



Alternative Investing 2026 Delaware Statutory Trust (DST) Guide for Investor



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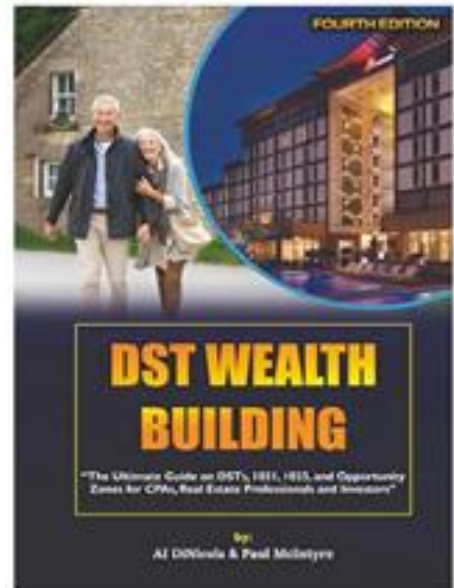
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Preface

Investing in alternative investments has gained popularity over the past ten years. Many investors are seeking non-correlated investing strategies in addition to their typical equity and bond strategies. In addition, the continued utilization of Section 1031 tax deferred exchange vehicle has expanded alternative investing to include Delaware Statutory Trust (DST). We appreciate your interest in discovering the potential benefits in our Guide for Investors. **DST are for accredited investors only.** Much of the information in this guide has been taken from ***DST Wealth Building*** available on Amazon and in Fourth Edition. Co Authors Al DiNicola and Paul McIntyre.

We have been involved in real estate consultation for over 40 years. This has involved a breath of knowledge that includes residential, commercial, REITs, Alternatives, §1031 exchanges and DSTs. However, one size does not fit every investor and client suitability is very important. This Guide for Investors is not an offer to purchase securities and is intended to be educational in nature.

We have gladly spent countless hours educating investors, CPAs, real estate brokers/agents and others to understand the potential value and impact of DST investing. We do not provide tax advice and suggest all investors consult with their tax advisors on their specific situation.



We always make time to speak with seasoned investors and new investors regarding their alternative investing goals and needs. Call us for a consultation regarding your general and specific questions. Additional information can be found on one of our websites.

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Section 1. Introduction- About FIDUCIARY CM

FIDUCIARY CAPITAL MANAGEMENT, LLC (Fiduciary CM) is a Registered Investment Advisor (RIA) that provides retirement plan consulting, portfolio management, insurance and other specialized consulting services to business owners and investors. **Our firm consists of a diverse group of experienced financial advisors, who love the industry and care about their clients.** We have full-service financial firm capabilities and are committed to helping our clients pursue and achieve their financial goals. FIDUCIARY CM provides a wide range of financial products and services to individuals and business owners, including both in-house portfolio management and access to numerous wall street portfolio management services.

FIDUCIARY CM has relationships with several significant financially strong institutions that can custody client portfolio assets. These include LPL Financial, SEI Trust Company, Interactive Brokers and AssetMark.

We believe informed clients will be better able to identify their goals and make sound financial decisions.

Please call or email Paul McIntyre if you have any questions about our firm or a question on the range of financial products and services we can provide. He can direct you to a financial advisor that can best serve your needs and objectives.

FIDUCIARY CM also specializes in consulting services related to tax-deferred §1031 Exchange strategies and options. For over 20 years, we have assisted individuals in securing alternative investments and have helped in the §1031 exchange process to dispose of existing property as well as select suitable replacement alternatives in securitized real estate. We are educators by nature and discipline. At the center of our process is the understanding of the specific objectives and goals of the investor.

We firmly believe in continued education and are members of FINRA. Our credentials include many various licenses.

To learn more about FIDUCIARY CM, visit www.FiduciaryCM.com . We also have two dedicated sites for information and education on Delaware Statutory Trust (DST). DST.Investments and DST.News.ORG. We also provide consultation without charge on a wide variety of real estate related topics including 1031 exchanges and DSTs.

Section 2: §1031 Exchange DST Advisor Requirements

Section §1031 Tax Deferred Exchange has been in existence (although modified at times) for over 100 years. This section has been considered an extremely beneficial section of the code and at times viewed as a loophole by some legislators. Recently there have been suggestions to alter or eliminate the tax deferred section. When analyzed, the benefit to the overall economy is hard to deny. The rules and timing of the exchange are very strict and need to be followed without deviation. The only exception may be when there is a natural disaster and certain areas of the

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country may have a brief extension. The penalty for not adhering to the rules and timeline will result in a failed exchange. A failed exchange could result in a large tax liability. Many investors work with financial advisors. However, all financial advisors may not be involved in or experienced with a Delaware Statutory Trust (DST) let alone a §1031. Working with an experienced §1031 exchange advisor can streamline the process through education and strategic planning. Having a real estate brokers or real estate agent license alone does not permit representation or acquisition of a DST.

Some of FIDUCIARY CM's advisors are highly experienced §1031 Exchange Advisors. This professional approach and understanding of the IRC rules, exchange process and replacement options has proven to benefit investors for years.

Investors selling one property and acquiring another may focus on the overall cost of sale, which affects net proceeds for future investment. In many respects we work for you. We operate as a Fiduciary on your behalf. We do not charge an upfront fee unless you as an investor hire us as an additional due diligence source for an investment you are contemplating. Similar to other real estate offerings, our compensation typically may come from the seller/sponsor of the replacement asset. However, we do provide specific enhancements to investor equity in certain situations.

We do believe we offer other benefits working with FIDUCIARY CM including:

- Understanding your tax liability is the first objective. While we are not CPAs or tax professionals, we can assist you in understanding your tax liability. We interface with many CPAs reviewing the individual investor situation. A §1031 exchange may be a solution, or you may have a better strategy utilizing another alternative strategy or to simply paying the capital gains.
- We understand the educational process for investors. The education included strategies for the exchange. Correspondence from the Qualified intermediary (QI) may be confusing to understand. We deal with many of the national QIs and can assist with instructions on filling in the 45-day notification forms.
- Each investor has financial goals typically align with investor lifestyle (moving towards passive investing). We assist in understanding how to identify, select and acquire §1031 replacement properties.
- The process from start to finish has milestones that need to be followed for total adherence to the IRS rules. We can guide the process.
- We communicate with all investor support teams including the CPAs, QIs, attorney, trust representative and others to protect the exchange. Ultimately the investor is at the center of the process, and we are involved in the entire process.

Section 3: Definition- Delaware Statutory Trust (DST)

Delaware Statutory Trusts, (DSTs) are available for accredited investors only. Cash investors as well as §1031 investors have invested in DSTs for a variety of reasons. DSTs are passive

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investments. Passive investments appeal to certain investors who are seeking a hands-off approach to real estate investing. Investors in a DST own a beneficial interest in a trust. The beneficial interest is referenced as an undivided fractional interest in the asset or property owned by the trust. In some respects, a DST may be compared to a limited liability company (LLC). The comparison would be in the structure as a pass-through entity with all income and dividends being taxed at the individual investor level. There may be a large number of investors, each with their own fractional interest (based on investment dollars or equity) in the assets/property of the trust. DSTs are also very popular with investors utilizing IRC section 1031. DSTs are typically high-quality institutional grade properties typically outside the financial reach of the individual investor. In 2004 the IRS recognized the DST as a suitable replacement property for the §1031 exchange.

Since the 2004 IRS ruling, a share of a DST qualifies as a “like-kind” investment in a §1031 exchange, meaning you can exchange or trade an investment or business property for a DST share. The exchange enables you to defer your capital gains.

DSTs may be a single asset property, or the DST may consist of multiple properties in a portfolio. Normally if there are multiple properties, they are all the same asset class. The holding period may be from 4 years to 10 years. There may also be longer terms than 10 years. The sponsor will determine when the property will be sold. Investors will be notified in advance regarding the sale of the property. The proceeds of the sale are distributed to each investor depending on their percentage of interest in the DST. The individual investors will decide what to do with the proceeds from the sale (and any appreciation). Investors may simply take the cash and pay the capital gains due. The capital gains due would be the accumulated gains from entering the DST via §1031 or any capital gains recognized from the DST appreciation. The investor may decide to enter another §1031 utilizing another DST. The investor may still enter §1031 and move into a traditional real estate investment property. Investors may seek to do a combination of options. Within the past few years there has been a fourth option some DST sponsors have structured. There may be an option to enter Section 721 UPREIT. There will be more discussion on this option. This may be an option or may be mandatory depending on the DST structure.

Section 4: Rise of Popularity

By design the state of Delaware has positioned itself as a leader in the country when it comes to financial and fiduciary services. Most of the other states utilize common law trust rules. There may be a lot of uncertainty when using uncodified rules when establishing and creating trust.

The Delaware Statutory Trusts, established in Delaware, comes under Title 12 Certificate of Trusts which is a comprehensive provision. The IRS’ §1031 Exchange approval utilizing DST in conjunction with the Title 12 Certificate of Trust have increase the popularity and use of the DST alternative. The DST foundation and framework provide the legal and enforceable structure and function of the DST.

Section 3805 is very direct in declaring your rights as beneficiary:

The rights of beneficial owners and trustees in trust property provides for the creation of several classes of trustees and beneficial owners. That determines assets distributions to beneficial owners.

Section 3806 provides for organizational structure:

Title 12 §3806: Management of statutory trust delegates powers to the Trustees. They in turn may re-delegate some of those duties to officers, agents or others designated in the Agreement.

Further, the 1985 Direct Trustee Statute allows Sponsor-appointed trustees to work with outside investment advisors and other trust specialists. A *Directed* trustee may engage independent investment and distribution advisors to provide investment, logistic, and other support.

