CAI INVESTMENTS

Developing Trust Through Transparency and Vision

THE ADVISOR'S GUIDE TO AN EVOLVING DST MARKET

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INTRODUCTION

As an investment advisor, your role in helping clients optimize the investment outcomes of their portfolios has never been more important. And a key part of that responsibility is creating diversified portfolios with a sensitivity to tax efficiency, especially as clients enter retirement.

The Delaware Statutory Trust (DST) has emerged as a powerful vehicle for tax deferral and real estate investment, particularly for your clients who are engaged in 1031 exchanges. The DST market has continued to evolve, adapting to regulatory and economic shifts, and is gaining even more popularity as a solution for accredited investors seeking passive real estate ownership.

In this guide, you'll gain a better understanding of DSTs—how they came into existence, their growth trajectory, and their continued appeal in the real estate investment world. This eBook will also explore the pivotal role CAI Investments plays in driving innovation within the DST market, with a focus on their recent $182 million 506(c) conversion project. We'll highlight why DSTs are a valuable tool for your clients and how to incorporate them into your practice.

Cover Page
Top picture: Global HQ of Kewaunee Scientific
Bottom picture: Global HQ of Pactiv Evergreen

THE ORIGINS AND GROWTH OF DSTs

The Delaware Statutory Trust structure was created in 1988 under the Delaware Statutory Trust Act, allowing entities to engage in passive real estate ownership while retaining limited liability for investors. However, it wasn't until 2004 when the IRS recognized them as qualified for "like-kind" replacement properties for 1031 exchanges that DSTs gained significant attention. Revenue Ruling 2004-86 opened the door for investors to defer capital gains taxes by reinvesting in high-quality, income-generating real estate assets through a DST.

From that point forward, DSTs became an increasingly popular option for real estate investors. What makes DSTs particularly appealing is their unique ability to allow fractional ownership of institutional-grade real estate. This means clients can invest in properties they might not have been able to afford on their own, benefiting from professionally managed assets with strong tenants and long-term leases.

THE RISE OF DSTS IN THE 1031 EXCHANGE MARKET

Over the last two decades, the DST market has grown exponentially. According to data from Mountain Dell Consulting, the DST sector experienced a steady increase in the number of offerings and investor interest, with a record-setting $9.5 billion in DST equity raised in 2022.[1] This reflects the heightened demand for tax-advantaged real estate options, especially as investors seek ways to hedge against stock market volatility.

A recent report from DST News confirms that investment in DSTs remains strong in 2024, even amid shifting economic conditions. The DST News August 2024 landscape review highlights how DST investments have continued to attract capital from accredited investors, especially in sectors like multifamily, industrial, and essential assets.[2] This consistency demonstrates the ongoing confidence in the DST market as a reliable investment vehicle.

[1] DST News | [2] DST News

HOW DSTS FIT INTO A 1031 EXCHANGE STRATEGY

Your clients' primary reason for engaging in a 1031 exchange is to defer taxes on the sale of an appreciated investment property. DSTs offer an ideal replacement property solution for these exchanges. Because DSTs are structured to allow for fractional ownership, they provide investors with access to large-scale commercial properties, something not typically possible when exchanging into a single asset.

FOR YOUR CLIENTS, THE BENEFITS OF INVESTING IN A DST ARE MULTIFACETED:

- **Passive Income:**
  DST investors receive monthly or quarterly income distributions without the burden of property management.

- **Diversification:**
  Your clients can allocate their investment across multiple DST properties, spreading risk while maintaining exposure to stable, income-generating real estate assets.

- **Low Minimum Investment:**
  DSTs often have lower minimum investment thresholds than traditional real estate, making them accessible to a wider range of clients.

Industrial cold storage for Martin Brower

A CASE STUDY IN DST INNOVATION

One of the most compelling examples of DST evolution in recent years is CAI Investments' $182 million DST offering, which was converted to a Regulation D 506(c) offering in March 2024. Originally launched as a 506(b) offering in April 2023, CAI raised more than $52 million of the planned $182 million from accredited investors before making the strategic decision to switch to a 506(c) structure.

WHY THE TRANSITION TO 506(C)?

