

Dow Jones Reprints: This copy is for your personal, non-commercial use only. To order presentation-ready copies for distribution to your colleagues, clients or customers, use the Order Reprints tool at the bottom of any article or visit www.djreprints.com

[See a sample reprint in PDF format.](#)

[Order a reprint of this article now](#)

THE WALL STREET JOURNAL

WSJ.com

REAL ESTATE | DECEMBER 22, 2010

Ruling Offers a Peek Into Boom's Fallout

By **ANTON TROIANOVSKI**

A national real-estate company committed fraud in an Austin, Texas, office-building deal, an arbitrator ruled, a sign of the troubles stemming from a popular type of commercial-property deal done during the boom for small investors.

The arbitration ruling last month against Grubb & Ellis Inc. is one of a number of cases alleging fraud and abuse in deals known as tenant-in-common, or TIC, transactions that promised small investors steady income and tax breaks.

While commercial-property deals done by both big and small investors have run into trouble as real-estate values fall and lending markets tighten, many small investors are putting the blame for the failure of these TIC deals on the companies that put them together.

Publicly traded Grubb's latest quarterly report filed last month with the Securities and Exchange Commission disclosed that the company has been named in multiple civil lawsuits related to its investment-management programs alleging negligence, fraud and other claims.

The ruling by the California arbitrator against a unit of Grubb involved a deal for an office building in Austin that was purchased for investors in a 2005 tenant-in-common deal run by a company named NNN Realty Advisors Inc.. NNN merged with Grubb in 2007 in a deal that made Grubb one of the largest tenant-in-common managers in the industry.



[View Full Image](#)

Mike Hull

This office building in Austin, Texas, is at the center of fraud allegations against Grubb & Ellis Inc. over a tenant-in-common transaction.

In a statement, Grubb said none of the people who carried out the deal, including NNN's former owner, Tony Thompson, are currently associated with the company. Mr. Thompson declined to comment on the arbitration but said in a statement that his current company, which he founded in 2008, "continues to be the number-one manager of choice for TIC investors who are seeking property and asset managers to help navigate the rough real-estate market today."

The dispute sheds light on the fallout from the last decade's rush by individual investors to get a piece of the commercial real-estate market. These deals were fueled by a 2002 ruling by the

Internal Revenue Service that made it easy for investors to use TIC deals to take advantage of a rule allowing capital-gains taxes to be deferred when selling a property by reinvesting the proceeds in another property.

In such a structure, a handful of investors each buys a slice of a property, typically organized by a sponsoring company that finds deals and brings investors together. More than \$14 billion in TIC equity has been raised since 2002, according to Omni Real Estate Services, a TIC brokerage and research firm in Salt Lake City.

Investors also have alleged fraud in the blowups of two of the largest sponsors of TIC deals, senior-housing company Sunwest Management Inc. and real-estate investment company DBSI Inc. Judges overseeing the workouts of both cases, a Delaware bankruptcy judge overseeing DBSI and an Oregon federal judge overseeing the Sunwest case, have found that both companies improperly commingled investor funds.

Sunwest went into receivership in 2009; DBSI filed for bankruptcy-court protection in 2008. Lawyers for DBSI's former chief executive, Doug Swenson, have disputed the Delaware judge's finding of commingling. DBSI bankruptcy trustee James Zazzali asserted in court papers that there was extensive commingling of funds.

Steve English, a lawyer for Sunwest's former CEO, Jon Harder, acknowledged the commingling occurred without investors being notified. But he said that the commingling consisted of loans among Sunwest entities that were recorded. Sunwest Chief Restructuring Officer Clyde Hamstreet said he agreed with the judge's findings of commingling.



Dorothy Sisam

In Grubb's Austin deal, the arbitrator found that investors weren't told in a timely manner about a structural flaw in the office building after it was purchased on their behalf for about \$45 million in 2005. Grubb also didn't tell the 26 investors that it was negotiating an insurance settlement related to the building flaw and then spent \$1.5 million of the proceeds from the \$6.4 million settlement on other properties, the arbitrator said. Grubb said, however, that the settlement negotiations were disclosed to investors.

Grubb, which manages \$5.5 billion of property investments mostly for individual investors, is appealing the arbitrator's ruling. A statement released by Grubb said the company "has and will continue to work diligently on [the investors'] and all investors' behalf to protect and enhance the value of their investments."

The lender on the Austin building has filed a foreclosure notice, and investors now risk losing

Ed Sisam sold the family farm in Iowa for about \$323,000 and reinvested nearly all of the proceeds in the Austin office building managed by Grubb.

their entire investment, according to their lawyer, Mike Hull. The arbitrator is expected to rule on damages in the next phase of the arbitration, lawyers for both sides said, so they

could recoup some or all of their money.

Grubb said it has worked to assist tenant-in-common owners of property through the tough real-estate environment, cutting its property-management fees and other fees by one-third and forgiving "millions of dollars in deferred fees and loans to various properties in the TIC portfolio."

Ed Sisam, a 64-year-old retired lawyer living in San Antonio, said he sold the family farm in Iowa in 2005 for about \$323,000 and reinvested nearly all of the proceeds in the Austin office building managed by Grubb. Mr. Sisam and his retired sister shared the monthly dividend checks, which totaled about \$25,000 a year.

"It was stable, and we weren't dependent upon corn prices or bean prices or the weather or the farmers' ability to pay," Mr. Sisam said. "We were looking for something that was safe."

Grubb's Austin building, occupied by a drug-testing company and Texas state government offices, sits on a moving slab, according to the investors' brief filed in the arbitration. The arbitrator found that the investors weren't properly informed after the purchase of this issue.

The building still is in use and safe, according to both sides. But the bucking slab causes cracks in the walls and other problems, and helped prevent the property from getting refinancing, the investors said.

—Nathan Koppel and Lingling Wei contributed to this article.

Write to Anton Troianovski at anton.troianovski@wsj.com

Copyright 2010 Dow Jones & Company, Inc. All Rights Reserved

This copy is for your personal, non-commercial use only. Distribution and use of this material are governed by our [Subscriber Agreement](#) and by copyright law. For non-personal use or to order multiple copies, please contact Dow Jones Reprints at 1-800-843-0008 or visit www.djreprints.com