Inland Private Capital Corporation

Delaware Statutory Trust

www.inland-investments.com

What is a Delaware Statutory Trust ?

A DST is a business trust created under Delaware law. A DST can be used in a wide variety of business settings. However, to use a DST in a Section 1031 syndication program, it must comply with the requirements of IRS Revenue Ruling 2004-86 and must also (if the DST's property is debt financed) meet lender requirements. To satisfy these requirements, each of Inland Private Capital Corporation-sponsored DSTs must:

- Be a special purpose entity (SPE). This means that the purposes of the DST must be limited to the acquisition, conservation, protection and disposition of its real estate assets.

- Be bankruptcy remote. This means that the DST must be operated both formally and functionally as an entity that is distinct from the sponsor, the investors and any other person.

- Be a passive holder of real estate. This means that (a) the trustee of the DST can have only limited power over the operation of the DST's real estate, and (b) the investors in the DST can have no powers whatsoever over the operation of the DST's real estate.

Lender Benefits

Management and control advantages. In tenant-in Common (TIC) deals, the IRS requires that certain fundamental decisions, such as a sale or refinancing of the property, or entering into leases, management or brokerage agreements, be made unanimously by investors.

In contrast, a Delaware Statutory Trust (DST) structure takes all decision-making out of the hands of investors and places it into the hands of a sponsor-affiliated trustee. Accordingly, in times of crisis, DSTs are more agile decision-makers than TIC programs.

Structural simplicity. In a TIC deal, each investor owns a fractional interest in the underlying real estate through a special purpose entity, usually a limited liability company (LLC). In addition, investors are required to join a Co-Ownership Agreement (governing relations with other investors), a management agreement or master lease (governing relations with the investment program sponsor), and become borrowers under the loan agreement.

In a DST offering, however, investors need to execute only one agreement -- the trust agreement for the DST. The DST will own 100% of the fee interest in its real estate, so unlike a TIC program, the lender only needs to make one loan to one borrower. In addition, due to the limited authority investors are permitted to have over a DST, lenders do not require investors to execute any nonrecourse carve-out guarantees, or to perform due diligence on any of the investors, beyond any standard anti-terrorism requirements and other similar “know your customer” due diligence.

Investor Benefits

Costs to investors of participation in a DST program are much lower than the costs of a TIC program. In a DST program, investors do not need to incur the annual costs of maintenance and qualification of a special purpose LLC to hold their real estate interest. In addition, DST investors are not required to execute lender guarantees or indemnities, given their purely passive relationship to the DST and the real estate. Furthermore, because all management authority in a DST is vested in the sponsor-affiliated trustee, there is no risk of investors being held hostage in a time of crisis by a "rogue investor," as has occurred too often in TIC workout situations.

Investors are also benefitted by the enhanced scalability and diversification DST programs can achieve. Because the IRS limits the number of investors in any single TIC program to 35, they are generally limited to mid-size or smaller properties (less than $25 million total value) and require large minimum investments (often at least $500,000). DSTs, however, are not subject to an investor limit under the tax law, and can have up to 2,000 investors. Thus, DSTs can own properties with aggregate value much greater than any TIC deal, while simultaneously accommodating much smaller minimum investments, allowing diversification of investments across multiple DST programs.

DST Limitations - Seven Deadly Sins

In certain respects, DST programs are more restrictive than TIC programs. In order for an interest in a DST to be treated as a direct interest in real estate for Section 1031 purposes, the IRS has held that it must not be able to violate the "seven deadly sins." They are:

1. Once the offering is closed, there can be no future capital contributions to the DST by either current or new beneficiaries.
2. The trustee cannot renegotiate the terms of the existing mortgage loans nor can it obtain any new mortgage financing from any party except where a property tenant is bankrupt or insolvent.
3. The trustee cannot enter into new leases or renegotiate existing leases except where a property tenant is bankrupt or insolvent.
4. The trustee cannot reinvest the proceeds from the sale of its real estate.
5. The trustee is limited to making the following types of capital expenditures with respect to the property:
   (a) expenditures for normal repair and maintenance of the property,
   (b) expenditures for minor non-structural capital improvements of the property, and
   (c) expenditures for repairs or improvements required by law.
6. Any cash held between distribution dates can only be invested in short-term debt obligations.
7. All cash, other than necessary reserves, must be distributed on a current basis.

Given the restrictions on their activities, DSTs are not designed for all property classes. They are best suited for properties subject to a long-term lease to a creditworthy tenant on a triple-net basis, and can also successfully be used with a "master lease" structure for multi-family, multi-tenant retail, and similar property types.

The Springing LLC as The "Emergency Parachute"

The typical trust agreement for an Inland Private Capital Corporation-sponsored DST provides that if the trustee determines that the DST is in danger of losing the property due to its inability to act because of the "seven deadly sins," and in certain other situations as may be required by the lender, it can convert the DST into a limited liability company (the Springing LLC), the operating terms for which are predetermined in the DST's trust agreement. In a conversion under Delaware law, the Springing LLC is treated as the same entity as the DST. This means that, for purposes of Delaware state law, there is no real estate transfer or change in the borrower. The operating agreement for the Springing LLC will contain the same SPE and bankruptcy remoteness provisions that are contained in the DST's trust agreement. However, it will not contain the prohibitions against the "seven deadly sins" and thus will permit the raising of additional capital contributions, the raising of new financing, the renegotiation of the terms of the existing financing, or entering into new or modified leases. In addition, it will provide that the trustee (or sponsor) will become the manager of the Springing LLC.

Although the conversion of a DST into a Springing LLC permits actions to be taken to conserve and protect an investor's investment, the Springing LLC will be treated as a partnership for federal income tax purposes. Among other things, this means that investors will not be able to engage in a Section 1031 exchange of their interests in the Springing LLC. While strategies exist that may be available in certain circumstances to put investors back into an ownership structure that can be exchanged for Section 1031 purposes, no guarantees as to outcomes can be given. Nevertheless, the benefits of the Springing LLC when the need for it arises vastly outweigh the uncertainty that exists with respect to tax aspects of an exit from a Springing LLC.

Important Risk Factors to Consider

- No public market currently exists, and one may never exist, for the interests of any IPCC-sponsored program. The purchase of interests in any IPCC-sponsored program is suitable only for persons who have no need for liquidity in their investment and who can afford to lose their entire investment.
- IPCC-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 IPCC-sponsored program will be achieved.
- The actual amount and timing of distributions paid by IPCC-sponsored programs is not guaranteed and may vary. There is no guarantee that investors will receive distributions or a return of their capital.
- Investments in real estate are subject to varying degrees of risk, including, among other things, local conditions such as an oversupply of space or reduced demand for properties, an inability to collect rent, vacancies, inflation and other increases in operating costs, adverse changes in laws and regulations applicable to owners of real estate and changing market demographics.
- IPCC-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.
- IPCC-sponsored programs may own single-tenant properties, which may be difficult to re-lease upon tenant defaults or early lease terminations.
- Continued disruptions in the financial markets and challenging economic conditions could adversely affect the ability of an IPCC-sponsored program to secure debt financing on attractive terms and its ability to service that indebtedness.
- The prior performance of other programs sponsored by IPCC should not be used to predict the results of future programs.
- The acquisition of interests in an IPCC-sponsored program may not qualify under Section 1031 of the Internal Revenue Code of 1986, as amended (the “Code”) for tax-deferred exchange treatment.
- Certain of the programs previously sponsored by IPCC have experienced adverse development in the pas

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