COMMON sense

written by JESSE FOWLER

The TIC market has shown incredible increase in value over the last four years.

Analyzing the San Francisco Tenancy in Common (TIC) market for this magazine's readership is always a fun task for me as one year comes to a close and a new one begins. As we look back, see the trends and compare notes from previous years, hopefully we are able to accurately forecast what is to come in this specialized market niche.

Data analyzed in 2015 seems to have one thread in common with the previous three years (2012, 2013 and 2014): a significant increase in the average sales price per door of TIC units. Between 2012 and 2013, the average unit price climbed more than $150,000. From 2013 to 2014, the average price per unit increased again, from $797,223 to a whopping $966,501—a 21% increase. As of late November 2015 the average per unit sales price had risen to $1,112,856, an approximately 16% increase! These numbers mean there has been a 72% increase in the price per door since 2011, when the average was $645,904. I repeat: that is a 72% increase in value of the average TIC unit in less than four years!

For owners of multiunit apartment buildings who have been reading my articles over the last eleven years while still sitting on the fence about converting their buildings into TICs, these numbers may provide reassurance. Yet the similarities with years past end with this incredible per-unit value increase.

The number of transactions (TIC units sold) decreased for the third consecutive year in 2015. The most recent high for TIC units sold was in 2012, when 357 TIC units traded hands. 2013 saw a mere three-unit decline in units sold, with the total dropping down to 354. However, in 2014 the number of units sold dropped to 295. 2015 is on pace with the declining trend, with an approximate 270 units changing hands.

So, you might ask, with values of TICs increasing so substantially, and transaction volume either growing annually or staying consistent, why are fewer units entering the market and being sold?

A Political Question

The question can be answered by looking into current and former policy issues more related to rent control and the politics of San Francisco than to the actual market. Though statistics that compare newly converted apartment buildings selling for the first time to end users (either from developers or long-time owners) with resales of existing end-user TIC units are not readily available, this broker can tell you that the majority of units that sold in 2015 were resales of existing TICs. With

Photos of 2009 Oak Street, an existing resale TIC that closed in October 2015. Photo credit: Open Homes Photography



very few exceptions, most TIC conversion projects were stalled beginning in 2014 as the result of the tactics implemented by some members of the San Francisco Board of Supervisors. These tactics took the form of new legislation that targeted the Ellis Act, a state law that allows owners to exit the rental market. The Ellis Act is generally the tool used to empty a building of existing tenants (some of whom are long-term and pay well below market rent) prior to converting to a TIC and selling the units to individual buyers.

In early 2014, supervisor David Campos introduced legislation that later came to be known as "Campos 1." Under this local legislation, which the city quickly turned into law, landlords were required to provide tenants evicted under the Ellis Act with an excessive and obstructive amount of compensation. This amount was calculated using a complicated formula to determine the supposed difference between the speculative market rent for a unit similar to the evicted tenant's current rental over a two-year period. These payments were untethered to the tenant's actual costs of relocating, as it was not required that the payments made to tenants for relocation be used for any specific purpose. In addition, the required payments by landlords to tenants were retroactive. This meant that landlords who had invoked the Ellis Act and served their notices to tenants prior to Campos 1 were expected to increase compensation to tenants under the new formulas as defined by Campos 1.

At a recent sit-down, leading real estate attorney Andrew Zacks of Zacks & Freedman, P.C. shared with me the effects of this initial and arbitrary change to local law. "Uncertainty became the biggest challenge and slowed down the pipeline of new Ellis Act cases," Zacks said. "Clients had questions, such as 'How much will it cost in relocation fees to Ellis Act my building, and how long will it take?' The newly introduced formulas and lack of specifics in the legislation made answering these questions difficult, and retroactivity proved to complicate matters even more. Overriding all of it was the fact that Campos 1 was counter to state law and clearly unconstitutional, and would be up for challenge in court."

Ultimately, as discussed in my December 2014 article, Zacks, along with several other parties and organizations, challenged the law in federal court. Campos 1 was indeed struck down by District Judge Charles Breyer on October 21st, 2014 as a result of *Levin v. CCSF*. The city currently has an appeal pending in the Ninth Circuit Court of Appeals.

Another state ruling, February 2015's *Jacoby v. CCSF*, reinforced the supremacy of the Ellis Act over local regulations written in an attempt limit state law itself. Specifically, the state said that the city could not retroactively create new laws. This ruling was important because it upheld the precedent of not allowing retroactive legislation. This case too is awaiting appeal, though Zacks suspects the result of the appeal will be the same as the initial ruling.

In late spring 2015, after *Jacoby v. CCSF* went in favor of the landlords, supervisor Campos proposed similar legislation again in another form. Campos 2 carved in a provision that capped the amount of relocation payments at $50,000 per unit (plus additional payments for those claiming senior or disabled status) and was passed by the San Francisco Board of Supervisors. Once again Zacks filed suit against the city in *Coyne v. City and County of San Francisco*, July 2015. On October 2, 2015, the court once again ruled that the new Campos 2 legislation was untenable, and it was thrown out in another victory for property owners' rights.

After the back and forth between property owners' rights' advocates (such as Zacks, the San Francisco Apartment Association, the Small Property Owners Association and the San Francisco Association of Realtors) and tenant activists, such as certain supervisors, the Tenderloin Housing Clinic, and the SF Tenants Union—where does this leave us today?

The Legal Storm Calms and Demand is High

The above actions directly contributed to the reduction in the number of TIC sales that we saw in 2014 and 2015. Landlords were waiting to find out the determinations of the courts; many Ellis Act cases in motion at the time were delayed, and some new projects halted while these issues were in adjudication. Therefore, the resale market was the most active during 2014-2015, with fewer new projects coming online. Simultaneously, the average prices for the limited supply of units on the market continued to climb, even in the midst of controversy.

If you are an owner of a multiunit apartment building who wants to maximize your investment, this current moment is a window of opportunity to accomplish that goal. Relocation fees under the Ellis Act are back down to more reasonable levels. No current legislation is on the books keeping owners unable to accurately determine the soft costs of removing a building from the rental market. It may be the best time to embark on what is generally a time-consuming yet profitable conversion venture. With low inventory generally comes high demand. Because of the "clog" in the pipeline that was created during the most recent squabbles surrounding relocation payments, there isn't enough product to satisfy consumers who are looking to buy. As Zacks explains, "For people who have buildings negatively impacted by low rents, the Ellis Act remains a viable way for owners to maintain and increase the value of their property. As long as the law remains intact in Sacramento, it seems unlikely that the city of San Francisco can thwart landlords' ability to invoke this option."

In addition, Zacks sees TICs in the same light as I do: as a valuable source of middle income housing stock. The Ellis Act is not a tool that is used solely for speculators. Zacks sees a significant number of clients who are long-time owners and who have no choice but to invoke the Ellis Act in order to obtain a fair return on their long-term investment.

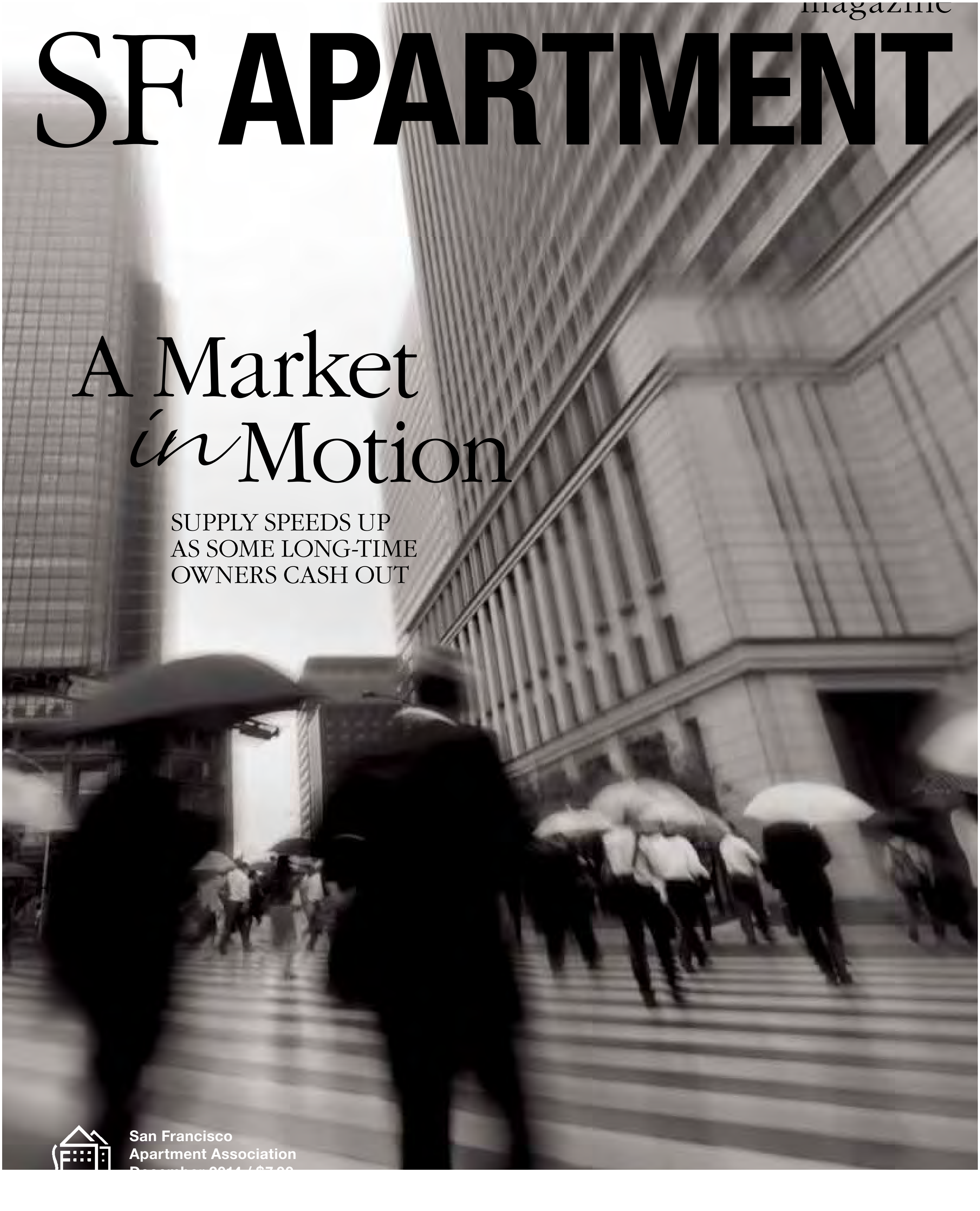
Fractional lending is as plentiful now as it has been at any time in the last ten years. Buyers can obtain seven-year fixed ARM fractional loans from at least three different lenders at rates less than 4.25%, which is only about .75% more than a competitive seven-year condo loan. Historically these rate differences were more than 1%, and for some time they were upward of 2.5% higher in premium. Construction loans to do the necessary work on your properties, as well as to pay for the soft costs associated with removing the building from the rental market are readily available, and lenders are eager to make such loans at competitive rates.

It is also clear from the statistics I'm seeing that the buyers of TIC units are willing to pay well in excess of $1,000,000 for good quality units in premium locations, regardless of condo versus TIC status. The gap has started to close between condo product and TIC product. Historically, the difference between a condo and a TIC unit averaged 15-20%; it has been well below that for the last few years. This closing gap remains true (and possibly more so) even after the city eliminated its previously coveted condo-conversion lottery system in 2013, leaving no option for new TIC projects to condo convert until well after 2023. While the intent of those who eliminated the lottery system was to hurt the values of new TIC developments—and effectively eliminate them, since buyers would see no conversion potential in the buildings—their intentions did not come to pass. Buyers now see TIC units for what they are: a viable long-term ownership opportunity that is generally a better value than a condo unit, and with financing that is very similar in rate and terms to what they are used to on comparable condominiums.

Once again, as has been the case in all years in recent memory, the city's efforts to thwart TIC developments and keep owners trapped with rental property that produces limited returns has backfired. By continuing to tamper with supply and demand, politicians have instead created another perfect storm of opportunity for new ownership housing in the city and for landlords to reap the rewards of holding on to their buildings for many years. This includes the continued ability to get out from under the draconian rent control policies that keep many landlords up at night, frustrated as they watch market rents continue to increase without the ability to create any upside for themselves. That door of opportunity is here now; the only questions that remain are how long that will be the case, and whether it is the right time to walk through that open door.

Realtor Jesse Fowler works with many other well-established real estate professionals and skilled builders to develop and market TIC projects in San Francisco. He has 20 years of experience in San Francisco real estate, listing and marketing TIC properties, single-family homes, condominiums, multiuse and income buildings. A Noe Valley native and homeowner, Fowler is a broker associate at Paragon Real Estate Group and can be reached at jesse@jessefowler.com or at 415-648-5800.

