DST Investments in Land: Not Your Traditional 1031 Exchange

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March 27, 2023

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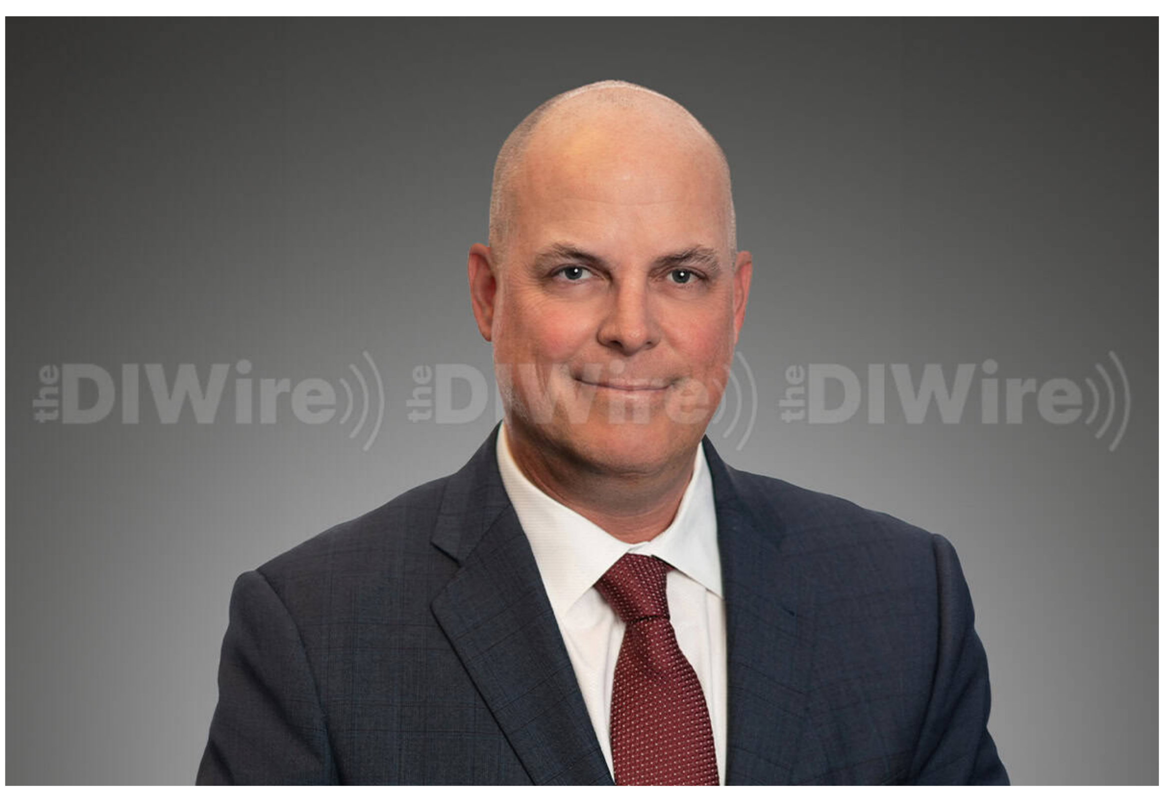

Subtitle: By: Todd Woodhead, Senior Vice President, Capital Markets at Walton Global

Savvy real estate investors are looking for ways to defer their capital gains taxes. One alternative, increasing in popularity, is Delaware statutory trust investing or 1031 exchanges that offer a passive investment strategy. The most common DST investment strategy is to transfer proceeds from a sale of a property and invest in existing commercial buildings or multifamily units to defer capital gains. Investing in land that will be used by home builders to develop residential communities is another 1031 exchange strategy that can produce positive returns.

Demand for homes in the United States is projected to remain high for many years to come and there is a great need for single-family housing units. Many economists suggest that the U.S. is amid a housing crisis mainly due to the current shortfall of homes across the nation. Projections can range from 4 million to 6 million homes needed, which will take more than a decade to fulfill. Since land is a crucial component to build homes, a DST offering using land as the investment can be an attractive option for accredited investors.

