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Today's solution for 1031 exchange replacement property is called a Delaware Statutory Trust

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Recently a client came to me who had just sold $1 million in investment property. He wanted me to help him find replacement property. His goal was to find a triple-net-lease property from a high credit-quality tenant which would pay him 8-10% on his new investment. I'm afraid his goals were not realistic - most property I've found in eastern Massachusetts with any sort of NNN lease provide a 6-7% cap rate. Some of these weren't even offered with high-credit quality tenants. However, I was able to provide him 7-8% in 1031-eligible replacement property which indeed conformed to his requirements of triple-net leases and high credit-quality tenants.

Financing problems have plagued commercial real estate since 2008. But problems for existing real estate owners have brought the best buying opportunities of our lifetimes. Institutional real estate owners have been forced to liquidate some of their real estate portfolio at bargain-basement prices in order to raise money to refinance expiring debt. More debt is coming due over the next two years that has to be paid off - creating more buying opportunities for cash-rich purchasers. A number of institutional real estate offerings are now available. They have long-term NNN leases and are large enough to attract institutional investors. Economies of scale enable a $20 million property to be a better value than a $2 million property. How can someone with only $1 million afford to invest in such high-quality real estate? The solution is called a Delaware Statutory Trust (DST).

Institutional-grade real estate offers the best prospects to investors, as it provides income as well as excellent capital gain potential. Investors can join forces to purchase Institutional-quality real estate today at bargain prices through a DST, which have been eligible for 1031 exchanges since 2004. In a 1031 exchange, the investor sells investment real estate but pays no immediate taxes on the sale. The basis and gain are 'exchanged' into a new property. DSTs are private placements and only eligible to accredited investors (those with a net-worth over $1 million not counting their principal residence according to a provision of the new 2010 financial reform bill).

Several property types are available as DSTs - although retail and multi-tenant (apartments) seem to be the best value today. Apartment buildings in growing areas which are located near major highways and shopping areas are among the safest investments today. These types of institutional multi-family properties pay investors about a 6% cash flow. Financing is readily available for multi-family offerings on the institutional level. Financing for other property types, however, is more difficult today. Thus retail DSTs pay from 7-8%, but most are cash deals and may not be appropriate for your 1031 exchange if your replaced property contained a lot of debt.

DSTs are a big improvement for investors than Tenant-In-Common vehicles, which have a huge load upfront as the sponsoring company can't make a profit on the back end due to 1031 regulations. DSTs, however, allow investors to "invest with the sponsor" - aligning the interests of the DST sponsor and their investors. DST sponsors indeed make money with the investors on the ultimate sale in 3-7 years (depending on the offering and market conditions). Since the real estate is being acquired at today's low rates - not only do they offer solid income, but investors enjoy excellent growth potential as well.

To see examples of how these investments can work for you, contact our firm for a consultation.

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