SF APARTMENT magazine



A Market *in* Motion

SUPPLY SPEEDS UP
AS SOME LONG-TIME
OWNERS CASH OUT

San Francisco
Apartment Association

contents

Features

16

Supervisors who enact legislation intended to quell the TIC market only end up making this property type more valuable.

San Francisco politicians have tried to quash the sales of TICs like the ones on these pages many times, but the market keeps responding with more demand and even higher-quality TIC offerings. Photos courtesy of Open Homes Photography.

MESSING *with the* MARKET

written by JESSE FOWLER

In my previous articles on tenancy-in-common sales, development and analysis, I shared information on the evolution of TICs, their entrance into mainstream San Francisco real estate, and the ups and downs of the market related to our specialized form of San Francisco home ownership. Despite another round of attempts by tenant activists and the majority of our board of supervisors to stop its continued growth, the current TIC market is steadily climbing back to its 2007 highs.

My last article in December 2013 predicted that we were poised to close out the year with another year-over-year increase in TIC sales. This ended up (mostly) true. At close of business on December 31, 2013, a total of 354 TIC units had traded hands over the course of the year, at a total sales volume of $282,216,895. That is three fewer units than were sold in 2012, but the total sales volume was 23% higher than the 2012 figures—a massive one-year increase. Given the fact that nearly the same number of units traded hands, there is at least one obvious conclusion that can be made: those who invested in TIC projects during the 2010-2012 downturn did very well if they liquidated their investments in 2013. The average sales price of a TIC unit was about $641,000 in 2012. In 2013, this average unit sale price increased to almost $970,000. How can this tremendous increase be explained?

There are several factors that contributed to this large increase. First off (and probably the most obvious), the rest of the San Francisco real estate market also increased in value during the same time period. As an example, average condominium year-over-year prices increased by about 17.5% from the average condo price in 2012—jumping from $832,481 in 2012 to $978,781 per door in 2013—so, obviously, market conditions in general had something to do with the increase. However, the average TIC unit not only outpaced the average condo in annual appreciation, but it also traded within $9,000 (less than 1%) of its "big brother," the old-fashioned condominium. So what happened, how did we get here and where might this be headed?

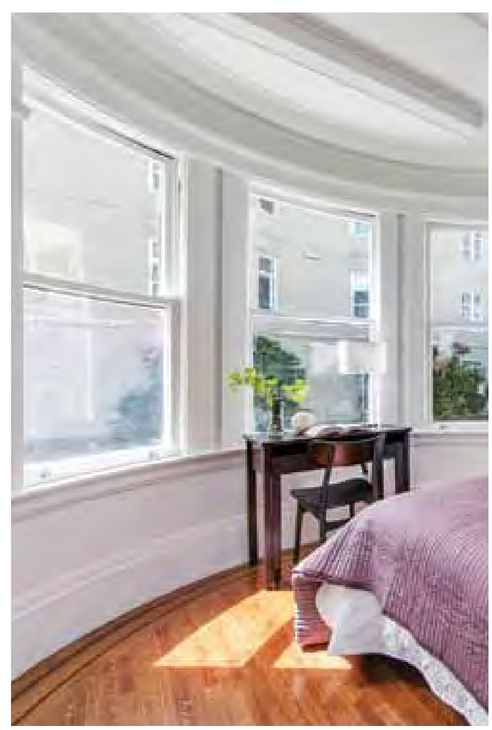
Governmental Tampering

As referenced in my articles over the last decade, our board of supervisors (in its infinite wisdom) continues to attempt to exert control over our real estate market in an effort to suppress prices. Not surprisingly, such interference has backfired. Just as rent control has raised new market rents to a staggering rate

Messing with the Market... continued on page 49

Our board of supervisors (in its infinite wisdom) continues to attempt to exert control over our real estate market in an effort to suppress prices. Not surprisingly, such interference has backfired.

TICs are now being sold for only slightly less than condos, in part because the TICs being developed are of such high quality. Photos courtesy of Open Homes Photography.



Messing with the Market… cont. from page 18

above what they would be without it, the restrictions that have been placed on creating new condos, as well as increased tenant relocation costs involved with utilizing one's right under state law to remove a building from the rental market, have driven prices up even beyond what an unhindered market would have done. The elimination of the condo-conversion lottery (for at least 10 years), which used to allow TIC owners to condo convert their properties either after various periods of occupancy or through attempts at luck through a bureaucratic "raffle system," has made my job as a sales broker much easier.

During years gone by, the typical TIC buyer would ask me all sorts of questions related to the building and if it was eligible for the condo lottery. If it was, they wanted to know how many years it had entered since the chances of conversion increased with more years of entry; ultimately, they wanted to know that someday the TIC may become a condo. They would become more resistant to purchasing property with a no-fault eviction (such as the Ellis Act) because those properties (since 2004) were, for the most part, barred from condo conversion. Because of this, buyers would naturally pay a higher price and show more interest in a "clean" building, free from Ellis or multiple evictions. Now, with little incentive to wait 10 years for the lottery to "possibly" return with the hope that one's "clean" building might enter it, buyers are no longer as worried about the conversion aspect. My answer to buyers' questions on almost all TIC projects formed after the elimination/bypass condo-conversion law was enacted is simple: it is very unlikely that you will ever condo convert this building.

The "progressive" politicians who enacted this law created their own worst nightmare. They allowed TIC sellers to "group" Ellised buildings with non-Ellised ones. Sure, we still disclose eviction history and, yes, these units can't be rented for market rent for at least five years. But, guess what? Buyers don't care anymore. Ten years is like a San Francisco lifetime. At this point, is there any incentive *not* to Ellis Act your building if you are thinking of selling as TICs? No. Why pay the tens or hundreds of thousands of dollars that tenant lawyers are demanding for buyouts when you can just pay mandated relocation payments to the tenants as prescribed under the Ellis Act, and then move on to doing other things? If any tenants looking for buyouts are disappointed that they aren't getting the type of relocation payments their friends received two to four years ago on a buyout, tell them they can thank their local supervisors.

On the subject of relocation payments under the Ellis Act, a certain supervisor *did* get an ordinance shoved through that dramatically increased relocation payments to certain tenants evicted under the state law. The formula had become more complicated, and the payouts more expensive, than ever. Nonetheless, Ellis Act evictions were still being initiated, and the new ordinance was challenged. That challenge was successful when, on October 21, 2014, U.S. District Judge Charles Breyer wrote that it is not the responsibility of landlords to cover the large costs of tenant relocation simply because the real estate market—and the housing shortage—has made relocation in San Francisco so expensive. New Ellis Act evictions will continue (regardless of cost), precisely for the reasons Judge Breyer cited in making his decisions.

Few Alternatives for Home Ownership

In general, many people would prefer to own rather than rent if they have the means to do so. With market rents where they are, the cost of ownership for many of these TIC units equates to even less than market rent and also provides tax incentives to buyers. Limited supply and high demand always drives prices up. While we are on this subject, let's discuss how your local politicians are trying to ensure less supply.

Proposition G was a bit of thoughtless legislation that aimed to levy a 24% transfer tax (otherwise known by tenant advocates as a "speculator tax") on the sale of existing buildings between 2 and 30 units. Luckily, it was quashed by the voters last month. Had it passed, the tax would have phased down annually over five years, after which it would no longer be levied during the sale. Prop. G was intended to curb TIC and small multifamily transactions, though inevitably would have had the same effect as all the other fruitless legislation discussed above. It would have driven prices of San Francisco real estate up, not down. Ultimately, it would not have curbed evictions; it would have created more of them over the long haul.

If government officials have yet to receive the message, developers certainly have. Their message, heard loud and clear from discerning TIC buyers, is that when you *do* develop a new TIC project, it must be of similar or superior quality to a comparable condominium. I have been repeating this for years to my clients who undertake TIC conversions, and it seems to have paid off. This is one more reason that the previously mentioned pricing statistics between TICs and condos might have changed so drastically from years past.

It is surely a great time to be a landlord contemplating exiting the rental business and converting the building to TICs. Considering the low inventory, the continued attack on your rights as a property owner, and that the demand for ownership housing is at an eight-year high, the time may be right to consider all your options with your multifamily building.

Local realtor Jesse E. Fowler, a broker associate at Brown & Co. Real Estate, specializes in listing and marketing tenancy-in-common properties, single-family homes, condominiums, multiuse and income buildings. A San Francisco property owner and investor, Fowler uses his knowledge of remodeling, construction and property management to help his clients maximize their investments. He can be reached at buyinsf@gmail.com.

TICs Triumph

written by
JESSE FOWLER

TIC sales are getting stronger, and are even being aided by the city's attempts to slow them down.

As predicted in my last article on tenancy-in-common trends at the end of 2012, the total TIC sales volume and number of units sold indeed has increased for the third straight year. On the final day of 2012, 357 TIC units had traded hands in districts 1-10 of San Francisco, for a total volume of almost $229 million. This was up about 11% in total units sold year over year and represented a more than 30% increase over 2011, where 272 TIC units traded hands. This trend of increasing TICs sales seems poised to continue at a strong pace.

Ellis Acts Up

There are many reasons for this trend. First, from 2008 to 2010 the real estate market was slower and buyers were less eager to jump in to the TIC market. As such, apartment owners and TIC speculators no longer felt comfortable with the risk of emptying their buildings of long-term tenants via the Ellis Act. The risk of not selling and also being unable to rent the units back out again seeming like a distinct possibility. The result was a lack of inventory in the TIC market and increased buyer demand.

As the market started to gain steam at the end of 2012, apartment owners and speculators saw the void in the market and once again started to take steps to fill it. Ellis filings are up approximately 26% from the lows of the great recession, as reported at the last annual San Francisco Rent Board Eviction Report to the city's board of supervisors. This comes as more and more apartment owners realize that they can create more affordable ownership housing and escape from the perils of subsidizing their current rent controlled tenants, while avoiding having to comply with more and more bureaucratic red tape imposed by the city. The result of the increases in Ellis Act filings means that we will see a continued increase in the offering of TICs over the next several years and, with a booming tech market in the mid-Market corridor and on the Peninsula, the demand from buyers should be there to support it.

Recently, we have seen a lot of negative political press regarding the Ellis Act, stating that the evictions are an "epidemic" from which the city is currently suffering. I would personally make the point, however, that rent control is a much larger "epidemic" as a whole. Even with the 26% increase, the total of units actually withdrawn from the market via the Ellis Act was only 116, or less than 0.01% of the rental inventory in the city. Much has been made in recent days and months of the eviction of the Lee family from their unit on Jackson Street. Even though this is an unusual story

Photos of the Park Lane by Openhomesphotography.com

and an unfortunate situation, the Lees did enjoy 34-plus years of well-below market rent, and the benefit of rent control. For their landlord, the only way out of privately subsidizing these tenants was to Ellis Act the building. Media attention from this one incident, however, may have greater impacts on landlords' rights than just this single case.

Prominent real estate attorney Andrew Zacks of Zacks & Freedman had the following explanation of why Ellis Act filings are on the increase these days and why this trend may continue for some time: "There are currently efforts in the state capitol to limit the Ellis Act, and many clients who have been waiting on the fence are now realizing that the time is here to file their Ellis before risking the loss of opportunity."

Zacks fears that with a state legislature that is much more progressive than in years past, there will soon be a significant challenge aimed at eliminating or severely restricting a building owner's opportunity to go out of the rental business. He is genuinely concerned that this could come into place sometime next year.

He expects that any legislation introduced at the state level may contain provisions invalidating Ellis Acts filed after the date of introduction of any proposed legislation (similar to techniques used by the San Francisco Board of Supervisors in introducing legislation over the last decade). Thus, if you are a landlord looking to remove your building from the rental market and ultimately sell your units as TICs, now would probably be a good time to call your attorney for a consultation.

Condo Conversions Quashed

Another reason for an increase in TICs is the recent condo-conversion legislation introduced and recently adopted by the San Francisco Board of Supervisors. Introduced by Supervisors Mark Farrell and Scott Wiener in 2012, their condo-lottery bypass legislation would have allowed TIC owners who had entered San Francisco's condo-conversion lottery to bypass the extreme backlog of about 1,800 TIC units in the lottery in exchange for a fee. Much to the chagrin of these two supervisors, though, their legislation was hijacked in a series of amendments introduced by Board President David Chiu, making the legislation "a mess," according to Farrell. In the end, after the legislation was amended, Farrell and Wiener were two of three supervisors who voted against it.

