

DSTs: An Option for Replacing Debt in a Section 1031 Exchange

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To complete a successful Section 1031 Exchange, investors must comply with various requirements as mandated by the IRS. It is fairly well known that exchange investors must replace the equity proceeds from the sale of a property with a “like-kind” replacement property (or properties) of equal or greater value. However, to qualify for full tax deferral on capital gains from a sale, investors ***must also replace the value of any debt*** they have on their relinquished property.

In replacing the value of the debt, 1031 exchange investors have a number of options, including[1]:

- - Taking out a new loan from a traditional lender
- - Contributing other available cash
- - Utilizing seller financing (where the seller of the replacement property finances the purchase using a carryback note)
- - Obtaining a private money loan

Investors may use any combination of the options above to fulfill the debt replacement rule for a 1031 exchange. Even with these alternatives, however, replacing debt in an exchange can be difficult, particularly given today’s high interest rate environment. Investors may be unable to obtain a loan, or only able to secure a loan that puts them “negatively leveraged” in their investment – both undesirable options for real estate investors.[2] Fortunately, one additional option that is gaining popularity with 1031 exchange investors is the use of a Delaware Statutory Trust (“DST”) to help replace debt.

DSTs qualify as Section 1031 exchange “like-kind” replacement properties, providing investors with opportunities to own fractional interests in investment grade properties that are professionally managed.[3] When purchasing an interest in a DST, investors not only acquire an interest in the property, but also acquire an interest in any debt held by the Trust. Importantly, as beneficial owners of a DST, investors do not have to qualify for or bear any responsibility for the Trust’s loan. Rather, exchange investors gain several valuable advantages from the financing that a DST already has in place.[4]

A leveraged DST can provide a simple and convenient way for exchange investors to satisfy Section 1031 equity and debt replacement requirements. Following the sale of a relinquished property, investors face the challenge of identifying a replacement property (or properties) within the mandatory 180-day exchange period, oftentimes while simultaneously working to secure a new loan or find additional cash. Since property held in the Trust is already owned and financing is already secured, investing in a DST as a replacement property can eliminate much of the hassle of the 1031 exchange process. Moreover, a DST with leverage increases the nominal values of investments, and investors are able to take tax write-offs each year for their portion of the Trust’s loan interest payments.[3] Perhaps most importantly, DSTs also allow exchange investors to invest down to the penny on their replacement value, ensuring that 100% of their exchange funds are invested and taxes are fully deferred.[5]

Through its partner, DST Farmland, Peoples Company Capital Markets helps facilitate Section 1031 Exchanges via the DST investment vehicle. DST Farmland has formally launched as a sponsor of Delaware Statutory Trust (DST) investment vehicles, focused on first-of-its-kind offerings in the farmland asset class. The application of the DST vehicle to farmland investing is exciting, as it allows investors to take direct ownership in an asset class historically requiring capital at a scale that is out of reach for many investors. Visit [DSTFarmland.com](https://www.dstfarmland.com) for more information on the DST investment vehicle and current offerings.

[1] “Replacing Debt in a 1031 Exchange.” *IPX1031*, 27 Apr. 2022.

[2] Gersten, Ehud. “Council Post: Delaware Statutory Trusts: An Option for Replacing Debt.” *Forbes*, 18 May 2023.

[3] Getty, Paul. “How a DST Can Help You Replace Debt on Your 1031 Exchange.” *FGG1031.com*, 9 Dec. 2021.

[4] Roussel, Thomas P. “Fulfilling 1031 Exchange Debt Requirements with DSTs.” *1031 Crowdfunding*, 30 Dec. 2022.

[5] Kay, Dwight. “How Do I Use a DST for Replacing the Debt in a 1031 Exchange.” *Kay Properties Investments*, 19 Nov. 2021.