



NextGen Private Wealth

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DST 1031 Exchanges

Defer Taxes. Preserve Wealth. Diversify. Generate Income.

For Advisor Use Only. Not for Client Distribution.

BACK TO THE EARTH

Current State of Section 1031 Exchanges Southwest Montana Farm & Ranch Brokers November 13, 2019

**Presented by: Max A. Hansen
Managing Director--Accruit, LLC**

115th Congress



KEVIN BRADY– WAYS & MEANS

- House Tax Bill HR-1 – “Tax cuts & Jobs Act”
 - Revenue Score doubled from 2014
 - Immediate Expensing in Place of 1031 for personal property
 - 1031 Exchanges for Real Property

- Corporate & Pass Through rates reduced dramatically
- Senate & House Bills Eventually reconciled and passed



ORRIN HATCH – SENATE FINANCE

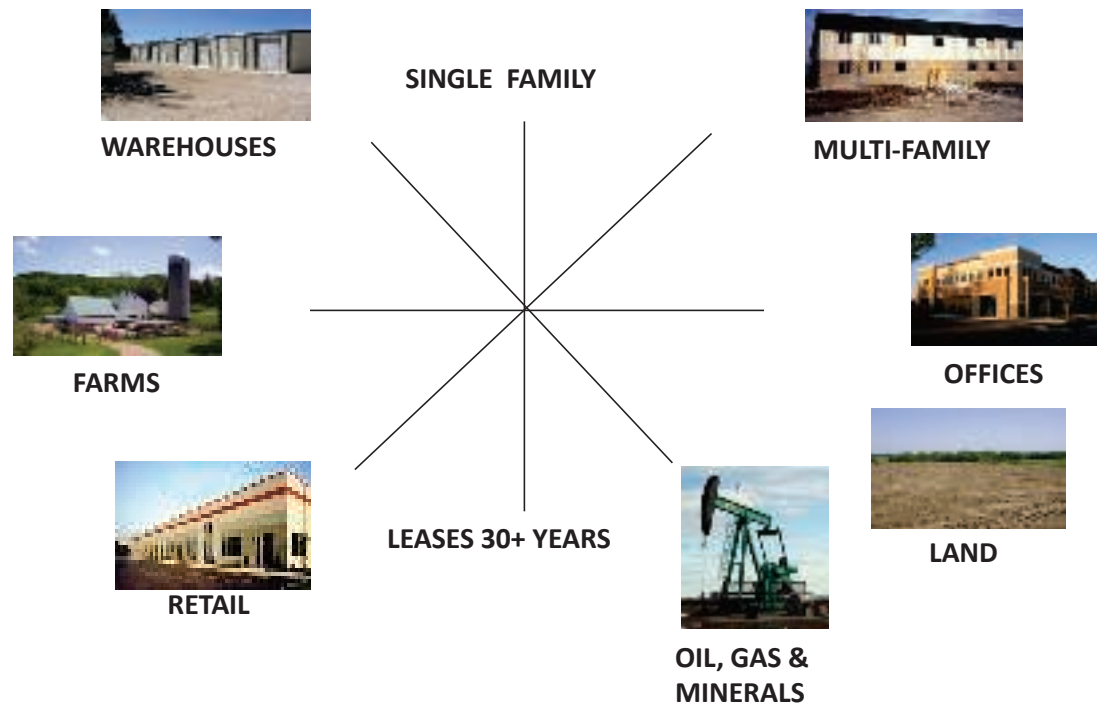
H.R. 1 (the “Tax Act”)

- Section 13303 of the Senate amendment revised Section 1031(a)(1) of the Code to provide that:

No gain or loss shall be recognized on the exchange of **real** property held for productive use in a trade or business or for investment if such **real** property is exchanged solely for **real** property of like kind which is to be held either or productive use in a trade or business or for investment.

