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A Delaware Statutory Trust is an option to invest in alternative structures while still deferring gains - by Michael Packman

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A real estate investor, if fortunate comes to a point where they want to sell a property at a profit. Many investors know they may be able to utilize Internal Revenue Code Section 1031 and exchange their property for a replacement property, in turn deferring the capital gains. This has been one of the cornerstones of real estate investing because the deductions taken to make income tax deferred while owning a property also reduces the cost basis. As long as the rules are followed each time an investor sells and subsequently buys a property, the taxes can potentially be deferred indefinitely. At the time of death, the property owner's heirs will generally receive a stepped-up cost basis to the current market value of the property, regardless of how many exchanges the investor may have done in the past (depending on the total market value of the estate).

While most real estate investors know how to take advantage of a 1031 exchange in the traditional sense, there is an option to invest in an alternative structure and still defer the gains. This is called the Delaware Statutory Trust or (DST). A DST gives investors another avenue to take advantage of the tax code while still staying within the parameters of the 1031 requirements. Many investors are utilizing the DST Structure as evidenced by Mountain Dell Consulting, LLC's1 estimate of around $3.5 billion in new equity placed in 2020. This industry has had exponential growth over the past five years; back in 2016, there was only just over $1.4 billion in equity raised in syndicated exchanges.
If a property owner is tired of dealing with the hassles of property management, yet has a low-cost basis, the DST structure still allows for a way to take advantage of section 1031 and pass on the day-to-day management tasks to some of the country's top real estate management firms. Along with hands-on management by an experienced sponsor, the investor receives detailed quarterly reports on the performance of the asset. If there is any leverage used in one of these programs, the debt is all non-recourse to the investor. This may be of particular interest if the current property owned has a personal guarantee, as the investor can exchange the property for a DST and not be liable for the new debt of the DST. A DST can also be used for a partial exchange. For instance, if an investor is selling a $10 million property and replacing it with one valued at $8 million, the remaining $2 million may be invested in a DST and still defer the capital gains. We also see DST's used quite often as a back-up plan in case one or more of the properties an investor identified to complete their exchange falls through.

The underlying real estate in a DST may be any asset class including, multifamily, office, retail, self-storage or industrial properties. In recent years, given the state of the economy and the demographics, the most utilized asset class has been multifamily apartment buildings, followed by NNN, credit-tenant properties, self-storage and industrial. The real estate in a DST is typically of institutional quality with professional management by a qualified sponsor. As they are completely passive investments, when evaluating a DST, it is important for the investor to due diligence on both the real estate and the sponsor of the offering. In many cases, investors enlist a financial advisor or securities broker to assist with locating a DST that may be a fit and help perform the due diligence necessary prior to investing. While a DST is an option for many 1031 exchange investors, it is not for everyone and therefore the investor should consult professionals familiar with the DST structure prior to investing.

Whether you are an investor, residential or commercial broker, CPA or attorney, being educated on the DST structure can be very beneficial. If you are an investor and are tired of managing your property, want to remove liability from the debt on your property, or need a property to fall back on because the planned exchange might not close in time, the DST structure may be your answer to avoiding that big tax bill.

Michael Packman is a founder and principal of KNPRE, New York, N.Y.

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