The 7 Deadly Sins of a Delaware Statutory Trust (DST)

Investors who want “mailbox money” may find Delaware Statutory Trusts attractive due to their passive nature. They are a kind of co-investment vehicle that allows investors to pool their cash and jointly own an asset, like real estate or a business. They are especially attractive to real estate investors as they count as “like-kind” assets for 1031 exchanges.

But there’s a catch. The IRS condition the creation of a DST on 7 non-negotiable rules the Trustees must follow in order to safeguard hard-earned investor capital. These rules are known as the “7 deadly sins”.

1. Thou Shalt Not Accept More Contributions Once the DST Offering is Closed

Once the offering is closed, it is closed. Investors purchased a proportional share of the beneficial interest of the DST. Accepting more contributions stands to **dilute** its ownership, which is unfair to the initial investors. For this reason, new contributions to a closed DST are disallowed.

2. Thou Shalt Not Take On More Debt or Restructure the Existing Debt

Before investing in the DST, investors have a right to understand and evaluate the debt structure as part of their **risk assessment** for an investment that they cannot easily get out of. If the trustee was allowed to renegotiate the current debt, or to take out or assume new debt, it would be unfair to the beneficiaries.

3. Thou Shalt Not Reinvest the Proceeds of the Sale of Assets in the DST

All proceeds of a sale must be distributed to the beneficiaries so that **they can decide** what to do with it. The investor can choose to pay the taxes or do another 1031 exchange. The trustee can’t make that choice for them by reinvesting the funds in new real estate.

4. Thou Shalt Not Make Prohibited Capital Expenditures

Trustees of a DST cannot make any capital expenditure they see fit. The rules require that the trustee only make capital expenditures on:

- Normal repairs and maintenance
- Minor non-structural capital improvements
- Those required by law.

More major, wall-moving type structural changes would greatly increase the risk profile of an offering.

5. Thou Shalt Not Invest Proceeds of the Sale in Disallowed Investment Vehicles

There may be an interim period between monthly distribution checks. The trustee may be tempted to invest the cash proceeds in another investment vehicle to keep the money working for the investors, but the trustee is also restricted in *how* (s)he can invest those proceeds. In the interim between monthly distribution checks to investors, the trustee can only invest the proceeds in **short-term debt obligations** that can be converted to cash quickly.

6. Thou Shalt Not Withhold Cash Beyond Necessary Reserves

The trustee is not allowed to withhold funds from the DST investors, outside of reasonable reserves for necessary repairs and emergencies. All other cash receipts must be distributed to the investors in a reasonable amount of time.

7. Thou Shalt Not Enter Into New Leases or Renegotiate Current Leases

The rules of a DST state that the trustee can't enter into new leases or renegotiate current leases. To work around this rule a master lease structure is used. This structure places the Trustee between the property renters and the investors. The Trustee's job is to maximize rents, minimize costs, and follow the rules of the Master Lease to pay investors timely.

In asset classes with shorter term tenants (like multifamily or self-storage), master leases are often structured with "bonus" rent potential. This "bonus" rent split may be as high as 90% to the investors and 10% to the Sponsor. "Bonus" rents align interests, because both the Sponsor and Investor participate when the underlying property outperforms financial projections.

The result of Trustees following these IRS rules - happy investors, eager to invest in DSTs.