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Time For TIC Deals

With a wave of financing from the mid-2000s maturing, many tenant-in-common (TIC) owners are finding that now's the time to sell student housing assets. Here are the intricacies of TIC deals.

By Randy Shearin

Tenant-in-common (TIC) structures became a popular way for investors to purchase real estate in the boom years of the early 2000s. Simply put, the structure allows for up to 35 investors to share in the ownership of a property; each investor has a direct ownership interest in the physical property, not an ownership entity. As a result, each owner shares in the benefits of property ownership and operating profits, as well as profits when the properties are sold. TICs were popular when real estate prices were high in the go-go days before the Great Recession because those exiting more operation-intensive real estate could invest in a TIC as a replacement property in a 1031 tax deferred exchange.

TICs are operated through sponsors, which pool the investors and locate the real estate investments; the properties are generally managed by third-party companies. In the boom times of real estate, it was easy for TICs to get commercial loans and CMBS debt with long-term amortizations over 10-year terms. That's right — 10-year terms, meaning the wave is just starting to crest on TIC deals. Four Point Student Housing Investments has tracked and forecasted 177 CMBS loans on student housing properties that will mature in 2017, many of which are owned by TICs.

Sandlapper Student Housing is in the process of creating a Delaware Statutory Trust to own Haven West, a student housing property that the company recently acquired in Carrollton, Georgia, near the University of West Georgia.

"Many of the assets purchased by TICs were done with 7-year and 10-year debt," says Chris Epp, principal of Four Point Student Housing Investments in Austin. "In 2015 and 2016, a lot of that debt came due, with the peak coming in 2017. Today, many TIC groups are not financeable by traditional lenders in the student housing space, like Freddie Mac, Fannie Mae and a number of the conduits (CMBS) and life insurance lenders."

National Asset Services was formed in 2008 by Karen Kennedy, a former executive with a major TIC sponsor, to independently assist TICs with decisions like selling, refinancing or re-formatting into other structures at the end of their lifespan. NAS has worked with more than 90 TIC ownership groups in the past eight years, representing more than 3,500 individual clients. NAS has

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helped facilitate more than 50 TIC sales over the past few years, including many in student housing.

"We end up being the single point of contact for the lenders and the lighting rod with the owners," says Kennedy. "We oversee the asset and act as a check and balance on the operation of the property, working with a property manager to oversee leasing and management."

Today, TIC financing can still be had, but there's a premium to be paid, and TICs often have other issues that may prevent refinancing. As a result, many TIC deals have come to the market as the loan terms approach expiration.

"TIC deals are starting to unwind because the debt is coming due and they could not consider selling too far out from loan maturity because of the pre-payment penalties on the CMBS debt," says Jaclyn Fitts, director of student housing for CBRE.

Transacting With a TIC

Off-campus purpose-built student housing properties were popular assets to own in TIC structures, and it has been a somewhat common sight to see a TIC asset come to market. TIC assets require some specialty — from the broker and the buyer — because they can take longer to execute due to the multiple owners and issues that must be resolved. For one, the listing agreement must be signed by all the owners in the TIC, so just getting the property to market can be a challenge. For a prospective buyer, the deal must be worth the time that will have to be invested.

"The one thing that we preach over and over to the buyers of properties being sold by TICs is that they have to be very patient," says Fitts. "The purchase and sale agreement (PSA), once negotiated, has to be signed by every single owner in the TIC; that could be 25 to 35 different owners. That could mean a period of three to four weeks before the PSA can be fully executed. In a normal deal, that's done much more quickly."

Because there are so many owners, re-trading a deal once the PSA is signed is difficult, because like the original agreement, any amendment to the PSA must also be signed by all owners in the TIC.

"We advise all buyers that they need to understand once they go in with a price, the price is firm," says Fitts. "There is just not the ability to get an additional signature from every owner in the TIC on something they are not going to feel good about."

"Any variation in pricing is like getting the Titanic to change course," adds Epp.

Most brokers who opt to contend with TIC sellers have had a deal implode after one or two members of the TIC decide not to sell or sign the PSA. Many TIC asset managers have now put provisions in place to remove such obstacles from sabotaging deals. One of the results of TICs is the rise of a new middleman business that helps TICs — independently of their sponsors — with decision-making, on everything from property management to exit strategies.

"The market perceives there to be a soft spot with the TICs," says Kennedy. "Decisions have to be unanimous and to get potentially 35 separate people who only know each other's voices — and who have suffered from 'TIC fatigue' over the years — to agree can be difficult."