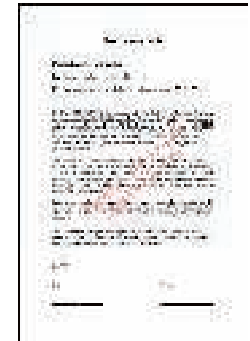
When the Dust Settled

- Like Kind Real Property Exchanges Intact



When the Dust Settled

- › Excluded property remains the same
 - Stock in trade, inventory and other property held “primarily for sale” to customers §1031 (a)(2)
 - Securities and promissory notes
 - Certificates of trust or beneficial ownership rights
 - Choses in action
 - Foreign Real Property §1031 (h)



No Personal Property Exchanges

All Personal Property Affected

- › 30.1 billion repeal score a factor
- › “Replaced” by immediate expensing



Other Personal Property Affected

- › Artwork
- › Collectibles
- › Franchises
- › Broadcast Rights, etc.



What is Like Kind Real Property?

- “Section 1031(a) requires a comparison of the exchanged properties to ascertain whether the **nature and character of the transferred rights** in and to the respective properties are **substantially alike**.”
- “In making this comparison, consideration must be given to the **respective interests in the physical properties**, the **nature of the title conveyed**, the **rights of the parties**, the **duration nature or character** of the properties as distinguished from their grade or quality.”

Koch v. C.I.R., 71 T.C. 54, 65 (1978)

Like, Not Identical

Examples of Like-Kind Real Property

- Commercial building and an unimproved lot (*Burkhard Inv. Co. v. U.S.*, 100 F.2d 642 (9th Cir. 1938))
- City real estate and a ranch or a farm (Treas. Reg. Sec. 1.1031(c)(2); *Rutland v. C.I.R.*, T.C. Memo. 1977-8)
- Tenancy-in-common interest and a fee interest (Rev. Rul. 79-44)
- A fee and a leasehold with 30 years or more to run (Treas. Reg. Sec. 1.1031(c)(2); Rev. Rul. 78-72)
- A remainder interest in one property and a life estate in another property where the life tenant has a life expectancy of at least 30 years (Rev. Rul. 78-4)
- A fee interest and a condominium unit (Rev. Rul. 77-423)

More Examples of Like-Kind Real Property

- A fee interest and a perpetual easement (PLR 9215049)
- Cell towers affixed to land and cable telecommunication signal distribution property affixed to land (PLR 201706009)
- A fee interest and shares in a co-op which includes a long-term occupancy right (PLR 200137032)
- A fee interest and perpetual water rights (Rev. Rul. 55-749)
(Beware of the *Weichens* Case and limited duration)
- A fee interest and most mineral estates (Rev. Rul. 73-428; Rev. Rul. 72-117)
- A fee interest in land and a fee interest in land with unharvested crops (Rev. Rul. 59-229)

Examples of Real Property Which Are NOT Like Kind:

- A leasehold of less than 30 years and a fee in another property (*VIP Indus. Inc. v. C.I.R.*, T.C. Memo. 2013-157)
- A fee interest in land and building and a building only (at least in IRS's view) (Rev. Proc. 2004-51)
- A fee interest in timberland and limited duration cutting rights (*Oregon Lumber Co. v. C.I.R.*, 20 T.C. 192 (1953))
- Water rights of limited duration and a fee interest (*Wiechens v. U.S.*, 228 F. Supp. 2d 1080 (D. Ariz. 2002))
- Attached railroad track and unattached railroad track (TAM 200424001)
- A fee interest and a “carved out” mineral interest (i.e., a “production payment”) (*C.I.R. v. P.G. Lake, Inc.*, 356 U.S. 260 (1958))

Disregarded Entities & Real Property

- Acquiring 100% interest in a single-member limited liability company is treated as an asset acquisition (PLR 201216007)
- Acquiring a beneficial interest in a grantor trust is treated as acquiring an undivided interest in the trust's assets (Rev. Rul. 2004-86)
- Interest in an Illinois Land Trust (Rev. Rul. 92-105)

Resulting Principles on What is Real Property

- Identical assets are like-kind regardless of their classification under state law (however, now, it is critical to determine if such assets constitute “real property”).
- Where state laws classify assets differently, federal law will uniformly determine the “real vs. personal” property classification.
- Thus, assets classified under state law as real property may not be like-kind to other real property regardless of comparable ownership rights.

