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Comparing TIC and Delaware Statutory Trusts

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This column is offered to help educate agents new to commercial and investment brokerage and serve as a review of basics for existing practitioners.

After last month's article on the History of 1031 Exchanges, I received several questions regarding Tenants-in-Common (TIC) and Delaware Statutory Trusts (DST). In this issue we will explore both. They are similar in that either may be used in a 1031 Exchange and both give the investor an opportunity for participation in a larger project; but they are also quite different.

One of the most difficult parts of doing a 1031 Tax Deferred Exchange is finding the right replacement property to purchase within the required 45-day identification period, and successfully closing the purchase within 180 days. Additional exchange opportunities of large investment grade buildings are offered by many firms as TIC or DST.

With TIC you own a pro-rate share of a building. In this structure each investor forms a single member limited liability company and the lender is financing individually with each investor. Each investor reaps their proportionate share of cash flows and eventual sale proceeds. But this structure can become convoluted as investors in the TIC must vote unanimously on all major investment decisions. It may become difficult to get all the co-investors to agree on an important decision.

One of the TIC rules is there can be no more than 35 co-investors. Practically speaking this limits the amount of funds available; say each investor contributes $100,000 and loans are secured for 50% of the value; the available funds to purchase are $7 million.

The DST is governed by the Security and Exchange Commission (SEC) regulation D of the 1933 Securities Act and later defined in 2010 by the Dodd-Frank Act. This requires each investor to be an accredited investor. These are individuals whose net worth is in excess of $1 million and/or earned annual income of $200,000 for two or more years, with expectation that this income level will continue. Typical DST's will have a 100 (sometimes more) investors, allowing then to raise significantly more capital and buy much larger buildings than with a TIC.

With the DST there are property sponsors who serve as trustees of the trust; they purchase the property and structure it as a securities DST, with written detailed offering documents. Mortgage banking and property management are pre-arranged by the property sponsor. The investor owns an individual beneficial interest in the DST; there is no need to form individual LLC's. The trust owns 100% of the real estate so unlike the TIC there is only one loan and one borrower.

The property sponsor administers the trust and operations of the property. Management is less complicated as individual co-investors or beneficiaries in a DST are not permitted to vote. There are numerous other rules and regulations regarding the DST operations.

Both TIC's and DST's can be set up as income producing properties; other offerings may have the strategy of directing all the income to pay down the loan, thereby increasing each taxpayer's equity over the course of the holding period. Upon disposition of the asset the taxpayer can potentially use another 1031 exchange, and do this all over again!

This is just a brief outline of these types of investments; be sure you or your client discusses these opportunities with your accountant and an expert in either TIC or DST.

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