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Rogers Aims to Grow DST Business into Bigger Investment Manager

Louis Rogers, a long-time specialist in structuring tax-deferred property exchanges, is aiming to buy more than $100 million of real estate through the rest of the year that would be syndicated through Delaware Statutory Trusts, or DSTs.

Rogers is widely viewed as a pioneer in the securitized tax-deferred exchange business. In the late 1990s, he helped launch Triple Net Properties, which until its acquisition by Grubb & Ellis in 2007 was the top player in the tenant-in-common, or TIC, business. He later formed Rogers Realty Advisors, and four years ago he launched Capital Square 1031, which has grown to some $485 million of real estate under management. Those properties are overseen on behalf of 29 DSTs it has structured.

Rogers' goal is to build his company into a broader-based investment manager. He's aiming to increase assets under management to at least $1 billion within the next 24 months by structuring additional DSTs and by launching two investment vehicles, a preferred-equity fund and a private REIT that would be capitalized by investors not necessarily looking for tax-deferred exchanges. Each of those will have a total equity capitalization of up to $30 million that when leveraged, could end up owning some $60 million to $75 million of real estate.

But driving Rogers' business is the ongoing demand for real estate to complete tax-deferred exchanges. The exchanges, facilitated by section 1031 of the tax code, allow property owners to defer paying taxes on capital gains from the sale of those properties if proceeds are re-invested into similar properties.

Demand for tax-deferred exchanges ebbs and flows with market conditions. If property values decline, fewer property owners sell, so the need for tax-deferred exchanges slips. But the opposite is true when values increase.

Given that values now are 16.8 percent higher than they were during the last market peak, demand for exchanges has grown tremendously. Rogers also pointed to aging Baby Boomers who might have owned rental properties as investments and are now ready to quit that business and own more passive investments.

"They can sell their rental houses and diversify their proceeds," he explained. He noted that rental houses in certain areas of the country, like Los Angeles, typically will sell for prices resulting in capitalization rates of less than 4 percent. Sellers can take advantage of that, and plow proceeds into a DST.

And because DSTs involve groups of investors, a property owner who has sold an investment property can plow proceeds into a number of trusts, effectively diversifying his or her capital.

Between 2005 and 2007, roughly $10.5 billion of capital was raised through TIC vehicles that were put together by some 85 sponsors. In 2002, when TICs were just starting to become popular, only 10 sponsors put together such vehicles. Perhaps five sponsors, including Capital Square, are now active in the DST business.

Like other investors, TICs often used mortgage debt to leverage their investment capital. So the $10.5 billion of equity could have been used to invest in perhaps $30 million to $35 million of real estate.

Complicating matters is that investors in TICs each hold a proportional share of a property's title. That proved to be complicating when things soured because any one of the up to 35 investors that formed each TIC could thwart a workout.

Last year, for instance, three investors in a TIC that owned 1818 Market St., a 1.1 million-square-foot office building in Philadelphia, filed for bankruptcy, temporarily thwarting the property's $184.75 million sale. While the bankruptcies were ultimately resolved and the property's sale completed, it showed just how cumbersome the TIC structure could be.

Indeed, lenders today generally are loathe to write a loan against a TIC-owned property unless all members of the group agree to certain ground rules.

Because TICs would have a difficult time finding financing, sponsors have turned to DSTs to promote their tax-deferred exchange services. Those operate much like general partnerships, where each investor owns shares in the DST, not the underlying property. That property is managed by a sponsor in exchange for fees. DSTs typically are capitalized by far more than the 35 investors that TICs are limited to.

Most DST sponsors will buy a property, then syndicate interests in a DST, so each must be relatively well capitalized. TIC-sponsors previously would syndicate interests before buying a property.

Rogers, in his plan to grow the size and scope of Capital Square, is promoting diversification. He's focusing on relatively conservative property types - class-B apartment properties in major areas, medical offices and triple-net leased retail properties - and arranging deals that would have varying maturities. Most recently, for instance, his company sewed up the purchase of a 9,500-square-foot medical-office property in Winchester, Va. Medical-office properties generally are viewed as very stable because their tenants, typically doctors and dentists, often will make expensive upgrades, like installing dental chairs and other medical equipment that can't easily be moved.

Rogers said the entire DST business is a tiny niche. "If you think of the whole national economy, real estate is a footnote." The securitized tax-deferred "exchange business is a footnote of a footnote."