EPISODE 766

[INTRODUCTION]

[0:00:00.0] ANNOUNCER: Welcome to The Real Estate Syndication Show. Whether you are a seasoned investor or building a new real estate business, this is the show for you. Whitney Sewell talks to top experts in the business. Our goal is to help you master real estate syndication.

And now your host, Whitney Sewell.

[INTERVIEW]

[0:00:24.7] WS: This is your daily Real Estate Syndication Show. I'm your host, Whitney Sewell. Today, our guest is Justin Kiehne. Thanks for being on the show, Justin.

[0:00:32.3] JK: Thanks for having me, Whitney.

[0:00:34.5] WS: Justin works with real estate investors to provide access to fractional ownership of his institutional quality real estate assets, structuring passive, tax-efficient portfolios through 1031 exchange and opportunities to own investments. He and his team at Fortitude have executed over $250 million in 1031 exchange Delaware Statutory Trust transactions in each of the previous two years and claim the largest single Delaware Statutory Trust transaction in the history of the industry.

Justin, thank you again for your time, grateful just to bring your experience and expertise on the show. This new thing about Delaware statutory trust, I feel like something everybody should know about but it's very unknown I think at the moment. So grateful to have you and to just bring that out so the listener understands who that's for, what that is and what you all do at Fortitude. Get it started, who you are, your special and let's jump in.

[0:01:29.9] JK: Yeah, absolutely. You and I had discussed a little bit, but in the syndication space and I speak to a lot of syndicators and commercial real estate brokers and real estate investors. The Delaware Statutory Trust, the DST is sort of a niche that is not well known. That's been around now for about 16 years. It was established in 2004. For those of you on your computers, Google 'revenue proceedings 2004-86' to get really granular on you. But that established the DST.

What that is, is that syndicated real estate that works in the 1031 exchange. The lion share of my clients are direct real estate owners. Property owners, real estate investors, folks that have owned, operated, managed their own investment or commercial real estate personally and are now looking to sell. And they've got a great offer on the property, things have appreciated significantly, until recently we're in the longest running bull market in US history, right?

Things have appreciated significantly, and along with that comes capital gains taxes, unfortunately. Uncle Sam has to get his piece of the pie, and the 1031 exchange allows you to defer those taxes, and what the DST works as, it's a tool. It's like syndicated real estate, but you can sell your property, you can do that 1031 exchange, you can defer those taxes and you could buy fractional ownership of these larger assets, right? These institutional assets that are managed by somebody else.

Being in the syndication space, you're very familiar with sort of the passive real estate investment and having somebody else manage those investments for you. This is very similar to that, but like I said, it's kind of a niche that applies to the exchange, the 1030 exchange that most folks aren't aware of.

[0:03:11.5] WS: Nice. It's interesting. When we talk about the DST or the Delaware Statutory Trust, is that different from a 1031? Is it the kind of the same vehicle, just so the listeners understand how do those things relate?

[0:03:24.2] JK: Yeah, sure. So, to take a little bit of a step back for you. The 1031 exchange, and that refers to Section 1031 of Internal Revenue Code. That's just a tax deferred real estate swap. You own a piece of real estate, it's investment or business purposes, it has appreciated or you have depreciated it. And when you go to sell it, they're going to be taxes involved: capital gains taxes, depreciation recapture. So, performing a 1031 exchange allows you to defer those taxes. You sell your property pursuant to some rules and regulations. There's an ID window where you have to ID the replacement property. Then there is a timeline involved in terms of how quickly you have to close on your replacement property. Qualified intermediaries involved. I'm really throwing some interesting words at you, I know. But it's a way for folks just to defer those capital gains taxes at the end of the day, and that it the 1031 exchange.

Generally, in the exchange, you sell one piece of actively managed real estate, then you do an exchange and you buy another piece of actively managed real estate, right? You sell three rental properties, three single-family homes, and you roll those up and you use the proceeds to buy maybe a commercial property because you want to go into the commercial space or you sell multi-family property that has appreciated significantly, and you buy something that's maybe triple net because you want to be a little bit more passive. That's the 1031 exchange, and that's been around for 100 years or close to it in some form or fashion.

The DST is a type of replacement property. It is separate from the 1031 exchange and that folks perform 1031 exchanges all the time, buying and selling normal run-of-the mill real estate. But the DST is an option and it's a passive option that is around and serves the purpose of allowing investors to get out of managing and get into maybe a diversified portfolio of larger assets.