Partnerships & Fractional Interests

- While Section 1031(a)(2)(D), regarding exchanges of partnership interests, has been repealed, partnership interests still cannot be exchanged.
 - They are intangibles, and thus ineligible.
 - Exception: Section 761(a) elections out of Subchapter K still work.
- TIC interests and Delaware statutory trust guidance is still favorable and controlling.
 - Those offerings should be unaffected, as they were largely all real property.
 - Same with mineral royalty trusts.



Thank You !

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What are DST 1031s?

DST 1031 Exchanges combine the tax deferral benefits of traditional 1031 exchanges, with the desirable fractional ownership structure of Delaware Statutory Trusts (DSTs) to allow for passive ownership in real estate. Most DST 1031 investments are sponsored by large, national Real Estate Companies and are offered through securities broker/dealers and registered investment advisers. Each DST program can have one or multiple properties in the offering allowing enhanced diversification for the property owner's real estate portfolio.



1031 Exchange

Section 1031 of the IRS Code states that “no gain or loss shall be recognized on the exchange of property ...if such property ...is to be held either for productive use in a trade or business or for investment.” In general terms, you are able to defer capital gains taxes upon the sale of an income-producing property as long as you reinvest the proceeds into another income-producing property.



Delaware Statutory Trust (DST)

A DST is a business Trust that can be used for real estate ownership where a trustee holds title to assets for the benefit of the trust interest owners. The investors in a DST own an undivided, passive ownership interest in the assets held by the trust. DSTs must distribute all cash flow, other than reserves, to the beneficiaries.

Timeline

Identify Replacement Properties

The seller of the property has 45 days to identify up to three* replacement properties that meets the 1031 guidelines. Because we have a continuous pipeline of approved DST investments, we often have discussed suitable investment portfolios with the client prior to sale of the property.

Passive Real Estate Owner

With the DST 1031 process complete, the investor becomes a fractional owner in a diversified portfolio of institutional-grade investment properties, setting up multiple streams of passive investment income.

DAY ZERO



Sell Current Property

The Exchanger completes the Exchange agreement and escrow account with the Qualified Intermediary (QI). Sales proceeds from the relinquished property are escrowed directly with the QI.

DAY 45



DAY 180



Deadline for DST Unit Purchase

QI releases funds to purchase units in each DST investment that have been selected by the client and NextGen DST Adviser.

Day 180+



Qualified Intermediary (QI)

Acts as intermediary under Internal Revenue Code 1031. Holds proceeds, prepares legal documents, and ensures transaction is completed within IRS guidelines.

Types of Investors

Utilizing the DST 1031 Structure

NextGen



Retirement

As property owners near retirement, they may consider selling the properties to avoid ongoing active management and liability. The DST must distribute all cash, other than reserves, to the beneficiaries. Because of this, they normally offer attractive current income to support retirement spending.

Estate Planning

Property owners may have heirs with little experience and/or desire to take over the active ownership of the investment properties if something were to happen. DST 1031s help to provide a clean transition of wealth as the unitholder's shares simply pass on to the beneficiaries upon death, with a step-up in cost basis.

Landowners

Many landowners only use a fraction of their land, and are sitting on large acreage that is generating little to zero income. DST 1031 investments offer attractive yields from the portfolio of real estate properties, making them a suitable option for Landowners that do not intend to develop, farm, or ranch all of the land.

1031 "Cash Boot"

It is common that the exchanger can not identify a property at least 100% of the Fair Market Value of the relinquished property within 45 days, leaving the difference to be taxed. Most DST 1031 minimums are in the \$100k - \$250k range, providing a solution the "boot" problem, as they can invest the difference into a DST 1031 and complete their exchange.

www.nextgenprivatewealth.com

Why NextGen DST?

