SREI Group

1031 Exchange Experts

DELAWARE STATUTORY TRUST

THE ULTIMATE GUIDE TO DSTS

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Delaware Statutory Trust (DST), defined.

Delaware statutory trusts are private governing agreements under which property is held, managed, administered, invested, and/or operated for profit by one or more trustees for the benefit of the trustor entitled to the beneficial interest in the trust property.

A **Delaware statutory trust (DST)** is a legally recognized trust for business purposes. First developed in Delaware, it is now recognized within the applicable IRS tax code used throughout the United States.

It is a popular tax-deferral investment strategy for estate planning or investors who want to transition from active to passive ownership. DST investments are offered as replacement property for accredited investors seeking to defer their capital gains taxes through a 1031 tax-deferred exchange and as straight cash investments for those wishing to diversify their real estate holdings.

Subject to the manager's sole discretion on timing, DST investors are notified that the project is going "full cycle," whereby the property is sold. Generally, investors elect to take their respective share of the proceeds in cash, roll the money into a subsequent 1031 exchange DST or real property, or, in many cases, roll their proceeds into a UPREIT (IRC 721).

The DST property ownership structure allows the smaller investor to own a fractional interest in large, institutional-quality, and professionally managed commercial property along with other investors, not as limited partners, but as individual owners within a trust. Each owner receives their percentage share of the cash flow income, tax benefits, and any appreciation of the entire property. Some managers provide cost segregation analysis of their projects, which is used in measuring depreciation. DSTs give the investor the potential for annual appreciation and depreciation (tax shelter), and most have minimum investments as low as $100,000, allowing some investors the benefit of diversification into several properties.

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The DST ownership option offers the same benefits and risks that an investor would receive as a single large-scale investment property owner, but without the management responsibility. Each DST property asset is managed by professional investment real estate asset managers and property managers, collectively referred to as Sponsors.

It used to be that only large institutional investors such as life insurance companies, pension funds, real estate investment trusts (REITS), college endowments, and foundations were able to invest in these properties. Now, as a viable 1031 exchange replacement property option through a DST, individual investors can invest in a diversified selection of institutional-quality investment property types that they otherwise could not purchase individually. DST investments are located throughout the United States.

The purchase of a DST is restricted to an accredited investor, which is an individual or entity with the financial capacity and experience to invest in private securities. Individuals with a net worth of $1 million (excluding primary residence) or income of $200,000 individually, or $300,000 jointly. Entities are required to have a net worth of $5 million, with all equity owners qualifying as accredited investors. (Securities Exchange Commission, SEC)

What is the role of the "Sponsor"

Delaware Statutory Trust (DST) Sponsor is a real estate company or individual that organizes and manages a DST investment. They are responsible for finding properties, acquiring them, and structuring the trust, as well as managing the property and distributing income to investors.

Identifying and Acquiring Properties:

- DST sponsors use their own capital to find and purchase properties that will be held within the trust.

Structuring the Trust:

- They are responsible for forming the DST and creating the legal framework necessary for the investment.

Arranging Financing:

- They may be involved in securing debt financing for the property. Any debt involved is non-recourse to the investor.

Marketing the Offering:

