The 411 on 1031 Exchanges and DSTs

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FINANCIAL EXPERTS NETWORK

Passive Real Estate Investing

Introduction to 1031 Exchanges into a Delaware Statutory Trust (“DST”)

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Goodbye to the 5 Ts:

Welcome to the World of Passive Real Estate Investing

You Can Go From Owning This:

(Hypothetical example)

To Owning This:

(Hypothetical example)

Capital Gains Tax

IN CALIFORNIA

30-40%

CAPITAL GAINS TAX

Long Term Capital Gain Tax Rates for Most Accredited Investors[1]

TAX ELEMENT	RATE
FEDERAL[2]	15-20%
STATE	0-13.3%
DEPRECIATION RECAPTURE	25% OF DEPRECIATION CLAIMED
MEDICARE SURTAX	3.80%

1. Some of these rates are based upon tax bracket and/or income.
2. Taxpayers in the 10% and 15% tax brackets pay no Federal Capital Gains tax.

This table is roughly accurate, but not a full representation of the tax code.
To understand your specific situation, please consult with your tax advisor.

Gains and Proceeds Living in California

PURCHASE PRICE	$100,000
IMPROVEMENTS	$50,000
BASIS	**$150,000**
SALES PRICE	$1,000,000
COSTS OF SALE	$70,000
LOAN PAYOFF	$500,000
PROCEEDS	**$430,000**
SALES PRICE	$1,000,000
COSTS OF SALE	$70,000
BASIS	$150,000
GAIN	**$780,000**
CAPITAL GAINS TAX DUE WITH NO 1031 EXCHANGE (40%)	$312,000
CASH REMAINING AFTER TAXES	$118,000

Hypothetical example for illustration purposes only.

Building Wealth
Sequential Exchanges

EQUITY BUILD OVER 20 YEARS
WITH AND WITHOUT 1031 EXCHANGES

SELL OLD AND BUY NEW INVESTMENT PROPERTY EVERY 5 YEARS	PERFORM 1031 EXCHANGES	DO NOT PERFORM 1031 EXCHANGES
YEAR 1 CASH INVESTMENT (PROCEEDS FROM SALE HOME)	$1,400,000	$1,002,500
YEAR 5 PROCEEDS AFTER SALE	$1,683,699	$1,144,689
YEAR 10 PROCEEDS AFTER SALE	$2,024,815	$1,307,046
YEAR 15 PROCEEDS AFTER SALE	$2,435,085	$1,492,430
YEAR 20 PROCEEDS AFTER SALE	$2,928,484	$1,704,108

ASSUMPTIONS:

- START WITH EQUITY FROM RENTAL HOUSE SALE
- 50% LOAN TO VALUE ON EACH PURCHASE
- APPRECIATION RATE 3%
- COSTS OF SALES 5%
- TAX RATE 30%
- REINVEST ALL PROCEEDS FROM PROPERTY SALES
- BUY TWICE AS MUCH PROPERTY AS PROCEEDS AFTER EACH SALES

Hypothetical example for illustration purposes only.

Avoiding Capital Gains Taxes is Critical to Greater Wealth Generation

Capital gains taxes paid are:

- Funds no longer available to generate future earnings
- Funds no longer available to acquire higher value properties

There are 2 ways to avoid capital gains:

- Buy and hold
- 1031 exchange

Buy & Hold

- Typically, highly appreciated property generates only 1% to 2% cash flow on equity
- Trapped equity – the appreciation accrued over time is not earning additional income for you
- Rent increases have not kept pace with the rate of appreciation

What is Your Cash Flow?

$$\text{Cash Flow} = \frac{\text{Annual Income} - \text{Annual Expenses}}{\text{Market Value of Property} - \text{Loans}}$$

- Historically, DST's have had starting annual cash flows of 4.0% to 5.0% on the cash you invest.[1]

[1] Projected cash flows are best estimated as underwritten by the sponsors upon acquisition of the properties. There can be no assurance that monthly cash flows will be as forecasted, reduced or eliminated.