NextGen

Portfolio Construction

We construct portfolios based on three key rules. We build geographically diversified, sector diversified, and Sponsor diversified portfolios sourced from high quality Sponsors. We review current economic and Real Estate market trends and combine that with the client's liquidity and time horizon goals to determine an optimal mix of assets. Weighting is dictated by our internal sector ranking and Sponsor scoring system. We focus on core sectors that historically demonstrated strong resilience in weak economies to preserve wealth across cycles.

Due Diligence

A well-developed, systematic due diligence (DD) process is at the heart of a successful DST 1031 investment. We conduct independent, objective research into both the DST fund offering, and the Fund Sponsor. We adhere to a rules-based process to source, review, and select DST investments for our platform. The process is ongoing to maintain a pipeline of quality DST investments to service clients on short notice of a property sale or for when a traditional 1031 transaction looks like it may not meet the 45-day identification deadline.



Client Support

We provide guidance at the start of the engagement to help determine if a DST 1031 is a suitable strategy for the client based on their unique sets of circumstances. We provide ongoing reporting to the client on their DST portfolio performance, due diligence updates, and work with their CPA for tax reporting and cash flow/depreciation reports as we receive them from the Sponsors.

Firm Structure

Sponsors pay out commissions to Broker-Dealers (BD) for recommending DST products to clients, often tallying 7%. NextGen does not take commissions on offerings due to the potential conflict of interest this presents. We are paid based on the work completed to identify and manage the portfolios. Sponsors normally credit the RIA client account this 7% rather than paying it out to us, leaving the client transacting a DST 1031 through NextGen roughly 14% ahead of a client going through the BD channel at day one, all else equal.

Due Diligence: Sponsor Screening

- We only source deals from Sponsors we have approved for our platform based on a defined system to evaluate and score the 35+ DST 1031 Sponsors in the market today.



● Estimated number of DST 1031 Sponsors in Market



● Number of Sponsors Meeting Track Record Qualifications



● Number of Sponsors that have stuck with their strategy over time



● Number of Sponsors Passing Third-Party Background check, legal review, ownership analysis, operational control analysis, financial review, and risk mitigation review.



● Number of Sponsors that align the investors' interest with theirs, consistently, by setting up a fee structure that incentivizes management to increase value.



Number of Sponsors Approved to the NextGen DST Platform. Our last criteria is the Character of the Sponsor. We only work with the highest quality people by evaluating their Character. From the front desk to the CEO, we evaluate the Sponsors on the quality of their team as our last criteria for selection.