About DST Investments

A DST, or Delaware statutory trust, is a legal entity that, if structured properly, allows investors to own undivided fractional ownership interests, treated as direct ownership, in professionally managed institutional grade real estate offerings around the U.S. DSTs are available to accredited investors who are looking for a replacement investment to defer their tax liability. The interests are sold as securities, so investors must work with a registered broker-dealer or registered investment adviser.

Traditionally, DSTs are tenant occupied facilities such as Class A multifamily apartments, medical buildings, hospitals, distribution centers, manufactured home communities, senior and student living, distribution facilities, storage portfolios and industrial buildings. With a DST investment in land, taxes can be deferred to a vehicle that allows investors to be hands-off and be part of a housing solution for the nation.

Over the last several years, there has been an increasing appetite for 1031 exchanges. In 2017 to 2022 alone, the 1031 exchange market has grown by a total of 336%, an average of 41% per year. A big driver of this demand is baby boomers who are downsizing and selling rental properties or businesses to simplify their lives and build generational wealth. Other generations are taking advantage of increased home values and selling if is the right time to downsize, consolidate their holdings or defer taxes from inheritances.

Land as a DST Investment

Land targeted for future home development in a master plan community is typically a large parcel ranging anywhere from 80 to 3,000 or more acres of unentitled land. Unentitled land means that the necessary approvals to begin development and the infrastructure required to build homes for a community don't exist, including sewage, public utilities and zoning. To prepare unentitled land for development, an entitlement process is required that takes time, working closely with municipalities and other local stakeholders, and is typically conducted by the home builder including all fees and costs. The impact on land pricing transitioning from unentitled land to entitled land can be significant, land values have the potential to increase by double or more than the original acquisition price.

In a land-based DST investment structure, investors can expect traditional appreciation based on market conditions, and the potential increase in value to the land upon entitlement completion by the builder. Once a builder signs a purchase agreement for a land parcel they expect to buy, they begin the entitlement process and eventually purchase the land from the DST to build homes. The investment in the land made by the home builder during the purchase agreement process is passed on to DST investors at the time of the land sale. For the DST investor, they have invested in a DST that owns property in the path of future development. The DST does not modify, either legally or physically, the property it owns. Instead, the DST's investors have acquired an interest in real estate for the purpose of realizing on its future value.

Growth DST and Land

A DST land offering is focused on growth versus traditional DSTs that place an emphasis on income. Growth DSTs typically do not generate cash flow, but rather focus on the exit of the investment and the total return to the investor.

Overall returns from DST structures involving land have the potential to be higher than traditional DSTs that primarily focus on income producing properties, such as tenant occupied developments that generate monthly or quarterly income of 3% to 5%. While both strategies have their own merits and risks, the return potential of a land-based DST can help investors diversify their DST portfolio with a focus on total returns.

All Land is Not Created Equal

Experience in land management is the key to success of a land-based DST. Identifying the right type of land that will be targeted by builders & developers, as well as having established relationships with a wide variety of them, is essential when it is time to market the land for a potential sale. The knowledge required to evaluate other factors before acquiring land such as population growth patterns, economic development, location and proximity to infrastructure all play an important role to make a DST investment in land profitable.

DST investments are projected to remain a popular choice over the coming years. Accredited investors who are looking to diversify their portfolio, defer their capital gains taxes and preserve their capital through a hard asset by using a growth strategy can consider land as solution for their 1031 exchange needs, while also helping increase the housing inventory in the U.S., allowing other Americans to obtain their dream of home ownership.

Walton Global DST Offering

Walton is launching an all-equity DST Growth offering targeting land for real estate developers. The offering aims to offer portfolio diversification, capital gains deferment, potential preservation of capital through a hard asset within a 3-5 projected exit strategy. For more information, contact Todd Woodhead at twoodhead@walton.com or 480-586-9258.

Todd Woodhead, senior vice president of capital markets at Walton Global, is responsible for sourcing new debt & equity capital for Walton and its investment vehicles, maintaining and growing client and partner relationships, and assisting in the execution of investment strategies.

Prior to joining Walton in 2007, Woodhead was a regional sales manager for a Fortune 500 high-tech firm in California, where he managed both the financial and high-tech markets.

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