11 Reasons to Consider a Delaware Statutory Trust (DST) in a 1031 EXCHANGE

Courtesy of Herb Alston
& Canyon Pacific Financial Services

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HERB ALSTON

With unmatched skills, credentials, experience and personality, Herb Alston, MBA has been assisting and educating clients on long-term real estate strategies for over 15 years.

Through his association with Coldwell Banker® he has assisted clients in buying and selling residential and commercial investment property throughout the San Francisco Bay Area and the State of California.

During this time, Herb discovered a unique & growing niche of clients with similar objectives. Clients who wanted to:

A) Continue to invest in real estate

B) Avoid the headaches and hassles of property management ("tenants, toilets, and trash")

C) Retain the tax advantages and avoid capital gains tax.

For years, Herb has been utilizing this strategy to assist clients by fashioning strategies to help meet their investment objectives. Effectively allowing real estate investors to continue to own real estate and enjoy similar tax strategies of real estate ownership without the headaches of the "toilets, tenants and trash."

Herb Alston holds a Bachelors degree in Business Management & Human Resources from Golden Gate University in San Francisco and an MBA in Global Business from Saint Mary's College of California of Moraga, CA completed in 2018.

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01 AVOID FINANCING OBSTACLES

In a 1031 exchange transaction, the debt placed or assumed on the replacement property must be equal to or greater than the debt relieved in the relinquished property. For example, if a property is sold for $4 million with a $2 million loan, the investor not only needs to purchase $4 million (or greater) in their exchange they must also obtain an equal $2 million replacement loan in the purchase of the replacement property.

Property owners may run into a roadblock when they try to get financing on their replacement properties. For example, using the above example, a property owner may wish to sell an apartment building worth $4 million with $2 million in debt, or 50% loan-to-value (LTV). If that property owner cannot get approved for a $2 million loan on their replacement property, then most likely the owner will not sell.

Many like-kind replacement options are structured so that the replacement property is owned by a Delaware Statutory Trust, or DST. The DST is a pass-through entity that owns the real estate assets. When a replacement property is owned by a DST, the DST will be the borrower of any loan; and investors in that DST will not need to be individually qualified with a lender[1].

1. Purchasers of a DST must fulfill the requirement of being an Accredited Investor. Accredited investors are typically defined as having a $1 million net worth excluding primary residence or $200,000 income individually/$300,000 jointly of the last two years; or have an active Series 7, Series 82, or Series 65. Individuals holding a Series 66 do not fall under this definition) and accredited entities only. If you are unsure if you are an accredited investor and/or an accredited entity, please verify with your CPA and Attorney.

DSTS MAKE GREAT BACK UP PROPERTIES

Common strategies utilized to identify replacement properties is the **"3 Property Rule, and the 200% rule"** where an exchanger may identify up-to three properties, without regard to their fair market value, within the 45-day identification period or by identifying any number of properties as long as the cumulative fair market value (FMV) of the replacement properties is no greater than 200% of the combined FMV of all of the sold property or properties (including DST like-kind replacement options).

Identifying only one property may be dangerous because a property can fall out of escrow for a variety of reasons: financing, inspections, etc. To secure an opportunity to execute a successful 1031 exchange, the exchanger could do the following:

A) UTILIZING THE 3-PROPERTY RULE:

1) Identify the first property as defined by the investor/real estate agent/broker.

2) Then identify two additional properties owned by DSTs. It costs the exchanger *no extra money* to identify additional properties.

i)Taking this precaution ensures that the exchanger has adequate back-up choices.

Property #1: Property identified by investor/broker

Property #2: Property owned by DST

Property #3: Property owned by DST

Total amount of this option is the FMV of the sold property.

B) UTILIZING THE 200% RULE (APPLYING THE ABOVE $4 MILLION SALE EXAMPLE):

Exchanger may identify any number of properties up to 200% of the sold asset, no greater than $8 million in replacement property options.

1) $2.7 million property identified by investor/broker

2) $1 million property identified by investor/broker

3) $300,000 property owned by a DST

3) $1.6 million property owned by a DST

4) $1.4 million property owned by a DST

5) $700,000 property owned by a DST

6) $300,000 property owned by a DST

Above total: $8,000,000 identified like-kind replacement property options[2].

Utilizing the 200% rule helps the exchanger have a "back-up" plan if anything goes sideways in their exchange.