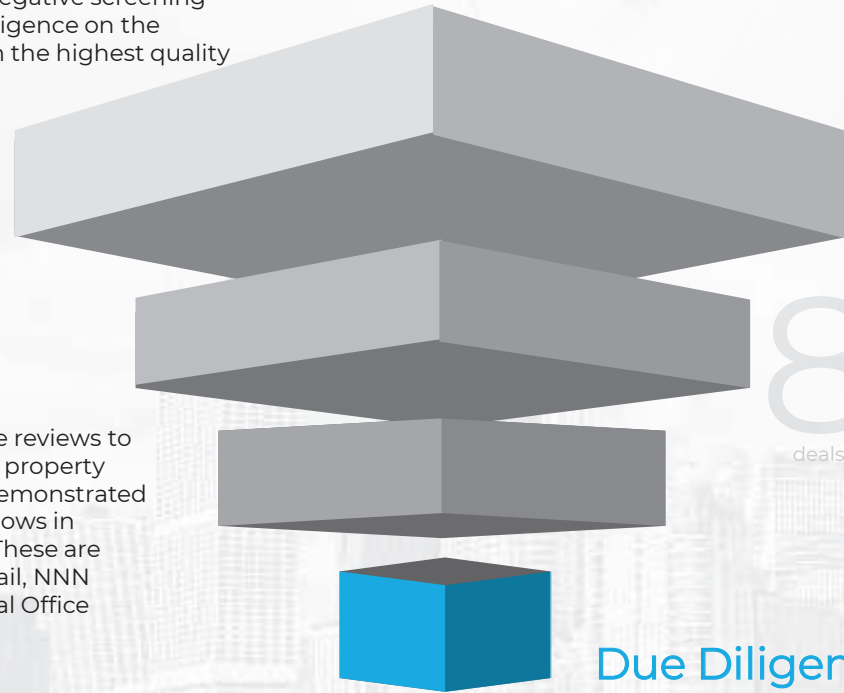
Due Diligence: Deal Sourcing

NextGen

25
deals

DST Deal Flow

Each quarter, there are roughly 25 new DST deals brought to the private investment market. We implement negative screening filters to focus our Due Diligence on the investments sourced from the highest quality sponsors and assets.



8
deals

Sponsor Screen

There are currently 30+ Sponsors bringing DST investments to the market. We implement a strict selection criteria and evaluate each one to work with only the highest quality Sponsors in the DST 1031 space.

5
deals

Property Screen

We restrict our Due Diligence reviews to DST investments in four core property types that have historically demonstrated the ability to generate cash flows in periods of economic stress. These are Multifamily, NNN Leased Retail, NNN Leased Industrial, and Medical Office Buildings.

3
deals

Due Diligence

We normally see roughly 20% of new DST offerings make it through our first two screens. After this is complete, we implement our full Due Diligence review. This includes full external* and internal reviews, and a unanimous Investment Committee approval to the NextGen DST pipeline. We generally approve 2-3 deals out of 25 that come to the market with our process.

*We partnered with FactRite™ to provide our external Due Diligence reviews alongside our internal review to improve the effectiveness and depth of Due Diligence.

Due Diligence: Property Screen

- we focus our reviews on DST deals that historically have the highest probability to preserve wealth and generate income.



Class A & B Multifamily

Strong millennial and baby boomer migration into multifamily the past decade. High occupancy rates throughout various economic cycles. Located in high growth cities (normally top 100 MSAs).



NNN Leased Retail

We limit our NNN leased retail investments to high quality tenants, with long term (usually 10+ year) leases. The long-term nature of the cash flows and expense structure aligns with the long time horizon of DST 1031 exchange programs.



Medical Office Building

High quality tenants with strong operating cash flows and corporate credit ratings. Medical services such as dialysis and surgeries non-correlated to the business cycle.



NNN Leased Industrial

Long-term contracts, with strict tenant requirements for market cap, ability to pay, and credit quality. Distribution networks are expanding due to online shopping and demand for quicker delivery.



Hypothetical Case Study of DST 1031



Property Type: Cattle Ranch

Land Size: 500 acres

Location: Montana

Income Producing Acreage: 300

NOI: \$200,000

Net Distributions to Owners: \$100,000 (before tax)



