MULTI HOUSING forum

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TOP STORY: Multifamily Gets New Suitor in TICs

By Sule Aygoren Carranza

New York City—The multifamily market's positive fundamentals and outlook, along with the heated investment climate of the past few years, have brought a number of new investors into the sector. Yet in recent months, a new player has emerged and is gradually making its presence felt. Tenant-in-common groups, which have been investing in a big way in the retail and office segments, are now making inroads into the apartment market.

White

"In 2003, we tracked four TICs buying multifamily properties. That grew to 15 in 2004 and 35 in 2005. Already this year, we've tracked at least four new ones in the apartment sector, on top of most of the ones that were active last year," says Robert M. White Jr., president of locally based **Real Capital Analytics Inc**. "So you can definitely see they're becoming more numerous and each one is buying more than last year."

TIC groups are comprised of a group of individual investors, who in a fractional ownership structure, pool their equity to purchase assets. TIC sponsors act as asset managers and make investment decisions on behalf of those individual investors, which can range from a doctor or lawyer with $250,000 to invest to a professional investor with millions of dollars to place. The profits are distributed proportionately.

More investors are asking their TIC sponsors to invest in apartment properties because they're considered a stable investment, according to Gary DeSanto, president of **DeSanto Realty Group** in Media, PA. The firm's minimum required investment will probably be about $250,000, which allows the greatest number of investors to participate, he adds.

The norm for the TIC sector, DeSanto says, is currently in the $450,000 to $500,000 range. In terms of deals, DeSanto Realty generally buys properties in the $25 million range. "Most of the investors that are looking at our product are a little bit older and a bit more conservative, so they definitely don't want to take any risks," he explains. "TIC interest in multifamily has increased during the past six months and there seems to be a downturn of interest in the office sector right now. We, in particular, are looking at three or four multifamily deals right now to come out as TIC offerings."

Paul

Multifamily is a natural fit for TICs because it's one of the least volatile property sectors in terms of the exposure an owner has with regard to tenant rollover, leasing commissions and tenant improvement allowances, concurs Marc Paul, president and founder of **SCI Real Estate Investments**. The Los Angeles-based firm invests in a variety of class A apartment deals ranging from $20 million to $100 million, with the average transaction landing between $30 million and $40 million. "Personally, I'm surprised there's been so many TIC investments in office, because office product in my opinion is much more volatile," he says.

Market conditions are coming together to work to the benefit of TIC investors. The competition has been so great in the investment sector that it was hard for those who could not lever up as much financing to compete for deals, says Paul. Now that interest rates are rising and are higher than cap rates in most cases, bidders on apartment sales don't have the ability to lever up deals. This has allowed players like REITs to compete more favorably in the market, he says. Like REITs, TICs can't lever up as much and sometimes even make all-cash payments. Typically, TICs lever up to about 65%, Paul relates, and many TIC buyers today might even start to put 45% to 50% equity into deals because there's no yield bonus for higher leverage.

"TICs by their nature are very risk-averse. They want easily understandable investments that are low on the risk scale and produce reliable income that's inflation protected. Multifamily fits right in there," he explains. "In this environment, if you're buying something at a very low cap rate, you need to have a product that has upside in rent growth. Probably the most interesting play in the acquisitions market today is multifamily because the rents are still quite low, and many buildings have a little higher vacancy and concessions to attract tenants. As interest rates have gone up and home prices have soared, the fundamentals of apartments are such that of all the property groups, you probably have the most upside for rental growth in multifamily. That's what drawing TICs to the sector. TICs are not investing in multifamily because they have higher cash flows than office or retail. They're doing it because they feel that there's higher potential for long-term growth."

So, apparently, do many other investors. The question is: How do TICs compete and how do they find opportunities? It's so competitive, relates DeSanto, that some TIC sponsors have become incredibly proactive. In addition to tapping the brokers that the firm works with, he says, "We actually have two people on staff who just cold-call and use relationships to see if we can find any owners that are interested in selling something that's not already on the market."

Older, more established TIC players with deep pockets have the ability to take down deals a bit quicker than private investors who would typically need to obtain financing, says Paul. Plus, they're less institutional than REITs, so TICs need to go through less red tape to get a transaction closed.

While they are, as Paul puts it, "the antithesis of the value-add investor," TIC buyers also tend to look at less traditional plays, such as assets in secondary or tertiary markets, where the yields are typically higher and there might not be as much competition as in top-tier markets like New York, Los Angeles or Washington, DC. Rather, says White, they're doing deals in places like Albuquerque, Norfolk, VA, Charlotte, NC, Mesa, AZ, Beaufort, GA and Jacksonville, FL.

TIC sponsor SCI Real Estate Investments bought Town East, a 224-unit class A community in the Dallas suburb of Mesquite, TX, for about $20 million.

And in comparison to other buyers, he adds, "TIC deals tend to be some of the newer, quality properties, no major redevelopment or repositioning plays. They really need to be cash-flowing, simple investments. They need higher yields." Some, like SCI and Pasadena, CA-based **Evergreen Development LLC**, are even looking at niche areas like student housing.

The TIC structure, meanwhile, provides an avenue for individual investors to get a piece of a large, profitable apartment property without all the headaches that usually accompany ownership. TIC firms usually bring in third-party management companies, many of which have become comfortable with the concept of working for 25 or 35 bosses, as opposed to just one. Sure, you also have to get your investment partners to agree on every decision regarding the property, but that's a good counterbalance to not having to deal with overflowing trashcans or clogged toilets.

Another interesting aspect of TICs' increased attention to apartments is that they might help to keep the investment market steady as it cools in the coming years, notes White. "The apartments were ignored by TICs and they're now some of the new capital sources," he explains. "It's neat to see, especially as the activity by condo converters starts to wane a little bit, a growing source of capital coming into the sector."

The converters, though, would leave huge shoes to fill, he adds, and it's not like they've completely left the market yet. Converters bought $30 billion worth of properties last year, White says. Compare that with TICs, which bought nearly $2 billion. "But TICs are still growing really quickly. We'll see what happens. As long as they're around, they're going to account for a much bigger percentage of apartment deals. And right now, there doesn't seem to be a reason why they wouldn't be around. Particularly **Triple Net Properties LLC**, one of the largest TIC sponsors, is looking to increase their buying activity almost tenfold."

Optimism Up for Multifamily, Sector Hits Sweet Spot

By Sule Aygoren Carranza

New York City—Property managers have become more optimistic about multifamily fundamentals and the spring leasing season, according to a recent survey conducted by **Bank of America**. The locally based firm's apartment optimism index rose 5%, from 64 in the first quarter of 2005 to 67 in the first quarter of this year (on a scale