Further, investors are offered a high degree of comfort under enforceable Trust legal oversight. The *Directed* trustee may engage trust protection advisors, as well. Since DSTs are a pre-packaged investment, it also means due diligence examinations have been performed by the Sponsor. All property inspections have been conducted as well.

Section 5: Delaware Statutory Trust Benefits

When an investor decides to sell their investment property, especially a property that has appreciated in value, including a DST as an alternative has many advantages. DSTs are very scalable, meaning they can be acquired in any needed amount. That means down to the exact dollar amount of the property being sold or relinquished. This provides flexibility as the primary replacement property or leftover proceeds. DSTs provide passive ownership meaning elimination of active management. In the event debt replacement is required, DST are structured with non-recourse financing. The advantage of non-recourse financing affords multiple benefits. Investors need not apply for or be responsible for any of the loans on DST that are leveraged. Leveraged DSTs are by design. The Loan to Value (LTV) may range from 20% to over 80% enabling investors to handle a variety of investment needs. We will cover debt replacement in the following section. There are also all cash DSTs.

There are a few other overall benefits of a DST:

- Potential to Own institutional quality real estate.
- Ability to diversify by property type and location.
- Turnkey solution: Sponsor is responsible for sourcing, due diligence, structuring and financing of debt, property, and program management.
- Fast and efficient closing process to meet timing requirements.
- Certainty of closing on acquisition of replacement property
- Elimination of property management responsibilities.
- Long-term, non-recourse financing in place.
- Asset protection- Limits rights of creditors (creditors of a DST investor cannot attach trust assets)

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- Liability Protection- DST Investors of the trust have the same liability protection that Delaware law provides to stockholders of a Delaware corporation (generally, no personal liability)
- Confidentiality-Provides privacy for the beneficial owners.
- Contractual flexibility- Provides maximum contractual flexibility.

Section 6: DSTs as Qualifying Replacement.

Since the IRS Revenue Ruling 2004-86 in 2004 Delaware Statutory Trusts qualify as a replacement property for IRC §1031 Exchanges. All of the rules regarding timing and financial requirements of §1031 are necessary to utilize a DST as a replacement property. DST may be the primary replacement property, a backup property or utilized to handle any “boot” that remains from the exchange. DSTs are very scalable and can handle uneven amounts of sales process remaining. See Section 8 comparing the DST to a Tenants in Common TIC.

Section 7: Deferral of Capital Gains Tax- Major Benefit

Real estate investors will benefit from executing a §1031 with the deferral (not elimination) of capital gains taxes. Depending on your state of residence and the location of the investment property the total tax bite may be over 40% or even higher. That would result in a reduction of reinvestment dollars by that amount. DSTs permit investors to defer capital gains from these areas.

- Recapture of depreciation 25% based on the type of investment property and length of ownership.
- Federal capital Gains rates 15% to 20% long term capital gains.
- Net investment Income tax 3.8%- on income over a certain level.
- State income tax as high as 13.3%.

Investors who follow all the rules of the §1031 exchange can defer (not eliminate) all the taxes. Section 9 will provide §1031 Exchange Review.

Section 8: DST vs. Tenants in Common (TIC)

Since the great recession (December 2007- June 2009) Tenants in Common (TIC) have almost entirely been replaced by DST. TICs have been used as an acceptable fractional ownership structure for §1031 exchanges. Revenue Procedure 2002-22 provided formal guidance on how the taxpayer could enter into a §1031 exchange and utilize the TIC fractional ownership interest as a like-kind exchange. The Financial Industry Regulatory Authority (FINRA) sent a notice to the members in March 2005. This notice covered many items including suitability, due diligence, Supervision/record keeping and splitting commission with unregistered individuals or firms. The notice prohibited members from paying referral commission to real estate agents. The main reason is that TICs (as well as DST) are considered securities and not real estate. Although

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the underlying assets to many TICs and DST are (securitized) real estate the Securities and Exchange Commission (SEC) warned the paying commission to real estate brokers or agents was prohibited.

A TIC is an arrangement in which each investor owns a fractional, undivided interest in a property as a co-owner. Investors are considered to be “tenants in common”, required to share the associated cost of ownership. The TIC owner would share a proportionate share of income, potential appreciation as well as tax shelter. The number of co-owners is limited to 35 investors (husband & wife considered one investor). With a limit of 35 investors the purchase price of the asset or property may be restricted. There are also restrictions on the entity ownership structure in a TIC. Each investor must accept financial liability for the other investors as well as sign on any financing or leverage on the property. TICs do enable each owner to have a say in the operation of the TIC. The one large risk of a TIC is the requirement for unanimous agreement for any major decisions to be made. Some experts point to this requirement with inability to sell assets before it was too late during the great recession. Today there are still TIC available for 1031 exchanges. However, many are all cash TIC there by avoiding the issues of requiring each TIC owner being responsible for the other TIC owner financial responsibility for a loan.

DST VS. TICs: Differences for Investors

	With a DST, Investors:	TIC, Where investors:
IRS Governance	Rev. Rule 2004-86. Must avoid the “7 deadly sins” to properly execute a 1031 exchange (Section 23)	Rev. Proc. 2002-22. Have 15 “should” guidelines to properly, execute a 1031 exchange
Ownership	Own a beneficial interest in the trust	Own a fractional ownership of the property by deed title
Debt	Do not personally assume liability for property-level debt	Must qualify for and assume liability for the property-level debt
Liability	Are limited on liability to invested equity	May assume personal liability above their invested equity
Investor Count	May have up to 499 (investors)	Are limited to 35 (investors)
Expenses	Incur no additional LLC costs	Generally, execute investments through an individual LLC
Voting Rights	Forfeit all voting rights for decision making to Trust manager	Have individual voting rights for decision making
Property Types	Are allowed multiple properties, but the asset classes are fairly limited	May have difficulty for multiple properties, but asset classes are open
Bankruptcy Remote	Yes	No (Yes if using a single member LLC)

Section 9: §1031 Exchange Review

Section 1031 of the Internal Revenue Code provides that no gain or loss shall be recognized on the exchange of real estate, provided that several technical requirements are satisfied.

Review of key elements:

- Commonly referred to as a “like kind exchange”
- The seller of relinquished property must reinvest sales proceeds into a like kind property.
- Allows for the complete deferral of all federal and state taxes on relinquished property.
- Can exchange any type of real estate for any other type of real estate (personal property does not apply).

Why Choose a Section 1031 Exchange? Taxpayers may structure a series of exchanges to compound the benefit of tax deferral, thereby potentially building wealth over time.

- Defer federal and state taxes (does not forgive taxes; tax will be paid if later sold in a taxable transaction)
- Build family wealth over time with multiple exchanges.
- Exchange non-income producing property (for example, land) of income producing property (for example, multifamily).

The taxpayer may exchange real property for any other real property located in the United States or its possessions for productive use in trade or business or for an investment.

- “Like-kind” refers to the nature or character of the property and not its grade or quality.
- Generally, all real property is “like-kind” to all other real estate property.
- Real estate and personal property are not like-kind.
- Real property can be improved or unimproved (land), which means taxpayers may exchange unimproved real estate for improved real estate or vice versa.
- The exchanger’s intent must hold the replacement property for investment or use in a trade or business.

Setting up the exchange: investors need to establish a relationship with a Qualified Intermediary (QI) prior to the closing of the relinquished property. The QI needs to receive all the proceeds from the relinquished sale and hold those proceeds until the replacement property is purchased.

- 1

The investor sells the relinquished property to a third-party buyer.
- 2

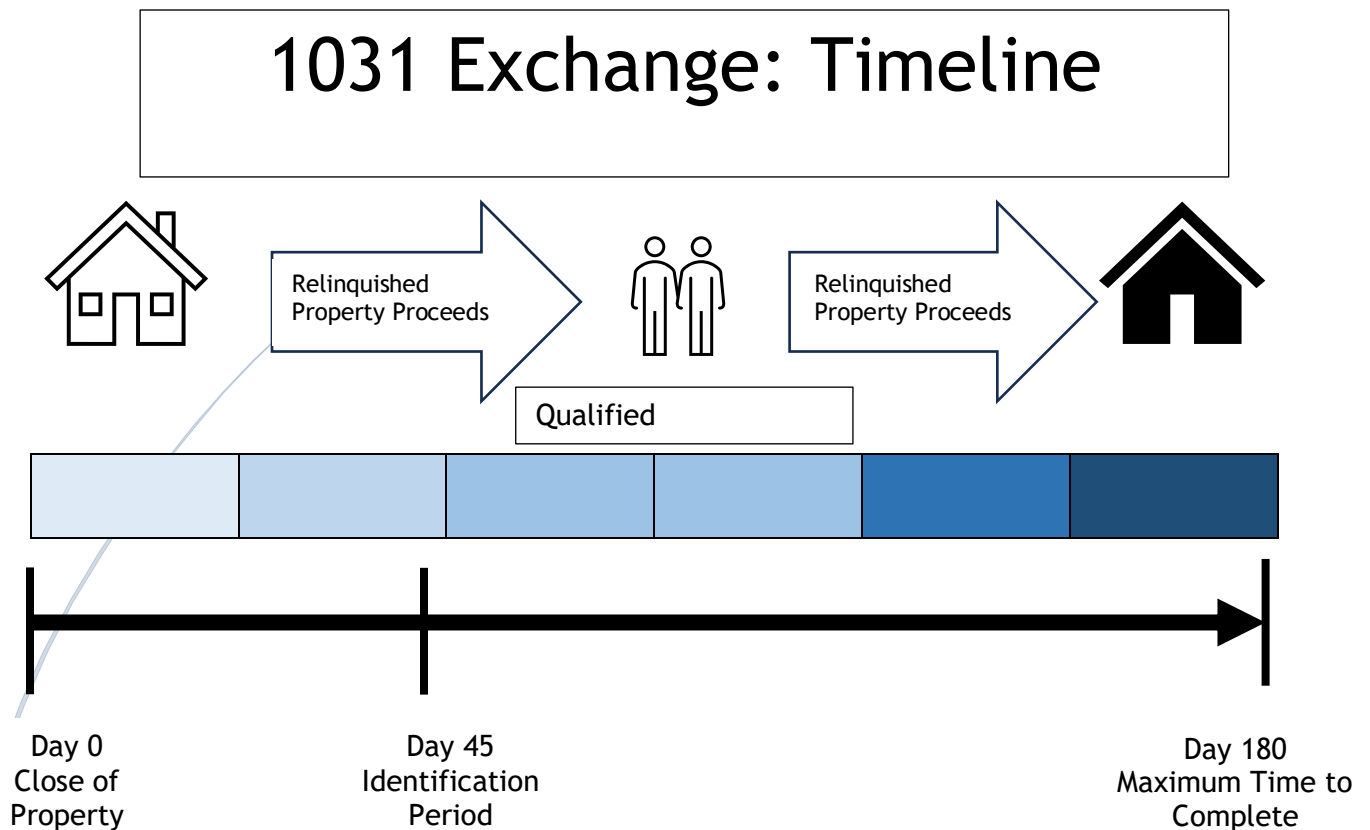
Sale proceeds are transferred to the qualified intermediary.
- 3