Property Value: \$4,000,000

Taxable Basis: \$200,000

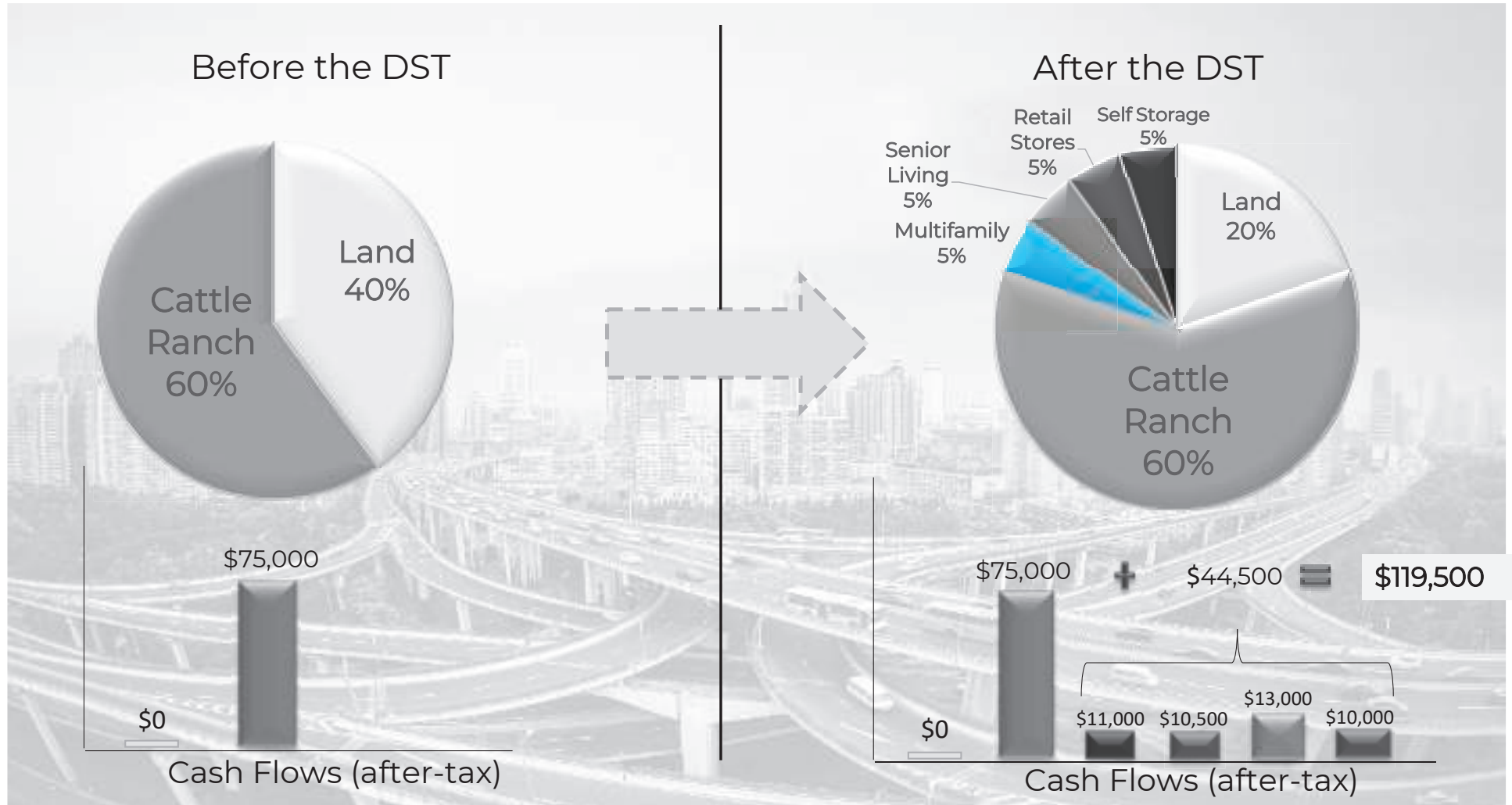
Capital Gains: \$3,800,000

Estimated Taxes: \$1,000,000



Scenario: we are going to sell 100 non-cash flowing acreage for total gross proceeds to the seller of \$800,000. Estimated taxes would be \$200,000 at long-term capital gains rates on a cash-out sale. The following pages show the benefits to the client using a DST 1031 instead of cashing out and paying the tax.

Diversification and Cash Flows



Hypothetical Property Portfolio



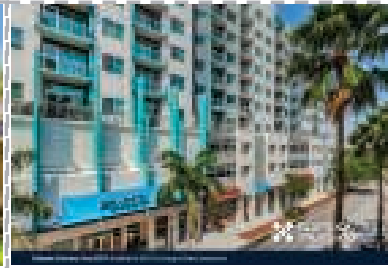
Location	Baton Rouge, LA
Property Type	Self Storage
Properties	2
Sponsor	Inland Capital
Distribution	5.00%
Property Value	\$17.9 million



Location	Multiple (15 cities)
Property Type	NNN Retail
Properties	23
Sponsor	Exchange Right
Distribution	6.50%
Property Value	\$103.2 million