"TIC fatigue" is the industry term for TIC owners who feel they have been locked into the structure or property for too long, hearing the same voices and the same questions on the phone on the regular conference calls among owners. In sales transactions, Kennedy says NAS prevents issues like re-trades by properly vetting buyers and having back up buyers on standby. NAS also spends time with owners to let them know what is expected. NAS also collects all documents ahead of time and gets permission to sign closing documents on behalf of the TIC.

"As you would expect in any transaction, a lot of it comes down to who you are doing business with and how much you can rely on them," says Kennedy.

Student housing properties owned by TICs come in all shapes, sizes and conditions. Well managed TICs have budgeted for upkeep, maintenance and maybe even some capital expenditures to keep up with the times.

"Student housing can be risky for TIC owners to manage because of turn," says Kennedy. "Occupancy is what it is once school starts and that can get pretty dicey for a TIC. Students are hard on the assets, and at turn, those expenses can really swing. TICs are not set up for cash calls; if they do not have enough money to get through the turn, it can be a real challenge when ownership is in a TIC structure."

TICs are also vulnerable because governing documents say that no contracts should be longer than one year; that is problematic for areas like bandwidth and telecommunications vendors and landscape management. Companies like NAS have come up with workarounds, like having all owners sign a waiver of that provision that might scare some vendors away.

Other TICs may have operational issues that become apparent at first glance at the property, or during due diligence later. Like any student housing property, those with poor cash flow are more likely to fall into disrepair.

"The properties are generally 10 years old, and many have not had a ton of capital put into them; there may be some deferred maintenance," says Epp. "Operationally, since management companies may not have been allocated money from the owners to correct issues, there may be some issues, and that may have affected whether the project has been able to keep good management and employees onsite. Operationally and physically, there is often a lot of heavy lifting that needs to be done. For buyers seeking a great value-add story, many TIC-owned properties offer that."

Because of the intricacies of TIC deals, the buyer pool is often smaller than for traditional assets.

"There are fewer buyers who want to buy properties 'where is, as is,'" says Epp. "So while there is not necessarily a discount on TIC deals, the spectrum of buyers who are able to transact this type of deal is smaller."

However, because of the number of TIC deals that have already transacted in the market, many buyers have come to know what to expect, and many TIC asset mangers have had enough expe-

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rience that they have developed some standard practices to deal with sales transactions.

"The sales process with TICs has gotten smoother," says Fitts. "The sponsors have started to streamline the process a little because it is so cumbersome."

Companies like NAS help TICs with exit strategies, including sales. In many cases, however, the best exit strategy is not a sale, says Kennedy, but instead a conversion to another ownership entity like a Delaware Statutory Trust (DST) or refinancing into another structure. This process often involves buying out some of the TIC owners who may no longer be interested in participating in another round with the same property.

"In that case, the remaining TIC owners have to have enough money in equity, or bring cash to the closing table from their own pockets or from another real estate transaction," says Kennedy.

Once a decision has been made to stay with a property, TIC owners are then faced with how to finance their properties. TICs, says Kennedy, are penalized slightly for their structure in the financial markets, but TIC deals are still getting done.

"It is usually a 25 basis point difference in the interest rate to remain as a TIC, but that can vary on the market, the lender and other factors," says Kennedy says.

The three most common exit options for TIC investors wanting to remain with their property are:

- Converting to a Delaware Statutory Trust (DST), which still allows fractional ownership and 1031 privileges.
- Moving to an UPREIT structure (private REIT).
- Rolling up interests into a limited liability corporation (LLC) or limited liability partnership (LLP) under section 721 of the Internal Revenue Code, also known as a "721 roll up." Unlike the other structures, the 721 roll up will not allow owners to exit again without capital gains taxes.

The sales or roll-up strategies are better facilitated when the TIC ownership creates what is known as a TIC Zero owner within the group. A TIC Zero owner is one who has gone and purchased enough of the interests within the TIC to be a controlling interest.

"The best assets to seek are those that have a strong asset manager, a strong TIC Zero presence or a strong steering committee," says Epp. "That shows buyers that a TIC is able to create a deal and that they have the elements to execute a deal."

Managing TIC-Owned Properties

Just as buying or selling a TIC property comes with more scrutiny, so does managing a TIC-owned student housing asset. Houston-based Asset Campus Housing (ACH) has managed a number of TIC-owned student housing properties, many from 2007-2010. Today, the company has paired that down to a few assets due to many being sold over the years. During the Great Recession, a number of TIC deals collapsed because of market conditions and were lost to foreclosure, says Randall Husmann, chief financial officer of ACH.