But Chiu and other progressive supervisors did not realize that market forces are always stronger than political legislation. By eliminating the lottery and allowing bypass for the existing TICs in the lottery, with the caveat of lifetime leases for tenants in place at the time of conversion as well as disallowing TIC conversions for 10 years, the newly amended legislation stripped away the incentive for landlords to offer a "buy-out" to their tenants in order to convert to TICs. In the past, to preserve the ability to condo convert for future buyers of their units, developers and landlords would offer the tenants in occupancy hefty sums of money to move out of their units and thereby avoid the Ellis Act, which has

eliminated San Francisco TICs from condo conversion since 2005. Now, with no conversion possible in the foreseeable future, that incentive is gone. And with it, so are the days of tenants walking away with five- and six-figure settlement payments. Without the incentive to sell to prospective buyers of condo conversion, the Ellis Act has become the most optimal way to go in getting tenants in buildings to vacate.

Larger Projects Come Online

The elimination of the lottery also leveled the playing field on the size of projects that would be offered as TICs. When the lottery existed in its previous form, most TIC projects were in the category of 2-6 units, as those could someday possibly condo covert. With conversion on new projects off the table for at least 10 years, the door was opened for larger projects to continue to come online.

One great example of this is the Park Lane, with 33 units in a 1925 Art Deco luxury building at 1100 Sacramento St. on the top of Nob Hill, where owner Russell Flynn has begun to sell off the units as TIC interests. The Park Lane is inevitably compared with two projects that previously held the record for largest number of units: Nob Hill Gardens (14 units) three blocks higher up the hill, and Francisco Palms in the Marina District with 17 units. The Park Lane differs in that it's the largest project to date and is a luxury building with the highest prices per square foot that we've seen recently. A penthouse unit was listed at $6,995,000, which provides 3,398 square feet at slightly over $2,000 per foot.

Don DeFranco with the Park Lane sales team says that response has been very good on the units, which are 50% sold on their first release. He notes that they are seeing the expected buyer crowd: affluent buyers planning on using the units as a *pied-a-terre*, downsizing from larger homes in Woodside, Atherton and Hillsborough, and even possibly some previous tenants in the building who will ultimately get the opportunity to become owners of their wonderful units. DeFranco, who early in his career specialized in high-end co-ops in New York, compares the practice of TIC ownership on the higher end here to that of co-ops being sold off in the mid 1980s in New York.

Wearing my real estate broker's hat for a moment, I am happy to see exposure of the TIC market on the ultra high end, as this should continue to bring more buyers into the prospect of owning TICs as a solution to the lack of acceptable or affordable inventory in a city with high demand and low supply. A buyer would be hard pressed to find a similar condominium unit as well located and finished as the Park Lane. For creating this opportunity, I am very grateful to Flynn and his investor group.

At about the time this largest TIC project ever was announced, Bank of San Francisco and Bank of Marin (an early TIC pioneer who had taken a break from TIC lending earlier this year) joined the market of TIC lenders, and word on the street is that a leading residential mortgage lender

TICs Triumph... continued on page 56

TICs Triumph... continued from page 20

will probably offer fractional TIC loans soon. Where we had two lenders lending at this time last year—Sterling and NCB—we now have at least four lenders willing to lend on fractional TICs and, if the large bank steps up, there will be five.

So what do I predict for the future of the TIC market? Well, the easy answer is that more of them will be developed, listed and sold. With more units in the development pipeline, more landlords realizing their ability to exit the rental market may be limited, and more competitive terms on fractional financing, 2014 should shape up to be a great year for the TIC market. Though a far cry from the 724 units sold in 2007, this year's projected numbers indicate we will have a third year of consecutive sales increases, and it is very likely that that trend will continue into 2014. Much to the dismay of tenant advocates and a majority of the San Francisco supervisors, TICs are here to stay; and no matter how hard they try to push TICs down, it keeps popping up in a different place, stronger every time.

Realtor Jesse Fowler works with many other well-established real estate professionals and skilled builders to develop and market TIC projects in San Francisco. He has 20 years of experience in San Francisco real estate, listing and marketing TIC properties, single-family homes, condominiums, multiuse and income buildings. A Noe Valley native and homeowner, Fowler is a broker associate at Brown and Company Real Estate and can be reached at jesse@jessefowler.com.

Photos by Derrick Doo

TIC Trends

written by

JESSE E. FOWLER

Take a look at how TICs developed in the first place, where the market stands today and where it may be going if the lending market loosens.

As reported and detailed in my last article at the end of 2011, the TIC market began to pick up steam last year, after a slow 2010 compared to previous years. During 2010, larger projects had more trouble selling than smaller ones, and both the total sales volume and the total number of TIC sales were down dramatically compared to past years. The last article indicated a steady increase in the 2011 sales volume and the total number of sales. This trend has continued into 2012, and the numbers show a continued resurgence of buyers seeking tenancy-in-common opportunities here in San Francisco. For those individuals who have not been paying attention to the evolution of the TIC market over the last decade, here is a brief recap of how this form of ownership became the type of saleable unit suitable for some of San Francisco's most discerning buyers.

Where Did TICs Come From?

All the way back to the late 1970s, the housing market in San Francisco has suffered from an extreme lack of owner-occupied units (primarily as a result of the effect of rent control, strict condo-conversion laws, and a lack of vacant housing supply available for purchase by owner-occupant buyers). As an alternative to single-family homes (which many buyers considered unaffordable), and condominiums at low supply with very steep premiums, buyers began purchasing 2-6-unit buildings as cotenants. They would share a group loan secured by the entire building and each would own an undivided interest in their building with an exclusive right to occupy a particular unit. These TICs would be governed by a TIC agreement (similar in goal and structure to CC&Rs in a condominiums), with the agreements evolving over time. The TIC trend continued, gaining momentum every year. By the early 2000s, we saw a major increase in TIC sales—from less than $100 million in sales volume in 2002 to over $250 million in the 2004 calendar year.

In 2005, the first fractional TIC loan closed escrow, allowing subsequent buyers in new TICs to purchase their own units with their own loans secured by their own deeds of trust on the individual percentage interests owned in the building. Fractional loans also enabled existing TIC owners to unlock the equity in their homes, which was otherwise trapped as a result of cotenants being unwilling or unable to refinance their group loan.

TICs attract discerning buyers looking for upgraded units at lower prices.

Suddenly, more buyers, including those purchasing for cash, felt more comfortable purchasing TIC units within multiunit buildings, knowing that they had more liquidity in their investments and the ability to sell without forcing a refinance of the entire building, as had been the case since the inception of the TIC. At that time, the typical TIC buyer was purchasing a building with one to five other partners (sometimes without any TIC agreement at all in place at the time of purchase) and sharing the costs associated with a group loan, property taxes, insurance, maintenance and other outside expenses. When it came time for one of these co-tenants to sell, the rest of the co-tenants would generally have to refinance their loan, sometimes at higher interest rates, making it much more difficult to sell an outgoing co-tenant's interest.

Today, we still see these existing group loans from days past, and they pose quite a challenge when a single co-tenant wants to sell his ownership interest and his fellow co-tenants desire to stay in the property. As in previous years, there were many times in 2012 that I was contacted by people trying to figure out a way to fractionalize their TICs to allow a cotenant to sell his share without a negative impact on the other cotenants in the building. Sometimes it was an easy problem to solve, and sometimes it wasn't. Solving the issues and figuring out how to do it primarily depends on their equity positions, willingness to cooperate and the going interest rates at the time the request was made by a specific cotenant.

In the best overall TIC sales year, 2007, the sales volume had skyrocketed to nearly $500 million, with 724 TIC units sold that year. Certainly, a hot market, few condo alternatives and a good availability of the new more-secure fractional financing helped propel such dramatic levels over such a short period of time. This was a record-breaking year for the TIC market, and still holds the all-time TIC sales and volume records.

These 2007 numbers suffered a hit when the rest of the real estate market went downhill from the impact of the subprime mortgage lending meltdown. By 2009, sales of the total number of units were similar to that of 2004. These years also had similar sales volumes ($245.5 million in 2009, compared to $239.4 million in 2004). Even so, the TIC market was still running at a much stronger pace than it is today.

The difference in marketability of these units and the financing which went along with them had dramatically changed in the five-year period between 2004 and 2009, and the TIC market probably would have continued its strong gains post 2007 had it not been for the fact that financing dried up so quickly at many different levels of lending. Since 2007, we have not seen any new lenders step into the arena of fractional TIC lending, and we have been left with only two or three solid lending options, some of which tend to pull back or step forward depending on the availability of funds to lend on this specific niche program.

At the close of 2011, 326 TIC units sold for a total volume of $212,502,326. This was a substantial increase from 2010, when 272

TICs like this one are selling faster than they have in years.

TIC units changed hands at a total sales volume of $157,312,119, according to San Francisco's Multiple Listing Service. This equates to an increase of 19.8% in total sales from the previous year.

Where Are TICs Going?

As for 2012, the trend seems to be continuing, as we are on pace for a year similar to 2011. As of October 14, 2012, 277 TIC units have traded, at a total sales volume of $175,515,814, which is an increase from the same time period during 2011. Between January 1, 2012, and October 14, 2012, the 277 TIC units that traded in San Francisco boasted an average sales price of $633,631, which was a slight decrease from the same period in 2011, even with an increase in total sales and volume of transactions. The lowest price was for a TIC unit located on Green Street, which traded at $145,000. This is compared to the high located on Pacific Ave., which traded for $2.15 million. The largest number of sales of TIC units continued to be in districts 5 and 9, which include the Noe Valley and Mission District neighborhoods, which have continued from TICs' inception to be the most popular neighborhoods for TIC buyers.

Even though TICs started in the middle of the city—where there is a greater stock of multiunit housing, sunnier weather and easy access to public transit and freeways—over the last five years there has been a trend of TICs starting to grow in the northern end of town. Pacific Heights, Russian Hill, North Beach, Cow Hollow, the Marina and other northern neighborhoods have become hot spots since fractional financing surfaced back in 2005. It appears that the buyers purchasing north of California Street were much more reluctant to get into the group loans that existed back in 2004, and they now feel secure moving forward with the purchase of TIC units as secondary residences or *pied-a-tier* residences for buyers downsizing out of larger single-family homes.

Many buyers purchasing TIC units recently have purchased with cash. These buyers are less affected by the thought of the initial

TIC Trends... continued on page 44

TIC Trends... continued from page 22

fixed-rate period expiring and, therefore, see better value (the price is typically between 15% and 20% less than comparable condominium units) in buying a TIC. Also, there has been very little default amongst fractional TIC owners. Only a handful of units have been taken back by lenders of fractional loans, mostly in buildings in which units were sold at the top of the market for prices which could not be sustained during the downturn, and where the owners found no other choice than to default on their interest in the building.

Unlike years past, where we had not seen a fractional loan foreclosure, we actually have seen these units go back to the lenders and most of them have been successfully resold to new buyers almost immediately following foreclosure. This speaks well to the lenders' previous concerns that they may not be able to properly "perfect" the foreclosure process on these units and may get stuck with them in inventory for years after a notice of default had been recorded. This simply wasn't the case and, as other lenders take note, hopefully they will become less reluctant to lend on TIC units, knowing that they are in nearly as secure of a lending position as a condo or single-family home lender.

Now that the kinks of the foreclosure process have been worked out and demand is showing steady signs of increase year after year, we expect that 2013 will continue to see a steady climb in the TIC market. Volume and sales for 2013 are expected to surpass the numbers of 2012, which are already on target to surpass those of 2011. Though it will take some time to recover levels of activity similar to that of 2007, more lenders and buyers are taking note of the activity level. They are also noting that this type of ownership was able to handle such tough times in the sales market and lending climate with minimal impact, almost no short sales and very few foreclosures.

There is a pent-up demand for well-priced, well-located projects and, as they did before, developers are likely to seize the opportunity and move forward once again, opening up the pipeline for new TIC projects, which have become fairly stagnant since the subprime crisis was at its worst and developers saw construction financing (typically used to finance construction on larger projects) dry up quickly. Several lenders who stepped aside are now back in the arena with these loans, making it possible for owners to once again escape the perils of rent control and sell their units to individual buyers in order to maximize on their most important investments.

As I have opined in previous years, this type of home ownership, though feared and reviled by those who oppose home ownership in general, is here to stay for the long haul. All that is separating these units from gaining a near "condo" status (and sales/volume) is a lender willing to take on a 30-year fixed loan product; this would allow the flood gates to open for many additional affordable home-ownership opportunities to be created.

San Francisco desperately needs more owner-occupied units to help fill the void on our tax rolls created by 30-plus years of stringent rent control, which has also kept the sales market hot due to low inventory. The policy has also led to low returns to our city coffers due to a lack of owners paying property taxes on their units, as the majority rent.

With a different political climate, lending markets beginning to open up once again, and many new buyers looking for home ownership opportunities, *now* is San Francisco's time to shine. TICs are the way to make it shine even brighter.

Local realtor Jesse E. Fowler, a broker associate at Brown & Co. Real Estate, specializes in listing and marketing tenancy-in-common properties, single-family homes, condominiums, multiuse and income buildings. A San Francisco property owner and investor, Fowler uses his knowledge of remodeling, construction and property management to help his clients maximize their investments. He can be reached at buyinsf@gmail.com.