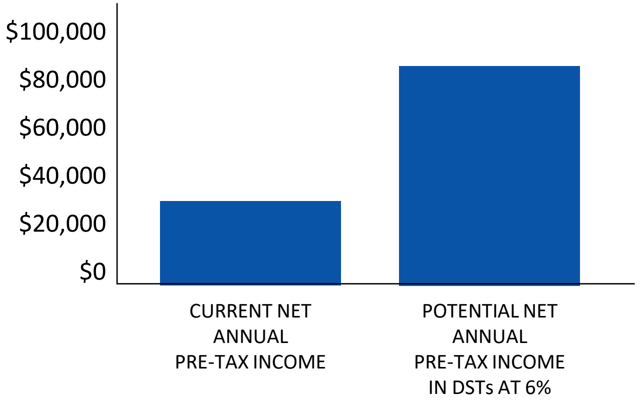
PRE-TAX CASH FLOW ANALYSIS CURRENT RESIDENTIAL PROPERTY VS. DSTs

$32,782 CURRENT NET ANNUAL PRE-TAX INCOME

$78,000 POTENTIAL NET ANNUAL PRE-TAX INCOME IN DSTS AT 6%

238% POTENTIAL IMPROVEMENT IN ANNUAL PRE-TAX INCOME

POTENTIAL PRE-TAX INCOME IMPROVEMENT



PRE-TAX CASH FLOW ANALYSIS CURRENT RESIDENTIAL PROPERTY VS DSTs

SOURCE DATA ANNUAL -ESTIMATES	BEFORE TAX
RENTAL INCOME	$100,000
HOA	$0
INSURANCE	$2,500
GARDENING	$1,800
LEGAL AND PROFESSIONAL FEES	$500
MAINTENANCE AND REPAURS	$8,000
MORTGAGE PAYMENTS	$28,368
PROPERT TAXES	$15,350
UTILITIES	$8,700
MISCELLANEOUS EXPENSES	$2,000
DEPRECIATION ALLOWANCE ESTIMATE	$15,333
ESTIMATED SALES PRICE	$1,800,000
MORTGAGE AMOUNT	$500,000
EQUITY	$1,300,000
CURRENT ANNUAL INCOME RATE	2.52%
POTENTIAL ANNUAL INCOME RATE	6.00%
CURRENT NET ANNUAL INCOME BEFORE TAX	$32,782
POTENTIAL NET ANNUAL INCOME BEFORE TAX	$78,000
POTENTIAL IMPROVEMENT IN GROSS INCOME	238%
ORIGINAL TRANSFER PRICE VIA ASSESSOR	$1,150,000
ORIGINAL TRANSFER DATE VIA ASSESSOR	09/16/09
DEDUCTION FOR DEPRECIATION ENDS	09/15/39
AMOUNT OF IMPROVEMENT VALUE VIA ASSESSOR	$460,000
ANNUAL DEPRECIATION ALLOWANCE FOR 30 YEARS	$15,333

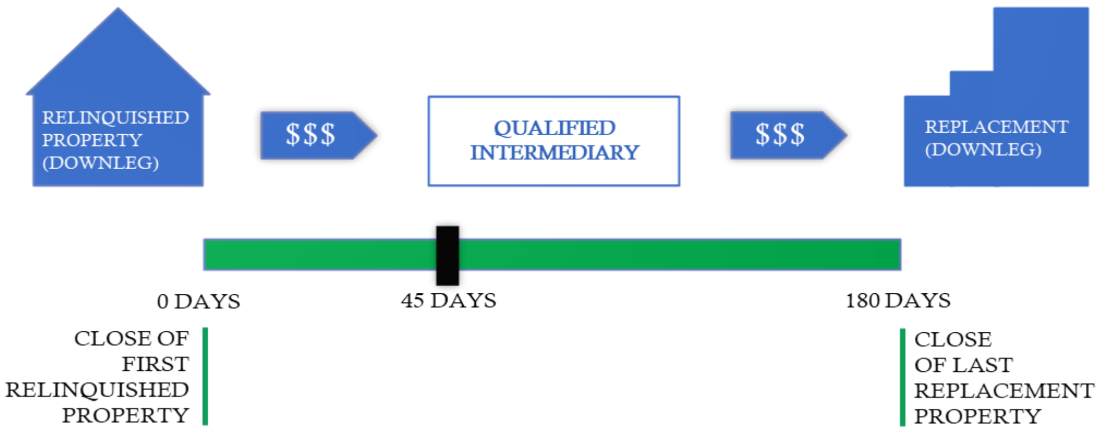
Your potential annual returns may be higher or lower than the 6.0% presented in the analysis. Returns may also fluctuate over time, as is true for all real estate investments. The calculations shown do not include any potential property appreciation. Returns are not guaranteed as in any form of real estate investing. All investments, including real estate, involve risk. Archer Investors is a branch of LightPath Capital, Inc. Securities offered through LightPath Capital, Inc. Member FINRA/SIPC. This is neither an offer to sell nor a solicitation of an offer to buy securities. The information on this page alone should not be used in making investment decisions. The Prospectus is controlling. Investors should carefully consider the investment objectives, risks, charges, and expenses associated with any investment.

