

# Delaware Statutory Trusts (DSTs) in Real Estate Investing

An Overview by Reeder CPA Group



## What is a Delaware Statutory Trust (DST)?

A Delaware Statutory Trust (DST) is a unique legal entity formed under Delaware trust law. It allows multiple investors to hold fractional ownership in investment-grade real estate assets. These trusts are often used to hold large commercial properties, such as apartment buildings, office complexes, and shopping centers.

## Advantages of DST Investments

### Portfolio Diversification

DSTs enable investors to diversify their real estate portfolios by acquiring interests in a variety of property types across different geographic locations.

### Lower Investment Minimums

Compared to direct property ownership, DSTs often have lower investment thresholds, making them accessible to a wider range of investors.

### Passive Income Streams

Investors can potentially receive regular income distributions from the trust's operations, although these are subject to the performance of the underlying real estate.

### Strategic Use of Leverage

Leverage in DSTs can reduce taxable income and provide liquidity through refinanced cash distributions, enhancing financial flexibility.

## DSTs in the Context of 1031 Exchanges

One of the most significant advantages of DSTs is their eligibility as replacement properties in 1031 exchanges. This allows investors to defer capital gains taxes by reinvesting the proceeds from the sale of investment properties into DSTs.

## Clarifying DSTs: Delaware Statutory Trusts vs. Deferred Sales Trusts

Understanding the distinction between Delaware Statutory Trusts (DSTs) and Deferred Sales Trusts (DSTs) is essential in real estate and broader asset investment planning. Although both share the DST acronym, they serve different purposes: Delaware Statutory Trusts facilitate collective real estate investments, allowing investors to own fractional interests in property and are favored in 1031 exchanges for deferring capital gains taxes. Deferred Sales Trusts, conversely, offer a broader tax deferral mechanism for selling various assets in exchange for a promissory note, not limited to real estate. This differentiation is crucial for investors strategizing for tax efficiency and portfolio diversification.

## Mechanics of DST Investments

### Structure and Operation:

- ▶ A DST is established by a sponsor who acquires and manages the real estate assets. Investors purchase beneficial interests in the trust, becoming trust beneficiaries.
- ▶ The trust itself holds title to the real estate assets, and the sponsor is responsible for all management and operational decisions.

### Investment Process

- ▶ **Due Diligence:** Investors should conduct thorough due diligence, often facilitated by financial advisors, to understand the properties held by the DST and the track record of the sponsor.
- ▶ **Acquisition of Interest:** Investors buy into the DST by purchasing a beneficial interest, which represents a fractional share of the trust and its assets.
- ▶ **Income and Distributions:** Income generated from the trust's properties, after expenses, is distributed to investors. These distributions are typically made monthly or quarterly.

## Considerations and Risks in Delaware Statutory Trusts

- ▶ **Management Dependence:** The success of a DST investment heavily relies on the sponsor's property management skills and reliability. Investors must carefully select a sponsor with a proven track record and a commitment to transparency, as their decisions directly influence the investment's outcomes.
- ▶ **Illiquidity:** DST investments typically lock in capital for 5 to 10 years, offering limited liquidity. This characteristic requires investors to have a long-term investment horizon and to evaluate their liquidity needs carefully before committing funds to a DST.
- ▶ **Market Risks:** As with any real estate investment, DSTs face market risks that can impact property values and rental income, such as economic shifts or changes in real estate demand. Diversification within real estate investments can help mitigate these risks, but investors should remain aware of the market's volatility.
- ▶ **Lack of Control:** Investing in a DST means entrusting decision-making to the sponsor, significantly reducing investors' control over the property and its management. This passive investment approach demands thorough due diligence on the sponsor to ensure their strategies align with investors' goals.

## Contact Reeder CPA Group

Explore the potential of Delaware Statutory Trusts in enhancing your real estate portfolio with the expert guidance of Reeder CPA Group. Contact us to discuss how DST investments can align with your financial goals and strategies.

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