TIC Turnaround

written by
JESSE FOWLER

After a precipitous fall in popularity just a few years ago, TIC sales are already beginning to make a comeback.


Photos by OpenHomesPhotography.com

As predicted in my last article at the end of 2010, the tenancy-in-common market has once again started to pick up some steam during 2011, after a slow 2010 compared to previous years. A year ago, I noted larger projects were having more trouble selling than smaller ones, with both total sales volume and the total number of TIC sales down dramatically compared to previous years. However, the TIC market appears to be changing.

Looking Back

For those of you who have not been tuned in to the evolution of the TIC market over the last decade, the following will provide you with a brief recap. All the way back to the late 1970s and early 1980s, the housing market in San Francisco has suffered from an extreme lack of owner-occupied units. Many buyers who considered single-family homes unaffordable and found condominiums at low supply and a steep premium began purchasing 2-6-unit buildings as co-tenants. They would share a group mortgage secured by the entire building and each own an undivided interest in the building, with an exclusive right to occupy a particular unit. These TICs would be governed by a TIC agreement (with a similar goal and structure to CC&Rs in a condominium project), and these agreements have evolved over time. This trend of buying a TIC as a condo alternative continued, gaining momentum every year. TIC sales volume saw a major increase from less than $100 million in 2002 to over $250 million in 2004.

In 2005, the first fractional TIC loan closed escrow, allowing buyers to purchase their own units, with their own loans, secured by their own deeds of trust on the individual percentage interests owned in the building. In turn, more buyers, including those purchasing with more cash, felt comfortable purchasing TIC units within multiunit buildings knowing that they had more liquidity in their investments and the ability to sell without forcing a refinancing

With upgraded interiors and tony locations, TICs are attracting more buyers.

of the entire building, which had been the case since the inception of the TIC. At that time in the 1970s, your typical TIC buyer was purchasing a building with one to five other partners (sometimes without any TIC agreement at all) and sharing the costs associated with a group mortgage. When it came time for one of these co-tenants to sell, the rest of the co-tenants would generally have to refinance their loan, sometimes at higher interest rates, making it much more difficult to sell an outgoing co-tenant's percentage interest.

Today, we still see these existing group loans from days past, which pose quite a challenge when a single co-tenant wants to exit and the others want to stay in their property. Several times each year I am contacted by individuals, groups and attorneys specializing in tenancies in common, who are trying to figure out a way to fractionalize their TIC to allow a co-tenant to sell their share without a negative impact on the other co-tenants in the building. Sometimes it is possible, and sometimes it is not, depending on their equity positions (but that is a story for another article).

By the time we wrote our first article for *SF Apartment Magazine* at the end of 2007, the sales volume had skyrocketed to nearly $500 million, with 724 TIC units sold that year. These numbers were double those from just three years prior. A hot market, few condo alternatives and good availability of the new, more secure fractional financing helped propel such dramatic levels over such a short period of time. This was a record-breaking year for the TIC market, and still holds the all-time TIC sales and volume records.

These 2007 numbers suffered a hit with the rest of the real estate market in 2008 due to the impact of the subprime mortgage lending meltdown. In 2009, sales of the total number of units were similar to sales in 2004, and these years also had similar sales volumes ($245.5 million in 2009, compared to $239.4 million in 2004). Even despite the lower numbers, the TIC market was still running at a much stronger and more efficient pace than it is today. As indicated in my article last December, the difference in marketability of these units, and the financing which went along with them, had dramatically changed in the five-year period between 2004 and 2009, and the TIC market probably would have continued its strong gains post-2007 had it not been for the fact that financing dried up so quickly at many different levels of lending. Since 2007, we have not seen any new lenders step into the arena of fractional TIC lending and have been left with only two to three solid lending options, some of which tend to pull back on lending and then step into the market again depending on the availability of funds to lend on this specific niche program.

At the close of 2010, 272 TIC units had changed hands at a total sales volume of $157,312,119, according to San Francisco's Multiple Listing Service. This was down

TIC Turnaround… continued on page 58

TIC Turnaround... continued from page 24

considerably from the 2009 numbers referenced above. Overall sales activity was also down, but TICs had taken a greater hit than condos and homes, as a result of lower interest rates on 30-year fixed loans on single-family homes and condos. Rates were one to two percentage points higher on TICs, with only 3-, 5-, and 7-year fixed loan options available. With slower anticipated appreciation, buyers had started to desire 30-year fixed loan products more than at any time in the past 10 years, which is part of what resulted in the TIC slowdown of 2010.

Looking Ahead

Some bright news for the TIC market seems to be surfacing, however. As of October 14, 2011, 259 TIC units have traded this year, at a total sales volume of $173,479,458. This total sales volume has already surpassed that of the entire 2010 year and, based on inventory both active and in escrow, the total number of sales will surely pass the 2010 numbers by the end of this year. Some of the increased activity can be attributed to the fact that the existing fractional lenders for TICs have lowered their interest rates since the same time last year, to complete with the already low rates on condominium and single-family home loans. As of yet, no 30-year fixed loan has surfaced on the TIC front, which if made available would definitely help increase both numbers of total sales and overall volume.

Between January 1, 2011, and October 9, 2011, 256 TIC units traded in San Francisco, with an average sales price of $671,092. The lowest price was for a TIC unit located on Wool Street, which traded at $115,000. This was more than $3 million less than the high, located on Pacific Avenue, which traded for $3,185,303. The largest number of sales of tenancy-in-common units was found in the Inner Mission neighborhood. Average time on the market during this period was 86 days. This is in sharp contrast to the same market indicators last year. In 2010, during the same time period of January 1 to October 9, only 218 TIC units traded in San Francisco, with an average sales price of $581,163 (almost $100,000 less than this year). The lowest priced sale in 2010 was on Natoma Street in the South of Market neighborhood for $189,000, compared to the highest sale on Greenwich Street, which sold at $2,195,000. Average DOM during this period was 99 days, 14 days longer than YTD 2011.

As with this year, the largest number of TIC units traded was in the Inner Mission. That being said, there has actually been a huge change in the neighborhoods in which TIC units are most desired. Although TICs started in the middle of the city, where there is a greater stock of multiunit housing, sunnier weather and easy access to public transit and freeways, we have noticed a trend over the last five years of TICs starting to grow to the northern end of town. Pacific Heights, Russian Hill, North Beach, Cow Hollow, the Marina and other northern neighborhoods became hot spots after fractional financing surfaced back in 2005. It appears that the buyers downsizing out of larger single-family homes and purchasing north of California Street were much more reluctant to get into those group loans that existed back in 2004 and now feel much more secure moving forward with the purchase of a TIC unit for use as a *pied-á-terre* or secondary residence.

Many buyers purchasing TIC units recently have purchased with cash. These buyers are less affected by the thought of the initial fixed-rate period expiring, and therefore see better value (typically 15% to 20% less than comparable condominium units) in buying a TIC.

Also, there has been very little default among fractional TIC owners. Only a handful of units have been taken back by lenders of fractional loans, mostly located in buildings in which units were sold at the top of the market for prices that could not be sustained during the downturn, and where the owners found no other choice than to default on their interest in the building. Unlike years past, where we had not seen a fractional loan foreclosure, we actually have seen these units go back to the lenders and most of them have been successfully resold to new buyers almost

immediately following foreclosure. This speaks well to lenders' previous concerns that they may not be able to properly "perfect" the foreclosure process on these units and may get stuck with them in inventory for years after a notice of default is recorded. This simply hasn't been the case, and hopefully as other lenders take note they will become less reluctant to lend on TIC units, knowing that their lending position is nearly as secure as that of a condo or single-family home lender.

Now that the kinks of the foreclosure process have been worked out, and demand is starting to once again increase, we expect that 2012 will continue to see a slow but steady rebound in the TIC market. Volume and sales for 2012 are expected to surpass the numbers of 2011. There is pent-up demand for well-priced, well-located projects and, as they did before, developers are likely to seize the opportunity and move forward once again. We expect they will open up the pipeline for new TIC projects, which had become fairly stagnant since 2008. Developers who saw construction financing (which they had typically used to finance construction on larger projects) dry up at a fast pace, now find that several lenders who stepped aside are back in the arena with these loans, making it possible for owners to once again escape the perils of rent control and sell their units to individual buyers in order to maximize on their most important investments. Though it will take some time to recover levels of activity similar to those of 2007, more lenders and buyers are taking note of the activity levels and the fact that this type of ownership was able to handle such tough times in the sales market and lending climate with minimal impact.

TICs are here to stay for the long haul. All that is separating these units from gaining a near "condo" status (and sales/volume) is a lender willing to take on a 30-year fixed loan product, which would allow the flood gates to open and for more additional affordable home ownership opportunities to be created. San Francisco desperately needs more owner-occupied units to help fill the void on our tax rolls created by 30-plus years of stringent rent control, which has kept the sales market hot with low inventory and also low returns to our city coffers due to a lack of owners paying property taxes on their units. With a different political climate, lending markets beginning to open up once again and many new buyers looking for home ownership opportunities, now is San Francisco's time to shine. TICs are the way to make it shine brighter than the rest.

Jesse E. Fowler, a San Francisco native, specializes in marketing TIC developments, single-family homes and multiunit properties. He is with Brown and Co. Real Estate and can be reached at 415-648-5800.

written by JESSE FOWLER

Setting Sights on Sales

TIC activity for 2010 was reminiscent of 2004, but the one bright spot was quick-selling small projects.

This, my third year-end article on the TIC market, comes with a more somber tone than previous articles. With more choice for buyers, growing alternatives to condos and higher fractional adjustable-rate mortgage (ARM) rates versus low 30-year fixed-rate loans for single-family homes and condos, TICs became more challenging to sell than ever.

901-911 Union St.

In 2009, 407 TIC units sold and sales volume edged just higher than $245.5 million. This number mirrored statistics from 2004, when the TIC lending was in its infancy and before today's fractional financing for TICs. Back then, only group-loan financed TIC projects (where individual buyers shared a group mortgage secured by the entire building) were available and the sales volume was $239.4 million. That volume corresponded with the sale of 395 units.

Ten Years of TICs

For those of you who have not been tuned in to the evolution of the TIC market over the last decade, here is a brief recap: prior to the late 1970s or early 1980s, owner-occupied units in multi-unit buildings were almost nonexistent. As an alternative to unaffordable single-family homes and few condominiums that came with steep premiums, buyers began purchasing 2-6-unit buildings as co-tenants. They shared a group mortgage secured by the entire building and each owned an undivided interest in the building with an exclusive right to occupy a particular unit. These TICs were governed by a TIC agreement. The TIC's appeal as a condo alternative gained momentum every year. By the end of 2004, TIC sales had grown substantially, from less than $100 million in 2002 to more than $250 million in 2004.

On a sunny day in September 2005, the first fractional TIC purchase closed escrow and the contemporary TIC was born. Financed by Bank of Marin and sold by Brown and Company Real Estate, the first three units closed escrow as part of five TIC interests located on Pine and Taylor streets in San Francisco.

Interior of 901-911 Union TIC project.

Although that building has since struck gold in the city's condo conversion lottery and converted, it paved the way for even more TIC projects in San Francisco. These new loans offered potential buyers the security of not having to worry their neighbors would default on their loans, lose their jobs or withhold their portion of the mortgage from the group as a whole. By the time we wrote our first article for *SF Apartment Magazine* at the end of 2007, the sales volume had skyrocketed to nearly $500 million and the market had surpassed 724 TIC units sold. That's double from just three years prior. Certainly a hot market, few condo alternatives and good availability of new fractional financing helped propel TICs' attractiveness to home buyers.

By the Numbers

So what is the latest news? The number of transactions dropped by nearly half between 2007 and the end of 2009. In 2007, TICs accounted for 24% of condo/co-op/loft/TIC sales. But in 2009, the number fell short of 19%. As of October 20 of this year, there have been 217 TIC sales, for a sales volume of $126.3 million. This indicates we may be on track for a less productive year than 2004. By October 20, 2004, there had been 280 TIC sales for a total sales volume of $171.2 million.

This somber news on the TIC front accompanies sobering news on the real estate market in general. The total sales volume for 2007 condo/co-op/TIC/lofts in San Francisco was $2.57 billion in 3,073 transactions. For 2009, that number dropped by just over 30% to 2,143 transactions, accounting for $1.59 billion in sales for the year. These numbers indicate that the decline in the market is not specific to TICs but is being felt in condominium inventory as well. Single-family homes, in contrast, have fared much better, with a decline in sales of less than 6% over the same two years as the 30% decline on the condo/co-op/TIC/loft front. Certainly, when given the choice and when competing properties are both within their price ranges, buyers will purchase a single-family home over a condo or TIC.

There are, however, some bright spots and a silver lining in the TIC market. Smaller buildings (2-6 units) seem to be selling faster than larger ones (7-24 units) when converted and marketed as TICs. Some insiders suspect that this has to do with the ability to condo convert, which ends when a building reaches seven units and above.