[0:05:21.4] WS: This is going to be for — I'll just give an example here. The investor, let's say somebody has been investing in real estate, in their own deals for a long time, maybe they have a portfolio of a dozen single-family homes, a few duplexes, whatever, small multi things like that and it's like okay. They're like, "Justin, it's time for me to — I don't want to manage these properties any more, I just want to get more passive." They could sell those properties and do a DST, Delaware statutory trust and essentially defer the taxes of capital gains from selling those properties, but move that capital into a syndication and be passive.

[0:05:56.9] JK: Exactly. We have clients that has single-family home portfolios. One client in particular who's selling off one home at a time, about 100 or 150,000 a clip. And at any given time, we have 15 to 20 different DSTs available on our menu to offer. He gives me a call, he says, "Justin, I'm under contract on another house. What do you have available? What do you like? Send me what you got." On the other side of it, I have a client who has a significant portfolio of commercial real estate, recently sold an Applebee's for example. We were able to build him, we put them to four different DSTs, diversified in both real estate sector and across the country. It is important to note and I haven't mentioned it yet. The DST is only suitable for accredited investors, and that's an SEC definition that I'm sure you're familiar with being in the syndication space.

[0:06:52.0] WS: Okay. That's good to know. I don't know if I remember that about the DST, but only for accredited investors. Can you breakdown kind of a timeline a little bit if somebody wants to use this, to have somebody maybe wants to buy their property? When do we need to contact somebody like yourself to get something like this rolling?

[0:07:09.5] JK: Sure. Very important if you're thinking about an exchange, if you have a property sale upcoming, very important to reach out to a qualified intermediary. These are the people that actually facilitate the 1031 exchange. They're the ones that take receipt of the sale proceeds, and it's very important that they take receipt of the proceeds if you individually sell your property. Money sitting in your bank account and you go, "All right. I'm ready to do am exchange." It's too late, you've blown he exchange. There's a page that's added to the closing contract, just wires the money to an Escrow account so that you don't have constructive receipt is the terms. It just means that you don't have access to it.

So very important, as early in advance, if you know you're selling your property a month out, two months out, that can be as close to as a couple of days prior, you contact a qualified intermediary. We always recommend clients that they reach out to us maybe a month in advance, because what we do is kind of a niche. We do a lot of education, and sometimes it takes a while for people to wrap their head around the whole process, and what DST is, and the options available to them. We always say about a month, in that way you can underwrite some of these deals, you can look through the PPMs, we can get you on the phone with various sponsors, and you can kind of weigh your options. In that way, when you do perform the exchange, right, I mean it's simple, stupid, very seamless.

[0:08:35.2] WS: What is the timeline into invest — like the 1031, are there timelines where we have to know what the investment or have a few options is going to be and identify those, and then actual invest.

[0:08:46.8] JK: Sure. With the 1031 exchange, with any 1031 exchange, the day you sell your property is day zero. You then have 45 days to identify one or multiple potential replacement property. So, there are couple of rules that are used to identify. The three-property rule is the most commonly used one. There is a 200% rule, there's a 95% rule. I'm not going into those. But you have 45 days to identify your potential replacement properties. After day 45, you have 135 days to close on one or multiple of the properties that you've identified. It's very important to kind of hedge your bets. There might be a property that you really, really like, that you're going to identify, but it's good to have a backup. Because after that day 45, if you do want to perform the exchange, you're only allowed to close on those properties that you've identified.

That's another use for the DST that we always recommend. Because these things are acquired prior to the investor investing, you'll have a better idea of what you're getting into, so you can put it as a backup. You're not in a situation where a deal is going to fall through when you're using a DST.

[0:09:58.7] WS: Say someone sells a property, they make $200,000, then they're identifying those properties that they want to invest in within that 45 days, does all that have to go into one investment? Can you make it across a few different investments? What does that look like?

[0:10:15.2] JK: You can make it across, depending on what rules you use to identify properties. You can make it across multiple investments. With the DSTs, we generally create a diversified portfolio, so we'll put people into three, four, five, six different DSTs depending on the amount of their exchange. But we see people using triple net real estate as a similar vehicle. When you sell a property for a million five maybe, and you're able to buy three different properties for $500,000 each, right? When you perform an exchange, the rules of the exchange to make sure that you get the full tax deferral is simply that you have to — the real estate that you buy has to be equal or greater in value than the real estate that you sold. There's nuance there, but that is really kind of simple, straightforward rule of thumb. The real estate that you buy has to be equal or greater in value than the real estate that was sold.

[0:11:07.9] WS: Okay. You mentioned, you may put this person in four or five six DSTs, what does that mean if your investor is saying, "What does that mean I'm going to be in that many different ones?"

