

Real estate is our domain<sup>SM</sup>

## TIC Investments Still Viable

By Duke Runnels, President and CEO FORT Properties, Inc.



Unprecedented economic conditions have claimed another casualty as DBSI, one of the nation's largest TIC sponsors with 232 office and retail properties, recently filed for Chapter 11 protection. Does this ring the death knell for tenant-in-common investments? Absolutely not! As the commercial real estate industry in general continues to be challenged however, investors must fully understand that a TIC investment must be viewed—first and foremost—as a real estate investment with associated risks and rewards and not as a guaranteed yield bond.

While the basic premise of tenant-in-common investments is the same regardless of the sponsor—fractional ownership in a commercial real estate asset—individual firms can and do structure their TIC programs differently. Some firms follow a model similar to that of DBSI, whereby the assets are structured inside a master lease with a stated monthly distribution by the master tenant (sponsor) giving the illusion of a guaranteed return.

While the quality and performance of the asset is paramount to the overall yield to the investor, current events have demonstrated that if the asset is underperforming to projections, the “guaranteed yield” offered under a master lease is only as strong as the financial stability of the sponsor. Although a promised higher yield might be attractive to an investor on the surface, questionable property in a questionable market with questionable tenants translates into a questionable investment when something goes wrong, regardless of a guarantee.

The majority of TIC sponsors, however, do not structure their programs this way. Most let each offering stand on its own merits, creating greater transparency through the use of a property management contract. Notwithstanding the vehicle used to invest in real estate, when considering the offered yield to the investor, the old adage still holds, “if it looks too good to be true, it generally is.”

Regardless of how the program is structured, the responsibility of due diligence and evaluation of the asset rests solely on the shoulders of

the TIC sponsor, so a comprehensive understanding of the sponsor's real estate experience is crucial. It's not enough for investors to simply evaluate the sponsor on historical returns. As we've seen in this current down market, conditions can change quickly and those who were able to succeed in a vibrant real estate market may not be able to weather the storms that arise. This is where commercial real estate experience counts—in bull and bear markets. Projections for the asset must be realistic and investors must be sure that the executive management team has the skills and experience to make adjustments deftly when conditions dictate.

Investors should also evaluate the contract's exit strategy to ensure that provisions are in place for ownership to act decisively as well. Exit strategies vary from firm to firm, but generally require a unanimous vote of all owners to make major decisions such as leasing or selling the property. This provision can make expedient reactions to market conditions nearly impossible. When reviewing the contract, investors should weigh the benefits of a super-majority that ensures a cohesive decision without the delay of unanimity.

Upcoming demographic shifts and economic policies will make this investment strategy increasingly attractive to investors. The first baby boomer received Social Security benefits this year. This aging demographic will continue to look for methods by which to maintain an interest in real estate investments without the responsibilities of day-to-day management. The ability to defer capital gains taxes, which may rise under increasing national budget pressures, will create a growing market for this strategy in the coming years.

For many TIC sponsors, however, the projected growth period for this strategy will not come soon enough. There will almost certainly be fewer TIC sponsors in 2009 than there were in 2008, but those that remain will have proven their commitment to their investors and to this investment strategy, demonstrating their ability to weather our generation's greatest economic challenge.