Slow Sales for Big Projects

Slower absorption of available inventory can also pose a problem for marketing larger TIC projects. When prospective buyers see projects with many available units, urgency can wane, especially for those buildings where all units have similar attributes and layouts. For instance, if units in a 12-unit building sell at a rate of one per month, potential buyers can dally, slowly examining the project, appreciating the units but still decide to wait to see if prices adjust or other issues surface with the project. This makes smaller buildings with fewer available units hold stronger prices and sell faster than larger projects.

One great example of such a large project is our current listing at 2057-2079 15th St. This property started conversion in 2007 and was completed in early 2010. After nearly a year of marketing, two units have closed escrow and two more are in escrow. The developers used top-notch finishes and have created excellent value in a solid location. Although the units started at $549,000 for three-bedroom flats, the fact that there were 12 units available has slowed down the overall pace of sales. Still, buyers are very receptive to the value, style, location and amenities that this modern-day fractional TIC has to offer.

Small is Profitable

TICs in two-unit buildings, meanwhile, have fared especially well, as buyers are seeing even more value in the potential for easier condo conversion. These buildings offer condo conversion incentives for owners where both units are owner-occupied and have no history of multiple evictions or evictions of a protected tenant. In these cases, owners are able to bypass the city's overcrowded condo conversion lottery and submit their applications after just one year of occupancy of both units. This makes apartment owners of two-unit buildings prime candidates to convert to TICs prior to sale to achieve top value for their properties even during a slower market.

For sellers who are willing to carry financing at a rate comparable to single-family homes, it is also a great time to convert to TICs. If you own your property free and clear, you can create a revenue stream

Setting Sights on Sales ... continued on page 56

Setting Sights on Sales ... continued from pg. 20

without being a landlord or dealing with the hassles of rent control. Two of the primary obstacles to vibrant TIC sales today are higher fractional interest rates and the absence of 15- or 30-year fixed fractional loans for TIC units. Projects can overcome these obstacles by offering buyers competitive financing at today's market rate fixed for 15 or 30 years. Most TIC buyers only stay in the same place for three to six years, so you can expect to recover your investment in a reasonable amount of time while deferring capital gains and keeping your investment in San Francisco real property. As fractional loans evolve, gain momentum and lower in rate as supply and availability increase, your seller financing may even get paid off before the buyer sells his interest.

Bargain Shopping

For buyers this is also a time of exceptional opportunities. With the slowdown in the market has come the availability of some gorgeous TIC units at bargain-basement prices. Fractional interest rates are now at historic lows. Rates that once started above 7% for a five-year fixed term loans have come down to the mid-5% range, with longer fixed-term offerings from lenders.

As developers eyed the growing TIC market in 2006 and 2007, they also increased the quality and quantity of TIC units they produced for the market. TIC projects in larger buildings generally took longer to complete than in smaller buildings and, because of tenant relocation and remodeling, could take between one and two years to complete. That meant that once the market began to slow, the inventory backlog and increased quality of projects to hit the market created increased choice for discerning buyers looking for quality units at great prices. Today, our office has some incredible opportunities for first time buyers in excellent San Francisco buildings, and TIC units continue to create ownership opportunities for San Franciscans.

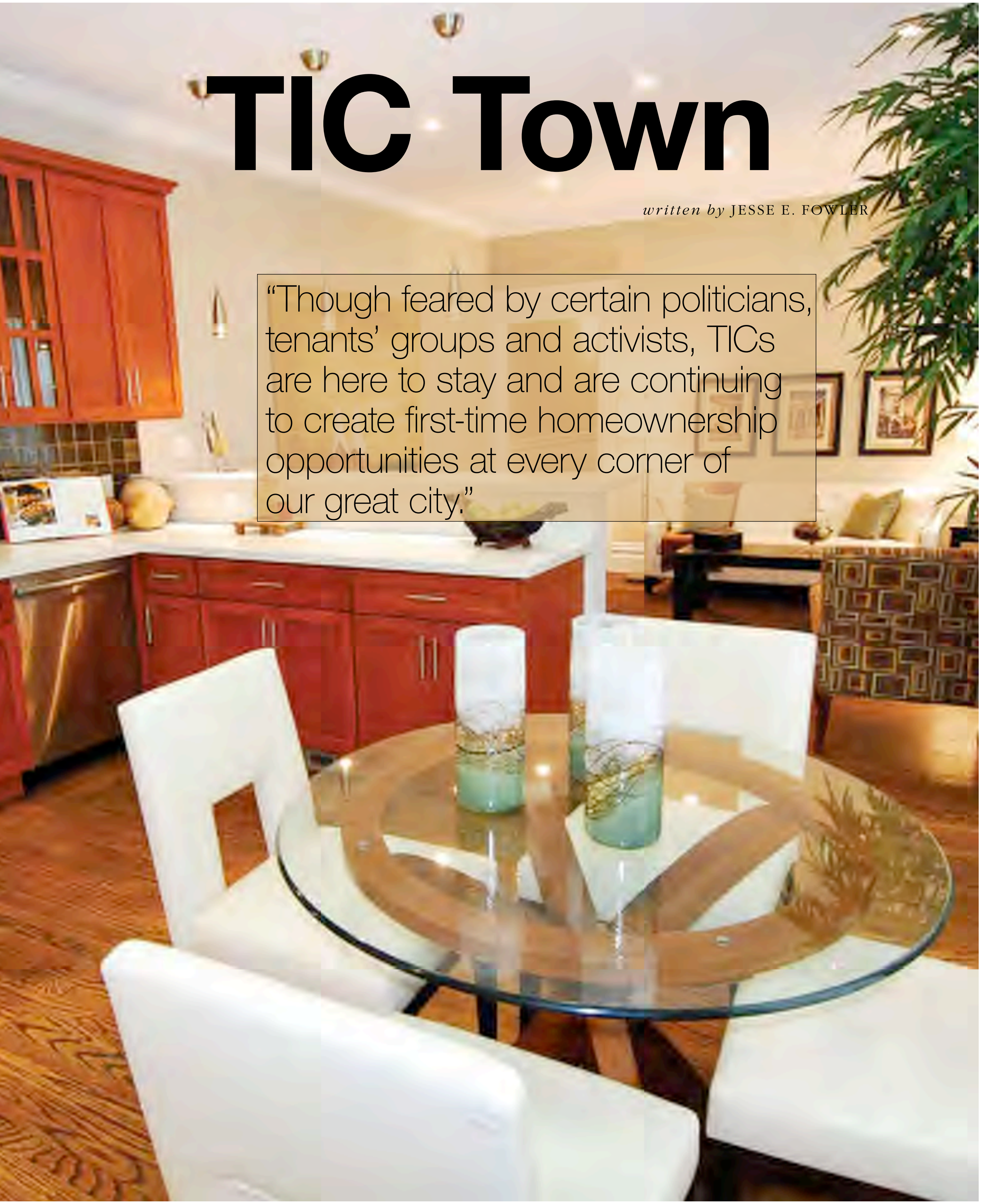
In some ways, buyers are also seeing less risk in their TIC investments. Many condo projects have seen a sharp increase in homeowners who have not paid dues to their respective homeowners' associations (HOA), sending the HOAs into a downward spiral of limited funding and/or litigation. But there have been very few defaults on HOA dues within fractional TICs, according to *sfticservices.com*'s Theo Albers, who manages or serves 265 TIC units in San Francisco. He notes that out of all the units he manages, only six co-tenants have fallen into serious delinquency with their dues. This is important because the typical delinquency rate for the same number of condominium units is significantly higher. TIC owners' better track record for paying their dues could be a result of tighter lender underwriting guidelines and higher down payment requirements by fractional lenders. Whatever the cause, it appears some buyers feel they may have more to gain from investing in a TIC. We continue to see a high number of cash and high net-worth buyers stepping into the TIC arena to realize good value on their purchases. Of six units our office listed last year on Union Street, for example, three units sold for all cash and four were to be used as second homes.

So what is our analysis of the TIC market in San Francisco at this time? We are finding that TIC sales have suffered fairly comparably with the condominium market in general but still remain alive and strong within the San Francisco marketplace. In earlier markets that saw decline, we noted that condominium inventory has historically suffered from a higher depreciation and a decreased transaction rate from that of single-family homes. Although we have seen some decreases in both volume and transaction of TIC units, we expect the market to gain steam again at the beginning of 2011. There are some great projects coming on line. And with the credit markets opening up, we expect that more lenders will step in to the TIC arena, bringing down the going fractional interest rate and hopefully helping increase demand back to the 2005-2007 levels again.

Jesse E. Fowler, a San Francisco native, specializes in marketing TIC developments, single-family homes and multiunit properties. He is a broker associate with Brown & Co. Real Estate and can be reached at 415-648-5800.

TIC Town

written by JESSE E. FOWLER



"Though feared by certain politicians, tenants' groups and activists, TICs are here to stay and are continuing to create first-time homeownership opportunities at every corner of our great city."

Two years ago, I wrote a story about what was happening in the tenancy-in-common market at that time. After the article was published, I was flooded with questions from apartment owners about what the future of TICs might hold, and if/how their buildings could be converted into TICs so that they could maximize their profits by going out of the rental business.

As a follow up to that article, I recently sat down with two of the city's top TIC attorneys, Lyssa Paul of the Paul Law Group and Denise Leadbetter of the Law Offices of Denise A. Leadbetter, for a talk about the current trends, breakthroughs and pitfalls that we are seeing in the TIC market. At a time when many areas of the country continue to see declining real-estate values, short sales and foreclosures, we have had the pleasure of working in a market where there has not been one single foreclosure.

That's right. Paul, Leadbetter and I have never experienced, or even heard of, a foreclosure on a tenancy-in-common property, either fractional, or group, in the City of San Francisco. This is a promising statistic, which supports the notion that, though—feared by certain politicians, tenants' groups and activists—TICs are here to stay and are continuing to create first-time homeownership opportunities at every corner of our great city.

Since our 2007 article, the TIC market has changed. Financing has somewhat dried up among lenders willing to originate fractional TIC financing. Between six and eight lenders existed at that time, and only two remained active in the market at press time. Most lenders who have stepped out have suffered from financial problems not specifically related to TICs, but related to the economy in general, or to other portfolios they may hold. In fact, of the lenders who have taken a break from the fractional financing market, most of them consider their TIC portfolios one of their most solid and best performing portfolios.

The trend of fewer lenders has led us back to what was once commonplace in the real-estate market in San Francisco: seller financing for either the entirety of a loan or a partial second. If a seller/developer has no debt on the property, there is an option to carry the entire loan for each purchaser. This can facilitate closings if the seller/developer extends loans at lower interest rates than institutional lenders and can also expedite the closing due to the elimination of the institutional underwriting process and associated timelines. It is, however, important that the seller/developer perform thorough due diligence in approval of each prospective borrower to ensure they are "financeable" down the road.

The other option is the seller/developer carrying a second loan, which can be beneficial when the downpayment requirement of the fractional lender exceeds the funds available to the prospective purchaser. Either structure allows developers to take offers from buyers with down payments of less than 20% (the lowest down payment allowed by institution lenders on fractional TICs) and opens up the market to those who may not otherwise be able to buy.

Some developers have found that by selling their buildings as TICs and financing the buyers, they have an income stream from the notes and no longer have to deal with the day-to-day management of their properties. Even if a seller/developer retains an interest in the property, building operating expenses are shared with the other co-tenants, as opposed to the seller being responsible for 100% of the operating costs. A seller/developer who retains an interest still has the rights to all rental income (to the extent applicable) from such interest but no longer has to deal with clogged toilets at midnight, management headaches or leaky roof calls. In the event that a borrower does default, the developer as lender has the option of foreclosing on the defaulting co-tenant and reselling the unit to a subsequent buyer.

Photos in this feature highlight a new TIC development at Sanchez Street and Duboce Avenue that combines San Francisco charm with modern ammenities.

Even with the slowdown on the financing front, TICs are still appearing as new inventory on the market and are selling quickly—if properly priced and if their marketing plan is well thought out and executed. One example from Brown and Company's listings is seven units in the Duboce Triangle area, where five of the seven units sold in less than two weeks. Just down the street in the Mission Dolores area, six units over two commercial units sold in less than one week. In the NOPA area, we have four of five units in contract, ranging from studios to three-bedroom units.

As this article was going to press, we also released six of twelve three-bedroom units in a great location at 15th Street at Church Street and expect them to sell very quickly to eager first-time homebuyers. They are a great example of what a successful TIC development can be.

According to the San Francisco Multiple Listing Service, Brown and Company Real Estate alone has represented buyers and sellers on the sale (closing) of 91 units since January 1 of this year. That's a pretty amazing statistic and an increase of 15 sales over the same period in 2008, when there were 76 sales by Brown and Company agents. The overall sales numbers in the city have also improved year to year in the TIC market.

