REAL ESTATE TODAY

As Pro-Tenant Laws Expand, Some Small Landlords Are Looking to Cash Out

By JIM SMITH, Realtor®

Under laws enacted by the 2024 General Assembly, Colorado tenants gained many protections, both from eviction and for "habitability," but those protections for tenants have made being a landlord trickier, more expensive, and riskier, especially for the small landlord who manages his or her own rental units.

In the posting of this article at http://realestatetoday.substack.com, I have included a link to an article with a fuller description of those new laws.

Last week, I helped one such small landlord dispose of his rental duplex and invest the proceeds in a way that deferred his capital gains without having to buy another rental property that carried those problems and management.

In his case, he had to deal with a squatter who knew his protections against eviction that already existed under Colorado law and refused to leave. That experience left such a bad taste in my client's mouth that he chose to sell instead of finding a new tenant. The new protections for residential tenants only add to the unattractiveness of being a small landlord of residential properties.

The changes in landlord-tenant law include the banning of occupancy limits based on familial relationships by local governments. Local governments may still implement residential occupancy limits based on demonstrated health and safety standards, such as international building codes, fire codes, wastewater and water quality standards, or affordable housing program guidelines.

College towns, including Boulder and Golden, have in the past implemented occupancy limits to prevent the use of single-family homes by large numbers of unrelated college students.

Rent increases of more than 10% over the prior year's rent are now prohibited.

Meanwhile, selling a long-held investment property can subject the seller to capital gains tax and depreciation recapture that can wipe out much of the profit from selling. A common tax strategy for deferring those taxes is to do a "like kind" exchange under Section 1031 of the Internal Revenue Code.

By purchasing a replacement investment property using the proceeds from your relinquished property, you can put the *pre-tax* proceeds to work generating income.

"Like kind" properties are broadly interpreted by the IRS to include any real estate, allowing you to reinvest funds as a passive investor in what's known as a Delaware Statutory Trust (DST). However, a DST investment is only for "accredited investors."

Individual accredited investors fall under two categories:

- They have an individual net worth, or joint net worth with their spouse, excluding primary residence, but including home furnishings and personal automobiles, of more than $1,000,000, or
- They have an individual income in excess of $200,000 or joint income with their spouse in excess of $300,000, in each of the two most recent years and have a reasonable expectation of reaching the same income level in the current year.

DSTs are exploding in popularity, and with good reason. A Delaware Statutory Trust is an ownership structure that allows an investor to purchase a fractional interest in a large property or portfolio of properties. The DST is a legal entity (formed as a trust under the laws of Delaware) which holds legal title to the property or properties held in the trust.

For Federal income tax purposes, each DST investor owns a "beneficial interest" in the trust and is treated as owning an undivided fractional interest in the real estate being held by the trust. A real estate company, as sponsor, purchases the real estate for the DST and sells "beneficial interests" to 1031 exchange investors through broker/dealers.

The investors, as beneficiaries of the trust, receive their prorated share of the income, tax benefits, and any capital appreciation produced by the real estate. The real estate company, as sponsor of the DST, serves as the trust manager and is responsible for making the major management decisions of the trust. Some examples of the type of real estate that a DST may invest in are: Industrial, Multi-Family, Medical Office, Student Housing, Senior Housing, Retail, Storage, etc..

If you list your investment property for sale and your listing agent doesn't tell you about DSTs, show him or her this article. Note: Your real estate agent can't sell you a DST, so they don't earn a commission if that's the reinvestment vehicle you have chosen.

We learned more about DSTs when **Wayne Bernardo** of **Bernardo Asset Management**, a boutique real estate securities firm in Evergreen, spoke to our brokers and me at a recent office meeting.

One problem with doing a traditional 1031 exchange is that you must identify your replacement property within 45 days of closing on the relinquished property, and close on the replacement property within 180 days. It's not uncommon for a 1031 exchange to fail due to missing these deadlines, leaving the seller of the relinquished property to owe the capital gains tax which he or she was intending to defer. The good news in that situation is that it takes almost no time to switch to a DST. If it's day 44 and you know you'll miss the 45-day deadline, there's still time to invest in a DST. But you must identify the DST by day 45 with your Qualified Intermediary (QI).

That's because there are always some DSTs being offered, and Wayne Bernardo can assist you in finding a DST option to complete your 1031 exchange. He proved that last week when he spoke to us on Monday, and I told him I had a closing that Friday in which the seller was facing over $500,000 in taxable capital gains which he was willing to pay to get out of his rental investment. "Can you help him," I asked. He did.

The answer was clearly "yes," because at the closing that Friday, the settlement statement showed $500,000 of the sellers' proceeds going to my client's Qualified Intermediary for a DST purchase.

Instead of paying capital gains tax (and depreciation recapture) on his sale and wondering how to invest what was left, my client is investing $500,000 in a DST that will earn him an expected monthly income stream over the life of the DST. (Note: Distributions are not guaranteed.)

One of the "negatives" about DSTs is that it is not a liquid investment. You can't pull your money out of the DST for at least 5 to 10 years, but if that is not a problem for you, it's a great solution for the seller who wants to get out of an investment property without paying capital gains tax but having no further management concerns or liabilities. Wayne refers to it as "mailbox money," because you get a check in the mail without the headaches of being a landlord.

Note: You don't have to invest your entire proceeds in a 1031 exchange. My client who invested $500,000 in the DST also received $153,000 in proceeds on which he will pay capital gains tax but which will provide over $100,000 in net proceeds for other purposes, such as travel. I did the same thing when I sold an office building in 2004 and didn't reinvest the entire amount using a 1031 exchange.

For more information about DSTs, check out Wayne's website **www.BernardoAsset.com**, or call Wayne at **303-981-1387.** Let him know you saw this article, which he fact-checked for accuracy.

Of course, my broker associates and I are ready and able to help you sell your investment property. Our contact info is below.

As with any real estate investment, there are risks with investing in DSTs. Here's how they are spelled out on Wayne's website:

- **Investors Do Not Hold Title:** 1031 Exchange DST investors do not hold title of the property but rather own beneficial interests in the trust and the sponsor controls the management and selling of the property.
- **Illiquidity:** A Delaware Statutory Trust interest is an illiquid alternative investment and there is no current active secondary market for selling your interest, which creates the inability to access immediate liquidity.
- **Potential for Property Value Loss:** All real estate investments have the potential to lose value during the life of the investment.
- **Reduction or Elimination of Monthly Cas Flow Distributions:** Like any investment in real estate, if a property unexpectedly loses tenants or sustains substantial damage, there is a potential for suspension of cash flow distributions.
- **No Performance Guarantee:** General real estate market risks also apply to DSTs. There can be no assurance that a property will perform as projected. DSTs are subject to economic volatility, tenants not paying their rent on time, and other traditional risks of owning, operating and selling real estate.
- **Potential Change in Tax Law:** Tax laws are subject to change, which may have a negative impact on a DST investment.

Why Are HOA Dues Surging?

With the above article, I ran out of space to include an article on this topic. To read it, go to our blog at **RealEstateToday.substack.com**.

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