Location	Houston, TX
Property Type	Senior Living
Properties	1
Sponsor	Capital Square
Distribution	5.25%
Property Value	\$4.28 million



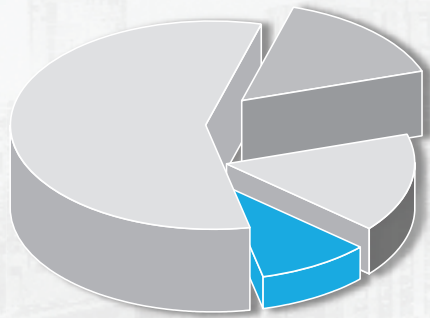
Location	Sarasota, FL
Property Type	Multifamily
Properties	1
Sponsor	Bluerock
Distribution	5.50%
Property Value	\$89.6 million

Note: the properties presented here are actual DST 1031 properties that could have been invested in during the 2019-2020 time period and represents a typical DST 1031 portfolio construction through NextGen DST.

Turned the client's piece of land into **27** (institutional-quality) **properties** located in **18** **cities**, spanning **12 states** across the US. Average distribution rate of **5.53%**, with a total market value of **\$215 million.**

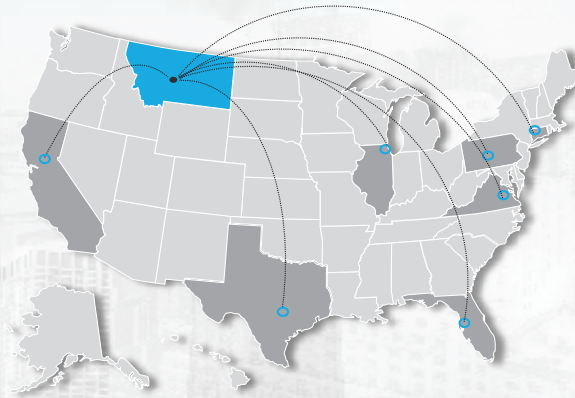
Summary: Diversification

DST 1031 Exchanges



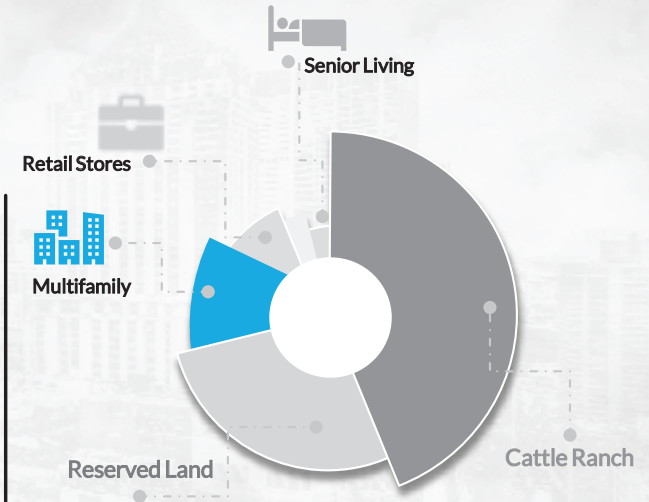
Estate Diversification

Prior to the DST 1031, the Family wealth was concentrated in the Cattle Ranch and land. The Family Estate now includes an allocation of 20% into passive, institutional quality real estate. The diversification into other income-producing properties reduced their concentration risk.



Geographical Diversification

The Estate went from 1 State, 1 City, 1 Real Estate Sector, and 1 Property to 27 Properties spanning 12 States, 18 cities, and 4 Real Estate Sectors,



Sector Diversification

The Portfolio now includes investments into Multifamily Apartment Complexes, Retail Stores with long-term leases, and a Senior Living property.