Another trend in the TIC market has been a steady increase in the quality of the TIC units entering the market. From custom rosewood cabinets and quartz counters to expanded garages with steel moment frames and seismic upgrades, we are seeing developers go the extra mile to see that their product is better than the comparable condo and available to buyers at a lesser price. It is now common to see high-end appliances, hardwood floors and luxurious fixtures to accent already beautiful Victorian and Edwardian buildings. Buyers are attracted to the value, space and charm of these buildings, and even with the knowledge that some lenders have exited the market, they still see upside in purchasing a TIC and making it their own.

Problems Amidst the Promise

Of course, more potential and legal co-ownership issues come with an increase in the amount of TIC transactions. One thing that my conversation with these great TIC minds did bring to light was an ever-increasing amount of internal TIC disputes. It is critical that the management of the TIC group be set up (as delineated in the TIC Agreement) from the inception. An organized TIC will run in the same manner as a condominium association, with operating and reserve accounts, managerial responsibilities assigned, decision making clearly specified, and each co-tenant paying his or her monthly obligations into a group operating account to minimize the exposure for property taxes and other joint expenditures. Also, many banks offer electronic banking in order to allow transparency of the accounting efforts of the owner responsible for keeping the books for the property. While only one or two owners have the right to write the checks on behalf of the property, all owners can monitor the bank's website to see when payments are made, to whom and for what amount. Such accounting options greatly reduce the small disputes that can arise with multiunit properties and co-owners.

In a scenario where each co-tenant has a fractional loan, the credit risk is eliminated. If a co-tenant has a fractional loan and defaults on the loan, that single co-tenancy interest is at risk of foreclosure, not that of the other co-tenants. In a group loan scenario, the entirety of the property is encumbered by the loan. The TIC Agreement will allocate the responsibility for debt repayment among the co-tenants, but insofar as the bank is concerned, if any one party fails to pay their share, in the absence of the group curing the default, the loan is in default and the property subject to foreclosure. There are ways to mitigate this risk in a TIC Agreement, including having a default reserve account into which each co-tenant deposits a specified number of additional payments, which can be drawn upon by the group if that person defaults on his or her obligation in the future.

One critical difference between group and fractional loans is the exit strategy. In a fractional loan scenario, the nontransferring parties' loans remain unaffected, whereas in a group loan, absent an assumable loan, the existing debt must be refinanced in the event of a partial transfer. A TIC Agreement can and should outline the procedures to be followed in a refinance scenario, including protections for the nontransferring parties to ensure their cooperation.

However, due to the current lending environment, underwriting standards are substantially more stringent than they were when many existing group loans were originated. What this means is that when one party is transferring and triggering a refinance, a nontransferring member of the group may no longer qualify for a loan and as a result may be forced to sell. There are numerous possible solutions to any problem, and it is imperative that a group be prepared to come to the table and work through the situation together.

Solutions include additional "cash in" on the part of the sellers, secondary financing on the part of the seller, and a more realistic approach to the current values of TIC properties in this environment, just to name a few. It is a good idea to contact the existing lender regarding the requirements for assumption of the existing debt. In this way, it may be possible to work with the lender prior to marketing the property in order to understand whether the existing lender would allow the seller to carry back some percentage of the purchase price to a new buyer due to more stringent lending standards.

Group loans also mean group credit exposure, which necessitates that all cotenants review, understand and approve each other's financials. The traditional "meet and greet" in a group loan situation should ideally go well beyond social niceties; it is important to understand the financial strength of your co-borrowers. The lender underwriting may not be sufficient, as they have recourse to the property in a default scenario.

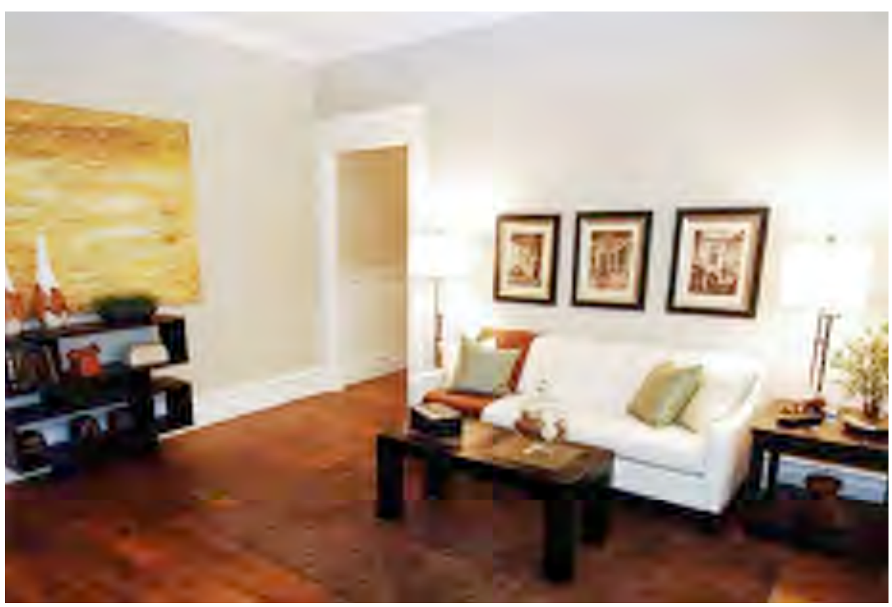
Fractional loans do not involve group credit exposure, so there is no formal approval process other than the requirement that a buyer review and sign onto the TIC agreement and acknowledge being bound by the rules, rights and obligations specified in the Agreement. However, it is always wise to be aware of a cash-strapped buyer in a fractional loan situation and be sure the operating and reserve account obligations of the seller are fully funded at the time of the close of escrow.

One other consideration for property owners is whether they have tenants who may be interested in and be financially capable of becoming owners. For purposes of the San Francisco Condominium Conversion Lottery, if a tenant becomes an owner (of the applicable minimum percentage interest on the title), his or her occupancy period as a tenant will count towards the occupancy requirements for the lottery entrance (three years dating back from the lottery). Depending upon the particulars of the property, financing and parties involved, a sale to a tenant may be a win-win for all parties.

So, given all of this information, where do we see TICs going as we head in to 2010? We all seem to agree that the amount of TICs in the acquisition and development stage has decreased in the past year; however, there are still many projects in the pipeline, which have yet to debut. Buyers seem to be willing to gobble up these properties as quickly as they come on to the market so long as there is an adequate method of financing their ownership percentage.

With more and more restrictions being put on condo conversion and evictions, the existing stock of TICs and future developments continue to be a viable method for middle-income citizens of San Francisco to own their own piece of the pie. Much to the chagrin of the politicians who helped enact the city's current policies, the TIC market will continue to flourish. As long as there continues to be a demand for homes, developers and landlords will be there to fill the void created as a result of the long and misguided policy of rent control in San Francisco.

Jesse E. Fowler, a San Francisco native, specializes in marketing TIC developments, single-family homes and multiunit properties. He is with Brown and Co. Real Estate and can be reached at 415-648-5800.



FEATURE

Extreme Home Makeover: Budget Edition

by Jesse E. Fowler

The drop in rents that began in the last half of 2008 has stimulated both tenants and rental property buyers to hunt for better values. Now is a great time to consider upgrades to your apartment building or multiunit property. Contractors are hungry for work, and competitive bids are easily in reach (compared to past years). I am regularly asked: what improvements can I make on my building that will bring the highest return on my investment?

Most prospective renters are looking for clean, move-in-ready apartments that suit their needs. One key aspect of making improvements is the careful and smart choice of finishes for kitchen and bath remodels. Flooring replacements, plumbing fixtures, painted surfaces and even lighting need to be low maintenance, and easily cleaned and rejuvenated upon vacancy and delivery to the next occupant. And, of course, it is important to make the kind of improvements that will last for a long time rather than having to make replacements each time an occupant vacates.

In addition, if there’s a possibility that you may decide to sell some or all of your units as tenancy-in-common units in the future, you should take into account what potential TIC buyers want to see. In most cases, buyers have higher expectations than typical renters. In converting an apartment building to TICs, your goal is to exceed the value and appeal of comparable condominium units. The added expense will result in a higher return on your investment. However, if you are sure that you are in the rental market for the long haul, the finishes you choose will be different, and, of course, will cost you less up front.

Kitchens

Some of the highest returns on investment, according to Remodeling Magazine, are in the places you would least expect them. For instance, a minor kitchen remodel will recoup about 79.5% to 95.5% on your investment over the long haul, whereas a major kitchen remodel will only recoup a 76% to 87.3% return on investment. In cases where you intend to continue to rent the units out, and where you might have frequent tenant turnover, it is key to select finishes that will wear well and last for years to come.

If you are doing a major kitchen remodel, rather than selecting cabinets from your local Home Depot or Lowe’s, consider the large number of prefabricated cabinet manufacturers and distributors who are looking for your business. The current trends are for cherry or maple, Shaker-style or flat-panel cabinetry, which can be purchased for less than $1,500 for an average-sized kitchen. These cabinets can be installed quickly and easily by your local contractor and, in most cases, are of the same or higher quality as those offered at the big-box stores. Some even have a better look.

Most distributors sell these cabinets to you unassembled in a flat box (like the ones that you get at IKEA). Also, most of the distributors will be happy to assemble and deliver the cabinets to your job site for a reasonable fee (between $10 and $20 per cabinet).When selecting countertops and plumbing fixtures, consider the many granite fabricators looking for your business. Most stores that sell the cabinets you are looking for also have prefabricated slabs of granite.

For planned TIC units, you probably want to go with Zodiac, Cesar Stone or another honed surface. For rental units, the prefabricated unhoned surfaces tend to wear and clean up far better than the honed surfaces because they are less porous. An occupant’s negligence in the use of the kitchen surfaces can amount to a real disaster on honed counters. For kitchen fixtures, take into account that undermount sinks, undercabinet lighting, garbage disposals, quality cabinet hardware and decent stainless steel appliances make a world of difference.
For minor kitchen remodels, there are also lots of options to spice up an outdated kitchen. Prefabricated granite slabs can be found almost everywhere and are an easy upgrade to make. They can be used on existing cabinetry if the cabinets are in good shape; if not, perhaps the cabinetry can simply be resurfaced. In many cases, by repainting or otherwise resurfacing the kitchen cabinets, you can bring new life to them. By spending less than $8,000 per unit, you can remove outdated or chipped tile or Formica countertops and replace the sink, faucet and appliances, greatly increasing the rent you would expect from your unit.

Bathrooms

Bathrooms are very important to occupants. Residents want to feel as if they are walking into a bathroom that is new. Obviously, a bath cannot be remodeled every time you rerent a unit; however, by selecting the right finishes and fixtures when you do remodel, occupant after occupant can feel that the bath is clean and new upon move in. Bathroom remodels typically bring about a 75% return on investment, indicating that you should be slightly more conservative when remodeling a bath. Some of the best baths, those that last the longest and feel the most timeless, are the simplest ones. For floors, consider using 12″ x 12″ ceramic tile with a nonslippery surface. For a fancier look and in larger baths, considering laying the tile in a diamond pattern. Also, travertine bathrooms are cheap, and easy to put together. Consider purchasing 18″ x 18″ tiles and making an interesting pattern by cutting the tiles into a combination of 18″ x 6″, 4″ x 4″, and other tile sizes.

For walls, consider a 3″ x 6″ subway tile up to 48 inches on the wall. Great-looking subway tile at very good prices can be found at big-box hardware stores, with all of the matching edges, soap trays and necessary pieces. A word of caution: some white subway tile has an orange backing that can be seen through the grout lines and be an eye sore, so be careful when selecting.

Use a quality toilet. The last thing you or your property manager want is a call at night reporting that the newly installed toilet is clogged or the tank is leaking. Even though it may be tempting, the cheapest toilet is normally the worst, and even quality brands may have lower-quality models that can give you trouble.

If your apartment has two bathrooms, consider providing one bath with a tub and one with a walk-in shower. Make sure the bathtub overflow device is properly installed to avoid problems after the occupant moves in. In rentals, a prefabricated shower pan is fine; however, if you are remodeling with a TIC in mind, then only a tiled shower will do. In this case, consider using smaller tile. Not only is it easier for your contractor to install and slope for water drainage, it also adds variety and interest to the whole bath.

Other Considerations

Consider installing hardwood floors in place of carpets. Many renters (and definitely TIC buyers) are looking for hardwood floors. Hardwood floors can be installed in a typical unit at minimal cost, enhancing the appearance and value of the entire unit. According to City Hardwood Floors owner Paul Li, typical hardwood floors can be installed for about eight dollars per square foot. Removing bathroom space from

the layout, a typical 650 sq. ft. one-bedroom can be completed at a cost of less than $4,500—money well spent considering the speed at which you will rent your unit and the fact that you won't have to continue to clean or replace carpets as occupants change. Refinishing existing hardwood or softwood floors that are in poor condition is also a no-brainer and is much
less expensive.

