

REISA Rises From TICA's Ashes

By JULIE NAKASHIMA

FROM THE CALIFORNIA REAL ESTATE JOURNAL

Tenant-in-common transactions may be gone, but they were far from forgotten during the recent Real Estate Investment Securities Association's West Regional Symposium.

Enhanced investor protections, increased regulatory scrutiny and efforts to isolate bad sponsors were the orders of the day for the conference, which drew 230 attendees to the Hyatt Regency hotel in Irvine on March 11.

No one, according to the participants, wants to see another DBSI, a failed TIC that collapsed in 2008, leaving thousands of investors across the country holding the bag.

Darryl Steinhouse, a partner in Luce Forward who created the legal structure for fractional ownership tenant-in-common deals, recalled a line he had used from the industry's heyday in 2006 that to be a TIC sponsor all one needed was "a pickup truck and a dog." But all that has changed.

Today, sponsors need to have money behind them and be able to perform, he said. If there's a problem with the property, investors want to know that the sponsors will be there.

"You look at some of the TIC sponsors," Steinhouse said. "They just disappeared, and investors don't want that anymore."

Aaron Cook, president and chief executive officer of Steadfast Capital Cos., pointed to a pervasive fear running throughout the broker/dealer community stemming from past problems with securitized real estate investments. Executive committees are stressing that they cannot have kind that kind of risk exposure again, he said.

"Broker/dealers don't want to step into it again," Cook said.

See **REISA**, Page 3

A Wide Spectrum of Challenges

With the TIC industry shut down, at least for now, REISA changed its name last year from the Tenant-in-Common Association and expanded its scope to include a wider spectrum of real estate securities, such as publicly registered, nontraded real estate investment trusts, private Regulation D offerings and real estate-based energy programs. The Irvine event was its first-ever West Coast symposium.

Keynote speaker Christopher Cox, a former chairman of the U.S. Securities and Exchange Commission, kicked matters off with a hearty plug for Southern California, observing that it is the country's second-largest economic center after New York. But there are a few things Southern California doesn't like to brag about, he said, such as the prominent role that the region, particularly Orange County, played in some of the excesses of the mortgage lending industry.

"Those are the problems that gave us in turn the housing bubble and then the credit crunch, and now the great recession that continues to plague commercial real estate," Cox said.

Since Cox represented Orange County in Congress for 17 years, he had a better window onto the situation than most. Today, he is a partner in the law firm Bingham McCutchen LLP in Orange County.

Cox talked about six big policy changes under way that have the potential to affect the U.S. economy dramatically for years to come, including the federal government's moving risk from private companies' balance sheets onto the government's balance sheet and the decision by both Congress and the Obama administration to borrow "massively" to stimulate the economy and drive down the unemployment rate.

He also cited the Bush administration's decision to take substantial ownership positions in the insurance, automotive and banking industries, and the current administration's decision to solidify those positions and "effectively institutionalize them" by putting off the development of clear exit strategies until at least 2011. A switch from a government policy favoring moderate taxation on invest-



ment to one that will consistently ratchet up the tax rate is the fourth major change, Cox said.

A fifth development that's under way may or may not prove significant but is causing a lot of ferment is the pending overhaul of financial services regulation under consideration in the House and Senate. And finally, the sixth area of government policy that would have far-reaching consequences is the consideration of a "new health care entitlement" that the Congressional Budget Office estimated could cost nearly \$1 trillion in the near term.

"The takeaway is that for now and for the extended future," Cox said, "there's going to be continued uncertainty about what the government is going to do with respect to one-sixth of the economy. Investors and markets have to assume that the bill could add trillions of dollars in new spending and commensurate increases in taxes to pay for it."

Focus Shifts to Non-Traded REITs

Because TICs are out of the picture, many eyes are focused on publicly registered, non-traded REITs. A large influx of former TIC sponsors are now jumping into the publicly registered, non-traded REIT area, said Richard Arnitz, executive vice president of sales for Grubb & Ellis Securities Inc.

"Currently, we have an unprecedented number of non-traded REIT offerings that are either effective or currently in registration," Arnitz said.

In 2009, the non-traded REIT industry raised \$6.1 billion of capital, and while that was well below the \$9.6 billion raised in 2008 and the record \$12 billion in 2007, he said the industry ended the year "pretty strong," especially given the tough economic environment.

With so many new non-traded REITs from which to choose, Arnitz said, it's a tough task for broker/dealers to determine which ones to approve and, for registered representatives, to decide which ones to recommend to their clients. They need to educate themselves on the various sponsors and products, he said.

Heath Linsky, a partner at Morris, Manning & Martin LLP, pointed out that traded REITs and publicly registered non-traded REITs are two very different investment products. Traded REITs are classic securities that are traded on an exchange — an investor can call his or her broker or go online to buy a share. Non-traded REITs also are publicly registered, but they have to go through a more diligent registration process — in particular, registering with the state because they're not listed on an exchange.

"Another major difference is that when you buy a listed REIT, you're going to buy at the price they're trading at the market," Linsky said. "With a publicly registered non-traded REIT, generally speaking you're going to buy it at \$10 per share during the life of the offer."

A Regulation D offering is virtually the same product, except the time to market is different and the investor pool is very different. The biggest challenges for a sponsor to transition from offering a Regulation D private placement to a publicly registered offering such as a non-traded REIT are time and money.

"Not only is the SEC reviewing it, but now you've got 50 different states that are reviewing the prospectus," Linsky said.

Liquidity, Transparency Issues

Peter Magnuson, chief executive officer and managing director of DMMS & Associates LLC a third-party due diligence officer, said evaluating a REIT can be a difficult proposition because it is a blind pool.

printing imperfections present during scanning