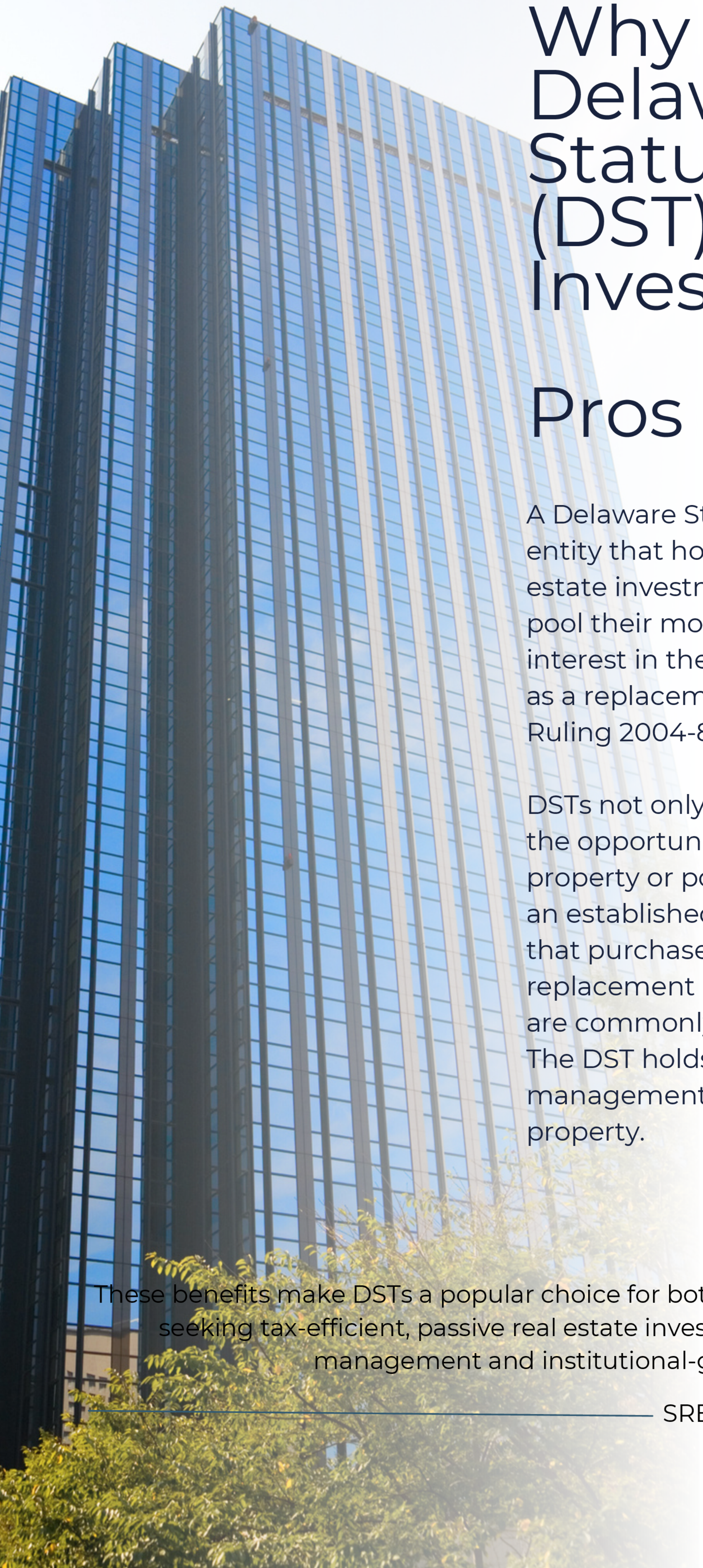
- DST sponsors will market the DST offering to broker-dealers to raise equity from investors.

Managing the Property:

- The sponsor is responsible for the day-to-day operations of the property, including leasing, maintenance, and property management. Their size generally affords favorable vendor pricing, which is extended to the investor.

Distributing Income:

- They are responsible for distributing income to investors based on their pro-rata share of the trust's assets.



Why consider a Delaware Statutory Trust (DST) Investment.

Pros and Cons

A Delaware Statutory Trust or DST is an entity that holds the title to a real estate investment. Investors in a DST pool their money to purchase an interest in the trust. DST trust qualifies as a replacement property per IRS Rev. Ruling 2004-86 (1031 Exchange).

DSTs not only provide investors with the opportunity to invest in a larger property or portfolio but also give them an established framework for having that purchase qualify as an eligible replacement property. That's why DSTs are commonly used in 1031 Exchanges. The DST holds the title and management responsibilities for the property.