As we all know, as far as colors go, neutral is best. If renting, use "landlord colors" such as Swiss coffee or antique white. If considering selling as TICs, use designer colors, and consider getting suggestions from a knowledgeable agent or a stager/color designer. The good news about TICs is that you only have to paint them once and you need not be as concerned about matching colors. With a rental unit that has to be repeatedly painted, it helps to have your color scheme down and a lot of paint on hand.

Be careful what you use for lighting fixtures, switches, dimmers, doorknobs and hinges. The trend is to shy away from shiny brass doorknobs and hinges, or ivory electrical receptacles and light switches. In historic buildings, use brushed or satin nickel, or another unobtrusive nonglossy style. For switches in a modern building, try using bright white Decora style receptacles and switches. Don't try to get too fancy by selecting items that you would like for your own home. Aim to please the general audience; in most cases, it won't be you living in the unit.

Make the exterior of your building stand out to prospective tenants. Consider repainting if the façade paint is faded, cracked or chipping. Street trees and landscaping in the front areas also help to spruce up what might now be empty patches of dirt. Properly stain, seal, protect and maintain all existing decking. Improve your common areas by replacing old carpeting; paint hallways and other common-use areas such as laundry rooms and garages.

New windows make a world of difference. Not only do they improve the look of your units, they can also provide energy savings. Natural light is always a plus. Consider adding skylights when replacing roofs. While you're on the roof, think about solar panels. With today's energy costs, solar hot water and photovoltaic systems make sense and appeal to savvy buyers and tenants.

Any of these measures can help your property show at its best. These simple and affordable upgrades will attract tenants and buyers who recognize quality and are willing to pay for it.

The opinions expressed in this article are those of the author, and do not necessarily reflect the viewpoint of the SFAA or the *SF Apartment Magazine*. Jesse E. Fowler, a San Francisco native, specializes in marketing TIC developments, single-family homes and multiunit properties. He is with Brown and Co. Real Estate and can be reached at 415-648-5800.

FEATURE

A Conversation With Top Names in TICs

by Emily Landes

In this magazine, we often offer a dissection of different components of the real-estate market, from 2 units up to 200. One segment that hasn't really been touched upon is the tenancy-in-common market, which had its beginnings in San Francisco's central neighborhoods and has now branched out to the rest of the city, and the rest of the world. In October, SF Apartment Magazine Managing Editor Emily Landes sat down with lawyer Andy Sirkin of Sirkin Paul Associates, who pretty much wrote the book on TIC agreements; lawyer and broker Meg Ruxton, who helps put TIC groups together for City Living; and agent Jesse Fowler, who puts his decade and a half of real-estate experience to work at Brown and Co., one of the city's top TIC sellers.

Q: *How did you get involved in TICs?*

ANDY SIRKIN: I've lived in San Francisco since 1983. Around 1985, I became interested in tenancies in common as a way to buy my own first home here. I put together a group to buy a six-unit building. People I knew saw what I was doing and were interested in doing it, so I started helping other people do it. Basically, by 1986 it was my full-time job. Over the last 22 years, we've probably done about 5,000 projects—that could be an agreement for a single unit, or a whole building full of units.

Increasingly, over the last five or six years, the practice has been less and less San Francisco-centric. Now, we're only about 30% in San Francisco, whereas five years ago we were probably 90% in San Francisco. I've got projects all over South and Central America, and all over Europe. We have offices in Paris, Denver and here.

We do different kinds of TICs in different kinds of places. I would say the common element though is high real-estate prices and conditions that are conducive to people sharing property in some way. Here, in the Bay Area and in Southern California, people tend to share multiunit buildings. In other places, our practice is more centered on sharing vacation and second homes. But the basic issues are the same. There are places where real estate is not expensive and people don't have to share things, and we don't have work there. Although, more and more as the market tightens up, we're doing more equity sharing, which is something we used to do a lot of in the 1980s. That's a TIC between an investor and an occupant, where the investor provides all or most of the downpayment and the occupant lives in the house and they share the appreciation.

MEG RUXTON: I used to practice law and I took some time off to have kids. I bought an apartment building and started managing that as my side job. I then decided to get my broker's license. I did some research into different areas of real estate, and I thought TICs would be a good area for me because I could use my legal background and background in apartment building management. I really enjoy helping people find their first-time homes, so we put together deals for people to buy buildings together. We also buy buildings, renovate the units and sell them off as TICs.

JESSE FOWLER: I started at BJ Droubi Real Estate in 1994, and we started doing a lot of TIC agreements. In 2004, I joined Brown and Company. I had done a few TIC projects of my own, but joined Tim Brown since he was doing a lot of the larger TIC projects in the city.

Q: *What's considered a "larger project"?*

JF: Seven units and above. I think that around 2001 we started seeing more of the 5-6 unit buildings, and now Tim and I have about 50 projects in the pipeline, with half of those being more than 6-unit buildings.

Q: *What's the biggest building you've seen as a TIC project?*

AS: We did a 60-unit building down in Santa Cruz, and a number in the thirties. We did a thirtysomething in the city that never went on the market. But as far as projects in the city that are sold out, I think the biggest are in the twenties and thirties.

Q: *Why wouldn't a project go on the market?*

AS: The seller gets all the approvals but for one reason or another decides that the timing isn't right. Also, financing is increasingly an issue, and as the projects get bigger they need more financing. Generally, they are too big for one bank, so then the financing package needs to get put together and that's a lot more complicated.

Q: *Is financing the reason these deals most often fall apart?*

AS: Today, yes. We had a period of about two or three years when, relatively speaking, TIC financing was easier to get. It was never as easy to get as other kinds of financing, but it was pretty easy, especially in San Francisco. Where we are now is that a lot of the fractional lenders have pulled back because the credit market in general is bad. So, while they all love the product—they're making lots of money, the quality is very high and there's never been any defaults—they're pulling back on everything. In some cases, they can't approve any more projects because they don't know if they'll have the money to fund them. In other cases, they still have the program going, but they're much more selective about the borrowers. What that's meant is higher down payments, higher credit scores required and higher debt-to-income ratios. If you go into the southern, western and eastern parts of the city, where credit quality is lower because people don't have as much money, it's very hard to get a project financed.

Q: *Where are most of the TIC projects in the city located?*

JF: I feel like TICs started in District 5 on the real-estate map, which is Noe Valley and Mission Dolores, and then worked their way to the north side of town where we started to see many more of them in the past two to three years than we had before. Then, in turn, it became more people using them for a pied-a-terre. Now, we're seeing a lot of folks buying with all cash. Just in the last few weeks, five offers out of seven we've accepted on TIC units have been cash.

These are people's second homes, generally, or folks with parents' money trying to invest for their kids in the city.

There still are fractional lenders out there and some of them are even dropping their rates and committing more to their programs. So, as people fall off it seems like other people are coming in and picking up the slack.

Q: *So, fractional loans are still a desirable product for lenders?*

AS: I think so. I was with Bank of Marin recently—they were the first bank to offer them—and they are very anxious to continue with the program, but right now they're just deciding what their allocation is for next year. At this point, they can't make any new commitments, but they're optimistic that they'll continue. They took a portfolio of their first generation of TIC loans and tried to sell it in the secondary market, but the timing was bad. It was right when everything fell apart, so not surprisingly they couldn't sell it. But they had a lot of inquiries and a lot of interest. Looking forward, there will be a point, hopefully, if the country ever recovers, where they'll be able to take $50 million of these and sell them and come back with new money.

Fundamentally, these are great products for lenders because borrowers are very strong and risk is relatively low in most places. There haven't been any foreclosures. There haven't even been any missed payments.

MR: That's pretty amazing when you think about it. No foreclosures? Compared to other parts of this industry?

AS: We could start to see some. We're looking back over a period where everything's just been going up and now that a lot of people's fortunes are reversing, I wouldn't be surprised if there were some defaults. But, relative to the market overall, I think the rate will be much, much lower compared to condos or house loans.

Incidentally, even on TIC group loans, there haven't been any defaults. So, even when you broaden the discussion—because statistically fractional loans are only a tiny percentage of the market—the credit quality has been very high.

Q: *Is that because there's a higher threshold for entry on these loans?*

AS: I think that's part of it. I also think there's quite a bit of buffer between a calamity to one of the owners, like a job loss or an illness, and an actual default to the bank. They're paying ahead, they have reserve funds and there are other people in the group. So, there's a lot of protection built in that's not there in the normal situation. When something does go wrong, the odds of it actually turning into a late payment or a default are much more remote.

Q: *How has the TIC market compared to the rest of the market in San Francisco?*

JF: I'd say its fairly consistent with what the condo market has been doing. We have seen a decrease in the average price by about $20,000. The biggest hit has been the one bedrooms. Two and three bedrooms are easier to sell because you've got a larger group of buyers out there and, generally, they're priced pretty competitively compared to condominiums. They're priced about 15% lower, though I think the gap is closing with fractional financing. Sometimes people need to see value and quality of finish. That's what people are looking for in all markets. Everyone's looking for value now.

AS: I would add that homebuying is a very emotional decision for most people and what they respond to is the real estate. The fact that it's a condo or a TIC makes a difference to people, but it makes less of a difference than you might think, especially in a place like San Francisco, where most people are familiar with and comfortable with TICs. If you have a really good property that people respond to, emotionally, they'll find a way to make themselves comfortable with the legal structure. On the other hand, if your property or location is marginal, this just becomes another reason not to buy it. Essentially, people are compromising on the property already, and they're looking for any reason to walk.

Q: *What makes for a really great TIC project?*

MR: You have to have a project where you can see people wanting to make it their homes. There are some apartment buildings that are not really suited for TICs because they don't have that homey feeling. You really have to see the potential in the building and, of course, you have to look at the numbers, the tenant makeup and the location. Basically, you have to see people being willing to invest in this as their home and make it more of a long-term commitment.

Q: *Are people still looking to eventually condo convert or are they content remaining in a TIC?*

MR: I think people are still looking to convert but its becoming less of a necessity for people now that they have fractional loans; they don't have to worry about being on a loan with other people.

AS: The other thing is that it's become much more difficult to convert. To the extent that people were interested in this product primarily as a vehicle to condo convert, those people aren't buying anything but two-unit buildings because the likelihood has been diminished so much that this is no longer a realistic strategy.

Q: *When people sell their TICs, where do they go?*

JF: It was primarily a first-time homebuyer vehicle, so we see a lot of people going out of TICs and into single-family homes—not so much condominiums because they're already in something similar to a condominium. They're leaving the city, or they're even renting. Sometimes they're just trying to capture the appreciation and move out.

One of the interesting situations that we're running into recently is people with existing group loans who want to go into fractional for their incoming buyers and are sometimes having trouble getting their equity out because they've got these group loans at really low interest rates. You get three co-tenants and two of them don't want to refinance and one of them does, to get out. That's where I've been having the most difficulty and having to do the most hand holding recently. It can hurt on the group loans because on most group loans, they're not assumable; so even if you were to assume the portion of debt that the existing co-tenant has, the lender either won't sign off on the assumability or it's not assummable at all.

AS: Notwithstanding the fact that for 20 years we've been hammering the buyers and the brokers on this issue, people in the end go for the rates and the terms and they ignore the legal advice. They end up with a product that doesn't allow anyone to sell, at least not without technically violating their loan docs. Then they come back and say, "Oh, I never should have bought a TIC. This is terrible. How could you let me do this?" I always say, "I don't think this has anything to do with it being a TIC. This has to do with you going against the advice that everyone gave you at the time that you needed to have an assumable loan." But, of course, everybody thinks when they buy that they're never going to sell. And when you point out to them that, of course, that's not true, the come back is, "We'll be able to work it out then." They do work it out, but it's a lot of pain.

Q: *How do these negotiations between co-tenants usually work?*

AS: In our agreements, we give the seller the ability to force a refinance. But that doesn't answer the main question: What about the costs of this? The costs come in the form of the origination of the loan and the changes of the rates. Then the question comes down to, who pays these costs? For the last few years, we have put most of the burden on the seller, who can then pass some of it on to the buyer. But, we do put some of it on the rest of the group. Some people say, "Why should I have to pay more or have less desirable terms?" Well, the answer is: it could've been you and it will be you! If we put all of the burden on the seller, what that can mean is that you've got someone who needs or wants to get out, and that's not a good thing for the group. In the end, people have to understand that there are consequences to playing hardball. Not only are they probably violating the terms of the agreement, but those consequences long term are going to come back and make their lives very unpleasant.

Q: *Does it make things easier if the people in the agreement were all friends to begin with?*

AS: Definitely not. It makes things harder.

