

ECONOMY

TICA Looks To Diversify In Challenging Times

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FROM THE CALIFORNIA REAL ESTATE JOURNAL

The Tenant-in-Common Association wants to diversify its membership base as the industry faces economic, regulatory and legislative challenges.

When TICA hosted its spring meeting from March 18 to 20 at the Manchester Grand Hyatt in San Diego, the organization's president, Bill Winn, announced a name change that is meant to attract more members and increase its visibility in Washington, D.C.

Winn, president and partner at Passco Cos. LLC, said on March 19 that TICA's membership had fallen from 942 members in 2008 to

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688 in 2009, with TIC sponsors making up the largest percentage of the decline.

On June 1, the group will use a new name: Real Estate Investment Securities Association. Winn said the association wanted a name that represents the fact that TICA members have more products than TIC investments. Ninety percent of the association's members sell real estate securities that are not in TIC structures.

Winn said TICA's new name could give the association more clout on Capitol Hill, especially as Congress prepares to consider changes to the tax code that could impact the TIC industry's main investors — those who are participating in 1031 tax-deferred exchanges.

TICA hired Deloitte Tax LLP to survey its members and produce a study of the TIC industry that could be shared with members of Congress.

Out of 56 TIC sponsors surveyed, only 11 companies have responded to Deloitte's survey so far, but Lou Weller of the consulting firm outlined some of the preliminary results for the TICA audience in San Diego on March 19. Deloitte also plans to survey TIC investors to generate demographic information for the industry study.

Of the 11 companies that have responded to the sponsor survey so far, 35.38 percent of their portfolios are invested in office properties, with 23.95 percent in apartments, 17.91 percent in retail, 7.55 percent in industrial and the rest in other assets — hotels, oil and gas projects, and senior housing. Less than 7 percent of their assets are in California.

In Deloitte's research on 1031 tax-deferred exchange transactions, it found Internal Revenue Service data that showed a steady increase in the number of exchange transactions from 236,691 in 2002 to 415,221 in 2005, but the volume began to decrease with 371,809 deals in 2006 and estimates of 237,207 to 316,276 in 2007 and 107,889 to 143,853 transactions in 2008.

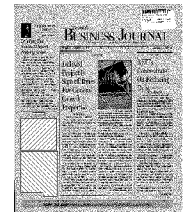
In its own study of the TIC industry, Omni Real Estate Services LLC tracked a growing number of TIC investment offerings through 2006 with a decline that began in 2007, according to data presented by Jim Shaw, president of Omni and president and chief executive officer of CapHarbor LLC.

According to Omni's data, there were just 16 offerings with total equity of \$166.6 million in 2001, which peaked at 341 offerings with total equity of \$2.65 billion in 2006 and dropped to 149 offerings in 2008 with \$1.24 billion in total equity.

"That's less of a decline than the overall real estate industry," Shaw said. "[TICs] gained market share."

Omni surveyed 68 sponsors and has so far received responses from eight companies. Out of 101 full-cycle TIC transactions, the sponsors reported to Omni that properties were bought for a total of \$2.2 billion and sold for \$2.8 billion, providing a 10.34 percent weighted average return for TIC investors.

Among the property sectors, Omni found that office had weighted average returns of 12.65 percent between 2001 and 2005 and



returns of 5.91 percent from 2007 to 2008. Retail showed only a 7.14 percent weighted average return between 2001 and 2005, dropping to 3.87 percent during the 2006 to 2008 timeframe.

"Almost all property types will have about a year of declining occupancy," said Glenn Mueller, real estate investment strategist at Dividend Capital Research and professor in the F.L. Burns School of Real Estate and Construction Management at Denver University, during a March 19 presentation at the TICA conference.

Mueller said he expects employment growth to be slower coming out of this recession than it has been at the end of previous recessions.

"When you get positive employment growth, it takes two quarters to start absorbing vacancy," he said.

Under a worst-case scenario, it could be early 2011 before commercial real estate markets see occupancy gains. However, Mueller said, constructing new buildings will be more expensive once the recovery begins and infrastructure issues will constrain new development, meaning that supply will drop off at a time when demand is surging.

While those factors will boost commercial property values in the long term, Mueller said he anticipates a slow rise in capitalization rates in the near term. He said there are some property owners selling assets in distress situations, but most owners have good enough cash flow to cover their debts.

Regulations and Taxes

The TICA conference provided a session on legislative and regulatory updates on March 20. Francis Grab of the Washington Council at Ernst & Young said there are bound to be changes in the tax code that will affect 1031 exchange investors under a new Democratic president, but the fact that Democrats hold 58 of the 100 seats in the Senate may have a bigger impact.

However, Grab noted that Congress has a lot of big issues to deal with this year, with boosting the economy seen as the top priority. Health care, climate change and tax reform are also on the agenda. While health care and climate change are likely to push tax issues fur-

ther down the list, some tax legislation may be introduced this year.

In his first budget proposal for the 2010 fiscal year beginning Oct. 1, 2009, President Barack Obama is calling for an increase in the capital gains tax from 15 percent to 20 percent.

Paul Mathews, director of the corporate financing department at the Financial Industry Regulatory Authority, a non-governmental regulator for U.S. securities firms, outlined Regulatory Notice 09-09 from the U.S. Securities & Exchange Commission, which is designed to protect investors.

The regulatory notice titled "Customer Account Statement and Due Diligence Requirements for Unlisted REITs and Direct Participation Programs" essentially emphasizes the high quality of due diligence that brokers should complete before they sell interests in TIC investments.

"If a broker is going to recommend a TIC product, they should have a reasonable basis to do so," Mathews said. "TICA has been very active in putting out best practices."

The regulatory notice doesn't require brokers to do anything differently, but it reminds them to look at all the information necessary to recommend TIC investments.

The Securities & Exchange Commission issued a no-action letter on Jan. 14 that said interests in TIC structures should be sold as securities, whether they take the form of master leases or property management transactions. The SEC opinion requires TIC sponsors to provide a higher level of disclosure to investors than if TIC interests were sold as real estate.

Alex Calero, staff counsel in the enforcement division of the California Department of Corporations, the state's investment and financing authority, said the department does expect to see an increased amount of enforcement actions this year in the TIC and 1031 exchange investment arenas.

"Because of the fall in the real estate market, we expect to have more investors calling in," Calero said.

The state of Idaho's securities claim against TIC Sponsor DBSI Inc. could have a lasting impact on the TIC industry and open sponsors up to a new set of liabilities and disclosures,

he said. DBSI is in bankruptcy, but its U.S. bankruptcy trustee is alleging that the company may have duped its investors with a Ponzi scheme.

“Unfortunately, it does take bloody shirts to show this is what can happen,” Calero said.

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Glenn Mueller
Dividend Capital Research