Intermediary uses proceeds to purchase the replacement property on behalf of the investor within the time limits defined in the Internal Revenue Code.
- 4

Upon closing, the investor owns the replacement property of a fractional interest in a trust that owns the replacement property.

Step 4 illustrates a DST as the replacement property. A traditional real estate property may also be the replacement property.

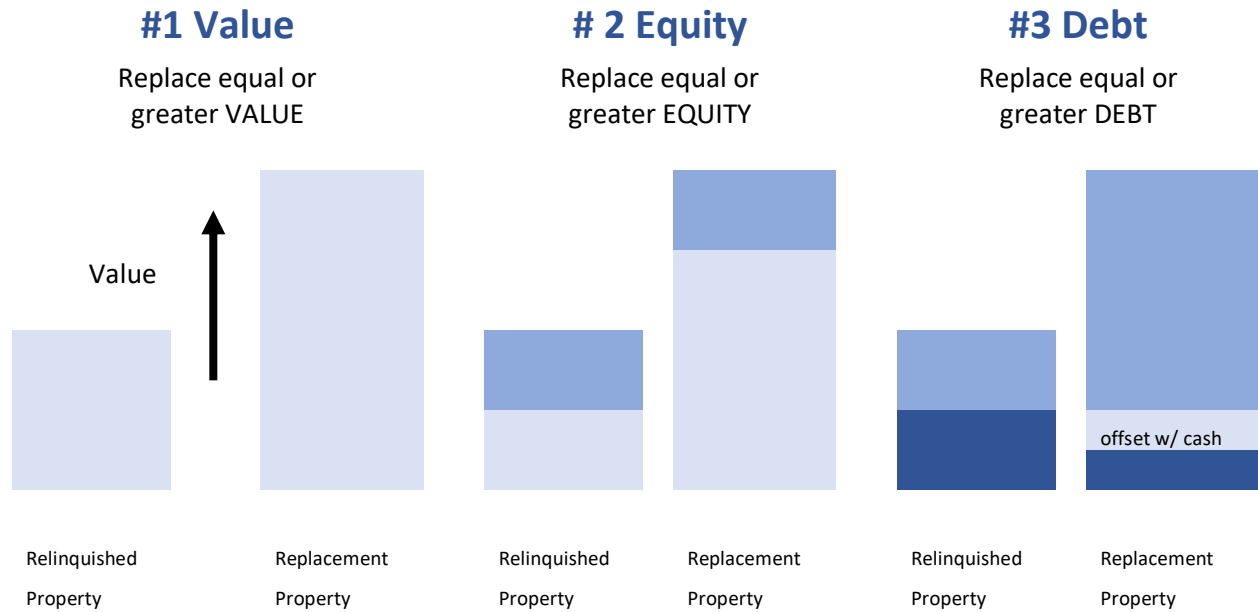
Timing of the exchange: The IRS provides two mandatory time periods: 45-day identification period from closing on the relinquished property and an additional 135 days (total of 180) from the closing on the relinquished property. If an investor has identified a traditional piece of real estate within the 45-days and then waits for closing the QI must hold all the proceeds. During this time the investors may not receive any return on their funds.



Financial Requirements: the investors have three financial requirements: the replacement real estate interest must be equal to or greater than the relinquished property; the investor must reinvest all the cash proceeds; the investor must replace any debt that was paid off with new debt or cash.

Property Replacement Rules

To Successfully complete and Exchange and defer capital gains taxes, investors need to satisfy the following requirements.



Replacement property identification option. The investor has three basic methods to identify replacement property.

- Three property rule- identify up to three properties regardless of their value.
- 200% property rule- identify as many properties provide the aggregated value does not exceed 200% of the required replacement value (including debt)
- 95% property rule- identify as many properties as the investor desired as long as investor closes on 95% of the identified properties.
- Investors must submit identified properties to QI prior to the expiration of the 45-day period.

Examples of Like-Kind Properties

Office Buildings	Rental Resort Property	Vacant Land
Duplex & Triplexes	Single Family Rentals	Industrial Property
Condominiums	New York Cooperatives.	Retail Centers
Hotels and Motels	Delaware Statutory Trust (DST) interest	Air Rights
Development Rights	Tenancy-in Comon (TIC) Interest	Easements
Mineral Rights	Leasehold Interest (30 years remain on lease)	Warehouses

§1031 Complication: The biggest challenge facing many investors within the 45-day period is to identify potential properties, perform due diligence and inspection, if a loan is required apply for the loan and be approved and removing any other contract contingencies. The other challenge is to ensure the sales do not fall apart between the 45 days and closing. We have successfully assisted investors who contacted us with less than seven (7) days remaining in the identification period.

Certainty of Closing: DSTs are prepackaged and once identified can close in a matter of days. If the DST has a leverage component that satisfies investor debt replacement that is also prepackaged and allocated. Quick closing naturally depends on how quickly the sponsor of the DST, and the QI can arrange the execution of the documents and wire transfer. In order to accomplish closing we handle all the Subscription Documents and signatures are typically handled electronically. The quick closing enables investors to start receiving their distribution. We also receive monthly and quarterly statements from the sponsors on our customer/client accounts. At the end of each year investors receive tax reporting documents.

Education is at the core of our fiduciary responsibility. We want to ensure all investors, whether they ultimately use our service, are comfortable with understanding the §1031 process as well as the benefits and drawbacks of investing in a DST.

Section 10: What is a 1033 Exchange?

Section 1033 Exchanges

Internal Revenue Code Section 1033 governs the tax consequences when a property is compulsorily or involuntarily converted in whole or in part into cash or other property. This is commonly referred to as an "involuntary conversion" since the loss of property is beyond the control of the taxpayer and realize gain because the insurance or condemnation proceeds exceed the owner's tax basis in the property. Section 1033 does not require a QI. In a Section 1033 Exchange, the taxpayer can receive the sales proceeds and hold them until the replacement property is purchased. If not all the proceeds are used towards acquiring the replacement property, the taxpayer is taxed on the difference. In addition, replacement property cannot be acquired from a related party. Section 1033 is a tax deferral strategy and does not eliminate taxes if there is a capital gain.

Events that may qualify for a 1033 Exchange:	
Casualty	Condemnation
Destruction	Earthquake
Eminent domain	Fire
Hurricane	Seizure
Theft	

Key Comparison of §1033 vs. §1031	
1033 Exchange	1031 Exchange
Involuntary Sale	Voluntary Sale
No Requirement for Accommodator (QI)	Required Accommodator (QI)
2-to-4-year replacement period	45-day identification and 180-day completion replacement period
Additional debt can offset equity	Additional debt cannot offset debt.
Replacement with “similar use”	Replacement with “like kind”

There are a few other considerations utilizing a §1033 deferred exchange with regards to the replacement property. The §1031 has a “like-kind” reference regarding property to be acquired. “Like-kind” would enable the exchanger to relinquish a vacant land parcel and replace with an apartment building or other commercial property as long as it is real property. §1033 has a more specific requirement of “similar use”. For example, if your property taken by eminent domain was an industrial property then your replacement property needs to be an industrial property (similar use). If you lost an office building to a disaster, then you need to replace it with another office building (similar use).

As noted above, additional debt can replace equity in a §1033 exchange as compared to a §1031 exchange where you may not use debt to replace equity. In a §1031 exchange selling a \$500,000 property with a \$100,000 loan being paid off, requires you to replace the \$100,000 debt with another loan (or additional cash) and then utilize the balance of the proceeds (\$400,000) to complete the exchange. Contrasts that with a \$500,000 award (using same dollar amount as precious example) for your property taken in an eminent domain event you may exchange using a §1033 exchange. If you as an investor takes on additional debt of \$100,000 more than the \$100,000 debt being paid off for a total of \$200,000, the investor would only need to use \$300,000 of proceeds to complete the exchange. The \$100,000 proceeds not utilized may be retained by the exchangers as tax free proceeds.

If the investor increased the debt amount (referenced above) then the investor would need to take on additional responsibility and liability for the debt. DSTs may provide significant benefits to investors who utilize a DST in a 1033 exchange, especially if there is debt that needs to be replaced. DST utilize non-recourse loans.

