CELEBRATING 55 YEARS

A Delaware Statutory Trust guide - How do DSTs work? - by Dwight Kay

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Dwight Kay

Investors wanting to know how does a Delaware Statutory Trust work could benefit from a DST 1031 guide that clearly explains Delaware Statutory Trust properties for a 1031 exchange and provides valuable information on topics like:

• How Does a Delaware Statutory Trust work?

• What is the history surrounding the Delaware Statutory Trust?

• What are the important dates that impacted the Delaware Statutory Trust?

• What are some of the benefits of the Delaware Statutory Trust?

• What are some of the risks of the Delaware Statutory Trust?

• What are some examples of Delaware Statutory Trust properties?

This article is designed to be a Delaware Statutory Trust guide for 1031 exchange investors, and provide a detailed look at the history surrounding Delaware Statutory Trust properties and why DST 1031 exchange properties are growing in popularity among real estate investors.

What is a Delaware Statutory Trust?

A good place to start a Delaware Statutory Trust Guide is with a definition of what is a Delaware Statutory Trust.

A Delaware Statutory Trust*, often referred to as a DST, is an effective and judicially secure legal entity that allows investors to participate in potentially higher-grade real estate investments they otherwise might not be able to afford via a 1031 exchange.

A DST sponsor company acquires and maintains various types of real estate and packages them as securities used to hold title to investment real estate. In today's world, DST asset classes vary and qualify as a like-kind asset for 1031 exchanges.

History of the

Delaware Statutory Trust

To understand the importance of the Delaware Statutory Trust for 1031 exchanges, this DST guide will now take a look at how trusts in general work and how this fits into the history of the Delaware Statutory Trust. Trusts have been used as a legal instrument to manage and protect assets for centuries. The concept of a trust was originally developed by the Romans, however the modern-day trust was created in England around the 12th century as a mechanism to hold property in a fiduciary relationship for the benefit of another person or group of people. The trust structure was used to protect land and assets from creditors or for religious and charitable purposes. In addition, trusts became popular as a way to pass on wealth to the next generation with the trust's trustees managing the assets for the benefit of the beneficiaries. Eventually the concept of trusts was adopted in the United States where they became a popular way to protect and manage assets. The first written trust in the United States was created by the Massachusetts Bay Colony in 1644.

The state of Delaware influenced more than the name of a DST, it actually influenced its entire composition. The concept of a business trust had been around for centuries, but in modernizing common law, Delaware was the first state to legally recognize statutory trusts when it passed the Delaware Statutory Trust Act in 1988. Since, statutory trusts are separate from their trustee(s), they are recognized as their own legal entity. However, it took nearly 75 years for a DST to evolve into its most current concept. Below is a short timeline of significant events.

Here's the progression of events relevant to the history of DSTs and Delaware Statutory Trust laws**:

• In 1929 Delaware changed its laws concerning investments in corporations which were not previously included.

• 1931 saw the law changed again to permit investment in bonds in non-transport or public service corporations which were engaged in productive real estate, and which were secured by a first mortgage but free from any prior liens.

• The 1931 legislation inserted a net earnings requirement with respect to those corporations and added a 60% debt limit.

• In 1933, perpetual trusts were linked to limited powers of appointment.

• A 1935 amendment added the ability of trusts to invest in: mortgage bonds when there had not been any loan default in the previous five years; land only within the estate of Delaware; and removed the "free from prior liens" stipulation.

• 110-year trusts were introduced in 1986, as was the "prudent investor" rule.

• 1995 saw perpetual trusts of personal property introduced.

• Domestic Asset Protection Trusts (APT) were introduced in 1997.

• 2006 saw Non Charitable Purpose Trusts introduced. These may, as of 2008, be made perpetual.

• DSTs were approved for 1031 Exchanges in 2004.

Listen more about the history of the Delaware Statutory Trust in the podcast featuring Kay

Properties and Investments, executive vice president and managing director, Jason Salmon.

How Can a Delaware Statutory Trust

Benefit Investors?

As part of this Delaware Statutory Trust Guide, it is important to explain how savvy real estate investors use Delaware Statutory Trust properties in their short, mid, and long-term real estate planning. While the Delaware Statutory Trust has both pros and cons, by deferring capital gains taxes, DSTs potentially help investors build and maintain wealth through real estate investment opportunities, including:

• Avoid the Three Ts:

Delaware Statutory Trusts offer the opportunity for passive income streams, and therefore the opportunity to avoid active real estate positions and their (often unpleasant) demands, such as managing and maintaining tenants, toilets, and trash (i.e. Beneficiaries are exempt from landlord duties; allows passivity to investors; no management responsibility).

• Access to Long-Term NNN Properties:

Depending on the property, triple net leased (NNN) properties offer investors a long-term income stream potential without the responsibility of daily management. Delaware Statutory Trusts offer investors access to these types of properties at much lower minimum investments as well.

• Non-Recourse Debt vs. Recourse Debt:

An investor’s liability to the lender is potentially limited through a Delaware Statutory Trust because most DST debt is non-recourse; a loan that adds an extra layer of safety and only seeks the property itself rather than the investor’s other assets in the event of a default. DSTs have varied amounts of leverage.

• Diversification* Into Smaller Amounts:

With a DST, investors can potentially avoid concentrating risks on one DST property, and instead can distribute the risk to multiple assets. This means investors have access to institutional-grade real estate for smaller dollar amounts.

1031 Exchange with a

Delaware Statutory Trust

One of the most beneficial aspects of a Delaware Statutory Trust and an important part of this DST 1031 Exchange Guide is to understand how it fits into a 1031 exchange. In order to defer capital gains tax upon sale of a piece of investment real estate, investors may utilize a 1031 exchange, replacing the relinquished property with “like-kind” investment property. A Delaware Statutory Trust qualifies as a like-kind property for a 1031 Exchange according to IRS ruling 2004-86.

Dwight Kay is the CEO and founder of Kay Properties and Investments, LLC, New York, N.Y.

*Diversification does not guarantee returns and does not protect against loss.

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For a complete list of current 1031 eligible exchange DST properties, visit www.kpi1031.com receive your FREE DST 1031 Exchange toolkit.