MR: That rarely happens, anyway. We've found that if we work with the group from the beginning to kind of help them bond and get them set up the right way, they will be more successful. If it's all laid out and people understand what they're getting into in the beginning, and develop a relationship that's respectful, I think you'll find that they are successful.

AS: Twenty years ago, we used to spend hours upon hours with these groups. The whole market was different; you sort of had to assemble the group and then you had meetings and you read them every sentence of the agreement and explained it to them. With this bull market that we've had, the market moves too fast for that. Also, from a legal services standpoint, there's competition between a lot of different lawyers for this business and that's pushed pricing down. There's no longer the space to spend 12 hours with a group because people are shopping price and they want an agreement for $1,000. In order to do that, you can't spend this kind of time. We deal with the building and financing, but we don't deal with the people very much anymore.

Q: *Are there any particular benefits to being in a TIC, aside from the price?*

JF: Sometimes you can get access to a nicer building. A lot of these buildings that have been converted are incredible buildings. I have a couple in the pipeline that were built in the early 1900s, and they're great properties. Sometimes it's the only way to get a unit of that size and quality at that price. There's a lot of nice buildings in the city, and a lot of developers have taken advantage of that by selling their units as TICs and getting a better price because of it. People want the charm, and they want to be in these neighborhoods that are older. It's like getting into a great rental unit, except you can purchase it and benefit on the appreciation.

MR: I think people are looking for high-end finishes; they don't want a fixer-upper TIC. When we're renovating buildings, we make sure we use high quality materials and keep the charm, but just make it really modern in the kitchen and bathrooms. You'll see stainless steel appliances and granite countertops.
JF: We have sold some fixer TICs, but a lot of the problems that I run into have to do with the infrastructure of the building. If you don't take care of these issues all at the same time, it can be hard for a group of 6 or 12 to come in and take on projects like upgrading the entire electrical system or putting on a new roof. So, generally, it's better to sell folks a building where the infrastructure has at least been updated.

AS: During the 1990s, there were a lot of TIC groups coming in and building garages. At the time, it seemed like 15% of all the agreements we did involved the construction of a garage. But that seems to have gone away now, and I don't know if that means all of the garages have been built or people have just gotten smarter about it and realized that it's actually quite difficult to build a garage.

Q: *Any other trends?*

JF: A lot of buyers want to have expansion potential so the two or three bedrooms are easier to sell. I think people now are looking for a little more of the long-term, as opposed to when the appreciation was just continuing to climb and people figured, "I'll just get in anything and move in two years." Now they realize that it could be a longer term investment, more of what we've always told people, which is a three-to-five-year timetable to expect any appreciation. In the last few years, people lost sight of that because things were always on the way up. So, the larger units are selling faster and at higher prices because people are realizing that they may need time to build their lives before moving on.

MR: I think more people are going to want to buy in the city, rather than moving out to the suburbs. As gas gets more expensive, and people are concerned about their impact on the environment, I think that instead of saying, "When I start a family, I'm going to move out to the suburbs," people are going to say, "I'm going to stay in the city and make it work." They may be more willing to look at TICs, which are more affordable than condos or single-families in the city. So, there may be more demand for them.

The opinions expressed in this article are those of the author, and do not necessarily reflect the viewpoint of the SFAA or the *SF Apartment Magazine*. Emily Landes is the managing editor of *SF Apartment Magazine*.

What's Really Happening in the TIC Market?

By: Jesse E. Fowler, Tim Brown, and Ryan Brown

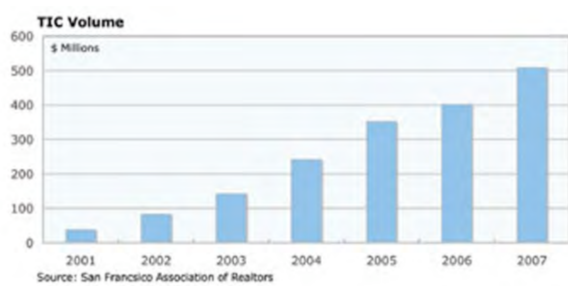
The facts are hard to ignore: The scope of San Francisco's housing stock has changed dramatically in recent years. Tenancy In Common (TIC) sales volume in San Francisco is projected to **exceed $500,000,000 in 2007. By comparison, TIC sales volume in 2001 was less than $50,000,000. That's right…in just six years, the TIC market has increased in volume by an astonishing 1000%!** TIC sales now account for 24% of today's condo/coop/loft/TIC home ownership sales.

This article will explore the evolution of how history, trends, and neighborhoods have contributed to this new and ever-expanding market for an innovative property type.

In San Francisco there has always been a need for affordable ownership housing, a need for an increase in available units, and a need for more practical TIC financing. There is also a desire on the part of property owners and developers to make use of their existing properties to bring higher returns.

TIC HISTORY

The Tenancy in Common home ownership market started to take hold in the early 1980's. At that time, increases in real estate prices and interest rates made it difficult for home buyers to find housing that was affordable and, at the same time, spacious enough to meet their needs. American resourcefulness and creativity prevailed, and friends or families would purchase older Edwardian and Victorian buildings that had previously been utilized as rental housing. The typical TIC at the time was a 2- to 4-unit building where the co-tenants would each own a percentage interest in the building as a whole and, either verbally or in writing, create covenants whereby each owner would have the right to occupy one, or in some cases multiple units. They would obtain a conventional loan on the building and each owner would be responsible for making their portion of the group mortgage. The co-owners would be jointly and severally liable for nonpayment of their or their co-tenants' payments.



Today these TIC arrangements still exist. Some have no written agreements in place at all, others have longhand written documents, while others have updated their contracts and engaged a qualified TIC attorney to draft a newer Tenancy in Common agreement and recorded a memorandum that such an agreement exists. Some have been forced into good judgment, having drafted new agreements as their co-tenants sold their percentage interest.

In late 2003 and early 2004 the TIC market started to gain momentum. [See Exhibit 1] As San Francisco housing prices continued to appreciate, buyers more frequently began to consider TICs as a viable option and a more affordable alternative to a comparable condominium unit (normally selling for 10-15% more than a TIC).

Financing Trends • TIC Agreement Trends

As lenders and prospective buyers saw TIC demand continue to increase, Bank of Marin created fractional loan programs which for the first time allowed buyer~~s~~ of Tenancy in Common interests to purchase their units with individual (fractional) financing. Each buyer has a separate loan, title insurance and deed of trust, and no cross liability. A traditional group loan, on the other hand, requires all of the co-tenants, even those who may have paid all cash for their interests, sign on the same note and deed of trust. The new fractional financing created a market for larger TIC buildings that we hadn't seen before.

The ability to avoid the objectionable group financing lets buyers feel confident that they will be able to resell their units in the future. There are no group members who carry first right of refusal. Co-tenants do not need group approval to sell or buy. And certainly, being responsible for one's own mortgage is paramount to a feeling of security and control.

Smaller buildings were generally preferred for TIC conversion because those with 7 units or more cannot enter the city's Condominium Conversion Lottery. Buyers of TIC interests were able to overcome their reluctance to enter into group loans because they counted on being able someday to convert their unit/interest into a condominium, thereby achieving their own parcel number (or APN) and having the ability to secure their own loan on the unit.

Fractional financing, however, solves both concerns. Large buildings can now be considered for TIC conversion because it is no longer necessary to build a cooperative group of stable buyers to share a single mortgage. Likewise, potential buyers of smaller units no longer have to be wary of units that may not be eligible for condo conversion (due to a previous eviction, for example) because they can achieve individual ownership and control without the bother of condo conversion.

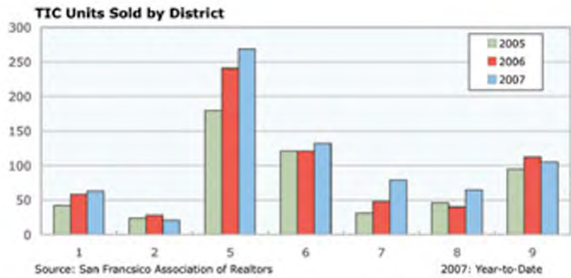
Currently at least nine lenders offer a fractional loan program and several others are contemplating entering the market.

Hot Neighborhoods for TICs

From their inception the typical Tenancies in Common were located near San Francisco's geographical center. Noe Valley, Duboce Triangle, the Haight, Mission District, Valencia Corridor, Mission Dolores, and North of Panhandle areas were most popular for TIC ownership. As the TIC market has evolved, it has also expanded to north side neighborhoods such as Pacific Heights, Nob Hill, Russian Hill, and North Beach.

We continue to see an increase in the volume of calls coming from different areas of the city. Owners who desire to maximize the value of their investment property see TIC conversion or development as a practical opportunity.

With some exceptions though, buildings in certain locations do not make ideal candidates for TIC conversion. These include such areas as the Excelsior, the Sunset and Richmond districts, Visitation Valley, and Bayview/Hunters Point. The Sunset and Richmond are slowly becoming more desirable by buyers. Still other neighborhoods lack the stock of multi-unit buildings that are required to convert to a Tenancy in Common, such as District 4 (Miraloma Park, Sunnyside, Westwood Park/Highlands, St. Francis Wood, Forest Hill, etc.).



With the prospect of higher rates of return on their investments, more property owners are now willing to convert their property to a Tenancy in Common prior to sale. With so many more TICs popping up in progressively larger buildings, the value of almost all income property has increased. TIC sales have also spread to North side neighborhoods. **For example, TIC units in District 7(Marina, Pacific Heights, Cow Hollow) and District 8 (Russian Hill, Nob Hill North Beach) have risen by 254% and 141% respectively from 2005 to 2007.**

The market continues to open up. Based on data from the Department of Real Estate for 5+ unit TIC properties (2-4 units buildings are exempted from a formal DRE public report to subdivide into TIC), we expect an additional 6-8% increase in TIC sales volume across the board.

IS THIS A GOOD TIME TO CONVERT YOUR BUILDING INTO A TENANCY IN COMMON?

Only a qualified agent with experience in Tenancy in Common sales can help you answer this question. But here is a basic checklist to determine if your building fits the bill:

Location: Is it in a neighborhood that is popular for TIC ownership? Does the building have easy access to transit, shopping, or nightlife? Are there any parking spaces in the building?

Unit Size and Condition: Although we sell almost every size and type of unit, some sell faster then others. Most buyers like typical layouts and if possible (but not always) multiple bedrooms.

Special Features and Amenities: Buyers enjoy common or exclusive outdoor space, roof decks, parking, laundry facilities (if not in the unit itself, at the very least in the building). Are there any unique or special features that make you building more desirable to potential buyers? Is there anything else unique or special that might make your building desirable to potential buyers?

Condition of building: Assess the condition of the building. Are the units remodeled? To succeed as a quality TIC the condition and presentation of your property should exceed the quality of competing condominium units. Usually this means renovating the units prior to sale, increasing their appeal to buyers.

Ratio of Residential to Commercial: Some multi-unit buildings contain commercial and residential units. Although it is possible to sell commercial TICs to the owners of the business that occupy them, or other parties, it is not always easy. Generally the buildings lack parking because commercial space occupies potential garage area. Some lenders doing fractional loans won't except buildings with more than 25% of the floor space being commercial, and lastly the type of business located in the building needs to be a quiet one (not a bar or night club for example) as buyers generally will object to occupying buildings of this type.

Call us for an evaluation of your building's TIC prospects or if you need more information on your specific situation and we'd be glad to help.

LOOKING AHEAD

Today, with the expansion of fractional financing, the TIC market has expanded to larger buildings, new neighborhoods, and different buyer profiles. The buyer profile has also evolved from those looking for larger flats in minimal unit buildings to buyers of every type. First time homebuyers with smaller down payments look to purchase one bedroom or studio units. Out of town, pied a terre buyers, with large down payments now look to TICs to fill their vacation or part time habitation needs. Buyers looking for larger flats(similar to the previous TIC buyer) now have moved to the higher end north side districts (7 and 8) rather than buying solely in the city center (district 5).

TIC developers, reacting to the increased buyer pool, have increased the quality and type of building being converted to TIC. We have moved from the traditional 2-4 unit building with a group loan to 5+ unit buildings with fractional financing. Now buildings containing 2, 4, 7, 14, and even 17 units have become viable options for TIC conversion. TIC developers and owners have expanded into new locations, and are doing higher end renovations of trophy buildings. Due to this fact we have also noticed a staggering increase in TICs in the $1-$2 million dollar range. As the TIC market has grown it has also evolved to include districts throughout the city, buyers of every profile, and buildings of varying size and type.

The opinions expressed in this article are those of the authors and do not necessarily reflect the viewpoint of SFAA or *SF Apartment Magazine*. Jesse E. Fowler, a San Francisco native, specializes in marketing TIC developments, single-family homes and multiunit properties. Fowler, Tim Brown and Ryan Brown are with Brown and Co. Real Estate and can be reached at 415-648-5800.

SF Apartment Magazine, December 2007 issue