ADISA
ALTERNATIVE & DIRECT INVESTMENT SECURITIES ASSOCIATION

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CSRA Leads with 1031 Training and Education

Question 1: Back in 2006, the TIC industry was a $3.5 billion equity business (over $7 billion of real estate acquisitions). Then, TICs became virtually extinct. What happened?

An unprecedented double dip recession. Starting in 2007 and again in 2009, the US economy experienced a severe, unexpected and long-lasting double dip recession. The recession disproportionately and adversely impacted old TIC real estate investments by reducing rents, shrinking the pool of quality tenants, and generally creating a negative atmosphere (malaise) in which to retain tenants or re-tenant buildings.

The TIC structure proved problematic: the requirement for unanimous TIC owner consent made it difficult to accomplish work outs with lenders and tenants. The structural TIC issues were exacerbated by the varying degree of investor sophistication and general investor inability (or unwillingness) to contribute fresh capital to old TIC properties. Many investors did not have funds to support sorely needed capital calls and others simply refused to "put good money after bad." Many TIC owners ran out of funds to re-tenant, repair and maintain properties to their former high standards. This happened even though most TIC properties were "adequately" funded with reserves to cover foreseeable events, but not the length and depth of the recession.

In addition, there was a general malaise in the country that instantaneously impacted valuations and made it more difficult to "get a deal done" with tenants and lenders. Many TIC investments had adequate reserves to weather a blip in the economy; few had enough reserves to weather "the perfect storm" that lasted five years.

CMBS debt, which financed most TIC properties, proved to be problematic in the context of a TIC work out. CMBS servicers transferred loans to special servicers who were generally slow in responding and uncooperative (or worse) in resolving property issues caused by the recession. Some special servicers seemed influenced by an unexpected profit motive at the expense of the TIC owners. In addition, CMBS debt essentially dried up overnight in mid-to-late 2007, making it much more difficult for TIC investors to finance their way out of challenging properties.

Finally, during the recession, many properties were sold or simply transferred from a nurturing and caring TIC sponsor to mercenary replacement sponsors, some of whom appeared to be more interested in collecting fees than saving properties and protecting the life savings of TIC investors. When the original sponsors exited and outliers took over TIC properties, many investors lost an ally and were left to fend for themselves in a complex world dominated by lawyers, servicers and investment bankers, well beyond their level of knowledge and expertise.

Question 2: What happened to the 50 plus sponsors who were "the leaders of the TIC industry"?

Most of the newbie TIC sponsors simply went out of business; some were put out of business. A small core of respected TIC sponsors transitioned into DST programs. They presently serve a vital role in providing fractionalized 1031 replacement property for old TIC and new exchange investors using the DST structure.

Question 3: What is the direction of fees and loads?

DST sponsor fees have trended down materially over the past five years. Most DST sponsors are working harder for lower net fees. Broker-dealer commissions and allowances have declined slightly and are poised to decline further over time. It is important to continue the moderation of fees and loads to help put more investor dollars in the ground for the ultimate benefit of investors first, and BDs, reps and sponsors who are seeking a stable business model built to last for the long haul.

Question 4: What was the biggest surprise?

Bankruptcy of LandAmerica Financial Group, once a Fortune 500 company listed on the New York Stock Exchange. Who could have imagined that LandAmerica Exchange's investment in auction rate securities would bankrupt an NYSE-listed public title insurance company? That was an eye-opener and a game-changer that demonstrated the fragility of even large, respected public institutions. If this could happen to LandAmerica, it could happen to any large company (Lehman Brothers?).

Question 5: Greatest opportunity?

Old TIC rollovers will create a nice opportunity for sponsors and service providers. The TIC industry peaked in 2006. Most TIC properties were financed with 10 year debt. That means that the bulk of the remaining TIC properties will have to be sold no later than 2016, when their debt matures. Many of those investors will want to structure new exchanges to defer substantial taxable gains. Most will have severe tax issues if they do not exchange because of their low tax basis and high leverage. Without a new exchange to once again defer the gain, many investors will not have sufficient net proceeds to pay federal and state income taxes. In other words, **without a qualifying exchange, a large number of old TIC investors will have to pay substantial deferred federal and state income taxes IN EXCESS OF THE NET PROCEEDS OF SALE.** This will create a real sense of urgency and an opportunity for sponsors, BDs and reps to help satisfy the demand for investors who want a fractionalized replacement property.