Section 11: Retire from Active Management

Ownership of real estate requires some level of management even if you hire a property management company. DSTs by design are passive investments meaning there are no management responsibilities. Ther is a cliché “no dealing with termites, tenants, or trash”. Once an investor (working with an advisor) selects the replacement DST there are no responsibilities once the DST is acquired. We as the advisor will assist in balancing the exchange and review potential DSTs that may be suitable for each individual investor. We interact and consult with each investor to determine the best potential DST that aligns with investor goals and objectives.

We research DST offerings on a daily basis and seek third party validation of our due diligence findings.

Section 12: Distribution (Cash Flow) Potential

Nearly all DSTs are structured with a projected distribution that is normally monthly. The distribution normally occurs about the 10th day following the previous month. Many of the DSTs are institutional grade properties that are normally out of the reach of most investors. Preserving capital investment is always one of the investment objectives. Growing revenue and overall appreciation also rank high in the objectives. Combining annual cash flow with potential appreciation results in an overall return to the investor.

Section 13: Low Barrier to Invest

Many new DST cash investors and §1031 exchange investors are surprised to find out the low barrier to entry with Delaware Statutory Trusts. Many DST sponsors accept \$50,000 for direct cash investment and \$100,000 is typically the minimum for the §1031 exchange. Investors may diversify their real estate holding either geographically or by asset class. We previously mentioned that DSTs are scalable. We have assisted investors with uneven proceeds from the sale of their relinquished property. An investment in a DST could possibly be \$475,689.23. That amount would be the exact amount of the DST investment. This may be very helpful since many real estate sales are not even numbers after all the closing cost are deducted from the proceeds.

Section 14: Institutional Grade Properties

DSTs provides an opportunity for investors to become involved in high quality, high-grade, institutional properties. When the IRS permitted DSTs to be used as an acceptable replacement for §1031 exchange there are strict guidelines and criteria required to be followed. The Trust requires properties to be of certain creditworthy assets. There is a move by DST sponsors to include credit-worthy companies when leasing certain DST properties. Individual DSTs as well as portfolio DSTs may range from \$20 M to well over \$350M. These assets are outside the reach of a typical accredited investor.

Section 15: Non-Recourse Debt Revisited

DSTs by design are structured with non-recourse debt. This means investors are not required to apply for any loans that may be on the property. The debt is allocated based on the amount of equity or cash being provided by the investor. For example, if the investor contributes \$100,000 cash (or \$100,000 proceeds from a §1031) to a DST with a 50% loan to value (LTV) then the total purchase price would be the \$200,000. The reason why many DSTs are structured with debt in place is to satisfy one of the IRC §1031 requirements to replace debt. Here are an expanded explanation and amplification of debt replacement rules.

One of the major benefits of debt being included with owning a DST may be enhanced cash flow, potential appreciation, potential addition depreciation for certain taxpayer non-recourse debt also reduced risk of ownership.

Section 16: Depreciation Reload

We always suggest investors speak with their tax advisors for specific benefits. Investors who have owned investment property may be seeking an increase basis for a potential increase in the annual depreciation. Investors in states without a state income tax may not be as interested as investors in higher tax states such as California, New York, and others. However, there would still be federal taxes to be paid on income earned. DSTs are in almost all states. DSTs in tax free states (non-income tax states) appeal to certain investors. Investors who have fully depreciated the property may lack offsets (deductions) against the income received. Acquiring a DST with non-recourse debt may increase the total basis of the investment, creating additional potential depreciation to be used against passive income.

Section 17: Appreciation Potential

Investors will have a beneficial ownership interest in a DST. This would be like owning other real estate mostly in a fee simple title. One of the goals of real estate investing is the potential for appreciation. Sponsor of the DST will determine the proper time to sell the DST (individual investors cannot dictate the sale) and all potential proceeds are distributed to investors. The investor will receive potential appreciation (profit) based on their percentage of ownership in the DST. If the DST was leveraged with any type of loans will need to be paid off prior to distributions to investors.

Section 18: Beneficiaries May Benefit

The individual investor may not cherish the “Step up in Basis” where there could be the elimination of all capital gain taxes. The step up occurs upon the passing of the investor. During the holding period prior to the step up the investor would benefit from any distribution of cash flow from the DST investment. Hopefully there will be an increase in cash flow and/or a reduction of principal loan amount if there is debt on the DST. The step up in basis means the investment (no matter what the original acquisition price) steps up to current value. Capital gains tax, depreciation recapture, net investment income tax are eliminated upon the death of the investor. Under federal income tax law, IRC § 1014 (b) (6), all community property (including both the decedent’s one-half interest in the community property and the surviving spouse’s one-half interest in the community property) receives a new basis at the death of the first spouse equal to its fair market value. This means the cost basis (original cost as well as all reductions to cost over time) is stepped up, and the assets may be sold without recognizing a capital gain.

Generational planning often includes the transfer of wealth lock up or included in alternative investments (not stocks and bonds) such as real estate. DST are alternative investments as well.

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Estate planners recognize the attractiveness of alternatives such as DSTs. Investors may bequeath their assets to family members or charities. DST enables the assets to be distributed to whoever the investor wishes. DSTs also eliminate any discussion on who (heirs) should manage the assets or property since the Trust is totally in control of the property until the sale. There is an opinion of some financial advisors that since the sale of DST is under the control of the sponsor this is an ill-liquid investment. Similar to other ill-liquid investments DSTs may be subjected to a discount when determining the value contributed to the estate. This may become important if Congress does not act to change the existing estate tax exemption. This would affect large estate and may be irrelevant to many investors.

Section 19: Trust Beneficiaries reduced Liability.

Investors in a DST assets or properties enjoy limited liability. Investors may be referenced as a trust beneficiary. Investors in a Limited Liability Company (LLC) or Limited Liability Partnership (Limited liability and DST are considered similar to these structures in this aspect. DST structure debt (if applicable) as non-recourse debt to the investors. Investors do not apply for their assigned portion of the loan based on their cash investments, nor does the debt assignment appear on any credit report. As a reminder investor in a DST needs to be accredited investors. In contracts a tenant in Common (TIC) requires investors to be personally liable for any debt as well as assuming responsibility for the debts of other TIC members.

Section 20: Diversification- Asset Class & Geographic

One of the more enjoyable discussions we have with investors is the topic of replacement properties when utilizing a DST. Investors who may be selling an investment property that may have a value of \$400,000 to \$500,000 are surprised to learn the DST replacement property may actually be multiple properties. Once the proper guidelines are followed with the identification process two, three, potentially four DST properties may be acquired. We mentioned previously there is a low barrier to entry in a DST with many minimums being \$100,000. This may provide diversification of the investor portfolio. AS a note diversification attempts to eliminate risk or spread risk among several properties. Each property may have a different geographic location and exit strategy as well as being a different asset class. If the investor plans the sale of multiple investment properties, the combined proceeds may be invested into one DST. Timing become very crucial to execute this exchange.

Section 21: Sponsor Expertise and Management

Due diligence becomes very important in the process of evaluating sponsors as well as individual offerings. Over the past four years we have reviewed over 450 individual DST offerings. This requires weekly reviews of sponsor offerings. We also meet sponsors on a one-on-one basis, in person, to engage in conversations to understand their acquisition process, management and ultimate disposition of the DST asset. We also look at the financial reporting and the third-party

evaluation of the individual assets. We take our role as a fiduciary very seriously and analyzing and examining sponsors' track records is paramount in the process. We are happy to share with you, our process.

What to Expect from DST Sponsors

Typically, Sponsors first create these pre-packaged 1031 Exchange into Delaware Statutory Trust containers with an eye to attracting investors. They orchestrate all day-to-day operations. Further, lenders make loans directly to DST Sponsors, not separate ones to each investor. As such, the DST directly owns the assets while trust shares are owned by individual investors.

Section 22: Exit Strategies for Delaware Statutory Trust

When an investor is considering investing in a DST either through a direct cash investment or §1031 exchange the exit strategy needs to be understood. A traditional DST has three basis exit strategies once the sponsor has decided to sell the asset. You may receive the proceeds and pay the applicable capital gains taxes; you may engage in another §1031 exchange via DST vehicle; you may do a §1031 exchange via a traditional real estate property. There is also an exit strategy that involves a required 721 UPREIT. There is also DSTs that offer a traditional exit strategy plus an optional 721 UPREIT exit strategy.

Section 23: 721 Umbrella Partnership (UPREIT).

Capital gains may be deferred through a contribution of investment property to a Real Estate Investment Trust (REIT). Basically, there is an exchange of real estate ownership for ownership interest or units in a REIT. DSTs may be structured as optional UPREIT conversion or mandatory UPREIT conversion. There are advantages and disadvantages of UPREIT. Moving into an UPREIT enables an investor to sell off units over time, spreading out the capital gain taxes when the units are sold. There is also diversification inside the REIT. Once there is a conversion to an UPREIT the investor may not do any additional §1031 exchanges. The inclusion of the UPREIT in DST offerings may have been a response to proposed legislative changes to holdings within IRA requiring certain assets to be sold. While that legislation has not become law the UPREIT strategy is embraced by some sponsors. Many of the sponsors embracing this strategy are vertically integrated and will structure larger REITs that will accept the investors DSTs.

Mandatory DST UPREIT conversion work on the premise that all investors will be required to participate in the UPREIT process. There will be a valuation of the DST equity owned by the individual investors and the value will be converted into operating units. There is a safe harbor period of two years from the acquisition of DST to the conversion to the UPREIT.

Optional 721 UPREIT.

There are traditional DSTs that offer the investor the flexibility to convert to the 721 UPREIT rather than utilizing the other traditional exit strategies. The sponsor will typically provide the investor with ample time to decide their individual exit strategy once the cash offer has been

accepted from the REIT on the DST. Investors who want to take the cash may do so as well as investors who direct the proceeds to be held by a Qualified Intermediary (QI) for subsequent exchanges. All investors who wish to participate in the UPREIT are free to do so.

