

ALTERNATIVES

	DSTs	1031
Smaller transactions	✓	
Control		✓
Required hold period	7-10 years	none
Liquidity-Secondary Market	only with REIT structure	✓
Returns / Risk	varies	superior
Capital calls	✓	✓
Financing	✓	✓

	DSTs	1031
Management	✓	✓
High acquisition, management, disposition costs	✓	-
Quality of Properties	varies	A+
Future 1031 Exchange	✓	✓
Future 1031 Exchange REIT	no	-
Stepped up basis upon death	✓	✓

► **Providing your clients alternatives builds trust and helps you become main advisor.**

1031 EXCHANGE

A 1031 exchange is a type of real estate transaction allowed under the U.S. Internal Revenue Code (IRC) Section 1031. It allows an investor to sell one property and then reinvest the proceeds into another “like-kind” property without paying capital gains taxes on the sale.

FACTORS TO CONSIDER WHEN EVALUATING ALTERNATIVES

- Estate planning considerations
- Does property meet risk profile
- Does property address long term goals
- Cap rate
- After tax flow considerations
- Lease Terms
- Price compared to replacement cost
- Price PSF
- Property Location – Infill land available for competition to enter market
- Store sales volume
- Tenant’s position & strength within the market
- Demographics: Average Household Income 1,3,5 Mile
- Population Statistics: 1,3,5 Mile
- Detailed credit analysis of current tenants
- How is property positioned in market?
- Is it a good submarket?
- Parking ratio
- Tenants currently in the Market & Major Tenant Relocations in Progress
- New developments near the property
- Any inherent problems with the building
- Are rents at market?
- Will it be easy to find a replacement tenant?
- How long will it take to re-lease?
- What tenant improvement costs should we budget if tenant moves out?
- Population growth projections
- Projected rental rate growth over the next 5 years
- How is property managed
- Potential upside / appreciation

IT'S NOT JUST ABOUT RETURNS

WHAT TO BUY AND WHERE

- ▷ Risks
- ▷ Returns
- ▷ Long-term asset growth

Industrial / R+D



Big Box

Retail



Anchor / Drug Center

Apartments



Office / Medical



Class A



Industrial Park



Single Tenant



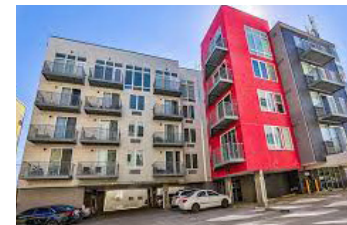
Low Rise



Incubator



Strip Center



Single Tenant



Food Processing



Medical

Delaware Statutory Trusts (DSTs) have gained popularity as a tax-efficient option for real estate investments, but advisors should understand the nuances of these structures to better advise their clients. In this article, we compare the alternatives of DSTs and 1031 Exchanges. There are advantages to both.

Issues with DSTs

When analyzing investment vehicles for clients, DSTs can initially appear attractive. However, a deeper dive reveals several drawbacks that might outweigh any potential benefits and could significantly impact a client's long-term financial objectives.

Lack of Control and Liquidity: Unlike direct real estate ownership, where investors have full control over management decisions and property strategy, DST investors lose control and typically have very little say in how the properties are managed. This lack of autonomy can be frustrating for clients who want the flexibility to make decisions or adjust to market changes. Furthermore, DSTs have no secondary market, meaning that investors are typically locked into their investments without the option to liquidate shares if needed.

Long-Term Commitment and Liability Risks: DSTs often lock investors into long-term commitments of 5 to 10 years, which can be problematic for clients needing liquidity or who are uncertain about market conditions over the long term. Additionally, clients may find themselves liable for unexpected capital calls if the DST sponsor encounters financial difficulties, potentially exposing them to unforeseen risks.

High Fees and Inferior Property Quality: DSTs are notorious for their high fees, which include acquisition, management, and disposition costs that can significantly erode returns. Moreover, the properties selected for DSTs are often not up to the standard of investments clients might make through direct ownership. Poor underwriting can lead to investments in properties with suboptimal returns, reducing overall profitability.

Overlooked Factors in DST Analysis: What Investors Miss

DSTs can often look too good to pass up due to the promise of passive income and tax benefits. However, many investors overlook critical

factors when analyzing DST opportunities, which can lead to unwanted surprises down the road. Here are the often-missed aspects that need more attention:

- **Estate Planning Considerations:** One of the most overlooked elements of DSTs is the impact they can have on an investor's estate planning. The unique structure of DST ownership can create tax liabilities and inheritance complications that may not be immediately apparent. It's important for investors to understand these risks, especially when planning for the future.
- **Property Metrics and Market Analysis:** As an advisor you know the importance of analyzing key metrics like cap rates, cash flow, lease terms lease-up assumptions, local market conditions and reversion cap rates. DST investors, however, often neglect these factors in favor of the perceived ease of passive income. Without evaluating critical aspects such as location, property dynamics, and market trends, investors can end up with subpar returns or underperforming properties.
- **Potential for Upside and Appreciation:** DSTs are typically positioned as stable, income-generating investments. However, by focusing only on the immediate tax advantages and cash flow, many investors overlook the potential for upside and property appreciation. It's important for investors to understand that there may be greater wealth-building opportunities by focusing on properties with long-term growth potential.
- **Risk Profile and Long-Term Goals:** Each investor has a unique risk profile and set of long-term objectives. When considering DSTs, many fail to assess how well these investments align with their financial goals. Understanding risk tolerance and future ambitions is crucial to ensuring a client's investments are on the right track.
- **Active Management vs. Passive Ownership:** DSTs promise a "hands-off" approach to real estate investment, but clients have the same benefit by hiring a qualified property or asset manager in a 1031 Exchange, still retain control and have the benefits of making key decisions. 1031 Exchanges allow clients to make strategic decisions and respond to market fluctuations, which can lead to better returns. While DSTs may seem like an attractive option for passive ownership, it's often more advantageous for clients to retain some level of involvement in their real estate portfolio.

Conclusion: Delaware Statutory Trust (DST) May Not Be in Your Clients' Best Interest

We have found that for clients with smaller exchange requirements or if clients have a couple of million dollars of equity remaining in an exchange, DSTs are a viable option. However, for larger requirements, investors generally prefer control and owning their own properties.

While the allure of DSTs as a passive investment option may seem appealing, it's essential to fully understand the limitations and risks these structures entail. By performing thorough due diligence and assessing the full scope of potential drawbacks, you can help your clients make more informed decisions that align with their long-term financial goals. Direct ownership of real estate generally provides more control, greater flexibility, and superior growth opportunities compared to DST investments.

In summary, it is better to fully understand the benefits and limitations of both DST's and 1031 Exchanges before making a decision.

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