returns and rolling them right back into new TICs.

Unlike limited partnerships, TIC investors have a say in how a property is operated — who manages it and whether to sell it, for example.

Plus, TICs give small investors a stake in institutional-grade assets they couldn't afford to buy on their own. That means an alternative to funneling savings into small properties such as duplexes.

Fewer Ownership Headaches

Perhaps best of all, TIC investors are passive owners. That means no midnight calls to unclog a toilet.

"TICs allow sellers to get out of the unpleasant part of management and get into a



Triple Net Properties last year paid \$150 million for the office tower at 123 N. Wacker in Chicago on behalf of a TIC, one of the biggest TIC transactions.

higher class of property," said Louis Rogers, president of Triple Net Properties Inc. in Santa Ana, Calif. Last year Triple Net acquired \$1.6 billion of properties on behalf of TICs.

Like other TIC sponsors, Triple Net contracts to buy real estate such as office buildings or apartments, divides the properties into shares and sells them to investors.

(Continued)

But while small investors helped drive the industry at first, bigger investors such as high-net-worth individuals now are plowing money into TICs, Rogers says. That lets TICs buy even larger, more pricey assets. Last year, for example, Triple Net acquired a 30-story office tower at 123 N. Wacker in Chicago for \$150 million on behalf of a TIC.

Despite the industry's growth, concerns surround TICs. Most sponsors, for instance, maintain that TIC shares are securities and sell them in private offerings through licensed broker-dealers. Among other demands, the offerings require sponsors to

provide full disclosure about properties and sell shares only to accredited investors.

But some sponsors argue that not all TIC shares are securities. They say it depends on how deals are put together. Those sponsors, such as SCI Real Estate Investments in San Diego, sell shares to any willing investor through real estate agents.

Also, deals are taking longer to close as more offerings chase after investors. The number of TIC sponsors has grown to more than 70 from a handful just a few years ago. So more properties are seeking TIC equity than ever before.

By the end of 2005, many TIC sponsors saw deals take more than the industry average of three weeks to close, according to Omni Brokerage.

TIC experts say the longer closing periods don't indicate waning investor interest.

"The number of investors and the amount of equity is going straight up," said Cary Losson, president of 1031 Exchange Options in Walnut Creek, Calif., a consultancy that placed investors in roughly \$800 million of TICs last year.

"But there are a lot of Johnny-come-lately sponsors who have come to the market with premature expectations."

What Makes TICs Tick: Tax Law, Pooling

Tax benefits and the chance to invest in higher-quality properties explain real estate investors' appetite for tenant-in-common offerings:

■ **1031 exchange tax advantages:** Under the tax code, Section 1031 exchanges let owners of income-producing properties sell them and defer taxes on the gains. Proceeds must go toward buying a similar income-producing property.

Also, an investor must contract to buy the new asset within 45 days of the original sale and close within 180 days.

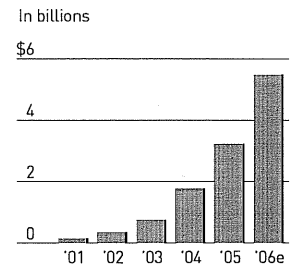
■ **Key tax ruling :** In 2002, the IRS ruled that TIC shares qualified as property under Section 1031. Before the ruling, small property owners might sell a fourplex, and buy a minimart. Buying into a TIC lets investors pool their funds with up to 35 in-

dividuals to buy larger properties.

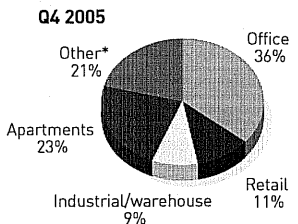
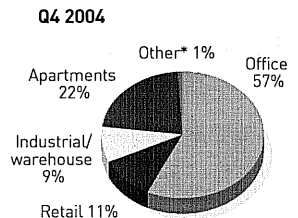
■ **Investment structure:** A TIC sponsor contracts to buy commercial real estate such as offices or apartments, then divides the ownership into shares, which are sold to investors. Depending on the property, share prices generally range between \$250,000 and \$600,000.

Sponsors typically invest in and manage properties.

More Growth Predicted In Investment In TICs



Equity By Property Type Showed Shift Last Year



*assisted living facilities, hotels, self-storage and oil/gas programs
Source: Omni Brokerage

Most treat TIC shares as securities and sell them via licensed broker-dealers. Others, however, contend that's not always required and market shares through real estate salespeople.