

TICs

Tenants-In-Common: What is it and why is it popular?

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The Tenants-in-Common Structure

Tenants-In-Common (TIC), as a property ownership structure, has been popular for many years. In 1995, some commercial real estate practitioners began using the TIC's structure for replacement properties used in 1031 Tax Deferred Exchanges (IRC 1031). This allowed multiple, individual owners to shape their exchanges as TICs and retain the capital gains tax deferral benefit of IRC 1031. It also allowed them to roll their investment over into a vehicle that afforded them the tax-deferred option, while eliminating the day-to-day property management responsibilities.

What Changed?

In March 2002, the IRS ruled favorably (IRS Revenue Proce-

dure 2000-22), and published guidelines, for TIC deals used in IRC 1031 Tax Deferred Exchanges. This ruling gave the industry a "road map" for structuring Tenants-In-Common transactions to withstand IRS scrutiny. The release of these guidelines swelled the number of TIC transactions in the commercial marketplace.

The ruling sought to assure that individual ownership of the property was maintained and that the replacement property, if a TIC, would not resemble a partnership. This was to avoid a situation where real property owners could potentially reap the benefits of IRC 1031 while trading into a limited or general partnership. In fact, Revenue Procedure 2000-22 published 15 guidelines to ensure this would not happen.

1031 Like-Kind Exchanges

There is no shortage of 1031 money flowing into the national real estate market. And our experience shows that almost every individual involved in a commercial real estate transaction, at least considers a 1031 exchange. From the sale of an office property in Manhattan, to a shopping center in Chicago, to farmland in Missouri—sellers (who become buyers) consider a 1031. TICs are now another replacement property alternative.

Direct Investment

While 1031 exchanges continue to gain popularity, direct investment in real estate as an alternative to other investments (stocks, bonds, commodities, etc.) is also increasing. This activity is fueled by the positive media coverage of real estate investments; historically low interest rates, poor performance in other investment sectors, continued strong REIT results, and the increasing age of the baby boomer generation. Many boomers are seeking lifestyle changes, but they want income, appreciation in value, and control over their investments. TICs are a very good alternative for this sector.

TICs Have Staying Power

TIC investments are gaining momentum. The total dollar volume of TIC transactions is expected to measure in with up to six billion dollars in product sales in 2004. Notable among TIC transactions were a \$27 million shopping center located in Kauai, Hawaii; a \$74 million

office property in Houston, Texas; a \$32 million multi-family property in Irving, Texas; a \$75 million multi-family property in Fort Meyers, Florida; a \$148 million shopping center in the City of Industry, California; a \$24 million industrial property in Tempe, Arizona; and a \$22 million hotel in Minneapolis, Minnesota.

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the position that TICs
are real estate and are
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estate investors, by real
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and owners.*

Sponsors

Today, most TICs are designed to allow up to 35 individual investors to provide the equity (and debt) necessary to purchase large, institutional-quality properties through a “sponsor” who acts as the investment catalyst and often retains an asset management role after the closing.

Each individual investor obtains a deed of ownership, as well as the depreciation, cash flow, mortgage interest deduction, principal reduction, and property appreciation associated with the TIC.

Why Do Investors Consider TICs?

There are abundant reasons to invest into TICs. Among them are:

- TICs have passive, direct ownership that allow for lifestyle changes while maintaining control at the property level.
- Risk can be mitigated through portfolio diversification.
- Investment can be made in multiple TICs.
- TICs provide an opportunity to invest in larger, institutional-quality properties—those that may increase the chance of better tenants, professional management, less deferred maintenance, and more potential for appreciation.
- TICs can provide the tax benefits of direct ownership including IRC 1031 Tax Deferred Exchange.
- Many TICs have pre-arranged, non-recourse financing which reduces investor headaches.

TIC Downsides

TICs are not without potential problem areas that must be considered before entering into a TIC transaction. Among them include:

- Revenue Procedure 2000-22 is not IRS tax code. Each TIC will have to survive audit and the associated risks.
- TIC sponsors are like partners. Some are good and some are not. Do your homework!
- Exit strategies for individual TIC units may not be clear at the property level.

Myth Statement: “TICs are a security, not real estate.”

The issue is being debated by experts such as: attorneys, accountants, tax practitioners, sponsors, brokers, and government regulators. There is an argument for TIC treatment as security and a very sound case that TICs are ultimately a real estate investment and should be offered as such. SIOR takes the position that TICs are real estate and are being marketed to real estate investors, by real estate professionals, and owners. Conversely, some acknowledge the broker dealers/securities brokers access to private capital, and their need to provide to their clients diversified products

including real estate (REITS, TICs, Real Estate Funds, etc.).

Ultimately, the appropriate governmental authority will resolve the issue and the TIC industry will adapt.

Meanwhile, do not immediately accept the mythical statement that “TICs are a security—not real estate,” since it is really the mantra of the securities brokers’ sector that stands to gain the most from a “pro-securities” ruling.

(SIOR is lobbying on your behalf. If you can offer support at any level, please contact the SIOR staff.)

What is the Future of TICs?

TICs are gaining in popularity and have become a significant

form of syndicated property ownership. The TIC market will experience the growth realized by other syndications—REITs, limited partnerships, and general partnerships—as demand for commercial investment property increases. There are many excellent TICs created by good quality sponsors, but there can be bad TICs as well. Commercial real estate professionals and investors will be faced (more often) with the prospect of selling, buying, advising, or managing people or properties associated with TICs. It is imperative to be educated about TICs, since one can either embrace Tenant-In-Common investing or simply watch the TIC business boom around them.