[0:11:18.8] JK: It just means you have exposure to greater diversification. Maybe we put you into multifamily deal, maybe an industrial deal, maybe a portfolio of triple net retail, portfolio of central business retail. Central business being kind of a buzzword during COVID. Maybe we could put you into a few different markets. You own a single property, you sold it for $3 million, you know your local submarket, but you really want to diversify around the country. And each of these DSTs contains within it properties and each of those properties might be in different markets. They might be in different sectors. It really depends on the preference of the investors, but we do tend to push people towards diversification if that's something that they're okay with,

[0:12:02.9] WS: So, the DST is more of like the investment or property specific as oppose to being specific to the investor?

[0:12:10.4] JK: I'm not sure what you mean.

[0:12:12.0] WS: Yeah. Just like, we're not going to have our own Delaware Statutory Trust, or I mean, it's this like this thing you all have in a purer investment vehicle.

[0:12:19.3] JK: Sure, yeah. The DSTs can accept up to 2,000 investors. It really is fraction ownership, right? And these are much larger assets, maybe it's an $80 million multifamily property in a top market, maybe it's a $75 industrial ecommerce, triple net lease to an ecommerce giant out in Phoenix, something like that. It really runs the gamut, runs the spectrum in terms of the types of real estate that can be contained in these DSTs. But you as an individual who investor, you're buying into something that has alongside other real estate investors.

[0:12:52.4] WS: As operators that are listening, how do they get involved in something like that so they can accept funds from a DST or how that works?

[0:13:00.7] JK: I'm not an attorney, and I'm not a CPA so I'm not going to be able to offer any kind of guidance around how you can structure DST. I know that there are number of sponsors in the space, there are smaller sponsors, larger sponsors. We tend to do business. Our organization tends to be one of the more conservative ones in the space, so we tend to do business with the larger sponsors that have established track records, 20-year, 50-year track records. If you're asking how you can structure one, I'm not the guy to talk to unfortunately.

[0:13:30.3] WS: Yeah. No, that's all right. I know you are an expert in this 1031 exchanges, can you just give your opinion on the upcoming elections. Just so our listeners know, we're recording this before the election but this can be coming out after the elections. But we'd love Justin's insight on what could potentially happen one way or the other.

[0:13:48.2] JK: Sure. Yes. So, Joe Biden has been talking about the 1031 exchange as being sort of a tax loophole. People love that term, loophole, right? It's written into the tax code, so I wouldn't call it a loophole. I think it's gotten some press because Donald Trump is historically a real-estate investor, "real estate mogul", has probably performed 1030 exchanges in the past. Can't speak to it, I don't have his tax returns I front of me, right?

Joe Biden has talked about that as being a possible way to fund some services. 1031 exchange has been around in some form or fashion for nearly 100 years. I mean, going all the way back to the 1920s, the 1930s, like kind exchanges existed in the US tax code. We're in a recession now. The commercial real estate market I think generally lags behind the general economy by 12 to 18 months, so I don't think we've really seen the full effect. Again, it being before the election, being the beginning of October right now, I don't think we've really seen the full effect of that in the commercial real estate world.

If Joe Biden were to win, I would find it to be very, very unlikely that he would take a step like removing the 1031 exchange. I mean, the impact on the commercial real estate industry would be I think catastrophic. Already being in a recession, already feeling some of those effects, at least not in first couple of years of his term would he even approach that just purely based on the catastrophe that the economy would be as a result.

Fun fact on the history of the 1031 exchange. I know that's not a phrase you hear often. The exchange initially existed for farmers to swap deeds to farmland. Until 2017, The Tax Cuts and JOBS Act actually changed some of the rules around the exchange. But until 2017, you could exchange cows because cows are part of a business. You could exchange equipment, planes. It could be exchanged artwork; it could be exchanged essentially anything that was held for investment and might see appreciation. It could be exchange in — so we work with some folks that have done exchanges for things like cattle.

[0:15:58.0] WS: Wow! Not anymore though? They can't do that?

[0:15:59.2] JK: Not anymore. It's limited to real property now. It generally refers just to real estate.

[0:16:04.5] WS: Wow! I have to keep my cows in.

[0:16:06.5] JK: Exactly. That's a tough one. And you're playing, right?

[0:16:11.7] WS: Justin, I feel like anyone who has success in business and as an entrepreneur has a high level of self-discipline. How did you gain such a high-level of self-discipline?

[0:16:20.8] JK: Well, I appreciate that first, the compliment. Thank you. For me, I think, I grew up playing sports and I'm in my late 20s now, I'm about to turn 30. I think the older that I get, the more I look back on that as being a huge influence. I mean, talk about delaying gratification. I mean, talk about putting the team before yourself, talk about putting in the work, putting in the time sort of away from the lights, away from the field so that you can come out and perform. I mean, that is such a huge thing.

