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Protecting the 1031 exchange client in a TIC investment

April 17, 2008 - Front Section

Hence, there is a level of accountability and leverage that can be brought to bear by broker-dealers and registered reps. if there is an error in underwriting or management. The investor remedy for a problem offering in a security transaction is a FINRA arbitration with the broker-dealer or registered rep., or a complaint to the SEC, and then a lawsuit if the issue can't be resolved.

On the other hand, non-securitized promoters are unable to have a continuing promoter role in the transaction, can't earn fees, and are not accountable to the R.E. salesperson, broker or investor. They cannot and do not sponsor anything. The remedy for poor underwriting in a non-securitized transaction is a lawsuit for rescission claiming the investment is a security under the investment contract definition in the 1946 case of SEC v. Howey, or some claim for fraud or misrepresentation under contract law. Lawsuits can be a financial and emotional burden on the investor.

One advantage of a non-securitized TIC property is that it may be resold easier than a securitized property. While securitized TIC resales do occur, the market may be smaller and the regulations may be cumbersome. Most TIC buyers are giving up liquidity for some period of time so that they can earn a cash flow return on the tax liability that they have deferred. They must enter any TIC transaction understanding that the investment is illiquid; anyone who tells you differently is living in a hypothetical world and may be stretching reality a bit.

If the investor studies a sponsor's portfolio and focuses on the real estate fundamentals, the comparison of projected vs. actual net operating income in past deals, and the likelihood of future appreciation, the quality sponsors will rise to the top. Then, a thorough analysis of the underwriting of present offerings will allow the investor to determine which offerings are the best for their given risk/reward ratio.

In every industry there are varying levels of sophistication, competence and honesty amongst suppliers, salespeople and customers. The prudent investor understands this variance and shops around accordingly to find the most competent Advisor, Sponsor, non-securitized

Promoter, broker-dealer and/or R. E. Brokerage firm. At one leading TIC broker-dealer, the due diligence team and investment committee reject 30% of the properties presented by sponsors. The registered representatives can then review the remaining approved offerings and determine which are suitable for their given investing clients. Conversely, no third parties reject properties offered by non-securitized promoters before they come to market.

The wise 1031 investor will do his homework when buying a TIC property and stand firm in asking for meaningful answers from sponsors, non-securitized promoters and salespeople. A telling inquiry to make is about the worst three performing properties they have ever brought to market, the names and numbers for the investors in those properties and an explanation of what occurred and why. This will ground the sales talk in reality and focus the investor on the downside possibilities.

Sometimes it is smarter to pay the capital gains taxes and pass on the exchange if the replacement property, the sponsor/non-securitized promoter and the salesperson are unable to make the investor and their advisors feel comfortable with the quality of the investment. Risk and reward go together, even in inefficient markets. The correlation between risk and reward may sometimes be inaccurate and unmeasurable which makes judicious decision-making somewhat challenging.