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Building, maintaining wealth through investment: TIC industry celebrates five years of growth

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It has been five years since the Internal Revenue Service issued Revenue Procedure 2002-22, outlining the requirements for tenant-in-common (TIC) transactions to be considered valid 1031 exchanges. That statement may sound like a legal anachronism from some obscure law journal. In fact, it is one of the key factors which enable ordinary Americans to build and retain wealth.

In the years following the issuance of the Revenue Procedure, various sponsors have emerged to lead the TIC industry. Most firms specialize in multifamily housing, office buildings, warehouse and industrial space, and in retail. Other firms have found more unusual niches such as senior housing, assisted living facilities, university housing, self-storage facilities, and hotels.

Sponsors acquire properties, often for a better price and with more advantageous financing than would be available to individual investors. Prior to acquisition, they undertake extensive due diligence efforts-analyzing everything from the physical integrity of the property to market and demographic fluctuations of the surrounding area, rent rolls, creditworthiness of tenants, and other factors which could benefit or adversely affect the property.

Chief among the benefits of TIC investment is the fact that 100% of the proceeds of the sale of the relinquished property work for the investor. In examining TIC offerings, it is important to remember that unlike the scenario in which a property is sold, taxes and depreciation recapture obligations are paid to the government and the remaining funds are invested; this is a 1031 exchange. Therefore, all of the proceeds from the sale of the relinquished property are working for the investor. Said another way: a man sells a building, netting him $1 million. His tax and recapture obligations amount to 40% and he comes away with $600,000 to invest. The 1031 exchanger, on the other hand, has the entire $1 million. If the first exchanger averages a 12.5% annual return in an investment with his remaining funds, he will have made $375,000 after five years, for a total of $975,000, $25,000 less than his $1 million pre-tax sale. If the TIC investor invests his entire proceeds and achieves an 11% internal rate of return when the property is sold in year five, his investment will be worth $1,550,000-a $550,000 profit-because all of his money was working for him during the term of the investment.

Among the many other benefits of TIC ownership are the following:

* Freedom from management headaches;
* Professional management and oversight;
* Advantageous financing and simplified closing process;
* Stable, predictable cash flow;
* Long-term leases;
* Investment-grade real estate and high credit tenants;
* Asset type diversification;

* Geographic diversification;
* New depreciation schedule and tax sheltering opportunities;
* Proportional share of monthly cash flow and back-end appreciation;
* Prudent estate planning and stepped-up basis at death.

There are plenty of real estate investors who are experienced 1031 exchangers. Over the past five years since the IRS issued Rev. Proc. 2002-22, many of these investors have obtained all of the benefits that Section 1031 affords while also obtaining relief from the pressures of active ownership and property management. Tenant-in-common investment can be a wonderful way of continuing to build wealth through real estate investment while freeing up time and energy to devote to children, grandchildren, golf, bridge, philanthropy and a host of other activities which are far more rewarding than attempting to get an electrician on the phone at 1:00 in the morning.

The above should not be construed as an offer to sell securities. It is for informational purposes only.

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