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Three 1031 Exchange investment options - by Dwight Kay

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It’s both an exciting time and a very trying time when an investor sells a property and wants to defer taxes in a 1031 Exchange. A 1031 Exchange is when an investor sells a property that was held for business or investment use and then exchanges into another property of equal or greater value in an effort to defer taxes.

There are three basic choices that investors can make in 1031 Exchange investment opportunities.

Before reading on, make sure you visit the Kay Properties resource page and learn more about 1031 Exchange basics so you invest like a professional.

1031 Exchange Investment Opportunity Number 1:

An investor can purchase a property that they own and manage on their own. This is what most investors think about and at first blush, seems like the easiest choice. However, when an investor tries to find a property, do their due diligence, and then close on the property within the timeframe of a 1031 Exchange, it’s often not as easy as it looks. If the purchase can be accomplished in time, the investor then has the burden of property management with the dreaded tenants, toilets, and trash that go along with management. Often, when purchasing a property to manage, investors find they must put all their money into one property which, to the investor’s detriment, negates any form of diversification*. The investor may even have to go to a bank to borrow funds to complete the purchase. Adding financing to a property adds potential recourse against the investors other assets, potential cash flow sweeps, and the potential to lose the property to the lender in foreclosure.

1031 Exchange Investment Opportunity Number 2:

A second option is when the investor purchases a triple net leased NNN property where the commercial tenant is responsible for rent, taxes, insurance, and some or all of the maintenance on the property. NNN properties often are priced from $1.5 million to over $10 million so it may be hard to diversify and investors could end up being over concentrated in one asset class, with one tenant, and one location. During the COVID-19 crisis, many tenants asked for rent relief including even Starbucks, an investment-grade tenant. This means NNN owners might have to hire an attorney to negotiate with a massive company over terms and payments which would be tricky for most 1031 investors to say the least. There are also other management issues that many owners don’t think about such as making sure insurance is up to date, that any common area maintenance fees are prorated and collected, that the tenant is indeed paying property taxes in a timely manner and how to re-tenant the building if the property becomes vacant. If there is a loan on the property, the monthly mortgage payment has to be made by the owner even if there is no tenant paying rent. It can get burdensome and be incredibly more risky than 1031 exchangers are often led to believe.

1031 Exchange Investment Opportunity Number 3:

Another way to invest in a 1031 Exchange is into DST 1031 Properties. The DST Delaware Statutory Trust property is where the investors own a piece of the property instead of owning the whole property. By dividing up their investment funds into multiple properties, an investor can own properties in different geographic locations, with different asset classes and different tenants and even different property managers. With a DST, investors are usually investing in high-quality properties that they might not be able to afford on their own. These properties are professionally managed and so they are passive investments where the DST sponsor companies (the asset managers) are the ones responsible with the day-to-day issues involving real estate ownership. Tenants, toilets, and trash are no longer a concern for the investors. If the 1031 investor needs to replace debt in their 1031 Exchange, the loans in the DSTs are non-recourse to the investors which means that the investor doesn't have to sign personally for the loans. For those investors not wanting the risk of lender foreclosure and not needing debt replacement in their 1031 Exchange, due to the fact that they already paid off their mortgages and own their property free and clear, debt free DSTs are available with no long-term mortgages encumbering the assets. DSTs feature properties in most of the major asset classes including multi-family, medical office, NNN retail, industrial, and even self-storage.

Kay Properties and Investments is a national Delaware Statutory Trust (DST) investment firm. The www.kpi1031.com platform provides access to the marketplace of DSTs from over 25 different sponsor companies, custom DSTs only available to Kay clients, independent advice on DST sponsor companies, and real estate research and analysis on each DST (typically 20-40 DSTs). Kay Properties team members collectively have over 200 years of real estate experience and have participated in over 30 billion of DST 1031 investments. Past performance does not guarantee or indicate the likelihood of future results. Diversification does not guarantee profits or protect against losses. All real estate investments provide no guarantees for cash flow, distributions or appreciation as well as could result in a full loss of invested principal. Please read the entire Private Placement Memorandum (PPM) prior to making an investment. This case study may not be representative of the outcome of past or future offerings. Please speak with your attorney and CPA before considering an investment.

There are material risks associated with investing in real estate, Delaware Statutory Trust (DST) properties and real estate securities, including illiquidity, tenant vacancies, general market conditions and competition, lack of operating history, interest rate risks, the risk of new supply coming to market and softening rental rates, general risks of owning/operating commercial and multifamily properties, short-term leases associated with multifamily properties, financing risks, potential adverse tax consequences, general economic risks, development risks and long hold periods. All offerings discussed are Regulation D, Rule 506c offerings. There is a risk of loss of the entire investment principal. Past performance is not a guarantee of future results. Potential distributions, potential returns, and potential appreciation are not guaranteed. For an investor to qualify for any type of investment, there are both financial requirements and suitability requirements that must match specific objectives, goals, and risk tolerances. Securities offered through FNEX Capital, member FINRA, SIPC.

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