NextGen vs BD/Other

NextGen

Gross Sale Proceeds	\$800,000
Land Broker Fees	(\$24,000)
Estimated DST Due Diligence Fees	(\$24,000)
RIA Client Gross Up	\$52,000
<u>NET</u> Due Diligence Fee	\$28,000
<u>Taxes Due</u>	\$0.00

Net DST1031 Investment **\$804,000**

Projected Cash Flow (Before Tax) **\$44,500**

BD / Other

Gross Sale Proceeds	\$800,000
Land Broker Fees	(\$24,000)
Estimated FINRA Broker Commission	(\$52,000)
RIA Client Gross Up	\$0.00
<u>NET</u> Due Diligence Fee (Commission)	(\$52,000)
<u>Taxes Due</u>	\$0.00

Net DST1031 Investment **\$724,000**

Projected Cash Flow (Before Tax) **\$40,000**

Broker Dealers are paid commissions by the Real Estate Sponsoring Company to offer their products.

Most RIAs often charge fixed "Due Diligence Fees" of around 5.0% no matter the size of the client investment. This is analogous to a commission in our opinion. They may also charge ongoing fees.

NextGen charges the client financial planning fees incurred for conducting due diligence on the properties and Sponsors. The fees are not fixed as a percent of the investment but are dictated by our time commitment to identify and vet these real estate investments for the client. There are no ongoing fees.

NextGen

+\$80,000 more invested

+\$4,500 higher annual income

\$11,747,434

Summary



Income

- Increased After-tax income from \$75,000 to \$119,500 (+\$44,500)
- Created Multiple Income Sources other than Cattle Ranch
- Income is tax-sheltered due to depreciation pass through



Taxes

- Deferred \$200,000 in taxes on an \$800,000 sale
- Converted an appreciating, no-income asset to a depreciating, income-producing portfolio



Fees

- The Net fees were a gain to the client due to RIA Gross Up
- NextGen fee structure put client \$80,000 ahead of the BD model
- NextGen fee structure led to \$4,500 higher annual income than the BD model.

Disclosure: this example is hypothetical and does not represent actual client experiences. The figures used in the case study are based on industry figures commonly found in DST 1031 investments.

Why partner with NextGen?

You Know Landowners

That are sitting on zero-income property earning nothing, that would not significantly impact their operations or elicit an emotional response (not a huge portion of the land)

Value-added services

Increase client satisfaction and demonstrate you are willing to go the extra mile to make sure they are receiving the highest service and planning possible.

Re-start old conversations

With previous clients that weren't ready to sell for tax purposes, emotional purposes, or otherwise.

Increase your Sales Volume

The DST 1031 gives your client another reason to sell property, leading to new-found sales from land that was previously overlooked.



DST Drawbacks and Risks

- Tax laws are subject to change. This may have a negative impact on a DST Investment.
- DST investments are direct investments in commercial real estate, which are subject to market value fluctuations, rental income declines, vacancies, issues with tenants, and government regulations.
- DST investments are long-term (5+ year), illiquid investments not actively traded on a public market.
- There are fees and costs associated with a DST investment that must be considered prior to investing. We provide a total cost analysis for full transparency with the client **before** we sign any subscription documents or agreements.
- A DST investor does not exercise control over the property and/or management of operations.
- No secondary market is likely to exist for a DST investment. If a secondary market did become available, it is likely to be at a substantial discount to the capital invested.
- Distributions to investors from the DST investment are subject to the Sponsor's ability to generate cash flows and are not guaranteed.
- The investor in a DST assumes the debt component to the acquisition of the property, even if their property had no debt. However, the debt is non-recourse.

DISCLOSURES

This presentation does not represent an offer to sell, a solicitation of an offer to buy, or a recommendation of any security. The case study results are hypothetical results and are NOT an indicator of future results and do NOT represent an experience of an actual NextGen investor. Actual capital gains rates vary by state and may be higher in the state in which you are a tax-paying resident. Investing in DST 1031 offerings involves the potential for loss of principle. Various risks exhibited in Financial Markets include Liquidity risk, Interest Rate Risk, Counterparty Risk, Bankruptcy Risk, Market Risk, Default Risk, Currency Risk, and Political Risk. All investments discussed herein contain risk and may lose value.

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Thank You

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