With TICs, there are two management roles: asset management and property management. Property management does not differ in any way from managing a non-TIC-owned property. Asset management, however, is much more involved. Rather than reporting to one owner, asset managers must provide reporting to all owners — up to 35 — in a TIC.

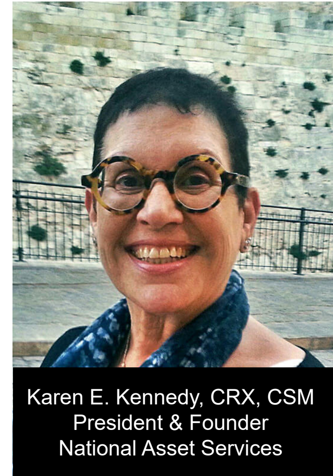
"From the asset management side, you have to seek all the annual approvals and renewals, rental rights and terms and other information," says Husmann. "As well, you can't report one set of numbers; you have to report them by each owner's percentage of ownership."

For ownership entities that are fractured or upset, getting owners to come to a consensus can be difficult.

"The process of a buy-in is exactly the same as it would be for a single owner, except for one signature, you have to get 25 or 30," says Husmann.

TICs Today

TICs are not as common as they once were; most sponsors have evolved to the DST format instead of the TIC for new placements. That is primarily due to the agreements required during exit strategies and capital calls that TICs suffered. The DST essentially offers the same benefits of TIC ownership but with a managing member who can call the shots and act as a lead investor. Sandlapper Securities LLC, a Greenville, South Carolina-based private placement investment firm, is one company creating DSTs to buy student housing. The company's principal, Trevor Gordon, has done more than 60 TIC deals during his career.



Karen E. Kennedy, CRX, CSM
President & Founder
National Asset Services

"There are still some tenant-in-common structures [being created] out there, but they are few and far between," says Gordon, who adds that his firm has done a few in recent years, but only on an all-cash basis. "Lending is for the most part non-existent for the traditional TIC structure."

The company recently launched a company, Sandlapper Student Housing LLC, to acquire student housing assets and then sell them into DST entities. The company has acquired four student assets thus far, two of which it has sold into DSTs. Gordon says the DST is the evolution of the TIC structure, with a number of differences that enhance benefits for investors, and prevent issues should another real estate crisis happen.

"The reality is that there are certain limitations of the [TIC] structure that restricted lending coming out of the credit crisis," says Gordon. "Lenders learned there is a fundamental flaw in dealing with 35 individuals on every issue when you are trying to rescue a property in a recessionary period. With the Delaware Statutory Trust, the spon-

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sor, or master tenant, is the borrower and that makes it a whole lot easier. The DST structure addresses that fundamental management problem that we saw during the recession."

According to Gordon, the key difference between DSTs and TICs is that TIC investors have a deeded interest to an undivided fractional interest in the property. DST investors have a beneficial interest in a trust that owns the deeded interest in the property.

"Beyond that they are pretty much the same," says Gordon. "The DST investor has less say than they did in the TIC structure, but ultimately, as we discovered during the recession, that is probably not a bad thing. They are coming to a sponsor in the first place to make the correct decisions for the investment program."

Many investors in DSTs, similar to TICs, are those seeking replacement properties for 1031 like-kind exchanges with the sales proceeds from other properties. These could be retirees, like physicians, attorneys and other small business owners, who may have owned their own office buildings and sold those upon retirement, and exchanged into a more passive real estate investment to avoid capital gains taxes.

For a DST sponsor, there is another key advantage: unlike a TIC, sponsors are not limited to 35 investors. DSTs have no IRS-imposed limit on the number of investors. Sandlapper has averaged between 40 and 50 investors in its DSTs.

Sandlapper Student Housing owns more than 2,000 student housing beds, all of which it holds or is planning to hold in DST structures. The company recently acquired Haven West, a student housing property in Carrollton, Georgia, near the University of West Georgia, which it is in the process of creating a DST to own. At the same time Sandlapper goes to contract on a property, performs due diligence and works towards closing, it is working with its attorneys to set up the trust and the holding company, as well as putting together its securities offering on the DST. The company begins raising the equity for the DST shortly before or after the closing. Gordon says the raise period can take anywhere from a month to six months, depending on the quality of the asset and the interest from investors. The hold period for DSTs, like TICs, are tied to the loan structure for the most part, by design.

"The IRS gives us a number of restrictions, including the inability to refinance," says Gordon. "In order to refinance, we have to take everyone out of the DST structure and make them LLC partners. They should be keeping their property in a condition that is marketable for sale everyday so when they reach the end of the hold period they can sell to a buyer at the appreciation they've been seeking." **SHB**

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