These benefits make DSTs a popular choice for both seasoned and new investors seeking tax-efficient, passive real estate investments with professional management and institutional-grade assets.

Benefits of a DST

Advantages

- Fractional ownership allows investors to diversify their investments
- Opportunity to invest in institutional-quality assets
- Active professional management, no investor responsibilities
- Debt within the project is non-recourse to the investor
- Low minimum investment starting at $100,000
- Greater income potential from rental as well as appreciation
- 1031 Exchanges capital gains tax benefits
- Reduce risk of missing exchange time windows
- Trust acquires the property prior to fundraising
- All due diligence is complete and available
- Minimal paperwork and a quick closing
- Capital gains tax mitigation strategy bridge for estate planning.
- Easy to add as primary or backup 1031 Exchange option.

Disadvantages

- Lack of management control
- Lack of liquidity - no active seconday market

Property Types

There are approximately 50 DST Sponsors that have created one or more DSTs each. The list below represents their major DST property types. Due to the varying inventory levels at any given time, the list of Sponsors, and property types may expand or contract accordingly. DSTs are created for investment, operation, and ultimately will be closed out, sometimes without notice. Recognition of this ever-changing inventory should be considered during the 1031 Exchange process.

Multi-Family Apartment Communities

Property investment with two or more units, such as apartments, condos or duplexes that can be rented as to achieve income. Diversification is a result of targeted demographics and national location.

Office Buildings

Commercial property, designed to generate income and appreciation. Buildings range from small, single-tenant building to large, multi-tenant skyscrapers.

Industrial Properties

Acquiring or developing real estate used for industrial purposes, such as manufacturing, warehousing, and distribution. These properties are typically large, open spaces with features like loading docks, high ceilings, and ample storage capacity.

Retail

Purchasing a property that is used for businesses selling goods and services to consumers. This includes various types of retail spaces, such as shopping centers, strip malls, regional malls, and power centers. Investors can gain income through rent from tenants operating within the property and potential appreciation in property value.

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Hospitality

A hospitality investment involves placing capital in businesses within the travel and tourism sector, such as hotels, resorts, restaurants, and other lodging or entertainment facilities.

Student Housing

A student housing investment involves acquiring and managing properties near universities or colleges, targeting student renters. This type of real estate investment differs from traditional multifamily apartments, often utilizing a "by-the-bed" leasing model where multiple students share a unit, maximizing rental income per square foot.

Assisted Living

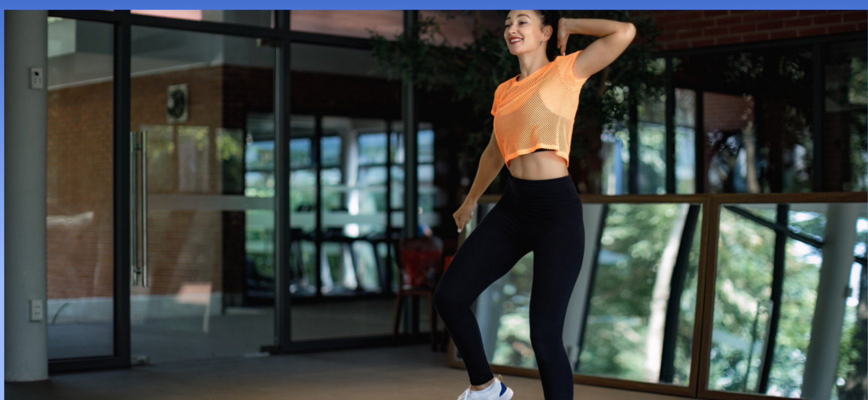
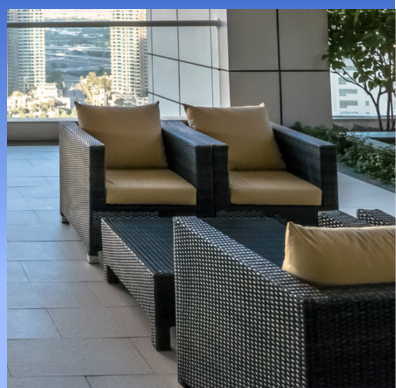
A real estate or business investment in facilities or services that provide supportive living arrangements for seniors who need assistance with daily activities but not necessarily the level of care provided in a nursing home.