Then actually, my background is in the sciences. I studied physics, and biology and engineering in school, which requires I think a high level of discipline and requires one to think methodically just because of the workloads. I would definitely say that the two of those things probably combined to create the person that I am today.

[0:17:13.5] WS: Do you have a couple of daily habits that you're disciplined about, that have helped you achieve success?

[0:17:19.6] JK: Sure. First and foremost, I'm like I said, former athlete. If I don't get to sweat in, I kind of lose my mind a little bit. During the economic shutdown, the gyms were closed and I had to get pretty creative. But I'm a guy who wakes up at 5:00, 5:30, and lift weights in the morning. For me, that's a way to have some me time, it's a way to start my day on my terms. I'm awake before other people. There aren't any demands on my time at this point. It's relaxing. The weightlifting for me is something that I really enjoy. Not everybody is that way, but it allows me to start my day with something that I really enjoy.

Then the other thing I do is, I make sure that I make time for both writing and reading. I've always been an avid reader. I mean, growing up even, science fiction or whatever. Obviously into adulthood, that becomes non-fiction and educational content. I feel really good about myself at the end of the day when I ensure that I've done some writing and that I spend an hour sort of quietly reading. For some folks, that might be your morning time. For me, I like to do the gym thing in the morning and kind of unwind with a book or some articles.

[0:18:33.9] WS: What's a way you've recently improved your business that we could apply to ours?

[0:18:40.3] JK: I think that, I mean, I have been much more active virtually, right? I mean, we all have to adapt due to some of these shutdowns, switch over to some of the video technology and whatnot. I've been much more consistent and I think being visible, posting some content. You and I were talking, I've gotten some new toys to do some video marketing and these things. I think just consistently marketing, which just sounds like such a simple thing, but if people don't know you exist, they can't use your services, right? It's just being consistent. You're the king of that. The daily Real Estate podcast, right?

[0:19:20.6] WS: Maybe this goes right into that one. What's your best source for meeting new investors?

[0:19:24.9] JK: We work very closely. Like I said, some of the virtual stuff is newer. We work very closely with tax advisors, CPAs, real estate attorney, commercial brokers. A lot of times specifically with the commercial brokers, our services can be a tool, and arrow in their tool belt. They can use to drum up some new business. Then on the tax advisor side, we build relationship. We are authentic transparent put the client first, and tax advisors tend to be sort of objective third parties, just want what's best for their clientele. So, they're great sources of referrals for us. We also have a fantastic website with all sorts of content. Here's my plug, 1031dst.com and we do get some inbound internet traffic as well.

[0:20:12.8] WS: What's the number one thing that's contributed to your success?

[0:20:15.9] JK: Consistency, and that goes back to your first question, right, the discipline, the work ethic and consistent work. It's one thing to kill yourself over the course of a week. It's another thing to be consistent over the course of years, right?

[0:20:30.5] WS: How do you like to give back?

[0:20:31.6] JK: That's tough. I try to help people. I try to genuinely add value. I do a little bit of volunteering here, down here in South Florida. We have some eco organizations that I do a little bit of volunteering at, and I've always been, like I said, study biology. I've always been interested in kind of the ecosystem. But with regards to the business environment, I think you just try to genuinely provide value to sort of an unselfish place. I think people recognize that.

[0:21:00.4] WS: Sure. Justin, grateful for your time today just really going through this Delaware statutory trust and who it's for, and maybe probably if someone has heard of it, they probably mistake it with a 1031 and how they're different and who it's for. Grateful for your time. Tell the listeners how they can get in touch with you and learn more about you.

[0:21:19.6] JK: Sure, so 1031dst.com is our website. You can find me on LinkedIn. I'm sure Whitney will include maybe a link to my profile in the caption here. You can give me a call, 401-703-6680. Always answer the phone. Pretty straightforward there.

[0:21:35.7] WS: Awesome. That's a wrap, Justin. Thank you very much.

[0:21:39.4] JK: Absolutely.

[END OF INTERVIEW]

[0:21:40.5] WS: Don't go yet, thank you for listening to today's episode. I would love it if you would go to iTunes right now and leave a rating and written review. I want to hear your feedback. It makes a big difference in getting the podcast out there. You can also go to the Real Estate Syndication Show on Facebook so you can connect with me and we can also receive feedback and your questions there that you want me to answer on the show.

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[OUTRO]

[0:22:19.8] ANNOUNCER: Thank you for listening to The Real Estate Syndication Show, brought to you by Life Bridge Capital. Life Bridge Capital works with investors nationwide to invest in real estate while also donating 50% of its profits to assist parents who are committing to adoption. Life Bridge Capital, making a difference one investor and one child at a time. Connect online at www.LifeBridgeCapital.com for free material and videos to further your success.

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