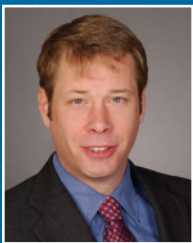


# Lead, Follow or Get Out of the Way

## Advice for Surviving a Difficult Market



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As all stakeholders in the TIC industry know, the turbulent economy has created numerous challenges for real estate deals in all stages of their life cycle. Sponsors, investors and other industry participants face challenging times. While we all hope for a quick recovery, most would admit that the near to medium term economic outlook is very difficult to predict. One thing each investor, sponsor and advisor can control, however, is his or her own actions. As you read this article, ask yourself, how you can best contribute to the success of the transactions with which you are involved.

Each of the topics discussed below could be its own article. And while we focus on syndicated real estate TIC transactions, the principles apply to other assets/structures as well.

### **Macro-Economics, a Primer**

While the performance of real estate investments is cyclical, few of us have experienced such unprecedented economic times. The negative implications of the economy are having a multifaceted impact on the TIC industry. Deal volume in the real estate industry is dramatically off from last year. Potential buyers are seeking to price acquisitions at higher capitalization rates. Financing to acquire properties or to refinance maturing debt is difficult to obtain, and the limited number of active lenders are using tougher underwriting standards, charging higher interest rates and are less enthusiastic about lending. Many real estate operators are experiencing a host of tenant related issues, including higher tenant default rates, lower renewal rates, decreasing or flat rents and increasing re-tenanting expense. Further, the credit-worthiness of many tenants is on the decline. And soon we will be transitioning to a new political administration with its own ideas on how to fix the system, again leading to more uncertainty, regardless of your political views.

Unless Fed Chairman Ben Bernanke or Treasury Secretary Hank Paulson happen to be TIC investors, industry participants will be unlikely to influence the macro-economic issues at work. However, all industry stakeholders should be focusing on how to implement practical and proactive responses to the investments in which they are involved – whether they are performing well or are in extremis.

### **What a Tangled Web We Weave**

TIC structures are complex and are designed with relatively decentralized decision-making attributes. These complex relationships must be understood as part of the on-going management of a TIC investment. One must be familiar with both the limitations and obligations inherent in the TIC structure. These are described in the private placement memoranda (PPM) prepared in connection with the offering of TIC interests.

When analyzing a TIC investment, many investors and others tend to focus on the real estate aspects of the project (i.e., property characteristics, lease attributes, tenant credit, etc.) which is a rational, primary focus. However, the terms of the contracts that govern the relationships between the investors, the sponsor and the lender are of increasing importance when things do not go as planned. Although investors do not enter into TIC transactions expecting to face a capital call or tough leasing decisions (e.g., restructuring an existing lease to keep a tenant from defaulting), the difficulty of the marketplace makes these situations all the more likely. This is true across all asset classes, regardless of the attributes of any particular property. Study the terms of the agreements and understand how they function. These documents circumscribe your rights and obligations and will very likely impact the decision-making process. If modifications are desirable, address them before they are needed.

Critical to any deal is the ability to understand the intricate, practical and legal relationships among the many parties that have the power to influence decisions and property performance. Starting with the lender, the old adage “he who has the gold makes the rules” is still true today. Investors should know who controls their loan (whether it’s a lender or a servicer). In most lending arrangements, the lender will have consent rights over many property-level decisions (e.g., major leases, capital expenditures, changes in property management, transfers of TIC interests, etc.). Lenders will also have enhanced and unilateral rights should its loan go into default.

The sponsor is the nexus for most other aspects of TIC investments. Notwithstanding that the TIC investors are responsible for the mortgage loan, the primary contact with the lender is generally the sponsor (or its affiliated property manager). The sponsor also interfaces with local leasing brokers, the third-party property manager and current tenants and is likely the best source of local market knowledge. This is not easily replaced but is often second-guessed. To the extent that a sponsor has retained an ownership interest in the property, it is also an investor and has a fundamental right to participate in TIC negotiations and decisions.

