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TIC INDUSTRY GROWS UP

The five issues that will shape the TIC industry in 2007 and beyond

Charles "Duke" Runnels

If the past few years can be defined as an era of extraordinary growth for TICs and TIC sponsors, the year ahead will likely be remembered as one of evolution and maturity. A series of political, regulatory and financial changes are on the horizon, destined to converge in 2007 and early 2008. This perfect storm will usher in a new era of investor focus and sponsor accountability, irrevocably altering the TIC industry and the way sponsors conduct business.

A New Democratic Congress

The political climate has changed and the Democratically controlled United States House of Representatives and Senate are very likely to revisit the Bush Administration's capital gains tax cuts. Though it is unclear if Congress will completely rescind the tax cut and restore a 25 percent capital gains rate, most financial and political pundits agree that the current 15 percent rate will rise. For real estate investors, a rise in capital gains taxes makes 1031 TIC exchanges even more attractive in terms of wealth preservation.

The high probability of a capital gains tax increase becomes a near certainty should the White House also change political parties in 2008.

TICs: Securities or Real Estate

The regulatory question of whether TICs should be defined as securities or real estate will be answered, or at least seriously addressed, in 2007. This hot button issue has been heatedly debated through the years and has reached a point where a ruling should be forthcoming.

Charles "Duke" Runnels
President and CEO
FORT Properties

Realtors view TICs as primarily a real estate transaction and, consequently, believe counsel should be left to those qualified to provide insight from this perspective. The National Association of Realtors is extremely active in promoting the concept that its members should be fairly compensated. Securities brokers place precedence on the securities component of this investment, therefore placing TICs in the province of financial advisors.

Regardless of the final outcome, creating a regulatory environment in which TICs become the exclusive domain of either realtors or securities brokers will impact the industry and, in important ways, change the way investors view this strategy.

Investor First

While the government grapples with its regulatory definition of TICs, the industry itself must further strengthen self-regulating procedures and standards for sponsors. The TIC industry should take a leading role in putting the needs of investors first. This can be achieved through reporting mechanisms that are objective and transparent.

The industry must establish regulations in which TIC sponsors must provide accurate and realistic data to interested investors. These regulations should include guidelines for how historical performances are reported and criteria for future performance projections. Investors should have ready access to information that details the sponsor's complete history, including capital calls. To this end, Standard & Poor's is currently developing a methodology that will rate individual TIC investment sponsors. This rating system would bring an additional level of transparency to the industry, providing investors with the information necessary to make a knowledgeable decision.

A greater number of TIC investors are prudently conducting their own due diligence on properties. As an industry, however, we should be providing the framework by which investors can also conduct due diligence on sponsors. For those investors that rely solely on the sponsor for due diligence, the industry must enforce policies that ensure projections are realistic and historical perspectives are complete and accurate.

The Consolidation of TIC Sponsors

Currently, there are approximately 88 TIC sponsors and that number is expected to fall by 20 percent by the end of the year. What does this mean for investors and for the industry?

The consolidation of the TIC industry has been Darwinian in nature—the strong have survived and will continue to do so. In the coming years, more firms will bow out of TIC offerings. The firms that remain will share common traits: commitment to investors and property acquisitions that are strategic and well managed. Investors will be able to choose from among the very best in the industry, which should result in greater predictability and consistency.

From an industry perspective, a reduction in the number of TIC sponsors has a significant impact. With fewer TIC sponsors competing for properties, the real estate industry may stabilize in certain markets, thereby making properties more predictable, a characteristic absent in today's wildly speculative environment.

The narrowing of the sponsor field to those firms that are experienced and have a proven record of results will undoubtedly be positive both for investors and for the industry as a whole.

Responding to the Needs of Baby Boomers

Every 7 seconds, an American turns 50, placing him or her squarely in the middle of the baby boomer generation—all 78 million of them. The eldest of the baby boomers will turn 61 this year, with many beginning the transition to semi-retirement. As the real estate investors of this generation have turned to more passive investments, which allow them to reap the benefits of real estate without the day-to-day management duties, the demand for 1031 TIC exchanges has grown considerably.

This trend will continue as more of this generation enters the life stage that was redefined by baby boomers—active retirement. Baby boomers as a group seem uninterested in retirement as defined by the preceding generation. They are keeping their hands in investments, and often in areas of their careers while pursuing retirement adventures. So, unlike the generation before them, where property owners would often keep real estate investments intact to pass on to their heirs, the baby boomers are selling actively managed real estate investments and preserving wealth through sophisticated financial strategies including 1031 TIC exchanges.

As more of these baby boomers begin reallocating their real estate portfolio, the TIC industry will need to continue addressing this generation's needs and responding to their high standards.

The coming year will be a challenging one for TIC sponsors, but will ultimately refine the industry and center the attention on the needs of investors. The impending changes for 2007 and 2008 will hopefully create a new overall environment for TIC investing—one that is investor-driven, results-focused and adheres to the highest standards of investing.

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