The decision to convert the DST offering from a 506(b) structure to a 506(c) was driven by CAI's desire to aid independent broker dealers' (IBDs) and their advisors and RIAs ability to expand their reach and align with regulatory trends. Interpretation of 506(b) rules by FINRA limits advisors to raising capital from accredited investors with whom they have a pre-existing relationship restricting them from being able to market to the public. By transitioning to a 506(c) offering, advisors can now publicly advertise and solicit investment from accredited investors across the country.

A CLOSER LOOK - MOTOROLA HEADQUARTERS TURNED ESSENTIAL ASSET

The DST offering in question involves the former Motorola North American headquarters in Harvard, IL, a massive 1.5 million-square-foot facility purchased from the U.S. Marshals Service in 2021. Due to its size, strategic location, and potential for tenant demand, the property was a prime target for CAI Investments. In March 2023, CAI secured the U.S. Medical Glove Company (USMG) as its sole tenant, a significant achievement that brought a new stability and long-term value to the property.

USMG is a Department of Defense contractor and the only U.S.-based company capable of producing large quantities of FDA-approved nitrile gloves. With a 23.5-year lease in place, this facility serves as USMG's global headquarters, combining office, manufacturing, and distribution operations. The lease provides an opportunity for a reliable income stream for investors, making it a standout asset in the DST marketplace.

CAI'S ROLE IN THE DST MARKET

CAI Investments is not new to the DST space. Headquartered in Las Vegas, CAI has built a reputation for financing, developing, and managing commercial properties across key U.S. markets. Their focus on single, high-quality tenants and premier strategic, diversified assets has made them a leader in the industry. CAI's 506(c) conversion project demonstrates the firm's commitment to adapting and evolving with market and regulatory trends, ensuring their offerings remain competitive and attractive to a wide audience of accredited investors.

CAI INVESTMENTS DST TO A REG. D 506(C) CONVERSION PROJECT

Global HQ of US Medical Group Co.

THE ONGOING EVOLUTION OF DSTS

As the regulatory environment continues to evolve, DST sponsors are finding new ways to innovate and attract investors. For example, changes in technology have made it easier to market DSTs to a wider audience, while shifting economic conditions have led investors to seek out real estate investments as a hedge against market volatility.

According to the August DST News 2024 Landscape Review, sponsors have been adjusting their offerings to align with new investor demands. Sectors like industrial and multifamily have been particularly popular in 2024, with steady growth in demand for income-generating real estate. The ability of DSTs to adapt to market trends while providing passive income and diversification opportunities has been a key driver of their ongoing success.

WHY DSTS SHOULD BE IN YOUR CLIENTS' PORTFOLIOS

As an advisor, you understand the importance of offering your clients compelling alternative investments uncorrelated to publicly traded securities. Finding tax-efficient investment solutions in the alternatives space is simply a bonus. DSTs are an excellent fit for clients looking to complete a 1031 exchange or those simply seeking to diversify into real estate without the responsibility of direct property management. In addition to the previously mentioned benefits DSTs offer, your clients can also enjoy:

FOR YOUR CLIENTS, THE BENEFITS OF INVESTING IN A DST ARE MULTIFACETED:

- **Tax Deferral:**
  Through 1031 exchanges, your clients can defer capital gains taxes while reinvesting in high-quality real estate.

- **Access to Institutional-Quality Assets:**
  DSTs provide opportunities to invest in large-scale commercial properties that would otherwise be inaccessible to individual investors.

- **Non-Recourse Debt:**
  DSTs using leverage generally provide non-recourse debt, which shields investors from personal liability.

By incorporating 506(c) DST investments into your client conversations, you are offering them an investment strategy that may withstand market fluctuations, are adapted to regulatory changes, and may provide reliable cash flow.

CONCLUSION

In the dynamic commercial real estate investment market, DSTs offer a unique combination of tax advantages, diversification, and passive income generation. For clients participating in a 1031 exchange or those looking to diversify their portfolios, DSTs are an essential tool to consider. CAI Investments' contemporary approach to DST investment management demonstrates how forward-thinking sponsors can anticipate regulatory changes and position themselves to benefit investors. By introducing DSTs to your clients, you're not just offering them a tax-efficient real estate solution—you're positioning them for long-term success in a market that continues to evolve and adapt.

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