Tenancy in Common: Keeping Your Ownership Interest Real

Published on Jun 22, 2022 by Peoples Company

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There are various avenues for individuals to invest and co-own real estate. Generally, when multiple individuals are looking to purchase real estate, establishing a land-holding entity is a common approach. However, the membership interest in the entity is classified as a personal property interest and does not provide the co-owners the possibility of a Section 1031 exchange. Suppose the co-owners are making a Section 1031 exchange or are conscientious of future Section 1031 exchanges. In that case, the co-owners may decide to own an undivided interest in the real estate as tenants-in-common (commonly referred to as a "TIC"). The TIC structure provides certain advantages and disadvantages. This blog post will give a general overview of the TIC structure and is not for the purpose of providing legal advice. You should contact your attorney and accountant for advice regarding your specific situation.

Section 1031 Advantage

Owning real estate via the TIC structure allows the TIC owners to have a real property interest in the land that affords Section 1031 advantages. The TIC owners will have an undivided interest in the real estate, and each TIC owner will be listed on the deed and hold legal title to the real estate. TIC owners will also have certain rights, obligations, and restrictions related to their undivided interest. To provide general guidance among the TIC owners, they will commonly enter into a Tenancy in Common Agreement (“TIC Agreement”), which is an integral part of the TIC structure.

TIC Agreement

The TIC Agreement provides general parameters and guidance among the TIC owners related to the real estate. Typically, the TIC Agreement will address the real estate management and the decision-making process amongst the TIC owners. It may also impose restrictions on a TIC owner from disposing of their undivided interest and partitioning the land without first offering the undivided interest to the other TIC owners to purchase at fair market value - commonly referred to as a right of first refusal. A right of first refusal is generally one of the only permitted restrictions on the alienation of a TIC owner’s undivided interest. Since one of the most significant advantages of the TIC structure is the ability to take advantage of Section 1031, a comprehensive TIC Agreement should be drafted and formulated to comply with Revenue Procedure 2002-22. Complying with Rev. Proc. 2002-22 will help ensure that the ownership interest will remain a real property interest and not a partnership interest.

TIC Owner’s Involvement

In addition to Section 1031 advantages, an important consideration for those contemplating the TIC structure is that each TIC owner must have involvement in the decision-making process related to their undivided interest in the real estate. Specifically, certain material decisions require unanimous consent amongst the TIC owners. TIC owners must retain the right to approve the hiring of any manager, disposition of the real estate, any leases on all or part of the real estate, or the creation of any liens secured by the real estate. Although a TIC owner must have a requisite level of involvement, they are not required to handle the day-to-day operations.

Management Agreement

Since most TIC owners generally do not want to be actively involved in the management of the real estate, Rev. Proc. 2002-22 does allow TIC owners the ability to enter into management agreements. Management agreements enable the manager to handle the day-to-day operations related to the real estate. A management agreement may address maintaining a common bank account for the collection of rent and payment of expenses; preparing statements for the TIC owners showing their share of the profits and losses; modifying insurance on the real estate, subject to the TIC owners’ approval; or negotiating and modifying lease terms, subject to the TIC owners’ approval. There is no restriction on who the TIC owners may appoint and hire as the manager, and a manager may be a sponsor of the TIC or a TIC owner.

Conclusion

The TIC structure is a great avenue that allows multiple individuals to co-own real estate while also taking advantage of Section 1031 exchanges. The TIC Agreement ensures that the TIC owners have a common understanding and parameters related to the ownership of the property. Lastly, although a TIC owner must have a certain level of involvement, they are not required to handle the day-to-day operations. Capital Markets provides various structures to invest in farmland, including Tenancy in Common. If you are interested in investing in farmland, please contact our team at CapitalMarkets@PeoplesCompany.com.