Section 24: Structure & Function of DSTs

In 2004 IRS Revenue Ruling 2004-86 was released and DST became an acceptable alternative for §1031 exchanges. However, investors must meet all the requirements of the 1031 when using a DST as a replacement property. Investors may find one thing in common with a DST. There is a similar structure that is found in all DSTs. The Private Placement Memorandums (PPM) follow the same flow and typically an investor will discover the differences in the types of properties being held or the asset class, if the offering is a single asset or a multiple asset referenced as a portfolio. The terms of the master lease may be different with regard to any revenue sharing as well as the projected holding times and exit strategy. The other difference would be if the property has leverage if the loan is principal and interest payment or interest only during the term. Principal and interest payment reduce the outstanding balance over the holding period. Interest only may increase the distribution to the investors. If you are doing research on DSTs, you may have heard of the Seven Deadly Sins. These regulations or rules are in place to permit DSTs to qualify as an acceptable replacement investment for a §1031 tax deferred exchange.

- No future contribution- Once the trust offering is closed, there can be no additional capital contributions made by either existing or new beneficiaries (investors). Sponsors cannot ask for more money from current investors or new investors.
- Debt Restriction- If there is an existing debt on the DST arranged by the trustee when the offering was structured the loan cannot be renegotiated. This includes negotiation for a new loan. This is one of the benefits some investors find with an all-cash DST. There may be some limited exceptions as we witness with the COVID epidemic.
- No reinvestment of proceeds- Trustees (DST sponsors) cannot reinvest proceeds from the sale of the trust's real estate. The choice of where to reinvest is retained by individual investors when the real estate is sold.
- Limited Capital Expenditures-Trustees can only make capital expenditures to the underlying real estate for purposes of normal maintenance/repair and/or non-structural capital improvements or to bring the property into compliance with legal requirements. This means DSTs cannot own speculative development property.
- Restrictions Investing Reserves Any cash held by the trust must be invested in short-term investments, such as government debt or bank accounts.:
- Required Distributions: The trustee must distribute all cash, except for a reasonable reserve for expenses, at least quarterly, to owners in proportion to their percentage interest.
- Restrictions on Leases- The trust cannot enter into new leases or restructure leases unless due to tenant bankruptcy/insolvency.

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One of the biggest advantages of a DST may be the passive nature of the investment, meaning the elimination of active management. The potential for stable monthly distributions, preservation of capital and potential appreciation is also an advantage investors are seeking. From a tax perspective the deferral of capital gains may go to the top of the list for §1031 exchangers.

Section 25: Establishing a DSTs for Investors

Long before a cash investor may consider a DST, or a §1031 exchange investor can identify a DST as a replacement property there are many steps in establishing the DST as an offering. Investors who understand the process may appreciate what happens in order for a DST to provide a solution to their problem. Understanding the process also may provide insight into the costs involved with structuring the DST. Not all properties that are reviewed by a sponsor make it as a DST. There is a process sponsors and real estate companies engage in to elevate a property to DST level.

STEP 1:

Sponsors of DST properties and large real estate companies who work to locate suitable properties. Real estate advisors in conjunction with DST sponsors will constantly search for investment or institutional grade real estate. The real estate needs to fit the underlying asset or property criteria as well as staying within the IRS guidelines. The bottom line may be, can the target property provide meaningful cash flow during the holding period and a meaningful return to their investors upon the exit or sale of the property. Sponsors may review dozens of properties each week and only a few may meet an acceptable score to go to the next round of review. This is prior to any letter of interest, a contingent contract and the necessary due diligence. DST sponsors need to be in a position to acquire the property or have the ability (credit line) to secure the property upfront until the DST is offered to individual investors. Once the DST is fully subscribed the sponsor upfront dollars are replaced.

STEP 2:

Structuring the Delaware Statutory Trust itself is the next step and involves a series of activities.

- The Trust is established.
- The reserves need to be collected and qualify for the offering.
- The master lease agreement is set up and established.
- The debt is structured (if applicable) for the DST. Fixed rate long term debt preferred.
- Creation and Submission of the offering documents to the Securities and Exchange Commission (SEC)
- Necessary opinion letter issued from a tax attorney with an opinion on whether the trust should be considered a qualified 1031 Exchange replacement property by the IRS.

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- Third party due diligence review of the offerings materials and projected financial components including projected returns.

STEP 3:

Initial reports and due diligence materials are reviewed and made available to FIDUCIARY CM (and other advisors) to perform initial due diligence and return comments.

STEP 4:

Broker-Dealer network to perform third round of due diligence.

STEP 5:

Once all preliminary steps are completed, we received final offering documents. The offering documents are contained in the Private Placement Memorandum (PPM). Each individual investor has different risk profiles and suitability needs. While we have reviewed the materials and supporting documents this is not a blanket recommendation for every investor. Each investor has specific and unique needs. When each individual investor closes on their investment acquisition the sponsor will receive their initial capital used to acquire the property. The other alternative may be the elimination of a bridge loan the sponsor may have arranged to secure the property.

Section 26:

Since the twenty-year evolution of DSTs there have been as many as seventy sponsors of DST at one time prior to the great recession. Currently there are approximately 35-40 sponsors with a variety of types and styles of offerings. DSTs may be found in various locations throughout the USA. There are a variety of types of offerings occasionally referenced as asset classes. Section 8 described the types of acceptable §1031 replacement interest. Many are available in a DST.

Here are the typical examples of DST assets.

- Multifamily (most often apartments), and all the former subsets of multifamily that include student housing, senior housing, single family rental communities, and manufactured housing communities.
- The industrial sector may include distribution centers as well as the popular last mile distribution centers.
- Operating companies such as manufacturing companies (some credit rated public companies) may offer triple net structures.
- There are medical office buildings (MOB) that are small to medium size and may include portfolios.
- Necessary retail that may be large facilities may include such recognizable names as Wal Mart neighborhood centers, Cabala's Bass Pro Shops, etc.
- Self-storage facilities offer single sites as well as portfolios.
- The office sector may be structured as a typical DST with a distribution stream or other structures offering special benefits to satisfy investor needs.

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- There is a new subset of office or industrial called Life Science.
- There are also Oil & Gas interests that are offered in a variety of structures.

There are strengths and weaknesses of any type of investment including DSTs. Frequently we recommend investors to consider diversifying their holdings by asset class, and geographic locations. This enables investors to own a portfolio of assets.

We are well versed in balancing the exchange with the required debt replacement as well as utilizing the cash being held by the QI. This balancing reduces the risk of “boot” and avoids potential capital gains tax liability.

Section 27: Holding periods of DSTs will vary.

DSTs by design are passive investments and investors yield the decision on when to sell the property to the sponsor. This means Delaware Statutory Trusts, similar to other alternative investments, are illiquid investments. In a previous section we covered the seven deadly sins of DSTs. One aspect worth amplification is the structure of a DST that includes debt. The DST Sponsor cannot be refinanced (IRS restriction) the asset. That requires the asset to be sold prior to the maturity date of the loan. This may impose a deadline for the property to be sold. Loan to value (LTV) typically may range from 20% to over 60% depending on the structure. Another reminder regarding the structure of the DST would be that DSTs by design has leverage enabling the investors to satisfy the IRS requirements to replace debt in a §1031 exchange. Typically, the loans will have a ten (10) year term which requires the property to be sold prior to the maturity date. Over the years DSTs have been held from as little as two years to nine years. A DST that may be sold in as little as two years may be the result of quick appreciation. There needs to be enough appreciation of any property to cover any and all acquisition costs built into the structure of the DST offering including any prepayment penalties. Generally speaking, most traditional real estate had a five (5) year holding period to cover all the cost of acquisition and cost of sale items. The balancing strategy included arriving at a selling price of the DST that can cover the acquisition cost, hold the property long enough to create an increase of cash flow making the property attractive to the next buyer, and cover any disposition cost. This is just like any other real estate investment. What sponsors need to be aware of is the pending termination of the loan and avoid being forced to sell the assets simply to satisfy the loan. All cash DSTs do not have any issues with satisfying loan payoffs or loan covenants.

What DST sponsors focus on is the most beneficial time to sell the asset. This included understanding the specific market and at the same time increasing the value of the property. During the holding period the sponsor (Trust) must review property metrics including all the financials and position the property to be sold at optimum price for the benefit of the investors. Investors should consider the DST an illiquid investment and be prepared to hold the assets for 5, 7 or 10 years. Historical holding periods have been about 4.75 years.

Section 28: Investor DST Personal Due Diligence

The disclosures that surround many of our articles and blog posts clearly state that Delaware Statutory Trusts are not designed nor suitable for every real estate investor. A DST that may be right for one accredited investor is not a suitable fit for another. During our discovery process with investors, we spend time discovering investors goals and objectives. Sometimes we advise not to move into a DST and potentially pay the capital gains. At another time we suggest looking into other alternative investments such as opportunity zones that may achieve investor goals. Investors who determine a DST may be a potential solution for their cash investing or potentially more import the §1031 exchange selecting the right advisor becomes paramount. Advisors who work daily on §1031 exchanges and have a background in real estate may be more beneficial for investors. Understanding the potential tax benefits also becomes part of the equation. Advisors who work with CPAs and understand the role of the Qualified Intermediary (QI) cannot be stressed enough. One of the more important tasks the DST advisor performs is balancing the equity debt replacement on behalf of the investor to eliminate the amount of potential “boot”. Boot is defined as cash remaining or mortgage boot the amount of mortgage not being replaced. Both are taxed as capital gains.

Our internal due diligence process looks at the specific offering as well as who is behind the offering. DST advisors need to interface with DST sponsors and review offerings prior to any recommendations to each investor. Each geographic area of the country has different demographics and indicators that may affect the performance of the property. We also engage with third party resources to validate the assumptions made by the sponsors. Projected distributions are just that “projected”. We engage to understand where the projects are sourced.