Self-Storage Facilities

A self-storage investment involves acquiring and managing self-storage facilities, which are commercial properties renting out individual storage units to individuals and businesses.

Medical Office

A medical office building (MOB) investment refers to acquiring or investing in real estate that houses healthcare providers, like physicians, clinics, and other medical facilities, to generate income through rental leases.


Summary DST Benefits

1

Defer Taxes

DSTs qualify as like-kind properties under IRS Revenue Ruling 2004-86, allowing investors to defer capital gains taxes when selling investment real estate by reinvesting proceeds into a DST.

2

Institutional-Grade Investments

Own fractional interests in large, high-quality commercial properties such as medical buildings, multifamily apartments, shopping centers, and triple-net-leased (NNN) properties which would otherwise be inaccessible to smaller investors due to high purchase prices.

3

Passive Income

Investors receive income distributions without the headaches of property management, tenant issues, or lease negotiations. DST sponsors handle all operational responsibilities, making it an attractive option for those seeking passive income, such as retirees or those transitioning from active real estate management

4

Limited Liability and Non-Recourse Debt

Investors enjoy liability protection as DSTs are separate legal entities, and most financing is non-recourse, meaning investors are not personally liable beyond their investment in the DST. This limits exposure to lender claims on other assets

5

Minimum Investment & Maximum Diversification

DSTs often have minimum investments around $100,000, allowing investors to diversify across multiple properties and asset types rather than concentrating risk in a single property

6

Long-Term, Stable Income

Many DST properties have long-term leases (5-20 years) with creditworthy tenants, providing predictable and durable income that reduces risks related to tenant turnover and lease renewals

“Sleep Comfortably with DSTs”

All investments have some degree of risk, and advisory services should be sought to measure your acceptance of those personal investment risks before making any investments. However, DST passive investment characteristics should be considered.

Potential Upsides that Might Contribute to "Sleep Well at Night":

- Passive Income Potential: DSTs can provide a relatively stable stream of income from rental properties, potentially resulting in more predictable cash flow.
- Diversification: Investing in DSTs enables you to diversify your real estate holdings across various sponsors, property types, and geographic locations, thereby helping to mitigate risk.
- Professional Management: DSTs are professionally managed, meaning you don't have to deal with the day-to-day headaches of property management. The Sponsor size affords operational efficiency, including better vendor pricing, such as for lending and insurance. The larger Sponsors have access to the preferred properties.

However, it's crucial to be aware of the risks that could potentially cause sleepless nights:

- Lack of Control: You relinquish control over property management decisions when you invest in a DST, relying heavily on the sponsor's expertise.
- Illiquidity: DST investments are typically illiquid, meaning you might not be able to easily sell your interest if you need to access your funds.
- Market Risk: Real estate values are subject to market fluctuations, which can impact the value of your DST investment.
- Sponsor Risk: The success of your DST investment depends heavily on the sponsor's experience and competence.
- Fees: DSTs often come with various fees that can reduce your overall returns.

In conclusion, DST investments can offer potential passive income and tax benefits. Still, they also carry risks, such as a lack of control and illiquidity, that need to be carefully evaluated.

DST Exit Options

Buy and Hold

DST is a "buy and hold" investment as there is little to no secondary market. During the DST's life, the Sponsor does not offer a redemption program. The DST offering term is governed by both the offering document, which sets forth the establishment of the Administrator (Sponsor), who then defines when the offering is determined to have reached the end of its term, "Full Cycle."