1031 Exchange

Challenges related to *traditional* 1031 exchanges:

- Finding quality properties
- 45/180 day exchange time limitations
- Buying someone else's problems
- Wind up with negative cash flow
- Still toiling with the 5 T's

1031 Exchange Process



- You must identify your list of possible replacement properties no later than 45 days after the close of escrow on the relinquished property
- You *cannot change* the list after the 45th day
- The number of properties you may identify is limited to up to 3 properties w/o regard to FMV of each property, **or** any number of properties as long as the sum of the FMV of all of them does not exceed twice the FMV of the relinquished property (200% Rule), **or** the taxpayer receives at least 95% in value of what was identified (95% Rule)

1031 Exchange *into a DST* Eliminates These Challenges

- Properties are available across the U.S.
- You can be fully invested in a DST property in 7-10 days after closing on your original property
- Potential for positive cash flow from Day One
- No more…

Polling Question #1

In order to complete a full 1031 exchange, the investor must purchase replacement property(ies) equal to or greater than:

- A. Only the amount of gain on the relinquished property
- B. Only the amount of the paid off principal balance on the relinquished property
- C. The sale price of the relinquished property minus closing costs
- D. The sale price of the relinquished property minus closing costs and paid off principal balance

Accredited Investors

- Net worth of at least $1 million
  (not including the value of primary residence)

OR

- Income of at least $200,000 each year for the last two years, with the expectation of making the same amount or more in the current year ($300,000 combined, if married).

What is a DST?

- The Sponsor purchases the property and places it in the Trust.
- The Trust holds the property for the benefit of the investors.
- The investors receive an undivided interest in the property held in the Trust.
- DSTs are a *turnkey solution* for investors who no longer want to devote the time, energy or expertise to find and manage property.

HOLDINGS OF IRS
REVENUE RULING
2004-86

"(1) The Delaware Statutory Trust is an investment trust, under § 301.7701-4(c), that will be classified as a trust for federal tax purposes

(2) A taxpayer may exchange real property for an interest in the Delaware Statutory Trust without recognition of gain or loss under Section 1031, if the other requirements of Section 1031, are satisfied."

DSTs Offer Many Benefits

- Access to institutional quality properties
- Passive (“hands off”), national class professional management
- Potential appreciation
- Pass-through of tax write-offs (depreciation)
- Portfolio diversification across geographic markets and asset types
- No closing costs – less paperwork
- Passive investment vehicle that you can 1031 *into* and 1031 *out of*
- Sponsor financing to satisfy debt replacement requirement.

DSTs Restrictions/Limitations

- DSTs are illiquid – no public secondary market
- Most DSTs are structured to be held for 7 to 10 years but may be sold sooner depending upon market conditions
- Investors have no control or involvement in property management
- The decision when to sell the property is at the discretion of the sponsor asset manager who generally consults with investors regarding the timing of the sale
- DSTs have costs and expenses, such as acquisitions costs, financing costs, property management fees, and costs related to capital formation, which investors should consider in light of the impact on the benefits of tax deferral.

Who are the Sponsors?

PASSCO

CANTOR Fitzgerald

BLUEROCK

RK PROPERTIES

NEXPOINT

EXCHANGE RIGHT

Role of a Sponsor

- Find and underwrite property
- Perform property due diligence
- Obtain financing
- Facilitate ownership structure
- Oversee closing process
- Asset management
- Select and supervise property management group
- Process cash flow disbursements
- Provide regular investor reports
- Coordinate property sale

Sponsor Track Record

$$\text{Internal rate of return} = \frac{\text{total pre-tax cash flow} + \text{appreciation} + \text{pay down of loan principal}}{\text{number of years held}}$$

- Archer carefully selects Sponsors based upon their experience and track record.
- A detailed history of each Sponsor’s past performance is provided in the offering statements for each investment.

