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With possible change on the horizon, a bright spot amid COVID: The Delaware Statutory Trust (DST) - by Michael Packman

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It certainly has been a wild year so far and continues to be in about every way possible. As I glanced out the window during a Zoom conference I was hosting this week, a couple of the trees on my property looked like they might end up part of my house due to the crazy storm that hit the East Coast. Between the pandemic, the riots, and now even the weather, I think many people are looking forward to putting 2020 behind us! In addition, and maybe partially because of some of these issues, November looks like it might bring change in Washington. Many looking to take advantage of current tax laws are rushing to get their planning or transactions done before that potential shift. One long-standing part of the tax code that is again possibly on the chopping block is Section 1031. While like-kind exchanges have been around for almost 100 years for real estate transactions, there is again talk of its demise. This would be a detrimental occurrence for the economy as a whole, and hopefully, the lawmakers will realize that and keep it on. However, there are those rushing to sell properties they have been considering selling and want to complete their exchange before any changes.

There was pretty much of a standstill in the 1031 world during the worst of the pandemic and then while waiting to see if there were any changes to the July 15th deadline the IRS had set. Since then, we have seen a surge in both completed and in-process exchanges, especially in the securitized segment of the space. This area of the 1031 market that had been rapidly accelerating is the Delaware Statutory Exchange (DST) market. These are passive investments, unlike REITS or traditional partnerships, which allow multiple investors to legally complete their exchanges without the hassle of day-to-day management. I recently spoke with Steve Haskell, vice president of Kay Properties, which operates a 1031 DST exchange marketplace at www.kpi1031.com, who gave me an update on the market for DST's. According to Steve, Kay Properties did $234 million of equity placement for 2019 and is already at $225 million for the first six months of 2020, on pace for a major record year. Aging demographics have been consistently growing the market in recent years as tired, active real estate owners are looking for investments that can generate potential monthly distributions without the hassle of the management of the assets. While the majority of Kay's clients historically have been smaller landlords with $500,000 to $20 million portfolios, they have lately helped some larger multifamily, commercial and hotel owners place as much as $20 to $60 million into a diversified portfolio of DST's. Large investors are understanding the potential benefit of DSTs as an exit strategy that provides for them a passive portfolio of exchange properties in multiple geographic locations and multiple asset classes. Investors should also remember that just like all real estate investing, DST properties have potential risks as well such as no guarantees for distributions, no guarantees for appreciation and declining market values as well as that diversification does not guarantee against losses as well as does not guarantee profit.

In addition to moving from an active to passive role, some investors are looking to diversify their exposure away from the East and West coasts. Others have a large amount of their net worth tied up in one market and want to move away from the risks of adverse changes in local regulation. During my conversation with Steve, he mentioned that his investors, who are mostly coming out of one-to-four door residential, commercial or multifamily properties, are not seeing a slump in prices, and surprisingly getting multiple offers when they list their properties for sale. Buyers on the residential side are mostly individuals or smaller real estate investors. While those acquiring the commercial and multifamily properties tend to be mid-sized real estate companies and also include institutional investors.

Steve mentioned that they had seen the biggest demand for 1031 exchange DST offerings with self-storage or warehouse and distribution facilities that have long-term leases in place with large tenants like Amazon or Federal Express.

Another boon for DST's has been the stay at home orders. This has made it challenging to get inspections scheduled as well as getting tenants to allow showings. With a lot of the due diligence already done, these offerings have become more attractive as it frees up investors from having to travel to the properties. Being an active real estate investor myself, I can attest to the difficulties of finding properties and visiting them to do the due diligence. It is interesting to see how in every disrupting economic time, there are always certain areas and companies that continue to grow despite challenges. DST offerings obviously have their own set of limitations and risks associated, including those that come with any real estate investment. For certain investors, they may be a good fit, but you should always consult your legal and tax advisors before making any decisions.

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