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“Delaware Statutory Trust” as replacement property in a 1031 Exchange - by Lynne Bagby

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New England business real estate investors in today’s market conditions may find it challenging to locate suitable replacement property for their 1031 exchange. One possible solution for certain investors, particularly “accredited investors” (high-net-worth individuals and certain entities, as defined in Regulation D of the Securities Act of 1933) is to acquire a fractional interest in a Delaware Statutory Trust (DST) as their 1031 exchange replacement property.

A DST is a type of trust formed under Delaware law. Provided that the DST’s governing documents conform to the requirements of Revenue Ruling 2004-86, a DST investor’s ownership interest in the DST is treated as a fractional interest in the property owned by the DST. Consequently, if the DST owns like-kind replacement property, an investor can acquire a fractional interest in the DST to complete a 1031 exchange.

An ownership interest in a DST, sometimes called a “beneficial interest” or “DST units” is an indirect way of owning investment real estate. This can be appealing to investors who are interested in acquiring a managed real estate investment. The trustee of the DST initially purchases the property and holds title to the property. A sponsor structures the investment and arranges for the issuance of beneficial interests in the DST. Although interests in the DST are treated as securities under federal securities laws, they are treated as ownership of real estate and thus like-kind pursuant to Section1031. The DST sponsor arranges the bank financing for the purchase of the property and coordinates the property management. In order to comply with applicable securities laws, the sponsor will provide a written document known as a Private Placement Memorandum (PPM) to the investor which discloses all aspect of the DST investment. The PPM provides information about the property, area demographics, tenants and leases, financial projections, risks of the investment along with additional information about the sponsor, and other disclosures.

WHEN TO CONSIDER A DST

• When an investor is interested in passive ownership of commercial property but, lacks the financial wherewithal to purchase the property on their own.

• When the investor wants a pre-packaged replacement property where the financing is in place and the sponsor has already performed due diligence.

• As a potential backup property on the list of identified properties in the event the primary identified property falls through, or the investor has not used all of the proceeds from the sale of the relinquished property and wishes to reinvest the remaining funds to achieve full tax deferral.

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