2. In the 200% rule option, the make-up of the purchase can be changed in any way to meet the criteria of totaling no greater than 200% of the combined FMV of all the exchanged properties.

AVOID TAXABLE GAINS ON BOOT

The exact dollar amount of the replacement property is a common challenge in 1031 transactions. In one example, the relinquished property sells for $2.0 million, and the exchanger identifies a replacement property for $1.65 million. The difference in the price of the relinquished property and the price of the replacement property results in a taxable amount on the remaining $350,000. Under the "3 Property Rule3," DSTs may provide an alternative solution:

Sale price of relinquished property:	**$2.0 million**
Replacement property #1:	**$1.65 million property identified by investor/broker**
Replacement property #2:	**$150,000 investment in property owned by DST**
Replacement property #3:	**$200,000 investment in property owned by DST**

NO PROPERTY MANAGEMENT HEADACHES

DST properties are professionally managed by a third party in a DST-structured 1031exchange. Professional managers handle the 3-Terrible-T's: Tenants, Toilets, & Trash. The investor is relieved of the headaches of property management, freeing up their time to enjoys other interests. DST programs offer additional benefits, including the direct deposit of potential distributions, if any, and annual reporting through substitute 1098/1099s.

05

DIVERSIFICATION BENEFITS

Investing in a DST can provide portfolio diversification. For instance, an investment could be made in a single DST that owns multiple properties in several states. It would be almost impossible for a broker to identify three replacement properties in three different states within the allotted 45-day time-frame. Therefore, DSTs are an alternative way to help achieve diversification.

06 DON'T GET SIDELINED

Many Realtors have clients that will not sell until they find the "right" property or achieve the ideal sales price. Having the option to invest in institutional-grade properties owned by professionally managed DSTs may help get investors off the sidelines, minimize negotiations, and help the Realtor obtain their commission.

07

SWAP TILL YOU DROP

The DST structure allows the investor to continue to exchange properties repeatedly until the investor's death. Upon the death of the investor, under current tax laws, the heirs would get a "step-up" in basis, thereby avoiding capital gains taxes on the original and subsequent properties.

ESTATE PLANNING TOOL

Everyone wants the best possible scenario for their heirs before they pass. Investing in a DST helps eliminate the opportunity for heirs to argue over what to do with an investment property when the owner passes away. The heirs continue to receive potential distributions from the investment, if any, and upon the sale of the property owned by the DST, each of the heirs can choose what to do with their inherited portion. For example, one heir can continue to exchange the investment, while another can sell and receive cash proceeds.

09 QUALITY PROPERTIES AND LEVERAGE OPTIONS

Canyon Pacific has access to a continuously changing platform of DST options across the United States, consisting of a wide variety of property types and leverage options. This range of opportunities enables investors to select institutional-grade private placements that best suits their needs.

10 LOW MINIMUMS

An investor can exchange as little as $100,000 of their exchange proceeds into DST. This can include the remaining assets leftover from a property exchange. Many DSTs also offer the option for investors to invest cash as well, often as low as $25,000 (separate from their 1031 Exchange).

TIMELY CLOSING

The team at Canyon Pacific are firm believers that the investor should put their exchange proceeds to work as soon as practical after their sale closes. We work with the investor during their escrow closing time-frame to select the DST options, prepare purchase paperwork and often are able to close within as little as 3 business days of the closing of the relinquished property. This way, the investor has put their exchange proceeds to work as soon as possible.

Disclosure:

Because investor situations and objectives vary this information is not intended to indicate that an investment is appropriate for or is being recommendation to any individual investor.

This is for informational purposes only, does not constitute as individual investment advice, and should not be relied upon as tax or legal advice. Please consult the appropriate professional regarding your individual circumstance.

Numerical examples are hypothetical and are for illustration purposes only. Individual results will vary and may not be guaranteed.

There are material risks associated with investing in DST properties and real estate securities including liquidity, 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 multi-family properties, financing risks, potential adverse tax consequences, general economic risks, development risks, long hold periods, and potential loss of the entire investment principal.

Potential cash flows/returns/appreciation are not guaranteed and could be lower than anticipated. Diversification does not guarantee a profit or protect against a loss in a declining market. It is a method used to help manage investment risk.

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Questions?

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to request a no-cost consultation.

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