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## **Growing market for 1031 Delaware Statutory Trust Investments - by Justin Amos**

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Justin Amos  
NES Financial

As part of the “Tax Cuts and Jobs Act” enacted in late December 2017, the definition of eligible property for Section 1031 exchanges was changed dramatically. After many decades of allowing exchanges of personal (i.e., non-real) property, Section 1031 treatment is now restricted only to real property exchanges. This statutory amendment not only changed what qualifies for tax-deferred exchanges, but also appears to have had an impact on the entire landscape of the 1031 exchange industry going forward.

Provided that real estate retains its current value, the syndicated 1031 exchange properties market is poised to extend the growth its realized over the last four years. During that span, we have seen an increasing demand for 1031 solutions by individual investors looking to diversify, minimize risk and have their specific financial goal realized. Numerous sponsors have entered the market to try and meet that demand, but 1031 DST (Delaware Statutory Trust) investments has proven to be the industry’s most adaptable solution.

A DST is considered a separate legal entity formed as a trust under Delaware Law. Classified as a grantor trust, which is a disregarded entity under federal income tax law, any investor that purchases an interest in the trust will also acquire an undivided interest in the asset(s) held by the DST, if the DST is structured to comply with IRS guidance. As detailed in Revenue Ruling 2004-86, the DST cannot purchase additional assets, accept additional contributions of assets, renegotiate loan terms, enter in or renegotiate leases, make structural changes and sell or exchange property to reinvest proceeds. This allows for the investor to use the beneficial interest in a DST as replacement property to complete their 1031 exchange.

Fresh off another record year of DST investments amounting to total of \$2.52 billion in securitized 1031 sales, eclipsing the 2017 total of \$1.97 billion. Industry leaders Inland, Passco, and Exchange Right have revolutionized the market for DST Investments by building a large portfolio of properties to offer as a viable tax-deferral vehicle, paving the way for other real estate investment companies to begin offering DST options.

The private placement investment opportunities offered by these companies provides a solution for investors seeking replacement property to satisfy their exchange as well as investors seeking a quality, multiple owner real estate investment. As we have learned over the last decade, there are a confluence of factors that comes with fulfilling the qualifications of a 1031 exchange. Which is why it's important to do advanced planning and consulting with your professional advisors prior to exchanging, investing in, or structuring a DST.

#### Importance of Due Diligence with DST Investments

It's crucial for investors to assess all 1031 exchange offerings and do their due diligence to understand the risks associated with each investment. Lack of liquidity is one of the most common disadvantages of 1031 DST investments. An investor's equity will remain invested until the property is sold by the DST. With an expected investment period of five to ten years, DSTs are considered a long-term investment. In comparison, with a 1031 replacement property that is owned solely by the investor, the investor has complete control over the decision to sell the real property and is better positioned to take advantage of improvements in the market. Some companies have been experimenting with investor-friendly resale solutions where the investor can sell their interest to an accredited investor. Still, DSTs remain an illiquid investment and there is no public market where investors can sell their ownership interest.

Maintaining management control can be seen as a benefit or a drawback to DST investment. If the goal is to defer your taxes and earn a monthly check from a piece of institutional real estate, DST investments would be a beneficial solution. But if you prefer to dictate the day-to-day operations, you may want to look at other options.

There are many advantages to an investor using a DST investment to satisfy their 1031 exchange needs. Any loans borrowed to purchase the property are underwritten to the DST, meaning the lender has no recourse to the individual investor's other assets. The typical minimal investment of \$100,000 allows the investor the flexibility to diversify their exchange into several properties compared to purchasing directly. Additionally, the transfer of any beneficial interest in a DST is somewhat easier due to less paperwork required than buying a property directly. All of which ties back to the idea as to why the market for 1031 DST investment is so popular right now.

As the market continues to grow, it's more important than ever to establish best practices for investment administration to prevent fraud and abuse from occurring. Engaging NES Financial as the administrator of a DST provides the security, transparency and compliance expected by the investors. NES provides a full-service solution for all accounting and reporting requirements to make sure your DST remains in compliance with tax regulations and investors are able to realize the tax deferral benefits.

Justin Amos is the Head of Business Development for NES Financial's 1031 Exchange division, San Jose, CA.

NES Financial provides technology-enabled services for the efficient middle- and back-office administration of highly specialized financial transactions. Their technology-enabled solutions

include EB-5 and Opportunity Zone Fund administration, 1031 exchanges, and private equity fund administration services. Many of the world's largest financial institutions and corporations rely on their proprietary technology, unparalleled expertise, and outstanding services to ensure the secure, transparent, and compliant management of funds while also lowering operational costs, reducing risk, and improving ROI.

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