- **1031 Exchange:**

  Investors can use their DST proceeds to acquire another DST or actual property, deferring capital gains taxes. This is a common option for those who want to continue investing in real estate and avoid immediate tax liability.

- **Cash Out:**

  Investors can receive their share of the sales proceeds and pay the applicable capital gains taxes on the profit. This option offers the flexibility to use the funds for other purposes, but it means the investor would need to pay taxes. If, during the hold period, a life event affects the investor, there may be estate planning considerations that impact tax obligations.

- **721 Exchange (UPREIT):**

  Some DSTs offer a 721 exchange option, where investors can exchange their DST interests for shares in a real estate investment trust (REIT). This allows for a more diversified investment and can offer additional tax benefits. Depending on the investor, there are select options for non-taxed cash distributions.

NOTE: Due to the complexities of the Federal and State tax code applicable to income and expenses, both short and long-term, the investor is strongly advised to consult with professional accounting, legal, investment advisors prior DST exit decisions.

DSTs to 721 UPREITs

Delaware Statutory Trust (DST) exiting to an Umbrella Partnership Real Estate Investment Trust (UPREIT).

A **DST to UPREIT (721) Exchange** involves an investor, individually or as an entity, first selling their property, then subsequently using a 1031 exchange to reinvest the proceeds into a Delaware Statutory Trust (DST).

Later, (generally on the second anniversary or beyond), the UPREIT acquires the DST investor's fractional interest. Avoiding a taxable event, the proceeds of the sale are received by the investor as Operating Partnership units (OP units) in the UPREIT. The two-step DST 721 allows for deferring capital gains taxes, estate planning, and potentially accessing UPREIT liquidity options. UPREITs offer a different income, expense, and diversification profile compared to DSTs.

The "two-step" DST 721 is an effective tax mitigation strategy for use with multi-investor entities, such as partnerships, LLCs, and tenants in common (TICs) etc. Once the entity has progressed into the UPREIT, the individual members, with their allocated OP units, are free to choose their investment options, including the option to liquidate.

- **1031 Exchange into a DST**
    - Sell the relinquished property: The investor (entity) sells their investment property to a third party.
    - Reinvest proceeds into an accelerated DST: The proceeds from the sale are used to purchase shares of a DST (specifically designed for a two-step application). DSTs are a pooling of investment capital into institutional-quality property, resulting in a "Sponsor" offering fractional interest in the trust's holdings and assets.
- **UPREIT Acquires the DST**
    - UPREIT acquisition: The UPREIT acquires the fractional interest of the DST.
    - Exchange for OP units: The DST investors receive OP units (proportional to their DST ownership).

DST to 721 UPREIT "2 Step" Key Benefits

Tax Deferral:

The two-step DST to UPREIT (721) process allows for deferring capital gains taxes and depreciation recapture.

Diversification:

Investors can further diversify their holdings by investing in a UPREIT, which is typically large and holds a diversified portfolio of multiple assets rather than a single property. UPREITs also have the benefit of repositioning debt within their portfolio, an option not afforded to an active DST.

Liquidity Options:

Depending on the UPREIT structure, investors may have access to liquidity options through the OP units or UPREIT shares.

Exit Strategy for Multi-Investor Entities:

It can be an effective tax mitigation option for entities with investors who have different exit criteria. Tax deferral into the UPREIT provides optionality for the entity's individual investors.

Important Considerations:

- **Since the investor's share is but a fractional interest in the UPREIT, it cannot be 1031 exchanged into subsequent "like-kind" properties.**
- **Not all DSTs are alike in their anticipated holding period. Some Sponsors design a select DST product to meet the IRS Code minimum hold period, affording capital gains tax mitigation and positioning the DST assets into the UPREIT.**
- **There is no guarantee that the UPREIT will eventually acquire the DST.**
- **The sale of the investor's interest may be a taxable event; therefore, consultation with appropriate legal and accounting professionals is recommended.**

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