There are risks associated with investing in any type of real estate and the beneficial ownership in a Delaware Statutory Trusts also carries risk. Passive ownership does not eliminate the risk of ownership. The additional risk of DST investing is clearly identified in all the private placement memorandums (PPMs).

Liquidity & Exit: The longer holding time of a DST has been mentioned on several occasions. The lack of liquidity or partial redemption needs to be noted and align with the investor objectives. If there were an option for a liquidity event (if a secondary market for DSTs develops) the investor would be exposed to selling at a discount. The longer holding period extending 5-9 years potentially also needs to align with investor timing.

No Investor control: Given the passive nature of the DST the investors, who have a beneficial interest in Delaware Statutory Trust, make no decisions. This includes the day-to-day operations as well as structuring the ultimate sale of the property. All decisions are made by the sponsor or real estate management company.

Due Diligence and Compliance. FIDUCIARY CM engages in a due diligence process that includes review of all sponsor materials as well as third party due diligence materials. Offerings are either listed as 506 (b) offerings or 506 (c) offerings. The difference may be subtle but important. Each

offering requires understanding of the structure and function of the DST. We are focused on compliance issues with regards to when we enter into an advisory agreement with the investor as well as a relationship with the sponsor of the DST. We are required to conduct client suitability and risk assessment for all investors. Non-compliance issues may affect the criteria the IRS has established to qualify for a §1031 exchange.

Loans in place cannot be modified. Once the financing is in place for the DST there can be no loan modifications. That does not mean a loan that starts out as an interest only loan cannot transition to an amortized (principal & interest) loan. Loan modification would require a change in the legal ownership structure. There is a master lease agreement executed between the real estate company or sponsor and the Trust.

Projections versus actual performance. When potential monthly or quarterly distribution are projected these are based on a set of assumptions. Many time sponsors will use a more conservative projection. There are a variety of outside events such as COVID that may affect the actual returns. Projected distributions are not guaranteed.

Appreciation subject to market conditions. Most investors anticipate appreciation in the property they have invested capital in. Property will retain or increase in value based on a variety of conditions including local market conditions, the overall economy as well as competition. The equity in a property and a DST may increase by appreciation or by the loans being paid off during the holding period.

Like all real estate there is no guarantee the DST property will sell for more than the acquisition price. Some investors may simply be seeking a deferral of capital gains, but a large amount of appreciation is not high on the requirements for investing in a DST.

Fluctuation of Interest rates: We have seen over the past 12-18 months the effects of rising interest rates have had on overall sales of residential and commercial real estate. Sponsors have increased the amount of equity required as well as decreasing the LTV on the new DST offering. When DSTs have lower LTVs in their offerings certain investors who need to replace debt are facing limited offerings especially if the investor needs a replacement LTV of over 50%. Changing interest rates have a direct effect on the velocity and potential values of property. A drastic rise in interest rates also slows the absorption of all properties. Sellers may not be inclined to lower prices simply because interest rates have risen.

Risk of Regulatory Changes: Depending on the political landscape there is always potential to change to the tax codes. §1031 tax free exchanges have repeatedly been the topic of discussion by various administrations. The IRS could change or alter the tax-free exchange rules. Regardless that the DSTs have been in existence for 20 years there could be changes.

Cost, Fee, and DST Management: Fees for DSTs are disclosed in the Private Placement Memorandum (PPM). Sponsors are entitled to recover operation costs as well as other fees from structuring the DST offerings. Ongoing fees are also disclosed in the PPM. Understanding the ongoing fees charged to the Trust and how those fees affect the projected distribution is a very important aspect of the due diligence process.

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Education is one of our main objectives. We interact with CPAs, financial consultants, commercial real estate agents/brokers as well as individual investors. There is an educational curve that we totally understand. We mention frequently that DSTs are not for all investors. Part of the educational process or due diligence is reviewing the Private Placement Memorandum (PPM). We have spoken about the PPM in previous sections of this document. These are very long documents and contain all the disclosures and risks associated with the investment. Fortunately (although some investors consider it unfortunate) the entire PPM needs to be delivered without mark ups or special notations or even the “cliff notes” version. Full disclosure is required. Typically, the layout of the PPM is similar across many of the offerings. This enables us to assist in answering questions. We started tracking on a spreadsheet the number of programs we have reviewed in just the last four years. We track a variety of metrics including LTV, distribution targets, current available equity, 506 (b) or 506 (c) offerings, and if the offerings are acceptable for IRA investors. Currently we have reviewed 700 programs across many geographic regions of the US including all the asset classes. We can assist in answering questions regarding the PPM as well as provide third party evaluations. We can assist you with questions no matter what stage of your investigation process you are currently engaged in.

Section 29: Timing and Process of DST Acquisition

There are many questions an investor may have regarding the DST structure and function. There needs to be a certain level of understanding of the process prior to making a decision of “go or no go”. The timing becomes almost the first critical item to fully understand. If you are a cash investor (without a §1031 exchange) you have the luxury to take your time since your funds may be accessible and more than likely after-tax dollars. If you are engaged in a §1031 exchange step one is to engage with a Qualify Intermediary (QI) by executing an agreement. All proceeds from the relinquished property sale need to be sent to the QI by the closing agent. You may also want to ensure your relinquished property contract provides for the cooperation of all parties to engage in a §1031 exchange. The individual investor needs to evaluate their current and future lifestyle and what style of management they wish to engage in, i.e. active or passive. However, prior to considering which DST may satisfy your goals would be if the §1031 tax deferred exchange is a positive option or solution. Consultation with your CPA or accountant may be in order. We do have tools on our website that may estimate your capital gains, but you will want to ensure the original cost of acquisition as well as depreciation are accurate. We are not CPAs, and our calculators are only meant to provide an estimate or ballpark of potential capital gain you may encounter. Frankly we have been on phone consultation where we suggested (upon their CPAs’ confirmation) to simply pay the capital gains taxes. We also have conversations and one of our first questions, if the investors affirm, they want to do a §1031 exchange, is to confirm the investor meets the qualifications of an accredited investor. Investors have stated to us that there are many aspects of DST that affirm their interest. Typically, the list included:

- Deferral of capital gains
- Build generational wealth.

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- Passive ownership
- Passive income
- Reduced management time
- Increase non-recourse debt to increase potential depreciation.
- Asset class diversification by owning multiple DST with proceeds.
- Geographic diversification
- Higher quality properties
- Multiple exit timing strategy when DST sells.

Accredited Investor Definition. We mentioned that DST replacement properties are for accredited investors only. Accreditation for single taxpayers is EITHER an annual income of \$200,000 for couples the annual income is \$300,000 OR a net worth of \$1M excluding personal residence. If the DST asset being acquired will be owned by multiple people, then all parties need to be accredited. If there is an LLC, then the entity needs to qualify. The offerings are typically Reg D offerings (with 506 (b) or 506 (c)). These are securities registered with the Eth Securities and Exchange Commission (SEC). As such these are not offered by a real estate professional who only has a real estate license or real estate broker's license. We continue to support real estate professionals with on-time or just-in-time information for their customers who are pressed to locate a suitable exchange property as their 45-day window closes. (See expanded definition of Accredited Investor in the Frequently Asked Questions section).

First things first (or maybe second). Once you have decided to sell your property and you are an accredited investor your relinquished property must be sold. Oh, there is one other item that may come before selling your property. The investor needs to engage with a Qualified Intermediary (QI) and enter into an agreement for handling the proceeds of the relinquished property as well as closing on the replacement property and in this case the DST. Selecting a competent QI is very important. We have worked with many local and national QIs. If you have not located a QI, we may be able to assist you. We are a member of the Federation of Exchange Accommodators.

Investors all have a different plan on their strategy for engagement. We have consulted with investors who are contemplating selling their real estate are in the DST educational phase. We have consulted with investors whose relinquished property has just gone under contract and will close in 30-60 days. This does provide ample time for many options. We have consulted with investors who have closed on the relinquished property and the proceeds are with the QI. We also (unfortunately) consulted with investors who have closed on their relinquished property and the funds are with the title company. STOP right there! If the funds are with the title company the IRS considers you have taken constructive receipt of the proceeds, and you may not do a §1031 tax deferred exchange. (We do have an alternative for what is considered a broken §1031). We also have received a call when investors have less than a week remaining in their 45-day identification period. We did have an investor with only 5 days remaining in their identification period. Fortunately, there was a very competent QI and CPA involved with the investors. We can

cover that in our case studies. - We can assist investors in all phases of their exchange because of the continued education and evaluation of existing and new DST coming on the market weekly.

Section 30: Cost of Structuring the DST Offering

Bringing any product to the market involves cost. These costs may be similar to a builder or developer going through the entitlement, permitting, construction, marketing, management and sale of the real estate. Individual investors when selling their real estate may engage the services of a real estate broker and pay a listing fee as well as closing cost on the sale. DSTs have a variety of costs associated with the offering as well. All these costs are disclosed in the PPM. Here are typical costs:

- Due Diligence Fees paid by the Sponsor.
- Due Diligence fees paid by sponsors to third party.
- Reports on the buildings such as engineering and structural report required by lender for loan reserves.
- Loan fees (bridge loans and/or end loans)
- Cost of sales including distribution and marketing cost
- Attorney tax opinion letter to qualify for potential 1031 exchange.
- Purchase price and closing cost associated with acquiring the property.

