Unlocking Portfolio Diversification Through 721 Exchanges

A Strategic Approach to Tax Deferral

Section 721 of the Internal Revenue Code offers an alternative tax-deferral strategy for property owners seeking an option beyond a traditional Section 1031 exchange. Through a Section 721 exchange, real estate may be contributed to the operating partnership of a real estate investment trust (REIT) tax-deferred. The REIT is structured as an umbrella partnership REIT, commonly known as an UPREIT. The 721 exchange is referred to as an "UPREIT transaction".

Rather than contributing a property directly to a REIT, a property owner may utilize a Delaware statutory trust (DST) as a path to complete the 721 exchange (UPREIT transaction) transforming direct property ownership into passive ownership of units in the operating partnership of the REIT (OP Units).

How the 721 Exchange Works Within the DST Structure

A property owner can sell a property and reinvest the proceeds in a DST, which may provide monthly income distributions. DSTs are considered long-term investments and are not readily liquid. After at least two years, the DST properties may be contributed to a REIT through a 721 exchange, or UPREIT transaction. Investors may then receive OP Units in exchange for their interests in the DST. The OP Units generally cannot be redeemed during the first year. After that, investors may have the option to redeem them for cash, depending on the REIT's redemption program. Redemptions are typically taxable, while OP Units passed to heirs may receive a step-up in cost basis. In addition, OP Units may continue to provide monthly income and can be divided among beneficiaries, offering potential flexibility for estate planning and future liquidity needs.

Step 1

Sell property



Step 2

Invest sale proceeds in a DST for a minimum of 2 years



Step 3

Investor exchanges ownership in the DST for OP units from a REIT's operating partnership that has an option to acquire DST interests.
(if option is exercised)*



Step 4

Investors with OP units may have opportunity to redeem for cash, subject to liquidity provisions outlined in the REIT OP's operating agreement



Key Considerations

Property owners cannot take possession of the proceeds from the sale of their relinquished property. Instead, the proceeds must be transferred directly to a qualified intermediary (QI) and held in a QI exchange account. Only proceeds handled through this process may be eligible for a 1031 exchange. The applicable identification and closing deadlines still apply when the proceeds are reinvested in a DST, regardless of whether a future 721 exchange is anticipated. The REIT may choose, but is not required, to accept the DST properties in exchange for distributing OP Units to investors in the DST. Because OP Units are partnership interests rather than like-kind real property, they are not eligible for a future 1031 exchange.

*It is important to note that there is no assurance that the operating partnership will exercise its option and the DST investors will receive OP units.

Important note: OP Units and shares of REIT stock do not qualify as like-kind property. If a investors sells OP Units or the shares of the REIT, or the REIT sells a portion of the portfolio and returns capital to its investors, investors will be required to recognize any capital gain or loss when taxes are filed.

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Please see reverse side for important disclosures.

Potential Benefits of a 721 Exchange via DST

Diversification
Access to an existing and growing portfolio of professionally managed, institutional-quality real estate diversified by asset classes and geography.

Flexibility & Self-Directed Liquidity
Possible liquidity flexibility through whole or partial redemptions, allowing investors to align decisions with their financial goals.

Income
May provide distributions from an actively managed portfolio of income-producing properties.

Tax & Estate Planning
Heirs may benefit from step-up in cost basis and greater flexibility over inherited interests.

Capital Appreciation
Opportunity for capital appreciation if portfolio values increase over time.

Simplified Tax Deferral
Potentially maintain tax deferral without the need to complete multiple future exchanges.

Important Distinctions between 1031 and 721 Exchanges

Both 1031 and 721 exchanges allow investors to defer taxes, avoid day-to-day property management responsibilities and pass assets to heirs. A traditional 1031 DST generally provides limited liquidity but preserves the ability to complete future 1031 exchanges, while a 721 exchange into REIT OP Units may offer greater liquidity flexibility but ends the opportunity for future 1031 exchanges. The appropriate strategy, or combination of strategies, will depend on the property owner's financial needs, long-term goals and desire for future investment flexibility.

1031 Exchange into a Traditional DST	721 Exchange into OP Units
Diversify into multi-million-dollar asset	Diversify into multi-billion-dollar portfolio
Limited liquidity (available upon sale of each DST)	Potential liquidity (subject to underlying REIT liquidity rules)
No management responsibilities	No management responsibilities
Future investment flexibility	Loss of future decision making
Appeals to younger investors in earlier stages of portfolio development	Appeals to investors in later life stages focused on long-term ownership and estate planning objectives
Defer taxes	Defer taxes
Pass assets to heirs/avoid capital gain tax	Pass assets to heirs/avoid capital gain tax
Perpetual 1031 exchange opportunities	Not eligible for future 1031 exchange
Allow tax-deferred return to direct property ownership	Offers flexibility to manage taxes over time and offset losses in a portfolio

An investment in an IPC-sponsored program is subject to various risks, including but not limited to:

- No public market currently exists, and one may never exist, for the interests of any IPC-sponsored program. The purchase of interests in any IPC-sponsored program is speculative and is suitable only for persons who have no need for liquidity in their investment and who can afford to lose their entire investment.
- IPC-sponsored programs offer and sell interests pursuant to exemptions from the registration provisions of federal and state law and, accordingly, those interests are subject to restrictions on transfer.
- There is no guarantee that the investment objectives of any particular IPC-sponsored program will be achieved.
- The actual amount and timing of distributions paid by IPC-sponsored programs is not guaranteed and may vary. There is no guarantee that investors will receive distributions or a return of their capital.
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- IPC-sponsored programs depend on tenants for their revenue, and may suffer adverse consequences as a result of any financial difficulties, bankruptcy or insolvency of their tenants.
- IPC-sponsored programs may own single-tenant properties, which may be difficult to re-lease upon tenant defaults or early lease terminations.
- Disruptions in the financial markets and challenging economic conditions, could adversely affect the operating results of properties owned by IPC-sponsored programs and the ability of such programs to service the indebtedness on their properties.
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Publication date: 11/6/2026