nyrej

1031 exchanges and the tenant-in-common (TIC) industry: An outlook for the balance of 2008

May 19, 2008 - Financial Digest

We have just concluded the first quarter of 2008 and the news on the residential real estate, credit, and capital markets continues to be grim. Although, some of these troubles have spilled over to the commercial real estate market, there is still some room for optimism over the next three quarters of the year.

There are several major obstacles that the 1031 exchange market needs to overcome. First, investment property owners have seen a decline in the market value of some of their properties relative to the past several years. This is especially true of owners of residential rental properties, and it is more pronounced in some markets than in others. This fact has certainly contributed to a slowdown in the number of like-kind exchanges during the first quarter. However, investment real estate owners who have been impacted by the market downturn should realize that there is still room for additional bleeding in many markets and there is still time to sell their investment property, thus locking in their gains before the market deteriorates further. This is especially true for long-term investors who may be considering retirement in the next three to five years. The corollary to this issue is that there are still opportunities for accredited investors to purchase fractional interests in stable, fully-occupied institutional replacement properties in the form of securitized tenant-in-common (TIC) offerings. Adding in a dose of securitized oil and gas royalties may further augment cash-on-cash returns.

Second, the credit crunch will affect all potential purchasers of replacement properties. Not only are lenders becoming increasingly cautious with their commercial lending practices, the issuance of full or partial recourse debt has become a factor with regard to some loans. Again, there are solutions. Many sponsors of syndicated programs, such as TICs, have close and longstanding working relationships with major lenders. Through these lender-borrower relationships and solid track records of success in past commercial real estate ventures, non-recourse financing for passive investors still exist. Moreover, the downtick in interest rates may eventually benefit 1031 investors in the purchase of replacement properties.

Third, to the extent that the overall economy is in decline, certain commercial real estate offerings will be affected. Once again, there are remedies. To the extent that would-be home buyers have been (1) victims of tight credit markets, (2) forced to sell at a loss and regroup, or (3) foreclosed upon, new opportunities exist for multifamily offerings. Good retail opportunities still abound. Certain hospitality offerings, senior housing offerings, student housing offerings, self-storage offerings and other miscellaneous asset class offerings may be more resistant to economic belt-tightening than some other asset classes. Finally, those asset classes most affected by economic downturn or recession, namely office and warehouse/distribution, must be evaluated on a case-by-case basis. The key is to purchase replacement properties which are leased to entities with excellent credit, sound finances, and which perform in sectors that are resistant to economic fluctuation. There are many such tenants, large and small, whose goods or services are necessary in both good times and bad. Thus, a more careful and exhaustive study of tenants, rent rolls, and tenants' ability to meet their obligations under their leases becomes essential during perilous economic conditions.

These are just three of the many factors influencing the 1031 and TIC marketplace this year. Space prohibits a more comprehensive discussion. Simply put, there are significant issues which must be addressed in the course of a 1031 exchange this year, but there are also many strategies available to overcome these issues.

Michael Burwick is the president of 1031 Property Group, LLC and the chairman of its parent company, Boston Advisory Group, Inc., Hyannis, Mass.