- Past results do not predict future results. Returns are not guaranteed, as in any form of real estate investing. All investments, including real estate, involve risk. This is neither an offer to sell nor a solicitation of an offer to buy securities. The information on this page alone should not be used in making investment decisions. The prospectus is controlling. Investors should carefully consider the investment objectives, risks, charges and expenses associated with any investment.

Risk

- Suitability
- Real Estate Risk
- Operator Risk
- Interest Rate Risk
- Liquidity Risk
- Past Performance
- DST fees and expenses compared to the tax deferral benefits
- Overconcentration of assets in real estate
- The Seven Deadly Sins

Polling Question #2:
Which of the following statements is false?

A. DST is a real estate trust that permits 1031 exchanges into passive, fractional, turnkey properties
B. The trust holds title to the property and the investors are the beneficiaries of the trust
C. DSTs are recognized by the IRS (Revenue Rule 2004-86) as qualified replacement property for real property
D. An investor can 1031 exchange into a Real Estate Investment Trust (REIT)

More to Consider…

- Most real estate brokers do not know about DSTs
- Securitized real estate cannot be sold by real estate brokers
- Diversify your portfolio with multiple DSTs – typical minimum 1031 investment is $100k
- Typical DST structured 50% Equity/50% Debt
  (for every $1 invested, receive $2 of ownership)
- Sponsor arranges permanent financing and investor receives non-recourse, pro-rata share of loan
- Debt assigned to investor is legal obligation of the Trust.

Hypothetical Sale of Property with *50% Debt*

Purchase of DSTs with 50% LTV

Assumptions:

1. **Relinquished Property Sale Price: $1,060,000**
2. **Closing Costs: -$60,000**
3. **Mortgage Principal Payoff: -$500,000**

- **Net Proceeds after Close of Escrow: $500,000**

- **In order to complete a full 1031 exchange, the investor must purchase a replacement property of at least $1,000,000.**

- **$500,000 invested in a DST with 50% LTV will have assigned to the investor $500,000 in sponsor secured nonrecourse financing for a total ownership of $1,000,000.**

- **The DST financing fully replaces the paid off mortgage debt on the sold property.**

PLEASE CONSULT WITH YOUR TAX ADVISER REGARDING YOUR INDIVIDUAL TAX CIRCUMSTANCES.

And Even More to Consider…

- Sponsor provides end of year tax financials which you simply hand over to your accountant
- DSTs are bankruptcy remote – creditors of the investors cannot pursue the assets of the property held in the trust
- The amount of equity held in the DST above the value of the relinquished property receives a new depreciation schedule
- Annual cash flow payout typically offset 50% to 70% by depreciation deduction[1]

[1]Available depreciation can vary from property to property. Each investors tax situation will be different. Consult with your tax advisor to determine your depreciation deduction.

Hypothetical Sale of Property with *No Debt*

Purchase of DSTs with 50% LTV

Assumptions:

1. Relinquished Property Sale Price $1,060,000
2. Closing Costs: -$60,000
3. No Mortgage Balance
4. Property Fully Depreciated

- **Net Proceeds after Close of Escrow: $1,000,000**

- $1,000,000 invested in a DST with 50% LTV will have assigned $1,000,000 sponsor secured nonrecourse financing for a total ownership of $2,000,000.

- The depreciation rules for 1031 exchanges require that the net proceeds ($1,000,000) invested in the replacement property retain the original depreciation schedule. The ownership amount in excess of the net proceeds receives a new depreciation schedule.

- Typically, 50% to 70% of the annual cash flow payout may be offset by the new depreciation write off.