The DST sponsors will provide the upfront cost of acquisition as well as all other associated costs. Once sales proceeds are received from the individual investors (via cash investment or §1031 exchange) the sponsor will recover (be reimbursed) for the cost of structuring the DST. During the holding time sponsors may share in the net operating income of the property in some way. Typically, there would be a base rent provided to the investors and if there is an excess in the proforma distribution (called bonus rent) there may be an additional distribution to the sponsor. For example, if the base rents are exceeded the sponsor may receive 20% of the excess and the investors receive 80%. When the property is sold (going full cycle) there may be an increase in the value of the property. There is a mandate from the IRS that states the sponsor of the DST may not share in the potential appreciation of the DST. However, many sponsors upon going full cycle will have an exit strategy for investors. Some DSTs have optional exit strategies for investors that include executing another §1031 into a DST (maybe considered a rollover) or potentially moving to a 721 UPREIT. There are other DSTs by design that have mandatory exit strategies to move into a 721 UPREIT. Exit strategies are described in the PPM. When investors execute these strategies, the Sponsor is compensated when additional acquisition of another DST or 721 UPREIT is acquired.

Section 31: FIDUCIARY CM Advisor Compensation

Investors have a different rationale for acquiring a DST. We work with all cash investors as well as investors utilizing a §1031 exchange. We also assist investors when acquiring alternative investments such as nontraded REITS, LLC Developments, Opportunity Zones (OZ), etc. We also

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focus our efforts as a Fiduciary working on behalf of the investors. We attempt to structure our compensation in the most tax efficient manner for the investor. This may mean not sharing any upfront fees to investors and extracting a fee from the typical commissions paid by the sponsor. Sponsors build in compensation in the offering much like a real estate broker builds in compensation in the listing agreement paid for by the seller. For other investment consultations we may work on an hourly basis for handling due diligence outside the acquisition of the DST property or other alternative investments. In most cases we charge a one-time fee based on the overall efforts and scope of work.

Here is our value proposition.

As a registered investment advisor. We represent the client, not the sponsor, meaning the issuer of the DST property. This is a significant difference because many representatives out there and in today's marketplace promote offerings that they themselves are sponsoring. In some cases, are making double digit returns in fees initially, and sometimes ongoing. Compensation or fees are disclosed in the Private Placement Memorandum (PPM). Our fee is based on a consultative relationship representing the client's needs and objectives. This is the prominent difference between us and other providers of DST placement services.

We are happy to review the overall fee structure and how we work in your best interest and provide a value-add equity arrangement in many cases.

Section 32: DST Acquisitions & Case Studies

There are a variety of examples to provide an overview of the types of solutions to DST acquisition. Many investors may gravitate towards asset classes or property types they are familiar with based on their past investment style. In all cases we consult with investors to ensure all the steps are followed. We understand the property that is being sold and how long the investor has held the property. We attempt to contact the investor CPA or accountant to determine if a §1031 exchange is the best strategy for the investor. We also attempt to understand the potential tax savings (tax deferral) each investor may enjoy. We design investor or client specific solutions with the DST asset class and geographic location. Every DST has a Private Placement Memorandum (PPM) that is delivered to each investor. We review the PPM and evaluate the suitability of the DST for individual investors. We oversee the subscription agreement and closing process for each investor. The following case studies are examples of a few investor acquisitions. We interact with all QIs to ensure all forms and deadlines are met to keep the exchange valid.

Cash Study 1: Investor currently lives in New York but will move to Florida within the next three years.

- Investors relinquished residential property valued at \$600,000. Property held for 30 years and fully depreciated.
- Relinquished property is fully depreciated, and the investor wants to take on debt with the purpose of increasing basis.

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- Investors seeking residential multifamily properties in a variety of locations.
- The addition of debt will increase the overall value of the replacement properties. The investor will have depreciation and interest write offs.
- Strategy- acquire four (4) replacement DSTs that have an average Loan to Value (LTV) of 48%. Total replacement value \$1,153,846.
- Acquisition- Four DSTs located in three states: Texas, Nevada, and Florida. Added benefit of the DST location is all replacement assets are located in states without a personal income tax. Investors seeking to move to a state without a personal income tax (Florida).

Case Study 2: Investor lives in California are in their mid-80's and wants to move into passive management and receive passive income. The investor will stay in California and has no intention of moving.

- Investment property selling for \$450,000.
- There is no debt on the property being relinquished.
- The investor was seeking to acquire DSTs without debt. The investor was not concerned with any tax efficiencies, meaning increasing basis for potential additional set off against DST income.
- Strategy- acquire one DST.
- Acquisition- One all-cash DSTs acquired. One triple net lease portfolio of properties. Portfolio is comprised of 18 properties located in 9 states.
- Investor seeking an easy solution with one DST sponsor.

Cash Study 3: Investor lives in Texas (no state income tax) and owns one apartment property located in Oregon. Investor will stay in Texas. Investor contacted advisor with less than one week in the 45-day identification period.

- Relinquished property valued at over \$6M.
- There is debt on the property in the amount of \$2.5M (which will need to be replaced).
- Strategy- Investor seeking a diversified portfolio and needs to have debt balanced to satisfy 1031 exchange requirements.
- The investor wants to take some cash out of the exchange to pay off other debts. Any cash taken will be considered "boot" and subject to capital gains taxes.
- Acquisition- utilizing \$3M in cash and acquiring seven (7) DSTs in five (5) states. Balanced the LTV requirements to replace the \$2.5M in debt. Multiple DSTs enable the investor to potentially have different timetables on potential sale of each DST. The goal will be to execute an additional 1031 exchanges and ultimately locate properties in states without an income tax.

Case Study 4: Investor lives in Illinois and has no intentions of moving. Investor has four different residential apartments. The investor wants to move from active management to passive

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management and passive income. Four properties will be sold over a period of 18 months to two years.

- All properties valued at over \$5.5 million. Individual values range from \$800,000 to \$1.5 million.
- There is no debt on the properties.
- The investor will consider taking on a certain level of debt to increase potential basis resulting in potential tax efficiencies.
- Strategy- acquire a geographically diversified portfolio of residential asset classes.
- Acquisition- over a period of nearly two years the investor acquired a total of 16 DST assets properties located in Florida, Tennessee, Nevada, Texas, Illinois, Maryland, and Georgia.
- Residential investment allocation included: Multifamily (36%), Manufactured Housing (25%) Student Housing (25%) Senior Housing 7% and Self-storage (7%). Increasing the potential depreciation included taking on additional non-recourse debt. Including all cash DST acquired the average loan to value (DST) percentage was 42%. This conservative approach accounted for an increase in basis of over \$3.7M.

Disclaimer: Client portfolio example is hypothetical and for illustration purposes only. Potential cash flows, returns, and appreciation are not guaranteed and could be lower than anticipated. Tax rates may vary per state. Individual results will vary.

Case study 5: Investor owns an industrial building that is an operating business. The state wants to expand the road in front of the property and seeks to take the property by eminent domain. While the investor objects there is an award for the value of the property.

- The award is for an amount greater than what the investor has paid for the property and there is a capital gain subject to capital gains taxes.
- Proceeds from the award is \$750,000 with a loan of \$100,000 that needs to be paid off.
- Investor utilized a DST with non-recourse loan in place.
- Investor secures a property with a 48% LTV.
- The investor uses \$390,000 in cash proceeds (from the award) to balance the exchange for a total replacement value of \$750,000. This resulted in the ability to pay off the existing loan on the property of \$100,000 extract a total of \$260,000 in tax free proceeds.
- Investors who are open to utilizing a DST to complete the §1033 exchange may have access to additional investment capital.

Section 33: How to Get Started

Everything may start with a phone call to your exchange advisor and hopefully we will be your first call. Here are points to consider.

- Cash investors may have an advantage because they are free to determine which DST to invest in and move forward without the concerns of selling a property.
- If you own investment property, consider your options early on.
- Discuss your goals and what you want to accomplish with your investments.
- Once you decide to sell your property make sure to include contract language enabling cooperation between all parties if the seller elects to utilize a §1031 tax deferred exchange.
- Consider your long-term overall tax plans and if you will stay in your current state or location.
- Start the education process prior to the start of the 45-day identification period.
- If you are inside your 45-day period and cannot locate a replacement property reach out ASAP to an advisor who deals with DST every day. Once again hopefully us.

1031 Exchange Key Terms

Qualified Intermediary (QI)- We always start with the QI first. Without a QI there will NOT be a successful §1031 exchange. Caution should be exercised when referencing the QI as an Escrow Agent. The Escrow Agent who handles the closing on behalf of the investor and holding the proceeds does not typically qualify as the QI.

Constructive Receipt: Exercising control over your exchange funds or other property including having money or property from the exchange credited to your bank account or property or funds reserved for you. Being in constructive receipt of exchange funds or property may result in the disallowance of the tax-deferred, like-kind exchange transaction thereby creating a taxable sale. An example of constructive receipt would be the investor selling his relinquished property and having a closing officer hold the proceeds in an escrow or trust account on his behalf. If the seller directs the proceeds to be held by anyone other than the QI this is considered constructive receipt. If anyone but a QI receives the proceeds the 1031 exchange shall not be valid.

Boot: Any consideration other than “like-kind” property received by the investor. Boot is subject to taxation to the extent there is capital gain. Boot can accumulate over each exchange and is retroactive back to the original relinquished property. Boot can refer to cash boot, mortgage boot and personal property.

Cash Boot: Any funds received by the Exchanger-either actually or constructively - from the sale of the property.

Exchange Agreement: The written agreement defining the transfer of the relinquished property, the subsequent receipt of the replacement property and the restrictions on the exchange proceeds during the exchange period. The exchange agreement specifies all the terms of the relationship between the investor and the qualified intermediary.

Exchange Period: The period of time during which an investor must complete the acquisition of the replacement property in a like-kind exchange transaction. The exchange period is 180 calendar days from the transfer of the investor's relinquished property, or the due date (including extensions) of the investor's income tax return for the year in which the tax-deferred, like-kind exchange transaction took place (whichever is earlier) and is not extended due to holidays or weekends.

