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## 1031 exchange

# Critical issues to consider for the first time tenant-in-common sponsors

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In a short amount of time, the Tenant-in-Common industry has become a force within the U.S. real estate market with industry sources projecting that approximately \$5.5 billion in equity will be raised in 2006. Despite the growing level of investment, there are relative few "sponsors" on a national basis and barely a handful in the Northeast. As the industry expands, it is likely that real estate firms will show an

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increased interest in becoming TIC sponsors. Based on our experience bringing new sponsors into the TIC industry, we have created the following list of issues that prospective sponsors should consider to structure a successful venture.

• **Develop a Business Plan.** New sponsors need a cohesive vision of where they want to position themselves in the TIC industry and how they are going to implement that

vision. For example, will this enterprise be a stand-alone venture or will it be a complimentary line-of-business to existing operations? Take time to investigate the industry - attend conferences, read articles. Understand the critical skills required to effectively run a TIC transaction. Although real estate is at the core of a TIC transaction, a new sponsor must build an awareness of the many collateral issues involved and develop a roadmap to success.

• **Build Your Team – Internal Focus.** Analyze the skill set of your organization and compare it to the transactional requirements. The TIC market demands a certain level of professionalism and commitment to the industry and new sponsors are expected to have suf-

ficient infrastructure to handle the entire life cycle of a transaction. Decide whether your organization has the requisite skills and, if not, whether you want to build them or outsource such matters.

• **Build Your Team – External Focus.** Sponsors need to align themselves with professionals who have TIC industry experience. Lawyers, accountants, lenders, etc. who have first-hand knowledge of the many specialized issues involved in structuring these transactions can help avoid costly pitfalls and delays. Establishing relationships with other industry partners, such as property managers and broker-dealers, is also critical to a successful platform.

• **Stay Current.** The TIC industry is going through rapid growth

and constant change. For example, during the past year a "best practices" movement regarding many aspects of a TIC transaction has arisen and the shifting sands of the marketplace have put intense pressure on a multitude of industry participants. Sponsors need to keep pace with such changes or risk trying to implement an outdated business model.

• **Dollars and Sense.** As a sponsor, you'll need to structure transactions that are economically attractive to both you and potential investors. The driving metric to the investor is an attractive annualized "cash on cash" return, while the focus on other deal-level economics such as IRR is increasing. A potential transaction also needs to support the "load" resulting from the expenses of structuring and selling the deal, which are generally passed along to investors. The strategic use of financial engineering, such as interest-only financing, can boost yield and/or smooth returns. All of this impacts how a sponsor evaluates a property suitable for an offering.

• **Complex Transactions.** TIC transactions are certain to present new challenges to any firm new to the industry. Sponsors need to appreciate the documentation that is associated with these deals. While the core agreements will look familiar, they will contain many TIC-specific provisions/limitations that need to be complied with and understood. A comprehensive understanding of the "form and substance" of these transactions is imperative to a viable sponsor.

• **Understand the Distribution Channel.** Without going into a full debate, suffice it to say that as a sponsor your "real estate" deal will be sold as a security through a defined distribution channel. Marketing considerations will factor into the success of your transaction.

• **Investor Relations.** Sponsors must be prepared for proactively dealing with investors. Managing investor relations/expectations and staying ahead of problems is critical. Under the current regulatory scheme, each deal can have up to 35 investors.

While the TIC industry offers an attractive market opportunity for sponsors, it is not a decision to be taken lightly. Sponsors who take the time to educate themselves about the industry and build a platform around that knowledge will have a competitive advantage over others.

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## GUIDANCE & LEADERSHIP



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