

REISA DST Webinar Q & A

April 30, 2009

Following are answers to the questions that were submitted during the DST Webinar. Answers are provided by the presenters, Patricia DelRosso and Arnie Harrison.

Please define the term: “bankruptcy remote.”

The DST is bankruptcy remote. That is, it contains provisions which prevent the bankruptcy creditors of the beneficiaries (investors) from reaching the DST's property and gives the lender greater security that the DST cannot itself file for bankruptcy so that the lender can foreclose on its first mortgage of the real estate should the need arise.

Can an investor in a DST reinvest after sale and defer under Section 1031?

Yes. Before the closing, investors who wish to complete a subsequent exchange will notify the sponsor to disburse funds to their account with their Qualified Intermediary. A subsequent exchange can then be accomplished by the investor.

Does springing into an LLC affect the original 1031 transaction?

Once the 1031 exchange is completed, it is done. The subsequent springing should have no effect on the previous exchange.

Why would the springing not affect a later 1031?

It should be pointed out that we do not know of any DST that has sprung into an LLC. If one did, and the property were sold during the time it was in the LLC, that would create a taxable event for the investor. However, it is possible that if the LLC converts back to a DST before the sale of the property that the investor would be able to do a subsequent exchange.

Why doesn't the 35 member limit apply to DSTs? This appears to be a 2002-22 problem, which should not depend on the form of organization.

The IRS staff member who was the primary author of the Revenue Ruling 2004-86 which deals with the DST, was a panelist at the TICA conference right after the ruling came out. He made it quite clear that 2002-22 deals with TICs and only TICs and 2004-86 deals with DSTs. He unequivocally stated that the “35 investor rule” does not apply to DSTs.

You didn't cover the Fannie/Freddie point, are those loans being done?

They are. Fannie and Freddie are both lending on apartment complexes in the DST format.

What are sponsors using to replace the backend participation on the DST?

There should be no backend participation on either TICs or DSTs. Some sponsors may charge a sales commission for their efforts in marketing the

property for sale; however, that is often paid to, or split with, a 3rd party real estate sales broker.

How are lease renewal options and loan extension options viewed as it relates to the seven deadly sins? Pre negotiated lease options held by the tenant with fixed terms and loans with an interest rate that resets at a certain period at a specified or formula rate are not considered violations of the “seven deadly sins.”

Do the investors have any estate planning and/or tax issues because they do not have legal title? No. It is easier to transfer the interest in a DST in the event of the death of the owner than it is in a TIC, and the DST is a disregarded entity in terms of tax issues. The tax benefits flow through to the holder of the beneficial interest (the investor).

If I can't sell a DST property after a 10 year hold due to a down market, is the only choice to spring into an LLC? If, after the 10 years, you need to renegotiate the lease or refinance the debt, the answer would be yes. The answer would be no, however, if you had a 20 year lease and no debt.

How do DST beneficiaries remove the Trustee? This depends on the terms in the Trust Agreement and perhaps the Loan Agreement.

Are loan costs; i.e., fees to initiate the loan allowed to be on the books of a DST or must they stay with the sponsor? Most reputable sponsors would have all income and expense items for each property “on the books of” that particular property.

Did Arnie say Trustee can add additional debt, but not a mortgage? The prohibition is against new or modified mortgage debt. Unsecured loans are not prohibited per se.

Does the Trustee have to be a Delaware state chartered trust company or bank authorized to do business in DE? I have heard that DE counsel will not provide an opinion otherwise. Typically, the signatory trustee of the DST is an LLC, or similar entity, which is registered to do business in Delaware. In the DST structure there is no need for an opinion from the state of Delaware, or any other state, in order to close the investor's transaction.

Do you think the Trustee will call for a vote of beneficiaries for possible sale of real estate or does this violate any trust structure? The sponsor will call for a vote if the trust agreement so provides; also the sponsor can do a straw poll, to understand the desire of the investors, but the straw poll is non-binding on the sponsor.

Under the master tenant structure if rents are below projections does the master tenant make up the shortfall (as in master lease) or do they just distribute actual collections? The master tenant is required to pay the rent in the Master Lease regardless of the property operations.

Can you place “qualified money” in a DST? Yes, but for ERISA reasons such money should be less than 25%.

What do you think about the beneficiaries waiving the discretionary trustee’s fiduciary duties under the Delaware law so that the discretionary trustee (the sponsor) can pledge its trustee interest to the lender which will allow the lender to become the substitute discretionary trustee in the event of default? This is a terrible idea and one which very likely would be prohibited by the bank.

Why are DSTs limited to 499 investors? If an entity has 500 or more investors, it will have public company filing requirements which are very expensive and complex.