### **Decisions Are Made By People**

Not to be underestimated – the human element greatly impacts the ability of investors (as a group) to manage their investment effectively. Each deal often has in

excess of 20 investors, each of whom has different personal characteristics, financial means, investment philosophies, risk tolerance, etc. When a deal is running smoothly, investors tend to be content, allowing the sponsor to implement the business plan presented at the time of the offering. However, when challenges arise, the differences among the investors can become magnified and potentially chaotic and unproductive.

Heightened emotions misdirect the decision-making process thereby impeding efforts to otherwise operate the property and deal with third-parties effectively. If investors are faced with a non-performing asset, they should draw upon their own experiences to gain perspective on the situation as they were once active real estate owners and operators. Investors who cannot govern themselves invite this chaos. While well-crafted transaction documents have safeguards in place (e.g., call provisions for dissenting investors), delays can still occur. Counterparties (e.g., tenants, lenders, leasing brokers, etc.) can become frustrated – making matters worse.

Although consensus building can be a challenging process (especially where tensions are high), it is critical that the investors establish a unified approach to decision-making and effective means of communicating among themselves and with the sponsor and other stakeholders. In some cases it might be appropriate to appoint a “management committee” consisting of a small number of TIC owners that have the expertise and inclination to be intimately involved in property-level developments. It is also important to arrange for appropriate advice from experts familiar with the TIC structure and the local market.

### **Active Sponsor Involvement**

Sponsors need to be even more vigilant in monitoring assets and their investors in this environment. Maintaining good communications with investors is not only industry established best practices but common sense. Managing people’s expectations goes a long way to relationship building between all industry participants. If things are going well, tell your investors. If things are not going well, tell them sooner. A temporary increase in the frequency of communication may be well received.

Sponsors should be proactive in identifying the biggest risks facing their investment properties and developing contingency plans. These plans may range from the inconvenient (e.g., considering the retention of more cash flow for emergency purposes than initially planned) to the nuclear (e.g., conversion

thorough. As a venue to introduce a new type of TIC oriented to investment in real estate using fractional ownership, it was invaluable.”

Attendees had the opportunity to attend 20 breakout sessions on various topics of interest in the TIC industry today like roles and responsibilities in a workout situation, marketing in tough times, state taxes and audits related to TIC investments, the current conditions in the capital markets, and much more! New at this year's conference were several sessions on oil & gas TIC investments and alternative investments. In addition to the breakout sessions, the conference offered two keynote speakers. Todd Buchholz opened the conference with his insight on how to thrive in a chaotic economy and gear up for prosperity. He described the current economy, how it

got the way it is and where we are going from here. Buchholz was the former director of economic policy at the White House, a managing director of the \$15 billion Tiger hedge fund and an award-winning economics teacher at Harvard. The conference closed with keynote speaker, Stephen M.R. Covey. He explained how trust is the critical component in making companies more profitable, people more promotable and relationships more energizing. Covey is the co-founder and CEO of CoveyLink Worldwide.

The next TICA event will be held March 19-20, 2009 at The Manchester Grand Hyatt in San Diego, California. Look for more information about sponsorship and registration coming soon. To find out more now, go to [www.ticassoc.org](http://www.ticassoc.org).

## WINNING *for the* LONG TERM

to a partnership to avoid control crises and enhance financing options). However, analysis of various options and discussing them with investors can facilitate quick action and go a long way towards preserving investor confidence.

### The Middle Sibling

As the interface between investors and sponsors, the broker-dealer community occupies a difficult and unenviable position when a deal starts going sideways. As problems arise, registered representatives and broker-dealers are pulled into a vortex and are often potentially at odds with the investors, the sponsor and themselves.

Registered representatives and broker-dealers can help move toward an effective solution by assisting in the analysis of the root causes of deal problems, helping to arbitrate and build consensus and bringing experience and reason to bear on the development of feasible solutions.

### Make the Best Possible Decisions

Times like these highlight that TIC transactions are, in fact, investments in real estate subject to risk. Preservation of the value of TIC investments (and hopefully increasing that value), requires sharp focus on the terms of the structure and cooperation between all of the industry stakeholders.

The industry is fortunate to have vast experience in managing such investments in good times and in bad. They say that half of life is just showing up – now is the time for the other half.