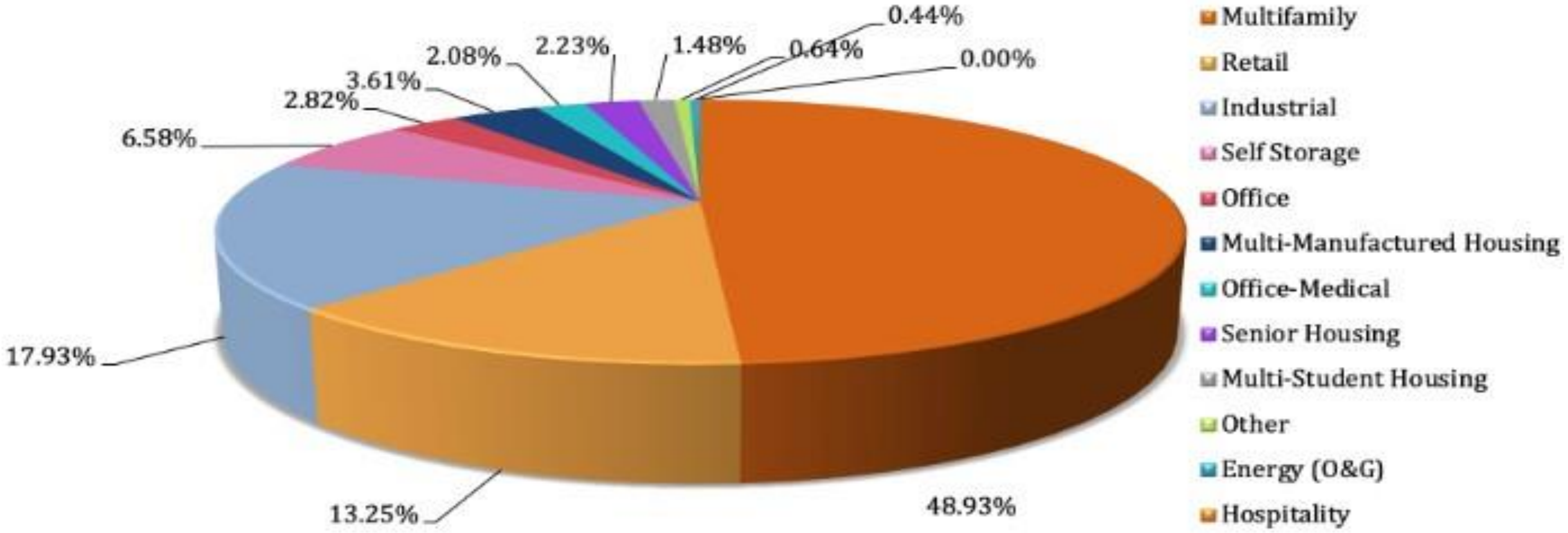
PLEASE CONSULT WITH YOUR TAX ADVISER REGARDING YOUR INDIVIDUAL TAX CIRCUMSTANCES.

Essential Estate Planning Tool

- DST interests are eligible for a step up in tax basis upon death
- The step up in tax basis will be equal to the fair market value of the DST at the time of death
- Investor will never pay the capital gains taxes accrued over his or her lifetime
- Swap until you drop
- DSTs avoid the potential discord among family members related to co-ownership, co-management and valuation of real property left in an estate
- DST interests are easily assigned to multiple beneficiaries who can individually determine what to do with the proceeds

SALES BY ASSET TYPE

Q4 2021/ Year End



Who is the Typical DST Investor?

John

Sold fourplex in Santa Rosa, CA held for many years
Invested in DSTs – no longer toiling with “5 Ts” and enjoying his free time and passive income

Sara

Sold 12 unit apartment complex
Purchased DSTs to preserve and diversify equity and set in place a mechanism to transfer her real estate to her family – tax free

Susan & Eric

Sold rental condo in San Francisco and struggled to find a 1031 replacement property due to hot market
Acquired a DST and avoided time pressures and challenges of finding a replacement property in a high cost area

Michael

Sold highly appreciated duplex with under performing annual cash flow
Purchased DSTs and tripled his cash flow while maintaining the same equity

(Hypothetical examples. Not real people. Your results may differ.)

Polling Question #3:

The following are some of the advantages of DSTs except:

- A. Access to institutional quality assets
- B. Diversification of assets due to lower minimum investment
- C. Pre-arranged non-recourse, institutional financing
- D. Illiquidity and lack of management control

Flat-Fee Multi Listing Services

Chris Carr, Co-founder

https://homezu.com/

HomeZu is a premier provider of Flat Fee MLS listings.

1

List in local MLS for as low as **$399**

2

Save thousands of $$$ in commissions

3

Have control over your own listing

4

Deal directly with an MLS Listing Expert

HomeZu 2021 Metrics

- 952 properties listed in 2021
- Average List Price $381,029.
- Average Sale Price $380,182. **Sale price is 99.78% of listing price.
- Average Days on Market before going under contract = 32 Day on Market
- Success Rate is approximately 75%
- Based on Average sale price of $380,000 the **average savings is $11,400 (3% of $380K)**