Broken/Failed Exchange- Investor failed to either identify replacement properties within the 45-day period or failed to close on one of the identified properties on the 45-day period list.

Opportunity Zones (OZ)- not covered in this guide but may be a solution for some investors either as a replacement for a 1031 exchange or as an alternative to attempt to fix a broken or failed §1031 exchange.

Relinquished Property: The property (or properties) owned by the investor that will be sold. This includes all liabilities for taxes as well as sales proceeds that will be considered part of the exchange.

Replacement Property: Identified within the 45-day identification period utilizing the property rules of the potential replacement properties that may be acquired. Tax liability of relinquished property shall be moved or rolled into replacement properties.

Exchange Identification (ID): This is a period of 45-days from the closing of the relinquished property where replacement properties are to be identified.

Replacement Form- Specific list required by QI and to be submitted prior to the end of the 45-day period. Investor may change and substitute d properties during the 45-day period.

Equal or Greater Value: For an exchange to be valid or successful the value of the replacement property must be equal to the relinquished property. This will accomplish a complete deferral (if the other elements are satisfied). The value of the relinquished property may be offset by certain closing cost (i.e. cost of sale items).

Tax Liability: There are a variety of potential taxes that may be due upon the sale of real estate. Total taxes may be a combination of Federal taxes on capital gains, Individual State income taxes due on capital gains, Federal depreciation recapture taxes and Net Investment Income Tax (NIT) due based on individual income bracket.

Capital Gains Tax: Tax rates on the Federal basis will range between 15% to 20%. The taxes will be based on the appreciation value of the property upon the sale of the property. There may also be state level capital gains tax as well. State level may be between 0% and 13.3%. Investors utilizing a §1031 exchange may defer capital gains taxes.

Depreciation Recapture: The IRS assumes that the investor has taken depreciation on the investment property. 27.5 years for residential and 39 years for other properties. There are specific calculations based on the month acquired and the month sold. Contact your CPA for the Mid Month adjustment. This is a flat tax rate of 25% of the depreciation taken (or assumed to have been taken).

Step-up in Basis: The individual investor will not personally benefit from the step up in basis. However, the heirs will benefit from this calculation. Upon the death of the investors the value of the investment will move up to current value. This shall eliminate the liability for taxes on appreciated property.

Like-Kind: The underlying basis for the §1031 exchange includes acquiring like kind property. All properties must be held for investment business purposes.

Beneficial Interest and/or Fractional Interest: DST are considered a beneficial interest in real estate. A Fractional interest is an undivided percentage ownership in a larger property.

Identification Period: The period during which an investor must identify potential replacement properties for a tax-deferred, like-kind exchange. The period is 45 calendar days from the transfer of the investor's relinquished property and is not extended due to holidays or weekends.

Identification Rules: Required rules on the identification of replacement property. Investors are required to submit a list of potential replacement properties to QI within the prescribed period. One of the three rules to be utilized: the Three Property rule, the 200% Rule or the 95% Rule.

Accredited Investor: Defined in Rule 501 of Regulation D to refer to investors who are financially sophisticated and have a reduced need for the protection provided by certain government filings. While each state may have additional accreditation requirements, individuals are generally considered to be accredited if they have a net worth exceeding \$1,000,000 (excluding the value of your primary residence), or if they have income exceeding \$200,000 in each of the two most recent years or a joint income with a spouse exceeding \$300,000 for those years and a reasonable expectation of the same income level in the current year.

DST Frequently Asked Questions

What is an Accredited Investor?

An accredited investor is a person or entity that meets certain financial criteria and is allowed to invest in securities that are not registered with the Securities and Exchange Commission (SEC). The SEC defines an accredited investor as someone who meets one of the following criteria:

Individuals (i.e., natural persons) may qualify as accredited investors based on wealth and income thresholds, as well as other measures of financial sophistication. To qualify as an accredited investor, an individual must have a net worth over \$1 million, excluding primary residence (individually or with spouse or partner), or an income over \$200,000 (individually) or \$300,000 (with spouse or partner) in each of the prior two years, and reasonably expects the same for the current year 1.

Professional criteria: Investment professionals in good standing holding the general securities representative license (Series 7), the investment adviser representative license (Series 65), or the private securities offerings representative license (Series 82); directors, executive officers, or general partners (GP) of the company selling the securities (or of a GP of that company); any “family client” of a “family office” that qualifies as an accredited investor; for investments in a private fund, “knowledgeable employees” of the fund 1.

Entities owning investments in excess of \$5 million; corporations, partnerships, LLCs, trusts, 501 © (3) organizations, employee benefit plans, “family office” and any “family client” of that office; owners as Accredited Entities where all equity owners are accredited investors; investment advisers (SEC- or state-registered or exempt reporting advisers) and SEC-registered broker-dealers; a bank, savings and loan association, insurance company, registered investment company, business development company, or small business investment company or rural business investment company.

What is the Exit Strategy for a DST?

One of the benefits of DSTs is the passive management. One of the drawbacks would be the lack of control over when to sell the DST. The Sponsor of the DST (Trust) will determine the best time to offer the DST for sale. The sale of the DST is referenced as going **Fully Cycle**. The strategy is to protect the individual investors’ equity. In addition, the sponsor wants to protect the DST in

What is the holding period for a DST?

The majority of DSTs are long term investments. Many PPMs state a holding period of 7-10 years. Over the years the average holding period has been about 5 years. If the DST has a loan in place there may be prepayment penalties on selling. The penalties may be reduced after a number of years. In all cases DSTs with loans in place will sell prior to the loans expire. There is no refinancing allowed for a DST.

Are DSTs Distribution guaranteed?

Many DSTs have projections that are included in the PPM. All distributions are projected. In typical real estate there are no absolute guarantees for distribution or overall returns. However, given the right structure and tenant screening both traditional real estate and DST should provide a distribution. This distribution is based on overall expenses and income of any asset. The location of certain properties may also reduce risk. For example, multifamily properties with good schools, employment opportunities and in stable areas may perform better. DST that are leased to corporate tenants may reduce the risk.

What happens when the DST property goes Full Cycle?

When the DST sells or goes full cycle investors will have several options. The sponsor or Trust wants to maintain the integrity of the DST enabling multiple options for the individual option. Investors may simply accept the cash and pay the applicable capital gains. If the investor has passed away the heirs will enjoy a step up in basis and may receive the cash proceeds without paying any capital gains taxes. Many investors will seek another §1031 exchange either with another DST or a traditional real estate property. There are DST that offer an optional 721 UPREIT. Some DSTs have a 721 UPREIT as part of the structure meaning the UPREIT is mandatory. Investors may also execute several options at the same time. For example, execute a §1031 into a DST as well as executing a 1031 exchange into a traditional real estate property.

What is your experience?

We have extensive industry experience, both in real estate (over 40 years as real estate broker) and the securities world (20 years). We focus on the education of professionals (CPAs, real estate professionals) as well as individual investors. We spend time face to face with sponsors to understand the offerings. We also attend due diligence conferences. We continue our own personal growth and seek additional certifications to benefit all potential investors.

DST Landscape Summary

On a weekly basis we interact with sponsors and monitor the offerings of nearly all the DST sponsors. You may reference the current state of DST offerings at this location. [DST Landscape Summary](#) | [DST Education and Market News \(dstnews.org\)](#)

Author BIO

Al DiNicola Private Fund Advisor & §1031 DST Specialist

Al DiNicola, AIF® has more than 40 years of experience in commercial & residential sales and development. Mr. DiNicola has extensive experience in real estate land acquisitions, development, investment and real estate securities.

Specializing in Alternative Real Estate investments designed for accredited investors. Alternatives include Private Funds, Delaware Statutory Trust (DST), Qualified Opportunity Zones, REIT investment, §1031 & §1033 Tax Deferred Exchange consolation, and 721 UPREIT solution.

Mr. DiNicola has worked with Public and Private developments including many of the top real estate projects, and amenity rich master planned residential properties in southwest Florida. He has been involved with the development and sales of over 35 projects that included 5,000 residential units totaling over \$3 Billion in sales.

DiNicola has worked with private and institutional lenders to provide mezzanine, bridge financing, short term or medium range financing. He assisted in Asset Management for a \$4B Bank REO portfolio restructuring. He has spoken on Distressed Asset Management.

He was a certified instructor for the National Association of Homebuilders. He has been a real estate broker in Florida for over 40 years and has been involved with the Florida Realtors and served as a Director for the National Association of Realtors. DiNicola was inducted into the Naples Board of Realtors' Hall of Fame in 2016.

Mr. DiNicola grew up in New Jersey and moved to Florida in 1980. He has been a coach and educator and uses those skills in his focus to assist investors in Alternative Real Estate investments including Delaware Statutory Trust (DST), Real Estate Investment Trust (REIT), Opportunity Zones and other non-correlated assets.

Mr. DiNicola is also the co-editor of the DST News, a 1031 industry resource on private securitized real estate offerings designed as 1031 replacement solutions.

There is a plethora of information on a wide variety of topics on our websites.

Websites:

[DST News | DST Education and Market News](#)

[DST Investments | 1031 Capital, Exchange & Investment Solutions](#)

Full Disclosure

This Guide is not a solicitation for the sale of any security. Material stated herein is subject to change and may be modified at any time (as tax laws change). We are not attorneys or CPAs.

DST's (Delaware Statutory Trusts) are for accredited investors only. Contact your investment adviser for additional details on how a DST may be a solution to your 1031 Exchange and complement your financial objectives. For more information on how to properly set up an IRC 1031 Tax Deferred Exchange or if you are an accredited investor and would like additional information on a DST contact Al DiNicola at 239-691-8098 or email adinicola@FiduciaryCM.com.

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