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All-cash equals a competitive advantage for some tenant-in-common (TIC) sponsors

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Access to affordable capital has become a key differential in the tenant-in-common (TIC) industry these days. TIC sponsors who are able to utilize an all-cash development, acquisition and offering strategy are getting a leg up on their leverage-dependent competition.

Sales volumes throughout the TIC industry are being negatively impacted by the national decline in real estate sales and corresponding slump in demand for 1031 exchange properties. TIC sponsors raised $729 million during the first half of 2008 - down more than 50% compared to the $1.6 billion raised during the first half of 2007, according to Omni Research & Consulting.

However, while sales volumes may be down, the industry is a long way from out. The TIC property ownership structure remains fundamentally sound for 1031 property exchangers and other property buyers who cannot benefit from a limited partnership structure. Buyers who are shopping the market are still finding an ample supply of TIC offerings from which to choose. TIC buyers who can acquire a property on an all-cash basis are well positioned to take advantage of current investment opportunities in the market.

All-cash advantage

The all-cash ownership strategy makes it easier for owners to weather the cyclical ups and downs always present in the commercial real estate sector and the broader economy - a trait that is increasingly apparent in the current market. An all-cash TIC transaction is a lower risk investment with benefits that include: less likelihood of reduced income, no foreclosure risk, no interest rate refinancing risk, less risk of capital calls, no bank applications, easier dispositions, and flexible closing schedules that can be arranged on a buyer-by-buyer basis.

TIC sponsors who operate on an all-cash platform are able to move more quickly to close a TIC transaction than those who rely on external financing. For example, AEI Capital Corp. was recently contacted by a financial adviser who inquired about the availability of current TIC properties. The adviser was working with clients who were closing on the sale of their farmland and time was running out to find, and arrange, a suitable 1031 exchange. A property solution suitable for the clients was arranged and, just two weeks after the initial phone call, all of the contracts and documents were signed, the 1031 closing was completed, and the adviser's clients were earning income as the TIC owners of their new property.

If their TIC investment had included financing, the adviser's clients would, quite likely, have been unable to complete their 1031 exchange for some time. Most lenders require that all TIC buyers be "signed up" in advance of providing any mortgage financing. As a result, a 1031 purchase of a leveraged property might take several months to close, depending upon how long it takes the sponsor to locate and organize all of the TIC investors.

Another advantage unique to all-cash TICs is less risk of a capital call. If a problem should surface, such as the loss of a tenant, it is very likely that the owners of a TIC property encumbered by a mortgage will have to pay out of pocket to cover the debt service costs while searching for a replacement tenant. The carrying cost of debt service is not a worry when a TIC property is purchased for all-cash.

Leveraged deals face hurdles

Although TIC offerings requiring leverage are still being offered, they are considerably more difficult to organize in the current capital-constrained markets and the time needed to complete the entire transaction has stretched out dramatically. Traditionally, TIC sponsors have relied on aggressive financing terms available from conduit or commercial mortgage backed securities (CMBS) lenders. But, in the wake of the residential mortgage crisis, the CMBS market has virtually shut-down, sending TIC sponsors scrambling to local and regional banks for financing.

Although bank financing remains available, its terms are more onerous as banks re-evaluate their lending standards. Major banks have basically stopped lending on TIC deals. This has prompted sponsors to turn to regional and local banks for financing that is more tedious, time consuming and expensive to arrange. Additionally, many of the regional and local banks are requiring higher equity-to-loan ratios, full or partial recourse from TIC co-owners, and limits on the number of co-owners who may participate in the ownership.

What is the downside to an all-cash TIC? Certainly, all-equity deals are not, typically, buying the $100 million shopping center or office tower. Instead, all-cash TIC offerings tend to focus on properties priced under $10 million. All-cash TIC properties usually generate a slightly lower rate of return - about 25 basis points lower than a leveraged property that uses interest-only financing. But, interest-only financing is short term, usually limited to one to three years, and many TIC investors are willing to exchange a slightly lower rate of return for a less risky financing arrangement. Ultimately, the all-cash model provides an added layer of protection that is especially attractive in a market where investors are increasingly adverse to risk.

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